TAX REFORM ACT OF 1969

2023-6

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-FIRST CONGRESS

FIRST SESSION

ON

H.R. 13270

TO REFORM THE INCOME TAX LAWS

PART 6 OF 7 PARTS

OCTOBER 3, 6, 7, 8 AND 22, 1969

GENERAL OUTLINE OF ORAL AND WRITTEN TESTIMONY IN PART 6:

Foreign Tax Credits
Foundations
General
Physically handicapped
Treble damages

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TAX REFORM ACT OF 1969

FRIDAY, OCTOBER 3, 1969

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 9:30 a.m. in room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Talmadge, Byrd of Virginia, Williams of Delaware, Curtis, Miller, Jordan of Idaho, and Hansen.

The CHAIRMAN. The hearing will come to order.

Is the Honorable Joseph Tydings in the room at this time?

I understand that Senators Ted Stevens and Charles E. Goodell will be here shortly as will Congressman Wright Patman.

Is Mr. Scott P. Crampton, chairman, American Bar Association, here? Mr. Walker Winter? Mr. Harold Ketelhut? Mr. J. M. Ford?

Is Miss Edna Anish here? Mr. Max Lupkin? Mr. Francis DeLone? Mr. Paul Seghers?

STATEMENT OF PAUL D. SEGHERS, PRESIDENT, INSTITUTE ON U.S. TAXATION OF FOREIGN INCOME, INC., NEW YORK, N.Y.

Mr. SEGHERS. First of all, Mr. Chairman, I would like to explain that our statement is not in the printed record because of a fraud on the part of the U.S. Post Office. They accept postage special delivery airmail, and take 3 days to deliver here.

I understand I am not the only one defrauded in that manner. I am very disappointed it is not in there.

For the record by name is Paul D. Seghers. I am appearing today as president of the Institute on U.S. Taxation of Foreign Income.

This institute recommends only two changes in the tax reform bill. We offer only two recommendations for changes in the bill because there are only two in there that strike particularly in our field.

What we are principally concerned with is what is not in the bill.

During the past 7 years, the administration and others have frequently publicized the vital need of increased exports and urged U.S. manufacturers to export. During the same 7 years, we have seen many added U.S. tax burdens imposed on the export of U.S. products, but no tax incentives to encourage exports. What is needed is action, not words.

This has been emphasized by many others. We think that it is time to do something to help the commerce and industry of this United States and not just talk about it and offer to spend money to help.

We do not need the Government to spend money. We just say, "Take off the burdens."

There is no need to remind this committee of the importance of U.S. exports and dividends from U.S. foreign sales subsidiaries as the principal means of combating this country's alarming annual international balance-of-payments deficits.

A business that is badly run shows deficits. What conclusion are we to draw? The figures on our deficits have been presented by more than one of those who have appeared before you. Dr. Danielian has a statement which I believe you will find enlightening on that.

Removal of some of the burdens on exports is essential to induce U.S. manufacturers to enter the export field or to expand their activities in that field.

To repeat: What is needed is action, not words. Therefore, what will be stressed first of all is the need to modify the proivsions of the Internal Revenue Code so that no penalty will be imposed on income earned abroad from the sale of U.S. products. It is hard to believe that anyone in this committee or in Congress could oppose removal of a tax penalty on the export of U.S. products.

Please believe me, there is now or are now numerous penalties on the export, U.S. tax penalties on the export of U.S. products. It is not spelled that way in the Internal Revenue Code. It is put in there with devilish cleverness, but that is the effect. It is spelled out pretty clearly in section 954 (d) and (e), but you will not see a word about exports.

We urge that you adopt the amendments proposed in our written statement.

Some of the larger multinational corporations can escape the penalties of those subsections by incorporating a separate selling subsidiary in each country where their goods are merchandised. However, this involves difficulties and expenses which are out of the question for the smaller U.S. manufacturer. Prior to 1963 a U.S. manufacturer could use a single foreign subsidiary to distribute its products in a number of foreign countries without being taxed on the income earned abroad until it was brought home.

The members of this committee fully realize that U.S. manufacturers do not wickedly accumulate their profits in numbered Swiss bank accounts to escape U.S. tax. That is a ridiculous assumption back of a very cleverly contrived scheme which does impose the U.S. tax penalty on exports, and I defy anyone to show me that it does not. They are happy to bring home dividends from their foreign operations just as quickly as is consistent with the sound business practice of using a part of the profits to expand the capacity to earn.

The record shows that U.S. coporations have brought home to the United States billions of dollars through export sales and dividend income that would not have been earned had subpart F been enacted in 1950 instead of 1962. This is fact. The record shows it.

We urge you not to place the added burdens on exports which would result from enactment of the provisions of sections 431 and 452 of the reform bill in its present form.

We do not oppose those two measures in toto, but we say that they should not impose a penalty on exports.

Section 431 probably aims especially at but not limited to oil producers would amend section 704(a) in such a way as to penalize some U.S. manufacturers using the "per country" method of computing the limitation on the foreign tax credit. This is no question of giving anything more, but of taking away less.

This penalty would apply only where the U.S. manufacturer has sustained losses in a foreign country.

Here I would like to stress that since 1962 there has been the most complicated and the most capricious system of taxation of foreign source income that the world has ever seen. You always must qualify every statement that is made by saying some are affected and some are not, and there is no particular reason to penalize those that are affected, no particular reason to exempt the others, but in making these tricky complicated provisions, that is the result.

Under existing law, such a loss sustained in a foreign country is never deductible twice. Neither can the U.S. manufacturer get credit more than once for the foreign tax it pays on income earned in that country. These are facts no one can deny. We ask that section 431 of the bill be amended so as not to impose any added penalty (by way of reduction of the foreign tax credit) on income earned abroad from the sale of U.S. products.

Section 452 of the bill would amend Internal Revenue Code section 312 in such a way that it probably would create substantial and apparently unintended hardship and penalty by reducing the allowable amount of the foreign tax credit. This has been amply explained in the statement heretofore presented to your committee on behalf of the Manufacturing Chemists Association. We recommend elimination or revision of that provision so as to eliminate this unintentional penalty.

We will not say more in defense of the foreign tax credit against unjustified attacks than again to quote the statement of former Assistant Secretary of the Treasury Stanley Surrey—quoted on page 6 of our written statement—that:

> American investment would not proceed at all without the foreign tax credit because then, as the chairman pointed out, two taxes would be imposed and the overall burden of the taxes would be so great that international investment would practically cease.

That is the answer to the outrageous proposal to eliminate completely the foreign tax credit.

The removal of a number of the penalties imposed on U.S. exports since 1962 is urgently needed and your committee is urged to give them careful consideration. The need to amend section 954 to eliminate the tax penalty on income earned abroad from the sale of U.S. products has already been urged. The tricky method of computing the 10 percent surcharge on income earned abroad and taxed in the United States likewise should be corrected.

This method of computation imposes a 40 percent higher surcharge on the tax payable by a Western Hemisphere Trade Corporation than on a U.S. corporation deriving no income from a foreign source.

A similar inequitable, discriminatory penalty is imposed by the method of computing the surcharge in the case of other income earned abroad and received in the United States.

Another reform deserving of consideration is the need for change in the only provision of the Internal Revenue Code which denies

taxpayers the opportunity to appeal to the courts against any adverse action by the Treasury. This is the sole provision in the Internal Revenue Code whereunder the Commission is superior to the U.S. Supreme Court.

No one can question the action of the Commissioner under section 267. This needs to be reformed or eliminated. It prevents many transactions in the course of normal overseas business activities of U.S. corporations.

For reasons that have been set forth fully in statements filed with your committee and with the Ways and Means Committee, section 367 should be repealed—or at least amended—to allow the same rights of appeal as are allowed under all other provisions of the Internal Revenue Code.

That is all that is asked. We suggest that this committee give serious consideration to the adoption of a "ton on value added"—TVA—as a substitute for all or a substantial portion of the corporate income tax.

We are suggesting that the committee give the study, because to present it here even if I took an hour I could not deal adequately with the whole subject, and yet it has great merit and deserves study.

Such a TVA could be used to raise more tax revenue than the present corporate income tax. It could be used as a "border tax," to increase exports and equalize the tax burden on imports. France and other countries in Europe are successfully using this as a means of encouraging exports and protecting domestic producers against unfair competition of foreign manufacturers. Germany likewise used this form of tax for that purpose until it recently changed its policy to one of discouraging exports—something which, unfortunately, is not needed in this country.

Finally, this institute urges your committee to give more attention to the problem of increasing exports and the inflow of foreign funds and less consideration to Treasury efforts to squeeze additional pennies of tax from U.S. manufacturers, and to remember that dollars of export sales, dollars of dividends from foreign selling branches, are worth more than pennies of additional tax which prevent the smaller U.S. manufacturer from embarking on exports. I know, because I got some of the smaller companies to start in the export field, and you could not talk to them after the 1962 act was adopted.

They feel that despite all the hot air the Treasury definitely intends to penalize exports, penalize overseas business, and talk does not mean anything. We want to see some action. We hope that the Senators who are not present will read the record of this statement.

The CHAIRMAN. Yes, and we will print your entire statement in the record too.

I am sorry the post office did not deliver it.

Thank you very much, sir.

(Paul D. Seghers' prepared statement follows:)

STATEMENT OF THE INSTITUTE ON U.S. TAXATION OF FOREIGN INCOME, INC., PRESENTED BY PAUL D. SEGHERS

SUMMARY

Eliminate provisions of H.R. 13270 Sec. 431 which would penalize U.S. manufacturers using the "per country" method to compute the *limitation* on the amount of the foreign tax credit.

Eliminate provisions of H.R. 13270 Sec. 452 which (unintentionally) would reduce the amount of the foreign tax credit.

Amend I.R.C. Secs. 954 to eliminate the tax penalty on income earned abroad from the sale of U.S. products.

Correct the method of computing the 10% surcharge so that it will not increase the amount of U.S. tax payable on foreign income more than 10%.

Recognize foreign "added value" and similar "indirect" taxes as income taxes for the purpose of the foreign tax credit.

Eliminate I.R.C. Sec. 367 or at least amend it to allow the same rights of appeal as under all other provisions of the Internal Revenue Code.

Adopt a "Tax on Value Added" ("TVA") and use it as a "border tax" as does France to encourage exports.

STATEMENT

It will be too late, after the prices if gasoline and fuel oil have gone way up, to explain to automobile owners and home owners why they must pay for the tax penalties imposed on oil producers. However, that is for others to worry about—this INSTITUTE is concerned primarily with U.S. exports and overseas selling activities. Hence, aside from the proposed penalties on those taxpayers, who, in good faith, elected the "per country" method of computing the *limitation* on the amount of the foreign tax credit, and one other, unintended, reduction in the credit, we are concerned primarily about what is NOT in the "Reform" bill.

The noble purposes of this bill bring back memories of the "noble experiment" of Prohibition—and also, in connection with its provisions which would affect foreign source income, the Congressional and Administration exhortations to U.S. manufacturers to export more goods, accompanied by seven years of added tax penalties on the export of U.S. products. These are not empty words—this is a statement of fact, supported by the record.

This statement does not merely protest against the injustice of a further penalty on exports proposed in this "Reform" bill and the really unbearable penalty being proposed by a member of this Committee and an "Old Guard" group in the Treasury. What is even more strongly urged is the pressing need to remove some of the U.S. tax penalties imposed during the past seven years on exports and on the repatriation of foreign earnings.

It is obvious that any legislative act that would increase exports (by eliminating U.S. tax penalties or affording incentives), would improve our fast sinking international *trade* balance and reduce our horrifying balance of payments deficit.

First—as to the proposal to penalize those taxpayers now using and compelled by law to continue using the "per country" method of computing the *limitation* on the foreign tax credit. This provision is aimed at the oil producers, but could penalize some U.S. manufacturers exporting their products, while leaving others untouched. The "Old Guard" proposes to cure this by devising a way also to penalize those using the "overall" method of computing the limitation.

These are the facts regarding the present method of computing the "per country" limitation where a U.S. corporation sells some of its products abroad and pays foreign income taxes on the resulting profits:

1. If the U.S. manufacturer sustains an operating loss in any country, that loss will enter into the computation of its net income for that year. Such loss will never be deductible twice.
2. If in a later year it earns a profit in the same country, it will be subject to both U.S. tax and foreign tax on that profit.
3. In such case it will be allowed credit against its U.S. tax for all or a portion of that foreign tax, subject to the limitation (that is, not more than the U.S. tax payable on that income.) There can be no double credit for the same foreign tax.

No amount of double talk can change these simple facts. Neither can any specious reasoning justify penalizing the use of the "per country" method of computing the limitation. Its only advantage to the U.S. taxpayer is that *in the year of loss* in one country, credit (subject to the limitation) may be taken for foreign tax paid on income earned in another country and subjected to U.S. tax. All income earned in the U.S. or abroad is subject to U.S. tax. Any allowable operating losses are deductible once and only once. Any foreign income taxes paid on the income earned in any country may be deducted only once and only from the U.S. tax on that income.

The net effect is the same where credit is allowed for foreign income taxes on income earned abroad by and received from a foreign subsidiary in the form

of a dividend. The principal difference is that in such cases the U.S. taxpayer obtains no benefit of a loss sustained by a foreign subsidiary as long as it remains in existence. Obviously, in computing U.S. tax on dividends received from such a subsidiary, there is no allowance for a loss of the subsidiary—such loss merely operates to reduce the amount of accumulated earnings and profits of the subsidiary available for distribution. The related foreign tax credit is allowable only to the extent of foreign tax paid on the income distributed or the U.S. tax computed on such income, whichever is the less.

Another proposed amendment (of I.R.C. Sec. 312) would require every corporation to use the straight line method of computing depreciation for the purpose of computing its earnings and profits, regardless of the fact that it may have been allowed to use an accelerated method of computing its depreciation deduction and its taxable income. This would create substantial and apparently unintended hardship by reducing the allowable amount of the foreign tax credit. as fully explained in the statement presented to this Committee on behalf of the Manufacturing Chemists Association. This provision should be eliminated or revised so as to eliminate this unintended penalty.

The unbearable proposal referred to above is to abolish the foreign tax credit entirely. Even after taking into consideration foreign income tax as a deduction from income subject to U.S. tax, the aggregate foreign and domestic tax on income earned abroad would, in many instances, amount to more than 75%. This would, as a practical matter, make it impossible for U.S. manufacturers to sell their products abroad. This obviously would destroy any hopes of building up U.S. exports and force U.S. manufacturers into the [illegible]ition of "If you want it, come and get it." This would reduce our exports to a mere trickle, as we no longer enjoy a superiority in the quality of our products or in the efficiency of our manufacturing processes sufficient to enable U.S. manufacturers to compete, under such a handicap, against Japanese, German, Italian and other manufacturers that aggressively sell in foreign countries and are given incentives rather than burdened by penalties for exporting.

The significance of the foreign tax credit was recognized by former Secretary of the Treasury, Stanley S. Surrey, in his testimony at hearings before the Senate Foreign Relations Committee with respect to the proposed United States-Brazil income tax treaty, where he stated:

"American investment would not proceed at all without the foreign tax credit because then, as the Chairman pointed out, two taxes would be imposed and the overall burden of two taxes would be so great that international investment would practically cease."

The United States has recognized that foreign investment is a necessity and that the granting of a credit for foreign taxes is a prerequisite in preventing the taxation of foreign source income at confiscatory rates.

EXISTING U.S. TAX—BURDENS ON EXPORTS

Following is a brief list of present U.S. tax burdens on the export of U.S. products and their sale abroad:

1. I.R.C. Sec. 954(d), which specifically penalizes the sale abroad of U.S. products. This sub-section and I.R.C Sec 954(e) should be amended so as not to apply to income resulting from the sale of US. products abroad.

2. The "gross-up" provisions which, in many cases, reduce the benefit of the foreign tax credit (Secs. 902, 960 and 78).

3. The tricky methods of computing the 10% surcharge tax which impose a surcharge of 14% on Western Hemisphere Trade Corporations (Sec. 51-d) and, in many cases, much more than 10% surcharge on other foreign source income. (Sec. 51-b)

4. The provisions which *could* tax some foreign corporations *directly* on certain income from sales of U.S. products abroad. (Sec. 864(c) (4) (B))

5. Denial of credit for foreign taxes paid on the income of subsidiaries below the second tier when received as a dividend.

SUGGESTED EXPORT INCENTIVES

In addition to removing these burdens, discussed further below, we suggest adoption of the following positive incentives for U.S. exports and the sale of U.S. products abroad:

1. Recognize foreign "value added" and similar "indirect" taxes as income taxes for the purpose of the foreign tax credit.

2. Allow "tax sparing" credit for foreign income taxes waived ("forgiven") by a foreign government as an incentive for foreign investment. (Failure to do so means that the U.S. Treasury grabs the tax waived by the foreign government—as expressed by one foreign government official, "foreign aid in reverse.")
3. Eliminate, or at least amend I.R.C. Sec. 367 to allow taxpayers the same rights of appeal as in the case of adjustments proposed under all other provisions of the Internal Revenue Code.
4. Restore the 7% investment credit to enable U.S. manufacturers to meet the competition, at home and abroad, of products made in Japan, Germany, Italy and other countries.
5. The "Conglomerate" provisions should be limited to acquisitions by domestic (U.S.) corporations.

Because of the limitations on the scope of these Hearings, the foregoing recommendations will not be discussed further in this statement. However, we believe that every one of these recommendations are desirable and for the benefit of our domestic economy, but the mood for reform has taken such a trend that it seems fruitless to urge these desirable reforms at this time. (See this INSTITUTE's statement presented at March 14, 1969 House Ways & Means Committee Tax Reform Hearings, Part 7, p. 2559, at 2565.)

AMEND I.R.C. SEC. 954 TO REMOVE ITS BURDENS ON U.S. EXPORTS

I.R.C. Secs. 954(d) and (e) penalize a U.S. manufacturer by taxing it on imaginary dividends measured by the income of a foreign subsidiary it uses to distribute and sell its products abroad, if that subsidiary sells such products to buyers in any country other than the country in which it was incorporated. Prior to 1963 there was no such burden on the export of U.S. manufactured products, and this encouraged many smaller U.S. manufacturers to begin to export their products.

To remove the penalties thus imposed on the export and sale abroad of U.S. products, Sec. 954 should be amended by adding the following subsections:

"(g) Foreign base company income shall not include income earned outside the United States from the sale of personal property produced in the United States for use, consumption or disposition outside the United States or from services rendered outside the United States in connection with such sale of such property.

"(h) Foreign base company income shall not include dividends or other income of the kind described in subsection (c) received by one controlled foreign corporation from another foreign corporation or from the disposition of stock or securities of such a foreign corporation to the extent that the amount of income received is out of or attributable to earnings and profits of such other foreign corporation derived from its receipt or accrual of income from the sale outside tho United States of property produced in the United States."

This proposed amendment of Sec. 954 would increase exports by encouraging U.S. manufacturers once again to export their products by using foreign selling subsidiaries. This would again permit using the profits earned abroad to build up their selling facilities abroad and the sales of their products abroad, free of U.S. tax on the income earned abroad by such subsidiaries until, but only until, brought home to the United States.

Proposed I.R.C. Sec. 954(g) would exclude from taxable income *only* income earned outside the United States by a foreign subsidiary from its activities abroad in selling U.S. products to foreign customers. It would only *postpone* U.S. taxation of such income until received by a U.S. taxpayer.

Proposed I.R.C. Sec. 954(h) is complex but is essential to correct the complex provisions of Subpart F which now impose U.S. tax on income earned and retained abroad by a foreign corporation, before receipt of such income by any U.S. taxpayer.

In its present form, I.R.C. Sec. 954(b)(1) excludes from the penalty classification of "foreign base company income" certain dividends and income, but only to an extent so limited as to afford no relief from the tax penalty under I.R.C. Sec. 954 in the case of most dividends and other income received by (and retained) by one controlled foreign corporation from another controlled foreign corporation.

Well established multinational corporations escape from the penalties imposed by I.R.C. Sec. 954 by electing the benefits of the "minimum distribution" pro-

visions of I.R.C. Sec. 963. However, the latter provision is of no value to the smaller manufacturer that, in the absence of I.R.C. Secs. 954(d) and (e), might commence to market its products abroad through the use of a foreign selling subsidiary.

Another approach to the whole problem of removal of tax penalties and the allowance of desirable tax incentives for the export of U.S. products would be to adopt a "tax on value added" ("TVA") such as is used in France and was used in Germany until quite recently to encourage exports. Such a TVA (at, say, 15%) could be used as a substitute for a large portion of the tax now being levied on corporations. This tax would be rebated on exports of U.S. products and be imposed on the import of products. France has insisted that such a "border tax" is not contrary to the letter or spirit of GATT. Hence, such a tax should be free of attack on the ground that has frequently been raised against other proposals, to allow some form of deduction or tax credit for income from the export of U.S. products.

CONCLUSION

Remove U.S. tax penalties on exports

1. Eliminate provisions of Sec. 431 of H.R. 13270 which would penalize U.S. manufacturers that have elected in good faith to use the "per country" method of computing the *limitation* on the amount of allowable foreign tax credit. The present method of computation does not result in any double deduction or any double credit for foreign tax.

2. Eliminate or correct the provisions of Sec. 452 of H.R. 13270 which would have the effect of reducing the amount of the allowable foreign tax credit. This provision is intended to prevent abuse of the "double declining balance" method of computing the allowable depreciation deduction. Whatever the merits of this proposed "reform" provision, it should not have the undoubtedly unintended effect of reducing the foreign tax credit because of an adjustment which would increase the amount of "earnings and profits" over the amount which would result if computed in the same manner as the depreciation deduction.

3. Amend I.R.C. Sec. 954(d) and (e) to eliminate the penalty on income earned abroad from the sale abroad of U.S. products. It is generally stated, and the Treasury has not denied, that very little tax is being collected under "Subpart F", of which these subsections are a part. On the other hand, it is asserted, without the possibility of contradiction, that provisions of Subpart F prevent many smaller U.S. manufacturers from entering the export field.

4. The tricky methods of computing the 10% surcharge tax should be eliminated so that the amount of the surtax would not be more than 10% of the amount of U.S. tax which the taxpayer would have paid on the same income in the absence of the surtax. As stated by the Chairman of this Committee:

> "If it is a 10-percent surcharge, it ought to be a 10-percent surcharge. If you are paying 14-percent, I think you have a right to complain." (Senate Finance Committee, July 9, 1969, Hearings on H.R. 12290—Proposed Extension of the Surcharge and Repeal of the Investment Tax Credit.)

5. Eliminate the "gross-up" provisions enacted in 1962 which, in many cases, reduce the benefit of the foreign tax credit. (I.R.C. Secs. 902, 960 and 78)

SUGGESTED EXPORT INCENTIVES

In addition to removing the above-mentional U.S. tax burdens on exports, we suggest the following positive incentives for U.S. exports and the sale of U.S. products abroad:

1. Recognize foreign "added value" and similar "indirect" taxes as income taxes for the purpose of the foreign tax credit.

2. Allow credit for foreign taxes paid on the income of subsidiaries below the second tier when received as a dividend by a U.S. taxpayer having an interest of 10% or more in such subsidiary.

3. Allow "tax sparing" credit for foreign income taxes waived ("forgiven") by a foreign government as an incentive for foreign investment.

4. Eliminate or at least amend I.R.C. Sec. 367 to allow taxpayers the same rights of appeal as under all other provisions of the Internal Revenue Code.

5. Restore the 7% investment credit to enable U.S. manufacturers to meet foreign competition.

6. Limit application of the "Conglomerate" provisions to acquisitions by domestic (U.S.) corporations—or, in the alternative, for some or all of the above provisions—

7. Adopt a substantial TVA to replace in whole or in part the corporate income tax and use such TVA as a "border tax" to afford an incentive to exports of U.S. manufactured products and equalize the tax burden on imports of foreign products.

FINAL WORD

The most desirable move to promote the export of U.S. products would be to amend I.R.C. Secs. 954(d) and (e), as set forth above.

The CHAIRMAN. We had called witnesses in the order they were to be here. I see the Honorable Joseph Tydings has arrived while the previous witness was testifying. I will call Senator Tydings.

Senator, I hope you were successful in reporting out the name of your distinguished constituent to the Maritime Administration yesterday. I left my proxy with you and I hope you got the job done.

STATEMENT OF HON. JOSEPH D. TYDINGS, A U.S. SENATOR FROM THE STATE OF MARYLAND

Senator TYDINGS. We got "aye" votes from all present, Mr. Chairman.

Mr. Chairman, I would ask that you insert my statement in the record in its entirety. I cover about seven points.

Let me just briefly go over them with you, because I know how pressed the committee is.

First of all, let me congratulate you and the whole committee on the very thorough way in which you are handling this frightfully difficult matter. I think that the Senate is certainly living up to its responsibility.

Let me ask you to turn if I might to page 10 of my statement.

The tax reform bill as it passed by the House possesses an imbalance that will produce a long-term revenue loss approximately of $2.4 billion a year. I think that is an unfortunate situation. Restoring fiscal balance to the tax reform bill will require the raising of additional revenue by closing some of the loopholes in our tax system that have remained undisturbed, or else the removal of some of the provisions which the House inserted.

Approximately $20 billion in capital gains annually escapes taxation, because the present law permits a tax-free stepup on the basis of death. To begin with, this costs the Treasury $2.5 to $3 billion a year in potential revenue, and that is more than enough to offset the revenue loss built into the House-passed version of the tax bill.

Economists have long opposed the tax-free stepup in basis on the grounds it inhibits capital mobility and distorts the allocation of resources in this country. This is because people are holding on to appreciated property that they would ordinarily sell in anticipation of being able to avoid paying taxes on the capital gains if the property is held until death.

Finally the loophole has constituted a serious inequity in our tax system, because it greatly favors those who have large amounts of accumulated wealth to pass on to the next generation. Thus for reasons of economy and equity, I urge the committee to amend H.R.

13270 to include a provision that would pass on the original basis of appreciated properties to those who inherit them.

In this way, when I sell the Seagrams stock which I inherited from my grandfather's estate I would be paying a capital gains tax based on the original basis of the cost of that stock or the IBM stock or any of the other stock I inherited as of the date that he acquired it. That way no capital gains would escape taxation and I think you would be able to balance your bill.

Now I might ask you gentlemen to turn back to page 1. In Maryland we have a unique system of investment which enables homebuilders to build houses or home buyers to purchase houses more economically. This is known as the "ground rent system." The person who owns the ground or the builder does not sell the ground at the time the person buys a house. He sells the house to the individual. The ground is kept at its cost by the builder. The person who purchases the house pays an annual ground rent. He can purchase it under Maryland law at any time he wishes capitalized at 6 percent, but it means basically that a young couple can buy a $20,000 house at perhaps $2,000 less than it might otherwise cost them.

This is a long-term situation in Maryland. Ground rents are investments which often have been held by banks, pension funds for many years.

The House by inadvertence left out ground rents as one of the enumerated type of investments which mutual savings banks may include in their investment portfolio. It is my understanding that the Ways and Means Committee realizes that this was an unintentional oversight, and that they would welcome an amendment to correct the omission. I would be grateful for your consideration on that.

In pages 4 through 6, gentlemen, I talk about the farm losses provision which the House included, with specific reference to parimutuel racing and the breeding of horses for racing. This is an extremely important industry in Maryland as it is in many other States.

I would urge you that three provisions of the farm loss section of the House bill be deleted. These are the provisions which relate to the gain from disposition of property used in farming where farm lossses offset nonfarm income, depreciation recapture, and hobby losses with respect to the racing and breeding of horses. I will offer an amendment for your consideration, but let me just briefly summarize it.

Parimutuel racing, which is held in 30 States, produced $426 million of State revenue in 1968. The revenue that the States will derive from this source in 1969 is roughly $500 million. In Maryland alone the State tax revenue is $14 million.

Treasury claims it is losing in revenue under the present farm losses provisions covering horses for racing and breeding is roughly $100 million, only a quarter of what the States realize from parimutuel racing. I would hope you would give strong consideration, gentlemen, to deleting these provisions. For each year racehorses in the Nation compete for purses amounting to only one-half of the operating costs for maintaining them; thus it is very difficult for all of the stables to operate at a profit. And to take $4 away from the States in tax revenue to give $1 to the Federal Government does not make a great deal of sense to me.

The question of the tax treatment of private foundations to the tax treatment in the House bill of private foundations. I am a strong believer that in a democratic capitalistic system you must encourage private giving. I think if the Government seeks to undertake the solution of all societal problems in this country, we are going to have to spend a great deal more money than we have ever contemplated before.

There is evidence that some private foundations have abused the tax exemption privileges. Such breaches of public trust simply cannot be condoned.

However, Mr. Chairman, I think it is incumbent upon your committee to take care not to undermine the spirit of voluntary giving in the United States in our efforts to insure that both the spirit and the letter of the law governing such giving are properly observed. I would like briefly to call to the committee's attention three such overkill provisions of the section on the tax treatment of private foundations.

First of all, gentlemen, there is the proposed levy of a 7½ percent tax upon a private foundation's investment income. There is no way you can avoid that tax taking away from those who would be the object of a foundation's giving.

Furthermore, once the Federal Government institutes a tax on foundations, then State and local communities are going to institute a tax on foundations, and the entire system of private foundations is going to be threatened.

I do not favor the administration's 2 percent proposal. What I do favor in this respect would be a registration fee, which would cover the actual cost of the administrative machinery needed to insure the private foundations are not abusing their privileges; a user fee rather than a tax.

Secondly, regarding the distribution of income by private foundations, I would respectfully request that you consider lowering the amount from 5 percent to a more reasonable rate of 2 percent. I do not think that there is any responsible investment trust today which is not willing to lower the caliber of its assets that can pay out 5 percent a year. I think 2 percent is a reasonable amount.

Next, there is the question of stock ownership limitations on private foundations. In principle the objective of the proposal to limit to 20 percent the combined ownership of a corporation's stock which may be held by a foundation is commendable. The use of foundations to maintain control of businesses can result in a diversion of a foundation's managers from the charitable duties they ought to be following to the affairs of the business.

However, in actual practice, Mr. Chairman, the 20 percent limit presents some real practical problems. Despite the divestiture provisions of the House proposal, the proposed limit is likely to result in the eventual sale of divested assets at considerably less than the real value. This is particularly true if the assets consist of securities of a closely-held company to meet the 20 percent limit, because then it really remains the sale of the company, if a fair price for the stock is to be obtained.

I am sure that this is not an outcome which the House envisioned or desired when it enacted the 2 percent limit.

Therefore, I would urge the committee to consider dropping this limit from the tax reform bill at least as it applies to existing foundations.

There is no justification for provision that would work a hardship almost exclusively on family-held businesses.

There is the matter of the charitable contributions of appreciated property. While I agree that people should not be able to come out net ahead by contributing to charity, I cannot support the change in the taxing of contributions of appreciated property contained in H.R. 13270; for as it is presently written, the proposal discriminates against small private special-purpose foundations in favor of big, well-known foundations.

A donor could continue to deduct the fair market value of contributed property where the donee was a large public charity or a large operating foundation, but not where it was a small private foundation. Thus you could deduct the fair market value of an appreciated security if you gave it to the PTA, for example, but not if the recipient were the Brookings Institute here in Washington.

I think the result of the discrimination would be to shift donations away from private foundations, many of which serve a very important role in the community in which they reside, and towards those foundations not covered by the proposal.

Finally, gentlemen, I would like to address myself to the tax treatment of State and municipal bonds.

I am sure you have much testimony on this. There is great concern with all of the local officials in my State, from the Governor right through the county commissioner of the smallest county in Maryland, that as a result of the proposal which passed the House, there is a great deal of uncertainty in the bond market. It is widely held that the adoption of the House provision might jeopardize the entire security market which relates to municipal and State bonds.

In July the State of Maryland postponed the issuance of $60 million in bonds. If States like Maryland are to meet their responsibilities, the bond market has got to be strengthened in every way. I realize that the House did not intend to jeopardize the ability of the States and localities to raise funds, but nevertheless that would be a result of the passage of the House proposal.

Even the possibility of change has thrown the bond market in this country into a state of chaos and confusion, and I think there is almost unanimous agreement among State and local officials across the country that the adoption of this particular provision would cast a psychological shadow over the entire bond market.

I think the risks inherent in any change in the status of State and municipal bonds outweigh the possible benefits. If we are to truly revitalize our Federal system and provide State and local governments with access to the resources they require to be responsive to the needs of their citizens, the Congress must preserve the present stability and the present status of State and municipal bonds, and I strongly urge the committee to adopt such a position in the legislation it reports to the Senate.

Mr. Chairman, I thank you for your courtesy. There is much more detail in my statement than I presented to you, but I tried to make it as brief as possible.

The CHAIRMAN. Thank you very much, Senator. I am impressed to see that you did not agree with everything in the bill just because the House proposed it.

Senator CURTIS. I want to commend the distinguished Senator on his statement on foundations and as I understand his position on the interest on State and local bonds.

I have one question. In your proposal to tax appreciated property at death, that is whether it is sold or not?

Senator TYDINGS. No, I am sorry, I did not make that clear. My purpose there would merely be to carry over the original basis through the estate. I think it would work perhaps an undue hardship on the widow of the estate to require her to pay a tax at the date of death or through the estate. My proposal would merely carry the original basis through the estate out to the beneficiaries of the estate, and when the beneficiary decided to sell the security, he would have to pay a capital gains tax based on the original cost of the property, and not the stepped-up basis as of the date of death.

Senator CURTIS. And you refer to all kinds of property and all sizes of estates?

Senator TYDINGS. Yes, all types of property in real estate, in stocks, bonds, anything which appreciates.

Senator WILLIAMS. When you refer to carryover of the old base, would you add to that old base the amount of the estate tax that had been paid each time?

Senator TYDINGS. That is a possibility which had not occurred to me, and that might be something which the committee would want to consider. You see the Treasury estimates that there is roughly about $2.5 billion a year of taxes which are not paid because of the stepped-up basis of property as of the date of death; and that constitutes a major loophole.

As I see it, it would not work a great hardship on a widow or a family, provided you did not make them pay it as of the date of death. If they just kept the security and perhaps at some later time wanted to sell it, then they would pay the capital gains tax on the original basis.

I think it might well be that you could work out some formula for the estate tax and put it on there. You would still have a major sum of mony that would inure to the Treasury.

Senator WILLIAMS. You would still achieve the same objective which you are seeking?

Senator TYDINGS. That is correct.

Senator CURTIS. It has been my observation that over the years there have been a few people in the Treasury who regarded all of the taxpayers' money that did not flow into the Treasury as loopholes, so I would not take their estimates too seriously.

Senator TYDINGS. You are in a better position to determine that than I am, Senator.

The CHAIRMAN. Thank you very much.

Senator TYDINGS. I have a chart on parimutuel and taxes paid to the States which I will ask be incorporated in the record.

(The tables referred to by Senator Tydings, and the Senator's prepared statement follow:)

STATEMENT OF HON. JOSEPH D. TYDINGS, A U.S. SENATOR FROM THE STATE OF MARYLAND

Mr. Chairman and members of the Committee. Permit me to open on a congratulatory note. The thoroughness and care with which the Committee has conducted these hearings offer eloquent public testimony of Congress' concern that the many inequities in our tax laws be eliminated. I am confident these proceedings will result in comprehensive reform legislation this year of the kind the people have rightly demanded.

The bill before the Committee is quite extensive in its coverage, and by the time these hearings are completed, expert testimony will have been presented on virtually every provision of the proposed legislation. Therefore, I shall limit my remarks to several aspects of the bill that have proven of particular importance to the people of Maryland.

MUTUAL SAVINGS BANKS, SAVINGS & LOAN ASSOCIATIONS, ETC.

In order to qualify for the full bad debt deduction under the legislation enacted by the House, a mutual savings bank must have 72 percent of its assets invested in certain qualifying categories specified in the bill. For the most part, these specified asset categories consist of residential mortgage loans and other investments acquired by banks for liquidity purposes.

The bill enumerates a wide variety of loans that would qualify as residential mortgages. Included are home loans, church loans, mobile home loans and school loans, just to mention a few. However, *ground rents* are not specifically included, though they have been treated as mortgage loans in all previous Federal income tax legislation.

The ground rent, which permits an individual to rent the land on which he owns a home, is an institution peculiar to Maryland. The mutual savings banks of Maryland have substantial investments in these ground rents. Therefore, the omission of ground rents from the definition of residential mortgage loans would make it extremely difficult for the majority of Maryland mutual savings banks to qualify for the full bad debt deduction in H.R. 13270.

The staff of the Ways & Means Committee has informed me that the failure to specifically include ground rents in Section 442 of the House bill was an unintentional oversight, and that they would welcome an amendment to correct this omission.

I would urge the Committee to include ground rents specifically in the Senate version of the Tax Reform Act of 1969 to insure that Maryland mutual savings banks are not unfairly discriminated against in this matter of bad debt deductions.

FARM LOSSES

Pari-mutuel racing and the breeding of horses for racing are important industries in Maryland which produce desperately needed revenue for the support of State services. Three provisions of the Farm Losses section of the House bill—the Gain From Disposition of Property Used In Farming Where Farm Losses Offset Nonfarm Income, Depreciation Recapture, and Hobby Losses—pose serious threats to the survival of these industries.

There are a number of reasons why the raising and breeding of horses ought to be protected by exclusion from these new Farm Loss provisions in the House bill. However, the most compelling relates to the aggregate revenue effects of the proposed changes.

Pari-mutuel racing provides the states with a form of voluntary taxation which yielded them $426 million in 1968 and which will yield approximately $500 million in 1969 (see attached Exhibit A). Maryland alone received $14 million in 1968. Since the Farm Losses proposals in the House bill will ultimately destroy pari-mutuel racing in this country because the vast majority of breeders and owners of race horses will be forced out of business, this sorely needed revenue will be lost.

This will simply be a case of the government cutting off its nose to spite its face. Very little of the $200 to $400 million in potential tax revenue the Treasury estimates it loses each year as a result of present provisions in the Farm Losses tax laws is attributable to horses. At the same time, including horses for breeding and racing in the proposed legislation will mean the loss of $500 million in tax

revenues to the states. This $500 million is not deductible against federal income taxes. If lost, this revenue will have to be replaced by other taxes—applicable to the public at large and deductible for federal income tax purposes. Such a trade-off makes no sense. The real losers will be the American taxpayers.

Furthermore, the Federal government probably realizes net tax benefits from pari-mutuel racing at the present time under existing Farm Losses tax law. Substantial Federal taxes are currently paid by tracks, their stockholders, employees and concessionaires; by the employees of breeding farms and racing stables; by owners on the ordinary income produced by the sale of yearlings by breeding farms; and by owners on capital gains on the sale of racing and breeding stock and on the sale of breeding farms.

In short, including horses for breeding and racing under the new Farm Losses provisions will have the effect of closing an imaginary loophole through which virtually no revenue escapes, at a cost of half-a-billion dollars to our State governments. This is neither good pubic finance nor good government.

To understand why the Farm Losses provisions in the House bill will kill pari-mutuel racing, it is essential to keep in mind the fact that horse breeding and racing are terribly hazardous businesses. An estimated 9 out of 10 race-horse owners lose money.

Each year the race horses of the nation compete for purses amounting to only one-half of the operating expenses of maintaining them (i.e., exclusive of depreciation). Lameness, sickness and accidents incapacitate or degenerate a majority of race horses. And they are insurable only for mortality. If a horse is incapacitated in any way or simply cannot run fast, it is of absolutely no worth to its owner.

Changing the hobby law to require "reasonable expectation of making profit" means that the test is no longer the owner's purpose or motive, but his objective prospect of making money. On such a basis, the prognosis can readily be shown to be very dim. This will force owners out. Virtually all horse racing losses will likely prove nondeductible.

The Depreciation Recapture proposal will also work to force owners out of business. For only by the occasional sale of a valuable, fully depreciated horse can an owner replenish his stable without recourse to his savings. In addition, depletion is a more appropriate principle to apply to race horses than recapture of depreciation. A race horse is a wasting natural asset. It cannot be restored by depreciation funds.

Finally, the proposed restriction of deductibility of horse-racing expenses against non-farm income will likewise force most owners out of business. Because of the hazards of horse racing referred to above, very few owners can depend on it for a living. If they must absorb horse losses, they will be forced to do so at the expense of the outside income with which they support themselves and their families.

Without the market provided by racing stables, all breeding farms will eventually be closed down and the net result will be the end of pari-mutuel racing.

The argument for excluding horses for racing and breeding from the proposed changes in the Farm Losses provisions is overwhelming. Therefore, I have introduced an amendment to H.R. 13270 which would exempt horses from the bill, a copy of which is attached. I strongly urge the committee to give careful consideration to this amendment in its deliberation. For I am convinced it is consistent not only with the well-being of the horse industry in this county, but with the best interests of the taxpayers as a whole.

TAX TREATMENT OF PRIVATE FOUNDATIONS

I am certain none of us would disagree over the importance of private giving to a democratic, capitalistic society. Government in the solution of societal problems in this country by means of laws supporting the establishment and operation of foundations.

At the same time, there is evidence that some private foundations have abused the tax exemption privileges extended to them. Such breaches of the public trust simply cannot be condoned. However, we must take care not to undermine the spirit of voluntary giving in our efforts to insure that both the spirit and the letter of laws governing such giving are properly observed.

I would like to briefly take up with the committee three such "overkill" provisions of the section on the tax treatment of private foundations.

The levy of a general 7½% tax upon a private foundation's net investment income would constitute a contradiction of our traditional commitment to encourage private giving and a dangerous precedent. Furthermore, the tax would fall on those who were intended to receive foundation benefits, *not* on the foundations themselves.

An approach more consistent with our time-tested policy of encouraging "voluntary charity" would be that of a user charge or a registration fee to provide enough money to finance the administrative machining to ensure that private foundations are not abusing their privileges. Personally, I would favor an annual foundation registration fee which would vary with the amount of a foundation's assets and income flow-through rather than the 2 percent tax proposed by the administration. I am very much opposed to the creation of a tax of any sort on the investment income of private foundations.

2) Distribution of Income by Private Foundations.

I fully concur with the requirement that private foundations distribute all their income currently. However, the additional provision that a private foundation must distribute the greater of all income or 5 percent of investment assets is unreasonable and, in the long run, harmful.

The 5 percent minimum distribution requirement will cause the managers of private foundations to invest in "high yield fixed income" securities of the type that are subject to substantial depreciation in value during a sustained period of inflation. Thus, while the required yield or the market value of foundation assets will be achieved, such fixed income, in real terms, will be eroded by inflation over the years. Not only will the purchasing power of these "fixed" dollars be reduced, but upon maturity or sale of the securities by foundations, losses in the value of such assets are bound to occur. Therefore, the recipients of foundation distributions will, in the long run, receive less funds to meet their growing needs.

To avoid this situation, I would urge the committee to consider replacing the 5 percent provision with the requirement that a private foundation distribute all income currently but not less than 2 percent of investment assets. For a 2 percent figure is more in line with prevailing economic conditions.

3) Stock Ownership Limitations on Private Foundations

In principle, the objective of the proposal to limit to 20 percent the combined ownership of a corporation's stock which may be held by a foundation is commendable. The use of foundations to maintain control of businesses can result in the diversion of the foundation's managers from their charitable duties and to the affairs of the business. However, in practice, the 20 percent limit presents serious problems.

Despite the liberal divesture provisions, the proposed limit is likely to result in the eventual sale of divested assets at considerably less than their true value. This is particularly true if the assets consist of securities of a closely-held company to meet the 20 percent limit really means the sale of the company if a fair price for the stock is to be obtained. I am sure this is not an outcome the House envisioned or desired when it enacted the 20 percent limit.

Therefore, I would urge the committee to consider dropping this limit from the tax reform bill at least as it applies to existing foundations. There is no justification for a provision that would work a hardship almost exclusively on closely-held family businesses.

CHARITABLE CONTRIBUTIONS OF APPRECIATED PROPERTY

While I agree that people should not be able to come out net ahead by contributing to charity, I cannot support the change in the taxing of contributions of appreciated property contained in H.R. 13270. For as it is presently written, this proposal discriminates against small private special purpose foundations.

A donor could continue to deduct the fair market value of contributed property where the donee was a public charity or large operating foundation, but *not* where it was a small private foundation. You could deduct fair market value of a contribution to the local PTA, for example, but not if the recipient were the Brookings Institute.

The result of this discrimination would be to shift donations away from private foundations and towards those foundations not covered by the proposal.

This is tantamount to putting the government on record as stating that large public foundations are somehow better than small private foundations. There is no precedent nor any basis in fact for drawing such a conclusion.

In my opinion and that of a vast number of experts in the field of philanthropy, this is a crippling proposal that must be struck from the bill. Nothing less than the survival of many of our great private charitable institutions is at stake.

TAX TREATMENT OF STATE AND MUNICIPAL BONDS

As the members of the committee well know, State and local governments have come under enormous pressure to provide more and better services and facilities. In 1950, total State and local bonds outstanding amounted to less than $50 billion. However, today, as a result of rapidly increasing capital requirements, that total has reached $140 billion.

In July, the State of Maryland postponed the issuance of $60 million in bonds to finance needed facilities because of unfavorable conditions in the State and municipal bond market. If States like Maryland are to meet their burgeoning responsibilities, ways must be found to strengthen the bond market. However, it appears that the proposals in H.R. 13270 regarding the tax treatment of municipal and state bonds will have just the opposite effect; the bond market will be critically weakened.

Even the possibility of change has thrown the bond market into this county into a state of chaos and confusion. State, county and local officials in Maryland have informed me with virtual unanimity that the prospect of a revision of the present tax laws regarding State and municipal bonds has cast a psychological shadow over the entire bond market which is frightening off prospective buyers in droves. They are convinced that enactment of the proposed changes in H.R. 13270 will cause the situation to deteriorate even further.

Clearly, the risks inherent in any change in the status of State and municipal bonds outweigh the possible benefits. If we are to truly revitalize our federal system and provide State and local governments with access to the resources they require to be responsive to the needs of their citizens, the Congress must preserve the present status of State and municipal bonds. I strongly urge the Committee to adopt such a position in the legislation it reports to the Senate.

PASSING ON THE ORIGINAL CAPITAL GAINS BASIS AT DEATH

The Tax Reform Bill of 1969 as passed by the House possesses an "imbalance" that will produce a long-term revenue loss of approximately $2.4 billion a year. This means less money in coming years to support needed public services such as education, health, pollution abatement and housing, to name a few.

Restoring fiscal balance to the Tax Reform Bill will require the raising of additional revenue through the closing of some of the loopholes in our tax system that have remained undisturbed.

As you know, more than $20 billion in capital gains annually escape taxation because the present law permits a tax-free step-up in basis at death. To begin with, this costs the Treasury $2.5–$3 billion a year in potential revenue, more than enough to offset the long-term revenue loss built into the House-passed version of the reform bill.

Economists have long opposed the tax-free step-up in basis on the grounds that it inhibits capital mobility and distorts the allocation of resources in this country. This is because people are holding on to appreciated property they would ordinarily sell in anticipation of being able to avoid paying taxes on the capital gains if the property is held until death.

Finally, this loophole has constituted a serious inequity in our tax system because it greatly favors those who have large amounts of accumulated wealth to pass on to the next generation. Thus, for reasons of economics and equity, I urge the committee to amend H.R. 13270 to include a provision that would pass on the original basis of appreciated properties to those who inherit them. In this way, when an heir sells the appreciated property, he would pay capital gains taxes on appreciation realized while he held the property as well as on the appreciation realized while the individual he inherited it from held it. And no capital gains would escape taxation.

Language to accomplish this is contained in Section 201 of S. 2211, a tax bill I introduced earlier this year.

STATISTICAL REPORTS ON HORSE RACING IN THE UNITED STATES FOR THE YEAR 1968

Prepared by

THE NATIONAL ASSOCIATION OF STATE RACING COMMISSIONERS

P. O. Box 4216

LEXINGTON, KENTUCKY 40504

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Compiled March 1969 by Secretary of NASRC
from figures submitted by the several
state racing commissions.

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Table No. 1

Pari-mutuel Turnover and Revenue to States

State	Racing Days				Attendance				Pari-mutuel Turnover				Revenue to State			
	Total	Thoroughbred	Harness	Qtr. Horse and Fairs	Total	Thoroughbred	Harness	Qtr. Horse and Fairs	Total	Thoroughbred	Harness	Qtr. Horse and Fairs	Total	Thoroughbred	Harness	Qtr. Horse and Fairs
Arizona (1)(2)	202	152		50	470,709	409,799		60,910	$ 20,675,726	$ 19,643,050	$	$ 1,032,676	$ 1,006,346	$ 1,006,346	$	$
Arkansas	50	50			486,704	486,704			35,796,288	35,796,288			2,328,901	2,328,901		
California (3)(4)	632	352	118	111 101	8,436,084	6,018,214	919,591	781,978 716,301	768,166,584	570,453,365	78,601,200	64,721,409 55,380,670	57,326,182	45,833,880	5,186,015	3,426,081 2,880,2[illegible]
Colorado (3)	143	86		28 29	445,363	350,043		70,259 25,061	19,670,510	15,950,236		3,200,029 508,245	660,184	539,553		101,439 19 162
Delaware	300	61	239		1,842,874	650,666	1,192,208		128,250,004	59,762,224	68,487,780		6,945,727	3,727,270	3,218,457	
Florida (1)(5)	258	169	89		1,626,856	1,412,989	213,867		196,945,624	183,570,440	12,375,184		16,877,543	15,858,290	1,019,253	
Idaho (6)	81	60		21	79,586	64,165	15,421		2,027,880	1,760,341		267,539	101,680	96,642		5,025
Illinois	723	307	416		6,860,835	3,556,175	3,304,660		473,128,179	265,710,128	207,418,051		40,024,116	23,777,144	16,246,972	
Kentucky	438	220	218		1,934,189	1,379,955	554,234		115,413,796	95,469,969	19,943,827		5,505,489	4,636,648	868,841	
Louisiana (1)(7)(8)	173	173			1,107,714	1,107,714			74,908,172	74,908,172			4,340,635	4,340,635		
Maine (9)	272	42	167	63	189,914	189,914	No Record		21,309,621	6,149,789	11,582,254	3,577,578	1,501,772	440,064	811,138	250,570
Maryland (10)(11)	345	159	126	60	2,656,273	1,758,345	509,446	389,182	238,607,993	179,053,502	27,800,190	31,754,301	13,911,393	10,317,806	1,771,681	1,821 [illegible]
Massachusetts (10)	216	90	90	36	1,824,971	832,539	787,839	214,593	127,510,221	74,556,270	40,346,815	12,607,136	9,419,423	6,101,449	2,608,312	709,662
Michigan	388	168	220	-	2,909,308	1,873,121	1,036,187		231,472,394	158,556,917	72,915,447		17,794,513	13,635 781	4,158,732	
Montana (12)(13)	62	62			132,650	132,650			1,461,287	1,461,287			None			
Nebraska	161	161			1,903,160	1,903,160			55,887,376	55,887,376			2,181,209	2,181,209		
Nevada (14)	8			8	11,300			11,300	218,481			218,481	None			
New Hampshire (9)	300	51	241	8	1,759,986	578,214	1,147,793	33,979	115,813,861	55,576,933	59,450,392	786,536	8,306,470	4,482,780	3,776,272	49,415
New Jersey	336	176	160		3,739,351	2,802,272	937,079		391,331,683	317,296,567	74,035,116		34,425,605	29,435,041	4,990 554	
New Mexico (3)(15)	203	203			732,976	732,976			34,083,203	23,961,207		10,121,896	803,016	803,016		
New York	1,331	360	971		15,930,357	7,109,131	8,821,226		1,450,628,840	723,020,731	735,609,109		155,695,563	80,799,092	74,[illegible]	
Ohio (3)(16)	939	400	398	1 140	3,619,483	1,795,999	1,569,326	4,826 249,332	213,325,689	137,585,855	74,315,211	158,342 1,236,201	15,103,971	10,561,327	4,466,296	11,[illegible] 61,4[illegible]
Oregon (17)	160	60		50	454,000	297,000		157,000	19,264,136	14,256,191		5,007,945	937,768	860,785		76,9[illegible]
Pennsylvania	248		248		1,762,791		1,762,791		120,737,666		120,737,666		7,407,983		7,407,983	
Rhode Island	150	150			1,206,310	1,206,310			116,232,376	116,232,376			10,560,003	10,560,003		
South Dakota (18)	58	52		6	90,698	74,113		16,500	4,610,347	4,271,704		338,643	143,705	132,415		11 290
Vermont	169	127	42		584,213	456,641	127,572		37,205,714	28,084,554	8,521,160		2,272,133	1,882,814	389,319	
Washington (19)(20)	155	138		17	508,098E	508,098E		No Record	42,943,560	42,691,130		252,430	2,169,008	2,151,902		15 [illegible]
West Virginia	541	541			2,122,981	2,122,981			154,714,930	154,714,930			9,090,365	9,090,365		
Wyoming	19	19			30,000E	30,000E			195,000	195,000			13,655	13,655		
TOTALS	9,051	4,579	3,743	729	65,460,434	39,859,973	22,869,240	2,731,221	$5,226,457,141	$3,426,821,582	$1 618 459,502	$181,176,057	$426,856,448	$285 599 953	$131,816 308	$9,4[illegible]

REMARKS:

(1) Arizona, Florida, Louisiana: Reports based on fiscal year, July 1, 1967-June 30, 1968.
(2) Arizona: Fairs—All revenue and breakage to counties.
(3) California, Colorado, New Mexico, Ohio: Bold Face indicates Quarter Horse.
(4) California: Fairs—Thoroughbred, Quarter Horse, Harness and Appaloosa racing.
(5) Florida: Charity and Scholarship days not included in revenue figures above. Thoroughbred—20 days; attendance, 115,57[illegible]; pari-mutuel turnover, $13,199,224. Harness—3 days; attendance, 4,737; pari-mutuel turnover, $250,165.
(6) Idaho: Thoroughbred, Quarter Horse, Appaloosa, and mixed races at most race meets.
(7) Louisiana: Quarter Horse, 277 races. Evangeline Downs, mixed racing.
(8) Louisiana: Donations to American Red Cross and Retarded Children's Funds not included in revenue figures above.
(9) Maine, New Hampshire: Fairs—All Harness racing.
(10) Maryland, Massachusetts: Fairs—All Thoroughbred racing.
(11) Maryland: Two-day Steeplechase meeting included in Thoroughbred figures. Estimated attendance, 28,000; pari-mutuel turnover, $309,908; revenue to state, $15,958.50.
(12) Montana: Thoroughbred, Quarter Horse and Appaloosa racing at same track, same meet. Some mixed races for Thoroughbred and Quarter Horse.
(13) Montana: State derives no revenue from racing. However, 1 per cent of 20% take-out is paid to Commission by licensee and deposited in State Treasury in Commission's account for expenses. Commission also receives toward expenses underpayments and license fee.
(14) Nevada: One per cent of total take-out is paid to Commission for administrative work.
(15) New Mexico: Mixed program each day of Thoroughbred and Quarter Horse racing.
(16) Ohio: Fairs—All Harness racing, except one day Quarter Horse.
(17) Oregon: There were 925 races programmed of which 792 were Thoroughbred, and 133 for Quarter Horse and Appaloosa.
(18) South Dakota: One race per day Quarter Horse.
(19) Washington: Fairs—Both Thoroughbred and Quarter Horse racing.
(20) Washington: Attendance estimated. Approximately 1,000 working passes issued—owners, trainers, jockeys issued two free passes, tax exempted passes issued to state, city and county officials.

Note on Attendance: At some meetings, principally Fairs, attendance records not always reported.
Note on Revenue to State: Totals computed to nearest dollar.
(E)—Estimated.

Table No. 2

Breakdown of Revenue to States — 1968

State	From Track Licenses: Thoroughbred	From Track Licenses: Harness	From Track Licenses: Qtr. Horse and Fairs	From Occupational Licenses: Thoroughbred	From Occupational Licenses: Harness	From Occupational Licenses: Qtr. Horse and Fairs	From Pari-mutuel Taxes: Thoroughbred	From Pari-mutuel Taxes: Harness	From Pari-mutuel Taxes: Qtr. Horse and Fairs
Arizona (1)	$ 18,532.00	$	$	$ 18,532.00	$	$	$ 947,720.61	$	$
Arkansas	25,000.00			14,635.00			2,147,777.28		
California (2)				64,544.00	15,602.00	11,217.00 11,821.00	40,761,735.00	4,969,355.00	2,896,707.00 2,819,64[illegible].00
Colorado (2)				10,45[illegible].00		4,542.00 5,045.00	526,327.07		96,343.47 13,467.09
Delaware	5,000.00	1,000.00			1,500.00		3,287,252.00	3,081,960.21	
Florida				67,270.00	18,671.75		14,237,031.12	866,262.68	
Idaho (3)	1,500.00			6,576.00		2,168.00	88,017.00		2,675.39
Illinois	41,000.00	89,350.00		52,377.00	49,684.00		21,263,462.35	13,595,115.48	
Kentucky (4)	212,000.00	27,460.00			11,280.00		4,190,020.38	797,753.06	
Louisiana				32,738.00			4,202,215.59		
Maine	5,000.00	380.00	140.00	2,002.75			430,573.03	810,757.78	250,430.46
Maryland (5)	156,00.00	3,150.00		83,590.00	10,280.00		8,952,075.10	1,435,070.14	1,605,[illegible]
Massachusetts	84,000.00	18,000.00	1,800.00	15,017.00	10,836.00	2,395.00	5,591,720.47	2,350,384.65	611,492.55
Michigan	1,000.00	600.00		14,481.0[illegible]	22,250.00		12,684,555.76	3,645,772.25	
Montana (6)									
Nebraska	11,800.00			27,995.00			1,995,435.04		
Nevada (6)	—								
New Hampshire				11,349.00	15,477.64	386.00	4,168,270.12	3,380,080.50	43,229.50
New Jersey				71,315.00	19,361.00		23,770,208.82	4,211,306.65	
New Mexico	57,410.00			30,729.50			683,908.90		
New York (7)	714,625.00	97,190.00		57,683.00	53,487.00		76,305,920.00	68,159,378.36	
Ohio (2) (8)	80.00	80.00	10.00 420.00	35,296.00	32,020.00	1,186.00 2,003.00	10,502,201.61	4,067,833.23	10,671.31 52,141.12
Oregon	25,000.00		9.00	2,723.00		910.00	831,524.00		75,119.00
Pennsylvania					26,218.28			6,336,883.30	
Rhode Island				22,600.00			9,879,722.00		
South Dakota (9)	520.00		60.50	2,419.00		1,136.00	128,151.12		10,150.29
Vermont	8,[illegible]	6,384.00		680.00	1,878.00		1,689,704.75	331,519.26	
Washington	13,800.00		1,700.00	3,645.00		685.00	2,134,556.50		12,421.50
West Virginia	130,250.00			31,583.00			8,896,107.49		
Wyoming	950.00			2,667.00			7,762.40		
TOTALS	$1,407,986.00	$213,044.00	$4,129.00	$678,512.25	$284,504.67	$43,514.00	$256,099,711.54	$118,489,121.99	$8,982,591.55

State	From Admissions: Thoroughbred	From Admissions: Harness	From Admissions: Qtr. Horse and Fairs	From Breaks: Thoroughbred	From Breaks: Harness	From Breaks: Qtr. Horse and Fairs	From Miscellaneous Sources: Thoroughbred	From Miscellaneous Sources: Harness	From Miscellaneous Sources: Qtr. Horse and Fairs
Arizona (1)	$	$	$	$	$	$	$ 84.10	$	$
Arkansas	22,935.50			107,202.80			11,327.07		
California (2)				4,671,752.00	170,860.00		335,849.00	30,701.00	34,157.40 48,739.[illegible]
Colorado (2)							806.40		833.40 650.0[illegible]
Delaware	113,626.00	84,211.40		287,078.00			34,414.00	49,692.25	
Florida	461,742.48	43,491.70		958,777.63	77,457.72		133,468.70	11,362.40	
Idaho (3)							620.00		[illegible]
Illinois	638,419.00	613,067.60		1,620,965.30	1,[illegible],424.07		219,969.73	106,781.00	
Kentucky (4)	161,191.05	16,242.22					73,424.00	19,316.00	
Louisiana	45,375.90						60,105.50		
Maine							2,467.80		
Maryland (5)	79,801.56	30,781.02	1,278.66	879,946.42	166,292.76	190,454.87	195,702.75	26,007.45	21,916.[illegible]
Massachusetts				400,156.20	2[illegible]9,501.28	61,913.76	40,561.20	19,[illegible]	12,0[illegible]
Michigan				838,310.49	4[illegible]903.70		97,4[illegible].90	51,297.40	
Montana (6)									
Nebraska	130,670.70						15,248.75		
Nevada (6)									
New Hampshire				264,377.50	3[illegible]9,176.25	4,159.12	38,783.10	42,233.15	1,542.10
New Jersey				3,416,132.89	7[illegible]5,051.84		177,766.20	57,[illegible]	
New Mexico	14,750.56						4,210.00		
New York (7)	1,802,087.00	1,626,667.23		6,850,774.00	3,7[illegible],601.27		1,656,203.00	1,170,276.07	
Ohio (2) (8)				210,553.71	[illegible]65.19	630.44	12,116.00	9,[illegible].53	4,271.[illegible]
Oregon							1,528.00		965.[illegible]
Pennsylvania		109,760.50			6[illegible],917.27			293,[illegible].64	
Rhode Island				593,057.00			65,224.00		
South Dakota (9)							1,225.00		25.[illegible]
Vermont				156,426.03	4[illegible]9.05		27,651.80	6,185.00	
Washington									
West Virginia							7,125.00		
Wyoming				2,140.00			135.00		
TOTALS	$3,171,712.35	$2,524,921.67	$1,278.66	$21,266,644.06	$8,[illegible] 697.45	$277,102.10	$2,615,564.02	$1,887,017.24	$129,676.73

REMARKS:
(1) Arizona: Fairs—All revenue and breakage to counties. Fairs—Licenses and Miscellaneous Sources included with Thoroughbred.
(2) California, Colorado, Ohio: Quarter Horse figures in Bold Face.
(3) Idaho: Fairs—Exempt from Track Licenses.
(4) Kentucky: Thoroughbred—Occupational Licenses held by Commission for expenses.
(5) Maryland: Occupational Licenses for Steeplechase and Fairs all included in Thoroughbred. Pari-mutuel Taxes from Steeplechase, $15,495.40 included with Thoroughbred. Miscellaneous Sources from Steeplechase, $462.10 included with Thoroughbred.
(6) Montana and Nevada: State does not derive any monies from racing, except 1% of total take-out paid to Commission for administrative expenses.
(7) New York: Thoroughbred—Track Licenses includes $12,625, and $702,000 franchise fees, N.Y.R.A.
(8) Ohio: Pari-mutuel Taxes—Total tax less 25% tax on Breakage.
(9) South Dakota: One per cent of Pari-mutuel Taxes to Breeders' Fund added to purses for state bred and owned horses.

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Table No. 3

Breakdown Sheet of Pari-mutuel Take-out and Breakage

State	Total Take-out Permitted			Pari-mutuel Tax to State			Breaks to			Disposition of Breaks to State			Disposition of Breaks to Association		
	Thoroughbred	Harness	Qtr. Horse and Fairs	Thoroughbred	Harness	Qtr. Horse and Fairs	Thoroughbred	Harness	Qtr. Horse and Fairs	Thoroughbred	Harness	Qtr. Horse and Fairs	Thoroughbred	Harness	Qtr. Horse and Fairs
Arizona (1)	18%		18%	4% - 7%		None	10c		10c				100%		100%
Arkansas (2)	16%			6%			10c			33⅓%			33⅓%		
California (3)	14%	14%	14% 14%	5% - 8%	5% - 8%	5% - 8% 5% - 8%	10c	10c	10c 10c	All over 50 million 100%			50% first 24 million [illegible] 50% purses 24 million-50 million 100% purses		
Colorado (4)	15%		15% 15%	3% - 6%		3% - 6% {3% - 6% {2%	10c		10c 10c				100%		100% 100%
Delaware (5)	15%	17½%		5¼%	4 [illegible]%		10c	5c		50%			50%	100%	
Florida (6)	15%	17%		8%	7%		10c	10c		50%	50%		50%	50%	
Idaho	15%		14%	5%		1%	10c		10c				100%		100%
Illinois	15%	15%		5% - 8½%	5⅛% - 8⅜%		10c	10c		50%	50%		50%	50%	
Kentucky	14%	17%		4% - 6%	4%		10c	10c					100%	100%	
Louisiana (7)	16%			5% - 7%			10c			None			66 2/3%		
Maine	18%	18%	18%	7%	7%	7%	10c	10c	10c				100%	[illegible]	100%
Maryland (8)	13%	16%	13%	5%	3½% - 7%	1% - 6%	10c	10c	10c	50%	100% if daily average exceeds $166,666.67	50%	50%	100% if daily average below $166,666.67	50%
Massachusetts	15%	17%	17%	7½%	5½% - 9½%	2½% - 3½%	10c	10c	10c	50%	50%	50%	50%	50%	50%
Michigan	15%	15%		8%	5%		10c	10c		50%	50%		50%	50%	
Montana (9)	20%						10c						100%		
Nebraska	14%			4% after first million			10c						100%		
Nevada (9)			16½%						10c						100%
New Hampshire	15%	17%	17%	7¼%	5½% - 9½%	5½% - 9½%	10c	10c	10c	50%	50%	50%	50%	50%	50%
New Jersey	14½%	16%		7¼% - 8½%	5½% - 6½%		10c	10c		100%	100%				
New Mexico	18%		18%	2% - 6%		2%	10c		10c				100%		100%
New York	16%	16%		{10% {9% {10% - 4%	5½% - 11½%		10c	10c		80% - 75%	50%		20% - 25%	25[illegible] - 25%	
Ohio	16½%	17½%	16½% 17½%	4½% - 8½%	3% - 7%	4¼% - 8¼% 3% - 7%	10c	10c	10c 10c	25% after the first $2000.			35% & 40%	35% & 40%	35% & 40 [illegible]
Oregon Option 1 Option 2	12½% 15%		12½% 15%	3% - 6% 5% - 7%		1½% 1½%	10c 10c		10c 10c				50% 50%		50% 50%
Pennsylvania		17%			6%			10c			50%			50%	
Rhode Island	16%			8½%			10c			50%			50%		
South Dakota	15%		15%	4%		4%	10c		10c				100%		100%
Vermont (10)	18%	18%		5½% (Sundays 6½%)	3% - 8% (Sundays [illegible] - 8%)		10c	10c		50%	50%		50%	50%	
Washington	15%		15%	5%		5%	5c		5c				100%		100%
West Virginia	15%			5¾%			10c						100%		
Wyoming	17%			4%			10c			100%					

REMARKS:

(1) **Arizona:** Fairs—All revenue and breakage to counties

(2) **Arkansas:** Breakage—One third to state, ⅓ to association and ⅓ to city where track is located.

(3) **California:** Any track operator that handled not more than $125 million qualifies to retain the breakage for purse distribution. Up to $24 million wagered, the track receives 50%, purses 50%. From $24 million to $50 million, 100% goes to purses. The state receives 100% over $50 million wagered.

(4) **Colorado:** Colorado State Fair—State receives only 2% of 15% take-out.

(5) **Delaware:** Thoroughbred—One per cent increase in pari-mutuel commission—[illegible]% allocable to purses and 50% to "serving [illegible] and repayment of cost and/or [illegible] present or future capital [illegible]

(6) **Florida:** Breakage—One half of breakage to Racing Promotion Trust Fund to supplement [illegible] purses.

(7) **Louisiana:** Breakage—Full amount used at track where breakage is collected, with [illegible] ⅓ to supplement purses for Louisiana breeders.

(8) **Maryland:** Steeplechase—Total take-out 11%, with 5% to state. All breakage to association.

(9) **Montana and Nevada:** Revenue to State—State receives no revenue, but 1% of take-out goes to Commission for expenses.

(10) **Vermont:** Pari-mutuel Tax to State—State receives 1% more tax on Sunday racing

Table No. 4

Brief Summary of Tax Methods by States

State	
Arizona	Total take-out 18%. State receives 4% of first $100,000 of daily pari-mutuel pool and 7% all over $100,000. Net underpay to state at end of meeting. Breakage 10c, all to association. FAIRS: County in which fair is located receives pari-mutuel tax revenue, instead of state.
Arkansas	Total take-out 16%. Pari-mutuel tax to state 6%, $500 daily license, 10c tax on admissions. Breaks 10c, divided 33 1/3% to city where track is located, 33 1/3% to association, 33 1/3% to state.
California	Total take-out 14%. State receives 5% of first $10 million handled, 6% of next $10 million, 7% over $20 million to $75 million, 7 1/2% over $75 million to $125 million, 8% over $125 million wagered. Occupational license fees and breakage. Breaks to 10c. Any racing association that handles not more than $125 million qualifies to retain breakage for purse distribution. All under $24 million wagered racing association receives 50%, purses 50%; $24 million to $50 million, 100% to purses. Over $50 million state receives 100%.
Colorado	Total take-out 15%. State receives 5% of first $200,000, 4% of excess over $200,000 which does not exceed $300,000, 5% of all in excess of $300,000 which does not exceed $500,000, 6% of all in excess of $500,000. Breaks 10c, all to association. At Colorado State Fair, state receives 2% of take-out.
*Delaware	THOROUGHBRED. Total take-out 15%. 1% of which allocated 50% for purses, 50% for capital improvements. Per season license $5,000. Admissions 20c. Breaks 10c, divided equally between state and association. Unclaimed pari-mutuel tickets payable to state one year following last date of meeting in which ticket was sold. HARNESS: Total take-out 17 1/2%. State receives 4 1/2%. Admissions 10c. Breaks 5c, to association. Uncashed pari-mutuel tickets revert to state after one year.
Florida	THOROUGHBRED: Total take-out 15%. State receives 8%. (3% and admission taxes divided equally among 67 counties after racing commission expenses deducted—5% and 1/2 breakage to General Revenue Fund. One half of breakage to Racing Promotion Trust Fund to supplement purses.) Breaks 10c, 5c on minus pools. Any track having an average daily handle of less than $100,000 per day for the preceding racing season operates on a fixed daily license fee. HARNESS. Total take-out 17%. State receives 7%. (Of state's commission, 3% and admission taxes divided equally among 67 counties after racing commission expenses deducted, 2% and 50% of breakage to General Revenue Fund, 2% to be divided equally among counties. Fifty per cent of breakage to Racing Promotion Fund to supplement purses.) Breaks 10c.
Idaho	Total take-out 15%. Non-fair associations receive 10% plus breakage and pay $25 daily license fee. Fairs receive 14% plus breakage, and are exempt from license fee. The 4% and license fee from non-fairs is deposited to Public School Endowment Fund. All occupational license fees deposited to General Fund. Associations accrue all monies in unclaimed tickets 30 days after close of race meet. Committee receives 1% of handle for operational expenses.
Illinois	Total take-out 15%. THOROUGHBRED—state receives: At race tracks within county of 500,000 or more or within county of less than 500,000 but within 100 miles corporate limits any city in state of 1 million or more tax rates, except charity: First $5,000,000 of annual handle—5%, $5,000,001 to $10,000,000—6%, $10,000,001 to $30,000,000—7%, $30,000,001 to $40,000,000—7 1/2%, $40,000,001 to $60,000,000—8%, over $60,000,000—8 1/2%. At race tracks within county of less than 500,000 and more than 100 miles of any city in state of 1 million or more tax rate, except charity: First $10,000,000 of annual handle—5%, $10,000,001 to $20,000,000—6%, $20,000,001 to $30,000,000—7%, $30,000,001 to $40,000,000—7 1/2%, $40,000,001 to $60,000,000—8%, over $60,000,000—8 1/2%. Breaks 10c, half to state. Charity meets, tax 7% plus half of breaks. HARNESS—state receives: First $[illegible],000 of annual handle—5 [illegible]%, $[illegible] to $25,000,000—6 1/2%, $25,000,001 to $40,000,000—7 1/2%, $40,000,001 to $60,000,000—8%, over $60,000,000—8 1/2%. Breaks 10c, half to state. Charity meets, tax 7%. Breakage, both Thoroughbred and Harness, 5c instead of 10c in case of minus pool.
Kentucky	THOROUGHBRED: Total take-out 11%. State receives 4% on all under $18 million wagered during year, 6% thereafter. Daily license $500 if average daily handle at track during year does not exceed $450,000, $1,000 at tracks with average daily handle $450,000 to $600,000, $2,500 at tracks where such exceeds $600,000. Breaks 10c, to association, 15c on admissions. HARNESS: Total take-out 17%. State receives 4%. Daily license $100 if average daily handle during previous year does not exceed [illegible], [illegible] thereafter. Breaks 10c, to association, 5c on admissions. Unclaimed tickets to state after two years.
Louisiana	Total take-out 16%. In a parish with population of 450,000 and over state receives: On total daily pools from 1c to $201,000—5%, $201,000 to $401,000, $10,050 plus 6% of that amount exceeding $201,000 up to $401,000, $401,000 and over, $22,050 plus 7% of any amount exceeding $401,000. Daily license fee $1,000. In a parish with population less than 450,000 state receives: On total daily pools up to $200,000—5% of that portion exceeding $30,000, $201,000 to $300,000, $8,500 plus 6% of that portion exceeding $200,000, over $300,000, $14,500 plus 7% of pool exceeding $300,000. Daily license fee $1,000. Admissions 10c. Breaks 10c, 2/3 to association and 1/3 to Louisiana Breeders Fund to supplement purses.
Maine	THOROUGHBRED: Total take-out 18%. State receives 7% sub-divided as follows: 5% to General Fund, 1% to Agricultural Stipend Fund, 1% returned to association to defray cost of operation. License fee $5,000 annually. Any outstanding balance in unredeemed mutuel tickets divided equally between association and state when account is closed. Breaks to 10c, all to association. HARNESS: Total take-out 18% with 6% to state General Fund 1% to Agricultural Stipend Fund, association 11%. One-sixth of state commission is returned to association for purpose of supplementing purse money. License fee $10 for each 6 days or less of racing. Bond up to $50,000 required for license. Breaks 10c, all to association.
Maryland	THOROUGHBRED (MILE TRACKS): Total take-out 13%. State receives 5%, association 7 3/4% of which 4% is allocated to purses and .24 of 1% to Maryland-bred Fund Races. One half of 1% of money wagered to Racing Fund for plant improvements. Daily license fee $1,000. Breaks 10c divided equally between state and association. COUNTY FAIRS (THOROUGHBRED): Total take-out 13%, with 1% of first $1,500,000 to state. 12% of first $1,500,000 to association, of which 3.66% is allocated to purses and .31 of 1% to Maryland-bred Fund Races. All over $1,500,000 6% to state, 7% to association, of which 3.66% is allocated to purses and .34 of 1% to Maryland-bred Fund races. Breaks 10c, divided equally between state and association. HARNESS: Total take-out 16%. Of all money wagered not in excess of $125,000 daily average, 3 1/2% to state, 12 1/2% to association. Of all money wagered in excess of $125,000 daily average, 7% to state, 9% to association. Daily license $25. Breaks 10c. Association retains all breakage if daily average is below $166,666.67, above this figure, state gets all breakage. STEEPLECHASE: Total take-out 14%. State receives 5%, association 9%. Breaks 10c, to association.
*Massachusetts	THOROUGHBRED. Total take-out 15%. State receives 7 1/2%, association 7 1/2%. License fee $600 per day. Breaks 10c, divided equally between state and association. HARNESS: Total take-out 17%. State receives on daily handle to $400,000—5 1/2%, $400,000 to $450,000—6 3/4%, $450,000 to $500,000—7 1/2%, $500,000 to $550,000—7 [illegible]%, $550,000 to $600,000—8 1/2%, $600,000 to $650,000—8 3/4%, $650,000 and over—9 1/4%. License fee $200 per day. Breaks 10c, divided equally between state and association. FAIRS: Total take-out 17%. State receives 2% of daily handle plus 1 1/4% of any amount over $65,000. License fee $50 per day. Breaks 10c, divided equally between state and association.
Michigan	THOROUGHBRED: Total take-out 15%. State receives 8%, association 7%. Breaks 10c, divided equally between state and association. HARNESS: Total take-out 15%. State receives 5%, association 10%. Breaks 10c, divided equally between state and association.

* Portion bold face type indicates change in law 1968.

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Table No. 4 (continued)

Brief Summary of Tax Methods by States

State	Tax method
Montana	Total take-out 20%. The licensee shall pay to commission 1% of all gross receipts of each day's pari-mutuel betting at each race meet, which sums shall be paid to commission within five (5) days after receipt by licensee. At end of each race meet should report show underpayments to be in excess of overpayments, such balance shall be paid to commission. (No tax paid to State of Montana.)
Nebraska	Total take-out 11%. State receives 4% on all over $1 million. Tax on admissions 15c which, along with monies received in license fees, is distributed among counties of state for county fair premiums. Breaks 10c, to association.
Nevada	Total take-out 16½%. With exception of Fairs, state receives 2% of which 1% is paid to State General Fund and 1% to racing commission. (Daily license $50 per day, however, law provides that a maximum of $200 per day may be charged.) FAIRS: Total take-out 16½%, with 1% to racing commission for administrative work. However, after July 1 of following year any amount over $10,000 is to be distributed to agricultural districts conducting horse racing proportionately to the amount contributed by each district. Breaks 10c, to association.
*New Hampshire	THOROUGHBRED: Total take-out 15%. State receives 7½%, association 7½%. No license fee, but bond not exceeding $50,000 required. Breaks 10c, divided equally between state and association. HARNESS: Total take-out 15% divided as follows: Of total mutuel pool for any one day, state receives 5½% up to $100,000, 6% $100,001 to $250,000, 7¼% $250,001 to $500,000, 7¾%—$500,001 to $550,000, 8¼%—$550,001 to $600,000, 8¾%—$600,001 to $650,000, 9¼%—$650,001 and over. One quarter of 1% of total pari-mutuel pools allocated to Agricultural Fairs of state, however, total amount allocated is limited to $150,000 in any one year. Track licenses paid to township where track is located. Breaks 10c, divided equally between state and association.
New Jersey	THOROUGHBRED: Total take-out 15%. Of first $40 million of handle, state receives 7½%, thereafter 8½%. Breaks 10c, all to state. HARNESS: Total take-out 16%. Of first $10 million of handle, state receives 5½%, thereafter 6½%. Breaks 10c, all to state.
New Mexico	Total take-out 15%. State receives 2% up to $250,000, 3% to $350,000, 4% to $400,000, 6% all over $400,000. New Mexico State Fair, state receives 2%. Daily license fee $300, half to state and half to county in which track is located except State Fair charged $10 per race day. Breaks 10c, all to association.
*New York	THOROUGHBRED: Total take-out 15%. State receives from Saratoga 5%, from Aqueduct and Belmont 10% of total mutuel handle. From Finger Lakes state receives 10% first $125,000, 5% next $125,000, 7% next $100,000, 6% over $350,000 to $500,000, 5% to $600,000, 4% all over $600,000. Effective April 1, 1968 additional 1% of take-out for purses. Breaks 1% state receives from Aqueduct-Belmont-Saratoga 60%, from Finger Lakes 75%. Franchise fee $2,000 per racing day paid by non-profit associations. Finger Lakes track license, $100 per day. HARNESS: Total take-out 15%. Of total daily pool, state receives 5½% not exceeding $175,000, 7½%—$175,000.01 to $300,000, 8½%—$300,000.01 to $400,000, 9½%—$400,000.01 to $500,000, 10½%—$500,000.01 to $600,000, 11½% all over $600,000. Breaks 10c, with state receiving 50%. Horse Breeders Fund 25%, association 25%.
*Ohio	THOROUGHBRED: Total take-out 16%. State receives 4½% first $10,000 wagered, 5½% next $40,000, 6½% next $50,000, 7½% next $200,000, 8½% all over $300,000. HARNESS AND FAIRS: Total take-out 17½%. State receives 3% first $10,000, 4% next $40,000, 5% next $50,000, 6% next $300,000, 7% all over $450,000. For both Thoroughbred and Harness, breaks 10c with state receiving 25% after first $2,000 in any year; 40% of breaks retained by track for increase in net purse distribution. Ohio Fair Fund. One half of 1% of total wagered at Thoroughbred, Harness and Fair meetings appropriated for Ohio Fair Fund. (Tax collected from take-out.) Thoroughbred Fund. Four tenths of 1% of total wagered at Thoroughbred and Harness meetings (not collected from Fairs) is appropriated for Ohio Thoroughbred Race Fund. (One tenth of 1% increase for 1968 season.) General Revenue Tax collected from Fairs refunded to Agricultural Societies.
Oregon	Total take-out 17% in Option 1, 15% in Option 2. Under Option 1, state receives 3% first $66,000, 4% next $67,000, 5% next $67,000, 6% all over $200,000 wagered in one day. Under Option 2 state receives 5% first $122,000, 6% next $67,000, 7% all over $200,000 wagered in one day. Non-profit Fairs, state receives 1½% under either Option. Daily license fee Option 1, $425; Option 2, $500. Per meet license nonprofit tracks [illegible]. Breaks 10c, half to association and half for purses Oregon-bred horses.
Pennsylvania	HARNESS: Total take-out 15%. State receives 5%, association 10%. In addition there is a 2% tax at tracks located in cities of first class paid directly to school district. In all other areas 2% tax paid to Department of Commerce for projects in accordance with law. Breaks 10c, divided equally between state and association, except in case where a minus pool is created, then breaks 5c.
Rhode Island	Total take-out 16%. State receives 8½%, association 7½%. Breaks 10c, divided equally between state and association.
South Dakota	Total take-out 15%. State Special Racing Fund receives 3%, state Breeders' Fund 1%, association 11%. Law also provides that 5% of winning purse will go to South Dakota breeder of winning horse. Breaks 10c, all to association.
*Vermont	THOROUGHBRED: Total take-out 14%. State receives 5½%. Breaks 10c, half to state and half to association. HARNESS: Total take-out 15%, with state receiving on first $150,000 plus 3%, $150,000 to $200,000 plus 4%, $200,000 to $250,000 plus 5%, $250,000 to $300,000 plus 6%, $300,000 to $350,000 plus 7%, $350,000 and over 8%. Breaks 10c, half to state and half to association. On Sunday racing, state's share increased as follows: Tax percentage 6½% instead of 5½% thoroughbred; tax percentage sliding scale 4% to 8% harness.
Washington	Total take-out 15%. State receives 5%, association 10%. Breaks 5c, all to association.
West Virginia	Total take-out 15%. State receives 5½%, association 9½%. Daily license tax $250 for tracks under one mile, $500 for tracks one mile or more. Unredeemed pari-mutuel ticket money deposited to Special Account to support State Breeders' Awards. Breaks 10c, all to association.
Wyoming	Total take-out 17%, with 1% to commission for operating expenses, 4% and breakage to State General Fund, 2% on a population ratio to cities and towns within county where track is located. Association retains 10%. Breaks 10c, all to state. The 1969 Legislature has passed a new pari-mutuel law permitting total take-out of 20%, with 2% to Pari-Mutuel Board, 2% to city where track is located, 16% to racing association. Breakage all to racing association.

* Portion bold face type indicates change in law 1968.

Table No. 5

Racing Revenue to States (for U. S.) by Years

Year	Revenue
1968	$436,856,448
1967	394,381,913
1966	338,452,125
1965	349,302,036
1964	350,085,925
1963	316,570,791
1962	287,930,030
1961	264,858,077
1960	258,039,365
1959	243,388,655
1958	222,049,651
1957	216,747,621
1956	207,454,272
1955	186,989,588
1954	178,015,825
1953	167,126,465
1952	142,489,696
1951	117,250,344
1950	98,366,167
1949	90,327,053
1948	95,803,364
1947	97,926,384
1946	94,035,850
1945	65,265,405
1944	55,971,233
1943	38,194,727
1942	22,005,278
1941	21,128,173
1940	16,145,182
1939	10,369,807
1938	9,576,225
1937	8,434,792
1936	8,611,538
1935	8,386,235
1934	6,024,193

Table No. 6

Monies Distributed in Stakes and Purses for 1968

State	Total Monies Distributed			
	Total	Thoroughbred	Harness	Qtr. Horse and Fairs
Arizona	$1,865,435.24	$ 1,439,171.44	$	$ 226,263.80
Arkansas	1,679,530.00	1,679,530.00		
California (1)	28,177,065.00	19,983,507.00	3,305,700.00	2,229,423.00 2,518,[illegible]
Colorado (1)	1,254,862.45	980,856.39		175,589.62 98,416.44
Delaware	6,660,294.00	2,953,180.00	3,707,114.00	
Florida (2)	6,679,375.00	6,679,375.00		
Idaho	136,940.00	104,229.00		32,711.00
Illinois	21,342,806.00	12,505,735.00	8,837,071.00	
Kentucky	6,960,796.50	5,258,364.00	1,702,432.50	
Louisiana	3,809,077.00	3,809,077.00		
Maine (3)	1,424,060.00	374,105.00	789,515.00	260,450.00
Maryland (4)	10,667,312.93	7,786,497.40	1,518,064.25	1,362,751.28
Massachusetts (4)	4,705,793.24	2,670,282.00	1,693,638.99	341,872.25
Michigan	8,796,569.00	5,540,774.00	3,255,795.00	
Montana	164,794.15	164,794.15		
Nebraska	3,001,506.00	3,001,506.00		
Nevada	21,421.00			21,421.00
New Hampshire (3)	4,121,837.89	1,965,559.00	2,094,167.89	42,111.00
New Jersey	13,009,516.00	9,902,255.00	3,107,261.00	
New Mexico (1)	4,442,315.06	2,213,331.21		2,198,980.85
New York (5)	44,635,511.34	21,813,315.00	22,792,296.34	
Ohio (1)	11,661,266.28	6,596,954.00	3,964,955.00	58,217.50 1,051,129.78
Oregon (1)	1,023,687.00	560,290.00		100,135.00 363,262.00
Pennsylvania	5,835,016.00		5,835,016.00	
Rhode Island (6)	3,561,442.00	3,561,442.00		
South Dakota	345,740.00	324,165.00		21,575.00
Vermont	1,887,396.00	1,438,896.00	448,500.00	
Washington	2,058,925.00	2,033,925.00		25,000.00
West Virginia	6,514,671.00	6,514,671.00		
Wyoming	No Report	No Report		
TOTALS	$206,275,040.05	$132,915 [illegible]	[illegible]	[illegible]

State	Amount Contributed by Associations			Amount Contributed by Horsemen		
	Thoroughbred	Harness	Qtr. Horse and Fairs	Thoroughbred	Harness	Qtr. Horse and Fairs
Arizona	$ 1,439,171.44	$	$ 226,263.80	$ No Report	$	$ No Report
Arkansas	1,659,545.00			19,985.00		
California (1)	19,080,677.00	3,305,700.00	2,171,700.00 2,735,222.00	902,830.00	No Report	67,723.00 113,211.00
Colorado (1)	No Report		No Report No Report	No Report		No Report No Report
Delaware	2,865,100.00	3,649,039.00		88,080.00	58,075.00	
Florida (2)	6,304,600.00			374,775.00		
Idaho	78,143.00		29,162.00	26,066.00		3,549.00
Illinois	11,822,680.00	8,837,071.00		683,055.00	No Report	
Kentucky	4,931,529.00	1,441,254.00		326,835.00	261,178.50	
Louisiana	[illegible]			213,127.00		
Maine (3)	374,105.00	789,525.00	260,450.00	No Report	No Report	No Report
Maryland (4)	7,443,402.40	1,429,109.75	1,359,826.28	343,095.00	89,224.50	2,325.00
Massachusetts (4)	2,649,332.00	1,664,450.00	341,872.25	20,950.00	29,188.99	
Michigan	5,428,554.00	3,219,895.00		112,220.00	35,900.00	
Montana	139,569.95			25,224.20		
Nebraska	2,925,075.00			75,430.90		
Nevada			19,954.60			1,466.50
New Hampshire (3)	1,950,900.00	2,090,425.90	42,111.00	14,659.00	3,761.99	
New Jersey	9,254,250.00	3,107,261.00		648,005.00	No Report	
New Mexico (1)	1,961,651.54		877,500.00	251,222.76		1,121,180.16
New York (5)	20,816,650.00	21,253,446.34		996,665.00	1,535,750.00	
Ohio (1)	6,596,954.00	3,964,955.00	58,217.50 1,051,129.78	No Report	No Report	No Report No Report
Oregon (1)	510,950.00		64,333.00 288,892.00	19,450.00		35,805.00 74,277.00
Pennsylvania		5,416,986.00			418,030.00	
Rhode Island (6)	3,560,252.00			1,190.00		
South Dakota	263,989.00		21,075.00	60,176.00		500.00
Vermont	1,438,896.00	448,500.00		No Report	No Report	
Washington	1,954,620.00			89,205.00		25,000.00
West Virginia	6,484,862.00			29,810.00		
Wyoming	No Report			No Report		
TOTALS						

REMARKS:
(1) Bold Face indicates Quarter Horse.
(2) Florida: Purse and Stakes Distribution not kept by Racing Commission [illegible] used supplied from Triangle Publications for 3 tracks—Gulfstream, Hialeah, Tropical
(3) Maine and New Hampshire: Fairs—All Harness.
(4) Maryland and Massachusetts: Fairs—All Thoroughbred.
(5) New York: Harness—Amount contributed by Horse Breeders' Development [illegible] $2,427,797.20, included with Track Contribution
(6) Rhode Island: Purse Distribution obtained from Triangle Publications

The CHAIRMAN. The next witness will be the Honorable Charles E. Goodell, Senator of the State of New York. I would like to say this for the benefit of all members as well as the audience. We hope to hear 15 additional witnesses in this morning's session. In order to do that we will have to ask the Senators to ask no more questions than absolutely necessary.

Thank you very much.

STATEMENT OF HON. CHARLES E. GOODELL, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator GOODELL. Mr. Chairman and members of the committee, I appreciate this opportunity to present my views. If I may, I will offer a full statemnt for the record to be included in the record and I shall be very brief in summation.

First of all, I oppose the blanket tax rate reductions in the House bill because of their inflationary effects. I think whatever tax bill Congress passes should match revenue raising measures and tax cuts, so that it comes out equal.

I oppose the repeal of the 7-percent tax credit. I think this is a mistake to keep turning this on and off. I believe that the long-range impact of this, the main impact will come somewhere between 6 months and 2 years, and at that time we may well be wishing we had more incentives to industry to create jobs, to modernize our plants, to compete with foreign imports and a variety of other things.

I oppose the changes in the treatment of capital gains in the House bill. I do not believe there has been sufficient study of their impact on the investment market.

I oppose the changes in the tax exemption for municipal bonds that are proposed in the House bill. It is very clear that if the House provisions were adopted, it would seriously interfere with the ability of States and localities to finance needed capital improvements. As a matter of fact, there already is a very serious crisis in the municipal bond market because of the House-passed provisions.

I oppose the 7½-percent tax on foundation income. I think it is an unwarranted departure from the principle that non-profit institutions organized for charitable purposes should be free from taxation. I think it would restrict significantly the ability of our foundations to perform the great contribution that they have been making in our society.

There is also a provision in the bill prohibiting foundations formulating positions on social issues. This much too sweeping, and prevents the foundation from really contributing to the solution of this Nation's social ills.

I recommend that be dropped.

I think we could have more effective enforcement of existing law prohibiting foundations from substantially carrying on lobbying activities, and that should be adequate protection for the public and the foundations.

There are also excessive penalties, tax penalties on foundations and foundation managers.

I oppose the new definition of private foundations as excessively broad. The House bill's definition combined with the qualifying distri-

bution requirement will bar many organizations from receiving essential foundation support.

I do believe that foundations should be required to exercise reasonable responsibility over the use of their grants by recipients, but the provisions in the House bill are too severe. I also think it is important that the requirement for a concrete result from grants to individuals be revised. It implies a requirement of Government approval of foundation programs, and encourages the undesirable public or perish syndrome in the academic community.

I oppose the limits upon production of gifts of appreciated property to colleges, universities, hospitals, museums and schools.

I have two proposals that I urge upon the committee. I would like to have attached to my testimony the provisions of the bill which would implement these two provisions.

Senator GOODELL. Number one, a new approach to tax credits for medical expenses, permitting a taxpayer to take a 25-percent credit for medical expenses, with a maximum limit of $500 to $800, depending on the number of dependents in the taxpayer's family, and a reduction in the amount of the credit in the higher tax brackets.

The taxpayer would be permitted the option of taking the medical deduction if this turned out to be more favorable to him than the credit. But the advantage of the credit is that it would particularly help those taxpayers who now cannot benefit from the medical deduction.

The medical deduction is not available to those who elect the standard deduction. It is not available for taxpayers whose medical expenses are below 3 percent of their adjusted gross income. And the value of the deduction goes down as the taxpayer's income goes down. So the credit has none of these defects and would provide real benefits to low-income taxpayers for their medical problems.

The estimated cost of this credit is $5 billion per year.

The credit for expenses of higher education is my second proposal.

This I have made for many years and a number of others have. I propose a credit for a portion of expenses incurred for undergraduate and postgraduate education, with a maximum amount of $325 per student. It would go into effect in 1972.

If the student himself took the credit he would have a 10-year period in which he could carry forward the credit. The estimated cost of this provision is $2 billion per year. By eliminating the general tax increase in the House bill, my recommended provisions would come out with revenue increases and revenue decreased relatively matched.

(The bill of Senator Goodell, for inclusion in the record follows:)

[S. ——]

A BILL To amend the Internal Revenue Code of 1954

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled. That this Act may be cited as the "Tax Relief Act of 1969."

SEC. 2. Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowable) is amended by renumbering section 40 as 42, and by inserting after section 39 the following new sections 40 and 41:

"SEC. 40. MEDICAL EXPENSES.

"(a) GENERAL RULE.—There shall be allowed to an individual, as a credit against the tax imposed by this chapter for the taxable year, 25 percent of the

amount of expenses paid by him during such taxable year for medical care of the taxpayer, his spouse and dependents (as defined in section 152) and not compensated for by insurance or otherwise.

"(b) LIMITATIONS.—

"(1) DOLLAR LIMIT.—The credit under subsection (a) shall not exceed $500 for any taxable year. Such $500 limit shall, however, be increased (to an amount not above $800) by $100 for each dependent of the taxpayer other than his spouse during such year.

"(2) SCHEDULE OF MAXIMUM CREDITABLE CHARGES: REGULATIONS.—The Secretary or his delegate shall prescribe regulations setting forth a schedule of maximum charges eligible for credit under subsection (a) in such defined categories of expenses for medical care as may be necessary to assure credit only of reasonable expenses pursuant to this section. The secretary or his delegate shall also prescribe such additional regulations as may be necessary to carry out the provisions of this section.

"(3) REDUCTION OF CREDIT.—The credit under subsection (a) as limited by paragraphs (1) and (2) of this subsection shall be reduced by an amount equal to 1 percent of the amount by which the adjusted gross income of the taxpayer for the taxable year exceeds $25,000.

"(c) DEFINITIONS.—For purposes of this section—

"(1) The term "expenses" for "medical care" means amounts paid—

"(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body,

"(B) for transportation primarily for and essential to medical care referred to in subparagraph (A), or

"(C) for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged) covering medical care referred to in subparagraphs (A) and (B).

"(2) In the case of an insurance contract under which amounts are payable for other than medical care referred to in subparagraphs (A) and (B) of paragraph (1)—

"(A) no amount shall be treated as paid for insurance to which paragraph (1)(C) applies unless the charge for such insurance is either separately stated in the contract, or furnished to the policyholder by the insurance company in a separate statement,

"(B) the amount taken into account as the amount paid for such insurance shall not exceed such charge, and

"(C) no amount shall be treated as paid for such insurance if the amount specified in the contract (or furnished to the policyholder by the insurance company in a separate statement) as the charge for such insurance is unreasonably large in relation to the total charges under the contract.

"(3) Subject to the limitations of paragraph (2), premiums paid during the taxable year by a taxpayer before he attains the age of 65 for insurance covering medical care (within the meaning of subparagraphs (A) and (B) of paragraph (1)) for the taxpayer, his spouse, or a dependent after the taxpayer attains the age of 65 shall be treated as expenses paid during the taxable year for insurance which constitutes medical care if premiums for such insurance are payable (on a level payment basis) under the contract for a period of 10 years or more or until the year in which the taxpayer attains the age of 65 (but in no case for a period of less than 5 years).

"(4) The determination of whether an individual is married at any time during the taxable year shall be made in accordance with the provisions of section 6013(d) (relating to determination of status as husband and wife).

"(d) SPECIAL RULES.—

"(1) TREATMENT OF EXPENSES PAID AFTER DEATH.—For purposes of subsection (a), expenses for the medical care of the taxpayer which are paid out of his estate during the 1-year period beginning with the day after the date of his death shall be treated as paid by the taxpayer at the time incurred. The preceding sentence shall not apply if the amount paid is allowable under section 2053 as a deduction in computing the taxable estate of the decedent, but this paragraph shall not apply if (within the time and in the manner and form prescribed by the Secretary or his delegate) there is filed—

"(A) a statement that such amount has not been allowed as a deduction under section 2053, and

"(B) a waiver of the right to have such amount allowed at any time as a deduction under section 2053.

"(2) APPLICATION WITH OTHER CREDITS.—The credit allowed by subsection (a) to the taxpayer shall not exceed the amount of the tax imposed on the taxpayer for the taxable year by this chapter, reduced by the sum of the credits allowable under this subpart (other than under this section and sections 37, 39 and 41).

"(e) DISALLOWANCE OF EXPENSES AS DEDUCTION.—No deduction shall be allowed under section 213 (relating to medical, dental, etc., expenses) or section 214 (relating to expenses for care of certain dependents) for any expense of medical care which (after the application of subsection (b)) is taken into account in determining the amount of any credit allowed under subsection (a). The preceding sentence shall not apply to expenses of medical care paid by any taxpayer who, under regulations prescribed by the Secretary or his delegate, elects not to apply the provisions of this section with respect to such expenses for the taxable year.

"SEC. 41. EXPENSE OF HIGHER EDUCATION.

"(a) GENERAL RULE.—There shall be allowed to an individual, as a credit against the tax imposed by this chapter for the taxable year, an amount, determined under subsection (b), of the expenses of higher education paid by him during the taxable year to one or more institutions of higher education in providing an education above the twelfth grade for any family member.

"(b) LIMITATIONS.—

"(1) AMOUNT PER FAMILY MEMBER.—The credit under subsection (a) for expenses of higher education of any family member paid during the taxable year shall be an amount equal to the sum of—

"(A) 75 percent of so much of such expenses as does not exceed $200.

"(B) 25 percent of so much of such expenses as exceeds $200 but does not exceed $500, and

"(C) 10 percent of so much of such expenses as exceeds $500 but does not exceed $1,500.

"(2) REDUCTION OF CREDIT.—The credit under subsection (a) for expenses of higher education of any family member paid during the taxable year, as determined under paragraph (1) of this subsection shall be reduced by an amount equal to 1 percent of the amount by which the adjusted gross income of the taxpayer for the taxable year exceeds $25,000.

"(c) DEFINITIONS.—For purposes of this section—

"(1) EXPENSES OF HIGHER EDUCATION.—The term 'expenses of higher education' means—

"(A) tuition and fees required for the enrollment or attendance of a student at a level above the twelfth grade at an institution of higher education, and

"(B) fees, books, supplies, and equipment required for courses of instruction above the twelfth grade at an institution of higher education.

Such term does not include any amount paid, directly or indirectly, for meals, lodging, or similar personal, living, or family expenses. In the event an amount paid for tuition or fees includes an amount for meals, lodging, or similar expenses which is not separately stated, the portion of such amount which is attributable to meals, lodging, or similar expenses shall be determined under regulations prescribed by the Secretary of his delegate.

"(2) INSTITUTE OF HIGHER EDUCATION.—The term 'institution of higher education' means—

"(A) an educational institution (as defined in section 151(e)(4))—

"(i) which regularly offers education at a level above the twelfth grade; and

"(ii) contributions to or for the use of which constitute charitable contributions within the meaning of section 170(c); or

"(B) a business or trade school, or technical institution or other technical or vocational school in any State, which (i) is legally authorized to provide, and provides within that State, a program of postsecondary vocational or technical education designed to fit individuals for useful employment in recognized occupations; and (ii) is accredited

by a nationally recognized accrediting agency or association listed by the United States Commissioner of Education; and (iii) has been in existence for two years or has been specially accredited by the Commissioner as an institution meeting the other requirements of this subparagraph.

"(3) STATE.—The term 'State' includes, in addition to the several States of the Union, the Commonwealth of Puerto Rico, the District of Columbia, Guam, American Samoa, the Virgin Islands, and the Trust Territory of the Pacific Islands.

"(4) FAMILY MEMBER.—The term 'family member' means the taxpayer, his spouse or any of his dependents (as defined in section 152).

"(d) SPECIAL RULES.—

"(1) ADJUSTMENT FOR CERTAIN SCHOLARSHIPS AND VETERANS' BENEFITS.—The amounts otherwise taken into account under subsection (a) as expenses of higher education of any individual during any period shall be reduced (before the application of subsection (b)) by any amounts received by such individual during such period as—

"(A) a scholarship or fellowship grant (within the meaning of section 117(a)(1)) which under section 117 is not includible in gross income, and

"(B) educational assistance allowance under chapter 34 or 35 of title 38 of the United States Code.

"(2) NONCREDIT AND RECREATIONAL, ETC., COURSES.—Amounts paid for expenses of higher education of any individual shall be taken into account under subsection (a)—

"(A) in the case of an individual who is a candidate for a baccalaureate or higher degree, only to the extent such expenses are attributable to courses of instruction for which credit is allowed toward a baccalaureate or higher degree, and

"(B) in the case of an individual who is not a candidate for a baccalaureate or higher degree, only to the extent such expenses are attributable to courses of instruction necessary to fulfill requirements for the attainment of a predetermined and identified education, professional, or vocational objective.

"(3) APPLICATION WITH OTHER CREDITS.—The credit allowed by subsection (a) to the taxpayer shall not exceed the amount of the tax imposed on the taxpayer for the taxable year by this chapter reduced by the sum of the credits allowable under this subpart (other than under this section and sections 37 and 39).

"(e) DISALLOWANCE OF EXPENSES AS DEDUCTION.—No deduction shall be allowed under section 162 (relating to trade or business expenses) for any expense of higher education which (after the application of subsection (b)) is taken into account in determining the amount of any credit allowed under subsection (a). The preceding sentence shall not apply to the expenses of higher education of any taxpayer who, under regulations prescribed by the Secretary or his delegate, elects not to apply the provisions of this section with respect to sdch expenses for the taxable year.

"(f) CARRYOVER OF EXCESS CREDIT.—Any amount by which the credit otherwise allowable under this section for the expenses of higher education of the taxpayer paid during the taxable year exceeds the tax which would be imposed on the taxpayer for such taxable year by this chapter in the absence of this section reduced by the amount of credit allowed for expenses of higher education of any other family member paid during such taxable year shall be allowed as a credit for expenses of higher education of the taxpayer deemed to be paid during the first, second, third, fourth, fifth, sixth, seventh, eighth, ninth, or tenth succeeding taxable years, in that order and to the extent such expenses were not deemed paid in a prior taxable year, in the amount by which the tax which would be imposed on the taxpayer for such succeeding taxable year by this chapter in the absence of this section reduced by the amount of credit allowed for expenses of higher education of any other family member paid during such succeeding taxable year exceeds the amount of credit allowable under this section for the expenses of higher education of the taxpayer paid during such succeeding taxable year plus the amount of credit allowable under this section for such expenses paid during any taxable year earlier than the current taxable year but deemed to have been paid during such succeeding taxable year, subject, however, to all

limitations imposed by this section on the amount of credit allowable for such succeeding taxable year.

"(g) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this section."

SEC. 3. The table of sections for subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 is amended by striking out the last item and inserting in lieu thereof the following:

"Sec. 40. Medical Expenses.
"Sec. 41. Expenses of Higher Education.
"Sec. 42. Overpayments of Tax."

SEC. 4. The amendments made by section 2 and 3 of this act shall apply to taxable years beginning after December 31, 1971.

Senator WILLIAMS. What increased taxes do you recommend as revenue producing in this bill?

Senator GOODELL. I would eliminate the blanket tax rate reduction in the House bill entirely.

Senator WILLIAMS. Those are the only two features of the bill that you approve?

Senator GOODELL. Oh, no.

Senator WILLIAMS. As revenue-producing?

Senator GOODELL. It sounds like a great opposition statement. I went down to point out the features of the House bill that I disapprove. The ones that I do not mention I generally approve.

The CHAIRMAN. Thank you very much.

Senator GOODELL. Thank you, sir.

(Senator Charles E. Goodell's prepared statement follows:)

STATEMENT OF HON. CHARLES E. GOODELL, A U.S. SENATOR FROM THE STATE OF NEW YORK

Summary

BLANKET RATE REDUCTION

Opposes the blanket tax rate reductions because of their inflationary effects. Supports the Administration proposals on low-income allowance, on the standard deduction and on rates for single taxpayers.

Proposes selective tax relief in lieu of blanket rate reductions.

CREDIT FOR MEDICAL EXPENSES

Proposes a 25% credit for medical expenses. This credit would be subject to a maximum annual limitation of $500 to $800 (depending on the number of the taxpayer's dependents) and subject to gradual reduction in the higher brackets. Taxpayers would be permitted the option of taking the existing medical deduction in lieu of the credit. The credit would take effect in 1972.

The existing medical deduction is of limited significance to low- and middle-income taxpayers because (1) it is not available for taxpayers who elect the standard deduction, (2) it is not available for taxpayers whose medical expenses are below 3% of their adjusted gross income, and (3) the value of the deduction goes down as the taxpayer's income goes down. The proposed credit has none of these defects, would provide real benefits to low-income taxpayers, and would encourage taxpayers to undertake the preventive medicine of regular medical check-ups and early professional consultation.

The estimated cost of the credit is $3 billion per year.

CREDIT FOR EXPENSES OF HIGHER EDUCATION

Proposes a credit for a portion of expenses incurred for undergraduate and post-graduate education. The costs of expenses such as tuition, books and supplies would be covered, subject to a maximum annual limitation of $325 per student and a gradual reduction of the available credit in higher tax brackets. For students working their way through college, the credit could be carried forward over a 10-year period. The credit would take effect in 1972.

The credit will constitute a major impetus to (1) improving our educational system at both public and private institutions, and (2) broadening the opportunities available to the public for higher educational training.
The estimated cost of the credit is $2 billion per year.

INVESTMENT TAX CREDIT

Questions the wisdom of repealing the 7% investment tax credit.

CAPITAL GAINS TAX

Opposes the changes in the treatment of capital gains proposed in the House bill, because insufficient study has been given to the effect of these changes upon investment and long-term national growth.

MUNICIPAL BONDS

Opposes the changes in the tax exemption for municipal bonds proposed in the House bill, because they would interfere with the ability of states and municipalities to finance capital construction.

TAXATION OF FOUNDATIONS

Opposes 7½% tax on foundation income because it is an unwarranted departure from established principles; is discriminatory; would adversely affect the educational, scientific, medical, cultural and social activities of foundations; and would create a dangerous precedent. Sees no advantages in this tax either as a revenue raising device or as a measure to reform abuses.
Recommends substituting an annual filing fee to cover the costs of increased auditing and supervision by the IRS. This fee should be charged either as an amount proportional to the assets of each foundation or a specified percentage—with an upper limit clearly set—of income.

FOUNDATION PROGRAM ACTIVITIES

Regards provision in bill prohibiting foundations from formulating of issues as too sweeping, ambiguous, and self-defeating.
Recommends this provision be dropped.
Maintains that more effective enforcement of existing law—which prohibits foundations from substantially carrying on lobbying activities—should be adequate protection for the public and the foundations.

EXCESSIVE SANCTIONS

Opposes House bill's tax penalties on foundations and foundation managers. Considers these proposals excessive and a threat to support for innovative programs. Recommends proposed penalties be scaled down to reasonable levels, and recommends a period for correction of violations before penalty is imposed.

DEFINITIONS OF FOUNDATIONS AND RESTRICTIONS ON GRANTS MADE ELIGIBLE AS "QUALIFYING DISTRIBUTIONS"

Opposes new definition of private foundation as excessively broad. Notes that the House bill's definition, combined with the qualifying distributions requirement, will bar many organizations from receiving essential foundation support. Recommends that definition be redrafted to reflect the public's traditional view of foundations as funded non-profit, private, grant-making organizations.

FOUNDATIONS' RESPONSIBILITY FOR THE EXPENDITURES OF GRANTEES

Recommends that foundations be required to exercise "reasonable" responsibility over the use of their grants by recipients.

GRANTS TO INDIVIDUALS

Maintains that requirement for a concrete result fom grants to individuals implies government approval and encourages undesirable "publish or perish" syndrome.

DONATIONS OF APPRECIATED PROPERTY

Opposes limits upon deduction of gifts of appreciated property to colleges, universities, hospitals, churches and schools.

STATEMENT

Last month, the House of Representatives passed a tax reform measure of comprehensive scope. That fact alone has provoked widespread interest in Congress and throughout the nation. Comprehensive tax reform is so long overdue that we are all grateful for a measure which does, in fact, address itself to correction of many of the inequities in our tax laws—inequities that over the years have transformed the democratic ideal of our graduated system of income taxation into a haven for special privilege.

Like a child who has taken his first few steps, we're a little awed by our own courage but delighted to discover that we do have, after all, the ability to go where we want to go. In our enthusiasm, however, let us not lose sight of where it is we want to go.

REVENUE-PRODUCING REFORMS

The House bill does represent a first step—some see it as a somewhat shaky and uncertain step—toward elimination of special tax privileges which do not serve the national interest. The Treasury estimated that this loop-hole plugging function of the bill will eventually bring in $4 billion per year in additional revenue collections. A feature of the bill designed primarily to fight inflation—repeal of the investment credit—is expected to bring in an additional $3.3 billion per year.

These revenue-producing provisions make possible for the first time in many years a responsible and creative reexamination of the ways in which the taxpayer's burden may be lightened—not just to serve the individual's narrow interest in decreasing his own taxes but to serve the national interest.

BLANKET RATE REDUCTION

I do not think the across-the-board reduction in tax rates included in the House bill are in the national interest.

The tax reform and anti-inflationary provisions in the House bill will in the long-term raise an additional $8.1 billion per year. The blanket rate reductions and other relief measures in the bill would cost $10.5 billion per year. This leaves a net loss of $2.4 billion per year.

This loss—unless it is offset by reductions in Federal spending—will simply add to inflationary pressures. The inflationary effect will be particularly strong because blanket rate reductions *directly* feed consumer spending.

If we really are concerned with fighting inflation—as I think we have to be—we simply cannot afford the fiscal luxury of this sort of wholesale rate reduction.

It is surely apparent that the last general reduction in tax rates which took effect in 1964 and 1965 has contributed materially to our present overheated economy. It may be appropriate in the future to consider another general reduction of the magnitude proposed in the House bill. This is not the time, however. Let us first give our unpleasant fiscal and monetary medicine a chance to bring the present bout of inflation under control before risking renewed infection.

It is, moreover, difficult enough to solve the pressing social problems facing the country in the present stringent budgetary situation. Passing a tax bill in which tax cuts exceed revenue-raising measures will only aggravate the situation.

For these reasons, and for other reasons detailed in the testimony of Secretary Kennedy before the Senate Finance Committee, I prefer the Administration proposals on the low income allowance, on the standard deduction and on the rates for single taxpayers to the analogous provisions of the House bill. I also prefer the Administration's proposal to eliminate the gasoline tax deduction.

I would, however, go further—and oppose the blanket rate reductions contained in the House bill.

SELECTIVE TAX RELIEF

It makes much more sense, in lieu of blanket rate reductions, to adopt a rational choice among our high-priority goals which may most effectively be served

by tax relief. Let me suggest two national assets which are fundamental to the quality of American life and which may be served effectively by carefully directed tax-relief innovations: the health of the body and the development of the mind.

I propose the use of income tax credits to lighten the burden of the lower- and middle-income citizens who incur expenses for medical care or for higher education. These tax relief provisions will inevitably extend the scope and improve the quality of modern techniques devoted to health care and higher education.

A recent Harris survey has shown that 33% of American families consider medical and educational costs as the major financial problems they are facing. The tax relief measures I am proposing will help reduce the impact of these costs on family budgets.

These two tax relief proposals—the credit for medical expenses and the credit for higher education expenses—are set forth in a bill which I am introducing today and which I would like to submit to this Committee with my statement. I respectfully suggest the Chairman consider the substance of this bill as an amendment to the Tax Reform Act this Committee is now considering.

CREDIT FOR MEDICAL EXPENSES

I propose a 25% credit against income tax for all reasonable, uninsured medical expenses—including hospitalization, professional fees, medicine, and related insurance premiums. This credit would be subject to a maximum annual limitation of from $500 to $800 (depending on the number of the taxpayer's dependents) and subject to gradual reduction in higher tax brackets.

Under existing law, a deduction is available for that portion of general medical expenses which exceed 3% of the taxpayer's adjusted gross income. And only that portion of the cost of medicine which exceeds 1% of adjusted gross income may be taken into account for purposes of calculating the deduction.

EFFECT OF STANDARD DEDUCTION

These existing provisions are of limited significance. One reason for this is that no relief is available to the broad category of taxpayers who elect the standard deduction. And more often than not it is these taxpayers who are most in need of relief. The enlargement of the standard deduction proposed in the House bill serves to underline this objection.

Under these provisions I propose, relief would be available by way of direct credit against the tax due, whether or not the taxpayer uses the standard deduction.

NEED FOR RELIEF

In the cases when the existing deduction does become available, another defect is apparent: the amount of tax relief increases with the taxpayer's bracket. A medical expense deduction is worth roughly twice as much to the taxpayer in the 50% bracket as it is to the taxpayer in the 25% bracket.

The tax credit provisions I am proposing would provide direct tax relief (up to the $500 to $800 limit), rather than a percentage relief based on the tax bracket. It thus provides real benefits to low- and middle-income taxpayers.

Furthermore, the credit would be decreased on a percentage scale as the taxpayer's income rises over $25,000. No credit at all would be available for the very wealthy—those taxpayers with incomes over $65,000.

OPTIONAL MEDICAL EXPENSE DEDUCTION

Because the credit is limted to a maximum of $500 to $800, taxpayers with unusually high medical expenses should continue to have the option to utilize the existing medical expense deduction. Accordingly, my proposal will retain this option.

PREVENTIVE MEDICINE

An undesirable feature of the present law is, in my opinion, its reinforcement of the economic barrier to periodic medical check-ups and to early professional consultation when the first symptoms of illness appear. The barrier is reinforced because the initial medical expenses in any year up to the threshold of 3% of adjusted gross income are not deductible. If the taxpayer's annual income is $10,000, that threshold is $300.

It is my hope that the full credit I propose for these initial expenses will encourage periodic physical examinations and early professional consultation. The key to good health lies in recognizing and overcoming the incipient threat of disease before it develops. The cost to us of failing to encourage the practice of preventive medicine, in terms both of human and monetary loss, is beyond measure. The tax credit I propose will fulfill this essential function.

LIMITATION TO REASONABLE EXPENSES

There must, of course, be safeguards to assure that the medical expenses incurred and sought to be credited are reasonable. The Secretary of the Treasury should be given authority to establish and adjust by regulation a schedule of maximum creditable charges for such items as hospitalization expenditures and consultation fees.

CREDIT FOR EXPENSES OF HIGHER EDUCATION

I propose a credit against income tax for a portion of expenses incurred for undergraduate and post-graduate education. The costs of expenses such as tuition, books and supplies would be covered, subject to a maximum annual limitation of $325 per student and a gradual reduction of the available credit in higher tax brackets.

Like the credit for medical expenses, the credit for expenses of higher education would be available whether or not the taxpayer uses the standard deduction. And reduction of the credit in higher brackets would assure that lower- and middle-income taxpayers receive the primary benefits.

SLIDING SCALE

The amount of the credit would be reduced on a sliding scale as the expense increases. This would equalize benefits betwen low-tuition and high-tuition institutions. Proportionately greater tax relief would be available for payment of low tuitions.

The sliding scale would operate in the following way. Of the first $200 in expenses for any one student, 75% would be creditable; of the next $300, 25% would be creditable; of the next $1,000, 10% would be creditable. Expenses for any one student in excess of $1,500 would be ineligible for credit in any year, and the maximum annual credit would be limited to $325.

PREVIOUS PROPOSALS

A sliding-scale credit for expenses of higher education is not a new idea. I sponsored legislation providing for such a credit while serving in the House of Representatives. In 1967 the Senate approved legislation similar to that which I now propose, but the credit, vigorously opposed by the Johnson administration, was eliminated in conference.

In two respects, however, my proposal differs from the measure approved by the Senate in 1967.

LIMITATION ON BENEFICIARIES

Under my proposal, relief would be limited to expenses for education of the taxpayer himself, of his spouse or of his dependents. The 1967 measure would have provided multiple credits for the education of anyone whose expenses the taxpayer chose to pay.

THE STUDENT PAYING HIS OWN WAY

One shortcoming of the 1967 measure was the likelihood that little or no assistance would become available to the student working his way through college. For at the time his expenses were incurred, his income would normally be so low that little or no tax would be payable against which his credit may be taken. This likelihood would be increased by provisions of the present House bill which enlarge the standard deduction and low-income allowances.

I propose, therefore, that to the extent any credit for the taxpayer's own educational expenses may not currently be used due to low tax liability, it be carried forward for use in any of the next ten years. This is appropriate since the training and skills acquired in the educational process contribute

materially to the production of income in later years, and I believe this to be true not just of specialized vocational training but of general curricula at both under-graduate and graduate levels.

IMPROVING AND BROADENING EDUCATIONAL OPPORTUNITIES

The general arguments for and against a tax credit for educational expenses are well known and have been developed at length in recent years.

What most impresses me is the impetus such a measure will inevitably give to (1) improving our educational system at both public and private institutions and (2) broadening the opportunities available to the public for higher educational training.

The legislation I propose will encourage the widest possible attendance at colleges and universities and help spread the benefits of higher educational training throughout our population.

In some ways, carefully directed use of tax relief is the most effective form of government assistance to higher education. It does not require the creation of cumbersome and costly bureaucratic machinery. And it avoids controversy over government determinations as to the institutional beneficiaries of federal support.

There can be no charge that, by government fiat, church-sponsored institutions are being favored, that secular institutions are being favored, that public institutions are being favored, or that private institutions are being favored. Institutions will benefit from the indirect support of the proposed tax credit solely to the extent they attract students. And the attraction for students will increase as educational opportunities improve.

FISCAL EFFECT OF TAX CREDIT PROPOSALS

The Treasury estimates that the annual cost of the credit for medical expenses I have proposed would be about $3 billion; and that the annual cost of the credit for educational expenses would be less than $2 billion. I would propose that both credits become effective for the 1972 fiscal year.

The total annual cost of both tax relief measures would be approximately equal to the annual increase in revenue expected to result by 1970 from the reform and anti-inflationary provisions of the House bill (other than the reform provisions which I oppose for reasons set forth elsewhere in this statement.

The enactment of these two tax credits would not have the same inflationary effects as the across-the-board cuts in the House bill. This is because their inclusion in the House bill—in lieu of the across-the-board reductions—would create a situation where the revenue-reducing measures in the bill would not exceed the revenue-producing measures in it by a large amount. In addition, these tax credits would not directly feed consumer spending to the same extent as blanket rate cuts.

THE INVESTMENT TAX CREDIT

I have serious reservations about the advisability of repealing the investment tax credit.

Vigorous fiscal measures are clearly needed to combat the inflation that now threatens our economy. We must accept the fact that these measures, to be effective, cannot be painless.

We must be equally aware, however, of the risks of putting all the fiscal and monetary brakes on at once. The anti-inflationary measures we are invoking now may take a substantial period of time before they are fully felt—and then may "grab" all at once.

This problem of a long "lead" time is particularly serious in the case of the investment tax credit. The credit does not primarily affect consumer spending now; it affects capital expenditures 6 months to 2 years from now. Removing the credit now may "take hold" at a future time when we are no longer so much concerned with inflation as with recession.

The experience of a few years ago—when Congress repealed the credit only to restore it—suggests the inadvisability of trying to turn the credit on and off to offset swings in the economy. Congress repealed the credit to halt the inflation—only to find that this action took affect in the economy when inflation was no longer the problem, and then hurried to restore it. I opposed repeal at that time.

I think it is essential to have a pemanent tax incentive for long-run economic growth. The investment tax credit serves this function.

I am aware, however, that repeal of the credit has broad support in both Houses of Congress and the Administration, and thus is almost certain to pass. Accordingly, in the calculations upon which my other proposals are based, I assume the credit would be repealed.

TAXATION OF CAPITAL GAINS

The Tax Reform Act proposes sweeping changes in the treatment of capital gains—including an increase in the rates and extension of the holding period necessary to qualify for long-term gains status.

In my opinion, inadequate study has been given to these changes.

These are some of the hard questions which will have to be fully explored in deciding whether to alter the existing system of capital gains taxation:

How will elimination of the 25% alternative tax on gains and application of a "minimum tax" to gains affect the availability of high-risk capital to finance new ideas, new technology, new businesses, new industries?

How will the expansion of the holding period to one year affect the essential liquidity of our securities markets?

How will the opportunity of lower- and middle-income families to build private capital for their future be affected?

The special treatment now accorded to capital gains is not just a loophole. It is a way of stimulating investment. Any change in this treatment must be considered, therefore, not in the loophole—plugging spirit merited by special privilege provisions of the tax code, but in the spirit of inquiry into all factors affecting capital formation and economic growth in this nation.

It may well be that changes of the present rules are desirable. But the effect of those changes on the economy, on markets, and on individuals must first be thoroughly understood. The haste with which action was taken on these changes in the House of Representatives did not permit adequate investigation of the consequences.

TAX TREATMENT OF INTEREST ON MUNICIPAL BONDS

I feel this is not the time to promote radical changes in the form of support extended by the Federal Government for the financing undertaken by state and local governments.

This support now takes the form of a Federal tax exemption for municipal bonds.

The Tax Reform Act now before this Committee would partially nullify this exemption by subjecting interest from tax exempt municipal bonds to a "minimum tax" and to a rule of allocation of deductions.

I do not think these measures are well advised. The limited revenues these changes would bring to the Treasury would be more than offset by increased costs and difficulties which states and municipalities would encounter in marketing their bonds.

Our Federal system of government now faces a crisis of fiscal imbalance. The revenue-raising capacity of the Federal government is simply not matched by that of state and local governments.

President Nixon has been the first president to recognize fully the gravity of their crisis and to propose a bold "New Federalism" to help rectify it. Among the President's proposed reforms is one I have long supported—Federal revenue sharing with state and local governments. With this important initiative, the President for the first time has created a realistic hope that revenue sharing will become a reality in the near future.

If revitalizing our Federal system is, indeed, our aim, we certainly cannot afford to take any action that hinders state and localities in marketing their obligations to finance their capital requirements.

TAXATION OF FOUNDATIONS

One of the most significant aspects of the House bill is its proposed changes in the tax treatment of private foundations.

Private philanthropic institutions have made incalculable contributions to the development of this nation. These contributions resulted from foundation inno-

vation, creativity and support for new ideas. The possibility for innovation must be protected and nurtured if we are to continue to reap benefits in the future. Therefore, any far-reaching changes made in the tax treatment of foundations must be considered with great care.

No one can argue that there have not been abuses by foundations in the past which require correction. Self-dealing between a foundation and its donors must be prohibited. The misuse of tax exemption for private influence or gain should be curtailed. Greater public disclosure of foundation activities is in the public interest.

Nonetheless, curtailing existing abuses should not be a vehicle for a punitive attack upon the very essence of private philanthropic activities in this country. It is for this reason that I recommend that the Committee consider the following changes in the bill as it passed the House.

THE 7.5 PERCENT TAX ON PRIVATE FOUNDATION INCOME

I am strongly opposed to the imposition of the proposed tax on foundation income.

In my judgment, this tax is an unwarranted departure from the principle that non-profit organizations organized for charitable purposes should be free from taxation.

It is discriminatory in that it would only be levied against foundations and not against other nonprofit charities such as schools, universities, churches, and hospitals.

It would hit not the donors or officers of foundations, but the whole range of educational, scientific, medical, cultural and social activities they finance. Any tax on foundations means an automatic corresponding loss of funds for these activities. To the extent that foundations aid the public, the public is hurt by a tax on their investment income.

Foundations have a commendable record of success in developing institutions overseas. Many foundations which operate in foreign countries receive the benefits of tax free status in those countries because of their exemption in the United States. Should a tax of any kind be imposed, this could result in a loss of their foreign exemption as well.

Finally, the tax creates a dangerous precedent. If it is appropriate to tax foundation income now at the rate of 7½ percent, then why not at 10 percent, or 25 percent next year or the year after? If the Federal government can tax foundations, why should State and local governments not do so? Should a tax be imposed, the road ahead is only too clear: government will take a larger and larger bite from foundation income, and a smaller and smaller portion will be left over to fulfill charitable and social purposes.

In my opinion, there are no advantages to be derived from imposing this 7½ percent tax. It would not be a revenue raising device of any significance, as it will bring in only about $65 million in the first year and $100 million by the tenth year. It would not aid in reforming known abuses, for these are dealt with in other sections of the bill.

In my opinion, the only rationale for collecting any revenue from foundations should be to encourage more effective supervision of their activities. For this reason, I would strongly recommend that the Committee substitute the requirement of an annual *filing fee* in place of the 7½ percent tax. This fee should be collected only to cover the costs of an increased program of supervision and audit by the Internal Revenue Service. This could be accomplished by charging each foundation either an amount proportional to its assets or a specified percentage—with an upper limit clearly set—of its income.

FOUNDATION PROGRAM ACTIVITIES

The bill would bar foundations from attempting to influence legislation through (1) attempting to affect the opinion of the general public or any segment thereof or (2) privately communicating with any member or employee of a legislative body or with any person who may participate in the formulation of legislation other than through making available the results of non-partisan analysis and research.

Foundations are engaged in studies or projects on almost every topic of public concern, be it drug abuse, air pollution, or international satellite communications.

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We as legislators have benefited from this expertise. The public interest has been served by these activities. Does it make any sense to prohibit foundations from taking a public stand on vital issues or from discussing them with legislators? Does it make any sense to limit their treatment of such issues to a vaguely defined term, "nonpartisan research" and to prohibit them from making definitive recommendations or taking definitive action?

Surely, this is self-defeating.

Existing law prohibits foundations from *substantially* carrying on propaganda or otherwise attempting to influence legislation or supporting political parties and individual candidates. It is generally agreed that more effective enforcement procedures would substantially reduce violations of the existing statutory standard. Allowing the existing law to remain as it now is, with increased enforcement and supervision, should be adequate protection both for the public and the foundations themselves.

EXCESSIVE SANCTIONS

The bill now imposes heavy tax liabilities on foundations and foundation managers for violations of the programmatic and financial provisions of the bill. In my view, these penalties are excessive and should be scaled down.

I submit to the Committee that the present sanctions far exceed the reasonable limits of enforcing these violations. With this club hanging over the head of foundations and their officers, the result will not doubt be to inhibit their support for innovative and creative projects.

Consider, for example, the penalties for violating the provision regarding an attempt to influence legislation discussed above. The foundation would be taxed at the rate of 100% of the amount of the program expenditure paid for the improper purpose. In addition, foundation officials who knowingly made this expenditure would be taxed at the rate of 50% of the amount spent.

Many medium-sized foundations make grants of $50,000 and more—and the large foundations often make multi-million dollar grants. The imposition upon a foundation officer of a fine of 50% of these large amounts could ruin him financially. I submit to the Committee that this is neither rational nor justified. I fear that this will be an effective bar to people seeking jobs in foundations.

Any penalties for violations of the bill must be reasonable. Moreover, there should be a period in which violations can be corrected before the penalty is imposed.

THE DEFINITION OF FOUNDATIONS AND RESTRICTIONS ON GRANTS APPROVED AS "QUALIFIYING DISTRIBUTIONS"

The bill creates a broad definition of private foundations which describes them from a totally new vantage point. The public has traditionally viewed foundations as private, nonprofit organizations with a principal fund of their own, established primarily to make grants in support of charitable, educational, scientific and civil purposes serving the public welfare.

The provisions of the bill would expand this traditional definition to such an extent that a wide range of other institutions would not be classified as "private foundations."

Some of these institutions are primarily engaged in research or conduct studies on education, medical, scientific and social issues. They have never been considered foundations in the past. Others are public service organizations working with the community on health, welfare and other programs. Many of them are heavily dependent upon foundation grants for their very existence. Newly classified as foundations under the bill, they would be subject to the supervisory tax or filing fee—thereby having less money available to conduct their activities. They would also be subject to the House bill's program limitations upon foundations.

In addition, the bill requires that foundations annually allocate at least 5% of their investment assets in order to insure prompt charitable distribution of annual foundation income. Grants from one foundation to another foundation

would not qualify as approved distributions under this provision, except in the case of those organizations classified as "private operating foundations".

It is reasonable to expect that because of this provision, foundations would make grants with an eye toward meeting their qualifying distribution requirements. This could have an extremely damaging effect upon a large number of institutions—those not classifiable as "operating" foundations—which currently depend upon foundation grants for their very existence. Overseas organizations established under U.S. foundation grants would also be affected.

I would recommend to the Committee that it redraft the present definition of a foundation now in the bill to reflect the traditional public view of foundations as funded nonprofit, private, grant-making organizations.

FOUNDATION RESPONSIBILITY FOR THE EXPENDITURES OF GRANTEES

I would agree that foundations should exercise responsibility for the grants which they make. However, this standard of responsibility should be one of reasonable care and diligence. It should not be absolute liability.

The bill—unrealistically, in my view—imposes a standard of absolute liability. Foundations are required to exercise "full" expenditure responsibility over the grants they make to all beneficiaries except for grants to publicly supported or other "$30 percent" charities. Foundations would have to make absolutely sure that the funds are spent for the purposes for which the grant was made.

In order to comply with this requirement, foundations would probably have to increase greatly their auditing and monitoring staff. It can be argued that an unintended result of the bill would be domination by the parent foundation over the program of its grantee: This is neither necessary nor desirable.

The requirement could have other effects. Foundations might tend to limit their grants to those charities exempted from it. New organizations, in the process of building a program, might suffer from lack of support. Once again, we would be discouraging innovation and pioneering.

Therefore, I would recommend that the Committee replace the standard of "full" responsibility with a standard of "reasonable care and diligence".

GRANTS TO INDIVIDUALS

Under the provisions of the bill, grants by foundations directly to individuals must be made according to "objective" standards. The Ways and Means Committee report states that the grants must be "directed toward the production of a tangible product (a book, paper, or other study, or a scientific development or useful process), the achievement of a specific objective, or the improvement or enhancement of a literary, artistic, musical, scientific, or other similar capacity talent, or skill."

These requirements would have the undesirable affect of barring the continuation of certain respected grant programs which are conducted simply to recognize excellence in a profession. There is also an implication here that the federal government would in some way have to approve the standards by which foundations make grants. The dangers of this need no further discussion.

I personally feel that we have already suffered too much from the effects of the "publish or perish" syndrome affecting our universities. Why encourage this further?

DONATIONS OF APPRECIATED PROPERTY

I do not favor the proposals in the House bill concerning the tax treatment of gifts of appreciated property for charitable purposes. Colleges, universities, hospitals, and churches now receive gifts of appreciated property in heavy volume, and depend upon such gifts for nearly one-half of their philanthropic support. The House bill imposes new limits upon the degree to which such gifts can be deducted from taxable income, and exempted from a capital gains tax. The quantitative impact of these provisions is very damaging.

As James Reston pointed out in an article in the New York Times on August 31, 1969, "In the opinion of university administrators and fund-raisers, it is precisely this tax incentive of deducting the full market value of appreciated securities that is responsible for the immense flow of private giving in recent years. For example, in the years 1965–68. the market value of securities donated by individuals to Yale University amounted to $33,007,690 or 65 percent of the total gifts from individuals during this period. In 1968–69, Harvard received $15,900,000 or 68 percent, and M.I.T. in 1968–69, $2,170,000 or 70 percent. Columbia University, which is now in the midst of a major fund-raising drive to deal with its serious financial problems, received $2,658,000 in security donations in 1966, $3,178,000 in 1967, and $6,038,000 in 1968 and it is still in deep trouble."

Of great concern to me is the provision in the bill which would prohibit the deduction of the value of works of art unless the appreciation is included in ordinary income. Assistant Secretary of the Treasury for Tax Policy Edwin Cohen pointed out that "Our finest museums and art galleries are dependent on such gifts, and their contribution to the good of our society is universally acknowledged. We see no sufficient reason to distinguish such gifts from gifts of appreciated securities to other charities."

REALIZING THE FULL POTENTIAL OF TAX REFORM

In most other respects, the reform features of the House bill deserve support, even those which fall short of expectations. Taken together, these reforms represent a creditable first step toward elimination of inequity in the tax system.

Even more important, these reforms now permit *selective* tax relief innovations which will serve fundamental national interests, such as the two I have singled out: the preservation of health and the development of intellect.

Lower taxes for all may appeal to the voter today. The higher prices which result tomorrow will not.

Higher standards of national health and education could constitute a lasting heritage which this Congress now has power to dedicate to future generations.

Another opportunity may not come, if history is a guide, for another decade. Let us, therefore, make the most of today's reforms so that our children can make the most of theirs. They will need all the health and education we can give them to solve the other problems we will leave them.

The CHAIRMAN. The next witness will be the Honorable Wright Patman, chairman of one of our very fine House committees and one of the great statesmen of this country.

STATEMENT OF HON. WRIGHT PATMAN, A REPRESENTATIVE IN CONGRESS FROM THE FIRST CONGRESSIONAL DISTRICT OF THE STATE OF TEXAS

Representative PATMAN. Mr. Chairman, I know the pressures that you and the members of the committee are under, and I will make my oral statement very brief. I have carefully prepared a written statement and have furnished the 50 copies necessary for distribution. I will just cover part of it.

I greatly appreciate your invitation to testify before this committee on H.R. 13270, the House-passed tax reform bill. I shall direct my remarks principally to the important subject of privately controlled tax-exempt foundations.

It has been puzzling to me for some time why the majority of privately controlled tax-exempt foundations were established in the

first place. The religious, charitable and educational contributions which are made by foundations can just as well be made by an individual. The fact that the foundation route is taken, immediately gives rise to a question as to the actual purpose for establishing the foundation.

A great many huge family fortunes have been continued in perpetuity through the private foundation route. Controlling interests in closely held corporations have been transferred to foundations with no apparent change in the continuity of direction and control through this technique.

I do not believe we really know the vast amount of tax dollars lost to this Nation by tax avoidance through the vehicle of privately controlled tax-exempt foundations.

It appears to me that the time has come to look very closely at this problem, and to develop sufficient information so that the Congress can make a decision on the desirability of continuing the present concept of privately controlled tax-exempt foundations. Later on in my testimony, I shall speak further to this point.

May I suggest, Mr. Chairman, that the House bill does not go as far as I personally or the Subcommittee on Foundations in the House would like to see. At the same time I realize that it makes many steps forward, and they are good steps I think, every one of them. I personally would regret very much to see the House bill weakened in any respect on the foundation provisions even though it is not as strong as it could be in some areas.

I believe though that H.R. 13270 is a good step in the right direction, and we must do something about this situation. There is great resentment over the Nation toward these privately controlled tax-exempt foundations, especially those that have been abusing their trust.

We discovered in our investigation that they even had schools teaching people for a fee on how to organize their own foundations, family-type foundations. They would have notices go out, to affluent people naturally, usually professional men in the high-income brackets asking them to come to a meeting. At this meeting they would state they had a foundation of their own, and that anyone who wanted to join the parade, if he would pay $10,500, then the foundation would help them organize a foundation of their own. If the one organizing the foundation would act according to the instructions of the parent organization they would not have to pay any income tax during their lifetime, and no inheritance tax would be paid after their death. It is rather an appealing proposition, and it would be surprising to you to know how many people actually paid the $10,500. It went up into, I believe, several million dollars.

Of course we gave our information to the Department of Justice and suits were brought, but the suits are still pending. The name of this concern is the ABC, American Building Constitutionally. They had several areas in the country where they were active.

Now, I do not know how many. They took the fifth amendment before my subcommittee.

I do not know how many people actually joined. But I believe that there were hundreds of them. It would not surprise me, Mr. Chairman, if there were over 100,000 foundations privately controlled that no one connected with the Government knows anything about. It is possible it could go even to a quarter of a million or even more. No one knows how many there are. No one is trying to find out, and no one has tried to find out in the past. They just don't make any reports and they just do not pay taxes. Of course the Internal Revenue does not have any complete list of them, and the foundations just go on without making any reports that they should make under the regulations.

Now, the foundations make the point that they have complied with what the law says, but they are not complying with what the regulations say. Therefore they stay away from the IRS, the Treasury Department, and keep their information to themselves. There are a lot of areas in this country where family foundations are organized. They even send their children to school and to college, and all the transactions are made through the foundation and they pay no taxes.

That has been going on some time. It hasn't been stopped.

We are trying to get legislation through for a separate agency for this reason. The IRS, when it comes before the House and the Senate for appropriations is usually, almost invariably reduced. They spend that money where they want to spend it the most, on revenue producing programs. They do not pursue the foundations because they claim that field is rather lean and they do not get as much money returned to the Government.

Therefore, this new agency should be independent of the Treasury Department. It should be away from IRS, and it should be sustained by the foundations themselves.

The 2 percent that has been talked about should go for that purpose. The 7½ percent tax is pretty small compared to a lot of the income, low-income people in this country who pay that much tax. It certainly would not be burdensome to these very rich privately controlled tax-exempt foundations.

The CHAIRMAN. A lot of those foundations are for educational purposes.

Representative PATMAN. Yes, sir.

The CHAIRMAN. And it would not be a bad idea to raise some money from the foundations and devote it to providing scholarships to a lot of young people who are worthy of going to college. Are you aware of the fact, Mr. Patman, that there will be some instances in which a Mr. Jones who has his private foundation and Mr. Smith who has his foundation, put their sons through college without any personal cost to themselves. For example, assume these two men know each other very well, and Mr. Jones uses his foundation to put Mr. Smith's son through college and Mr. Smith then uses his foundation to put Mr. Jones's son through college. Theoretically there is no self-dealing involved there.

Representative PATMAN. That is right.

The CHAIRMAN. It is just a nice little mutual arrangement.

Representative PATMAN. That is right.

The CHAIRMAN. Where each puts the other fellow's son through college and in that way it does not appear that he is benefiting himself when in fact he is benefiting himself.

Representative PATMAN. And then a foundation makes contributions to another foundation, and some families in this country have as many as 13 foundations. Every member of the family has a foundation, and they can make contributions to the other's foundation and get credit for it. There is no way of checking up on it under present law, restrictions and limitations, so Mr. Chairman, I just want to express the hope that you let the House bill go through insofar as privately controlled foundations are concerned, although it does not go as far as I think it should go. It is certainly an important step in the right direction.

We are getting something done, and I think that will be pleasing to most of the people of this Nation who have given serious thought and study to this problem.

The CHAIRMAN. Maybe we can improve on it some. You are not opposed to us trying to do that?

Representative PATMAN. I wish you would.

Thank you.

The CHAIRMAN. Some Senators have some ideas on how we might improve on the House bill.

Representative PATMAN. Good, I hope you do. I would be in favor of it.

Senator TALMADGE. Congressman Patman, you have done a great deal of work in this area and I compliment you for it. Do you have any idea of the total wealth that may be tied up in foundations?

Representative PATMAN. I would guess from $20 to $30 or $50 billion. There is no way of telling.

Senator TALMADGE. Is that increasing annually or decreasing?

Representative PATMAN. It has been increasing. Now over the last 7-year period, their assets rose from $10 billion to over $17 billion in 7 years, it increased about 75 percent. The trend has been to accumulate, not give away, to accumulate, and they do that in competition with the small businessman, and business generally.

It is certainly not fair. They are in business just like any other businessman, and they pay no taxes, and that is not very good.

Senator TALMADGE. Do you think a foundation should continue in life, in perpetuity?

Representative PATMAN. No, that is one thing I am strongly opposed to. It does not fit into our concept of government the way I see it in the West. Of course, the old countries have gotten away from these trusts in perpetuity, but now we are establishing them.

Senator TALMADGE. Is the United States the only country that permits them in perpetuity?

Representative PATMAN. It is the only one I know of although I am not in a position to give an expert answer on that.

Senator TALMADGE. From time to time we read in the press about some contributions that some foundations have made to some of these extremist groups that go around the country preaching the overthrow of the Government, revolution, and things of that nature. Are any records being kept as to how these funds are being spent?

Representative PATMAN. None whatsoever, and no supervision.

Senator TALMADGE. Do you think a foundation should keep adequate records?

Representative PATMAN. Why certainly. They should be subject to public inspection.

Senator TALMADGE. I have read from time to time that some of the foundations have been spending a great deal more money overseas at a time when we are suffering a serious balance-of-payments problem than they are spending in this country. What has your committee discovered on that problem?

Representative PATMAN. I am familiar with what has been done and sometimes it runs into hundreds of millions of dollars at the very time when it is damaging to our balance of payments and there is no record made of that and no supervision over it. And our country, my dear sir, is the only country in the world that does not have some control over the export of its capital. We have no control. Now, that, of course, is very damaging.

I think in goods and services over the years we have been in very fine condition, just on the balance of payments on goods and services, but it is just exporting of capital and credit that has upset us.

Senator TALMADGE. Why should the taxpayers of this country subsidize the export of capital through private foundations overseas? We have pending on the Senate Calendar right now an interest equalization tax to try to prohibit that same thing.

Representative PATMAN. Well, that is something that is worthy of great consideration and real action, because it is really upsetting the way these private foundations are sending this money overseas. In fact, I doubt that they should be allowed to send any money overseas.

Our country is the one giving the exemption, and they should certainly spend the money here.

Senator TALMADGE. Thank you very much, Congressman Patman.

Representative PATMAN. Yes, sir.

The Chairman. Thank you so much. We are proud to have you over here at any time, Congressman Patman.

Representative PATMAN. Thank you, sir.

(Representative Patman's prepared statement follows:)

STATEMENT OF HON. WRIGHT PATMAN

PRINCIPAL POINTS

1. H. R. 13270 endorsed strongly. Requests that provisions affecting such organizations not be weakened.
2. Question raised why many privately controlled tax-exempt foundations are established.
3. 27 recommendations listed to deal with abuses uncovered by study of Subcommittee on Foundations.
4. Statistics cited indicating growth in economic power of foundations studied. Concern expressed for small business taxpayers who must compete with tax-exempt business.
5. Demonstrates that from 1951–1967 about 50 percent of foundation receipts were distributed for contributions, gifts and grants. Shows that expenses during this period ran $25 for every $100 in contributions, gifts and grants made; for 1967, $33 for every $100. Discounts statements that 7½ percent tax on net investment income will impair philanthropic activity.
6. Suggests more prudent business-like approach by foundations in their operations—reduce non-essential expenses, carefully review yield on stocks in portfolios and policies on contributions, gifts and grants.

7. Emphasizes there are many problems other than tax matters which require scrutiny—SEC, anti-trust, conflict of interest, etc.
8. Numerous deficiencies of Internal Revenue Service listed in administering and enforcing laws and regulations applicable to foundations.
9. Lack of public knowledge of foundation operations emphasized. Only 140 out of 30,000 publish annual reports.
10. Discusses H. R. 13725, Bill to establish independent Government Agency to control and supervise privately controlled tax-exempt foundations.
11. Efforts not directed to eliminating all foundations but to clearing up the bad apples in the barrel.
12. Declares that taxes in a democratic society should be shared equitably by all. Passage requested of H. R. 13270 as passed by the House and H. R. 13725.

STATEMENT

Mr. Chairman, I greatly appreciate your invitation to testify before this Committee on H. R. 13270, the House-passed tax reform bill. I shall direct my remarks principally to the important subject of privately controlled tax-exempt foundations.

It has been puzzling to me for some time why the majority of privately controlled tax-exempt foundations were established in the first place. The religious, charitable and educational contributions which are made by foundations can just as well be made by an individual. The fact that the foundation route is taken, immediately gives rise to a question as to the actual purpose for establishing the foundation.

A great many huge family fortunes have been continued in perpetuity through the private foundation route. Controlling interests in closely held corporations have been transferred to foundations with no apparent change in the continuity of direction and control through this technique. I don't believe we really know the vast amount of tax dollars lost to this nation by tax avoidance through the vehicle of privately controlled tax-exempt foundations.

It appears to me that the time has come to look very closely at this problem, and to develop sufficient information so that the Congress can make a decision on the desirability of continuing the present concept of privately controlled tax-exempt foundations. Later on in my testimony, I shall speak further to this point.

At the outset, I would like to strongly endorse the provisions of H. R. 13270 dealing with privately controlled tax-exempt foundations. I hope this Committee takes no action to weaken the provisions affecting these organizations. This Bill is a step in the right direction and contains only the minimum reforms needed as shown by the experience of the Subcommittee on Foundations in dealing with this problem.

The Subcommittee on Foundations has been conducting a continuous and in depth review of the activities of privately controlled tax-exempt foundations for a number of years. During this period, seven reports were issued and two hearings were held. As a result of our study, a number of abuses of the tax-exempt privilege were uncovered and recommendations were made to deal with them. Although these recommendations have heretofore been made public, I believe it important that they again be made a part of the record.

1. In my view, consideration should be given to a limitation of 25 years on the life of foundations instead of permitting them to exist in perpetuity.
2. Tax-exempt foundations should be prohibited from engaging in business directly or indirectly.

Foundations controlling corporations engaged in business, through the extent of stockownership in those corporations, should themselves be deemed to be engaged in that business.

3. Commercial money lending and borrowing by foundations should be banned.
4. Self-dealing transactions should be prohibited. A foundation should not be permitted to use its funds to grant benefits to a controlled company's employees. This is quite a competitive advantage.
5. Foundation or donor solicitation or acceptance of contributions from suppliers or users of goods or services should be prohibited.
6. A foundation should not be in the position of exercising control over any corporation, directly or indirectly. In my view, all foundations should be limited to ownership of no more than three percent of the stock of a corporation and should not be allowed to vote such stock.

7. Standards should be established with respect to foundation behavior in a proxy fight.

8. Another area that needs consideration is that of investments. There is a sharp difference between investing in securities and speculating or trading in securities. In other words, there is a difference between being a passive investor and an active securities merchant or gambler.

9. Is the tax law sound in permitting a deduction for charity to a person who merely transfers funds to a foundation that he himself controls, where the money has not as yet reached actual operating charities?

In my view, a contributor should not be allowed a deduction for payments to a foundation that he controls until the foundation actually uses the money for charity. The foundation should be recognized as being the alter ego of the controlling contributor. Income earned by the foundation should be taxable to the controlling contributor until put to charitable use.

10. Exemption should be denied if a foundation has been formed or availed of for tax avoidance purposes or to get financial benefits for the contributor. Conversely, a controlled corporation should not be allowed a contribution to a foundation, but instead the payment should be considered as a dividend to the controlling stockholder where the amount is significant and the foundation is unrelated to the business purpose of the corporation.

The tax law says that a foundation's earnings may not inure to the benefit of any private individual. It should be made clear that "individual" includes corporations and trusts.

11. Isn't there something out of gear with the tax law that, under the guise of charity, permits a taxpayer to actually enrich himself at the cost of all other taxpayers? One answer may be to treat gifts to foundations in the same way as private gifts, and figure them at the cost of the property given or their value, whichever is lower.

12. In the case of corporations that are treated like partnerships (Subchapter S, Chapter 1, Internal Revenue Code) contributions to foundations should "pass through" to the stockholders and be included pro rata as contributions by the stockholders personally. In that way, the 20 percent and 30 percent limitations on contributions will be maintained. At present, through the mechanics of Subchapter S (Chapter 1, Internal Revenue Code), an extra 5 percent of the corporation's income becomes deductible by the stockholders.

13. For the purpose of figuring the accumulation of income, contributions to a foundation and all capital gains of the foundation should be considered as income, and not capital. Both the original contribution and the income from it are ordinarily available to the foundation without distinction.

This would eliminate a device for avoiding unreasonable accumulation of income: contributions from one donor-controlled foundation to other foundations controlled by the same donor.

14. For the purpose of computing the accumulation of income, amounts unreasonably accumulated in corporations controlled by a foundation should be added to the foundation's direct accumulation as if the two were one.

15. Corporations controlled by foundations should be subject to the unreasonable accumulation earnings tax in section 531 of the Code. At present, that tax is imposed where dividends are held back to save the existence of unreasonable accumulations for foundations otherwise exempt from tax.

16. Re gift and estate taxes,

(a) Exclude from the base for the marital deduction amounts left to foundations that are hence untaxed.

(b) While amounts given to foundations are not subject to gift and estate taxes, the rate brackets to be applied to amounts that are taxable should be the same as if the foundation amounts were part of the taxable gifts or estate.

17. Consideration should be given to a regulatory agency for the supervision of tax-exempt foundations.

18. A penetrating review of every application for tax exemption is needed.

19. All matters relating to the granting or denial of tax exemption, as well as revocations and penalties, should be made public.

20. The full content of foundation tax returns should be open to public inspection.

21. A national registry of all foundations should be published annually.

22. The tax returns of foundations should require disclosure of amounts spent

for instigating or promoting legislation, or political activities, or amounts paid to other organizations for the purpose.

23. The returns should likewise require disclosure of amounts spent for TV, radio, and newspaper advertising.

24. The returns should call for a description of all activities, directly or indirectly engaged in by the foundation, in which commercial organizations are also engaged.

25. The program of field auditing returns of foundation should be greatly expanded.

26. Stiff penalties and revocation of tax exemption for improper or insufficient reporting would help curb abuses.

27. A reasonable tax on income of foundations should be assessed.

These and other reforms are vitally necessary.

H.R. 13270 contains provisions dealing with some of these recommendations; others still remain.

A glance at these recommendations indicates quite clearly that while tax reform is extremely important, there are many other facets of the activities of these organizations which bear close scrutiny. Further, although H.R. 13270 is less restrictive than H.R. 7053, which I introduced in the House on February 18, 1969, I support the provisions of H.R. 13270 since I believe they are a step in the right direction.

For instance, H.R. 7053 recommended a 20 percent tax on gross income, but H.R. 13270 establishes a tax at 7½ percent on net investment income. Further, my bill recommended restricting stock ownership by foundations in corporations to three percent. The bill under consideration by your Committee allows 20 to 35 percent.

To place this entire matter in perspective, I would like to give some over-all statistics on those foundations under study by the Subcommittee on Foundations.

In the ten-year period ending 1960, 534 foundations had total receipts from all sources of $6.9 billion. In the succeeding seven-year period (575 to 647 foundations were studied), their receipts totalled $8.6 billion, or, $1.7 billion (25 percent) more in a three-year shorter period. These same foundations more than doubled their accumulated (unspent) income from $1 billion at the end of 1960 to over $2 billion at the end of 1967 and their net worth increased from $6.8 billion to $10.1 billion, or about 50 percent.

During the period from 1951 to 1967, these foundations had $15.7 billion in total receipts. Of this amount, $7.3 billion or somewhat less than half came from such sources as business income, interest, dividends, rents and royalties. Of the balance, $4.1 billion came from capital gains on the sale of assets and the remainder, $4.3 billion from contributions, gifts and grants.

At the end of 1967, the 647 foundations under study had total assets at market value of $17.8 billion, as compared to some $10.2 billion at the end of 1960; an increase of almost 75 percent. The $17.8 billion valuation is 50 percent greater than the $11.8 billion of the capital stock, surplus undivided profits and contingency reserves of the 50 largest banks in the United States. When one considers that these figures are for only 647 of the 30,000 foundations, even though most of the larger ones are included, the size of the problem strikes one in full force.

One of my greatest concerns is the impact of such organizations on the small businessmen of this country. Foundations, because of their tax-exempt status can unfairly compete with a business which does not enjoy the benefits of such privileges. Holdings by foundations in enterprises constitute a powerful influence in corporate control, in the market place and in proxy solicitations. Our last report shows that almost 25 percent, or 154 of the 647 foundations studied, held sizeable amounts of stock, from 5 to 100 percent in 313 corporations. The carrying value of these shares was $2.7 billion, with an estimated market value of $6.2 billion. The market value of all corporation stock holdings by these foundations amounted to the staggering sum of $13.1 billion, or, almost 80 percent higher than the holdings at the end of 1960.

As *Fortune* magazine of June 1969 states, "Philanthropy does get shortchanged however, when the corporate stock that a foundation holds for control purposes produces meager income." It cites the Lilly Endowment and the James Irvine Foundations as examples of disbursements representing only about one percent of its assets.

It would be interesting to take a look at what the foundations have done with their tax-free dollars. In the years 1951 through 1967, of the receipts of $15.7

billion, disbursements were $9.9 billion, of which $1.9 billion was paid out for expenses and $8 billion was distributed for contributions, gifts and grants. In other words, the foundations had distributed as contributions, gifts and grants only about 50 percent of what they had received; it cost them $25 in expenses for every $100 of contributions, gifts and grants made. However, this is an over-all average. When we look at 1967, we see that it cost the foundations $33 in expenses ($253 million) for every $100 in contributions, gifts and grants made ($754 million).

I am therefore constrained to view rather cynically the statements made by foundations' representatives that a 7½ percent tax on net investment income will seriously impair the ability of foundations to continue their philanthropic activities. This view is further supported when the record shows that the Rockefeller Foundation spent half as much just running its New York office—$5.4 million—as it spent throughout the entire nation in 1966. It spent more just running its New York offices—in salaries and the like—than it spent in "benevolence" in New York and California combined.

In fiscal years 1966 and 1967, the tax-exempt Ford Foundation lost $92,500 and $100,200 respectively in the operation of its cafeterias and dining room, and, of course, the taxpaying restaurant owners in New York City lost over several hundred potential customers.

In 1966 and 1967, the tax-exempt Rockefeller Foundation lost $44,500 and $47,200 respectively in the operation of its lunch rooms and taxpaying restaurant owners in New York City also lost several hundred potential customers.

Mr. Benson Ford received $15,000 for attending three meetings of the Ford Foundation.

I could go on and on giving examples of loose administrative practices, unconscionably high expenses, and free spending on the part of foundations. The reports issued by the Subcommittee on Foundations are replete with examples of complete disregard of the public interest in the operation of foundations.

If the foundation managers adopted a more prudent businesslike approach to the cost aspect of their operations, exercised a more careful review of contributions, gifts and grants policies, and paid more attention to the kinds of income producing stocks in their portfolios, the 7½ percent tax, contemplated in H.R. 13270, would not be the burden they protest it would be. In fact, I would hazard a guess that tightening their belts would make more funds available for charitable purposes.

The provisions of H.R. 13270 were reviewed in depth by me. While much more remains to be done, the provisions relating to privately controlled tax-exempt foundations will have a salutary effect on the operations of such organizations. I strongly support its provisions.

As I have indicated, much remains to be done with respect to the control and supervision of the activities of privately controlled tax-exempt foundations. The foundation problems are far more numerous and serious than Treasury officials have been willing to admit publicly. During our Subcommittee's 1964 hearings, I made the following statement, in part:

"The Secretary of the Treasury has testified that it is the Treasury's duty to be alert to all possible violations of law. The Secretary also says (1) he does not consider it proper for a foundation to engage in insider's stock deals, stock price manipulations, short sales, margin trading, speculation in commodity futures, or to act as an unregulated source of stock market credit, and (2) the SEC should be alerted to the possibility of a foundation's involvement in insider deals and stock price manipulations.

"Yet, testimony before this Subcommittee indicates the following:

"The IRS does not examine foundations to determine whether they are violating any Federal securities laws—including those relating to insider's stock deals, stock price manipulations, and unregulated sources of stock market credit.

"The IRS has not collected any information, as to the extent that foundations are involved in speculation and trading on margin.

"The IRS has not collected any data on the involvement of foundations in corporate proxy fights.

"The IRS does not examine foundations to determine whether their foreign operations may be in conflict with Government policies.

"The IRS does not examine foundations to determine whether the foundations are channeling income and corpus in a direction that may hurt competitors and investors.

"The IRS does not examine foundations to determine whether they are being used as a device for engaging in various trade practices which might be in violation of certain statutes administered by the Federal Trade Commission or the Antitrust Division.

"Few of the persons in the IRS who examine foundation tax returns would be sufficiently familiar with the antitrust law to know whether the practices as cited may violate Section 5 of the FTC Act or the Sherman Act.

"The IRS does not examine foundations to determine whether there is a conflict of interest between the duties of a foundation's directors or trustees and their interests as officers, stockholders and employees of business corporations whose stock is controlled by the foundation.

"The Acting Commissioner does not know of any cases where compensation of officers, directors or trustees among the large foundations has been unreasonable or unjustified. Yet, Mr. Benson Ford received $15,000 for attending three meetings of the Ford Foundation.

"The IRS does not review a foundation's individual charitable donations.

"The IRS has no rule of thumb regarding the percentage of income that a foundation must spend for the purpose for which it was granted tax exemption.

"The IRS does not examine foundations to determine whether contributions are being made to the foundations by persons or organizations that supply goods or services to companies interlocked with the foundations.

"The IRS does not know how much money was spent overseas by U.S. foundations in 1963.

"The IRS does not examine foundations to determine whether they are making loans overseas that may be contributing to our balance of payments problem.

"This is the most impressive record of do-nothing that I have seen in my 36 years in Congress."

I regret to say that those observations are just as pertinent today as they were in 1964.

The fact that foundations are exempt from taxation does not mean that they are exempt from other Federal laws. Hence, antitrust law, FTC law, SEC law, etc. are applicable to foundations.

It is, of course, possible for a foundation to be used as a device for engaging in various trade practices which may be a violation of certain statutes administered by the Federal Trade Commission or the Antitrust Division. For example, contributions may be made to a foundation by (1) persons or organizations that supply goods or services to companies interlocked with the foundations, or (2) from persons or organizations that buy goods or services from companies interlocked with the foundation. The point is that if the company that is interlocked with a foundation is doing business with and by a contribution to the parent foundation they get the business because of that interlock, they are obviously getting an advantage.

In other words, a contribution can be made to a foundation for a business purpose rather than an eleemosynary purpose. For example, under the Robinson-Patman Act, business concerns are prohibited from making disproportionate discriminatory discounts to particular buyers if the effect might be to substantially lessen competition or tend to create a monopoly. Hence, contributions to a foundation can be a method of getting around this provision of law.

Also, there is the business practice known as reciprocity, which may violate the antitrust laws. It involves tacit or actual agreement to do business with a firm if it reciprocates and gives business in return. Foundations may be parties to reciprocity arrangements. For example, a business affiliated with a foundation may say to one of its suppliers, "I will buy from you if you will contribute to such and such a foundation" or, "if you buy from me, such and such foundation will make you a business loan at favorable terms".

Our study indicates that many business suppliers and buyers have made sizable contributions to foundations controlled by customers. For example, we know that a number of suppliers of the Hilton Hotel chain are contributors to the Conrad N. Hilton Foundation, of Los Angeles. Mr. C. N. Hilton, Jr., Secretary of the Conrad N. Hilton Foundation, has acknowledged that, during the fiscal years ending February 28, 1952 through February 28, 1963, 29 donors—who were suppliers of goods or services to Hilton Hotels Corporation or its subsidiaries—made contributions to the Conrad N. Hilton Foundation in the amount of $61,695.18.

Does not this kind of situation appear to raise the specter of business reciprocity—We will buy from you if you contribute to our foundation?

If so, does it not raise a number of serious antitrust problems? Specifically, may it not involve a possible violation of the Robinson-Patman Act because it involves the inducement of discriminatory prices?

Or may it not involve a violation of Section 5 of the FTC Act as have other instances of business reciprocity because they involve "unfair methods of competition?"

Here is another case that we discussed in our hearings. The Rogosin Foundation, of New York City, is controlled by the Rogosin family. The Rogosin family has also dominated Beaunit Corporation (formerly Beaunit Mills, Inc.), Rogosin Industries, Limited, and Skenandoa Rayon Corporation.

At December 31, 1952, the Foundation held 33⅓ percent of the nonvoting preferred stock of Beaunit Mills, Inc. (carrying value $2.7 million) as well as 5 percent of the common voting stock of the same corporation (carrying value $1.0 million).

Beaunit Mills, Inc., manufactures synthetic yarn, knits and weaves fabrics, and manufactures intimate apparel. The Goodyear Tire and Rubber Company of Akron, Ohio, has been a buyer of tire-cord yarn from Beaunit Corporation.

In March 1952, Goodyear made a cash donation of $150,000 to the Rogosin Foundation. Additionally, on March 10, 1952, Goodyear loaned $2.5 million to the Rogosin Foundation at 4 percent interest. The loan was to be paid off in installments due January 3–August 15, 1953, January 3–August 15, 1954, and January 3–August 15, 1955. According to the Foundation, payments on the loan were made on August 15, 1953, August 15, 1954, and August 15, 1955.

The Foundation states that it used the $2.5 million loan to purchase from Beaunit Mills, Inc., 30,000 shares of the latter's preferred stock. An identical number of shares of Beaunit Mills, Inc., preferred stock was pledged by the Foundation as collateral for the loan.

So, here we have the question as to whether this arrangement involves a price discount from Rogosin to Goodyear, for which Goodyear, the buyer, compensated Rogosin by making a contribution to the Rogosin Foundation. If this were the case, would it not seem to raise both tax and antitrust problems. First, it is a method whereby the buyer compensates the seller by making a tax deductible contribution to the Rogosin Foundation? Second, would not this practice, at best, be a distortion of the pricing and exchange process in a free enterprise economy? Third, might not this practice actually involve, (a) a violation of the Robinson-Patman Act because it involved discriminatory pricing, or (b) a violation of section 8 of the Federal Trade Commission Act because it is an unfair method of competition? Additionally, of course, Goodyear was acting as a source of unregulated credit.

Then there are the possible antitrust problems—actual or potential conflict of interest situations—that may stem from situations where board members of foundaions also sit on the boards of business firms that compete with each other. As we all know, Section 8 of the Clayton Act provides that no person shall be a director of two or more competing corporations. Now, that Act does not apply to indirect interlocks, such as when a foundation has two board members, one of whom is also a board member of corporation A and the other member is on the board of corporation B (a competitor of A). While there is nothing illegal about such an arrangement under Section 8, there could be a special public interest problem when a foundation establishd for eleemosynary purposes becomes a vehicle for such indirect interlocks which might affect competition.

Here is another area that this panel should explore. Does a businessman in government pose a greater potential conflict of interest than the officials of foundations in government—such as, for example, McGeorge Bundy, President of the Ford Foundation, whose overlords, the Ford family, have immense commercial interests throughout the world, including the Middle East? It seems to me a bit inconsistent for the Congress to require a businessman to completely eliminate potential conflict of interest when, at the same time, it permits Mr. Bundy to wander in and out of the Government while retaining his $65,000 annual salary from the Ford Foundation. This was the case in June 1967 when Mr. Bundy became Executive Secretary to the National Security Council Committee on the Middle East.

Now, to turn to the stock market—there is ample evidence that many foundations are actively trading in the market with substantial portions of their funds. Judging from the content of their portfolios and the frequency of turnover, many foundations are concerned less with equity yields and inflationary trends than

they are with the lure of capital gains to swell their principal funds. I might add that former Secretary Dillon testified that he shares my view that speculative gains for charity are not worth the risk of speculative losses, and that he knew of no case where directors or trustees of a foundation have reimbursed the foundation for losses incurred in speculation.

One of the operations that should be subjected to the close scrutiny of this Committee is that of the private pooling of investments by some foundations—in other words, the pooling of capital to trade in the stock market. For example, some of the Rockefeller foundations have informed us that they have a joint investment staff of 16 persons, not including secretarial, headed by Mr. J. Richardson Dilworth, which provides investment services with the cost shared by the various Rockefeller participants.

Does this not raise some potential problems—the possibility of speculative tactics, the possibility of a conflict of interest, the possibility of huge buying power that will have a strong impact on the prices of stock they deal in?

Secretary Dillon also testified that a foundation can be a source of unfair competition arising from active use of foundation assets by donors or trustees for private business ends, and that there are an infinite number of ways in which foundation assets or income can be used for the preferment of one set of private persons over another. The Secretary agreed that (1) foundations' moneylending activities put them into unfair competition with private lenders and also give the foundations an element of influence over a wide range of business ventures, and (2) such activities may present problems, such as preferential rates of interest. All this is made possible by the fact that, at present, the only restraint on a foundation's moneylending appears to be that loans must carry a "reasonable" rate of interest and adequate security, and that nothing prevents the foundation from making loans to its founder or his family, the businesses under his control, or a donor.

I conclude with this thought: There is something fundamentally wrong in conditions which make such acquisition of economic power possible, and which tolerate its continuation. And it is the responsibility of Congress to correct those conditions.

The Internal Revenue Service has proven itself over the years unable to administer and enforce effectively the laws and regulations governing such organizations. For many years the Subcommittee on Foundations attempted to obtain a list of privately controlled tax-exempt foundations. Finally, in December 1968, after many delays and much prodding, such a list was submitted to the Subcommittee. This list contained the names and addresses of 20,262 foundations. Shortly, thereafter, almost 300 corrections were made to the list.

In attempting to broaden our study of such organizations, and after unsuccessful attempts to obtain the kinds of information we needed from the Internal Revenue Service, we undertook to obtain the information by communicating directly with the foundations. We are presently in the first stages of such a project. Of the first several thousand mailings made, about 1,000 have been returned with the notations, "Moved, not forwardable," "Addressee Unknown," "Addressee moved and left no forwarding address," "Insufficient Address." In some cases we were advised that some foundations had been out of existence for years, one as long as ten years ago. The list furnished us by the Internal Revenue Service is replete with duplications and incomplete addresses and names.

If the Internal Revenue Service cannot even come up with the current addresses of the organizations for which they have responsibility, I shudder to think of the kind of audit and review that is being undertaken by them. Several years ago in on of our studies, we indicated that some of the larger foundations had not been audited for many years. In fact, as a result of prodding by the Subcommittee, some $28 million in assessment have been levied against a number of foundations.

The public is entitled to complete disclosure of information concerning these organizations which have been granted tax-exempt status. It is estimated that only 140 such organizations publish annual reports. The only other data is in the Form 990–A which is required to be filed with the IRS annually, which is admittedly limited in depth.

Recently, as a result of Congressional interest, there has been a great deal of scurrying around by the foundations to establish some kind of a self-policing organization. In view of the record, allowing such self-policing would be akin to having the fox guard the hen house or letting the goose watch over the shelled corn. Stronger Government action is urgently needed.

The proliferation in the number (2,000 new ones in the past year) of such organizations and in their increasing economic and other powers makes it necessary that their activities be given the closest scrutiny.

Accordingly, I introduced legislation in the House on September 9, 1969, (H.R. 13725) to establish an independent Government Agency to control and supervise the activities of privately controlled tax-exempt foundations. Because of its relevance to the deliberations of this Committee, I would like to request that the text of this bill be included in the record of these hearings.

The new Agency, "The Private Foundation Control Commission," would be headed by three Commissioners appointed by and reporting to the President. Commissioners will serve five-year staggered terms with a Chairman whose term as Chairman would be co-terminus with the President's term.

As stated in the bill . . . "The establishment of a Private Foundation Control Commission is necessary in the public interest to:

(1) Provide general leadership in the identification and solution of problems relating to private foundations;

(2) Facilitate the enforcement of internal revenue laws and regulations relating to private foundations and aid in the development of a more equitable tax structure with respect to such foundations;

(3) Develop and recommend to the President and the Congress policies and programs designed to ameliorate the problems relating to Federal taxation and regulation of private foundations; and

(4) Establish and administer a comprehensive registration and reporting system for private foundations and to determine and centrally record the financial and other operations of such foundations in order to assist in the accomplishment of the foregoing objectives.

Under the legislation, no private foundation will be eligible for tax exemption unless it is registered with the Commission. The Commission would be authorized to revoke such registration under appropriate circumstances.

The Commission will be self-sustaining through assessing the foundations a registration fee and an annual maintenance fee. Such fees are not a substitute for the tax on net investment income of foundations included in H.R. 13270, the tax reform legislation recently passed by the House and under consideration by this Committee. The legislation is restricted to private foundations, which are defined in the legislation.

Mr. Chairman, I appreciate the time and courtesy afforded me in presenting this rather lengthy statement to the Committee. I would like to make it clear that my efforts are not directed to the elimination of all foundations as a constructive part of our democratic society. Rather, it is my hope that the corrective actions being considered by the Congress will clean up the bad apples in the barrel and allow those privately controlled tax-exempt foundations which are operating in the highest and best public interest to continue their worthy efforts.

In a democratic society, the burdens of taxation should be shared equitably by all. Privileges granted to any particular group for any special purpose must be accompanied by the acceptance of the responsibilities that such privileges carry with them. With the passage of this tax reform bill as passed by the House, and my bill (H. R. 13725) which I consider to be a companion bill, it is hoped that these objectives may be attained.

The CHAIRMAN. It is with great pleasure that I welcome before the committee the Hon. Ted Stevens. Senator, you proceed as you wish.

STATEMENT OF HON. TED STEVENS, A U.S. SENATOR FROM THE STATE OF ALASKA

Senator STEVENS. Thank you, Mr. Chairman and thank you for giving me this opportunity to testify before this committee on behalf of this important tax legislation.

There has been a great outcry from the American people for tax reform. If there is any one common element of tax reform which is a consistent part of this cry, it is for greater equality in the distribution of the tax burden. The House bill, while containing several excellent

provisions toward this goal, leaves several important inequities untouched. I have introduced several bills which would help to correct these deficiencies.

The first bill I would like to call to this committee's attention is S. 1908. This bill has two main purposes. The first would raise the personal exemption from its present $600 level to $1,000. Personal exemptions benefit, primarily, the poor and middle income tax paying families, and these families are, in my opinion, the most heavily burdened by our present income tax. In 1913, when the income tax became a permanent part of our economic fabric, the dollar was worth far more than it is today, but the personal exemption was $3,000 and was never less than $1,000 until 1940. It was then gradually reduced during the years of World War II to $500. It was last increased in 1948—when a dollar was worth more than twice what it is today—to its present $600 level. In other words, in terms of today's dollars, the personal exemption of 1948 was worth over $1,200. Thus, the first purpose of S. 1908 would help to restore the balance of our graduated tax system that inflation has destroyed.

The second purpose was to help to correct a long-standing inequity in the income tax. This provides for an increase in the personal exemption in those areas of the country where the cost of living exceeds the national index. In some regions of our country the cost of living is 10, 20, even 50 percent higher than the national index. It is 8 percent higher in San Francisco, 11 percent in New York City, 22 percent in Honolulu, and 43 percent in Fairbanks. Obviously, if the graduated income tax is to affect persons of equal standards of living equally, the differences in the cost of maintaining that standard of living must be taken into account. S. 1908 would help to correct this inequity.

I would now like to draw this committee's attention to three bills, S. 1047, S. 2739, and S. 2760, which would allow certain expenses of taxpayers to be deductible. The first of these bills would allow for the deduction of funeral and burial expenses, in the same way medical expenses in excess of 3 percent of adjusted gross income are presently handled. The costs of medical care are spiraling upward, and the costs of major illnesses are truly devastating. These excessive medical costs are deductible, and rightly so. But, should the illness prove to be terminal, the costs of final disposition of the deceased are not deductible. I believe these expenses should be viewed as terminal medical expenses. My bill would correct this deficiency. To assure that this deduction does not promote more expensive funerals, it specifically excludes cemetary plots and memorials from the category of deductible expenses and limits the deduction to $2,500.

The second bill, S. 2937, would enlarge the class of expenses that may be deducted as legitimate moving expenses to include reasonable expenses for traveling to search for a new residence, for meals and lodging while in temporary quarters waiting to move into a new permanent residence, and expenses incident to the sale of the taxpayer's former residence or resolution of his lease and incident to the purchase of a new residence. The total deduction for moving expenses would be limited to $2,500. In those situations in which a taxpayer is not reimbursed by his employer for moving expenses, the costs described above represent a real hardship to the transferred employee.

And, if his employer does choose to reimburse him for such expenses, he must report such reimbursement as ordinary income even though he was required to make such expenditure in order to retain his job. This is obviously an unjust situation and S. 2739 would correct it.

The third bill, S. 2760, would remove the restriction which presently limits deductions for care of dependents of working mothers to taxpayers whose combined husband-and-wife earnings are less than $6,500. The present limit was designed to assure that the benefit would be available only to those families in which the mother was required to work in order to support the family. Unfortunately, a flat limit cannot accomplish this end fairly, for it clearly gravitates against larger families or families living in areas having excessive costs of living. I, therefore, favor removal of the limit so that all working mothers may enjoy this benefit equally. S. 2760 would accomplish this.

I would now like to discuss another inequity in the present tax law which S. 2736 is designed to correct. Employees under qualifying plans and self-employed persons may have part of their salary placed in a fund and not have to pay tax on this money, nor on the earnings of such a fund, until the money is distributed. But the employee whose employer does not offer a qualified plan cannot take advantage of this tax benefit. S. 2736 would allow such an employee to be treated as a self-employed person, and thus eliminate this inequity.

H.R. 13270 also dealt with the tax treatment of lump sum distributions of these retirement funds. The presumed purpose of denying capital gains treatment to these distributions was to prevent the receipt of substantial amounts of deferred income at capital gains rates. But I would like to point out to this committee that, under H.R. 13270 as passed by the House, a person who has had his employer contribute $25 a month for the past 20 years will be affected to a far greater extent than a person who has had $1,000 per month set aside for the previous 5 years. Assuming our first employee was living only on social security at the time of the distribution, he would pay a tax of $500 under present rules and $885 under the provisions of H.R. 13270. This is more than a 75 percent increase in taxes. The second hypothetical employee would pay $11,150 under the present system and $14,150 under the House bill. This is less than a 30 percent increase in taxes. A person receiving a very large distribution, say $1 million, would indeed be required to pay nearly 150 percent increase in taxes.

I suggest we allow every taxpayer to receive a limited amount of money as a lump sum distribution tax free and require everything over that amount to be taxed as ordinary income. This would continue the incentive to create retirement benefit and profit sharing programs. The average lump sum distribution made in 1968 by Sears, Roebuck & Co., which has one of the Nation's oldest profit-sharing plans, was reported to the House Ways and Means Committee as being slightly over $100,000. I suggest that an exemption of $50,000 would be appropriate, since this would leave the average distribution in precisely the same position it is in today. I urge this committee to consider this proposal. If the incentive for private retirement plans is to continue to perform the function for which it was designed, it should not be eroded in the way H.R. 13270 proposes.

I have also offered several amendments to H.R. 12290, which, taken in the aggregate, will do the following: They will continue the benefits

of the 7-percent tax credit for investments in depressed areas, for small business property and for intrastate pipeline property. A depressed area, under my amendment No. 102, is defined as a State or political subdivision with an unemployment rate of 6 percent or more for the calendar year. During the last 12 years, my State has experienced chronic unemployment ranging from a low of 8 percent to a high of 10.3 percent and, in fact, experiences unemployment in excess of 80 percent in certain remote villages. By retaining the credit for investment in depressed areas, the employment balance in America could be dramatically improved and chronic unemployment in certain areas of this country could be ended by stimulating private enterprise. If we are to deal directly with unemployment, the costs will be staggering. I prefer to continue the incentive to provide new jobs. The provisions involving small business and intrastate pipelines would also be of assistance in helping to end this unemployment problem.

Finally, I would like to point out an inequity in procedures that presently exists in IRS practices. When the IRS files a lien on real property for nonpayment of income taxes, that lien is duly recorded. When the taxes are paid, the IRS notifies the property owner that his slate is clean, but it is not required, nor does it in practice notify the county or borough recorder to remove the lien. When the taxpayer sells his property, the purchaser will discover the lien and will usually end up bearing the cost of removing the lien in order to obtain title insurance. Any other person placing a lien on property would be required to remove it, but the IRS is not. There is no reason why the IRS should enjoy this special advantage nor, according to its own policies, should it enjoy this privilege. My bill, S. 2879, would require the IRS to notify the place at which the lien was originally recorded that it has been satisfied.

I would now like to draw the attentions of this committee to the provisions of H.R. 13270 that would reduce the depletion allowance for oil and gas from 27½ percent to 20 percent and would require the intangible drilling expenses for these industries to be capitalized rather than expensed.

Mr. Chairman, as everyone is now well aware, large oil discoveries have been made in the forbidding Arctic regions of my State. The discovery is of such a magnitude that it is expected to increase the proved oil reserves of this country significantly. But the costs of exploration that led to this great discovery were far greater than any previous exploration. The costs of developing these reserves will be far greater than the costs of developing previous discoveries, and the cost of transporting this oil to domestic markets is significant. If it had not been for the incentives—and that is what the existing tax provisions are: incentives, not loopholes—exploration in the Arctic regions probably would not have taken place, and our great reserves might be unknown today. These reserves are now ready to be developed, but the costs of this development are staggering. The pipeline which will carry the oil from Prudhoe Bay to Valdez on the Gulf of Alaska will cost an estimated $900 million; each well will cost an estimated $1.2 million compared with an average of $50,000 for previously drilled wells. This is a tremendous capital investment. Where will the money for such investments come from?

For the most part, it will come from the recovery of capital invested in earlier oil fields. How is this money recovered? It is recovered, previously, through the depletion allowance. That allowance assures that the oil industry will retain enough capital to continue exploration and development programs. If this allowance is reduced, it will have significant effects on the future growth of the oil industry.

The investment made so far in exploring for oil in Alaska is estimated at $1.3 billion. That investment was made on the assumption that the incentives contained in the depletion allowance and the expensing of intangibles, which originally encouraged the oil industry to attempt the development of Alaska's petroleum, would be continued. Now this committee is considering a bill which would, in effect, tell these companies who have committed themselves to investing a great amount of money in Alaska that these incentives, which would have provided the capital for the continued development of Alaska's oil reserves, are to be significantly reduced and that these companies will have to look elsewhere for needed capital. Where else, today, can they look?

But this bill goes further than that. It tells the people of Alaska that the incentives which helped to develop the oil reserves in Pennsylvania, Wyoming, Texas, California, Oklahoma, and the other oil producing States are to be denied Alaska. If these incentives are reduced, Alaska must face the fact that she will be denied the benefits that spurred the development of other States; that Alaska's hopes for the future, which have risen so high with the September 10 lease sale, are now to be dashed on the rocks below.

The Alaska Department of Natural Resources has studied the effects the proposed reduction in the depletion allowance and the elimination of the provision allowing the expensing of intangible drilling costs on my State. The annual loss of income to the State of Alaska—from such sources as leases, royalties, and taxes on the oil and related support industries—that would result from the passage of H.R. 13270 would be approximately $100 million—more than half the entire State budget for fiscal 1969. And this takes into account only the loss on proven oilfields. It does not even contemplate the effects of discontinuance of exploration in several other promising areas that will probably result if these incentives are reduced.

Aside from the gross unfairness to one State that will result if H.R. 13270 is passed, this committee should consider the effects on the economy and particularly on the consumer that result from this legislation. Already the oil industry is preparing to build the $900 million Trans-Alaska Pipeline; it has authorized the construction of three new tankers larger than any ship yet built in American shipyards and is considering building a fleet of tankers twice that size to sail the Northwest Passage; it is planning to build airfields, refineries, and dozens of other support facilities. The effects on the construction industry, the shipbuilding industry, the steel industry, and dozens of other industries involved in this development will be drastic if the capital for these projects is severely curtailed, as it most certainly will be if H.R. 13270 is passed. The oil industry is hardly the exclusive beneficiary of these incentives; they benefit all of America.

And what of the consumer I mentioned earlier. In the end, he will bear the burden of the reduction of these incentives, as he does all

tax increases. The discovery of oil in Alaska has been made just at a time when rising consumption was exceeding discoveries of new reserves. As those reserves were gradually exhausted, the price of a gallon of gasoline would have risen significantly. Gasoline is one of those rare items which, taking inflation into account, costs less today than it did 20 years ago. In 1949 the average cost of a gallon of gasoline was 41.5 cents in terms of 1969 dollars, while today it is only 33.7 cents. The development of Alaskan oil can continue this price stability, but, if the capital to develop these new fields is not available, Alaskan oil will not reach the marketplace in sufficient quantity to prevent the impending price rise.

Many critics of the depletion allowance are quick to point out that the allowance would only be reduced, not eliminated, by H.R. 13270. I must point out that the economic feasibility of the Alaskan oil fields, with the high cost of development in the harsh Arctic environment, is dependent on the savings of large scale production made possible by the magnitude of the Prudhoe Bay discovery. The scale of development must be enormous if our oil is to be competitive. You cannot decide to build a $500 million pipeline instead of a $900 million one if it will be 300 miles short of the oilfields. You cannot settle for fewer tankers if the tankers cannot handle the full capacity of the pipeline. The point is, the industry needs all the capital the existing incentives will provide if any of the development in the Arctic is to make economic sense.

We are thus at a time, and I hope I have made this point clear, when the reduction of these incentives could do irreparable harm not only to Alaska, which will most certainly suffer severely if this legislation is passed, but also to the entire Nation. I see no reason to deny the consumer of America the benefits of Alaskan oil in the name of tax reform. The oil industry is not even one of those industries escaping taxation. It pays a larger percentage of its gross revenues in taxes than does the average American business enterprise. And that does not take into consideration excise and sales taxes, which are 3 times greater for the oil industry than they are for the average American business. It pays less in Federal corporate income taxes, it is true, but it pays much more in State and local taxes. At a time when the Federal Government is urging revenue sharing, this committee has before it legislation that would cause a greater share of the oil industry's tax dollar to flow into the Federal Treasury. And, if you think the Federal treasury will gain by reducing those incentives, I would like to point out that the tax revenue from oil lying undeveloped in the ground 8,000 feet below the frozen Arctic is precisely nothing. Where is the tax saving in that?

The reduction of these incentives will have nothing but deleterious effects on the economy, the consumer, and the Treasury, and contributes nothing to the goal of tax reform. I urge this committee to delete those provisions from H.R. 13270 and allow the oil industry to continue to utilize the incentives that brought them to Alaska so that it can stay there and benefit all Alaskans and all Americans.

I would like, at this point, to request the committee's permission to offer at a later date testimony regarding those provisions of H.R. 13270 that affect the interest paid on municipal bonds.

Thank you for this opportunity to present my views to this committee on this important piece of legislation.

The CHAIRMAN. Thank you for a fine statement, Senator Stevens.

Senator Smathers, we are honored to have you with us again. Would you please proceed.

STATEMENT OF HON. GEORGE A. SMATHERS, FORMER SENATOR FROM THE STATE OF FLORIDA, ON BEHALF OF MANUFACTURERS HANOVER TRUST CO. AND MORGAN GUARANTY TRUST CO. OF NEW YORK

Senator SMATHERS. Thank you Mr. Chairman. I represent Manufacturers Hanover Trust Co. and Morgan Guaranty Trust Co. of New York. My remarks are limited to three sections of the bill: Section 443 relating to gains realized by banks on the sale of bonds and other debt securities; section 441 relating to bad debt reserves; and section 515 relating to lump distributions from profit-sharing plans.

As explained in more detail under separate headings, we believe the proposed changes embodied in these sections of the House bill are inappropriate. In connection with section 441 (bonds transactions) and section 443 (bad debt reserves), the bill contains inequities which in any event should be corrected.

Under present law, commercial banks are allowed to treat as ordinary losses any excess of capital losses over capital gains resulting from their transactions in bonds and other corporate and governmental evidences of indebtedness. At the same time, they are permitted to treat any net gains from such transactions as capital gains. Under section 443 of the House bill, this would be changed. Commercial banks would be obliged to treat net gains from these transactions as ordinary income instead of as capital gains. Net losses would continue to be fully deductible as ordinary losses.

It is not believed that this change is desirable. The present law is not the result of an unintended omission. The present treatment of losses on the sale of debt securities by banks dates back to World War II and was deliberately adopted to encourage financial institutions to support large new issues of bonds. It is not believed that it is in the public interest at this time to discourage financial institutions from acquiring bonds. The pendency of the House bill already has had an adverse impact on the demand for long-term issues and has had the effect of reducing the already low liquidity of the banking system.

The modification of the present treatment of gains realized by banks on debt securities will increase the difficulty of the Treasury and State and local governments in issuing securities and consequently will tend to increase the cost of such financing. The impact on the present liquidity of the banking system arises from the fact that termination of the present treatment of gains will reduce the effective yield of issues now outstanding and selling below face value. In short, we feel that there continue to be valid public policy objectives for maintaining the present nonparallel treatment of gains and losses.

If, despite the above considerations, the Congress sees fit to adopt the proposal embodied in the House bill, it is submitted that such

change should be made effective only with respect to bonds or debt securities purchased after the effective date. As indicated above, the present treatment was designed to encourage banks to perform the important functions of providing a market for governmental and corporate securities. It is therefore obviously inequitable that the current holdings of debt securities of banks which were purchased in the light of this favored tax treatment should not continue to enjoy such favored treatment.

For many years for Federal income tax purposes, commercial banks have been permitted to establish bad debt reserves. The present regulation which was adopted in 1965 permits transfers to such reserves to be made until the total equals 2.4 percent of eligible loans. Transfers in any single year are limited by certain provisions designed to prevent unduly rapid or large transfers.

The present treatment is the result of regulations which have been modified from time to time after considerable deliberation. It cannot be regarded as an inadvertent loophole, but rather reflects broad public policy with respect to the structure and functioning of the commercial banking system.

Unlike many other nations, the United States has followed the policy of encouraging a high degree of decentralization in our banking system. As a result, there are more than 13,000 commerical banks in the United States, the great majority of which are small enterprises. It is of the utmost importance that the stability and solvency of this system be assured. Bad debt reserves have contributed to such solvency and stability.

Subject to a transition rule designed to prevent hardship, section 441 of the House bill would eliminate the present rule which permits a bad debt reserve of 2.4 percent of outstanding uninsured loans and would substitute therefor a reserve based upon each bank's own experience as indicated by losses for the current year and the 5 preceding years.

While in a period of economic stability the present rule permitting a reserve of 2.4 percent of eligible loans may result in a reserve that is more than adequate for many banks, it is submitted that it is important that banks be permitted to have a cushion against the possibility of an economic downturn. In the absence of such a cushion, many banks throughout the country could, in the event of a recession, suffer such an impairment of capital as to force liquidation or reorganization. The undesirability of this from the standpoint of the entire economy is obvious.

If, despite the above considerations, the Congress should determine to adopt the proposed change to a 6-year moving average, there is one inequity in the bill which should, in any event, be corrected. This inequity arises in connection with the transition rule which is designed to prevent hardship where a bank has a bad debt reserve in excess of the amount that would be allowable on the basis of its own experience. The transition rule, as embodied in the House bill, would permit the bank to maintain its present dollar reserve and to deduct actual bad debt losses where no addition to the reserve would be justified under the 6-year moving average. The inequity stems from the different levels and circumstances in which individual banks

find themselves with respect to their reserve balances as of the close of 1969 and in light of an incomplete transitional formula by which they are governed under existing Revenue Ruling 65-92.

By way of background, Revenue Ruling 65-92, issued by the Internal Revenue Service in 1965, was designed to provide a uniform percentage for computing annual additions to reserves for bad debts by banks. Under the ruling a bank was allowed deductions for additions to its reserve for bad debts until the reserve equals 2.4 percent of loans outstanding at the close of the taxable year. However, in order to minimize the revenue impact and still put banks on a parity, a bank whose reserve was less than 2.4 percent of outstanding loans at the close of its 1964 taxable year (the year of change) was permitted to make up the difference over a period of not less than 10 years. This catchup period runs at least through 1974. As a result, many banks' so-called base year balance in their reserves are at the 2.4-percent limit but other banks are still in the process of increasing their reserves to that limit under the Internal Revenue Service formula.

In moving from the existing uniform percentage formula for bad debt reserves to be proposed new experience formula, it seems inequitable to freeze the base year allowances in the case of banks who have not yet reached the 2.4-percent limit and are in midstream in the catchup formula under existing law.

As part of the transition to the proposed new formula, banks whose base year balances have not yet reached the 2.4 percent limit should be able annually to increase such balance by at least the amount of their experience under the new formula until such balance reaches the 2.4 percent ceiling for the base year. The effect would be to reach a greater degree of equivalency among competing banks (which was the purpose of Revenue Ruling 65-92) over a period of time but by a formula tied to actual experience as proposed in the bill. Stated differently, our proposed change would permit a gradual equalization in the point of departure of change from existing to newly proposed bad debt reserve rules. Had the Internal Revenue Service catchup formula run its course for all banks prior to the pending legislation, such a change would not have been necessary.

Section 515 of the Tax Reform Act of 1969 pertains to the taxation of distributions from profit-sharing plans. That section, as contained in the act passed by the House of Representatives, would tax as ordinary income that portion of a lump-sum distribution from a profit sharing plan which consists of amounts contributed by the employer after 1969. Under present law, such amounts would be taxed at long-term capital gains rates. This change appears undesirable.

At the outset, it may be helpful to describe in general terms the provisions of the profit sharing plan of Manufacturers Hanover Trust Co., which are believed to be typical of those of many other banks. Manufacturers Hanover Trust Co. has adopted this plan in addition to a fixed benefit retirement plan. The employee looks primarily to the fixed benefit retirement plan to provide him with security in retirement. The profit-sharing plan serves the purpose of permitting the employee to share in the bank's profits and of encouraging him to be thrifty. It makes it possible for him to accumulate a sum which will enable him following retirement to travel, to purchase a home

in a vacation area or to invest in a small business. The imposition of confiscatory taxes is inconsistent with the achievement of these purposes.

Under the plan, all regular employees become eligible to participate after the completion of 1 year of continuous service. Each year, the bank sets aside for profit sharing under the plan 10 percent of net operating earnings after taxes. The sum so set aside is allocated among the employees in the proportion that each employee's base compensation bears to the total base compensation of all employees participating in the plan. The employee is not obliged to make any contribution to the plan.

The employee is given the right to elect to have his share in the profit sharing fund invested in whole or in part in one of four different investment funds. One of these funds is invested in stock of the employer bank. The other three funds consist of miscellaneous securities, the most conservative consisting solely of U.S. Government obligations, another of relatively conservative securities (including, however, common and preferred stocks), and the third of a less conservative type of securities.

Three methods of payment are provided: (a) a lump-sum payment, (b) annual installments of not more than 10 in number and (c) purchase of an annuity contract. While the method of payment to each employee is decided by a retirement committee, the employee's desires are taken into account. If the share of the employee has been invested in securities of the employer bank, the payment will be made in this medium if requested by the employee.

It is believed that in the light of this description of the profit sharing plan of Manufacturers Hanover Trust Co. it is possible better to understand the tax treatment of profit sharing distributions. The present law which has been in effect for approximately 25 years provides for capital gains taxation of lump-sum distributions if they are made in 1 taxable year as a result of separation from service; and where the distribution includes securities of the employer corporation, such securities are valued at the original cost thereof to the plan, any appreciation up to the time of the distribution being ignored. As a result the unrealized appreciation is not taxed until the employee later sells the securities.

Under the House bill, the existing rules would be changed to impose ordinary income tax, rather than long-term capital gains treatment, on that portion of a profit sharing distribution which consists of employer contributions attributable to years beginning with 1970. The bill provides a special averaging device to minimize somewhat the effect of the bunching of income in the year of retirement. Under this device, one-fifth of the employer's contributions would be added to the other income of the employee and a computation would be made to determine the tax on such one-fifth. The tax so arrived at would then be multiplied by 5 to determine the total tax to be paid by the employee on the contributions of the employer. The bill contains a further novel provision which permits the employee to recompute his tax for the taxable year of retirement and each of the four following taxable years (on the assumption that the lump-sum distribution has been paid to him in five equal annual installments), and if such com-

putation produces a lower tax than that in fact paid by him, permits him to file a claim for refund.

Except for this change in the method of taxing the portion of the lump-sum distribution representing employer contributions, the House bill makes no change in the present law with respect to the tax treatment of profit sharing distributions. To the extent that a lump-sum distribution is attributable to earnings realized by the fund over the years in which the employee has been participating in the plan, the distribution would be taxed as long-term capital gain. Likewise no change would be made in the rule which, in the case of distribution of employer securities, disregards the unrealized appreciation on such securities. Accordingly, the tax on such unrealized appreciation would be deferred until the employee realized the same through a sale of the securities.

At this point, it is well to note another change proposed by the House bill which, although not specifically related to profit sharing, does have an effect on the taxation of profit sharing distributions. This is the proposed removal of the 25 percent maximum tax on long-term capital gains. We are not expressing any view on the wisdom of this proposed change, but are referring to it merely for the purpose of pointing out that even if the provisions of section 515 of the House bill are eliminated as herein recommended, the tax payable on lump-sum distributions from profit sharing plans will not as under existing law, be limited to a maximum rate of 25 percent.

It is our position that irrespective of the tax rate, the capital gains method of taxing lump-sum distributions from profit sharing funds is preferable to that proposed in the House bill both from the standpoint of fairness as well from the standpoint of practical administration.

The capital-gains treatment which under present law is applicable to lump-sum distributions from profit-sharing plans is not a method of taxation peculiarly reserved to the taxation of gain on securities and other capital assets. Rather it is a method which was devised for the taxation of income accumulated over a number of years which under the "annual accounting" concept followed by our tax law is bunched into 1 year. Lump-sum distributions from profit-sharing plans represent an accumulation over many years of service, sometimes as many as 30 or 40 years, which is received by the employee in one taxable year. No better illustration could be found of the type of situation for which the capital gains method was devised. Capital gains treatment further is appropriate to these distributions because an employee's profit-sharing account represents an investment which he has had at risk throughout his employment. During this entire period he was the true owner of his share in the fund even though such share may stem from contributions made by the employer. While the moneys are in the profit-sharing fund, the employee is subject to the risk of the fluctuations of the securities markets. If the investment experience is good, the employee stands to gain; but if it is bad, it is the employee who will bear the loss. It thus appears entirely appropriate to apply the capital-gains treatment to these distributions without any fragmentation such as is proposed by the House bill.

If it be suggested that ordinary income treatment is appropriate to the extent of the employer's contribution because such contribution is attributable to the employee's own labor, it is submitted that this

argument proves too much. If it were sound, ordinary income taxation would be appropriate to the proprietor of a small business who sells the business after a long period of time over which he has built up the goodwill of the business. Such a proprietor is of course given capital-gains treatment on the sale of his business even though what he is selling obviously stems largely from his own personal efforts. In this connection, it is to be noted that the philosophy underlying the proposed change in the tax treatment of lump-sum distributions appears inconsistent with the philosophy underlying the provisions of section 802 of the House bill which propose a maximum tax rate of 50 percent on earned income. Implicit in the latter provision is a recognition that our tax laws in the past have unfairly discriminated against earned income such as salaries and other forms of compensation, and that the imposition of confiscatory taxation may result in discouraging further effort on the part of both low- and high-paid employees who recognize that as their compensation increases, the percentage thereof that goes to the Government likewise increases. Since distributions from profit-sharing funds are a means of encouraging employees to greater effort, it seems that the proposed elimination of capital-gains treatment is a movement in the wrong direction.

The House bill recognizes that it would be inequitable to tax a substantial portion of a lump-sum distribution as ordinary income in one taxable year. Accordingly, it adopts the above-mentioned averaging device as well as the cumbersome refund procedure. This necessary averaging is, it is submitted, better accomplished, with less administrative burden to both the taxpayer and the Internal Revenue Service, by leaving the present capital-gains treatment undisturbed. The present law achieves an equitable result in a way that is easily understood by taxpayers and is capable of easy administration by the authorities. The proposed treatment including particularly the refund provision would be very difficult of comprehension by unsophisticated taxpayers. In many instances, the refund provisions would have to be utilized by the estates of deceased employees under circumstances where the necessary records would be difficult to locate.

The proposed averaging device, while it avoids the extreme pyramiding of income which would result in the absence of an averaging device, fails fully to take into account that much of the distribution may represent earnings of the employee when he was being paid a very modest salary and, consequently, was in a low tax bracket. Many of the employees of a bank start at the very bottom of the ladder and after many years reach a level where their top income is subject to tax at high surtax rates. The 5-year averaging device will in those cases fail to level out the rate of taxation in a manner that properly reflects the rates which would have been applicable had the employee received the payments in the years in which he rendered the services. Capital-gains taxation, it is submitted, more closely approximates the tax which would have been paid if the moneys had been distributed currently. This will be particularly true if, as provided in the House bill, the 25 percent maximum tax rate on long-term capital gains is eliminated.

The refund provision of the House bill, which would entitle the employee to a refund at the end of 5 years if he has relatively small income during the 5-year period following termination of service, in addition to being subject to the criticism that it is administratively

cumbersome, is unfair in that it will deprive the employee for a period of 5 years of the use of the money which is ultimately refunded to him.

In conclusion, it is submitted that the present provisions of the code properly apply capital-gains treatment to lump-sum distributions in recognition of the fact that the employee has an investment in the profit-sharing plan which is at risk over a long period of time. These provisions are equitable, understandable, and result in a fair approximation of the tax which would have been paid over the period of years in which the average employee participates in a profit-sharing plan. A tax provision which governs payments to many low-salaried employees should in all events be simple and easily understood. The provision in the House bill fails completely to meet this test.

The CHAIRMAN. Thank you very much, Senator.

Senator SMATHERS. Thank you, Mr. Chairman.

The CHAIRMAN. Our next witness will be Mr. Scott P. Crampton, chairman of the American Bar Association, section of taxation, Washington, D.C.

Mr. Crampton, you have a very full statement here and we will have to ask you to abbreviate it and try to stay within 10 minutes. We will print the entire statement and try to make it available to everyone.

STATEMENT OF SCOTT F. CRAMPTON, CHAIRMAN, AMERICAN BAR ASSOCIATION, SECTION OF TAXATION, WASHINGTON, D.C.; ACCOMPANIED BY SHERWIN T. McDOWELL, CHAIRMAN-ELECT, AND DONALD McDONALD, VICE CHAIRMAN

Mr. CRAMPTON. My name is Scott P. Crampton. I am appearing here before you this morning as chairman of the section of taxation of the American Bar Association. With me is our chairman-elect, Mr. Sherwin T. McDowell, and our vice chairman in charge of committee operations, Mr. Donald McDonald.

The officers of the section of taxation appreciate very much this opportunity to appear before your committee and to bring you the views of our organization.

As I am sure many of you already know, the membership of the American Bar Association is now in excess of 140,000 attorneys of whom about 12,000 are members of the section of taxation.

When the Tax Reform Act of 1969 was being considered by the House of Representatives, the section of taxation was concerned that under its then limited authority, it might not be authorized to act in a number of areas where we thought our membership could be helpful. As a general rule, no member of the American Bar Association is authorized to speak for that Association with regard to pending legislation, unless the position to be urged has first been approved by its House of Delegates.

In view of the technical nature of the proposals for tax reform that are now pending, and the need for early action, Mr. Charles C. MacLean, my predecessor, appeared before the House of Delegates of the American Bar Association to request for the section of taxation additional authority so that our assistance to this Committee may hopefully be more meaningful.

Mr. MacLean was successful in this regard and the section of taxation has been authorized by the American Bar Association to comment on the pending proposals subject to several provisos, the most important of which is as follows:

With the chairman's permission I would like to read this one paragraph:

> That the section shall neither support nor oppose any proposal of a controversial nature affecting the distribution of a substantial part of the tax burden to a particular class or classes of taxpayers, but shall confine its action with respect to any such proposal to explaining the effect thereof and commenting on problems of statutory draftsmanship, undue complexity in the structure of the tax law, and alternative methods of accomplishing the same general objectives.

It may seem to you that I have labored this position a bit, but we feel that it is important to establish at the outset the scope of our authority. There are certain areas regarding the pending tax reform proposal in which the American Bar Association, through its House of Delegates, has taken a position, and in those instances we have endeavored to make it clear to the committee that we are speaking for the American Bar Association. In all other instances, however, we ask that the committee be mindful of the fact that we are today speaking for the section of taxation and pursuant to this limited authority to which I have referred.

We have submitted to the committee a printed report setting forth in considerable detail our views, suggestions and questions with respect to the pending bill. In a number of instances we have pointed out problems without suggesting what the solution should be. The omission of a proposed solution frequently resulted from our effort to avoid questions of policy which might go beyond our limited authority.

One other preliminary point should be mentioned. Many of our section members, as individuals and acting on their own responsibility, have made or are making technical comments with respect to specific sections of H.R. 13270.

I believe there are several hundred of these comments that have been collected by the section of taxation, and then forwarded to the staff of your committee, to the Joint Committee staff, and to the Treasury Department for consideration.

In this short oral testimony, we desire to discuss only two subjects. One is retroactivity or effective dates as they are set forth in the bill, and the second is the extensive delegation of authority to supplement the statute by regulations.

On the question of effective dates, I believe one of the tax services set forth the various effective dates and that it took seven pages of their printed document to cover them. There are numerous situations in the bill where statutory provisions are made effective as of some months ago—frequently when the subject was discussed in a press release. One count of these I believe reached 45.

It is realized that the suggestion of a change in tax legislation may encourage some people to act in order to take advantage of the existing provisions. There is another side of the coin, however, and that is the belief that taxpayers are entitled to act in reliance on existing law, and particularly when there is no actual notice of the proposed change.

This problem was considered some time ago by the section of taxation, which approved a resolution on the subject. A part of this resolution is printed in the introduction to our report. The conclusion in short was as follows:

> That the foreclosure of such last-minute tax avoidance is considered less important than the preservation of the principle that a taxpayer may rely upon an existing statute in planning his affairs.

We realize that this general subject may have more or less significance in various areas of the bill, but we do urge this committee in fixing effective dates to endeavor to do so with a minimum of retroactivity.

On the subject of regulations, or the delegation of authority to supplement the statute by regulations, we find over 70 instances where the bill provides for details to be supplied by regulations to be issued by the Secretary or his delegate.

Since the public is still awaiting some regulations to be issued under the 1950 act, that is 19 years ago, it is not surprising that the section of taxation has touched on this subject in the introduction to its report. The substance of our view in this regard is that the legislative program should be scheduled so that there is sufficient time to incorporate all major policy decisions within the statute.

In closing I was going to request that our printed report be made a part of the record, but I understand you have already done that.

The CHAIRMAN. Yes, we have a very lengthy statement by you. Thank you very much, sir.

Senator CURTIS. Mr. Chairman, may I ask one thing. I would commend you for everything you have said, but particularly on the matter of delegating authority to the Secretary or his delegate rather than the Congress writing the tax law. I think this is most important, and particularly out in the interior country where I come from, where they do not have access to committee reports and so on.

I am inclined to believe that insofar as possible, taxpayers' lawyers should be able to turn to the statute and find out what the tax law is. I understand that is what you are driving at.

Mr. CRAMPTON. I believe you have probably expressed it better than we did.

Senator CURTIS. Now you said there were 70 instances where instead of deciding something by the Congress, the Secretary is delegated to do it. I wish that you would submit to this committee the list of those 70 instances and in a separate column the proposed language that you would use in lieu thereof.

Mr. CRAMPTON. Mr. Senator, I think we can——

Senator CURTIS. Now that is a job you have asked us to do, Mr. Crampton.

Mr. CRAMPTON. I think that we can give you a list rather readily of the 70 places where there has been a delegation of authority, but in view of the limited authority which the section of taxation has from the House of Delegates of the American Bar Association, there are a number of these areas in which I feel without going through our formal procedures——

Senator CURTIS. I will modify my request in this regard, not suggesting that you make the policy decisions but give us some alternatives, after we decide what policies should be.

Mr. CRAMPTON. I believe we could.

Senator CURTIS. Insofar as possible.

Mr. CRAMPTON. I believe we could make a real effort on that.

Senator CURTIS. Maybe not on all but if you could help with some of them it would be very helpful.

Mr. CRAMPTON. We will be glad to do so.

Senator CURTIS. Thank you, sir.

(The committee subsequently received the following additional information:)

COMMENTS OF THE SECTION OF TAXATION OF THE AMERICAN BAR ASSOCIATION, ON THE DELEGATION OF AUTHORITY TO THE SECRETARY OF THE TREASURY OR HIS DELEGATE TO PROMULGATE REGULATIONS UNDER H.R. 13270, THE TAX REFORM ACT OF 1969

1. Page 8, Line 23, Sec. 101, § 507(b) (3) of the Code

May be deleted. Covered by § 7805(a).

2. Page 11, Line 13, Sec. 101, § 508(a) of the Code

The provision as to time operates as an effective date provision during the transitional period after enactment of the bill. It should be changed to provide that notification may not be required prior to a stated date after adoption of the regulations. Other sections relating to classification of organizations as private foundations and deductible contributions are dependent on this provision, and therefore the transitional effective date provision is important.

3. Page 11, Line 20, Sec. 101, § 508(b) of the Code

Unnecessary. Should refer to § 508(a).

4. Page 11, Line 24, Sec. 101, § 508(c) of the Code

This would appear to be an acceptable delegation.

5. Page 12, Line 18, Sec. 101, § 508(d) of the Code

May be deleted. Covered by § 7805(a).

6. Page 25, Line 17, Sec. 101, § 4941(e) (4) (B) of the Code

The standards by which the Secretary determines an appropriate period under this subsection should be stated. Perhaps a fixed period, say one year, following termination of litigation should also be provided.

7. Page 27, Line 18, Sec. 101, § 4942(e) (2) of the Code

The last sentence should be deleted. The required valuation should be determined under general principles of law.

8. Page 28, Lines 1 & 4, Sec. 101, § 4942(e) (3) of the Code

The objections of the Section of Taxation to this delegation of authority are set forth on page 8 of the Report of the Section of Taxation dated October 1, 1969. It is submitted that the applicable percentage for years subsequent to 1970 should be determined under some statistical index that may be published by the Federal Reserve Board or the Department of Commerce.

9. Page 30, Line 20, and Page 31, Line 9, Sec. 101, § 4942(g) (2) of the Code

While this subsection does not use the word "regulations", it appears to require the equivalent rule making action and does not set forth any standards to be followed by the Secretary or his delegate. It is suggested that the section be amended to delete the discretionary grant to the Secretary or his delegate and permit a taxpayer to make a set-aside for a stated term, say five years, for the purposes described in the section.

10. Page 32, Line 10, Sec. 101, § 4942(h) (2) of the Code

May be deleted. Covered by § 7805(a).

11. Page 33, Line 17, Sec. 101, § 4942(j) (2) (B) of the Code

The standards by which the Secretary determines an appropriate period under this subsection should be stated. Perhaps a fixed period, say one year, following termination of litigation should also be provided.

12. Page 37, Line 14, Sec. 101, § 4943(c)(3) of the Code

This delegation would appear to be unnecessary because the applicable principles are adequately set forth in the bill, provided proposed Code Section 4943 (c)(3)(A) is amended as suggested in pp. 12–13 of the Report of the Section of Taxation dated October 1, 1969.

13. Page 42, Line 7, Sec. 101, § 4943(d)(3)(B) of the Code

The standards by which the Secretary determines an appropriate period under this subsection should be stated. Perhaps a fixed period, say one year, following termination of litigation should also be provided.

14. *Page 46, Line 23, Sec. 101, § 4945(e) of the Code*

We would suggest deleting the requirement for advance approval by the Secretary or his delegate. The proposed statute would appear to set forth the standards to be met.

15. *Page 56, Line 7, Sec. 101, § 4947(d) of the Code*

May be deleted. Covered by § 7805(a).

16. *Page 57, Lines 14 & 17, Sec. 101, § 6033(a)(1) of the Code*

May be deleted. Covered by § 6001 and § 7805(a).

17. *Page 57, Line 24, Sec. 101, § 6033(a)(2) of the Code*

This would appear to be an acceptable delegation.

18. *Page 61, Line 4, Sec. 101, § 6104(c) of the Code*

This delegation should be deleted as surplusage. As to the merits, see Report of the Section of Taxation, October 1, 1969, beginning at p. 15.

19. *Page 74, Line 20, Sec. 101, § 6034(a) of the Code*

May be deleted. Covered by §§ 6001 and 7805(a).

20. *Page 95, Line 1, Sec. 121, § 514(a)(1) of the Code*

We suggest that the delegation of authority to supplement the statute by regulations should be deleted. If some method of averaging other than arithmetical is intended, the statute should be clarified in this regard.

21. *Page 104, Line 21, Sec. 121, § 514(c)(7) of the Code*

We suggest that the delegation of authority to supplement the statute by regulations should be deleted. If some method of averaging other than arithmetical is intended, the statute should be clarified in this regard.

22. *Page 105, Line 22, Sec. 121, § 514(e) of the Code*

May be deleted. Covered by § 7805(a).

23. *Page 108, Line 6, Sec. 121, § 6050(b) of the Code*

May be deleted. Covered by §§ 6001 and 7805(a).

24. *Page 116, Line 1, Sec. 201, § 170(b)(1)(H) of the Code*

May be deleted. Covered by § 7805(a).

25. *Page 118, Line 1, Sec. 201, § 170(b)(1)(J)(iv) of the Code*

May be deleted. Covered by § 7805(a).

26. *Page 123, Line 9, Sec. 201, § 170(e)(1) of the Code*

May be deleted. Covered by § 7805(a).

27. *Page 125, Line 2, Sec. 201, § 170(e)(4) of the Code*

Lines 2 and 3 on p. 125 should be deleted as covered under § 7805(a). If the first portion of the sentence is not sufficient, perhaps the section should specify that allocation be made in direct proportion to the value of the interest retained and the interest given.

28. *Page 128, Line 23, Sec. 201, § 642(c) of the Code*

May be deleted. Covered by § 7805(a).

29. *Page 135, Line 11, Sec. 201, § 664(a) of the Code*

May be deleted. Covered by § 7805(a).

30. *Page 141, Line 13, Sec. 211, § 1251(b) (3) (A) of the Code*

We suggest that the delegation of authority for regulations in this section should be deleted. The Committee may desire to consider a revision of the statute reading as follows:

(1) An amount equal to the farm net income for such year, and

(2) The amount of those deductions of the taxpayer which did not reduce his tax under this substitle for the taxable year or any preceding taxable year.

31. *Page 142, Line 24, Sec. 211, § 1251 (b) (4) (B) of the Code*

May be deleted. Covered by § 7805(a).

32. *Page 144, Line 18, Sec. 211, § 1251 (b) (6) of the Code*

It is believed that this delegation is undesirable. The statute might be revised to provide that the excess deductions account follows the "farm recapture property" when joint returns are no longer filed.

33. *Page 146, Line 2, Sec. 211, § 1251 (c) (2) (B) of the Code*

This delegation is objectionable because of the lack of legislative standards. One method of allocation might be in proportion to the amount of farm income on each separate return.

34. *Page 164, Line 3, Sec. 231, § 217 (f) of the Code*

May be deleted. Covered by § 7805(a).

35. *Page 168, Line 13, Sec. 301, § 84(c) (4) of the Code*

Since there are standards set forth in the section, by the reference to § 1374(c) (1), a specific delegation is unnecessary.

36. *Page 184, Line 14, Sec. 311, § 1304(e) (2) of the Code*

This section repeats § 1304(f) (3) of existing law. In view of the principle that reenactment of a statute frequently constitutes an approval of existing Treasury Regulations, the Committee should consider Treas. Regs. § 1.1304-5 to see whether it approves the principles set forth. If so, it is submitted that these principles should be outlined in the statute.

37. *Page 187, Line 2, Sec. 321, § 85(c) (2) (B) of the Code*

May be deleted. Covered by § 7805(a).

38. *Page 192, Line 2, Sec. 331, § 1354(b) of the Code*

This is another example of delegation of legislative authority without any standards by which such authority can be tested. One alternative would be to count the period of service subsequent to the execution of the general plan, if shorter than the employee's entire period of service with the employer. A second alternative might be for the statute to prescribe a fixed period of time over which deferred compensation payments be deemed earned. Another, the entire period of employment, whether shorter or longer than the existence of the general plan, might be considered.

39. *Page 192, Line 18, Sec. 331, § 1354(c) of the Code*

If compliance with such regulations would be a condition to utilization of the benefits of section 1354(a) (1), the inability to comply for one year out of many might bar a taxpayer, even though he were willing to have the income attributable to such year taxed at the maximum possible rate for such year.

Consideration should be given to providing statutory criteria of proof which would permit a taxpayer to meet his burden of establishing the increased tax which he would have incurred in prior years.

Provision could be made permitting a taxpayer to rely conclusively on the facts shown on his return filed for any prior year with respect to which the statute of limitations has expired.

40. *Page 195, Line 16, Sec. 341, § 665(c) of the Code*

This provision appears in the present law so that the amendment would not change the existing delegation. It should be noted, however, that in the current Regulations issued under this Section, the authority has been exercised by merely stating that such a trust is to be treated as a trust to which Subpart C applies, "in all respects." It would, therefore, appear that the provision for

regulations prescribed by the Secretary or his delegate could be deleted and the words "in all respects" substituted.

41. *Page 200, Line 18, and Page 201, Line 2, Sec. 341, § 668(b)(5) of the Code*

If compliance with such regulations would be a condition to utilization of the limitation under Section 668(b)(1)(A), the inability to comply for one year out of many might bar a taxpayer, even though he were willing to have the income attributable to such year taxed at the maximum possible rate for such year.

Consideration should be given to providing statutory criteria of proof which would permit a taxpayer to meet his burden of establishing the increased tax which he would have incurred in prior years or the facts concerning the operation and accounts of the trust.

Provision could be made permitting a taxpayer to rely conclusively on the facts shown on his return filed for any prior year with respect to which the statute of limitations has expired.

42. *Page 205, Line 3, Sec. 401, § 1561(a) of the Code*

May be deleted. Covered by § 7805(a).

43. *Page 205, Line 9, Sec. 401, § 1561(a) of the Code*

This delegation would appear unnecessary. As an alternative, it is suggested that the items covered in §§ 1561(a)(1), (2), and (3) should be divided equally among all members of the group unless such members agree to an unequal apportionment.

44. *Page 207 Line 10, Sec. 401, § 1564(a)(2) of the Code*

May be deleted. Covered by § 7805(a).

The statute should be clarified to indicate whether an annual election is permitted.

45. *Page 211, Line 4, Sec. 401(b)(2).*

May be deleted. Covered by § 7805(a).

46. *Page 215, Line 6; Page 216, Line 24; Page 217, Line 17; and Page 218, Line 5, Sec. 401, §§ 46(a)(5), 179(d)(6), 821(f), and 823(c)(3) of the Code*

These delegations would appear to be unnecessary. As an alternative, it is suggested that the items covered in §§ 1561(a)(1), (2), and (3) should be divided equally among all members of the group unless such members agree to an unequal apportionment.

47. *Page 223, Lines 1 and 2, Sec. 411, § 279(c)(3) of the Code*

We suggest that the delegation of authority to supplement the statute by regulations be deleted. If a method of averaging other than arithmetical is intended, the statute should be clarified in this regard.

48. *Page 225, Line 16, Sec. 411, § 279(g) of the Code*

May be deleted, Covered by § 7805(a).

49. *Page 228, Line 3, Sec. 412, § 453(b)(3) of the Code*

We suggest that this delegation be deleted since the statute appears to be specific. If something more is intended, Congress should so provide.

50. *Page 236, Line 13, Sec. 413, § 6049(a) of the Code*

May be deleted. Covered by §§ 6001 and 7805(a).

51. *Page 241 Lines 3 and 10, Sec. 421, § 305(b)(3) and (c) of the Code*

This has been discussed at length in the Report of the Section of Taxation, October 1, 1969, at pp. 62–63.

52. *Page 244, Line 13, Sec. 431, § 904(a)(4) of the Code*

We suggest that the portion of the sentence following the word "subsection" in line 12 be deleted. If Congress intended something else, then the statute should say so.

53. *Page 244, Line 23, Sec. 431, § 904(a)(6)[1] of the Code*

We suggest deleting the reference to regulations and starting the sentence with "If" (line 24).

54. *Page 248, Line 13, Sec. 431, § 904(g) (3) of the Code*
This delegation appears to lack the requisite standards.

55. *Page 263, Line 17, Sec. 442, § 7701(a) (19) of the Code*
May be deleted. Covered by § 7805(a).

56. *Page 264, Line 1, Sec. 442, § 7701(a) (19) of the Code*
May be deleted. Covered by § 7805(a).

57. *Page 272, Line 23, Sec. 461(c)*
If the effective date of this section is continued, the transitional problems should be covered by express statutory provisions. The statute might provide that net losses occurring on or before the July 31, 1969 effective date should either (i) offset pro tanto net gains realized during the same taxable year after such date, or (ii) offset only such amount of such gains as is in proportion to the comparative tax rates before and after such dates (*i.e.*, such gains might be offset only to the extent of 25/30ths, or 83⅓%, of such losses).

58. *Page 278, Line 13, Sec. 501, § 636(c) of the Code*
We believe that § 7805(a) adequately covers this situation; but, if not, then Congress should spell out its intention more specifically in the statute.

59. *Page 282, Line 7, Sec. 511(c)*
The delegation of authority should be deleted, and the statute should specify the policy to be applied during the transition period. This would include (1) whether or the extent to which net gains or losses realized before the effective date of the Act should offset net gains or losses realized after such date; and (2) whether net gains realized before the effective date will be subject to the alternative tax rate.

60. *Page 291, Line 3, Sec. 515, § 402(a) (5) of the Code*
May be deleted. Covered by § 7805(a).

61. *Page 292, Line 2, Sec. 515, § 403(a) (2) (C) of the Code*
May be deleted. Covered by § 7805(a).

62. *Page 302, Line 15, Sec. 521, § 167(j) of the Code*
May be deleted. Covered by § 7805(a).

63. *Page 303, Line 14, Sec. 521, § 167(k) of the Code*
May be deleted. Covered by § 7805(a).

64. *Page 305, Line 2, Sec. 521, § 167(k) of the Code*
We suggest deletion of the words "pursuant to regulations prescribed under this subsection" (Line 2). Covered by § 7805(a).

65. *Page 308, Line 6, Sec. 521, § 167(c) (3) of the Code*
May be deleted. Covered by § 7805(a).

66. *Page 318, Line 10, Sec. 601, § 103(b) (2) of the Code*
Reference to time and manner should be deleted since these are covered by § 7805(a), but if the election is to be subject to any conditions, they should be specified in the statute.

67. *Page 318, Line 18, Sec. 601, § 103(c) of the Code*
The delegation should be deleted and the statute should define an "arbitrage obligation."

68. *Page 340, Line 24, Sec. 704, § 168(b) of the Code*
May be deleted. Covered by § 7805(a).

69. *Page 345, Line 3, Sec. 704, § 168(f) of the Code*
This is a delegation lacking specific standards. A possible standard might be that portion resulting from direct (or possibly indirect) expenditures for the construction (or the acquisition) of a certified pollution control facility.

70. *Page 348, Line 9, Sec. 705, § 451(m) of the Code*
May be deleted. Covered by § 7805(a).

71. *Page 353, Line 8, Sec. 801, § 4(c) (3) of the Code*
May be deleted. Covered by § 7805(a).

Senator TALMADGE. Mr. Chairman, Mr. Crampton, I want to commend you and those of the section on taxation of the American Bar Association for a thorough and comprehensive report that you have made on the bill. I am sure that it will be of material help to the committee.

Assistant Secretary Cohen has referred to this bill as a bill for the relief of tax lawyers and accountants. Do you think that is an accurate appraisal of the bill?

Mr. CRAMPTON. Well, perhaps to a certain extent we are endeavoring to deprive ourselves of some business, because we are asking that efforts be made to clarify this bill. We believe that it is exceedingly complex, and in 87 pages we have pointed out any number of areas where we suggest that improvement should be made.

Senator TALMADGE. I understand that you think it was rather hastily and imprecisely drawn, and needs correcting in a lot of places.

Mr. CRAMPTON. We do think there are a number of areas where it should be improved and the details should be spelled out; yes, sir.

Senator TALMADGE. Do you think the bill could be improved if more time were devoted to those sections of the bill that are obviously complex, argumentative, unclear, and in some instances inadequate to achieve the purpose for which they were written?

Mr. CRAMPTON. We feel the bill can be improved. We do not want to be—you asked about more time—we do not want to be in the position of urging any delay or being against tax reform in general, but we do think that if it takes more time to come up with clear answers on some of these questions, here again I am speaking in sort of a representative capacity, but if I estimate the tenor of our council right, I believe they would urge you to take the time to do a thorough job. I might ask my associates if any of them feel differently.

Senator TALMADGE. Thank you.

The CHAIRMAN. Thank you very much, sir.

(Scott F. Crampton's prepared statement follows. Oral testimony of the next witness commences at p. 5208.)

STATEMENT OF SCOTT F. CRAMPTON, CHAIRMAN, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION

This report has been prepared by the Section of Taxation and has not been approved by the House of Delegates or the Board of Governors of the American Bar Association, and should not be taken as representing the opinions, views, or action of the American Bar Association, its House of Delegates, or Board of Governors, unless expressly so stated herein, but only the opinions, views, or action of the Section of Taxation.

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Sec. 513. Letters, Memorandums, Etc.
Letters, Memorandums, Etc.
Sec. 515. Total Distributions from Qualified Pension, Etc., Plans.
Total Distributions from Qualified Pension, Etc., Plans.
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Other Changes in Capital Gains Treatment.

Subtitle C—Real Estate Depreciation

Sec. 521. Depreciation of Real Estate.
Depreciation of Real Estate.

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Qualified Pension, Etc., Plans of Small Business Corporations.

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Fifty-Percent Maximum Rate on Earned Income.
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Collection of Income Tax at Source on Wages.

SECTION OF TAXATION

AMERICAN BAR ASSOCIATION

REPORT ON H.R. 13270 91ST CONGRESS, 1ST SESSION

INTRODUCTORY

This report of the Section of Taxation of the American Bar Association on H.R. 13270, 91st Congress, 1st Session, The Tax Reform Act of 1969, has been prepared for submission to the Senate Committee on Finance in connection with its hearings on the bill. The report represents only the opinions, views, or action of the Section of Taxation, and nothing herein is to be construed as representing the opinions, views, or action of the American Bar Association, its House of Delegates, or Board of Governors, unless expressly so stated herein.

The Section believes that the bill makes many desirable reforms in the Internal Revenue Code. However, to conserve time we have largely limited our report to comments on problems of statutory draftsmanship, undue complexity in the structure of the tax law, and alternative methods of accomplishing the same general objectives.

There are two recurring problems that merit preliminary comment. The first is the retroactive effective dates and the second is the delegation of legislative powers.

The Section of Taxation has heretofore adopted the following policy on retroactivity:

Retroactivity is determined with reference to the date upon which the amendment becomes law. It is recognized that in some cases publicity attendant upon a proposed amendment may induce taxpayers to take advantage of an existing "loophole." Nevertheless, the foreclosure of such last-minute tax avoidance is considered less important than the preservation of the principle that a taxpayer may rely upon an existing statute in planning his affairs.

We urge that the principles be applied to the fullest extent possible in this bill.

There are many instances where the bill provides for supplemental details to be provided by Treasury Regulations. In some sections the bill provides standards to be followed by the Secretary of the Treasury or his delegate. However, in many sections no standards are provided.

The Section of Taxation after prolonged consideration adopted the following suggested statement of policy in this regard:

Since the Treasury has the general statutory power to issue reasonable regulations, an express delegation of the legislative function to the Treasury in a particular statute serves no useful purpose. The legislative program should be scheduled so that there is sufficient time to incorporate all major policy decisions within the statute. It may be appropriate, however, for the statute to indicate that specified procedures and administrative detail are to be prescribed by regulation.

We urge the Committee to give serious consideration to these principles when reviewing the many delegations of rulemaking power.

TITLE I—TAX EXEMPT ORGANIZATIONS

Subtitle A—Private Foundations

SEC. 101. PRIVATE FOUNDATIONS

Bill pp. 5–6, § 101(a) [IRC new § 506]

Tax on Investment Income

1. This provision appears to be designed primarily to raise funds to pay the increased expenses of the Internal Revenue Service in administering the audit program for private foundations under the Tax Reform Act of 1969. The rate of tax, therefore, should be only that which is reasonably necessary to raise the required funds. We recommend that, in lieu of a tax on income, an excise tax be imposed on all receipts from all sources of private foundations. Such a change would simplify the statute as well as simplify the computation of the tax. We believe that a tax on receipts would be as accurate a measure of audit costs as a tax on net investment income.

2. If the section is enacted, the following changes are recommended. Section 506(b)(3) of the bill provides that the deductions from gross investment income

allowable in determining net investment income of a private foundation are in substance those now available to individual taxpayers under the first two paragraphs of section 212 of the Internal Revenue Code. Presumably, therefore, such deductions would not include those allowed under the third paragraph of present section 212 (expenses incurred in connection with the determination, collection, or refund of any tax) even though such expenses might be incurred in connection with the determination of the taxes imposed by sections 506, 507, and chapter 42 of the bill. We recommend the allowance of a deduction for such expenses.

Similarly, the bill does not provide for a deduction for interest, taxes, losses, bad debts, amortizable bond premium, depletion, or depreciation with respect to investment assets. We believe that such deductions should be allowed in determining net investment income subject to the tax. Note that the Report of the Ways and Means Committee (H. Rep. No. 91-413, 91st Cong., 1st Sess., Parts 1 and 2, hereinafter referred to as "House report, par —") specifically states that a deduction for depreciation will be allowed. (House report, part 2, p. 2).

Section 506(b)(4)(B) provides that in determining net capital gain or loss of private foundations "there shall be taken into account only the sale or other disposition of property" used to produce gross investment income or unrelated business income except to the extent accounted for under section 511. It is not clear whether the capital gain income intended to be taxed is only that which otherwise would be taxable under applicable provisions of the Internal Revenue Code. The use of the word "disposition" would appear to include gains that are not otherwise recognized as, for example, those arising from involuntary conversion or in connection with tax free reorganization exchanges.

Bill pp. 6-11, § 101(a) [IRC new § 507]

Tax on Termination of Private Foundation Status

1. This section is highly complex and contains serious procedural deficiencies. Consideration should be given to an alternative provision which would permit a private foundation desiring to terminate its status to do so free of penalty by transferring its assets to a charity qualifying as public under section 170(b)(1)(B) as amended by the bill. If the Secretary or his delegate gives a private foundation notice of termination of its status pursuant to section 508(e), no tax would be assessed for a reasonable period, pending action by the appropriate State authority to transfer the assets of the foundation to another charity under the applicable State law relating to the doctrine of cy pres. If the State does not act within this period, a tax equal to 100 percent of the assets would be imposed.

2. If section 507 is enacted in its present form, a transition period should be provided to permit existing section 501(c)(3) organizations to determine through rulings whether they are private foundations and, if so, what they may be required to do to convert themselves into public organizations meeting the qualifications of section 170(b)(1)(B).

Section 507(e) provides that the Secretary or his delegate *may* abate the unpaid portion of any tax imposed under section 507(a) if the private foundation satisfies the requirements of section 507(e). The abatement should be mandatory not discretionary.

Section 507(f) provides that in the case of a substantial contributor (anyone who contributes more than $5,000 in any year) the disallowance of the deduction will relate back to the date of the first act of the foundation culminating in the loss of its exemption. This unrealistically assumes that a substantial contributor will have knowledge of such act and be in a position to prevent it. Furthermore, subsection (f) applies to estate tax deductions and hence, the disqualifying act may occur after the date of death.

Bill pp. 11-15, § 101(a) [IRC new § 508]

Special Rules with Respect to Section 501(c)(3) Organizations

Section 508(b) provides that any organization described in section 501(c)(3) which does not notify the Secretary or his delegate that it is not a private foundation shall be presumed to be a private foundation. A further provision should be added to subsection (b) to provide that late filing of such notification, if not delinquent after specific notice to the foundation, will prevent the automatic classification of the foundation as a private foundation.

In section 508(c) there is no need to state expressly that churches and schools *may* be exempted from these procedures, since the general authority given to exempt any class of organization would cover such organizations.

In section 508(e), the termination of status tax under section 507 can be invoked by the Secretary or his delegate if the organization so acts as to give "rise to liability for tax under chapter 42," i.e., the taxes on self dealing, failure to distribute income, etc. The following points are not clear:

a. Must the liability for tax under chapter 42 be finally determined before the termination of status tax under section 507 can be invoked? Or is it enough that a notice of deficiency for tax under chapter 42 be issued? Or is it enough that the Internal Revenue Service merely assert, as on field audit, that there is such a deficiency?

b. Will a final determination that there is no liability under chapter 42 necessarily preclude the tax under section 507?

c. No statute of limitations has been provided for the assessment of the tax under section 507 (see page 64, line 3, of the bill). Some reasonable limitation period should be provided.

d. A drafting problem arises on page 12, line 21, and page 13, lines 9 and 14, in referring to subsection (e) as a section with which the organization "has complied" because subsection (e) of section 507 involves a discretionary abatement of tax by the Secretary. "Compliance" is up to the Secretary, not the organization.

The requirement of section 508(g) that the governing instrument of the private foundation contain certain provisions is unnecessary. The statutory requirements for exemption are clearly set forth in section 501(c)(3). The addition required by section 508(g) merely restates the operational tests for continued exemption elsewhere required by the bill. To require the change in governing instruments to include the stated provisions would impose undue hardships on many thousands of tax exempt organizations. To receive and file the amended instruments would also be an unnecessary burden upon the Internal Revenue Service. State agencies and courts would likewise be burdened in making or authorizing the making of the unnecessary changes.

Bill p. 15, § 101(a) [IRC new § 509(a)]

Private Foundation Defined

1. Section 509(a)(2) sets forth the test for determining whether an organization receives adequate public support to avoid the definition of private foundation. It is not evident why subparagraph (B) states that no more than one-third of the foundation's support can come from investment income. For aught that appears, the investment income could have been generated from an endowment that was received from public contributions. It should be sufficient that one-third of the total support comes from gifts and the specified related sources.

2. Clarification is needed for the meaning of the term "grants," particularly whether grants are in the nature of gifts (as referred to in new section 509(a)(2)(A)(i) and in section 102) or income (as referred to in new section 509(a)(2)(A)(ii) and in section 61). If, for example, a research grant is received that contemplates the preparation of a report, it might be treated either as a grant under clause (i) or a fee for performance of services under clause (ii). If such a grant is treated as a grant under clause (i), the 1 percent test of clause (ii) would not apply.

3. Section 509(a)(3) excludes from the definition of a private foundation an organization which is organized, and at all times is thereafter operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of, one or more organizations described in paragraph (1) or (2). The Congressional intent should be clearly expressed whether private foundation status exists in the following cases: (1) a trust which was originally established for private and public purposes (i.e., for the benefit of private annuitants and charity), but which later becomes operated solely for public purposes (i.e., upon the death of the private annuitants); and (2) an organization with a defective charter which could be amended ultimately to satisfy the "organized" test.

4. There appears to be no reason why an exempt charitable organization which is operated "in connection with" two or more qualified institutions should not be protected as well as one which serves only *one* qualified institution. Section 509(a)(3)(B), on page 16, appears, however, to apply only to the *one* institution situation.

5. Some attempt should be made to define the term "support" since the present use of that term under Regulations section 1.170-2(b)(5)(ii) may not be entirely consistent with the scope intended of section 509(a)(2). For example, under the section 170 regulations, support excludes amounts received in further-

ance of an exempt function and includes unrelated business income. Section 509 (a)(2) suggests that support includes amounts received in furtherance of an exempt function and excludes amounts received from an unrelated trade or business.

6. On page 16 of the bill, line 21, the word "and" should be changed to "or." Otherwise all paragraphs of section 509(a) would have to apply in order for an organization to escape classification as a private foundation. The intent clearly is that any one of the four paragraphs defines an organization which will escape classification as a private foundation.

Bill pp. 17–25, § 101(b) [IRC new § 4941]

Tax on Self-dealing

1. In section 4941(e)(3) the phrase "dealing under the highest fiduciary standard" is used. It is not known what this means or to what standards the provision refers unless the self-dealer in effect becomes an insurer.

2. The definition of "correction period" in section 4941 uses different language than the definition of "correction period" in sections 4942 and 4943. In those sections the "correction period" may be extended for a period determined to be "reasonable and necessary" to make the correction, whereas in this section the "correction period" may be extended for a period which is "conducive to bringing about correction." The reason for this difference is not clear.

3. Subsection (c) is ambiguous as to the liability of a foundation manager where it provides under subsection (c)(1) that the liability shall be joint and several and in subsection (c)(2) that the liability shall not exceed $10,000 as to a foundation manager. If the liability is joint and several under subsection (c)(1), it might exceed $10,000 regardless of subsection (c)(2).

4. Reference is made to the definition of a government official in section 4946(c). It would seem that a government official could be defined in something less than a page and a half of a statute—e.g., "an employee who receives an annual salary of $15,000 or more, and his personal or executive assistant or secretary."

5. In subsection (d)(2)(E) the word "reasonable" should be substituted for the words "not excessive."

6. One of the effective date provisions (Bill p. 81) exempts the sale to a disqualified person of property owned by the foundation on May 26, 1969 if such sale is necessary to comply with the rules on excess business holdings (section 4943). This provision should be cross-referenced in section 4941 to section 101(k)(2)(B) of the bill.

Bill pp. 25–34, § 101(b) [IRC new § 4942]

Tax on Failure to Distribute Income

1. The House report, part 1, pp. 26–27, states that the tax is imposed for each year until the private foundation is notified of its obligation to make distributions or until the foundation itself corrects its earlier failure by making the necessary payouts. The fact that there is an annual tax is by no means clear from reading section 4942(a). The purpose of the parenthetical clause beginning on line 25 of page 25 is not clear.

Neither is it clear when and how the tax liability is to be determined. Presumably the private foundation will not be confronted with an assertion of liability until the Secretary or his delegate sends a notice of deficiency. This could be some years after the asserted failure to distribute income.

2. On page 26, lines 15 and 16 and on lines 19 and 20, reference is made to "any time" in determining when income of a private foundation is undistributed. There is no apparent reason why the determination of the amount of undistributed income cannot be made as of the end of an annual accounting period or taxable year. It seems plain, however, that it was not intended to do so, because the provision just mentioned, taken in connection with new section 4942(h) on page 31, indicates that tracing will be needed in order to determine, *during* any taxable year, whether a distribution is from income of the immediately preceding taxable year or from income of the taxable year. Such tracing will entail complications of accounting. It would seem preferable to use the concept employed in personal holding companies, i.e., treat a distribution within a limited period after the close of a year as having been made from the preceding year's earnings.

3. Section 4942(e) refers to the minimum investment return "for any taxable year." This is computed by applying the applicable percentage to the fair market

value of the foundation's assets. Paragraph (2) describes the valuation to be used. The value of securities for which quotations are readily available is to be determined on a monthly basis. Other assets are to be valued at such times and in such manner as the Secretary or his delegate shall by regulations prescribe.

In the House report, part 1 at page 25, it is said that the base upon which the applicable percentage rate is to apply is the average value of the non-charitable assets during the taxable year. Paragraph (2) of the bill on page 27 should state that the value should be an average one. Preferably, however, the computation of the base upon which to compute the minimum investment return should be the lowest fair market value during the foundation's taxable year.

Use of an annual instead of a monthly valuation procedure is consistent with other provisions of the bill. See, for example, bill page 115 at line 7 and page 137 at line 6.

4. In section 4942(e) (3) the applicable percentage for taxable years beginning in 1970 is 5 percent. Presumably this is deemed to be an appropriate yield for 1970 on income producing property. If it is, the use of the 5 percent figure leaves out of account the previously imposed burden of the tax on investment income imposed by section 506, and the 5 percent figure should be reduced accordingly. Alternatively, the section 506 tax should be included as a qualifying distribution under section 4952(g).

There is a fundamental question whether 5 percent is the correct percentage to use for 1970. Based upon many economic studies and surveys, and the Dow Jones industrial average, 3½ percent figure would appear to be more reasonable. The use of 5 percent may require continuing corpus distributions from foundations which are funded substantially with equities instead of fixed obligations.

5. Section 4942(f)(3)(A) allows as deductions in computing adjusted net income only the deductions that are ordinary and necessary expenses paid or incurred for producing or collecting gross income or for the management, conservation or maintenance of property held for the production of such income. These are the deductions allowed by section 212 except for the deduction provided in section 212(3) for ordinary and necessary expenses paid or incurred in the taxable year in connection with the determination, collection, or refund of any tax. Thus, no deduction would be allowed for expense of contesting the tax incurred under chapter 42, for example, on the failure to distribute income. This does not seem equitable.

Deduction is not, but should be, allowed for interest, taxes, losses, bad debts, amortizable bond premium, depletion, and depreciation with respect to investment assets.

6. As noted above, a payment of the tax under section 506 should be treated as a qualifying distribution unless the applicable percentage is changed to accommodate the impact of the section 506 tax in determining the minimum investment return under section 4942(e).

In defining a qualifying distribution there is no provision in subparagraph (A) to treat as a qualifying distribution amounts required to be disbursed in defraying costs of administering the charitable program and costs incurred in earning investment income. These amounts should be deducted before a tax is asserted for failure to distribute either the minimum investment return or the adjusted net income.

7. Section 4942(g)(1)(A) excludes from classification as a qualifying distribution an amount paid to an organization "controlled (directly or indirectly)" by one or more disqualified persons. A definition of the quoted phrase should be included or provided by cross-reference. Does control mean ownership of stock having 51 percent or 80 percent of the voting power? Do the attribution rules apply in determining control?

Section 4942(g)(1)(B) treats as a qualifying distribution any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B). If a distribution is made in the acquisition of an asset which the Internal Revenue Service claims is not used directly in carrying out one of the stated purposes, the fact is that the distribution will nevertheless have been made and no income will remain after the expenditure from which to pay a tax which would result from not having the benefit of the qualifying distribution. Moreover, the shortage of qualifying distributions thus occasioned would be a permanent condition which would continue indefinitely with the result that the income so used would each year during the continued existence of the foundation be subject to the 15 percent tax imposed by section 4942. If that is the intention of Congress, it should be clearly stated.

Section 4942(g)(2) should be worded so as to permit a foundation to set aside income where controversy has developed over potential liability for taxes, legitimacy of the charitable trust or proper application of income or corpus in suits by heirs, and similar circumstances dictating needs to accumulate earnings which are not strictly charitable.

8. Section 4942(h)(1) provides that distributions made during a taxable year shall be treated as made, first out of undistributed income of the immediately preceding taxable year, second out of undistributed income for the taxable year, and finally out of corpus. The extent to which annual accounting periods will be ignored for purposes of determining the source of distributions is not clear.

The distribution is treated as first out of undistributed income of the immediately preceding taxable year "(if the private foundation was subject to the tax imposed by this section for such preceding taxable year)." A question arises when the allocation of the distribution to the undistributed income of the immediately preceding taxable year can occur. Is it (a) after there has been a final determination of tax liability under section 4942, (b) after a notice of deficiency is sent, (c) after the assertion of such liability upon field audit, or (d) merely because a private foundation is subject to the provisions of section 4942 whether or not a tax is in fact due under that section? Perhaps the phrase "subject to the tax" should be changed to "liable for tax."

It is not clear what purpose is served by the sentence appearing in section 4942(h)(2) in lines 23 and 24 on page 31 stating that "for purposes of this paragraph, distributions shall be taken into account in the order of time in which made." This raises the same questions noted earlier about the making of determinations otherwise than on an annual accounting basis.

Section 4942(h)(2) provides that in the case of any qualifying distribution which is not treated as made out of the undistributed income of the immediately preceding taxable year, the taxpayer may elect to treat any portion of such distribution as made out of the undistributed income of a designated prior taxable year or out of corpus. The only distribution that would not have been first charged to income of the immediately preceding taxable year will be undistributed income of the current taxable year. Thus, the foundation's election is only as to which of its items of undistributed income will remain subject to tax, namely, the undistributed income of a designated prior taxable year or of the current taxable year. It is not evident why this election has any significance since in any case the undistributed portion will continue to bear the 15 percent tax imposed by section 4942.

9. Section 4942(j)(3) defines an operating foundation. To be such, with the attendant advantages, it is provided in subparagraph (B)(i) that substantially more than half of the assets must be devoted directly to the exempt functions. There is a question as to the meaning of "substantially more than half." In some tax areas, even half is a substantial amount. What, then, is the meaning of substantially more than half? A more precise definition is needed. If two-thirds is intended, it should be stated.

10. Instead of describing assets "devoted directly" to the exempt activities, it would seem preferable to describe them as they are elsewhere in the bill, i.e., as "used (or held for use) directly" in carrying out the activities. See for example, section 4942(e)(1)(A), page 27, line 8.

In section 4942(j)(3)(B)(ii), reference is again made (page 34, line 8) to "support" of the organization. As noted above, a definition of "support" is needed.

In section 4942(j)(3)(B)(ii) (page 34, line 11), reference is made to 5 or more "exempt" organizations. A more precise reference should be made to organizations exempt under some particular section of the Code. It is not adequate to refer merely to 5 or more exempt organizations which are *not* described in 4946(a)(1)(H). Is the phrase "exempt organizations" intended to mean any organization exempt under any of the provisions of section 501(c)?

11. In numerous places in the bill the Secretary or his delegate is directed to determine various matters relevant to the determination of the tax imposed by section 4942.

On page 27, line 19, the Secretary or his delegate is directed to prescribe regulations setting forth the times and manner of determining the fair market value of a foundation's assets other than securities for which market quotations are readily available. Regulations already exist on the subject of valuation for a variety of purposes. A further valuation regulation hardly seems warranted.

On page 28, line 1, the Secretary or his delegate is directed to proclaim an applicable percentage figure to use in determining the minimum investment return and is directed to produce a rate that bears a designated relationship to the 5 percent figure that appears in the statute. The designated relationship involves a determination of money rates and investment yields which the Secretary is being asked to compute.

On page 30, line 21, the Secretary or his delegate is directed to prescribe the terms and conditions upon which the set-asides can be established and on page 31, line 2, the Secretary must be satisfied that the set-aside will be paid out within the specified period. Also, on page 31, line 9, the Secretary or his delegate for good cause shown can extend the payout period.

On page 32, line 10, the Secretary or his delegate is directed to prescribe by regulations the basis upon which the taxpayer may elect to treat a portion of a distribution as being made out of undistributed income of a designated prior taxable year or out of corpus.

On page 33, line 17, the Secretary or his delegate is directed to determine what time is reasonable and necessary in which to permit a distribution of undistributed income to be made.

It is submitted that the administration of section 4942 places an undue administrative burden upon the Secretary or his delegate. Means should be provided to be more specific in the statutory language, to avoid the necessity of involving the Secretary or his delegate in so many policy determinations.

Bill p. 34–42, § 101(b) [IRC new § 4943]

Taxes on Excess Business Holdings

1. Section 4943(c)(4) (B) and (C) provides for 2- and 5-year interim dispositions of excess business holdings. Consideration should be given to the necessity for such provisions. They serve only to evidence the good faith of the foundation in commencing to comply with the 10-year grace period for divestiture of its excess business holdings. Furthermore, in the case of closely held stock it may not be possible to dispose of 10 percent of the excess holdings at a fair price, if at all.

The 2-year 10-percent rule may be avoided upon proof of hardship coupled with proof that control of ten percent of the excess interest will be exercised by persons other than the foundation or a disqualified person. By whom would such control be exercised? To whom can a fiduciary properly transfer the right to control a portion of its investment? What is accomplished by establishing third-party control of such a small portion of the stock?

2. Section 4943(c)(4) provides a 10-year grace period for disposition of excess business holdings held on May 26, 1969. Paragraph (5) provides that in the case of holdings acquired by will, the 10-year grace period will commence to run on "the date of acquisition by will" instead of May 26, 1969, if the will is executed on or before July 28, 1969 and if the terms thereof are in effect on July 28, 1969 and at all times thereafter.

The meaning of the language "under the terms of a will executed on or before July 28, 1969, which are in effect on such date and at all times thereafter" is not clear. It would seem that the terms take effect only upon the death of the testator. If in fact the controlling date is the date of execution of the will, then the 2-, 5- and 10-year periods may be lost because the death of the testator may occur after the expiration of such periods. The effect of the execution of a codicil is not clear. Will it destroy the July 28, 1969, date if the original will was executed on or before that date?

3. Section 4943(c)(3) attempts to equate non-corporate business holdings with corporate holdings. It provides that in case of a partnership or a joint venture, a "profits interest" shall be substituted for "voting stock" and "capital interest" shall be substituted for "non-voting stock." As a catch-all, the bill provides that in any other case "beneficial interest" shall be substituted for "voting stock." Whether a foundation's interest in a partnership is in profits or in capital is not determinative of the nature or extent of its voice in partnership affairs. It would seem more appropriate in this context to equate general partnership interests with voting stock and limited partnership interests with non-voting stock.

Bill pp. 42–43, § 101(b) [IRC new § 4944]

Investments Which Jeopardize Charitable Purpose

Section 4944 states that if a private foundation invests any amount in such a manner as to jeopardize the carrying out of its exempt purposes, a tax is imposed on the making of such investment equal to 100 percent of the amount so invested.

The House report, part 1, p. 31, states that the purpose of the new section is to apply the same basic tests to the investment of assets as presently are applied to the investment of income under section 504(a)(3) although the latter section would merely cause loss of exemption instead of the 100 percent tax as currently proposed. Present section 504(a)(3), after which section 4944 is patterned, has not been amplified by regulations since its enactment 19 years ago.

The tax may be unduly harsh. For example, if the foundation invests $1,000 of its funds in a way which is deemed to jeopardize the carrying out of its exempt purpose and if the investment declines in value to $500, the proposed new tax would require payment of $500 from the foundation's other assets. By hypothesis, only $500 remains from the imprudent investment but there will be a tax of 100 percent of the original $1,000 investment.

The House report, part 1, p. 31, states that "it is expected" that the 100 percent tax could be avoided where a State attorney general exercises his power to preserve the foundation's assets for charity by appointing new trustees, by requiring the distribution of the offending foundation's assets to a public charity, "or by taking other appropriate action." It is not apparent, however, where that relief is provided.

Bill pp. 47–51, § 101(b) [IRC new § 4946]

Definitions and Special Rules

1. In the case of excess business holdings, section 4943, consideration should be given to excluding from the term "substantial contributor" members of the substantial contributor's family (and corporations, etc. controlled by them) if the substantial contributor made his contribution more than 10 years prior to the questioned transaction or activity. Likewise, for the purposes of section 4941, perhaps a substantial contributor should cease to be such after 10 years. It is questionable whether members of the family of an individual donor, dead perhaps 30 years, should be treated as per se disqualified persons where the family's own involvement in recent years would not make them in their own right disqualified persons.

2. The term "substantial contributor" is defined in section 507(b)(2) and section 4946(a)(2). It is used not only in connection with the excise tax provisions but also in connection with the requirement of filing public information returns (§ 6033(b)(5)), making the names of such persons part of the return. It is not known whether a separate standard is to apply or whether failure to cross-reference the definition was intended to allow the use of a higher or lower figure (other than $5,000) which may be prescribed by regulations.

3. With respect to the attribution rules contained in section 4946, attention is invited to the position of the American Bar Association as to the desirability of uniformity and simplicity in the attribution rules throughout the Internal Revenue Code. (*Tax Lawyer*, Vol. XXI, No. 4, pp. 921–930; *Tax Lawyer*, Vol. 22, No. 3, pp. 449–450; ABA Reports, 1969, Vol. 94, p. —). The rules set forth in section 4946 are not consistent with this position.

4. In the definition of a disqualified person for purposes of section 4943 (§ 4946(a)(1)(H)(i)) reference is made to a private foundation "which is effectively controlled (directly or indirectly)." Contrast this with section 4942(g)(1)(A) which refers to an "organization controlled (directly or indirectly)." Is there a difference between "controlled" and "effectively controlled"?

Bill pp. 56–57, § 101(c) [IRS new § 6684]

Assessable Penalties for Repeated, or Willful and Flagrant, Acts Under Chapter 42

1. The taxes imposed under chapter 42 are, in reality, penalty taxes, in most cases, particularly in the case of taxes imposed after the expiration of the correction period. In such instances this additional penalty seems too onerous both in circumstances of application and amount. It seems incongrouous for this penalty to be twice the civil fraud penalty, and to be imposed in addition thereto. Section 101(f) of the bill and section 101(j)(50) of the bill make the civil fraud penalty applicable to chapter 42 taxes. It would seem that the 50 percent civil fraud provision is adequate for chapter 42 taxes.

2. The 100 percent penalty provision has several defects. The penalty is imposed whenever a person has "theretofore been liable for tax" under chapter 42. Under chapter 42, a tax is imposed on self-dealing; another tax is imposed on failure to distribute income; another tax is imposed on excess business holdings;

another tax is imposed on investments which jeopardize charitable purposes; and other taxes are imposed on certain expenditures which are considered improper for a private foundation. The effect of this penalty, as now written, is to impose a penalty for a tax on one activity by reason of one having previously been liable for a tax on another activity. At the very least, the words "such section" should be inserted in line 22 on page 56 of the bill in place of the words "such chapter." The penalty is also imposed if the act or failure to act is both willful and flagrant. The word "flagrant," which is unknown in the tax law, has many connotations. Its use would undoubtedly result in much litigation to interpret its meaning in this context.

Bill pp. 57–60, § 101(d) [IRC amended § 6033 (a) and (b)]

Information Returns of Exempt Organizations

1. The "efficiency" standard of section 6033(a)(2) undoubtedly contemplates excusing small organizations from filing an annual return. It would be preferable if a statutory exception were provided for organizations with less than $5,000 in gross receipts or assets excusing them altogether. Such a provision is appropriate because the potential for abuse in small organizations is minimal; the organizations probably rely on volunteer assistance (not necessarily trained in accounting procedures); and the information would probably be of interest to few, if any, members of the public.

2. The amendment to section 6033(b)(5) would appear to be an unnecessary invasion of the privacy of charitably inclined individuals. It might serve to curtail donations. It appears to serve no substantial tax purpose. It might be well to provide that contribution information would be required only for use by the Internal Revenue Service in its enforcement program for cross checking individual and corporate tax returns with exempt organization information returns. (*Cf.* Treas. Reg. § 1.170–1(a)(3)(iii) and § 1.6033–1(a)(4)(i), and instruction 17, Form 990–A.)

It may be desirable to require an information return to be filed upon the termination or liquidation of an exempt organization similar to that now required for non-exempt corporations under section 6043.

Bill pp. 60–61, § 101(e) [IRC new § 6104(c)]

Publicity of Information Required by Certain Exempt Organizations

Section 6104(c)(1)(C) provides for furnishing any information relevant to "any determination under State law." This provision seems unduly broad, as it would permit the Internal Revenue Service to furnish information relevant not only to the organization, but also apparently to its donors, officers, donees, etc. To that extent it constitutes an extension of present rules applicable to publication of information by the Internal Revenue Service. It would seem appropriate that the statute itself provide that the disclosure of information be relevant only to determinations under State law that relate to the satisfaction of its charitable purpose by the organization or its liability under State tax laws.

Bill p. 62, § 101(f) [IRC amended §§ 6211(a), 6212(c)(1), and 6213]

Petition to Tax Court; Deficiency Procedures Made Applicable

Sections 6211(b)(2), 6212(a), 6212(b)(1), and 6213(a), and the title of subchapter B of chapter 63, subtitle F of the Code should be amended so as to reflect the inclusion of chapter 42 taxes.

A provision should also be added to give the Tax Court jurisdiction in the case of penalties imposed under section 6652(d) (penalties in connection with failure to file an exempt organization information return).

Bill pp. 63–64, § 101(g)(2) [IRC new § 6501(c)(7)]

Termination of Private Foundation Status

Section 101(g)(2) provides that "In the case of a tax on termination of private foundation status under section 507, such tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time."

This appears to be a provision relieving the Commissioner of the necessity of assessing a tax prior to its collection, which would have ramifications throughout the Internal Revenue Code. It would also seem to prohibit the application of *any* statute of limitations to such collection. The only similar provisions are

contained in sections 6501(c)(1) (relating to false returns); 6501(c)(2) (relating to willful attempt to evade tax); and 6501(c)(3) (relating to failure to file a return). The American Bar Association has recommended an eight-year limitation in the case of fraudulent returns and the non-fraudulent failure to file returns. (ABA Reports, 1956, Vol. 81, p. 397; ABA Reports, 1961, Vol. 86, pp. 123, 125, 329–30).

Section 507 is a confiscatory tax equal to prior net tax benefits to the foundation and its substantial contributors or, in the case of lack of records, the net value of the foundation assets. The tax under section 507 can be imposed only upon (1) voluntary termination by the foundation of its status by notification to the Secretary of the foundation's intent to terminate (section 508(d)), or (2) termination of foundation status by the Secretary for "willful repeated acts (or failures to act)" or "a willful and flagrant act (or failure to act)." (Section 508(e)).

In either case the Secretary would have actual notice of the termination and could assess the tax within the normal three-year limitation period.

In the event that a limitation period is placed upon the assessment of tax under section 507, an appropriate amendment should be made in proposed section 6501(c)(7) to provide that in the event a tax is imposed under section 507(a), by virtue of termination of status under section 508(d) or (e), the tax may be assessed or action for collection without assessment may be begun within the three years after the date of notification to the Secretary of voluntary termination of status under section 508(d), or notification by the Secretary of termination of status under section 508(e).

It would also be necessary to amend section 6511 relating to limitations on credit or refund, to provide that a claim for credit or refund of a tax imposed under section 507 must be filed within the period prescribed by section 6501(c)(7) for the assessment of a tax.

Also, amendment of other chapters of the Code would be essential if chapter 42 is enacted. Chapters requiring special attention in this connection are chapter 64 (Collection), chapter 65 (Abatements, Credits and Refunds), chapter 70 (Jeopardy, Bankruptcy and Receiverships), and chapter 71 (Transferees and Fiduciaries).

Bill p. 64, § 101(g)(3) [IRC new § 6503(h)]

Suspension Pending Correction

Although it would seem proper to allow an extension to be made to encourage the correction of improper action, either by the foundation or by action of a State, the proposed section would allow the Secretary to extend the period for *any time* without limit, without the consent of the taxpayer. This would seem to be unduly broad. It is suggested that any extension under this section, without the consent of the taxpayers, should be limited to a specified period of time, such as one year.

Bill pp. 65–66, § 101(i) [IRC new § 7422(g)]

Civil Action for Refund

Contrary to present excise tax refund requirements, proposed section 7422(g)(1) requires that chapter 42 excise taxes must be paid in full (as to the initial or additional tax) before commencing a suit for refund. There should be no requirement that both the tax on the disqualified person (§ 4941(a)(1)) and any participating foundation manager (§ 4941(a)(2)) be paid in full to test the correctness of the assessment.[1] It is unclear whether, in joint assessments, both must join in the refund suit. It should be clear that a satisfactory partial payment by one or the other should suffice. Since the standard of liability as to each participant is distinct (though the transaction is bilateral), the foundation manager should not be required to join in the suit.

Since some of the taxes may be assessed for transactions continuing over a period of years in the taxable period, the taxpayer should be given the right to pay tax for only one year in the taxable period in order to contest the tax. *Steele v. United States*, 280 F.2d. 89, 91 (8th Cir. 1960). The Government would protect its interests by filing a counterclaim as to the remaining tax in dispute.

Bill pp. 66–80, § 101(j)(43) [IRC new § 6214(c)]

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[1] To the extent that *Flora* v. *United States*, 357 U.S. 63 (1959), on rehearing, 362 U.S. 145 (1960), which involved income tax, suggests a contrary rule, it is the position of the American Bar Association that this decision should be overruled by legislation. (ABA Reports, 1961, Vol. 86, pp. 123, 333–334).

Technical, Conforming, and Clerical Amendments

Paragraph (43), page 76 of the bill adds a new subsection (c) to section 6214. This new subsection may create an ambiguity. It appears that the intent of this amendment is to extend the present income and gift tax jurisdictional provision in present section 6214(b) to chapter 42 taxes. The basic problem appears to be due to the use of the phrase "any other tax has been overpaid or underpaid" at the end of new section 6214(c) in lieu of the phrase "the tax for any other year has been overpaid or underpaid." It would seem that consistency of draftmanship and intent would require requires that lines 4 and 5 of paragraph (43) at page 77 of the bill be amended to read "jurisdiction to determine whether or not the taxes under chapter 42 for any other period, act, or failure to act have been overpaid or underpaid."

In subsection 101(j)(50) of the bill the word "overpayment" should be changed to "underpayment."

Subtitle B—Other Tax Exempt Organizations

SEC. 121. TAX ON UNRELATED BUSINESS INCOME

Bill pp. 85–86, § 121(a) [IRC amended § 511(a)(2)(A) and § 511(b)(2)]

Organizations Subject to Tax

It is suggested that there be a parity between exempt corporations and exempt trusts with respect to the rate of tax imposed upon unrelated business income. It is recommended that the rate of tax applicable to section 501(c) trusts should be the rate imposed on corporations under section 11, rather than the individual rates presently imposed upon such trusts.

Bill pp. 87–89, § 121(b)(1) [IRC amended § 512(a)(3)]

Special Rules Applicable to Organizations Described in Section 501(c)(7), (8), (9), or (10)

Under section 512(a)(3)(A), as amended, deductions directly connected with "exempt function income" will not be deductible. This may be inconsistent with the allowance under present Treasury regulations and under the proposed section on "advertising," of a deduction for the editorial costs to arrive at the "net" revenues from advertising. If this is an ambiguity, it should be corrected.

Gains from the sale or exchange of property (used to carry out exempt functions) should not be taxed as they apparently would be under this proposal. See *Mill Lane Club, Inc.*, 23 T.C. 433 (1954); *Cf.* Rev. Rul. 66–149, 1966–1 C.B. 146.

To the extent that charitable and educational expenditures are made from the investment income of social clubs or of organizations exempt under section 501(c)(8), it might be desirable to make such distributions deductible in determining net investment income.

Bill pp. 90–93, § 121(b)(2) [IRC amended § 512(b)(4), (12), (15), and (16)]

Modifications

With respect to the taxability of certain income from controlled corporations, it may be desirable not to define the control requirements as the statute now does by reference to section 368(c) of the Code. Section 368(c) refers to "ownership of stock." A membership organization, organized under a non-profit statute, may not be treated on an equal basis even though it pays rent to its exempt parent.

It may be appropriate to consider a transition rule postponing the effective date of the statute with respect to so-called controlled corporations.

Bill pp. 93–94, § 121(c) [IRC amended § 513(c)]

Advertising, Etc., Activities

If this provision is intended to codify present Treasury regulations relating to advertising profits derived from publications of exempt organizations, it should be appropriately limited. As drafted, the statute would tax *any* activity of affected organizations without regard to regularity, profit motive, or continuity.

The proper allocation of expenses (direct and indirect) between taxable advertising and non-taxable activities of an affected exempt organization may be difficult. House report, part 1, p. 50, states that the Secretary or his delegate will

prescribe regulations with respect to such allocation. It is recommended that guidelines for such allocation be set forth in the statute.

Bill pp. 94–107, § 121(d) [IRC amended § 514]

Unrelated Debt-Financed Income

This provision subjects debt-financed income of an exempt organization to tax. The purpose of this provision is to overrule the *Clay Brown* case[1] and eliminate the ability of an exempt organization to purchase a business on a "bootstrap" basis by paying for it out of earnings which are not subject to tax. This provision is similar to a recommendation heretofore made by the American Bar Association except that it applies the unrelated business tax to debt-financed dividends, interest, and capital gains. (Bulletin of Sec. of Taxation, Vol. XX, No. 4, p. 69; Tax Lawyer, Vol. XXI, No. 3, p. 457; ABA Reports, 1968, Vol. 93, p. —). It is believed that the extension of the debt-financed tax to these sources of income is unnecessary to correct the basic abuses involved in bootstrap transactions. There are also over provisions in the bill relating to neighborhood land and churches which are outside the scope of the recommendation of the American Bar Association.

Bill pp. 108–109, § 121(f) [IRC amended § 7605(c)]

Restrictions on Examination of Churches

This provision restricts the right of the Internal Revenue Service to conduct an audit of a church unless the Secretary or his delegate, who may be no lower than the principal Internal Revenue regional officer, notifies the church that he believes it may be engaged in an unrelated trade or business. This difference in audit procedure with respect to churches appears to introduce an unnecessary complication.

TITLE II—INDIVIDUAL DEDUCTIONS

Subtitle A—Charitable Contributions

SEC. 201. CHARITABLE CONTRIBUTIONS

Bill pp. 112–114, § 201(a)(1) [IRC new § 170(b)(1) (D), (E), (F) and (G)]

Unlimited Charitable Contribution Deduction

This provision repeals the unlimited charitable deduction. Transitional rules provide for a five-year phaseout. The "transitional income percentage" of adjusted gross income is the amount below which charitable contributions cannot reduce taxable income. The "transitional deduction percentage" is the percentage of taxable income which must consist of charitable contributions and taxes in order for an individual to be eligible for the "unlimited deduction." As the deduction percentage decreases, the income percentage increases, and by January 1, 1975, both percentages will be 50 percent.

The provisions for limiting tax preferences (LTP) and allocation of deductions (AOD) would appear to be applicable to taxpayers who qualify for the unlimited charitable deduction during the phase-out. If this is so, and if the phase-out provisions also apply, then the interaction of the two should be considered.

Present section 170(g) precludes section 170(b)(5) carryovers by taxpayers claiming the unlimited charitable deduction. While appropriate under existing law, interaction of transitional rules of new section 170(b)(1) (E), (F) and (G) may make such carryovers desirable; i.e., during the 5-year transitional period a taxpayer who has qualified for the unlimited deduction under section 170(b)(1)(D) may have that deduction partially reduced if his taxable income is less than the transitional income percentage of his adjusted gross income.

Bill pp. 114–116, § 201(a)(1) [IRC new § 170(b)(1) (H) and (I)]

Denial of Deductions

This section changes present law by disallowing a deduction for a gift of an income interest to charity. Where a donor transfers his entire interest in property irrevocably and retains no reversionary interest, there is no sound reason for

[1] *Commissioner* v. *Clay B. Brown*, 380 U.S. 563 (1965).

disallowing a deduction for a gift of an income interest to charity. The "double tax benefit" argument, House report, part 1, p. 61, proves to much. It applies with equal force to an outright gift to charity. Here, too, the donor will receive a tax benefit from excluding the income from his return (for the rest of his life) but will nevertheless receive the benefit of a tax deduction for the full value of the property given to charity. Furthermore, there is no basis for differentiating between a gift to charity of an income interest and a remainder interest. Indeed, the charity receives the benefit of an income interest immediately but must wait to receive the benefit of the remainder interest. In short, there is no basis to distinguish between an outright gift, a gift of an income interest or a gift of a remainder interest.

Bill pp. 116–118, § 201(a)(1) [IRC new § 170(b)(1)(J)]

Special Limitations on Contributions of Appreciated Property

Section 201(a)(1) adds a limitation of 30 percent of the contribution base in the case of gifts of appreciated property not covered by section 201(c) of the bill (IRC amended § 170(e)).

1. This provision would appear to conflict with the stated purpose of the increase from 30 percent to 50 percent in the percentage limitations on individual deductions. The House report, part 1, p. 52, states that the increase to 50 percent was desirable to counterbalance the financial effect on charities of the repeal of the unlimited charitable deduction. Denying gifts of appreciated property eligibility for the 50 percent limitation significantly undercuts the effect of the increase to 50 percent.

In any event, the proposal in its present form could have an unintended harsh result in some cases. The limitation applies to the full value of the contributed property and not just to the appreciation element. Thus, the deduction of a gift of stock worth $100,000 would be limited to 30 percent whether the donor's basis was $1.00 or $99,999; however, if his basis were $100,000 the 50 percent limit would apply. If there is a special 30 percent limitation for such property, logically the limitation should apply only to the appreciation, with the basis of the property being eligible for the additional 20 percent allowance as provided by section 170(b)(1)(B).

2. It should be pointed out that the House report, part 1, p. 52, incorrectly describes the new limitation. Specifically, the suggestion that the 30 percent limitation would apply to all contributions of appreciated property is incorrect. Such limitation is actually only a maximum; in the case of gifts to private foundations the 20 percent limitation of section 170(b)(1)(C) would control.

3. The new section also creates a separate carryover category of excess contributions of appreciated property which is not explained in the general explanation of the bill, and appears to be incorrectly explained in the technical explanation of the bill on page 33. The example there given states that where there is an excess of contribution of appreciated property and also an excess of cash contributions by reason of the 50 percent limitation, *all* of the excess must be carried over "to any contributions of appreciated property in the following years." There is no reason why excess cash contributions should have to beadded to excess appreciated property contributions in determining subsequent years limitations on contribution appreciated property.

Bill pp. 119-120, § 201(a)(3) [IRC new § 170(b)(6)]

Contribution Base Defined

If LTP and AOD are to be applied to charitable contributions of individuals. the allowable tax preferences should be included in the contribution base as section 201(a)(3) proposes. However, as presently drafted, it appears that computation of the base may produce in some instances circular computations. For example, the contribution base equals adjusted gross income plus allowable tax preferences as determined under section 277(c)(2) (p. 120, line 5). Allowable tax preferences equal tax preferences as determined under section 84(c) minus those that are included in gross income under section 84 minus $10,000 (§ 277(c)(2), p. 175, lines 12-20). Tax preferences include deductions under section 170 which are attributable to the appreciation and which are allowable for the taxable year (§ 84(c), p. 166, line 8). Therefore, if appreciated LTP property is given to public charities, there can be instances where in order to determine the amount deductible under section 170 one must know the amount of tax

preferences, and in order to determine the amount of tax preferences one must know how much is deductible under section 170.

Bill pp. 120-121, § 201(a)(3) [IRC new §170(b)(7)]

Disallowance of Deduction in Certain Cases

During the transition period, this provision creates unintended hardships on existing section 501(c)(3) organizations. To preclude disallowances for charitable contributions paid in taxable years beginning after December 31, 1969, section 170(b)(7)(A) requires the donee section 501(c)(3) organization to be exempted from or to have complied with the provisions of section 508(a), (b), or (g). Subsection (b) of section 508 applies to existing charitable organizations and requires, unless exempted, notification of the Secretary pursuant to his regulations that it is not a private foundation. The effect is to preclude a charitable contributions deduction to certain existing section 501(c) (3) organizations until the Treasury issues regulations. To avoid these unfortunate results, references should be deleted to section 508(b) in the following places: lines 14 and 18, p. 120; lines 21 and 23, p. 130; line 24, p. 132; line 1, p. 133.

Bill p. 121, § 201(a)(3) [IRC new § 170(b)(8)]

Denial of Deduction in Case of Contribution of Partial Interest in Property

This section disallows a charitable deduction for contributions of partial interests in property. It would seem to be broader than the House Committee's general explanation of the reasons for this change. Deductions for non-trust charitable contributions of less than entire interests in property are denied unless otherwise permitted under section 170 for gifts in trust (i.e., under the annuity or unitrust provisions in section 170(b)(1)(H) (line 17, p. 114) or section 170(h) (line 15, p. 127). The effect may be to deny contribution deductions for outright gifts of undivided interests in property as well as of legal life estates or remainders unless all other interests in the property also are contributed.

The provision is effective for contributions made after April 22, 1969. This is unwarranted, particularly since the Treasury's proposals issued on April 22 gave no indication of the breadth of disallowances caused by the proposal.

Bill pp. 122–125, § 201(c)(1) [IRC new § 170(e) and § 83]

Charitable Contributions of Appreciated Property

1. If the abuse sought to be corrected by this section occurs primarily in connection with charitable contributions of ordinary income property, such as inventory, it should be noted that section 83 requires recognition of gain in a number of situations not falling within the area of such abuse. For example, the recognition requirement would apply to gifts of works of art, even to public museums. Further, application of the proposed general rule to future interests of all types of property produces an effect that goes far beyond eliminating the most flagrant means of avoiding taxes. It is suggested that section 170(e) apply solely to gifts of ordinary income property.

2. We have the following comments regarding the proposed statutory language of these sections.

It is noted that section 170(e)(3)(B) (p. 124, line 15), requires distribution of *all* gifts of appreciated property. This will mean, as a practical matter, that a private foundation subject to this requirement will have to make corpus distributions in an amount equal to 100 percent of all contributions of property received. Neither the bill nor the House report indicates how the 100 percent is to be determined vis-a-vis increases or decreases in value of the contributed property between the dates of contribution and distribution.

The intent of section 83(b) (p. 126, lines 2 and 3) is unclear. We suggest that the reference to "section 170(e)(1)" in line 2 should be to "section 170(e)(3)." In proposed section 170(e)(3)(B) (p. 124, line 10), "first year" should read "first taxable year."

Bill pp. 126–127, § 201(d) [IRC amended § 1011]

Bargain Sales to Charitable Organizations

There seems to be no valid reason to differentiate between bargain sales to charities and bargain sales to other donees. Where the donor is willing to make a gift to charity of the difference between the fair market value and the purchase price, he should receive the full tax benefit. For example, taxpayer A gives securities worth $50 with a basis of zero. He receives a deduction for the entire $50

and has no recognizable gain, assuming new section 170(e) does not apply, and he would not be required to include any amount as income. On the other hand, if taxpayer B sells property to a charity at his cost of $50 at a time when it is worth $100 he would have a $50 charitable deduction and would also be required to report $25 of gain. We believe such a distinction in tax treatment is not justified.

In any event, it should be made clear to what extent, if any, the portion of the bargain sale treated as a gift falls within the ambit of section 170(b)(1)(J) (applying a 30 percent limitation on contributions of appreciated property) and section 170(e) (p. 122, line 25) (relating to contributions of appreciated property). It would appear that the rules of those sections would be applicable to the gift portion of the sale.

Bill pp. 127–128, 135–137, § 201(e) and § 201(i) [IRC new § 170(h) and § 664]

Charitable Remainder Trusts

The basis for these provisions, the argument that the value of the remainder can be wiped out, is questionable because: (i) trustees are bound by state law to protect the remainderman's interest, (ii) State attorneys-general increasingly exercise supervision, (iii) the remainder man itself can protect its interest, and (iv) even with a unitrust or annuity the remainder could be destroyed by bad investment.[1]

1. The provisions of this section are applicable to transfers in trust made after April 22, 1969, but the provisions of section 664 defining "charitable remainder annuity trusts" and "charitable remainder unitrusts" are not effective except with respect to transfers in trust made after date of enactment of the bill. This would appear to create a hiatus between April 22, 1969, and the date of enactment of the bill. The difference in effective dates also creates a severe problem for draftsmen during this interim period since even if the effective date provisions were to be modified so as to permit a deduction for the gift of a remainder interest to a trust which would otherwise qualify under section 664, if made after April 22, 1969, and prior to date of enactment, such a trust would probably not qualify for unlimited deduction of amounts set aside permanently for charitable purposes under section 642(c) of the existing law.

2. The retroactive date of April 22, 1969, is inequitable. The bill goes beyond the proposals submitted by the Treasury to the House Ways and Means Committee on that date. Donors, on April 22, 1969, were not put on notice of the requirements for obtaining a charitable deduction with respect to contributions of remainder interests. It is quite likely that many charitable remainder trusts have been established after April 22, 1969, in ignorance of the proposed new rules.

Bill pp. 128–130, § 201(f) [IRC amended § 642(c)]

Charitable Contributions by Estates and Trusts

The proposed amendment to section 642(c) is consistent with the other proposals contained in section 201. However, we suggest that transitional rules be added to cover existing trusts and estates, the governing instruments of which were presumably drafted without reference to the unitrust or annuity trust concept. We also suggest that consideration be given to adding a provision for reformation of instruments if possible, as well a provision to have cases where the executor or trustee would make a current payment to charity, but for circumstances beyond his control, such as uncertainty as to the identity of the charity and charitable beneficiary or as to amounts available for payment because of obligations chargeable to gross income.

It is also suggested that the words "trustee" and "administrator" used in line 21, page 28 of the bill be changed to "fiduciary." The latter term is defined in section 7701(a)(6) as including "executor" as well as administrator and trustee.

Bill pp. 130–135, § 201(h) [IRC amended § 2055 and § 2522]

Estate and Gift Tax Deductions for Income Interests, Charitable Remainders or Other Partial Interests in Property

We see no reason why either a charitable income interest or a chariatble remainder after a normal life estate should not continue to be allowed as an estate or gift tax deduction. Aside from an outright transfer, such a remainder is the

[1] See, *infra*, pp. 26–31, for comment on estate and gift tax deductions for charitable remainder trusts.

most common form of charitable bequest or gift. This garden variety of trust is customarily used by testators or creators of lifetime trusts who desire to leave all or a substantial portion of their estates to charity after making provision through life estates for one or more relatives (such as a surviving wife, sister, or unmarried daughter). This form of bequest predates the tax laws and, in our experience, has not been the subject of tax abuse.

The House report, part 1, pp. 58–59, describes two situations in which contributions deductions have been allowed for income tax purposes for gifts of trust remainder interests even though it was not probable that the gift would ultimately be received by the charity.[1] However, the report concedes that the contributions deductions "would not have been allowed in these situations if the probability of the charity receiving the specified interest were determined under the rules presently applied in the case of the estate tax." Therefore, the two examples cited in the report furnish no reason for changing the estate or gift tax law in this area.

The Internal Revenue Service and the courts have, in fact, carefully policed the estate and gift tax charitable deductions for income remainder or other partial interests in property. The value of the charitable interest is deductible only insofar as that interest is ascertainable at the time of death, and, hence, severable from the noncharitable interest by actuarial or other recognized techniques. Treas. Reg. § 20.2055–2(a). No deduction is allowable for a charitable transfer which is dependent on the performance of some act or the happening of some event unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. Treas. Reg. § 20.2055–2(b). The taxpayer has the burden of proving that, under these tests, the charitable interest is severable and not subject to defeat.

The proposed legislation makes no allowance for the often legitimate desire of the testator or settlor to make principal available to his wife or other income beneficiary in the event of future need or emergency. Powers to invade for emergency needs are extra precautions for the security of the income beneficiary, and are neither intended nor administered as devices to defeat the interest of the charitable beneficiary or remainderman. Under present law the charitable remainder is deductible if the executor can show that the power of invasion is subject to an ascertainable standard and that, by application of that standard, the possibility of invasion is sufficiently remote to be disregarded. The rules in this area have been developed in a solid body of decisional law. They are not the subject of abuse, and there is no good reason for discarding them.

The House report, part 1, pp. 58–59, questions the accuracy of the tables prescribed by the estate and gift tax regulations for valuation of remainders and other actuarial interests. These tables, adopted in 1952,[2] are based upon a mortality table derived from the 1940 census[3] and interest at the rate of 3½ percent a year, compounded annually. Valuation of actuarial interests is, of course, an exercise in prediction, as to both mortality and interest yield. Nevertheless, it is a generally accepted—indeed, indispensable—valuation technique. We note that the House report contemplates the continued use of the present tables in valuing charitable remainders of annuity trusts and unitrusts.

Life abounds in contingencies. The estate and gift taxes are founded on the principle that tax collection—like much other human activity—cannot await their resolution. These taxes are based upon valuations existing at the time of death or of gift. The actuarial art is an accepted element of this valuation process. It is used to separate complete from incomplete gifts, to value interests in property owned by the decedent, to measure reversionary interests in transfers made during life, to determine the marital deduction for remainder interests, and to measure the charitable deduction for remainders and other limited interests. Similar tables used by insurance companies in connection with the sale of commercial annuities and life insurance policies also govern the valuation of such properties for gift and estate tax purposes. There does not appear to be any indication that the use of actuarial methods of valuation in the charitable deduction area has been the subject of manipulation or that it has produced results that justify the radical legislative change proposed in the bill.

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[1] This is not, in our opinion, a fair characterization of the income tax decisions taken as a whole.

[2] T.D. 5906, 1952–1 C.B. 155.

[3] Table 38, United States Life Tables and Actuarial Tables 1939–1941, U.S. Department of Commerce, Bureau of Census.

Even if we assume *arguendo* that allowance of estate and gift tax deductions determined by actuarial means should be circumscribed because charity may receive less than the actuarial forecast, we still find the proposed legislative classification unsatisfactory. One of the two types of trusts the bill would permit to qualify for the deduction, the annuity trust, is more of a "gambler's device" than the bulk of the trusts that the bill would disqualify. In the traditional trust to pay the income to an individual for life with remainder to charity, the charitable remainderman is assured of the trust principal, subject only to the prospect of its appreciation or depreciation in value and the prospect that the life beneficiary may outlive or predecease the predicted year of mortality for a person of his age. In contrast, an annuitant may exhaust the trust, so that charity would receive nothing although the bill would grant a substantial charitable deduction.[1] In our judgment the proposed statutory classification is not a sound one.

Congress should not arbitrarily restrict the estate and gift tax charitable deductions to two limited and novel forms of charitable remainder trusts. It would be unreasonable to force testators and settlors into the defined annuity or unitrust arrangements. To require the use of such arrangements would be unwise because of their lack of flexibility. The proposed legislation is overly rigid and unduly restrictive and should not be enacted.

If sections 2055(e)(2) and 2522(c)(2) are enacted, consideration should be given to the following matters as they would affect charitable remainders:

a. The proposed definitions of a charitable remainder annuity trust and of a charitable remainder unitrust (Bill p. 136, line 16 through p. 137, line 15) would not permit a charitable deduction for the transfer to charity of an undivided fraction of a trust remainder, of a remainder in specific trust assets, of a charitable cash legacy out of a remainder, or of a charitable remainder subject to a private cash legacy. The definitions qualify a charitable remainder for deduction only if the entire remainder interest in the trust passes to charity. It is not unusual for a testator to divide a trust remainder into fractions for charitable and private remaindermen, or to charge small specific private legacies against an otherwise charitable remainder. There is no reason to deny deduction of whatever interest charity has in the remainder.

b. The definition of a charitable remainder annuity trust or unitrust would also eliminate any deduction for the charitable remainder of a trust, the income of which may, in the trustee's discretion, be distributed to a private individual, applied to his support, or accumulated. This type of trust may serve useful and important purposes where the income beneficiary is a minor, an incompetent, a person who is under a physical or mental disability, a spendthrift, or a person whose needs are so variable that predetermined fixed distributions would be unsatisfactory. We see no justification for penalizing the granting of such discretion to the trustee.

c. The proposed legislation would deny any estate tax charitable deduction for a charitable remainder following a legal life estate. Bequests of this variety are commonly used in some States, particularly for real estate or tangible personal property. It is also not unusual to designate a charity as the last taker under a life insurance setlement option or a commercial annuity contract. These charitable future interests do not lend themselves to the proposed annuity trust or unitrust treatment. They involve no element of tax avoidance and should remain eligible for the charitable deduction.

d. A trust my give a charity and a private beneficiary fixed shares of both the trust income and principal, the purpose generally being to avoid the extra expense and inconvenience of creating and administering separate trusts. An undivided interest in property may also be bequeathed or devised outright to charity. The proposed legislation would, for no good reason, disallow any deduction for charity's undivided interest in such a trust, bequest or devise.

e. The definitions of a charitable remainder annuity trust and of a charitable remainder unitrust are too rigid in requiring that the payments to the private beneficiary be either for a term of years or for life. Charitable trust remainders

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[1] Under present law the courts have disagreed over the allowability of an estate tax charitable deduction for the charitable remainder of a trust following a private annuity where there is a significant possibility of exhaustion of the trust principal. Cases disallowing the deduction: *Moffett's Estate* v. *Comm'r.*, 269 F.2d 738 (4th Cir. 1959); *Florida Nat'l Bank* v. *United States*, 1962-2 U.S.T.C. ¶ 12,082 (S.D. Fla. 1962). Cases allowing the deduction: *Schildkraut's Estate* v. *Comm'r.*, 368 F.2d 40 (2d Cir. 1966), *cert. denied*, 386 U.S. 959; *Estate of Helen Stow Duker*, 18 T.C. 887 (1952).

may vest upon other events. For example, alimony trusts sometimes provide that the trust shall terminate in favor of charity upon the wife's death or remarriage. A deduction is now allowable for the charitable remainder (computed as though the wife's interest were a full life estate). The bill would deny that deduction.

f. The application of the definitions of a charitable remainder annuity trust and of a charitable remainder unitrust to the following three situations seem uncertain or unsatisfactory: (a) A testator (or the creator of an inter vivos trust) creates a trust for the joint lives of two individual beneficiaries with remainder to charity. (b) The creator of an inter vivos trust reserves the initial beneficial interest for life, gives his wife a second beneficial interest for life, and leaves the remainder to charity. (c) The creator of an inter vivos trust reserves a beneficial interest for life with remainder to charity. Situation (a) could not apparently qualify under the definition (which apparently permits only one life tenant); situation (b) could apparently qualify for estate tax purposes upon the creator's death but not for gift tax purposes initially; situation (c) would apparently not be subjected to annuity trust or unitrust treatment for gift tax purposes (since no interest passed from the decedent to a private person, as required at Bill p. 131, line 16, *et seq.*). Further thought should be given to the classification of these situations.

g. The proposed legislation would severely limit the types of assets that could be bequeathed or devised to, or invested in by, trusts with charitable remainders. Residences, jewelry, assets with low or fluctuating income and poor liquidity or marketability, and assets not having readily ascertainable fair market values would, for one reason or another, not easily be adaptable to annuity trust or unitrust treatment. This is another example of the undue rigidity of the legislative approach.

h. The proposed section 2055(e)(2) is in conflict with existing section 2055(b)(2), which specifically qualifies for the charitable deduction one type of trust having a private income beneficiary and a charitable remainderman. It is not clear which of these two conflicting statutory provisions is intended to override the other.

i. As is noted in the footnote on page 28, the courts have disagreed over the allowability of a charitable deduction under present law for the remainder of an annuity trust where there is a significant possibility that the annuitant may consume the trust principal. It is not clear whether the court decisions disallowing such deductions are intended to be overridden by the proposed legislation. Is the legislation intended to qualify for the charitable deduction remainders of annuity trusts that may not qualify under existing court decisions, or does it simply add a new limitation to thost now in effect?

j. The proposed definitions of a charitable remainder annuity trust and of a charitable remainder unitrust provide that the trust remainder must go to or for an organization or use described in section 170(c). (Bill p. 137, lines 1 and 14.) Section 170(c) describes the organizations to or for the use of which contributions deductible for income tax purposes can be made. There is an additional category of organizations to or for the use of which transfers deductible for estate and gift tax purposes can be made. These are religious, charitable, scientific, literary or educational corporations, trusts, etc., created or organized outside of the United States. (Compare sections 2055(a)(2) and 2522(a)(2) with section 170(c)(2).) Since outright gifts and bequests to or for the use of such organizations are deductible, there is no reason to circumscribe deduction or remainders more narrowly.

The estate tax amendments under discussion would apply to all decedents dying after the date of enactment of the bill and the gift tax amendments to all gifts made after April 22, 1969. These effective dates will cause a great deal of hardship and confusion. All existing wills and trusts of living persons will have to be reviewed and, if found to contain charitable remainder or income trusts or legal estates, will have to be changed, if possible. This will be a time-consuming task. Irrevocable or unamendable trusts cannot be changed, nor can the wills of testators who have lost their testamentary capacity or who die before the review of their wills can be completed. If these provisions are to be enacted, a substantial period of grace should be provided, as well as relief for existing irrevocable or unamendable trusts and existing wills of testators under disability.

Bill pp. 139–152, § 211 [IRC new § 1251]

Gain from Disposition of Property Used in Farming Where Farm Losses Offset Nonfarm Income

Under present law, a taxpayer engaged in farming is allowed to deduct in the year expended many of the costs of farming which in other trades or businesses would be treated as capital items recoverable only through depreciation or as a return of capital upon the sale of the property. This tax advantage increases, of course, with the tax bracket of the taxpayer.

1. The new section would modify the potential tax advantage under present law by requiring the taxpayer engaged in farming operations (with certain limitations) to maintain a bookkeeping record of his farming operations known as the excess deductions account, the purpose of which is to recapture farm losses on the sale or other disposition of farm property, gain from which under present law is taxable as long-term capital gain. In applicable cases, this would remove, or reduce, the tax advantage under present law of deducting costs against ordinary income and taxing the gain at capital gain rates.

We are not convinced that the problem which the section seeks to correct is sufficiently great to justify such complex legislation; but, if it is, then the approach reflected by the section is more acceptable than attempts to deal with it by other means, such as tampering with the timing of losses and gains as proposed in earlier legislative drafts in this area.

2. There are several technical features of the section which deserve comment. Since as to farm land there is a 5-year recapture rule, there should also be a limit on the recapture period for other farm property. A ten-year period would seem adequate.

An unintended effect of the section in the case of a taxpayer who uses an inventory method of accounting for his livestock, but elects to expense the costs incurred in clearing land or for water and land conservation, is to subject such taxpayer to the provisions of section 1251(b)(4)(A) with respect to his livestock dispositions. After five years such land expenses are not included in computing the amount of recapture on the sale of land under section 1251(e)(5).

Section 1251(e)(4)(B) provides for the aggregating of all farm businesses into one business, apparently to determine whether a taxpayer comes within the exceptions of sections 1251(b)(2) and 1251(b)(4). However, as written, it applies to all of section 1251 and, for example, in the case of a taxpayer who first engaged in ranching and lost money and then engaged in the orchard business and made money, would prevent him from offsetting the loss against the gain. There is no apparent reason for this result, and the section should be modified accordingly.

With respect to the excess deduction account, it is clear in section 1251(b) that farm income in the second year will offset a farm loss in the first year, but it is not apparent that the reverse is true. This point should be clarified.

Section 1251(d)(6), relating to transfers to controlled corporations, appears to have an inadvertent omission in not including "securities" as well as "stock" as "farm recapture property." As written, it might permit a taxpayer to transfer farm recapture property to a controlled corporation for stock and securities and then dispose of the securities and realize capital gain.

Gain realized by a taxpayer on farm recapture property which would be taxed as ordinary income under section 1245(a), as amended by section 212, should be applied to reduce the excess deduction account. Apparently this would not be the case under section 1251(e)(2). As long as ordinary income equals ordinary losses, section 1251 should have no application.

Bill pp. 152–153, § 212 [IRC amended §§ 1245(a)(2), 1245(a)(3), and 1231(b)(3)]

Livestock

This section would subject livestock acquired by purchase to the same recapture provisions now applicable to other tangible depreciable personal property. Technically, the section presents one problem of importance to farmers.

At present, section 1231(b)(3) provides that livestock held for draft, breeding, or dairy purposes and held by the taxpayer for 12 months qualifies as section 1231 property, the net annual gain from which is capital gain, while the net annual losses are ordinary losses.

Section 212(b) of the bill would delay the start of the holding period until the time at which the animal would normally be used for one of the specified purposes. The stated purpose is more readily to distinguish between animals held for one of the specified purposes and those held for sale. As to hogs (and possibly some other animals), this requirement would result in an inadvertent inequity. An older sow will become so fat and expensive to feed that at the end of the delayed holding period she would have little economic or market value.

This difficulty may be solved by adopting an "actual use" test rather than a mere holding period requirement. Thus, the first sentence of section 1231(b)(3) might be amended to read:

> "Such term includes livestock which has been held by the taxpayer for 12 months and which during such period has been actually used for a period of six months by the taxpayer for draft, breeding, sporting, or dairy purposes."

SEC. 213. HOBBY LOSSES

Bill pp. 153–154, § 213 [IRC, amended § 270]

Hobby Losses

The proposed amendment to section 270 appears to contain so many technical deficiencies that we suggest that consideration be given to a complete redraft.

a. Although labeled as dealing with "hobby losses," section 213 of the bill is much broader. Under the proposal, section 270 would be amended to apply not only to the traditional "hobby" but also to the normal profit seeking business and investment activities, including real estate operations, equipment leasing and oil and gas development and exploration.

b. The amendment to section 270 is not confined to losses incurred by individuals. The change in the caption of the section from "Limitation on Deductions Allowable to Individuals in Certain Cases" to "Limitation on Deductions in Certain Cases" confirms this despite the fact that the proposal is contained in Title III (Other Adjustments Primarily Affecting Individuals) of the bill.

The House report, part 1, p. 71 on the other hand, contains repeated references to activities carried on by an *individual*. This suggests that the section may have inadvertently been drafted more broadly than was intended.

c. In its present form, the proposal would extend to any business which incurred deductions in excess of gross income more than $25,000 for any three of five consecutive years. If such losses occurred, the taxpayer would be required to rebut the statutory presumption that the business was not carried on with a "reasonable expectation of realizing a profit." Difficulties abound in determining what is a "reasonable expectation of profit." Would this rule preclude the losses of a high risk venture where the potential profit is substantial? Obviously, a slight chance of success might be reasonable where the potential profit is great.

d. The proposed new rules relate to the allowance of "*Items* attributable to an *activity*." "Items" is not a defined term. If it is not synonymous with deductions, it should be defined. If it is, "deductions" should be substituted for "items."

Furthermore, the term "activity" is not defined. Clearly, an "activity" would include an entire trade or business. Would it possibly include part of a trade or business? Would it include investment activities as well as personal transactions (for example, nonbusiness loans).

e. The proposal fails to indicate what "deductions" are attributable to an "activity." This deficiency could create problems.

f. The proposed section also fails to indicate whether it will be applied retroactively to the three years in which the excess losses occur or whether it applies only prospectively.

g. The proposal could result in a denial of business losses against future income from the same business. At least, in such a case, the taxpayer could be faced with the necessity of proving that the business was being carried on with a reasonable expectation of profit.

Subtitle C—Interest

SEC. 221. INTEREST

Bill pp. 154–158, § 221 [IRC new § 163(d)]

Limitations of Interest and Investment Indebtedness

1. The statutory provisions do not make clear the order in which the three limitations ($25,000; net investment income; and long-term capital gains) are

applied against the investment interest. The technical explanation indicates that the order is: first, $25,000, second, net investment income, and, finally, capital gains. The order of application is important since it affects the amount of the deduction and the consequent amount of the tax. This is especially significant if the ordinary income generated by sections 1245 and 1250 is also added to the list. Because of its importance, the order of application should be spelled out in the statute. Section 221(b) provides that the deduction for capital gains shall not exceed the sum of the net short-term capital loss and the amount of the investment interest allowable as a deduction under section 163(d)(1)(C). It should be made clear that the application of investment interest against long-term capital gains is applicable only after first applying the available investment interest deduction against the $25,000 allowance and the amount of the net investment income. The phrase "succeeding taxable year" in section 163(d)(2) should be changed to "succeeding taxable years."

2. The special rule in new section 162(d)(4)(C) provides that expenses allowable under section 162 must exceed 15 percent of rental income, or such income will be considered as investment income and not income from the conduct of a trade or business. There are undoubtedly many real estate investment situations which would constitute the actual conduct of a trade or business but which have deductions allowable under section 162 of less than 15 percent of gross rental income. In computing such expenses the reasonable compensation of a proprietor for his services should be allowed as part of the expenses for purposes of computing the 15 percent.

3. In the definition of rents (section 163(d)(4)(C)) the references to a guarantee of a specified return or a guarantee in whole or in part against loss of income should be made more specific. Every lease pursuant to which a tenant is personally liable is a guarantee of the rent and indirectly a specified return of income. Where the lease contains escalation provisions it is arguable that there is a guarantee against loss of income or a guarantee of a specified return.

4. It should be made clear that a trade or business exists during the period of the construction of a building, which when completed will be operated as a trade or business, so that the interest expense prior to the receipt of rental income will be deductible.

Bill pp. 158–165, § 231 [IRC amended § 217(a) and new § 82]

Deduction for Moving Expenses

1. Consideration might be given to the substitution of a "reasonable expenses" limitation for subparagraphs (C) and (D), such as that presently imposed (and to be continued) in the case of the expenses described in subparagraphs (A) and (B) of section 217(b)(1). There is no reason to assume that taxpayers would incur unwarranted expenses under subparagraphs (C) and (D) to any greater extent than under subparagraphs (A) and (B). In all four cases only actual out-of-pocket expenses will qualify for the deduction, and, in the case of taxpayers receiving reimbursements from their employers, the additional element of employer review provides a safeguard against abuse of this deduction.

2. Both present law and the proposal limit the available deduction to employees and do not provide for a deduction in the case of self-employed taxpayers. It would seem that need for relief for self-employed taxpayers is equally meritorious.

3. Subsection (b) of section 231 of the bill adds a new section 82 providing for the inclusion of moving expenses in income. This may be considered necessary because of the allowance of the deduction for the offsetting expenses. However, the Ways and Means Committee, at page 77 of its general explanation (House report, part 1, p. 77), states that the reimbursement would be subject to the withholding provision of section 3401(a). This conclusion would seem to be erroneous since section 3401(a)(15) provides that remuneration paid on behalf of an employee is not subject to withholding if at the time of the payment it is reasonable to believe that a corresponding deduction is allowable under section 217. It should be made clear that there should be no withholding on the reimbursement as to which it is expected there will be an offsetting deduction by the employee.

Title III—Other Adjustments Primarily Affecting Individuals

Subtitle A—Limit on Tax Preferences and Allocation of Deductions

SEC. 301. LIMIT ON TAX PREFERENCES FOR INDIVIDUALS, ESTATES, AND TRUSTS

Bill p. 166, § 301(a) (1) [IRC new § 84(c) (1) (A)]

Charitable Contribution of Appreciated Property

This subparagraph uses a new and undefined statutory term "appreciation in the value of property." It is assumed that the amount of such "appreciation" would be measured in the usual manner for determining gain. Therefore, it is suggested that the term, "excess of fair market value over basis," be used. It is more precise and would avoid introducing a new and undefined term into the Code. Compare the manner in which the terms are used at bill p. 123, section 170(e) (1) and (2).

Bill p. 166 § 301(a) (1) [IRC new § 84(c) (1) (B)]

Accelerated Depreciation

1. In view of the revisions made in accelerated depreciation recapture in section 521 of the bill, there is considerable question whether this item continues to constitute a tax preference.

If accelerated depreciation is retained as an item of tax preference, the recapture rule under section 521 of the bill should be changed to provide for a correlative reduction of the amount recaptured as ordinary income on disposition. No language in new section 218 (providing for a mere increase in basis) has the effect of first reducing capital gains before reducing the amount taxed as ordinary income on disposition. A similar problem exists in a new section 84(c) (1) (D) but appears to have been covered by new section 1251 (b) (3) (A) at bill p. 141. Needless to say, the treatment of these items as tax preferences will extensively complicate both the preparation and the audit of tax returns.

2. The reference to "amortization" in excess of the "depreciation deduction" under section 167(b) (1) (relating to the straight line method of depreciation) could possibly be construed as making the amortization of leasehold improvements a tax preference where the lease is for a term less than the useful life of the improvement. If this result was not intended, the language should be clarified.

3. In three separate provisions, section 301, new section 84(c) (1) (B), relating to tax preferences, section 452, new section 312(m), relating to earnings and profits, and section 521, new section 1250(b) (4), relating to rehabilitation expenditures, the bill establishes requirements, in addition to present section 1250 (b) (1), that straight line depreciation be computed in respect of property on which depreciation for income tax liability purposes is computed by another method or a different life. In no two of the four provisions is the requirement exactly the same.

The concept of "straight line equivalent depreciation" presently finds use in the computation of class life required by the guideline test procedures set out in Revenue Procedure 62–21, where class life is determined by dividing the straight line depreciation into the total basis (see Rev. Proc. 62–21, Secs. 4.03 and 4.04, 1962–2 C.B. 434). The mehods for computing the required straight line equivalent depreciation are set out in Question 58 of Appendix II of the Revenue Procedure (1962–2 C.B. 480–485).

The variation in the requirements will place an undue burden on an affected taxpayer. Thus an individual who owns existing section 1250 property being depreciated in a group account under the double declining balance (DDB) or sum-of-the-years digits (SYD) method must make one computation for existing section 1250 purposes and another on an item basis for section 84 purposes. In addition, if he has elected to be tested by guideline procedures and uses the SYD method, he will be grouping assets by years of acquisition and will have to maintain a separate set of item records in order to make the necessary computations for section 84. This would appear to be true even though presumably he will be permitted to use a single group account for the section 1250 straight line com-

putation. Furthermore, the average life used for the group computation may not be used for item computations unless the group consists of homogenous property.

It is suggested that the statement of and the rules for computation of straight line equivalent depreciation and the collateral consequences of the use thereof be uniformly stated to whatever extent is possible and that a consistent computation be indicated.

4. Section 84(c)(1)(B) is inequitable to the extent that it ignores the fact that over the greater part of the useful life of the individual property, straight line depreciation inevitably exceeds SYD or DDB depreciation in any given year. It seems only fair that such excess be treated as a negative tax preference which would reduce (but not below zero) the amount of disallowed tax preferences.

Bill pp. 169–170, § 301(a)(2) [IRC new § 218]

Adjustments for Disallowed Tax Preferences

Because of the progressive tax rates, it will be possible for a taxpayer to realize a greater tax reduction in one or more of the five carryover years than the increase in tax attributable to inclusion of disallowed tax preferences in gross income in the earlier taxable year. Conversely, a taxpayer having an amount of other taxable income in the later year less than the disallowed tax preference carried forward would receive a tax reduction in the later year significantly lower than the effective tax cost of the disallowed tax preference. In some cases the income averaging provisions of the Code would reduce the effective rate of the tax reduction attributable to the carryover adjustment below the effective tax cost of the disallowed tax preference in the earlier taxable year, but this would not be true in all situations.

This problem could be avoided in large part by providing that the carryover, instead of giving rise to a deduction, would give rise to a credit for taxes paid in the later year equivalent to the amount by which the preference year's tax was increased by reason of the amount for which the bill now would allow a deduction. The suggested procedure would be similar to that now provided in section 1341(a)(5).

Bill pp. 173–180, § 302 [IRC new § 277]

Allocation of Deductions

The enactment of section 302 would adversely affect thousands of taxpayers, since the time-consuming adjustments called for by section 302 would apply, or figures would have to be assembled to determine whether they would apply, every year. Almost none of the figures necessary to make the adjustments required by section 302 are items already required to be shown on a tax return. They are largely items which, apart from section 302, would never have to be computed by the taxpayer (except in instances covered by section 301 of the bill, and some of the "preferences" described in section 302 are not included under section 301). In view of the universal desire for *simplification* of the tax laws, the desirability of a provision which will substantially complicate the return and recordkeeping requirements of a large number of taxpayers appears to be open to question.

For example, all taxpayers who may become subject to section 302 will have to keep records of all their income from tax-exempt municipal bonds. The additional computations and recordkeeping required under section 302 with respect to intangible drilling expenses, straight line depreciation, cost depletion, and the keeping of a separate set of farm books using the inventory method of accounting (including the taking of a beginning and ending inventory each year) introduce further complexities. As an example, in order to calculate for any year the amount of accelerated depreciation in excess of straight line depreciation (or, in the case of oil and gas wells, the amount of straight line depreciation which would have been allowed if the taxpayer had elected to capitalize intangible drilling expenses), the taxpayer will have to make a separate determination of the salvage value of each item (a determination which is not necessary under the 200 percent declining balance method) and if there has at any time been a change in useful life, he will have to recalculate straight line depreciation on a year-by-year basis from the time of his original acquisition

of the property in question. Similarly, to determine the excess of percentage depletion over cost depletion, the taxpayer will have to determine the units of the natural resource extracted and sold during the year as well as the reserves at the beginning of the year. Reserves must be determined by an engineering report which must be updated to reflect changes affecting the estimate of reserves.

It is evident, therefore, that section 302 would require a number of exceedingly complicated computations and tax return entries (never heretofore required) to be made by a large number of taxpayers, and would entail additional work by the Service in auditing, checking, and reviewing such additional computations and the evidence necessary to verify them. It would be a step in the opposite direction from the objective of tax and reporting simplification which much of the bill (particularly the proposed increase in the standard deduction) was designed to accomplish.

Bill p. 173, § 302(a) [IRC new § 277]

Allocation of Deductions—Application to Estates and Trusts

The heading of section 277 would indicate that it applies only to individuals, although the language of the section makes it applicable to any taxpayer other than a corporation, and the House report, part 1, p. 81, indicates that it was also intended to apply to estates and trusts. It is suggested that the heading be revised so that it is not misleading.

The application of the allocation provisions to estates and trusts is not clear. For example, assume that a simple trust has income and expenses as follows:

Dividends	$10,000
Tax-exempt interest	5,000
Capital gains	25,000
State income taxes	1,000
Actual distribution ($15,000—$1,000)	14,000

The Section 277 fraction would seem to be computed as follows:

Numerator:	
Tax-exempt interest	$5,000
Capital gains deduction	12,500
Total	17,500
Less: excluded	10,000
"Allowable tax preferences"	7,500
Denominator:	
Dividends	10,000
Taxable half of capital gain	12,500
Total	22,500
Less state income taxes	1,000
Distribution deduction	9,000
Total	10,000
Taxable income (without regard to § 277)	12,500
Add back State taxes	1,000
"Modified adjusted gross income"	13,500
Add "Allowable tax preferences"	7,500
Total	21,000
Section 277 fraction ($7,500÷$21,000) (percent)	35.7
Disallowed deduction for tax (35.7 percent×$1,000)	$357

The effect on the taxable income of the trust and the beneficiary would seem to be as follows:

Recomputed taxable income of trust:	
Dividends	$10,000
Taxable half of capital gain	12,500
Total	22,500
Less allowable State income taxes	643
Total	21,857
Less: Distribution deduction	
Ordinary income	10,000
Allowable deduction	643
Total	9,357
Taxable income of trust	12,500
Taxable income of beneficiary	9,357
Nontaxable income of beneficiary	4,643
Total distribution	$14,000

However, further clarification of the impact of section 277 on present sections 651 and 661 would appear to be desirable. The computations are even more confusing in the case of a complex trust or an estate.

Bill p. 173, § 302(a) [IRC new § 277(c) (1) (A) (i)]

Allocable Expenses—Interest

It seems improper to disallow deduction of interest payments under section 265 of the Code because they are related to tax-exempt interest received and at the same time to allocate some of the taxpayer's *other* interest payments in part to the same tax-exempt interest. If section 277 is enacted, section 265 should be repealed or the numerator of the "Section 277 Fraction" (section 277(b)) should exclude the tax-exempt interest which results in a section 265 adjustment at least to the extent of the section 265 disallowance. Furthermore, interest that is specifically attributable to carrying income-producing property should be excluded from the numerator of the "Section 277 Fraction" just as interest paid or incurred in the conduct of a trade or business is excluded under proposed section 277(c) (1) (B).

Bill p. 174, § 302(a) [IRC new § 277(c) (1) (A) (ii) and § 277(c) (1) (B)]

Allocable Expenses—Taxes

These provisions define allocable expenses to include taxes except taxes paid or incurred in the conduct of a trade or business. We believe it is improper to allocate any taxes which are incurred on taxable income, such as compensation or taxable investment income, or which are imposed on income-producing property, between taxable and tax-exempt income. These are deductions which in fact are economically attributable entirely to taxable income and are a cost of realizing the taxable form of income, as is already recognized in the exception proposed in section 277(a) (1) (B) relating to taxes incurred in the conduct of a trade or business. It is submitted that section 277(c) (1) (B) should be expanded to except from the definition of allocable expenses taxes paid or incurred on taxable income or on income-producing property.

Bill p. 174, § 302(a) [IRC new § 277(c) (1) (A) (iv)]

Allocable Expenses—Charitable Contributions

The inclusion of charitable contributions in the list of allocable expenses presents a serious policy question. Under this provision an individual who has tax-exempt income would receive a lesser tax benefit from an identical charitable contribution than an individual who has no tax-exempt income.

The classes of organizations most seriously affected by this provision would be those charitable and educational institutions dependent primarily for their support on medium and large-sized gifts from individuals who measure their gifts

by their "after-tax" cost. Thus while other types of "allocable expenses" are for the most part involuntary payments and their amount should not be appreciably affected by enactment of section 302, charitable contributions are by their very nature voluntary. The amount of charitable giving above the $1,000 level depends largely on the tax effect of such giving. Recognition of the impact of this on private colleges, hospitals, etc. resulted in a narrowing of the scope of section 201(c) and (d) of the bill (taxing charitable contributions of appreciated property) to the point where it will apply to only a small percentage of such contributions. However, section 302 is not similarly restricted and partially disallows the charitable deductions in question in *all* cases where such unrealized appreciation (plus other forms of exempt income and preferences described in section 302) exceeds $10,000. The inclusion of charitable deductions in "allocable expenses" under section 302 will undoubtedly cause many individuals who have previously made substantial charitable gifts of appreciated property to stop making such gifts.

Bill p. 175, § 302(a) [IRC new § 277(c)(2)(A)(iv)]

Allowable Tax Preferences—Charitable Contributions

The possibility of a circular computation under this section has already been noted in our discussion of pages 119–120 of the bill.

Bill pp. 175–176, § 302(a) [IRC new § 277(c)(2)(B)]

Interest on Certain Governmental Obligations

Exempt interest for purposes of section 302 of the bill is to be taken into account only with respect to obligations issued after July 12, 1969. However, as stated in the introduction to this Report, the Section of Taxation is opposed to the retroactive application of tax legislation, and, therefore, if this provision is accepted on policy grounds, it is submitted that the change should apply only to obligations issued after the date of enactment.

Bill p. 176, § 302(a) [IRC new § 277(c)(2)(C)]

Depletion and Intangible Drilling and Development Costs

Computation of cost depletion requires an estimate of recoverable reserves. It is believed that many of the larger operators and practically all of the smaller operators claim percentage depletion. This section will require all such individual taxpayers also to compute cost depletion with the attendant engineering expenses.

It is suggested that this burden be removed by giving the taxpayer an option to compute cost depletion or amortize his costs over a 10-year period. This would achieve the objective of the bill while relieving the taxpayer of an expensive cost depletion computation.

Substitute B—Income Averaging

SEC. 311. INCOME AVERAGING

Bill pp. 180–181, § 311 [IRC amended §§ 1301, 1302, 1303 and 6511]

Income Averaging

This provision appreciably extends the benefit of the income averaging provisions and simplifies their operation. Perhaps more should be done to reduce the inequities between taxpayers with level and taxpayers with fluctuating incomes. Consideration might be given to permitting averaging the excess over 100 percent of average base period taxable income, provided the $3,000 test is met.

In the interest of clarity the reference "(relating to penalties applicable to certain amounts received by owner employees)," should be inserted after "section 72(m)(5)" in line 24, bill p. 180.

Subtitle—C Restricted Property

SEC. 321 RESTRICTED PROPERTY

Bill pp. 185–188, § 321(a) [IRC new § 85]

Restricted Property

Under this provision a person receiving restricted property for services becomes taxable when his beneficial interest is transferable even though still sub-

ject to forfeiture. Furthermore, he is taxed at full market value determined without giving effect to the forfeiture provision or any other provision which will lapse. Thus a person could be taxed at full value on property which he has not yet earned and may have to forfeit, even though he could dispose of it only at a substantial discount. It is suggested that an employee be made taxable prior to termination of forfeitability only if he transfers the property to an unrelated third party and then only to the extent of the consideration received. This inequity in the proposed provision can be avoided by drawing the contract so as to restrict transferability until the rights become nonforfeitable. Hence the provision serves only as a trap for the unwary.

The key reference in the proposed new section is to the "transfer" of stock. Presumably "transfer" is intended to refer to the point at which a taxpayer obtains equitable title to shares, not when legal title passes (i.e., issuance of the certificates). This is the current rule for determining the holding period for purposes of calculating long-term gain. The legislative intent would be more clearly expressed by substituting "acquired by" for "transferred to" in line 11, bill p. 185, and the word "acquired" for "transferred" in lines 6 and 7, bill p. 188.

Even with these changes the proposed amendment raises serious problems for a closely held corporation. Such a corporation must often offer one or more key employees a greater equity interest than can be made available through a qualified stock option plan, but because of the practical problems involved in the disposition of stock by minority stockholders can do so only with substantial restrictions on transferability of the stock. The bill will expose such employees to the receipt of substantial amounts of ordinary income in one year.

The application of the proposed rules would appear to be unfair where the restrictions have a business purpose and the parties have in good faith fixed the fair market value at which the stock was sold to the employee. It is suggested that a provision be included similar to that appearing in section 422(c)(1).

Bill p. 188, § 321(a) [IRC new § 85(f)]

Transition Rules

There is a conflict between the effective date in section 321(d), "the date of enactment of this Act," and the June 30, 1969 date in the transition rules of proposed section 85(f). We submit that sound legislative policy would not make the new provisions applicable to transfers prior to the date of enactment.

Section 85(f)(3) establishes an effective date applicable to property transferred after February 1, 1970, if pursuant to a plan adopted and approved before July 1, 1969. This is apparently to enable taxpayers to make a distribution of restricted stock for the calendar year 1969 under the old rules. This intention could easily be frustrated because of administrative or clerical inability to make the transfers within one month after the close of calendar year 1969. It is suggested, therefore, that this date be extended to April 1, 1970.

Further, section 85(f) operates in an unfairly retroactive manner. Prior to the proposal of the bill, the Internal Revenue Service had announced its intention to change the tax treatment of restricted stock. Amended regulations were to go into effect in November 1968. The Service changed the effective date of the regulations to July 1, 1969, thereby permitting taxpayers who were "granted" options for restricted stock on or before June 30, 1969, to treat their income in the manner provided by the old rules. The new legislation has turned back the clock and has made April 22, 1969, the cutoff date, unless an option is both "granted" before July 1, 1969 and exercised before February 1, 1970.

Furthermore, relying on provisions of the existing regulations for statutory stock options taxpayers have assumed that they could, by analogy to the provisions of section 425(i) or Treasury regulations § 1.421-7(c), treat options as "granted" when action was completed by the Board of Directors and were not required to wait until shareholder approval to treat the options as "granted."

The House report, part 1, p. 89, indicates that, if shareholder approval is required by state law to make the options effective, such shareholder approval must *also* have occurred before July 1, 1969, in order for the option to be treated as "granted" before that date. Such a requirement will unduly penalize taxpayers who obtained options before July 1, 1969, subject to shareholder approval, relying upon the Service assurance of the continuation of the old treatment without realizing that they would need immediate shareholder approval.

Bill pp. 188–190, § 321(b) [IRC amended §§ 402(b) and 403(c)]

Non-exempt Trusts and Nonqualified Annuities

Under present rules relating to nonexempt trusts, the amounts payable to an employee are treated as ordinary income. This is so whether they are taxed to him at the time of contribution to the trust (if then nonforfeitable) or when distributed to him. Accordingly, there is no reason to change the rules of nonexempt trusts to preclude the possibility of converting ordinary income into capital gain. Thus the basic purpose of the restricted stock proposals is not applicable to nonexempt trusts.

Treating interests in nonexempt trusts in the same manner as restricted stock would tend to put smaller and less financially sound employers at a disadvantage. Many employers award annual bonuses which require an "earn-out" period of several additional years. Where the employer is a financially sound company and can utilize a plain contractual obligation, the employee will not receive taxable income until distributions are made. But, in the case of an employer whose financial status is not as sound and who must make contributions to a nonqualified trust in order to give his employees comparable protection, the employee would be forced, under proposed section 402(b), to pay a tax when the earn-out period ends. Thus, in the latter case, the employee is at a substantial disadvantage, unless he has other available and noncommitted funds to pay a tax prior to actual distribution from the nonexempt trust. This economic disparity would tend to help large companies obtain and retain quality management, to the corresponding disadvantage of the smaller or less financially secure companies.

The "economic benefit" theory of taxation should be sparingly used, since it demands the exaction of a tax from an employee before he has received the dollars with which to pay it. It seems proper to apply the economic benefit theory to the area of restricted stock since the employee is already the registered owner, can vote the stock, and can receive dividends on the stock. This is not the case with respect to funds held in a nonexempt trust. Why, then, apply the harsh effects of the economic benefit theory in this situation?

The corresponding question of the deduction to the employer in these situations should also be dealt with in the statute. This would require an amendment to section 404(a)(5) of the Code. The rule of *Russell Manufacturing Company v. United States*, 146 Ct. Cl. 833, 175 F.Supp. 159 (1959), should be adopted by statute, permitting the employer a deduction when the employee becomes taxable, even though the employee's rights were forfeitable when the contribution to the nonexempt trust was made. It would seem, however, that the employer's deduction should be limited to the amount which the employer contributed to the trust.

Subtitle D—Other Deferred Compensation

SEC. 331. DEFERRED COMPENSATION

Bill pp. 190–193, § 331(a) [IRC new § 1354]

Deferred Compensation

1. This section, which would penalize deferred compensation by taxing it, not at the rates for the year it is received, but at the *higher* of the rates applicable to the taxpayer in the year earned or the year received, introduces complexity into the law which is out of proportion to any "tax perference" involved.

The provision contains technical deficiencies. Read literally, the words "deferred compensation payment" could be deemed to cover any payment which is "properly attributable" to services rendered in a period prior to that in which payment is received. It could thus apply to a bonus or current profit-sharing payment, measured by profits of the year the services were rendered, but paid only after the financial results have been determined. It might also cover a retroactive pay increase. Since non-employees are embraced in the provision, it could cover the unbilled or uncollected fees of a doctor, lawyer, engineer or architect, whether or not the amount was determinable or collectible in the year the services were rendered.

In such cases, it would ordinarily be fortuitous that the income fell in a different bracket than was applicable in the year the services were rendered. To apply the section to such cases would for those who find themselves regularly in the situations mentioned, require complex calculations and adjustments every year of their active careers, and would result in always imposing the greater, never the lesser, of the taxes applicable in the two years involved each time.

There are what may be deemed borderline cases involving an element of tax planning. A professional man, anticipating a lower income year or a tax cut, may refrain from billing until after the end of a year. But that is not the classic "deferred compensation" arrangement to which the provision seems to be addressed—one that obtains for the employee or independent contractor some of the benefits of a qualified retirement plan without having to meet the requirements of section 401. House report, part 1, p. 90.

It is suggested that the bill adopt the language found in section 404(a) ("a plan deferring the receipt of such compensation") to make it clear that the foregoing cases are not embraced in the provision. Under section 404(a)(5) and its predecessor (section 23(p) of the 1939 Code), it was established that bonuses paid after the end of the year, when profits were ascertainable, were "current payments for current services rendered" and were, therefore, not "deferred compensation." Rev. Rul. 55-446, 1955-2 C.B. 531, 532; Rev. Rul. 57-88, 1957-1 C.B. 88, 89.

2. The first formula for computing the minimum tax requires substantial recordkeeping which may be an undue burden to place on a taxpayer, who may remain an employee for a considerable period of time prior to receiving deferred compensation payments.

To avoid the recordkeeping problems of the first formula, the employee is forced to use the second formula which is arbitrary and does not make allowance for non-compensatory income, such as that derived from the sale of a capital asset, in selecting the three highest years. Thus, using "taxable income" as a base for computation purposes could result in a substantially distorted application of tax bearing no relation to an employee's earned compensation.

In addition, the two formulas fail to cover the situation of the transitory employee who may not remain at a job for more than a couple of years, but yet leaves one or more of the jobs with a deferred compensation arrangement payable at age 65. The second formula will not operate in this case and if he has not kept records to apply the first formula, he will be unable to compute the "minimum" tax under section 1354. There is a further problem if the employee works for an employer for one year, receives a deferred compensation arrangement payable at age 65, terminates his employment and then, years later, again works for the same employer. Would the measuring period under the second formula include years in between with other employers?

3. The problem of income in respect of a decedent as related to deferred compensation is unresolved, as is the problem of deferred compensation paid to a widow and that of the joint tax return vs. the individual tax return.

No consideration is given to the situation where a bookkeeping investment account is used in conjunction with deferred compensation and the employee grosses a much larger payout than that originally deferred for him. The account may continue to grow when the employee is no longer employed by the employer but payout is deferred. Treatment of the excess is unclear.

Finally, section 1354(b) would seem improperly to leave to regulations the problem of determining the years of an employee's service to which his deferred compensation is attributable.

Subtitle E—Accumulation Trusts, Multiple Trusts, Etc.

SEC. 341. TREATMENT OF EXCESS DISTRIBUTIONS BY TRUSTS

Bill p. 194, § 341 [IRC amended §§ 665–668]

Accumulation Distribution from Trusts

The evil which the section seeks to remedy is the tax avoidance that results from multiple trusts created by the same grantor for substantially the same beneficiaries. Undoubtedly, other accumulation trusts have been used for tax avoidance purposes, but most of them are used for legitimate purposes, such as accumulation to avoid the necessity of court appointed guardians or conservators. In any event the revenue involved in the single accumulation trusts used for tax avoidance purposes would appear to be insignificant.

There are a number of other suggested solutions to the evil of multiple accumulation trusts that are much less complex than the proposal in the bill. These solutions do not impose unwarranted complexity on single trusts which have accumulated income over a long period of years and which involve little revenue.

The enactment of section 341 will greatly increase the complexity of taxing provisions already excessively complex. The present rule involves a five-year

throwback. The complications involved in applying a statute which reaches back over a longer period of years would be much greater. The application of the throwback rule involves recomputing the tax of the beneficiary for each of the preceding years in which trust income was accumulated, taking into consideration various classes of income as well as deductions and credits and amounts which have been distributed in prior years. The proposed provisions for limited tax preferences and for allocation of deductions will not simplify these recalculations. A glance at the present Schedule J to be filed with the fiduciary income tax return on form 1041, calling for information in reference to "allocation of accumulation distributions," and the instructions on the back of the form, is sufficient to show that the present rules are exceedingly complex.

Most trusts providing for accumulation are not created because of tax considerations and have sound social purposes. The most frequent accumulation provision relates to income received during the minority of a beneficiary or during the existence of some other disability of the beneficiary. In many instances the operation of this provision will result in refunds. Certainly where a minor beneficiary has no substantial amount of other income, the trust will pay a higher tax because it has only a $100 exemption whereas the beneficiary has a $600 exemption plus at least the standard deduction. It is doubtful that the difference in tax would justify the burdensome task of attempting to recompute the tax over a long period of years.

It would be necessary for trustees, as well as individuals who are potential beneficiaries of accumuated income, to preserve their income tax returns and other records for the duration of a trust which accumulates income. In order to examine such returns properly, the Internal Revenue Service should preserve the returns of trusts and individuals for an indefinite period. If an unlimited throwback rule is enacted, it will probably be necessary for the Internal Revenue Service to train a large number of revenue agents to examine returns involving accumulation distributions. In view of the comparatively small amount of revenue involved, it is likely that the time of such agents could be spent more profitably in other fields.

1. The administration of a statute which requires the examination of income tax returns and records extending back over a large number of years would be a constant source of irritation and expense to taxpayers and the Internal Revenue Service alike. The "short cut method" provides for computing the beneficiary's tax by including the average annual amount of accumulated income in his return for the current and two preceding years. However, in order to do that, it would be necessary to know the exact amount of accumulated trust income in each of the preceding years, the amount of each class of income, the amount of each partial distribution, and the amount of tax paid by the trust. In order to determine whether the "short cut method" or the "exact method" would produce a lower tax, it would be necessary to make both sets of computations.

2. The application of the unlimited throwback is not clear where there is a "pour-over" trust, i.e., on termination of one trust, the assets are transferred to a second trust (either newly created or already in existence). Logically, the accumulation and tax payments of the first trust should carry over to the second without imposition of a second tax until distribution is made to an individual. Similarly, where on the death of an income beneficiary a trust is split into two or more separate trusts for successor income beneficiaries, provision should be made for splitting the accumulations. Presumably this problem can be readily avoided by drafting the old trust in such a way as to keep it in existence. However, many existing trusts were drafted by reference to existing rules and provide for "pour-overs" on termination, as, for example, the distribution of assets in the marital trust to the residuary trust following the death of the widow.

3. The retention of old trusts may be undesirable from the standpoint of trust administration. For example, assume separate trusts for the benefit of each of three children with provision that if one should die without descendants, the corpus is to be divided between the other two trusts. Such an arrangement may be superior to a provision that the first trust continues for the benefit of the other two children in equal shares.

The complexity of the provisions introduced by the bill may lead to distortion of normal trust management. For example, the operation of the "shortcut" method makes it desirable for the trustee to accumulate at least some small amount of income each year of the trust so as to reduce the average annual income.

Conversely, the effect of the bill may be to cause trustees to distribute income currently to minors (or other beneficiaries), if they have discretion to do so. Such action is frequently unwise from a property management standpoint and will in many cases (especially with minors) reduce, rather than increase, the tax collected on the income.

Bill p. 194, § 341(a)(1) [IRC amended § 665(b)]

Elimination of Minority, Emergency, and De Minimis Exceptions

The retention of a de minimis provision (which could well be increased from $2,000) would greatly alleviate administrative problems. In order to avoid the multiple trust problem, the de minimis provision could be allowed only for years in which distributions are made from one trust to the same beneficiary.

Trusts to accumulate income during minority are usually not used to avoid taxes, but for legitimate, non-tax reasons. For example, it is common to accumulate income during the minority of a beneficiary, since he is not capable of, or legally qualified to, manage his property. Since the minor usually has little or no other income, no tax avoidance results. The existing statute recognizes this fact and excludes from the throwback any income acumulated before the beneficiary attains the age of 21.

There are other situations as well where a beneficiary is under a legal disability or is not capable of managing property, so that the trustee is required to manage the property and distribute income as and when needed. Since these needs may vary from year to year, and bear no direct relation to the amount of trust income, there may well be accumulations in some years, followed by distributions of more than current income in other years. The present law recognizes certain situations of this type by exempting distributions for "emergency needs" of a beneficiary from the throwback.

Bill p. 195, § 341(a) [IRC amended § 665(e)]

Effective Dates and Transitional Rules

The effective date of section 341 should be changed. To be fair to taxpayers who have created trusts in reliance on the present statute, the new provisions should apply only to trusts created after the date of enactment. Many existing trusts would have been drawn differently if the new rules had then applied. For example, many trusts now require accumulations during minority, whereas with the new law it may be desirable to give the trustee discretion to accumulate or distribute income.

If the new rules are not limited to new trusts, the section should apply only to income accumulated after the date of enactment. The new rules are now made applicable to income accumulated during the last five years (*i.e.*, years ending after April 23, 1964), apparently on the basis that distributions of income from those years may be subject to the throwback of the present law. This fact, however, does not justify making the new rules retroactive. Beneficiaries, as well as trustees in some instances, may not have retained all of the records which they must have in order to use the exact method for these years. As a general rule records are required to be kept for tax purposes only for three years after the tax return is filed. There was, therefore, no reason to retain them longer in situations where the present throwback rule is not applicable. The most obvious examples are minors who have not had to file tax returns. Under the bill, such beneficiaries who have not had any occasion to keep records could not use the exact method and they would have available only the shortcut method which can cause great distortions, depending on the amount of income from unrelated sources. It should also be pointed out that many trusts have been established either through inter vivos instruments or through testamentary provisions which cannot be changed. These might have contained different provisions if the rules of the proposed bill had been known when the instruments were originally prepared. This is especially true in the case of trusts for the benefit of minors.

Bill pp. 198–199, § 341(d) [IRC new § 668(b)]

Alternative Methods of Computing Tax on Amounts Deemed Distributed in Preceding Years

The shortcut method has a built-in inequity in that in the year of termination of a trust the beneficiary will normally have at least one year's income from

the property of the trust includable in his current income so that the income representing average prior accumulations is placed in a higher bracket for that year. An option should be granted in computing under the shortcut method to disregard the year of termination of a trust and spread over the three prior years.

There would appear to be no justification for prohibiting a beneficiary who was not alive for each year of the accumulation from using the exact method with respect to those years following his birth where he can establish the necessary facts. In such a situation the beneficiary should be allowed to use the shortcut method with respect to the balance of the distribution. Such splitting would appear to be possible if the trustee can make a distribution in two taxable years with the first being in such amount that no portion would be allocated to a year before the beneficiary's birth. This further complicates trust administration. Such proposed prohibition discriminates against after-born beneficiaries of trusts.

Bill p. 200, § 341(d) [IRC new § 668(b)(4)]

Multiple Distributions in the Same Taxable Year

The bill provides that where accumulation distributions are made from more than one trust to a beneficiary in the same taxable year, the beneficiary may determine which distribution is made first. The reason for this provision is puzzling as the order of distribution would not appear to affect the computation of tax.

Sec. 342. Trust Income for Benefit of a Spouse

Bill p. 203, § 342(a)(1) [IRC amended § 677(a)(1) and (2)]

Income for Benefit of Grantor's Spouse

The provision of the bill which will tax the grantor on income actually distributed to the spouse may be open to question. Where a joint return is filed, no problem is presented. However, in case of divorce, inequities may result in the year of divorce and problems in negotiating property settlements may be created. Such problems could be eliminated by providing for taxation of the spouse in all cases where the income is actually distributed to her in the current year. Such a provision would not appear to present any serious tax avoidance problem.

Bill p. 203 § 342(a)(1) [IRC amended § 677(b)(3)]

Payment of Insurance Premiums

There would also appear to be equitable grounds for providing that income which which may be used to pay premiums on insurance on the spouse's life should not be taxed to the grantor unless the income is actually so used. There appears to be no greater tax avoidance possibility here than in the case of income usable for support obligations. In most instances such insurance will be payable for the benefit of children and not the grantor or his spouse. Such possibilities may well creep into trusts for the benefit of children where the children own policies of insurance on the life of the spouse. The proposed rule creates one more pitfall to be watched in situations where no tax avoidance is involved. In addition, the suggested change in the proposed bill would make it easier to administer since the existence of insurance policies on the life of the spouse may be unknown to the trustee. The possibility of use of trust income to pay such premiums may well be doubtful, raising complex legal issues. Of course, where income of the trust is actually used to pay premiums that fact is known to the trustee and is easy to examine. In fact, it might be desirable to extend the same rule to insurance on the grantor's life.

Bill p. 203, § 342(b)

Effective Date

The amendments should be made applicable only to trusts created after the enactment of the amendment. Last minute tax avoidance is considered less important that the principle that a taxpayer may rely upon an existing statute in planning his affairs.

Title IV—Adjustments Primarily Affecting Corporations

Subtitle A—Multiple Corporations

SEC. 401. MULTIPLE CORPORATIONS

Bill pp. 204–206, § 401 [IRC new §1561]

Multiple Corporations

The provision is section 1561(a), with respect to the apportionment of the limitation on the life insurance company small business deduction, confers power upon the Secretary rather than the taxpayer to determine whether there shall be any but an equal division of the aggregate limitation among the component members of the group. This is at variance with the treatment in the same subsection of the surtax exemption allowed to a controlled group.

The cross-reference to be added to section 804 should be to section 1561 as well as to section 1564.

The bill would have no effect upon mutual companies other than life subject to tax under section 821. Since such a company has no stockholders, it can be a member of a controlled group of corporations within the meaning of section 1563(a) only as the common parent of such group. In other words, only one mutual company can ever be a member of a controlled group as long as the existence of such a group is determined by reference to stock ownership. For this reason, the proposed amendments in bill section 401(g) to sections 821, 832(c) and 501 (c)(15) designed to apportion or limit the dollar amounts otherwise provided in those sections among all the corporations taxable under section 821 that are members of a controlled group are of doubtful effectiveness.

No part of the limitations on surtax exemptions, the $100,000 amount under section 535(c)(2), the investment credit or first year depreciation provided for in bill section 401(a) through (f) would apply to any company taxable under section 821. All such provisions are made only in respect of the component members of controlled groups. A section 821 company is an excluded member by reason of section 1563(b)(2)(D).

Subtitle B—Debt-Financed Corporate Acquisitions and Related Problems

SEC. 411. INTEREST ON INDEBTEDNESS INCURRED BY CORPORATIONS TO ACQUIRE STOCK OR ASSETS OF ANOTHER CORPORATION

Bill pp. 219–227, § 411 [IRC new § 279]

Interest on Indebtedness Incurred by Corporations to Acquire Stock or Assets of Another Corporation

This provision is intended to discourage acquisitions by large corporations through the use of debt instruments having characteristics making them akin to equity. Although section 297 might produce a proper tax result in the relatively few situations to which it would apply, it is believed that it would represent an unwise addition to the tax law. The section's limited coverage, the likelihood that it would contribute little toward accomplishment of its major purpose, its lack of coordination with other provisions of the Code, the possible implications which might arise from the provision with respect to situations not covered, and its bewildering complexity, appear to outweigh the limited benefits likely to result from it in correcting a few cases of abuse.

1. A major stated purpose is to discourage concentration of economic power through corporate acquisitions which may fall outside the scope of the antitrust laws because of their conglomerate nature. In relation to this purpose, the provision seems questionable.

Even if it is conceded that it may sometimes be proper to use tax measures to attain objectives other than raising revenue, the goal might be better achieved by legislation in the antitrust field where the solution can be more complete and more precisely tailored to the nature and scope of the problem.

The provision is too narrow in scope materially to advance this objective. It would not apply to nontaxable acquisitions. Moreover, even the use of debentures in taxable acquistions will probably not be significantly curtailed. Whereas its antecedent, H.R. 7489, the so-called "Mills Bill," disallowed interest on all

debentures providing major consideration for acquisitions, section 279 confines the disallowance to debentures meeting certain conjunctive statutory tests for resemblance to equity. Although this limitation is appropriate as a matter of tax theory and equity, it limits the likely effectiveness of the provilson in that:

(*a*) Its application only to indebtedness subordinated to claims of trade creditors will permit ready avoidance by issuance of indebtedness not so subordinated. In the case of conglomerates and other holding companies operating through subsidiaries, claims of trade creditors are frequently insignificant;

(*b*) Its application only to convertible debt or debt associated with an option will permit avoidance by issuance of ordinary debentures; and

(*c*) Its application only where the issuing corporation fails either the 2-to-1 debt-to-equity ratio or the 3-to-1 income-to-interest test will probably make it ineffective with respect to many large corporations; and others may be able to conduct their affairs so as to render it ineffective by intermixing acquisitions in which no debt is issued.

The need for such a provision to discourage debenture acquisitions will be largely eliminated by the enactment of section 412 of the bill, in which receipt of marketable debt securities will ordinarily disqualify the seller's gain for installment treatment. Deferment of the seller's gain until collection or disposition of a debenture received in a sale of stock or assets has been a key element in the popularity of debenture acquisitions. Imposition of tax on the seller's receipt of the debentures should inhibit future recourse to this form of acquisition.

2. Section 411 cannot be justified as an attempt to re-define the distinction between debt and equity for tax purposes because of its failure to deal comprehensively with this subject. Its application is restricted not only by the $5,000,000 allowance but also by its confinement to "corporate acquisition indebtedness"; there is no apparent tax policy justification for distinguishing between such indebtedness and debt issued for other purposes. Moreover, the debt-equity distinction is applied only to the deductibility of interest. There is no attempt to deal with the other situations in which the distinction is relevant, such as the relative consequences of a retirement of debt or equity or receipt of securities or stock in a merger, eligibility of payments for the intercorporate dividend deduction, the individual dividend exclusion, and the like.

In spite of its limited coverage, the provision may have unfortunate and unpredictable collateral effects on the state of the tax law as to the distinction between debt and equity. The principles applied in distinguishing debt and equity for these purposes have been developed and refined over the years in a long series of court decisions. Some of these principles are at variance with the standards established in section 279. While the section itself, as well as the House report, part 1, p. 107, states that no inference is to be drawn from the provision as to the nature of any instrument for the purpose of any other provision of tax law, the possibility that those charged with administration of the tax laws, as well as the courts, may be influenced by these standards cannot be ignored. It is submitted that the tests of section 279 would not afford a suitable statutory definition of indebtedness for all purposes.

3. The definition of corporate acquisition indebtedness in section 279(b)(1) to mean an obligation "issued to provide consideration for" an acquisition is apparently intended to include securities issued to obtain cash to finance cash acquisitions. The purpose of the borrowing appears to control and the determination of this purpose will give rise to numerous problems of application in situations where cash acquisitions are made by corporations concurrently engaged in borrowing for various purposes:

(*a*) Corporate borrowings are frequently made to raise cash for a number of purposes. The bill leaves it unclear whether the obligation will be acquisition indebtedness only if issued solely to provide consideration for a purchase; whether the principal purpose will determine the status of the entire issue; whether the entire issue will be tainted if any portion is to provide such consideration; or whether the issue will be fragmented and only the portion issued to provide consideration will be acquisition indebtedness.

(*b*) The exact uses of borrowed funds and the amounts to be required for each use are frequently not known at the time the obligation is issued. In such a case, it is difficult to see how the necessary determination could be made, unless there is authority to make it retrospectively by reference to the actual use of funds.

(*c*) Funds may be borrowed for one purpose and used for another. Thus, due to a change of plans, funds borrowed for plant expansion or working capital may be used for an acquisition or vice versa. Is the original purpose or the ultimate use controlling?

(*d*) Obligations whose proceeds are used for other corporate purposes may free internally generated cash for acquisition. Should these be deemed to have provided such consideration and, if so, will the statute permit it?

4. The provisions of section 279(b)(1) apparently would apply regardless of how few shares are acquired. Recognizing that ownership of a relatively small percentage of stock may represent effective control, it may nevertheless be desirable to exempt purchases for investment by adding a minimum percentage ownership test, say 5 to 10 percent.

In section 279(b)(1) (Bill p. 220, line 12) the word "except" should be changed to "provided."

The House report states that, in applying the debt ratio and interest coverage tests to a financial institution, its obligations are to be reduced by amounts owed to it and its interest expense is to be reduced by its interest income. (House report, part 1, p. 106). The bill in section 279(b)(4), (c)(2) and (c)(3), makes no such exception. If one is to be made, it should be set out in the statute.

The use of the adjusted basis of assets in determining the debt-equity ratio as provided in section 279(c)(2) is unsound in theory and would be inequitable in practice. This standard has been uniformly rejected in the cases. Rapid depreciation on the one hand and inflation on the other have made adjusted basis a poor measure of the capacity of tangible assets to support debt; and intangible values would ordinarily be left totally out of account. The desire for ease of administration is understandable but does not justify use of this standard.

In the case of acquisition of less than "control" of a corporation as defined in section 368(c), the acquired corporation's earnings under section 279(c)(3)(A) are not considered in testing interest coverage. The control definition of section 368(c) is unduly restrictive, since the required ownership of 80 percent of each class of nonvoting preferred stock is hardly relevant to the acquiring corporation's access to the acquired corporation's earnings. Substitution of a control test which excludes non-voting preferred stock would be preferable and would be consistent with section 279(g). Moreover, for accounting purposes, corporations customarily consolidate earnings of 50 percent-owned subsidiaries; and development of an allocation formula to permit inclusion of a proper share of earnings and interest in such cases might prevent some unfair results. Since future interest is to be measured against past earnings, the latter should be as inclusive as possible.

In order to prevent distortion and manipulation, it would be desirable in section 279(d)(3)(B) to exclude extraordinary gains and losses from the earnings used in the interest coverage test.

In excluding acquisitions of certain foreign corporations, the requirement in section 279(f) as to income from foreign sources should be stated in terms of a specified percentage, e.g., 80 percent, rather than by means of the imprecise "substantially all" test.

SEC. 412. INSTALLMENT METHOD

Bill pp. 227-229, § 412 (a) and (b) [IRC amended § 453(b)(1) and new § 453(b)(3)]

Installment Method: Periodic Payments Requirement

If these provisions are adopted, the effective date should be changed to exclude sales made prior to the date of enactment of the bill or pursuant to contracts made prior thereto.

The stated purpose of the amendments is "to limit the availability of the installment method of reporting gain to situations where" payments "are spread relatively evenly over the installment period." (House report, part 1, p. 108). Presumably the Secretary's regulations would implement this purpose. Such a drastic restriction of the installment method appears highly undesirable. The installment method was made available, in cases where receipt of a major part of the consideration for a sale is deferred, to permit postponement of tax until receipt of the consideration. Otherwise, the taxpayer might lack funds to pay the tax; or he might pay a tax based on expected payments which are never received. The need for this deferment is at least as great where the deferred payments are irregular or uncertain in time or amount as where they are regular and definite; and where the installments are few in number as where they are nu-

merous. Irregularity of payments results far more often from business considerations than from a desire to reduce or defer tax. Denying use of the installment method in such cases would work considerable hardship on taxpayers required to pay a tax that might largely absorb or even exceed the down payment received.

1. It is doubted that there is any significant abuse of the installment method which the amendments would correct. The House report cites the uncertainty in present law as to the number of installment payments required to qualify for the installment method. (House report, part 1, p. 108). This uncertainty could be removed by requiring at least two payments. The only other reason given in the House report is that it is not "appropriate" to allow use of the installment method where the number of payments is limited, especially in the case of a single installment deferred for a long period of time. (House report, part 1, p. 108). Why this is not "appropriate" is not stated.

Adoption of proposed section 453(b)(4), disqualifying readily marketable corporate securities as installment obligations, would eliminate the only substantial problem which is believed to exist under present law.

2. If the provision is adopted, its effective date should be changed. At present it applies "to sales or other dispositions occurring after May 27, 1969." (Section 412(c)). Sales made pursuant to contracts entered into prior to the effective date should be excluded in order to prevent inequity and hardship.

3. It is not clear whether the percentage payment requirements of proposed section 453(b)(3)(B) apply to the total selling price or to the principal amount of the installment obligation resulting from the transaction. The House report refers to "the principal of the loan"; but the provision itself refers simply to "the principal" which may be intended to mean the principal amount involved in the transaction. (House report, part 1, p. 108). For example, if 20 percent of the purchase price is paid at the time of sale, 10 percent later in the year of sale and the remaining 70 percent in subsequent installments within 4 years of the sale, it is not clear what portion, if any, of the 70 percent must be paid by the first and second anniversary dates. The apparent purpose of the provision is to require regular payments on the total price, which would lead to giving credit for any down payment by making the entire selling price the base for the percentages.

Bill pp. 227–229, § 412(b) [IRC new § 453(b)(4)]

Installment Method: Marketable Securities

The phrase "readily tradable on an established securities market" in section 453(b)(4) will likely leave most taxpayers in considerable uncertainty as to what constitutes "an established securities market" and what conditions must exist before a security can be considered "readily tradable" on it. The House report sheds no light on the question. In view of the time which will doubtless elapse before regulations are promulgated, an explanation of what is meant by the phrase would be helpful

SEC. 413. BONDS AND OTHER EVIDENCES OF INDEBTEDNESS

Bill pp. 229–237, § 413 [IRC amended § 1232(a) and (b) and § 6049(a) and (c)]

Bonds and Other Evidences of Indebtedness

Throughout section 1232(a), the holding period referred to is 6 months, which is inconsistent with other provisions of the bill requiring a 12-months holding period.

Proposed section 1232(a)(3)(B) also raises several technical questions: (i) Is this provision intended to apply to any subsequent holder (as its text would seem to indicate), or only to a "purchaser" (as (C) would indicate)? (ii) It would appear that section 1232(a) would follow the bond into the hands of an heir, which was probably unintended; and that estate tax value, no matter how high, would not reduce his reportable income, which seems even more improbable. The fact that the heir's acquisition is not a purchase would preclude only the relief provided by this provision. (iii) On page 233, line 17, query whether "cost" should not read "adjusted basis." This affects the immediately preceding question, but would have other effects as well wherever there are post-acquisition items affecting basis.

Section 1232(a)(3)(C) should also relate to section 1232(a)(3)(D) to provide a consistent definition of a purchase.

Section 6049(a)(1), relating to the reporting of interest, will presumably product information based upon original issue discount, and cannot reasonably reflect the application of proposed section 1232(a)(3)(B) which provides an adjustment for a subsequent holder related to any gain realized by the seller. In the case of most purcharers, this will in variably produce a discrepancy between the amount reported by the issuing corporation and the holder, and will presumably cause the Service's computers to show "tilt" even when the issuer and holder of a purchased obligation have reported with complete propriety. Discrepancies will presumably also be picked up by the computers where the holder is a fiscal year taxpayer.

Requiring inclusion in taxable income prior to receipt, beyond presenting the bondholder with a liquidity problem, seems substantially inconsistent with the realization concept and with the cash method of accounting. Special treatment of this one item does not seem justifiable.

The revenue considerations involved would not seem to justify the hardships that these proposals would create for bondholders and issuers or the considerable additional complexity introduced into the Code.

SEC. 414. LIMITATION OF DEDUCTION OF BOND PREMIUM ON REPURCHASE

Bill pp. 237–239, § 414 [IRC new § 249]

Limitation on Deduction of Bond Premium on Repurchase

The word "repurchase" at page 238, line 8, would seem to render the provisions inapplicable to a purchase by a successor interest to the issuer or a parent or subsidiary of the issuer.

In instances where the obligation bears an interest rate less than the going rate and is trading at its converted value, allowance as an offset of the "normal call premium" provided for at page 238, line 13, may be unwarranted.

SUBTITLE C—STOCK DIVIDENDS

Sec. 421. Stock Dividends

Bill pp. 239–243, § 421 [IRB amended § 305]

Distributions of Stock and Stock Rights

Many problems in section 421 are dealt with only by creating a broad authority to tax and leaving it to the Secretary or his delegate to develop specific rules. This method of dealing with the problems will likely leave the law in an unfortunate state of uncertainty for years to come. Moreover, the bill would aggravate the present lack of coordination and integration of the treatment of stock dividends with other areas of subchapter C, such as the rules concerning redemptions, liquidation, recapitalizations and section 406 stock. Any regulations issued under proposed section 305 and revised regulations under section 306 are certain to be even more complex than the statute. A further effort should be made to find a simpler solution. An example of another approach is the one taken by the American Law Institute in its February, 1954, draft of Federal Income Tax Statute.

It is recommended that modification of section 305 be deferred and be made a part of and integrated with a more comprehensive technical revision of subchapter C of the Code.

1. While section 421 purports to retain the general rule of non-taxability of stock dividends, the exceptions are so broad that they reinstate the "proportionate interest" test, a test which was rejected by Congress in 1954 because of the difficulties encountered by the courts in applying it. A return to a standard of determining taxability that has already proved difficult to apply does not seem an appropriate solution, at least until other approaches have been more fully explored.

2. The Secretary would be given broad authority under section 305(b)(2) and 305(c) to determine whether various events have the effect of making certain stock distributions taxable. For example, a redemption which is treated as a section 301 distribution may be determined by the Secretary to give rise also to a constructive distribution to any shareholder whose proportionate interest in the earnings and profits or the assets of the corporation is thereby increased. The House report, part 1, p. 114, gives as an example a periodic redemption plan under which each shareholder may annually elect whether to have a small

percentage of his stock redeemed. But, the broad language of the statute might permit the Secretary to go much further than an across-the-board election and to determine, for example, that a 40 percent stockholder of a corporation receives a constructive distribution when a 60 percent stockholder causes the corporation to redeem 10 percent of its stock from him. Similarly, under the broad language the Secretary arguably could visit dividend taxation on the continuing shareholders in the case of a non-pro rata spin-off or of an "A" type reorganization wherein some shareholders take stock and others cash. The breadth of his authority and the lack of any standard to guide him or by which to determine the propriety of his action will produce undue uncertainty and risk of administrative over-reaching in an area of wide significance to many taxpayers. Moreover the issuance of regulations under such a complex provision of a major revenue revision is frequently long delayed. During this period, it is usually not possible to obtain rulings on proposed transactions. These considerations make it undesirable to give the Secretary such broad regulatory authority.

3. Section 305(b)(1) continues the provision of present law that a stock dividend is taxable if it is payable at the election of any shareholder in property or stock. Thus, under existing law, a common shareholder who has an election to receive a dividend in either common stock or cash is currently taxable even though he elects to receive the common stock. Where the election is to receive either common stock or preferred stock, however, under present law the shareholder is not currently taxable since "property" does not include stock in the corporation making the distribution. (Section 317(a)). The preferred stock constitutes section 306 stock and has ordinary income potential upon ultimate disposition.

It is probable that the same result is intended under the bill, since actual distributions of section 306 stock on common stock are not generally taxable. However, the status of common stock received pursuant to such an election is unclear. The rule that a shareholder who has an election to receive either stock or property is currently taxable would be retained; but section 306 stock is treated for this purpose as property which is not stock. On the other hand, under section 306(c)(1)(A), stock is section 306 stock only if it is not includible in gross income by reason of section 305(a). Since includibility in income under section 305(a) is the point in issue, a circularity would exist, rendering it impossible to determine whether the preferred stock should be treated as property or stock.

This problem can be eliminated by amending the last sentence of section 305(a) to provide that section 306 stock shall be treated as property which is not stock only for purposes of subsection (b)(2).

In the situation described above, although the distribution would presumably not be taxable by reason of section 305(b)(1), if some of the shareholders elect to receive common stock while others elect to receive preferred stock, those electing to receive common stock would be currently taxable under section 305(b)(2) whereas those electing to receive preferred stock would not be currently taxable, but instead, assuming the problem referred to in paragraph 1 above is resolved as suggested, the preferred stock would constitute section 306 stock. It is unclear whether this is the result intended by the bill.

Under current law as well as under the bill, a stockholder who has an election to receive either cash or common stock would be currently taxable even though he elects to receive common stock. Moreover, under current law if a shareholder has an election to receive cash or preferred stock, he is currently taxable even though he elects to receive the preferred stock. Under the bill, however, it is unclear whether the shareholder would be currently taxable when he takes preferred stock because of the circularity referred to above. If the preferred stock constitutes section 306 stock, it would be treated as property which is not stock for purposes of section 305(b)(1). The shareholder would thus have an election to receive two types of property, neither of which would be treated as stock; and the section 305(b)(1) exception would be inapplicable. The test of taxability would, therefore, be under the general rule of section 305(a). Since section 306 stock is treated as property other than stock only for purposes of sections 305(b)(1) and (2), it would presumably still be stock for purposes of section 305(a) and the distribution would be nontaxable. This would appear to be an unintended result.

4. The lack of coordination which presently exists between section 305 and other provisions of subchapter C would be aggravated by the increased number of stock dividends taxable under section 305. For example, a recapitalization and a stock dividend may be substantive equivalents; but a recapitalization might be tax-free in circumstances where a stock dividend is taxable. Thus, if preferred

dividend arrearages were satisfied through a distribution of preferred stock (or common stock) to the preferred shareholders, under the bill the distribution corporation recapitalized and additional preferred stock (or common stock) were issued in exchange for the dividend arrearages, the exchange would ordinarily be tax-free. (See Treas. Reg. § 1.368-2(e)(5).) While this is also the situation under existing law with respect to distributions in lieu of cash dividends for the current and preceding year, the extension of taxable treatment to stock distributions in lieu of preferred dividend arrearages antedating the preceding year will increase the impact of the artificial distinction between such a stock dividend and a recapitalization having the same effect.

5. Under the bill, distributions of stock or stock rights made before January 1, 1991, with respect to stock outstanding on January 10, 1969 (the effective date of the existing regulations), are exempted from the amendments to section 305. Literally, therefore, where cash dividends are paid with respect to stock issued after January 10, 1969 and stock dividends are paid on stock issued prior to such date, the new rules will not apply. The House report, part 1, p. 115, indicates that this situation would be covered; but if this is intended, the bill should be amended to make it clear.

Distributions prior to 1991 are exempted where made with respect to stock issued pursuant to a contract binding on January 10, 1969. This "binding contract" exemption may not be sufficiently broad to protect all issues as to which a substantial commitment existed on January 10, 1969. Corporate acquisitions customarily involve the execution of an agreement, approval by boards of directors and, finally, shareholder approval. The parties may not be legally committed until shareholders' approval is obtained; but, as a practical matter, they are bound when the directors act. It may be appropriate, therefore, to treat transactions in which stock was to be issued by one corporation to the shareholders of another as binding on January 10, 1969, where approved by the boards of directors on or before that date.

Subtitle D—Foreign Tax Credit

SEC. 431. FOREIGN TAX CREDIT REDUCTION IN CASE OF FOREIGN LOSSES

Bill pp. 243–246, § 431 [IRC new § 904(a)(3)]

Foreign Tax Credit

Under the bill, if recapture occurs by reason of the disposition of property, there seems to be no provision which would credit this recapture as an offset in the event that income is subsequently realized by the taxpayer in the same country. Thus, whereas section 904(a)(6)(A) would be applicable only to the extent that the amount of any loss exceeded the amount of recapture under section 904(a)(3), there is no provision under section 904(a)(3) which would make that paragraph inapplicable if the recapture rules of section 904(a)(6) had been applied in an earlier year. This would seem to be an unintended result, which could be remedied by making section 904(a)(3) inapplicable to the extent that section 904(a)(6) had previously applied.

Where a United States taxpayer has sustained a loss in a foreign country and that foreign country does not permit a carryover of the loss to later years for purposes of computing taxes payable in that country, the effect of section 431 will be to subject some taxpayers to double taxation. In subsequent years the loss would reduce the limitation on the allowable foreign tax credit for United States income tax purposes. At the same time, since the loss does not reduce earnings for purposes of computing the foreign tax, full credit will not be available (where the foreign tax rate is high). It would seem questionable whether, in light of the general purpose of the foreign tax credit provisions to relieve the international double taxation on a unilateral basis, it is an appropriate implementation of this intent to limit the foreign tax credit in cases where the foreign loss is not taken into account in computing the foreign tax in later years.

Where the foreign country does permit a carryover of the loss for foreign tax purposes, the operation of the 50 percent rule of proposed section 904(a)(3) would operate to deprive a taxpayer of credit he is intended to have. For example, taxpayer has a loss of $100 in year 1 and profits of $100 in each of the years 2 and 3. The foreign country allows a carryover so foreign taxes are paid only in year 3. If the foreign income (numerator of the fraction) is reduced by 50 in year 2 and 50 in year 3, half the credit will be lost in year 3. Although intended as a relief provision, this 50 percent rule could thus work a hardship. This re-

sult could be obviated by giving the taxpayer an election between section 904 (a)(3)(A) and section 904(a)(3)(B), or by providing that the reduction amount shall be reduced by the amount of foreign income which is offset by allowance of the loss carryover or which is subject to a tax holiday.

Consideration should also be given to confining recapture within a limited number of years from the year in which the tax benefit was realized. For example, a taxpayer who engaged in a losing activity in a foreign country during 1951–1955 and then withdrew should not be burdened with recapture if he undertakes another activity in the same country beginning in 1970.

SEC. 432. SEPARATE LIMITATION ON FOREIGN TAX CREDIT WITH RESPECT TO FOREIGN MINERAL INCOME

Bill pp. 246–251, § 432 [IRC new § 904(g)]

Separate Limitation on Foreign Tax Credit with Respect to Foreign Mineral Income

The effect of this amendment to section 904 is to deny application of any portion of the tax imposed by the foreign government on mineral income as a credit against the United States tax on other foreign income, regardless of whether any of such foreign tax on mineral income could be proved to be a royalty. The rule adopted by the bill is that the part of the foreign extraction constituting a tax may not exceed the amount of United States tax on the same income.

The provision will presumably apply to mineral income from sources within a number of countries which are not usually thought of as involving the "royalty versus tax" problem—in that such countries, while requiring the payment of royalties on property owned by the government and also imposing income taxes on mineral income, appear to set both the royalty rates and the income tax rates on the basis of considerations normally applied to such separate determinations. Such countries would include Canada, Israel and Mexico.

It should be noted, also, that overseas mineral operations often include the refining, processing and marketing of mineral products, as well as production, within the same foreign country. Not uncommonly, the foreign rates may vary in different activities and a higher tax on extraction may be acceptable because the tax on the integrated operation is acceptable. Accordingly, it might be more appropriate to consider all of the taxes imposed by a foreign country on the entire integrated operation in that country, and all of the income therefrom, as the basis for the separate tax credit limitation.

In some foreign countries, companies engaged in the production of minerals as their primary activity, and in some cases companies engaged in related activities, are required to pay a higher rate of income tax on all of their income than the rate applicable to companies engaged in other activities. It is not clear whether, under the provisions of section 432 of the bill, such a country would be deemed to impose income taxes "on such income" (that is, "foreign mineral income") at a higher rate than "on other income" (that is, other income derived by the same taxpayer who engages in mineral operations). Further, is "other income" to be income of United States nationals, or mineral income of nationals of the foreign country, or non-mineral income of nationals of the foreign country?

The special provision permitting a United States taxpayer to elect to return to the per country limitation without consent of the Secretary or his delegate seems unduly restrictive in that the election must be made with respect to the first taxable year beginning after the date of enactment of the bill, whether or not the taxpayer in fact has foreign mineral income in that year. Authorization to make such an election without consent, could equitably be extended to the first year, after enactment of the bill, in which the taxpayer receives any "foreign mineral income."

Subtitle F— Depreciation Allowed Regulated Industries; Earnings and Profits Adjustment for Depreciation

SEC. 452. EFFECT ON EARNINGS AND PROFITS

Bill pp. 270–271, § 452 [IRC new § 312(m)]

Effect on Earnings and Profits of Depreciation

1. The depreciation limitation under section 312(m)(1) applies to any corporation "for the purpose of computing its earnings and profits with respect to

any taxable year beginning after June 30, 1972." This language presumably means that the limitation applies only in computing the earnings and profits for such year, i.e., realized in such year. However, some persons have understood it to mean that the limitation applies in determining accumulated earnings and profits whenever it becomes relevant in a taxable year beginning after June 30, 1972, and thus might require a redetermination of depreciation for all prior years in which such earnings had accumulated. The House report, part 1, p. 135; part 2, p. 103, indicates that the recomputation is to be made for all years beginning after June 30, 1972, and not for prior years, which we believe to be the intended result. This possible ambiguity should be resolved by either a change in the language of the provision or an appropriate statement in a Committee report.

2. Amendments to section 312(a)(3) and (c)(3) appear to be required in order to coordinate them with section 312(m). Under section 312(a)(3), earnings and profits are decreased by the "adjusted basis" of distributed property, which presumably means its adjusted basis as determined under sections 1011 *et seq.* However, the use of different depreciation in determining earnings and profits would give rise to a different adjusted basis for earnings and profits purposes; and it is this adjusted basis which should be used in determining the reduction of earnings and profits under section 312(a)(3). Thus a special definition of adjusted basis appears to be required for purposes of such paragraph.

Similarly, the recognition of gain on a distribution under sections 1245(a) and 1250(a) will no longer give rise to an equivalent increase in earnings and profits. Accordingly, the amount of the adjustment of earnings and profits under section 312(c)(3) by reason of gain recognized under section 1245(a) or 1250(a) will often differ from the amount of such gain. If the existing language of section 312(c)(3) is thought to be sufficiently general to permit this, the statute should make clear that this is intended.

The "income tax basis" rather than the "earnings and profits basis" should continue to be used for corporate distributions under section 301(b)(1)(B)(ii) and the other provisions of section 301.

3. Reference solely to "the straight line method" (Bill, p. 270, line 21) will leave problems of whether salvage value must be taken into account. A taxpayer using the declining balance method need not determine salvage value; hence the computation under section 312(m) might require determination of a purely hypothetical salvage value. It is suggested that the purposes of section 312(m) would be adequately accomplished by providing that the straight line depreciation shall be calculated without regard to salvage value.

4. The proposed amendment will, unless modified, make substantial changes in the taxation of income derived by United States taxpayers from foreign sources, although the House report gives no indication that these effects were intended or considered. A United States shareholder may, of course, receive a dividend from a foreign corporation which would now be considered tax-free under section 301 in the same manner as the distributions referred to in the House report. In addition, however, the determination of the earnings and profits of a foreign corporation has significance with respect to several sections of the Code where a change in the computation will not have the same significance which it has under section 301.

Under section 902 a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends is deemed to have paid foreign income, war profits or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or any possession of the United States on or with respect to the accumulated profits out of which such dividend is paid. Consequently, the domestic corporation is entitled to a foreign tax credit for such taxes under section 901. The term "accumulated profits" is defined by Treasury regulations, section 1.902-3(c)(1) and (2), to mean the earnings and profits of the foreign corporation (with adjustment in certain cases). In general, the earnings and profits so referred to are to be determined under United States tax accounting standards. A taxpayer may choose to determine the earnings and profits under the rules provided by Treasury regulations, section 1.964-1 (with certain exceptions), and must so determine the earnings and profits if the foreign tax credit under section 902 is claimed for a year with respect to which the domestic corporation has elected to receive a minimum distribution under section 963.

It would appear that, if a taxpayer computes "accumulated profits" of a foreign corporation, for purposes of section 902, under United States tax accord-

ing standards, section 452 of the bill would require the earnings and profits of the foreign corporation to be computed on the basis of straight line depreciation. If the taxpayer chose to compute the earnings and profits of the foreign corporation under Treasury regulations, section 1.964–1, subsection (c)(1)(iii) of that regulation would permit depreciation to be computed "in accordance with section 167 and the regulations thereunder." Since, in general, the regulations under section 964 do not require strict adherence in every respect to United States accounting standards, it is not predictable whether such regulations would be amended, following adoption of the proposed amendment to section 312, to require depreciation of the foreign corporation to be computed in the same manner as for a domestic corporation.

If computations of the earnings and profits of a foreign corporation required to be made under section 902 are to be affected by the proposed amendment to section 312, this will effect a dramatic change in the amount of foreign taxes allowed as a credit. In general, foreign countries allow depreciation to be taken into account for tax purposes at accelerated rates. If the foreign corporation's earnings and profits are to be determined by taking depreciation only on a straight line basis, the effect will be to increase markedly the earnings and profits of the foreign corporation and thus increase the denominator of the portion of the foreign taxes available for credit. This would decrease markedly the available foreign tax credit under section 902.

Under section 952(c), the subpart F income of a controlled foreign corporation (which under certain circumstances is taxed to United States shareholders of such corporation, even if not distributed) is limited so that, in general, the amount thereof may not exceed the earnings and profits of the foreign corporation for the year, reduced by net accumulated deficit in earnings and profits from certain prior years. While this rule may be expected to apply only to a limited number of cases, a change for post-1972 years in the computation of earnings and profits may have effects (all of which we have not yet been able to determine) on this limitation.

Under section 960, if a domestic corporation is required to include in gross income an amount of subpart F income of a foreign corporation, it is entitled to a foreign tax credit comparable to the foreign tax credit allowed under section 902 with respect to actual dividend distributions. The same considerations discussed above, with respect to section 902 would apply in the application of proposed section 452 to the determination of this foreign tax credit.

Under section 963, a domestic corporation which elects to receive a "minimum distribution" of the earnings of a controlled foreign corporation is not required to include in gross income any amount with respect to the subpart F income of such corporation for the election year. If proposed section 452 is applied to this provision, it will substantially alter the determination of the required minimum distribution. In general, the amount of the required minimum distribution is computed by reference to the "effective foreign tax rate" paid by the foreign corporation. This in turn is determined by comparing the foreign tax paid to the earnings and profits of the foreign corporation (before foreign taxes). In addition, once the effective foreign tax rate is determined (and if such effective foreign tax rate is less than roughly 90 percent of the applicable United States corporate rate), then the amount of the required minimum distribution is stated as a percentage of the earnings and profits of the foreign corporation. If earnings and profits are to be determined for both of these purposes by taking into account only straight line depreciation, the effect will be both to reduce the effective foreign tax rate (which will increase the percentage of earnings and profits required to be distributed) and also to increase the absolute amount of the required distribution.

5. Consideration should be given to the possible effect of the application of section 452 to other determinations, including the following:

(*a*) Under section 956, a United States shareholder in a controlled foreign corporation must include in gross income his pro rata share of the increase for any taxable year in the earnings of a controlled foreign corporation invested in United States property. Such amount is included, however, only to the extent that it would have constituted a dividend if it had been distributed. Such amount is necessarily determined by reference to the earnings and profits of the foreign corporation.

(*b*) Under section 959, actual dividends received by a United States shareholder from a controlled foreign corporation are excluded from gross income to the extent that such distributions are made out of earnings and

profits of the foreign corporation previously subjected to tax in the hands of the United States shareholder (or, under certain circumstances, prior shareholders). Under section 959(c), "ordering rules" are established determining the extent to which distributions are deemed to be made out of previously taxed earnings and profits and out of untaxed earnings and profits.

(c) Under section 1246, gain recognized upon the sale or exchange by a United States person of shares in a foreign investment company (as defined) is treated as gain from the sale of a non-capital asset "to the extent of the taxpayer's ratable share of the earnings and profits of such corporation" accumulated in taxable years after 1962. The remainder of the gain is treated under general concepts and normally will constitute a long-term capital gain.

(d) A generally comparable, though more limited, provision is made under section 1248 with respect to the sale or exchange of stock in a controlled foreign corporation (as defined in section 957).

TITLE V—ADJUSTMENTS AFFECTING INDIVIDUALS AND CORPORATIONS

Subtitle A—Natural Resources

SEC. 501. NATURAL RESOURCES

Bill pp. 273–276, § 501(a) [IRC amended § 613(b)]

Percentage Depletion

The Section of Taxation takes no position with respect to percentage depletion rates.

The bill would limit oil and gas percentage depletion to wells located in the United States, Puerto Rico, or the Outer Continental Shelf. Depletion on foreign oil wells would be limited to cost.

1. Under existing law depletion is allowed on foreign oil only if the income is reported for United States taxation. Denial of percentage depletion on foreign oil may cause the operator to form a foreign subsidiary to operate the property, thus giving rise to the possibility of removing the income from United States taxation.

It should be pointed out that under the proposal to eliminate percentage depletion on foreign production, the holder of a royalty interest may, as a practical matter, also lose any right he would have to cost depletion because of the difficulty entailed in obtaining reserve figures on which to base his cost depletion computation. It is common knowledge that such information is carefully guarded, hence the apparent hardship to the royalty holder.

2. The disallowance of all percentage depletion on foreign oil and gas is inconsistent with the treatment proposed for other minerals. Thus percentage depletion is allowable on foreign sulphur and uranium deposits at the same rate as domestic. For metal mines, depletion on foreign deposits is allowed at 11 percent instead of the domestic rate of 15 percent. For a long list of other minerals the rate for foreign deposits is the same as for domestic.

3. The amendment defines the Outer Continental Shelf as being that defined in section 2 of the Outer Continental Shelf Lands Act. Since the enactment of the Outer Continental Shelf Lands Act, the United States has ratified the 1958 Geneva Convention on the Continental Shelf which gives jurisdiction to each country to the depth of 200 meters or such depth as can be exploited. The 200-meter depth has already been passed on the California coast. It may be that between the Convention and the Act some offshore wells might be denied depletion under the bill. This potential problem could be solved by defining the Outer Continental Shelf in line 16, page 273, as any area where the United States exercises jurisdiction.

4. On page 277, line 7, the words "economic interest" are used. This term is not defined anywhere in the Internal Revenue Code. It is suggested that it be defined, using the Supreme Court's definition in *Palmerd v. Bender*, 287 U.S. 511 (1933), as follows:

"An economic interest in a mineral property is one whereby the taxpayer by investment has acquired an interest in the mineral in place and has secured by any form of legal relationship income derived from the extraction of the mineral solely to which he must look for a return of his capital."

The term "mineral production payment" used in several places on page 277 and on page 279 also is not defined in the Code. It is suggested that the definition given

by the Supreme Court in *P. G. Lake, Inc.* v. *Commissioner*, 356 U.S. 260 (1958), be used, as follows:

"A mineral production payment is a right to a specified sum of money payable out of a specified percentage of the mineral, or the proceeds receivable from its sale, if, as and when produced."

Bill pp. 279–280, § 501(c) [IRC new § 615(h)]

Exploration Expenditures

Under section 615 of present law, a miner may expend up to $400,000 on exploration for minerals and elect to deduct it. Such amount may be for either domestic or foreign exploration. As to domestic exploration, under section 617 he may elect to deduct an unlimited amount but such amount shall be recouped from depletion or a sale after the mine becomes productive.

It is now proposed to make the $400,000 recoupable also. The exception, on page 280, line 12, provides that any taxpayer who has deducted less than $400,000, under either section 615 or section 617, may deduct the balance after the effective date of the amendment on foreign exploration, subject to recapture.

Thus, for the first time, foreign exploration expenditures may be deducted under section 617. Under these circumstances it would appear that taxpayers who have previously elected under section 615 should be granted a reasonable period for making a new election under section 617, if they choose to do so.

Subtitle B—Gains and Losses

SEC. 511. REPEAL OF ALTERNATE CAPITAL GAINS TAX FOR INDIVIDUALS

SEC. 512. CAPITAL LOSSES OF INDIVIDUALS

SEC. 514. HOLDING PERIOD OF CAPITAL ASSETS

Bill. pp. 281–285, 287–290, §§ 511, 512, and 514

Repeal of Alternative Capital Gains Tax

1. Since the subject matter of these sections invloves everyday activities of many taxpayers throughout the country, the proposed effective date seems particularly unfair. Undoubtedly many taxpayers, unaware of the press releases of the House Ways and Means Committee, consummated many bonafide transactions which they would not have completed had the law been changed as proposed. The result is aggravated in the case of fiscal year taxpayers by the proposed increase in the holding period required for long-term gain treatment. The effect could be to impose a tax of 77 percent instead of the anticipated 27 percent.

2. If the effective date is not changed, it is submitted that the provision should be amended to cover a number of situations that do not appear to have been considered.

Example A—A taxpayer enters into an enforceable contract in June, 1969 and the property is actually conveyed in August, 1969. Do the provisions of the pending bill include or exclude such a transaction? Is there to be a distinction between a contract of sale and a contract to sell, and if so, does this not only raise a question of the validity of the distinction but also of the practical difficulty of distinguishing between the two?

Example B—A corporation in June, 1969 agrees to liquidate under the provisions of section 337 of the Internal Revenue Code of 1954. The liquidating dividends are actually received by the stockholders in August, 1969 and in subsequent months. Do the provisions of the pending bill include or exclude such a transaction?

Example C—In August, 1969 a taxpayer sells a capital asset which has been held by him for seven months. The new averaging provisions in the pending bill apply to taxable years beginning after 1969. The existing law requires a segregation of capital assets in determining the averaging provisions. Under the pending bill can the transaction in this example be brought under the averaging provisions?

Example D—A taxpayer acquired an asset in April, 1969 which has since then materially decreased in value. Because of his individual carryover situation a short-term loss is of no benefit to him in 1969. Does the new bill permit him to defer his loss to 1970?

3. In section 511(c) the Secretary of the Treasury or his delegate is authorized to prescribe regulations with respect to taxpayers having fiscal years. However,

no standards are set forth which the Secretary of the Treasury or his delegate is required to follow.

SEC. 513. LETTERS, MEMORANDUMS, ETC.

Bill pp. 285–287, § 513 [IRC amended § 1221(3) and § 1231(b)(1)(C)]

Letters, Memorandums, Etc.

Although the House report, part 1, p. 149, states that "letters and memorandums addressed to an individual are considered as prepared for him," section 513 does not so provide. If this result is intended, ambiguity could be eliminated by slight modification of the statutory provision.

SEC. 515. TOTAL DISTRIBUTIONS FROM QUALIFIED PENSION, ETC., PLANS

Bill pp. 290–296, § 515 [IRC new §§ 402(a)(5), 403(a)(2)(C), and 72(n)]

Total Distributions From Qualified Pension, Etc., Plans

Section 402(a)(5) uses the term "benefits accrued" in both subparagraphs (A) and (B). The closing sentence of proposed section 402(a)(5) provides for the delegation to the Secretary of regulatory authority to carry out the purposes of this change.

1. The first question is whether the word "accrued" is to include benefits which have not as yet vested. The word "accrued" is used in several different ways in describing a participant's rights in qualified plans. Accordingly, since it should be the intent of this section to include benefits which have not vested, it is suggested that the following parenthetical phrase "(whether or not vested)"—or words of similar purport—be added after the word "accrued" in the above subparagraphs.

It is not clear whether the proposed statutory language would continue the favorable capital gains treatment of existing law where an amount is paid into a trust by an accrual basis employer on, say, March 15, 1970, with respect to a plan year which ended on December 31, 1969. Presumably, the favorable treatment would include the March payment as an "accrued benefit."

2. With respect to profit sharing, stock bonus or money purchase pension plans and individual retirement income contracts, it is relatively easy to determine, at a given date, the amount of "accrued benefits." This would be the amount actually contributed to the trust be the employer prior to that date, plus the most recent plan year's contribution if the presumption of the above paragraph is correct.

In the area of pension plans, however, it is not certain whether the term "benefits accrued" refers to the actuarial value of the benefit to which the employee is entitled on account of service up to the given date, or whether it means the actual amount contributed on his behalf by the employer up to the applicable date. The House report, part 1, p. 155, is ambiguous. Under (i) on page 155, it states that the limitation "will not apply to employer *contributions made* on behalf of the employee *during* the plan years beginning before January 1, 1970" (emphasis added). But, the next sentence states that the bill "will have no effect on benefits *previously accrued* by employees." It is recognized that the regulations could take a position in this regard. However, because of the importance of the alternatives, it is suggested that a more accurate meaning of the term "benefits accrued" be given in the statute itself.

3. Another substantial problem inherent in the phrase "benefits accrued" is to determine the amount of those benefits, since there are several different appropriate methods. For example, two employees of identical age and salary who enter their respective pension plans at the same time would have different amounts of "benefits accrued" at January 1, 1970, depending on the method of funding their benefits, i.e., entry age normal, attained age normal, etc. If the bill were to levy different tax burdens depending upon the method of determining actuarial liability or contributions, then the result would be inequitable. The power to provide regulations would not necessarily cure this inequity.

It is submitted that what is needed in the statute is an alternative method of computing "benefits accrued" which, although it may be imprecise, will not be inequitable. What is suggested, specifically, is a simple proration of the amount of the employer-provided benefit depending upon the number of years the employee has been a participant in the plan. Section 331 of the bill, dealing with deferred compensation, provides such a "career average" method for the purpose

of that section. It is suggested that that approach be applied to proposed section 402(a)(5) as an alternative method, so that either the career prorated amount or the amount computed according to the regulations, whichever is *greater*, shall be used for this section.

In this manner, the employee would receive a more liberal treatment, since, under several actuarial methods, pension liability and contributions normally increase as the employee's age increases. This "short-cut" method seems appropriate since it would avoid difficult and costly actuarial computations, and, in many instances, different tax consequences for taxpayers whose situations are substantially the same. The use of a proration of benefits over the employment span would also help alleviate the problem of determining "benefits accrued" under pension plans which use the so-called "aggregate" method of funding (i.e., where employer contributions are not allocated to individual employees).

4. It has been pointed out that, by action of section 511 of the bill (which repeals the alternative capital gains tax), an employee who receives a lump-sum distribution from an exempt trust subsequent to July 25, 1969, will be taxed at a higher rate on that lump-sum distribution as compared with a distribution prior to that date. This result would seem to be inconsistent with the carefully drawn effective date provisions of section 515 of the bill, which would leave inviolate employee benefits accrued prior to 1970.

Furthermore, there does not seem to be the usual need here for an early effective date. There are limited avoidance possibilities in the case of distributions under employee benefit plans since the employee does not often have much choice in the timing of lump-sum distributions. Under the circumstances, it is suggested that the July 25, 1969 effective date of section 511 of the bill should not apply to distributions made under section 402(a)(2), as amended, with respect to benefits accrued prior to January 1, 1970.

5. The following comments relate to section 515(b) of the bill (proposed section 72(n)(1)(C)):

a. Subparagraph (C) refers to an employee who has been "a participant in such plan." Language should be inserted at this point to make clear that "such plan" also includes the plan of a predecessor or successor employer, etc., as is now provided in section 331 of the bill—proposed section 1354(b).

b. The same subparagraph refers to "5 or more years." The question is, what is the meaning of the word "years"? Does this refer to a plan year, taxable year of the employee, taxable year of the employer, or calendar year? Or, does it refer to anyone of them as sufficient to meet the 5-year requirement? It is suggested that, in keeping with other provisions of section 515 of the bill, it would be appropriate to use "plan year" in this instance.

c. This same subparagraph also refers to an employee only if he has been a "participant." What is meant by "participant"? Does this mean an employee who is eligible under the plan, eligible but not vested (in whole or in part), or eligible but vested? Many plans have an eligibility waiting period but then, once that has been satisfied, provide credit for all or part of the waiting period as credited service. In this situation, when would the count of years begin for determining when the employee was a participant? In reserving this matter, one approach which should *not* be taken is that now found in section 72(n)(1)(C)(ii); this approach is too restrictive for the purposes of the new 5-year rule for all employees, since, in many pension plans, actual contributions may not be made on account of an employee for one or more years in situations where there is an actuarial surplus by reason of substantial forfeitures. Under present law, section 401(a)(8), forfeitures must be applied against future contributions. However the problem is ultimately solved, it should be done with the precision of language now found in section 72(n)(1)(C)(ii).

SEC. 516. OTHER CHANGES IN CAPITAL GAINS TREATMENT

Bill pp. 296–300, § 516 [IRC new § 1001(e) and new § 1252]

Other Changes in Capital Gains Treatment

Section 516(a) amends section 1001 to provide that in determining gain or loss on the sale or other disposition of a term interest in property, the adjusted basis of such interest determined under section 1014 or 1015 shall be disregarded.

1. The section as presently drafted covers life and other term interests acquired by gift, bequest or inheritance and, thus, follows the pattern of section 273 which provides the amortization of an interest acquired in the manner described. Neither present Code section 273 nor section 516(a) of the bill covers a term

interest created by the taxpayer, initially retained by him and then either amortized or sold.

Assume, for example, that a taxpayer transfers a remainder interest in stock to his son or to a charity and retains the right to the dividends for his life. The question has arisen whether he may amortize the life interest on the theory that it is a wasting asset and is not specifically covered by section 273. Whether a term created by the taxpayer may be amortized appears to have been discussed in only two cases. *United States v. Georgia R. & Banking Co.*, 348 F. 2d 278 (5th Cir. 1965), and *Illinois Merchants Trust Co.*, 14 B.T.A. 890 (1928) (Dis. Opin.).

Perhaps a retained income interest such as the one described above should not be amortizable. Similarly, perhaps the sale of such an interest should not be given preferential treatment over the sale of an identical interest acquired by gift, bequest or inheritance. Yet, as with present Code section 273, section 516(a) of the bill appears not to preclude the offset of gain from the sale or exchange of a retained life estate by a portion of the basis allocable to it. In cases where assignment of income principles do not require ordinary income treatment on the sale of a retained income interest, such an interest should also be covered by section 516(a) of the bill. If section 516(a) is retained, it might be an appropriate time to amend similarly present Code section 273.

2. The reference in proposed section 1001(e)(3) to "a fee interest" (Bill p. 297, line 16) may provide too broad an exception. Although the exception is fundamentally proper where the underlying fee interest is sold as part of the same transaction, two limitations should probably exist: (i) that the fraction of the fee interest sold should be at least as great as the fraction of the term interest sold, and (ii) that the same fraction of estates and interests intervening between the fee interest and the term interest also be sold.

Subtitle C—Real Estate Depreciation

SEC. 521. DEPRECIATION OF REAL ESTATE

Bill pp. 300–310, § 521 [IRC new § 1250(j) and (k), amended §§ 1250(a), (b), 167(e) and 381(c)(6)]

Depreciation of Real Estate

The decision to restrict accelerated depreciation for nonresidential housing and to provide additional accelerated depreciation for rehabilitation of low or moderate income housing appears to be a policy decision based upon national housing goals unrelated to the goals of uniformity and simplification of the Internal Revenue Code.

1. The subsection (k) proposed to be added to section 167 (relating to depreciation) provides for accelerated depreciation of rehabilitation expenditures in connection with "low-cost rental housing." The definition of "low-cost rental housing" contained in section 167(k)(3)(B) refers to dwelling units held for occupancy on a rental basis by families of "low or moderate income as determined by the Secretary or his delegate in a manner consistent with the policies of the Housing and Urban Development Act of 1968." The Housing and Urban Development Act of 1968 and predecessor acts have used the terms "low income," "lower income" and "low or moderate income" for various special programs. The term "low or moderate income" does not appear in the Housing and Urban Development Act of 1968 but does appear in earlier Housing and Urban Development legislation. For these reasons, it is submitted that the definition of "low-cost rental housing" proposed for purposes of the special depreciation deductions to be allowed in the case of rehabilitation expenditures is inadequate.[1]

2. The inclusion of rules similar to those provided in paragrphs (5), (9), (10) and (13) of section 48(h) for the purpose of new construction begun or contracted for before July 25, 1969 preserves the right of certain transferees to compute depreciation allowances under present law rules. The inclusion of the new rule of section 167(j)(1) in paragraph (6) of section 381(c) without providing

[1] Section 521(a) of the bill (beginning at line 5, page 300) amends section 167 by redesignating subsection (j) as subsection (n) and by inserting after subsection (i) new subsections (j) and (k). This would leave the lettering of subsections to run from (a) through (n) without any subsections (l) or (m). Neither the House report nor the bill make reference to the fact that new subsections (l) and (m) are proposed to be added to section 167 by sections 451 and 705 of the bill, respectively. This may cause technical difficulties if section 521 is retained intact and sections 451 and 705 (or either of them) are rejected before final passage. This should be corrected by adding at the end of line 7, page 300 the following: "to follow subsection (m) (added by section 705)."

for rules just referred to in section 48(h) for used section 1250 property results in a prohibition of the carryover of depreciation methods in the case of used section 1250 property acquired after July 24, 1969. This may be intentional since it conforms to the rule under present law which denies to transferees 200 percent declining balance depreciation even though the transferee's basis is determined by reference to the basis in the hands of the transferor under section 351, 371(a), 374(a), 721 or 731. However, the failure to provide for a carryover of the transferor's 150 percent declining balance depreciation (which is permitted for used property acquired before July 25, 1969) in the case of transfers covered by section 381(a) is apparently unintended since present law provides for the carryover of 200 percent declining balance depreciation in such cases and, under present law, no carryover provision in necessary to permit the transferee to use 150 percent declining balance depreciation. Under the new rules, unless there is a carryover provision, the transferee will be limited to use of the straight line method of depreciation. This could be remedied by changing section 521(f) so that section 381(c)(6) will be amended to read as follows:

"(6) METHOD OF COMPUTING DEPRECIATION ALLOWANCE.—The acquiring corporation shall be treated as the distributor or transferor corporation for purposes of computing the depreciation allowance under paragraphs (2), (3), and (4) of section 167(b), or subsetcion (j), (k), or (m) of section 167, on property acquired in a distribution or transfer with respect to so much of the basis in the hands of the acquiring corporation as does not exceed the adjusted basis in the hands of the distributor or transferor corporation."

Alternatively, the same result could be accomplished by including subparagraph (4) of proposed section 167(j) as an exception in subparagraph (1).

3. Section 312(m) is unclear. A literal reading indicates that the straight line computation is to be made as if the previous year had been computed on the double declining balance method or sum-of-the-year digits method. If this is the intent, then the full cost of the property will not have been recouped by the end of its useful life, as would be the case were a continuing straight line schedule to be maintained. It is assumed that for earnings and profits purposes, gain or loss on disposition will be adjusted to reflect the lesser depreciation allowed, although this is nowhere indicated.[1]

Subtitle E—Subchapter S Corporations

SEC. 541. QUALIFIED PENSION, ETC., PLANS OF SMALL BUSINESS CORPORATIONS

Bill pp. 313-317, § 541 [IRC new § 1379]

Qualified Pension, Etc., Plans of Small Business Corporations

The American Bar Association has recommended that the $2,500 limitation under H.R. 10 should be removed. (ABA Reports, 1969, Vol. 94). Th extension of such a limitation to subchapter S corporations is inconsistent with this recommendation.

1. So long as the many differences between partnership taxation and subchapter S taxation continue, it is difficult to justify further tinkering which in no way alleviates the difficulties encountered in the past but merely applies yet another layer of complexity.

The proposed section would add a third category of pension and profit-sharing plans and represent a backward step which would widen the gap between overall equality in tax treatment of pension and profit-sharing plan contributions and benefits. Specifically, these problems would result in:

a. Keeping accounts for purposes of limitations on forfeitures (section 1379(a)) and carryovers (section 1379(c)).

b. Recordkeeping by shareholder-employees to obtain relief proposed under section 72. These persons must keep all returns to prove their contributions to the plan in order to arrive at their percentage of exclusion.

c. Where an annuitant dies soon after retirement, deduction for unrecovered section 1379 income comes normally during a low income tax period, whereas the recognition of income has occurred in a high income tax period (section

[1] Since straight line depreciation exceeds the double declining balance method or sum-of-the-years digits method over the greater part of the useful life of an individual property, a fair approach for purposes of the limit on tax preferences might be to adopt the concept of a negative tax preference to take care of the excess in any year of straight line over "liberal" depreciation. This subject is also discussed above in connection with p. 166 of the bill.

1379(b)(3)). This is at variance with the stated purpose of the overall reform to equalize the burden of taxation over a period of years.

d. Extensive revision of existing plans of subchapter S corporations will be required as well as plans of any corporation hereafter electing subchapter S.

2. Under the H.R. 10 rule only partners with "more than ten per cent" capital or profits interest are treated as owner-employees. A policy restricting the availability of benefit plans for subchapter S shareholders would seem to relate solely to major shareholders. Hence, it would seem that the 10 per cent limitation found in H.R. 10 would be more logical than the 5 percent stockholder rule proposed.

3. Stock bonus plans have been thought not possible for subchapter S corporations. Unless the intention of Congress is to open the way for such plans, in some new provisions dealing with subchapter S, it may be well to delete references to stock bonus plans and make the section applicable only to profit-sharing plans.

4. Section 401(a)(8) provides that in a qualified pension plan, forfeitures must not be applied to "increase" the employees' benefits. In proposed section 1379 (Bill, line 12, p. 314) forfeitures would not be allowed to "inure to the benefit of" a shareholder-employee. If there is a difference in the meaning of these terms, it should be explained. If not, use of the same language would be preferable.

At line 9, page 314, the phrase "forfeitures attributable to contributions" seems incomplete. The phrase "forfeitures of benefits attributable to contributions" would be better.

At line 8, page 316, the bill fails to identify the person entitled to the deduction. It would seem better to delete "then there shall be allowed as a deduction" and insert "then the employer may deduct."

TITLE VII—EXTENSION OF TAX SURCHARGE AND EXCISE TAXES; TERMINATION OF INVESTMENT CREDIT

SEC. 704. AMORTIZATION OF POLLUTION CONTROL FACILITIES

Bill pp. 339–347, § 704 [IRC new § 168]

Amortization of Pollution Control Facilities

1. Section 168(a) permits the taxpayer to elect to begin the amortization period either with the month following the month in which the facility was completed or with the succeeding taxable year. Although the section provides that the amortization deduction "with respect to any month shall be in lieu of the depreciation deduction . . . for such month," it does not make it clear whether a taxpayer electing to begin the amortization period with the succeeding taxable year is entitled to depreciation deductions under section 167 during the year in which the facility was completed. This uncertainty should be resolved.

2. The certification process will undoubtedly be time-consuming. There is no indication as to what a taxpayer is to do if certification is not completed by the due date for filing his return. In addition, property may not be certified to the extent it appears that "by reason of profits derived through the recovery of wastes or otherwise in the operation of such property, its costs will be recovered over its actual useful life . . ." Section 168(e)(2). The term "profits" is not defined. Ordinarily, this would mean an excess of receipts over expenses including an allowance for the recovery of costs in the form of depreciation. Under this definition of "profits," costs would have to be recovered twice to prevent certification. Also, it is not clear whether some portion of costs could be certified if there were a partial recovery through "profits." In any case, certification depends upon a projection of "profits" which may not in fact be recognized.

If the certifying agency follows literally the requirements of section 168(d)(1)(B), certification will be very time-consuming and complex, and may involve difficult questions of financial and cost accounting. The cost of adequate presentation may dissipate the proposed benefits in many cases. It is suggested that the opportunity for abuse is not great and does not justify this complexity. The requirements of subsection (d)(1)(B) should be eliminated.

3. The House report's general explanation at page 198 indicates that additional first year depreciation under section 179 could be claimed even though the facility is amortized under section 168. It is doubtful that the proposal ac-

complishes this result. Section 170 allows an additional deduction only where a deduction is permitted under section 167. The deduction under section 168 is in lieu of a deduction under section 167. If it is intended to permit a deduction under section 170 as stated in the House report, that section should be appropriately amended.

4. Section 704 of the bill classifies pollution control facilities as section 1245 property. Consequently, adjustments to basis reflecting depreciation or amortization will result in ordinary income to the extent of any gain upon disposition. Under section 168(d)(4), a building that is "exclusively a treatment facility" may qualify for the amortization deduction. Such a building would therefore become subject to section 1245 rather than section 1250. There appears to be no reason why a building qualifying as a "treatment facility" should be subject to the provisions of section 1245 rather than those of section 1250.

The stated purpose of section 168 is to provide an incentive for taxpayers to invest in pollution control facilities. It is not clear why this purpose is not equally well served by investment in either new or used facilities. Nevertheless, the proposal grants the incentive only with respect to investment in new facilities. The fact that such a distinction existed under the investment credit—which was designed to achieve a quite different purpose—is not sufficient reason to adopt that distinction in this instance.

Section 704 does not deal wtih the question of salvage value. Presumably, salvage value is not to be taken into account as to the portion of the taxpayer's investment subject to amortization. The section also does not state whether accelerated depreciation is intended to be available after termination of the election. However, these deficiencies are also present in existing section 168, dealing with amortization of defense facilities, and presumably the rules to be developed under that section will apply.

5. Section 168 neither defines "adjust basis" nor specifies the treatment to be accorded to capital additions to qualifying property. These matters should be dealt with in the statute, as was done in the existing section 168 dealing with amortization of defense facilities.

Title VIII—Adjustment of Tax Burden for Individuals

Sec. 802. Fifty-Percent Maximum on Earned Income

Bill p. 354, § 802 [IRC new § 1348]

Fifty-Percent Maximum Rate on Earned Income

Section 802 of the bill adds section 1348 to provide in general that earned income is to be subject to a maximum tax rate of 50 percent.

The rule for calculating the maximum tax as set forth in section 1348(a) appears to have been drafted backwards. The references in the bill to "the lowest amount of taxable income on which the rate of tax under section 1 exceeds 50 percent," should be references to "the *highest* amount of taxable income on which the rate of tax under section 1 *does not exceed* 50 percent." See House report, part 2, p. 139.

The definition of "earned income" for purposes of the maximum provision excludes deferred compensation. This would seem to be an unwarranted discrimination against this method of compensation. It would work with particular harshness where the 50 percent limitation would have applied if the income had been paid when earned, and where, therefore, the throwback rule provided in proposed section 1354 is not applicable because it would not result in a higher tax than treatment of deferred compensation as income of the year in which it is received.

The provision has been drafted so that each increase in earned income pushes unearned income into a higher bracket. Thus, the effective rate on an additional amount of earned income will be 50 percent plus the increase it produces in the tax payable on the taxpayer's unearned income.[1] The formula under proposed section 1348(a) might be revised to provide that a taxpayer's unearned

[1] If the taxpayers in the example at page 140 of the House report, part 2, had $25,000 more earned income, their tax for 1971 would go up $18,826, not $12,500 as it would if the intent is to limit the tax burden on earned income to 50 percent.

income plus his earned income up to the 50 percent tax bracket shall be taxed at normal graduated rates, with the excess of his earned income being taxed at 50 percent. If his unearned taxable income (unearned income less his deductions) standing alone would take the taxpayer past the 50 percent bracket, such income would be taxed at the normal rates and all of his earned income should be taxed at 50 percent.

SEC. 803. INTERMEDIATE TAX RATES; SURVIVING SPOUSE TREATMENT

Bill pp. 356–358, § 803(a)(2)(E) [IRC amended § 1(b)(3)]

Intermediate Tax Rates; Surviving Spouse Treatment

Section 803(a)(2)(E) provides that for the purpose of determining whether an individual who has been married is entitled to the new "intermediate tax rate," only the last marriage shall be considered. This provision could result in a hardship where a surviving spouse has remarried and the second marriage has been terminated by annulment or divorce.

SEC. 805. COLLECTION OF INCOME TAX AT SOURCE ON WAGES

Bill pp. 366–368, § 805 [IRC amended § 3402]

Collection of Income Tax at Source on Wages

The provisions of this section are intended to bring the withholding tables in line with the new income tax rates prescribed by section 1 and the low income allowance.

1. The proposed amendment to section 3402(a) requires that the tables to be prescribed by the Secretary be the same as the tables contained in this subsection as in effect before August 1, 1969, except that they be computed on the basis of the rates prescribed by section 1. The present statutory framework is too rigid for practical application where payrolls are computerized. This fact has been recognized in Revenue Ruling 66–328, 1966–2 C.B. 454. The necessary flexibility would be achieved if in line 17 of page 366 of the bill the word "substantially" were inserted after the words "shall be" and before the words "the same."

2. The withholding allowance provisions of section 3402(m) are keyed to the value of a withholding exemption and the percentage rate of the standard deduction. The current value of a withholding exemption and rate of the standard deduction are revised by sections 801-805 of the bill. In 1972 the applicable percentage for the standard deduction will be 15 percent of adjusted gross income. Withholding tables will be structured on the basis of an annual value of $600 for each withholding exemption. If section 3402(m) is not amended the following result will occur where an unmarried individual with adjusted gross income of $6,000 is entitled to $1,500 in itemized deductions:

A. Taxable income will equal $6000 less $1500 less one exemption of $600 for a total of $3900.

B. The new withholding tables will compute an amount for withheld tax on the basis of a taxable income of $6000 less $1100 (low income allowance) less $600 for a total of $4300.

C. The taxpayer will be entitled to one withholding allowance $\left(\frac{\$1,500-\$600}{\$700}\right)$ under section 3402(m) and by taking advantage of the allowance (which is treated as if denominated an exemption) will have withheld an amount of tax on the basis of a taxable income of $6000 less $1100 (low income allowance) less $1200 (2 exemptions) for a total of $3700.

This amount is $200 less than his actual taxable income. Thus, by using the present withholding allowance provisions the taxpayer would be able to reduce his withholding below the amount of his tax liability.

The CHAIRMAN. I apologize to Congressman Vanik. It was an inadvertence that his name was not included in the mimeographed list of witnesses. We do apologize for that and we are pleased to have you here.

STATEMENT OF HON. CHARLES A. VANIK, A REPRESENTATIVE IN CONGRESS FROM THE 22D CONGRESSIONAL DISTRICT OF THE STATE OF OHIO

Representative VANIK. Mr. Chairman, after 6 months of this tax reform proposal on our side I can fully appreciate the problem which confronts you. While I must say that our work on the House side was not perfect, I think you will agree that most of our deliberations were extensive and exhaustive and they were well intentioned.

Section by section we approved most of the language of the bill that came here by almost unanimous vote, and I think that that is pretty much borne out by the report.

With this in mind, I must tell you that I endorse the principal provisions of our work.

Our decisions were made in response to what we determined was an overwhelming mandate which each of us had received from our constituencies, and I do not believe that that urgency has diminished. But neither the House nor the Ways and Means Committee initiated the drive for tax reform. We were pushed into it by angry taxpayers. We were pushed into it by disclosures of tax abuse, and as these matters came to light I think it added fuel to the fire. I think frankly, Mr. Chairman, that the alternative to tax reform is something like an open tax revolt.

There are those who would desire for one reason or another to keep reform in suspension as a political issue. I would rather see a fair and reasonable proposal written into the law. The reform proposal in my judgment is in many instances only a soft touch on tax privilege. It is not any heavy hand. It is certainly a lot less than I would like to see in certain areas. But it deals with no citizen unfairly, and I think it is a step that we must take toward tax justice.

There are those who criticize our efforts to impose a minimum tax on the wealthy, and this criticism may be proper, but then I think those who criticize it must find some other way to insure that those people who have large income can contribute to the tax burdens of the country. I think the American public demands it. And I think that if such an alternative can be devised, it might be helpful to all of us to take it under consideration.

I would like to direct my attention now to the treatment of the oil depletion allowance. Considering what could have happened, the small reduction in the depletion allowance enacted by the House is what I would believe a minimum, a minimum that could be embodied in a reform bill, and there could be no tax reform bill without some reduction of the oil tax privileges. Nothing was done about the intangible drilling costs, the accounting procedures, and several other devices that spare oil taxation.

It seems to me that the oil industry should be able to assume this taxation without threats to increase consumer prices. I do not believe that blackmail of this type will work on either the Congress or the consumer.

Domestic oil prices are substantially controlled by State commissions working in unison toward price stability through production controls. Foreign oil import controls further prop-up domestic oil

prices at a consumer cost of billions of dollars. The authenticity of reports of depleted reserves must be questioned in light of the advantages that are inherent in suppressing reported reserves in an effort to shelter these reserves from taxation.

There was some talk before our committee about the natural gas shortage, and I think we dispelled the myth of the shortage within the record that was made in the House Ways and Means Committee, and I believe that although the administration has finally agreed to accept the House recommendations for a reduction in the depletion allowance to 20 percent, they favor retaining the foreign oil depletion allowance, which was completely eliminated by the House.

There is no rational legislative reason, Mr. Chairman, for extending the privilege of the depletion allowance to foreign produced oil. The combination of the depletion allowance and the foreign tax credit have made most of these profits tax-free. These tax-free profits of American investment in foreign oil have corrupted and they have misdirected American foreign policy in many oil-rich countries.

This has resulted in American policies of costly military assistance and involvement, in support of temporary rulers who will undoubtedly be removed when their people find out what is going on.

There is no reason for the American taxpayer to subsidize these activities. In some of the provisions of the reform bill there may be room for improvement particularly with respect to the language on charitable giving, and I also hope that your committee will consider providing taxpayer relief by increased exemptions instead of reducing the rate to the extent that we have.

From projections of tax receipts which I have seen, it would seem feasible to increase exemptions at the rate of $100 per year per dependent for the next 4 years until the dependency allowance reaches $1,000 per dependent. Every taxpayer relates the dependency exemption to the actual present-day costs of support. To the taxpayer this is far more meaningful than increased standard deductions which disregard family size.

In considering a taxpayer's fair share of taxation, it is important to know how a taxpayer must divide his available income among his dependents, and this is hardly a boon even to the wealthy taxpayer whose expense in supporting dependents escalates with his station in life.

Poverty and large families are synonymous. Increased exemptions are the only method that I know of to relate the need for tax relief to family size.

One major objective of tax reform in the House which was not achieved is the critical need for simplification in tax returns and payment procedures. This is an area in which the chairman has made some very strong and forceful positions. For the individual taxpayer there is a need for a simplified appeal procedure.

As it stands now the tax court procedure is a court for the wealthy. Less than 1 percent of the challenged cases reach the appellate division of the Internal Revenue Service. Some lawyers argue that it is not feasible to take up a tax dispute unless the tax claim is upwards of $10,000. What would be wrong with a system of small tax claim referees who could establish essential facts in small claims and provide a necessary and a human service for the average taxpayer?

And then, Mr. Chairman, I would like to point to one major oversight. In these days of high interest it apears that the Internal Revenue Service is being used as a bank by tax delinquents who pay 6 percent interest on taxes owed the Federal Government, using the tax monies for other purposes. According to the latest Internal Revenue Service figures provided to my office, interest on delinquent taxes owed to the U.S. Treasury by individuals and corporations in fiscal 1969 amounted to over $567 million. This amount of interest would indicate a $9½ billion tax delinquency. At this rate the tax delinquency will increase in fiscal 1970 by 12 percent, or over $11 billion.

There is no joy to the Treasury in collecting interest at 6 percent. Who can get money cheaper than that today? The delinquent taxpayer can invest these funds in Federal bonds at 8 percent and profit by the arbitrage. If a taxpayer, for example, has a tax liability of $12,000, he pays the Government $720 for delinquent, and saves $240 simply by investing what would otherwise be his tax money in 8 percent Federal bonds.

Now, in addition to that, it is incredible but the delinquent taxpayer has another gimmick. He can get a writeoff against his current taxes for the interest he pays the Internal Revenue Service on his delinquent tax bill. The reward for delinquency adds a cruel insult to the average taxpayer who has to pay his tax bill before it is due.

It seems to me, Mr. Chairman, that the tax reform proposal should be amended to raise in some way the interest rate for delinquency, and bring it in line with normal charges, and to eliminate deduction for interest paid on delinquent taxes.

Mr. Chairman, I know that your committee is critically pressed for time in your deliberations, but there is a sense of urgency about tax reform which should prompt us to make difficult and responsible decisions this year.

The CHAIRMAN. Thank you very much, sir.

Senator MILLER. First, just an overall comment.

Congressman, the thing that troubles me about the overall tax bill, and I speak only for myself, is that it seems that what the House did was not just to go after this income that is not being taxed or the income that results in very little tax, not to just go after that by the use of the limit on tax preferences, and the allocation of deductions, but then it dumped in on top of that all of these other provisions attacking this kind of income. In other words, it doubles up, as I see it.

Now, if the House had taken one approach or the other that would be one thing, but because they did everything, we have received a great amount of testimony which indicates that we might promote inflation, we could promote a recession, we could aggravate the high interest rates that people are suffering here today, and I just thought I would make that comment to you.

Although I recognize that I do this as a tax lawyer, you can skillfully penetrate some of these areas of tax avoidance by specific approaches. If you use that approach, that is one thing. But when you come along and use the limit on tax preferences or the minimum tax approach and the allocation of deductions on top of that, it seems to me you have gone too far.

Now, just a comment about my reaction to what the House has done on percentage depletion, and when I talk about that I am not

just referring to the petroleum industry. I am referring to all these other extractive industries. What the House has done in effect is this. Take two petroleum corporations, A and B. A has $1 million of percentage depletion, B has $1 million of percentage depletion. A takes the million dollars of percentage depletions and plows it back into the drilling and development and exploration for the purpose of expanding the resources for the good and the benefit of the people of this country. B does not do anything with it except perhaps pay it out to shareholders. What you have done is to treat them exactly the same, and that is why I refer to it as a meat ax approach.

I cannot justify treating those two entities the same way, but you have.

And then on the exemption I must tell you that my reaction to increasing the exemptions is this. You advocate increasing the personal exemptions from $600 to $1,000. For taxpayers in the 20-percent bracket, that $400 would give them a tax break of $80, but for taxpayers in the 70-percent bracket, that would give them a tax break of $280, and it seems to me that that approach tends along the lines of making the rich richer and the poor poorer, and is a very regressive way of handling it.

You said you have not found any other way of handling it. I suggest to you most respectfully that another way of handling it is to get off the exemption approach and use the tax credit approach, so that whether you are in the 70-percent tax bracket or 20-percent tax bracket, you get so much tax cut, and it is all the same for each dependent.

Now I know you have not proposed that in the House bill. It may take quite a bit of time to go into it, but I offer that to you as an alternative.

Representative VANIK. Mr. Chairman, we have talked about the tax credit proposal. We did it extensively in committee. What I was suggesting was an alternative to the increased standard deduction because that failed to reach the problem of family size. The tax credit approach would reach that problem.

I might point out in my statement I did indicate that a wealthy person with dependents in proportion to his station in life certainly spends more for his dependents, as many of you know, than a person of lower income level. I would suppose that supporting an exemption in some levels might run into thousands and thousands of dollars.

I do not know how you can work out either proposal, either a tax credit proposal or an exemption proposal without proposing some increased advantage for persons of higher income levels, because even a tax credit proposal would result in a lesser way but would provide some greater reduction for the persons in higher income bracket from those in the lower bracket.

Senator MILLER. May I suggest to you that the higher income individual can afford to do that, and why should he have a higher tax break for his child than the lower income taxpayer? I cannot understand it. Our tax code takes a different approach through the graduated income tax rate.

Representative VANIK. Mr. Chairman, I must just say with respect to the point on oil, we discussed those provisions very extensively. We discussed alternative procedures, and it was our best judgment that

while we could not take care of all situations, that we felt that the depletion cut would be the most effective, and it was certainly the simpler way of handling the problem. If you deal with simplicity in returns, and in the calculation of tax, you get into more complications when you try to meet the problems of every situation.

Thank you, gentlemen.

The CHAIRMAN. Thank you very much, Congressman Vanik.

Representative VANIK. Thank you, Mr. Chairman.

The CHAIRMAN. The next witness is Mr. Donald H. Gleason, on behalf of the National Association of Manufacturers, Washington, D.C.

STATEMENT OF DONALD H. GLEASON, REPRESENTING THE NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, D.C.

Mr. GLEASON. Mr. Chairman and members of the Finance Committee, my name is Donald H. Gleason. I am vice president Finance CPC International, Inc., Englewood Cliffs, N.J. I appear here on behalf of NAM as a member of its taxation committee and chairman of its International Taxation Subcommittee.

Our members produce approximately three-quarters of the manufactured goods in the United States, and employ a commensurate number of workers in our labor force. While the interests of our members are somewhat diverse, our full written statement which we ask be included in your printed record deals with a number of provisions which are all of interest to our members and upon which we have a strong consensus.

I am not going to enumerate these, but I am going to refer generally only to one, and that is the anticapital formation thrust of the bill.

In the press and elsewhere a number of provisions of the code have been referred to as loopholes. These provisions, special provisions if you will, were enacted after long and careful study by the Congress and some have pretty well stood the test of time in their opration. Our economic way of life has been influenced by and has adapted itself to them. And some of the changes which are suggested by the bill in the interest of closing loopholes will certainly create confusion, and indeed will be to the economic detriment of the country as a whole, if they are enacted.

Two provisions in this category come to my mind. These two are not included as subjects of our detailed written statement for these do not directly relate to manufacturing companies, nor were they specifically considered by our committee. The first is the proposal to tax with some limitations gifts of certain types of appreciated property to charities, schools, foundations and so on.

If this provision is enacted, the very tenuous financial stability of many of these institutions will be jeopardized, for a very substantial portion of the giving which now supports them will cease.

The second is the backdoor tinkering with the tax exclusion for State and municipal bond interest. Constitutional questions aside, when one considers the problems which our largest cities and towns now face, inhibiting in any way the ability of these entities to borrow is short-sighted in the extreme.

The resulting thrust of this bill in its endeavor to close loopholes emphasizes its most serious drawback, that is its negative implication for the capital formation and the real growth in the economy.

As George Champion recently stated, the capital shortage in this country and indeed it is worldwide, has been worsening for many years, and unless this shortage can be corrected reasonably soon, it will create a tragedy in human misery and world unrest. Witness right now what has happened to interest rates.

The American worker now enjoys the highest standard of living in the world, because someone has invested $15,000 to $20,000 in the tools that he works with in his job. He is able to do his job because of his education. He has time to think, read and dream because he is prosperous by any reasonable comparison, and he is prosperous because capital has been invested in him.

Population pressures, both here and abroad, are increasing, and the required capital to put additional workers into constructive and creative jobs is becoming enormous. All economists I think will agree that one of the keys to the problem of inflation, which we now face, is the productivity in real goods of the worker. He cannot work efficiently without capital support, and indeed if this is lacking, it can only result in further inflation and indeed ultimate chaos.

Intelligent planning for the efficient use of the tax dollar is certainly a must. As Assistant Secretary Cohen recently advised you, about $5 billion of the estimated $8 billion of revenues raised in the bill would be added to the tax burden of corporate taxpayers. While the direct impact would very according to the type of business, the overall burden is equivalent to approximately a 12-percent increase in corporate tax liability at current levels, and it ladles out substantial tax reductions for lower- and middle-income individuals from whom little or nor risk capital can be expected to be generated.

No rate reduction at all, even prospective, has been provided for the corporate sector, the major generating mechanism for the creation of risk capital and the tools for more efficient production.

We would like to again point out that the proposal to repeal the credit was originally made last spring in response to short-term economic circumstances, but now alas has become a part of the task reform program involving a massive redistribution of tax burdens on a long-term basis.

Whatever the arguments for or against the various provisions on an individual or narrow basis, their cumulative impact is a serious blow at domestic investment, a stunting of our economic growth, and a weakening of our competitive position abroad. This can only lead to further inflation.

The administration has proposed a tax cut of 1 percentage point of the corporate tax rate for 1971, and another percentage point for 1972. This would help in part to redress the imbalance of the bill, but it would still mean a very substantial increase in tax burdens in the corporate sector.

We recommend a cut of at least 5 percentage points to be spread out over a 5-year period, say 1971 to 1976. As pointed out by Secretary Kennedy, we do not know how stable the economy will be in the 1970's, and a large net tax reduction bunched over a 2-year period as provided in H.R. 13270, could have considerable inflationary consequences.

The important thing is our opinion is not only in the specific timing but a legislative commitment to rate reduction to assure adequate capital formation over the long term.

I think I will stop here now, in the interests of time.

The CHAIRMAN. Thank you very much, sir.

Senator BYRD. Could I make a brief comment.

You mentioned the Nation having the highest standard of living of any in the world for the average citizen. I think that is certainly correct. And you mentioned that in the context of not destroying investment incentive. Your point I believe is that it takes a great deal of investment and there must be incentive for investment in order to provide the jobs at the wages which this country now enjoys. That is the burden of your thought in that regard, I believe?

Mr. GLEASON. Well, with the increase in technology, I think I would add to that that it is getting more and more expensive to appropriately equip a worker for efficient production. The efficiency of the production of the worker is the only ultimate thing that can kill inflation. We are saying the same thing perhaps.

Senator BYRD. I think you make a good point in that regard. Whatever the committee and the Congress does in regard to tax legislation you feel it is important that the Congress does not destroy investment incentive if we are going to maintain this high standard of living?

Mr. GLEASON. I do, sir.

Senator BYRD. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much. I have read through your statement and I agree with quite a bit of what you have said.

Mr. GLEASON. Thank you, sir.

(Mr. Gleason's prepared statement follows:)

STATEMENT OF DONALD H. GLEASON, REPRESENTING THE NATIONAL ASSOCIATION OF MANUFACTURERS

SUMMARY

The most serious drawback of H.R. 13270 is its negative implications for capital formation and real growth of the economy. This is apparent in the provisions to repeal the 7% investment credit, increase the corporate capital gains tax, repeal the alternative capital gains tax for individuals, drastically restrict the depreciation treatment of commercial and industrial real estate, and change the tax treatment of natural resource industries. The cumulative impact of these provisions could be a serious blow at domestic investment and our competitive stance abroad.

The most obvious means to help assure adequate capital formation for the future is a significant cut in the corporate income tax rate. We recommend a cut of at least five percentage points spread over a five-year period from 1971–1976. A legislative commitment to rate reduction is more important than the specific timing.

The proposal for the tax treatment of deferred compensation would add great complexity to the Code, even though no abuse has been shown and there is slight revenue effect. The NAM also opposes sections of the bill relating to lump-sum distributions and the foreign tax credit. Good, but incomplete, starts are made in the bill with respect to moving expenses, taxation of cooperatives and pollution control.

Mr. Chairman and members of the Committee on Finance, my name is Donald H. Gleason, and I am vice president-finance of CPC International, Inc., Englewood Cliffs, New Jersey.

I appear here on behalf of the National Association of Manufacturers as a member of its Taxation Committee and Chairman of its International Taxation

Subcommittee. My statement will deal with a number of provisions of H.R. 13270, "The Tax Reform Act of 1969."

Without any prejudice to the need for tax reform in a number of areas or the hard work put in by the Committee on Ways and Means, we submit that the very haste accompanying adoption of this bill in the House, with major changes being made right up to the last minute, has allowed some serious distortions to mar it. In this testimony we shall outline means to correct what we feel are its principal flaws and make other suggestions for its improvement.

I. Anticapital formation thrust of the bill

By far the most serious drawback of H.R. 13270 is its negative implications for capital formation and real growth of the economy. An estimated $5 billion of the $8 billion of revenues raised by the bill over the long term would be added tax burdens on corporations. While the direct impact would vary according to the type of business, the overall burden would be equivalent to a 12-percent increase in corporate tax liability at current levels. And while the House bill provides substantial tax reductions for lower- and middle-income individuals, no rate reduction at all has been provided for the corporate sector.

It should be emphasized that these estimates, based on "straight-line" projections of revenues without accounting for normal economic growth or inflation, undoubtedly understate the true damage to be done to the corporate sector. In fact, we have serious doubts about the estimates of the bill's revenue shifts throughout, owing to the extreme complexity of so many of its provisions.

Thus, we certainly concur with Secretary Kennedy that the bill is "overweighted in favor of consumption" and "could impede economic growth in the years ahead by curtailing the incentive to make productive investments."

The anti-capital formation thrust of this bill is most obvious in the provision to repeal the 7% investment credit. We already have presented our views on this before your Committee, and in recognition of your instructions, will not dwell on the issue. However, we would like to point out that the proposal to repeal the credit was made originally last spring in response to short-term economic circumstances but is now part of tax reform program involving a massive redistribution of tax burdens on a long-term basis. It is joined by several other provisions of H.R. 13270 which would have a similar effect, including an increase in the corporate capital gains tax and repeal of the alternative capital gains tax for individuals, a drastic restriction of the depreciation treatment for commercial and industrial real estate, and proposed changes in the tax treatment of natural resource industries. Whatever the arguments for and against these provisions on an individual basis, their cumulative impact would be a serious blow to domestic investment, an inducement to send funds abroad, a weakening of our competitive stance abroad, and a stunting of our economic growth.

We recognize that in the particular circumstances of late 1969, capping a long boom in business capital spending, large increases in such investments are not needed. But the boom will not last forever. In fact, there are plenty of signs right now that the boom is petering out—that the long business expansion in general is weakening and that capital spending in particular shortly will be on the wane. Therefore, we should be thinking of the kind of tax system that will be appropriate to the economic conditions that will prevail for the long term after the boom is over.

We feel strongly that this tax system should not penalize domestic capital formation—growth of which is essential to provide adequate jobs in the 1970's for the large number of new entrants into the labor supply. Anyone who has even a casual knowledge of interest rate trends will recognize the worsening, worldwide capital shortage today, and that regardless of the fate of the investment credit, we will be in great need of a favorable climate to assure an adequate capital supply in the 1970's.

The most obvious means to help assure this climate is to provide some general corporate tax relief in the form of a significant cut in the corporate income tax rate. Many studies have indicated the perverse effect of the high corporate income tax on capital formation, efficient allocation of resources and economic growth. It is a tax of uncertain and varying incidence, the only certainty being that the real burden is not borne by corporations at all, but by live human beings who may in varying degrees be investors, workers or consumers.

The economic distortions created by any tax tend to be proportional to the rate of the tax. Lowering the corporate rate in general would reduce the distortions. Therefore we strongly urge your Committee to recommend a significant

reduction in the corporate income tax rate to take effect along with the cuts you propose for individual taxpayers.

The Administration has proposed a cut of one percentage point in the corporate tax rate for 1971 and another percentage point for 1972. This would help redress the imbalance of the bill, but still would mean a very substantial increase in tax burdens on the corporate sector. We recommend a cut of at least five percentage points to be spread over a five-year period 1971–1976. When fully effective this would mean a reduction of approximately $4 billion in corporate income taxes, substantially less than the relief proposed for individuals under H.R. 13270. Of course, the extent to which this could be characterized as true "relief" for the corporate sector would depend on how Congress acts with respect to other provisions of the bill. Repeal of the investment credit, for example, would almost completely offset the corporate tax reduction that we propose.

As pointed out by Secretary Kennedy, we don't know how stable the economy will be in the early 1970's, and large net tax reductions bunched over a two-year period, as provided in H.R. 13270, could have considerable inflationary consequences. The important thing in our opinion is not the specific timing but a legislative commitment to rate reduction to assure adequate capital formation over the long-term.

II—Capital Gains

From a revenue standpoint, the most significant provision of H.R. 13270 in the capital gains area would remove the alternative tax rate for individuals. This would result in an estimated $360 million revenue increase on an annual basis.

According to the Report of the Ways and Means Committee, this provision is justified to bring capital gains treatment more in line with the progressive rate structure. In fact, coming on top of the proposal for a minimum income tax (or LTP) and allocation of deductions, the thrust of this bill emphasizes the ability-to-pay principle to the exclusion of everything else, including simplicity and possible basic economic dislocations. No consideration is given to the impact of eliminating the 25% ceiling on the provision of risk capital as an essential ingredient for the growth of many new enterprises, and as a crucial motivator of effort in our society. Certainly before the ability-to-pay principle is extended in this manner, more serious consideration should be given to possible economic and other effects, and indeed, to whether or not capital gains should even be considered part of regular income taxation.

H.R. 13270 also proposes extension of the six-month holding period to one year for qualification for long-term capital gains treatment. Whether or not your Committee adopts this proposal, we urge you to consider lowering the existing capital gains rate schedule for productive investments held over a substantial period, say ten years or more. Appreciation in shares of closely-held firms, for example, where there is a clear-cut case of capital transfer rather than receiving of income, should receive more favorable treatment, and the drift of H.R. 13270, if enacted in a form close to what has been proposed, would greatly increase the need for such treatment.

Alternative corporate capital gains rate

The case for moderate taxation of corporate capital gains is esentially the same as that for individuals' capital gains—to encourage the provision of risk capital for the expansion of new enterprise or re-invigoration of existing businesses. In view of the obvious need for such treatment in a dynamic enterprise economy, it is extremely difficult to follow the rationale for raising the alternative corporate capital gains tax from 25% to 30% on income over $25,000 as provided in H.R. 13270.

As stated in the Ways and Means Committee Report, H.R. 13270 would eliminate the alternative tax for individuals raising the maximum rate to 32.5% (after 1972) and, therefore, "a comparable adjustment should be made to the corporate alternative tax." But even if one accepts the bill's case for extending the ability-to-pay principle to individuals' capital gains, this is hardly grounds for heavier taxation of the corporate sector accounting for well over 90% of all net corporate capital gains.

Since, as the Report acknowledges, corporate incomes are subject to only a one-step graduation of $25,000, while individuals are subject to 25 steps of graduation, the question of ability to pay is involved in corporate capital gains only by the most tortuous reasoning. Certainly, a one-step graduation in cor-

porate income taxation was never intended to serve as a model of progression to penalize larger enterprises.

Adoption of the proposal would raise the corporate capital gains rate to substantially more than half of the regular corporate rate of 48% (exclusive of the surcharge). Not even under H.R. 13270's punitive measures for treatment of individuals' capital gains would any individual pay a capital gains rate more than half his top regular rate.

We see no reason why this proposed provision should be considered a tax "reform" or how the present system of corporate capital gains taxation could be considered an abuse. We are at a loss to understand why it has been included in this general tax reform bill except, of course, to provide additional revenue without regard to the economic consequences. We strongly urge your Committee to reject this short-sighted approach and recommend against increasing the corporate capital gains tax.

Lump-sum distributions

The House-passed bill is defective, we feel, in regard to the proposal to change the rules governing the taxation of lump-sum distributions from qualified employees pension, profit-sharing, stock-bonus, or annuity plans.

Under present law, distributions to an employee from a qualified plan are taxed to the employee when he receives them. Generally speaking, the distributions are taxed at ordinary income rates, based on the employee's total taxable income in the year of receipt. An exception to this rule was enacted by Congress in 1942. It provides that when an employee receives his total distribution within a single taxable year, the amount of the distribution will be taxed as long-term capital gain. This exception was enacted in recognition of the inequity of taxing as ordinary income amounts which are attributable to many taxable years.

The House-passed bill proposes to change the present law regarding lump-sum distributions so that all amounts received by the employee which are represented by the employer's contributions over the years will be taxed as ordinary income. Capital gain treatment would be limited solely to the net taxable portion of the distribution in excess of the employer's contribution. The amount represented by the employee's contribution is, of course, not taxed since it represents his investment in the plan and is thus a return on his investment. Under the House proposal, the portion of the distribution treated as ordinary income would be averageable under a five-year forward averaging provisions.

We do not believe that the House proposal to change the taxation of lump-sum distributions should be enacted. The present law has been in effect for 27 years and has worked well to reflect the long period of time during which employees accumulate benefits under qualified plans. At least five million employees currently are accumulating such benefits. The present law also has the advantage of being easily understood by taxpayers and simple to administer. In addition, there has been no showing that the present law has been abused, and neither the Johnson nor the Nixon Administration advocated changes in the present rules.

Perhaps the primary defect of the House proposal is its extreme complexity. In fact, it is inconceivable that the ordinary taxpayer would be able to compute his tax liability under the proposed rules without assistance of a tax consultant. Several steps will be necessary in each computation and much of the information necessary for the computation will not be readily available to the employee. Thus, it is certain that the cost of compliance and administration will be significantly higher under the proposed rules than under current law.

Another defect of the House proposal is its failure to adequately take into account the fact that many employees accumulate benefits in qualified plans for as long as 30 years or more. The five-year averaging device proposed by the House is clearly defective since its maximum effect would be a five-year spread out and it would not operate until five years after the employee has received the lump-sum distribution and paid tax based on his income in the year of the distribution. In other words, under the House proposal a taxpayer would pay a tax in the year of distribution based on the full taxable amount of the distribution and his other taxable income, and he would be required to wait five years before seeing whether the so-called "averaging" device entitles him to a refund for overpayment of tax. The taxpayer would thus be deprived of the overpayment during the five-year period, and would have to go to the trouble of filing for a refund of taxes which he never in fact owed. The defect of this rule is even clearer when one considers that the taxpayers to which it applies will in many cases be retired employees who may well need the money in order to provide for their retirement.

Certainly, if the Congress does change the rules governing lump-sum distributions, we would advocate that averaging be permitted on a prospective as well as a retroactive basis.

In analyzing the House proposal, it is also necessary, we feel, to consider two other provisions of the House bill. The first of these is the proposal to remove the 25% maximum alternative rate on capital gains of individuals. This proposal will, when coupled with the proposal regarding lump-sum distributions, deal a double blow to employees receiving lump-sum distributions, for this would conceivably result in a higher tax rate being applied to even that portion of the distribution which will continue to be taxed as capital gain. In view of this, we feel that if the Congress does adopt the House proposals that it retain the maximum 25% alternative rate at least in this instance.

The second House proposal which should be considered, we feel, is the provision to place a 50% ceiling on the tax rate on earned income. As presently drafted this provision does not apply to lump-sum distributions, and thus although treated by the House as earned income, such distributions could conceivably be taxed at rates higher than 50%. There does not seem to be any rationale for this discriminatory treatment, and we would hope that if the House's proposal on lump-sum distributions is adopted, such distributions will be made subject to the 50% limit on earned income.

III—Deferred compensation

One of the primary concerns of the NAM regarding the House-passed bill is its proposed change of the rules governing the taxation of deferred compensation not involving restricted stock.

Of all the changes proposed by the bill, this is perhaps the most striking example of the addition of extreme complexity to the Code even though no abuse has been shown and where the effect of the change could well reduce rather than increase federal revenues.

Under present laws, if an employee and an employer contract that the employee's services will be compensated both during and after his tenure with the employer and the amount which the employee is to receive after separation is not at his disposal until that time, the employee is not taxed until he actually receives the income. When he receives the income, the employee is taxed at ordinary income rates based on his total net income in the year of receipt. No income escapes taxation, no capital gains treatment is involved, and the employer is not allowed a deduction until the income is actually paid out. The current method of taxing such income has been upheld in many court cases, and was officially sanctioned by the Treasury Department in 1960 in Revenue Ruling 60–31. Innumerable companies have built their compensation structures in reliance on these authorities.

The House proposes to drastically alter the rules governing the taxation of deferred compensation. Under its proposal, deferred compensation would continue to be taxed in the year of receipt, but the amount of the tax would be computed as if the employee had received the deferred compensation during his service with the employer. This fictional approach would, as far as the amount of the tax is concerned, result in the employee paying tax as if he had the use and benefit of the income during the time that it was being retained by the employer. This fundamental break with traditional tax principles would, we believe, have several negative results.

One of the obvious difficulties with the House's proposal is the problem of compliance and administration. Although some of the details of the proposed rules are to be developed in Treasury Regulations, the basic structure of the proposal is contained in the House bill. This structure is both historic in effect and monumental in complexity. It provides that deferred compensation in excess of $10,000 received during a taxable year will be subject to a so-called minimum tax, which is arrived at by looking back to the employee's taxable years during his service with the employer paying the deferred compensation. The minimum tax is to be the lower of two alternative amounts. The first alternative amount of minimum tax is the aggregate increase in tax resulting from adding to the employee's taxable income for each taxable year in which the excess is deemed to have been earned, the portion of the excess over $10,000 deemed to have been earned in that taxable year. For this purpose, the deferred compensation is deemed to have been earned ratably over the employee's entire period of service with the employer. Under the second alternative, an average increase in tax is computed by adding to the employee's taxable income for the three taxable years for which his taxable income is highest during the last ten years of the earning

period, the portion of the excess over $10,000 deemed to have been earned in those three years. This average increase is then multiplied by the number of taxable years in the earning period, to determine the total tax. The mere statement of these rules clearly indicates the problems which would arise in complying with and in administering the House proposal.

An even more basic difficulty with the House proposal is the impact the proposal would have on the entire concept of deferred compensation arrangements.

Deferred compensation arrangements antedate the income tax laws, and are used by thousands of companies, both large and small. A 1969 report of the National Industrial Conference Board, Inc., based on data obtained from a large sampling of firms, indicates that 51% of surveyed manufacturing companies and 65% of surveyed retail companies (most of which, of course, are relatively small firms) have deferred compensation programs.

There are many reasons for the use of deferred compensation plans other than tax reasons. From the employee's point of view, a deferred compensation arrangement offers a means of averaging his compensation and providing for his retirement period. The concern is not primarily to have these earnings taxed at lower rates, but rather to provide a "spread-out" of earnings over the actual rather than economic life of an employee.

From the point of view of the employer, deferred compensation arrangements have basic benefits in that they permit the employing company to retain amounts that would otherwise be paid out as current compensation and, when the amount of the deferred compensation is based on the market price of the company's stock or the amount of dividends paid on the company's stock, there is a continuing incentive to the employee to improve the profitability of the company. The flexibility available to an employer through the use of deferred compensation plans increases the likelihood that he will be able to motivate employees successfully. The variety of interests and needs of employees is virtually as great as the number of employees. To say, as does the Committee Report of the House, that deferred compensation is primarily used by the already highly paid is merely another way of recognizing that it is a useful compensation arrangement.

The benefits available to companies through the use of deferred compensation plans are applicable to small companies as well as large. In some respects they are especially important to small and medium sized companies who cannot afford large fixed salary commitments and who face economic uncertainties and possible future financial difficulties. In fact, a deferred compensation plan is one of the primary ways a small company can attract and retain competent executives and technical personnel who might otherwise prefer a larger current salary from a bigger company.

Enactment of the House proposal, we believe, would result in the termination of the use of deferred compensation plans. If employees are going to be taxed as if they had received income in earlier years, many will naturally wish to receive the income in the form of current compensation. One result of the termination of deferred compensation plans, we believe, would be to encourage the piracy of employees by those companies who are willing and able to pay higher current compensation, thus interfering with stable long term employment relationships. Another result, we believe, would be a reduction in federal revenues. The House Committee Report estimated a slight gain in revenues from the adoption of this proposal. However, this estimate was based on the assumption that deferred compensation arrangements would be continued in their present form, with the only change being that the deferred compensation would be taxed at the presumably higher tax rates of an employee's earning years. As indicated, we do not feel that this is a valid assumption. To the contrary, we feel that the House proposal would result in a shift to current compensation arrangements or to more extensive use of qualified pension and profit-sharing plans. In either case, the corporation would be entitled to a current deduction in the full amount paid out as salary or contributed to a plan. Since the corporate tax rate will undoubtedly be higher than the average of the tax rates of the applicable employees, and since in the case of qualified plans taxation of the employees will be deferred until receipt of the benefits, the result could be a loss in federal revenues.

Another difficulty with the House proposal is its inconsistency with the provision in the House bill which would limit the marginal tax rate on earned income to 50%. As it passed the House, this provision would not apply to deferred compensation. Thus, deferred compensation would in effect be subject to prejudicial tax treatment, since unlike current compensation it could, under

the House bill, be taxed at rates higher than 50%. There is no rationale for this prejudicial treatment and it would clearly increase the likelihood that the use of deferred compensation arrangements would be terminated.

In sum, we feel that the House proposal would add a complicated and fictional rule to an already complex tax code, and would change the law in an area where no abuse has been shown. Deferred compensation arrangements are firmly based in the economy, there are many non-tax reasons for their use, and no income escapes taxation. Furthermore, unlike the House proposal, the current method of taxing deferred compensation is soundly based in tax theory. Virtually all employees are cash basis taxpayers, and under the cash method of accounting, income is not taxed until it has been actually or constructively received. Yet, the effect of the House proposal would be to tax employees receiving deferred compensation as if they had received the income during earlier years. For all of these reasons, we agree with the Administration that there should be no hasty legislation in this area.

IV—Real estate depreciation

Section 521(a) of the bill would deny the use of accelerated depreciation methods to new depreciable real property (other than residential) and would require that the straight-line method be used for such used property.

The report of the Ways and Means Committee indicates that its purpose is primarily to eliminate the trading in losses and opportunities for tax avoidance which are primarily of benefit to the real estate operator. However, although the committee's purpose hardly applies, even depreciable real estate constructed or acquired for use as an integral part of manufacturing and other business and industrial operations would be included under these very broad provisions. Nonspeculative properties of this type, whether factories, warehouses, or office buildings, are essential to the modernization of industrial capacity and, therefore make a constructive contribution to increased productivity and real economic growth.

The haste with which this section was conceived is clearly evident in that it follows by only a couple of months the Administration's announced plans to explore liberalization of depreciation allowances for productive facilities. We strongly urge your Committee to revise Section 521(a) to ensure that accelerated depreciation methods continue to apply to real estate used for its intended function by the owner in the active conduct of his trade or business.

V—Depletion

H.R. 13270 would reduce rates of depletion allowance for various minerals, most notably that for petroleum from 27½% to 20%. We believe this would be unwise. The continued existence of a sound extractive natural resources industry requires recognition in the tax laws that this industry is unique in that it exhausts its assets in the course of operations. Currently, exploration for, and discovery and development of, new mineral deposits are becoming even more difficult, more costly, and financially more hazardous. Therefore, we believe that, not only should adequate provision be made for the current deduction of research, prospecting, exploration and development costs, or deferment at the election of the taxpayer, but percentage depletion allowances at not less than existing rates should be continued. We strongly urge the Committee to delete from the bill provisions for reductions in the rates of percentage depletion allowances.

VI—Foreign tax credit

Foreign business activities play an important role in U.S. foreign economic relations and policies. Such activities abroad are exposed to greater risks than are business activities in the United States and must compete with foreign enterprise often subsidized and often subject to lower basic tax rate. Consequently, business income earned abroad by United States enterprises should be afforded tax treatment which gives due consideration to the additional factors involved.

Nevertheless, not a single one of the many suggestions made by industry representatives and others for relief of unnecessary tax burdens and inequities under existing law in this area was picked up in H.R. 13270. Instead its provisions continue to trend, evident since 1962, toward harsher treatment of foreign source income.

Section 431 provides a recapture rule in the event that U.S. taxpayers sustain foreign losses which are taken into account in computing their worldwide taxable income tax for U.S. income tax purposes. In general, the rule as contained in the House passed bill would affect all U.S. taxpayers who use the per-country

limitation for foreign tax credit purposes. Under the recapture concept, any reduction in taxable income produced by a foreign source loss in one taxable year would be offset in later taxable years by reducing the amount of the foreign tax credit that would otherwise be allowable under existing law when income is derived from that foreign source by the U.S. taxpayer.

In one manner of speaking, Section 431 seemingly indicates there is no justification for recognizing as a creditable tax an income tax paid to a foreign country which does not allow a net operating loss carryover. Historically, the U.S. has never required that the income tax system of a foreign country exactly parallel the U.S. system in order for the tax credit to be allowable since it recognized that income tax systems of other countries vary, and necessarily will continue to do so, because of the manner in which they were developed and the likelihood of the continued existence of most foreign countries as separate sovereigns. In actuality, there is no need to reduce the allowable foreign tax credits in these types of cases because the net effect of an income taxing system of a foreign country which fails to allow a net operating loss carryover in the computation of their income tax means that the effective rate of tax imposed by such country is higher than it would have been had such a loss been recognized.

If the proposed change were enacted, it would result in discrimination against those taxpayers operating in foreign countries whose tax laws did not parallel in principle the provisions of the U.S. law. Furthermore, the mechanics of the proposed provisions can result in apparently unintended effects over and above the penalty imposed upon those companies operating in countries not allowing loss carryovers. For example, even where a company operates in a foreign country allowing loss carryovers, it is possible that the mechanics of the new provision would result in additional U.S. taxes. Assume, for instance, that a loss in a foreign country having the same rate as the U.S. were offset exactly in the second year and there was no foreign tax paid in the second year. At this point the U.S. has recaptured the so-called tax benefit of the first year in full. In year three a foreign tax is paid but in this year the limitation on allowable foreign tax credits is reduced by 50% of the loss in year one since only 50% of such loss was used as a reduction of the foreign tax credit limitation in year 2. In year 3, therefore, the taxpayer would not be able to recover the full amount of the foreign income taxes paid by him notwithstanding that the U.S. had already recaptured the full amount of the so-called tax benefit of the first year.

In addition, the effect of this proposed change would be to penalize new business activities abroad, in that losses are often incurred for the first several years of such activities. We believe that any venture which would take several years to become profitable should not be made less attractive by discriminatory tax treatment.

Section 432 provides for a separate country-by-country FTC limitation with respect to "foreign mineral income" derived from within any foreign country or possession of the U.S., or any agency or instrumentality thereof, that (a) requires the payment of any bonus or royalty with respect to property which gives rise to "foreign mineral income," (b) holds substantial mineral rights with respect to such property, or (c) imposes any income, war profits, or excess profits taxes on such income at an effective rate higher than on other income.

The stated justification for the addition of this section is that it is difficult to distinguish royalties paid to foreign governments from income taxes paid to the same governments. But the facts do not support this. As in the case of the United States Government, foreign governments which own mineral properties collect royalties for the right to carry on extractive operations and impose income taxes on profits derived from those operations. The same criteria that distinguish the royalties which the U.S. Government collects in its role as owner of mineral rights from the income taxes which it collects from mineral operators carrying on operations on Government-owned lands, are available to make is determination when the operations are carried on in a foreign country. We note that Assistant Secretary Cohen when he appeared before your Committee early in September stated that the Treasury Department did not feel that the characterization of foreign taxes on mineral income in excess of the U.S. rate as royalties was justified.

Section 432 is discriminatory in that it denies the use of the overall limitation in computing the allowable foreign tax credit to a single industry, i.e., the mineral industry. The concept which justified the addition of the overall limitation to the Code was based upon the fact that many U.S. companies treat their entire foreign operations as an integrated operation separate from a U.S. operation and

that in such cases it was appropriate to permit such companies to compute the foreign tax credit on the basis of income from all sources outside the U.S. rather than on a country-by-country basis.

To single out one industry and deny it the availability of computing the foreign tax credit on an overall basis is in effect a precedenet for dissecting a single business operation into its various component parts rather than treating it as an economic unit. From a practical point of view, section 432 fails to recognize that production in one foreign country is of little avail if it cannot be processed and marketed in other foreign countries. Thus, the effect of the proposal is to deny the use of the overall foreign tax credit concept in those situations where the overall business operation (producing, processing, transporting and marketing) is taxed at various rates by various foreign countries, which is exactly the type of situation for which the overall limitation was enacted by Congress.

Accordingly, we recommend that your committee reject the addition of sections 431 and 432 to the Code.

Limitations of space prevent us from detailing industry's case for changes in the application of the foreign tax credit. However, at this time we would emphasize two points.

(1) Where the business form of a foreign operation is a foreign corporation owned by a U.S. corporate parent, an indirect credit under Section 902 with respect to dividend income received by the parent is allowed for foreign income taxes paid by the foreign corporation and attributable to the dividend, provided that prescribed percentage of ownership tests are met. Those tests require that the U.S. parent own at least 10% of the voting stock of a first-tier foreign corporation, and that the first-tier foreign corporation own at least 50% of the voting stock of a second-tier foreign corporation. No provision is made for lower tiers.

Since the 10%-50% ownership rules became law in 1951, the great growth of U.S. corporate investments abroad has been accompanied by increasingly complex foreign rules, frequently preventing U.S. investors from owning as much as 50% of the stock of foreign corporations. There are also many cases involving lower tier companies resulting from acquisitions and business requirements.

We recommend that, to relieve the inequity of the present ownership requirements, the indirect credit be allowed with respect to any second or lower tier foreign corporation at least 5% of the voting stock of which is owned indirectly by a U.S. corporation.

(2) The other major point involves the effect of the income tax surcharge on the foreign tax credit. The present 10% tax surcharge, which when proposed was consistently called a temporary tax on a tax, was generally understood to apply equally to all taxpayers, regardless of the nature of their income. This important equity objective is achieved only by imposing the surcharge as the last step in the tax computation.

As it was enacted, however, the surcharge is imposed in an intermediate computation before the foreign tax credit, instead of on the final tax, with the result that corporate taxpayers having foreign source income bear a tax surcharge having a disproportionately high effective rate. This is not only inequitable, but also questionable under the foreign tax conventions. We recommend that the law be amended to limit the tax surcharge to 5% (or whatever rate is determined after 1969) of the tax which would have applied in the absence of the surcharge.

VII—Moving expenses

The House-passed bill recognizes that more equitable tax treatment of moving expenses is necessary. Labor mobility helps both the employer requesting the move and the economy as a whole. But it almost always inconveniences the individual involved and his family. For them—the half million or more families involved in employment-related moves each year—the least that can be done is to insure that the tax effect is neutral.

The recognition of the need to go beyond a "bare-bones" definition of moving expenses to include so-called "indirect" expenses is welcome. The mechanics of the proposals, however, raise some problems. It is reasonable to treat new employees, who may have to relocate to assume their duties, in the same fashion as transferred employees. However, in attempting to achieve uniformity in the tax treatment of reimbursed and non-reimbursed employees, the proposal would

have reimbursements included in gross income with an offsetting deduction for specified costs, subject to an over-all limit of $2,500 for the "indirect" expenses.

The dollar limitation would limit the revenue loss to $100 million a year. We question whether that is an appropriate criterion in this situation. The personal income tax is a tax on net income and a reimbrusement of expenditures incurred as a result of the taxpayer's employment is not income in an economic sense if no enrichment has taken place. The taxpayer is merely restored to the same position financially that he would have occupied had the transfer not taken place. They are expenses that the employer has agreed to bear because of the move. As such, the reimbursement is an employer expense—not employee income. Similarly, in the case of new or non-reimbursed employees, the expense of the move should properly be considered as an expense attributable to the earning of income. We are not basically dealing with a revenue problem here, but with a technical defect in the law.

We would also like to point out that inasmuch as the categories of deductible expenses would be stringently limited, it is not necessary to provide additional controls in the form of dollar limitations.

One improvement that we suggest, if categories of deductible expenses are to be specified, is in the proposed time limit for deductible living expenses while occuping temporary quarters in the new location. The legislation now before your Committee would limit such deductible expenses to those incurred during any period of thirty consecutive days. We regard this as unreasonably restrictive. Many moves, for example, are made on short notice. If it is considered necessary to impose some time limitation, it should be not less than ninety days.

Also, the provision to extend the twenty-mile test to fifty miles seems unreasonable. Under this, no deduction would be allowed unless the taxpayer's new principal place of work is at least fifty miles farther from his former residence than was his former principal place of work. In many congested metropolitan areas where most jobs are located, an additional thirty miles of commutation is a real hardship and forces a move of residence. We recommend that the present twenty-mile test be retained.

It is our belief that the most realistic and equitable approach to moving expenses is that all reimbursements and allowances for reasonable expenses and losses actually incurred should not be subject to tax and that such expenses or losses to the extent *not* reimbursed should be allowed as deductions. If it is necessary to limit the expenses and losses so treated to certain categories, then certainly no further limitation should be imposed.

VIII—Taxation of cooperatives

It has long been NAM's policy that the discriminatory distribution of tax burdens between cooperative and non-cooperative enterprises should be eliminated. The deduction of patronage refunds from income before the calculation of corporate income tax leaves cooperative enterprises in a preferred position with respect to retained earnings. This results in an advantage over their tax-paying competitors and a loss to the Treasury.

Section 531 of H.R. 13270 builds on the reform began in the Revenue Act of 1962 by raising from 20% to 50% the patronage allocations that must be paid out currently. However, this change would take ten years to accomplish. This section also adds the requirement that, to be treated as qualified, patronage allocations and pre-unit retains must be paid out in fifteen years. While this, too, is a step in the right direction, the period of time is much too long. At a minimum, your Committee should consider shortening the pay-out period requirement from fifteen years to five years.

IX—Pollution control

Section 704 of the bill provides for a five year write-off of investments in air and water pollution control equipment. We believe that broad social benefits accrue through the air and water quality control efforts of industry, and that in most instances these efforts do not bring an economic return. We advocate that such investments should be accorded accelerated amortization up to and including the immediate write-off of the facility, at the option of the taxpayer, plus a liberal tax credit as is provided in numerous bill which have been introduced in this and previous sessions of the Congress. Therefore, while the provision in the pending bill is a step in the right direction, it is still not commensurate with

what is needed to achieve the benefits and alleviate the burdens involved in obtaining better environmental quality throughout the nation.

In addition, the provision includes two undesirable provisions. The first is a requirement that certification of the equipment must be obtained not only from a state agency but also from a federal agency. This dual certification requirement, with attendance red tape, paper work and delay, will serve to weaken attainment of the objective of the provision. Because the Congress has declared a national policy that the states have primary responsibility in the pollution control field, we strongly urge that certification of the equipment should rest with the state agencies.

A second undesirable feature of this provision is that it would authorize the Secretaries of Interior and Health, Education and Welfare to promulgate minimum performance standards for such equipment. This, likewise, is contrary to the declared Congressional policy of placing primary responsibility upon the states. We believe it would be unwieldly and impractical to put the federal government into the business of establishing specifications for the manufacture of this type of equipment.

X—Corporate mergers

Section 412 of the bill would disallow a deduction for interest on certain bonds issued in connection with the acquisition of a corporation. The only comment we have on this section is to suggest that it not apply to those cases where there is evidence of serious negotiations or a binding commitment prior to May 27, 1969, the effective date of the proposed section of the legislation.

XI—Transfers of franchises

Under Section 516(c) of H.R. 13270, amounts received upon transfer of a franchise would not be treated as proceeds from sale or exchange of a capital asset or of property to which Section 1231 applies if the transferor retains any significant power, right or continuing interest with respect to the subject matter of the franchise. Such provisions, however, would not apply with respect to amounts received in connection with a transfer of a franchise to the extent attributable to the transfer of all substantial rights to a patent, trademark, or tradename, (or an undivided interest therein which includes a part of all such rights), to the extent such amounts are separately identified and are reasonable in amount.

In addition to patents, trademarks and tradenames, the transfer of a franchise could also include the transfer of other property necessary and pertinent to full realization of the benefits of the franchise, such as secret processes which have not been patented. We see no reason why property rights transferred in connection with a franchise which are not patented should be treated in a different manner than property in the form of patents. We recommend, therefore, that the exception contained in subsection (c) of proposed Section 1252 as now worded be amended to include "secret processes" in addition to patents, trademarks and tradenames.

XII—Treble damages in antitrust actions

I would like at this time to state the position of the NAM regarding a tax proposal which although not part of the House bill is now pending before this Committee. The proposal referred to, as contained in S. 2156 and S. 2631, would overturn a 1964 ruling of the Internal Revenue Service (Rev. Rul. 64–224) holding that amounts paid in satisfaction of treble damage claims under Section 4 of the Clayton Act are deductible for federal income tax purposes as ordinary and necessary business expenses.

We are opposed to the enactment of the proposal contained in S. 2156 and S. 2631 for the following reasons: (1) Rev. Rul. 64–224 is a correct interpretation of the applicable tax law; (2) the Tax Code should not be used for "backdoor" regulation of what is essentially a social and economic problem; and (3) the denial of a deduction for treble damages paid by a corporation harms the corporation's shareholders who, especially in publicly-owned companies, will in general have been innocent of any wrongdoing.

The Supreme Court has consistently held that it will countenance the disallowance of otherwise permissible business deductions only where the allowance would "frustrate sharply defined national or state policies . . .". *Commissioner* v. *Tellier*, 383 U.S. 687 (1966). The Court has denied business deductions on the ground that they "frustrate sharply defined" public policies in only two

categories of cases: (a) Payments of fines and penalties to governmental bodies, and (b) Payments specifically prohibited by longstanding Treasury regulations. Treble damages obviously do not fit the second category, and although there is contrary dictum in the case of *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955), it has also been consistently held that treble damages are not meant to punish wrongdoers as is the case of fines and penalties, but instead are remedial and compensatory in nature. *Huntington* v. *Attrill*, 146 U.S. 657 (1892); *Overnight Motor Transportation Co. Inc.* v. *Missel*, 316 U.S. 572 (1942). Any legislation to deny a deduction for treble damages must be analyzed with the consideration in mind that it would be inconsistent with the principles laid down in the above line of cases.

It has been readily admitted by proponents of the subject proposal that it is intended as a deterrent to violations of the anti-trust laws. We submit that the Internal Revenue Code is the wrong place to deal with this problem. The anti-trust statutes already contain many deterrents to violations, including substantial fines and penalties which, even under present law, are not deductible. The integrity of the tax statute, however, should, we feel, be maintained. As stated by Mr. Justice Stewart in the Court's opinion in the unanimous decision in *Tellier*, *supra:*

"We start with the proposition that the federal income tax is a tax on net income, not a sanction against wrongdoing. That principle has been firmly imbedded in the tax statute from the beginning."

The burden of a treble damage payment made by a corporation is ultimately, of course borne by the corporation's shareholders. The subject proposal would increase this burden by denying the corporation a deduction for a payment which most agree is an ordinary and necessary expense of the corporation. This "sanction against wrongdoing" will thus harm persons who by and large, especially in publicly-owned corporations, will have been innocent of any wrongdoing.

For these reasons we urge that the proposal to deny a deduction for treble damage payments in anti-trust cases be rejected.

CONCLUSION

In conclusion, I would like to quote from an address by George Champion, former Chairman of the Board of The Chase Manhattan Bank, before our Taxation Committee last year. His remarks go right to the heart of the problem with H.R. 13270:

"For far too many people, the words still conjures up a 19th century vision of little old ladies clipping coupons in bank vaults. They think of capital as stagnant, lifeless, having nothing whatever to do with them or the world they live in.

"These people must be reminded that capital is what keeps us all going, rich or poor, young or old. The American worker enjoys the highest standard of living in the world because somebody has invested $15,000 to $20,000 in the tools he works with. He is able to do the job because we are investing 6 percent of our total Gross National Product every year to educate him and millions of others. If he has time to think, to read, to dream, to enjoy life, it is because he is prosperous—and he is prosperous because capital has been invested in him."

Capital is what keeps us going, and I urge your Committee to revise the anticapital formation features of this bill so that it can continue to perform the job we all want it to.

The CHAIRMAN. The next witness is Mr. Saul Pearl, president of the Machinery Dealers National Association.

STATEMENT OF SAUL PEARL, PRESIDENT OF THE MACHINERY DEALERS NATIONAL ASSOCIATION (MDNA)

Mr. PEARL. Mr. Chairman and members of the committee, my name is Saul Pearl and I appear here today as a member of the small business community as well as in my capacity as president of the Machinery Dealers National Association (MDNA).

MDNA is a national trade association composed of 300 companies who have joined together to promote the growth of the used machine tool industry in the United States and Canada. The association has asked me to testify primarily on the failure to include tax revisions in H.R. 13270 to assist small businesses.

We believe that tax incentives should be provided for small businesses or H.R. 13270 should be amended to include reforms of the depreciation of tax structure. This vital segment of the American economy is hampered more than ever by the shortage of working capital, compounded by the high-interest rates and spiraling inflation.

We are concerned because our members and most of our customers are small businesses. The products of our industry, reconditioned used machine tools, often present the only economically justifiable means for medium or small business enterprises to modernize their facilities.

Small businesses in the United States have a difficult time competing with large domestic and foreign firms because they have difficulty in securing adequate debt and equity capital. These problems are particularly acute in the metalworking industry where capital outlays are necessarily high. To illustrate, the Subcommittee on Special Investigations of Small Business Problems of the House Select Committee on Small Business held hearings in 1966 on the problems of the tool and die and the machine tool industries and reported to Congress that:

(1) these industries are basic to the economic health of the Nation; and

(2) that additional financing is not available from the private sector of the economy or from special programs of the Small Business Administration.

Due to inflated costs and high interest rates, conditions today are less favorable than in 1966 when those hearings were held.

In Secretary Kennedy's appearance before this committee on September 4 and 5, he indicated that the Treasury Department was considering other tax incentives to replace the investment credit to stimulate the continued modernization and expansion of our Nation's industrial plants. When and if these incentives are considered by the Congress, we would hope that special attention is given to the problems of small businesses. In the interim, we hope that the committee will amend H.R. 13270 to provide special relief for small businesses in the following particulars;

1. The investment credit should be reinstated, limited to the first $100,000 of purchases of both new and used equipment.

The prospect of repeal of the investment credit has already had an inordinate impact on the economy. We note that used machine tool sales in August 1969 declined 19 percent from July and plummeted 39 percent in the last 3 months. New machine tool sales in August declined 16 percent from July and now are 56 percent below levels 4 months ago.

In our judgment the limited reinstatement of the investment credit would be the simplest and most effective means of preserving our Nation's small businesses.

2. The normal corporate tax rate should be reduced on the first $25,000 of taxable income from 22 percent to 20 percent. The 26 percent surtax would remain in effect, thereby making the total corporate rate 46 percent.

Secretary Kennedy recommended a reduction in the corporate rate structure to 46 percent. MDNA's recommendation concerning the normal and surtax rates in consistent with Secretary Kennedy's recommendation except that by reducing the normal rate, rather than the surtax rate, small businesses would benefit more significantly.

3. The depreciation tax structure should be reformed to provide faster write-offs on purchases of new as well as mixed groups of new and used equipment.

Most of the major industrial nations permit industry a rapid write-off of plant and equipment investments which provides a greater cash flow for research and development and additional investments in new plants and equipment.

I have brought with me a reprint on this subject and request that it be included in the record following my remarks.

The CHAIRMAN. The reprint that you mention will be placed in the record of this hearing.

Mr. PEARL. Thank you, Mr. Chairman.

The Treasury Department in 1962 moved in the right direction of the depreciation pattern of other nations, except for the reserve ratio test. Previous witnesses have presented testimony on the shortcomings of the reserve ratio test and I have no intention of taking up the committee's time by repeating those criticisms.

In brief, MDNA believes that it is essential to eliminate the reserve ratio test not only because of its complexity but also to establish more effective depreciation patterns.

For the years 1950 through 1967, fixed investment as a percentage of gross national product was less in the United States than in any major developed country, except the United Kingdom. Unless more internal funds can be generated by American industry, and particularly by small businesses, we will find our competitive position further weakened in the world marketplace.

Internal cash flow could be generated by amending section 167 of the Internal Revenue Code to eliminate the requirement that the taxpayer establish a salvage value for depreciation purposes. Now, the need for a taxpayer to take salvage value into account is obviated by the depreciation recapture provisions of section 1245.

This section works automatically to recover as ordinary income any gain on the sale of equipment which is attributable to depreciation deductions. Accordingly, we recommend that section 167 be amended to do away with the requirement that the taxpayer's annual deduction for depreciation should be limited by the salvage value.

Another way to provide direct assistance to small business would be to increase the additional first year depreciation allowance of section 179 from the present $10,000 ceiling to a more realistic level of at least $25,000. The existing $10,000 ceiling has remained unchanged since this section was added to the code in 1958. During that period, costs have spiraled to such an extent that the $10,000 ceiling is no longer realistic.

Purchases of modern used machinery enables many small firms to upgrade and modernize existing facilities. Depreciation incentives applicable to both new and used machinery will not encourage prospective purchasers of new machine tools to purchase used machinery since these items do not compete in the same market. The average cost of a new domestic machine tool is approximately $22,000, while the average price for a used machine tool is approximately $4,500.

In summary, MDNA recommends that Congress provide specific incentives for small business to modernize existing plant and equipment or, in the alternative, to reform the existing tax depreciation structure by eliminating the reserve ratio test, removing the salvage value as a consideration in determining allowable depreciation, increasing the $10,000 ceiling on the additional first year depreciation to $25,000 and by permitting rapid write-offs for equipment. This latter recommendation should take into consideration the shorter remaining useful life of used equipment.

We appreciate this opportunity to appear before this committee and will do our best to answer any questions which members of the committee may have.

The CHAIRMAN. Thank you.

(There follows, communications received by the committee expressing an interest in the subject of tax treatment of small businesses:)

STATEMENT SUBMITTED BY ELIOT H. SHARP

My name is Eliot Sharp, and I am chairman of the board of IDD, Inc., publisher of the Investment Dealers' Digest, 150 Broadway, New York City 10038. The corporation is a "small business".

Inflation And Tax Reform.—This statement is filed for the sole purpose of urging upon the Committee Members consideration, in connection with Tax Reform, of the substantial inflation that has occurred in recent years since certain maximums were set respecting various taxes; specifically, the law leading to IRS Section 531 relating to accumulation of surplus, which maximum was increased from $60,000, to $100,000 in 1958, since which time there has been such substantial inflation and deterioration of the dollar as to make $100,000 a pitifully small amount, perhaps suitable for a few showers but surely not for a rainy day; and the maximum of $25,000 beyond which a corporation is subjected to a higher tax rate, inflation again having produced drastic deterioration in the intended worth of that benefit to a small business.

If Congress deemed these amounts, when they were established many years ago, as suitable, recognition of the extent of inflation since then strongly indicates that under any Tax Reform measure, they should be appropriately increased.

The Congress, quite properly, seems to be concerned about corporate takeovers and mergers. In a small way, I am a candidate, but ONLY because of Section 531. I am quite aware of the potential abuses 531 is designed to cure; the only question is whether its poison is worse than its cure. As presently constituted, the law encourages—indeed, almost forces—acquiescence on the part of small companies to offers of takeover or merger. If this is a shocking situation, the law has created it.

STATEMENT OF JOSEPH O. EVANS

Mr. Chairman and Members of the Committee, my name is Joseph O. Evans, and I testify before you today as a self-employed business man. I do not represent any organization or firm. I speak only for myself. However, many of my thoughts on Tax Reform have frequently been voiced to me by others with whom I have come in contact as I conduct my business. Since my statement is a short one, I will present it to you in its entirety.

With two exceptions, as will hereinafter be stated, I am most concerned with the individual income tax which I feel needs the greatest reform. While I am

concerned about those who live in poverty, and about the ever increasing tax burdens of widows and widowers, it is the plight of the small self-employed business man with whose tax problems I am most familiar, that I am most concerned.

As of March, 1966, there were 6,061,000 self-employed men and women in non-agriculture industries in this country, and an additional 2,125,000 men and women engaged in agriculture. This results in a total of 8,186,000* self-employed people in the United States who have to pay Federal Income Tax each year.

STANDARD DEDUCTIONS

It is my belief that a new classification of tax payers should be adopted for those who wish to take a standard deduction, with new groupings as follows:

(1) For those with very low incomes, I am in agreement with the Treasury recommendation. This increase in the standard deduction for those with very low incomes would reduce the needs of other forms of governmental help to these individuals.

(2) For the self-employed over 35 years of age, who have a gross income of 10,000 dollars a year or less, the standard deduction should be increased to $2,000. Many of the self-employed are forced into business by circumstances beyond their control. Small companies for whom they may formerly have worked for many years may have gone out of business because of the retirement or death of the owner, or because the owner could not meet competition from larger firms. This has caused many qualified employees to be unable to find other employment because of their age at the time of the liquidation of the company for whom they had worked (some firms have now established employment age for new employees as low as 30); because of physical handicaps preventing them from passing physical examinations required for new employment; and because of recently added higher educational requirements which were not in effect at the time of their original employment. Self-employed persons must stay in business no matter how high the cost of their tools; travel for new business; local transportation; cost of help; or income tax, yet they can seldom raise the fees for their services or the prices of their products because of the competition from larger firms.

(3) For the widow or widower whose gross income is $15,000 a year or less, the standard deduction should be $2,000 since these people have financial commitments already incurred during their time of marriage and not normally experienced by the young never married nor the presently young married wage earner, and which commitments must continue at a time when retirement may soon become mandatory and when opportunity for additional employment becomes nil because of age restrictions.

It is to be understood that my above recommendations do not put a ceiling on deductions arrived at by itemization of legitimate expenses which are approved by the Internal Revenue Service for individuals whose added expenses warrant itemization.

OTHER DEDUCTIONS

(1) Self-employed persons should be permitted to deduct cost of education needed to cope with newer knowledges, skills, and technology in new fields to which he must turn in order to operate his business.

(2) Cost of traveling of self-employed persons, with yearly gross income of $12,000 or less, to secure a business contract or the like should be permitted, as denial of this prevents the small business man from obtaining work because he cannot afford cost of travel. Section 162(a) of the Internal Revenue Code states, "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." The expenses incurred in traveling to secure a contract, when one's business consists of the performing of duties set forth in a contract given by other business men, is one's business. This travel should be therefore allowed as a business deduction.

For example: A company suggests that you come to their plant or office to show you their product and/or to discuss their services in the light of how you can best serve their interests. This cost of travel should be allowed as a deductible expense.

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*_The U.S. Book of Facts Statistics & Information_ for 1967. New York: Washington Square Press, Inc. Distributed by Simon & Schuster, Inc. 1966. p. 230.

Attention is called to need for change in the tax rate of certain individuals. Legitimate heads of households should be permitted to use the same rate as that used by married persons. Widows and widowers with adjusted gross incomes of $16,000 or less should be permitted to use a rate similar to that now used by heads of households. The single persons rate works a great hardship on these people, especially as they near the end of their employable income.

TREATMENT OF THE ELDERLY

Before any consideration is to be given to the tax treatment of the elderly, one must first determine who is elderly. I personally feel that for any purpose relating to ones earnings, the long concluded age of 65 is outmoded and ridiculous. As I have stated elsewhere in this testimony, the age of 30 has, in at least two cases brought to my attention, been considered elderly in so far as employment of new persons is concerned. For tax purposes, the age of 50 would be a more realistic age to be considered elderly. I recommend considerable research be done in this area before a final decision on the tax treatment of the elderly is made.

TAX-EXEMPT FOUNDATIONS

I believe that all foundations, organizations, social clubs and fraternal organizations should pay some amount of Federal Income Tax. Churches that make investments should only be exempted from taxation when the returns from their investments are used for the upkeep of the churches and for the care of the poor and needy in their own parishes. State and city societies, and clubs having a membership of/or relating to people of a foreign country, or clubs whose sole purpose is educational in the American way of life or in the arts or culture should be exempt from taxation.

TREATMENT OF STATE AND MUNICIPAL BONDS

I fully support the belief that Federal Income Tax should be paid on all interest received on state and municipal bonds, the tax being paid by the purchaser and/or holder of the bonds. It is the considered opinion of those who are knowledgeable about such matters that one must have at least $50,000 to invest in tax-free bonds before one derives a usable income from the investment. The average working man, who may really need to derive an income from such an investment, is therefore left completely out of the picture. I believe that anyone who has $50,000 to invest can certainly afford to pay a tax on the earnings of the investment.

In view of the fact that many people have purchased tax free bonds with the belief that they would not have to pay any tax on the same, all present holders of the bonds should be exempt from paying any tax on the bonds for a period of three years. However, all bonds purchased after a predetermined date, which date should not be divulged ahead of time, should be taxed. By not disclosing the date of the beginning of taxation of the bonds far in advance, a rush to purchase bonds would be avoided and an unfavorable bond market would be prevented.

Mr. Chairman, I fully realize that the question that you and the other Committee Members may be asking is where and how is the government going to obtain money to make up for all the increases in the Standard Deductions and Other Deductions which I have advocated. I believe the collection of tax from present tax-free bonds and taxation of the above noted organizations will go a long way to make up this deficit. I also recommend Federally Controlled gambling, legalized in all of the 50 states and a reasonable Federal Tax on the same. We know that people will gamble, therefore, our government should receive some tax benefits from this habit. I believe that my recommendations would, if adopted, greatly relieve some of the more pressing tax burdens on the poor, the self-employed, and the widows and widowers.

When the Standard Deduction was made law, each taxpayer in the low or middle-income bracket paid a tax of approximately 20% of his income. The ever increased cost of living and the static Standard Tax Deduction have resulted in the average taxpayer now paying nearly 50% of his income in taxes. I therefore recommend that a study be made to see if some form of sliding scale for the Standard Deduction be worked out, a scale based on a percentage of the increasing cost of living.

I will be pleased to try to answer any questions which the distinguished members of this body may desire to ask.

SUMMARY

Standard Deductions

I recommend that a new classification for tax payers be adopted for those who wish to take a standard deduction, with new groupings as follows:

(1) For those with low income, I am in agreement with the Treasury recommendations.

(2) For the 8,186,000 self-employed people, many of whom are over 35 years of age, I recommend a standard deduction of $2,000, if their gross income is $10,000 a year or less.

(3) For widows and widowers whose gross income is $15,000 a year or less, I recommend a standard deduction of $2,000. This should not put a ceiling on those who itemize deductions.

Other Deductions

I recommend that self-employed people be permitted to deduct the cost of traveling to obtain new business.

I recommend that self-employed people be permitted to deduct the cost of education needed to cope with newer knowledges, etc.

Treatment of the Elderly

I recommend that studies be made to consider one elderly at 50 year old for tax purposes.

Tax-Exempt Foundations

I believe that most foundations etc. should pay some tax to help support the government.

Treatment of State and Municipal Bonds

I support the belief that Federal Income Tax should be paid on state and municipal bonds.

Change in Tax Rate

I call the attention of the Committee to the need to change the tax rate for certain individuals. For heads of households, change to the present rate for married persons; for widows and widowers, change to the old head of the household rate.

I have stated in my testimony that I believe that by taxing foundations, etc., and by placing a tax on state and municipal bonds, and by legalizing gambling and placing a tax on gambling, the Federal Government will realize enough income to more than make up for the above recommended deductions in personal income tax.

The CHAIRMAN. The next witness will be Mr. Walker Winter, who is vice president and chairman of the tax committee, and Mr. Robert R. Statham, taxation and finance manager, Chamber of Commerce of the United States, Washington, D.C.

We are very pleased to have you here. You represent a very fine and distinguished organization.

STATEMENTS OF WALKER WINTER, VICE PRESIDENT AND CHAIRMAN OF THE TAX COMMITTEE, ACCOMPANIED BY ROBERT R. STATHAM, TAXATION AND FINANCE MANAGER, CHAMBER OF COMMERCE OF THE UNITED STATES, WASHINGTON, D.C.

Mr. WINTER. My name is Walker Winter, I am a vice president of the Chamber of Commerce of the United States and chairman of its taxation committee. I am also a partner in the Chicago law firm of Ross, Hardies, O'Keefe, Babcock, McDugald, and Parsons.

The CHAIRMAN. I believe you once served on the staff of the Joint Committee on Internal Revenue and Taxation?

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Mr. WINTER. That is correct, sir, a very pleasant period of my life.

The CHAIRMAN. We are sorry to lose you.

Mr. WINTER. I am accompanied by Robert R. Statham, Taxation and Finance Manager of the Chamber.

Mr. Chairman, the national appreciates this opportunity to present its views on the proposed Tax Reform Act of 1969. The American business community is exceedingly concerned with the burden of taxation and its effect on the economy. We commend your committee for this intensive reappraisal of the taxing system. There should be a continuing and thorough consideration of the entire Federal tax system, with particular emphasis on the rate structure, other revenue sources, and on amendments needed to remove the ambiguities and the unintended hardships and inequities from the code.

This legislation is said to be the most extensive attempt at reforming the tax laws ever undertaken. Assuming its passage, it will play a major role in the course of the Nation's economy, and every segment of the American free enterprise system is certain to be affected by its provisions. It is in the best interests of the country that this legislation be used to provide greater equity in the tax laws and simplify compliance for the taxpayer. It should not be used as an instrument to quash individual initiative to save and invest and provide jobs and a better standard of living for our citizens.

This legislation received hasty consideration in the House at the time of its passage. Legislation of this magnitude and complexity requires that a great amount of time be given to the review of its contents and impact on taxpayers. It is urged that the committee give adequate time to the consideration of the tax proposals in this bill. The goal is not the enactment of just a tax reform bill—but the enactment of a tax reform bill to serve the long-term best interests of the Nation, and the chamber urges the enactment of such tax reform legislation.

A reason given for the enactment of this legislation is to maintain the confidence of taxpayers in our self-assessment system of taxation. It is contended that taxpayer morale is an important factor to be considered. Serious questions have been raised these past months which tend to undermine the confidence of taxpayers, both individual and corporate, in the Federal tax laws. If this confidence is not restored, those administering the tax laws will have problems obtaining the revenue required for necessary government operations.

Many of the proposals in this legislation affect sections of the Code which have been on the books for many years and were adopted by the Congress with good and proper reason at the time. It is important that we guard against constant change in the tax laws lest this in itself have a demoralizing effect. It is realized that time and conditions change, and what may have been equitable in the judgment of Congress at one time may not now be considered equitable. Nevertheless, Congress must avoid including provisions in the tax laws which will require abrupt change after a short period of time. It is exceedingly important that adequate consideration be given to proposed changes to make sure that what is being enacted will provide lasting solutions rather than temporary confusion.

In brief:

The chamber supports:

increasing the standard deduction as providing a degree of simplification for a large number of taxpayers;

reducing tax rates of individuals and corporations as providing a degree of equity for a large number of taxpayers;

adopting the 50 percent maximum tax rate on earned income, but requests the concept be applied to all personal income;

broadening the allowable moving expense deductions, but recommends a liberalizing of the dollar limitations;

repealing the unlimited charitable deduction;

enacting the Clay-Brown provision extending the unrelated business income tax;

liberalizing and simplifying the income averaging provisions as granting needed relief from the overprogressive income tax rates, and

liberalizing depreciation provisions.

The chamber opposes:

extending the capital gains holding period or changing the rate as seriously impairing the flow of needed investment capital;

limiting the use of accelerated depreciation on real estate as being harmful to an industry vital to our economy;

allowing an option to State and municipal governments to issue either taxable or tax-exempt bonds as a first step toward dependence on Federal subsidies;

changing the present law on deferred compensation, restricted stock, and lump-sum distributions;

taxing revenues of exempt organizations unless derived from an unrelated business;

creating an excess deductions account as too complicated an approach to the problem of farm losses, and

the provision relating to the disallowance of allocated deductions.

Under the provisions of H.R. 13270, during 1971 and 1972 tax rates of individuals will be reduced. When totally effective in 1972, the rate schedule will run from 13 to 65 percent instead of the present 14- to 70-percent range. The national chamber favors tax rate reductions for both individuals and corporations and urges such reductions.

The national chamber has consistently opposed the highly progressive income tax rates and the detrimental effect such rates have on our economy. Taxes should accomplish their purpose of raising revenues with the least harm to a free economy. Whenever tax rates get so high that they deter individual initiative from concentrating on improving business efficiency, they tend to divert that initiative into finding ways of avoiding taxes.

The 50-percent limit on tax rates applicable to earned income provided in the bill is a step in the right direction. However, it is the view of the national chamber that the goal should be to get the maximum tax rate on all personal income below 50 percent.

With lower rates, the need for tax planning will be reduced and some of this Nation's most creative energies will be unleashed to con-

tend with the myriad problems which confront us every day. We must attempt to confine our tax system to its prime purpose of obtaining essential Government revenues without seriously injuring taxpayers and impeding economic growth. If we do not, we will have a revenue system which will be used as a means of forcing social and economic changes which are in vogue at that time. The result will ultimately be a more complex and incomprehensible code than we presently have, and the concept of equity among taxpayers will be subjugated to the pressing demands of the day.

This legislation provides for tax rate reductions for individuals but does not presently provide a rate reduction for corporations. The bill in its present form is out of balance. To provide tax rate reduction for one class of taxpayers and not for another, in effect, shifts the burden of taxation. Corporations under the provisions of this bill will not only be denied tax reduction but will get a tax increase as a result of the repeal of the investment tax credit. The original enactment of the credit was a reason given for not providing corporations the same tax reduction as individuals in the Revenue Act of 1964. The House Committee Report 749 of September 13, 1963, at page 27, stated:

> This tax cut for corporations, when fully effective, will amount to $2.2 billion a year. It should, of course, be viewed in connection with the reduction provided by Congress last year in the form of an investment credit and the reform provided last year in the depreciation guidelines. These taken, together, provide corporations with a tax reduction of approximately $4½ billion.

And this committee in its Report 830 of January 28, 1964, at page 8, stated:

> This bill provide a balanced reduction between individuals and business firms. In this respect, the bill is much the same as the bill that came from the House. When fully effective, the bill will reduce individual income taxes by $9.2 billion and will reduce corporate taxes by about $2.4 billion. These figures must be evaluated along with the effective tax reduction of 1962 through the investment credit and depreciation reform, the largest share of which went to corporations. Taking the 1962 and 1964 programs together, the share of the reduction going to individuals is about two-thirds and to corporations about one-third, which is approximately the present relative shares of individuals and corporations in income tax liabilities.

Thus, to eliminate the investment tax credit results in a discriminatory increase in taxes for corporations. To give a tax reduction to individuals and not to corporations in this legislation compounds this discrimination. There is no reason why the taxpayer who has chosen to incorporate his business should be discriminated against, and the noncorporate taxpayer favored in legislation designed to provide tax rate reduction.

Efforts should be made to simplify the tax laws. In terms of equity, the complexity of the Internal Revenue Code may be the largest loophole in the tax laws. This reverse loophole prevents taxpayers from utilizing provisions beneficial to them and is just as inequitable as the more renowned loophole which provides an unintended benefit. It might well be the information gap that exists between taxpayers on the one hand, and the reasons for the various sections on the other, that is playing a large role in generating the so-called taxpayers' revolt.

We realize simplicity and equity do not always go hand in hand, and that there must be complex provisions in the tax laws to provide fair treatment for many of our modern complex problems. While taxpayers bemoan the many pages added to the Internal Revenue Code each time Congress enacts a tax bill, there is simply no way in which this can be avoided entirely if we are to continue to place the emphasis which we now place upon the income tax as a source for raising necessary revenues. It is hoped, however, that simplification will be an ingredient of consideration for tax reform deliberations.

The National chamber supports an increase in the regular standard deduction as the clearest way to simplify compliance with the tax laws for a large number of taxpayers. The resulting deduction should conform to the deduction profile reflected in current returns in order to retain equity between taxpayers using the standard deduction and those itemizing deductions.

The bill increases the present 10 percent standard deduction with its maximum of $1,000 to a rate of 15 percent and $2,000 by 1972. Nearly 34 million returns will benefit from this increase. This is slightly more than one-half of all taxable returns. This will increase the number of taxpayers using the standard deduction from 58 percent to nearly 70 percent, resulting in a shift of 8.4 million taxpayers, who now itemize, to the use of the standard deduction.

Allowing 8.4 million taxpayers to eliminate the tedious bookkeeping necessary for itemizing deductions would simplify compliance and serve both the individual and government. It would greatly reduce the need for audits. Just as important, it would greatly simplify the tax laws for a large segment of taxpayers.

Our sharply progressive tax rates are clearly one of the prime reasons for having income averaging provisions. Our rate structure results in a significantly greater tax liability when an individual receives a large portion of his income in a single year, than there would be if that income had been received in equal amounts over several years. The income averaging provisions were designed to afford a measure of relief to such an individual.

The national chamber supports the principle of income averaging. We believe that the benefit of the income averaging provisions is greatly increased by the provisions in the House bill. The chamber urged in the House hearings that the 133⅓ percent requirement be lowered to 120 percent or less and that the provisions be simplified. The House bill accomplishes this and also simplifies the provisions by not excluding capital gains, wagering and gifts from averaging.

The present income averaging provisions do not apply where the income of the current year is below the average base period income. The national chamber recommends that averaging be available to those who suffer a reduction in income, on the same basis as those who have an increase in income. This form of averaging could be adopted by allowing a credit against current tax liability for a portion of prior taxes paid.

The national chamber believes that employee moving expense deductions are in the best interest of the Nation and the economy, and will not result in the loss of tax revenue over the long run. A mobile labor force is a necessity. Factors which restrict mobility and cause employee

hardship should be eliminated. Many companies have realized this and are reimbursing their employees for moving costs. These reimbursements are not considered compensation by employers or by the employees. This is merely an effort to reduce the personal loss caused by an employee's move from one job location to another.

The provisions of H.R. 13270 reduce the inequities of employee moving expense taxation by allowing deductions for the following:

1. Expenses for premove househunting trips, including cost of transportation, meals, and lodging for the taxpayer and members of his household;

2. Temporary living expenses at the new job location, including costs of meals and lodging for the taxpayer and members of his household at the new job location while waiting to move into permanent quarters, and

3. Certain expenses of selling the old house, buying a new house, or settling an unexpired lease.

Allowing these deductions will lessen the tax burden on employees who are reimbursed for financial losses incurred in moving from one job location to another. These deductions would be allowed whether or not taxpayers are reimbursed by their employers.

In conjunction with the above proposal to broaden the allowance for moving expense deductions, the bill provides for a $2,500 overall limitation on these three new deduction categories. The total of the first two cannot exceed $1,000. The national chamber does not feel that such limitations are appropriate. If the categories of allowable expenses are reasonable, then the actual expenses incurred should be allowable without regard to an arbitrary limit.

Under the terms of the bill, the so-called 20-mile test would be increased. Presently, to qualify for moving expense deductions, the taxpayer's new place of employment must be at least 20 miles farther from his old residence than his old place of employment. The 20 miles has been changed to 50 miles. This proposal is inequitable and would result in unfair treatment. According to the House report this was done to eliminate deductions for intersuburb moves within a metropolitan area. However, to illustrate the inequity of such a proposal, a 50-mile limit could eliminate the deduction for a taxpayer who had a job change from Washington to Baltimore.

It is important to consider that a number of companies are moving out of the cities and into the suburbs. A 50-mile test would be restrictive on many of the lower income employees who live in the city, and discourage them from following their employment. Clearly this is a change which should be given further consideration before being adopted.

The national chamber has long supported a broadening of the moving expense deduction. The chamber would go further and include expenses of improving the salability of the old residence and also include any miscellaneous expenses related to the move.

This legislation is prone to place a much greater tax burden on the investor. This is particularly true in the case of capital gains. The economic consequences of the proposals in this area are certain to be undesirable not only for those taxpayers affected, but also for the Nation as a whole. The administration recognizes this. In his

testimony before this committee on September 4, 1969, Secretary of the Treasury David M. Kennedy stated:

"Investment in the years ahead may also be impeded by the proposed changes in tax treatment of capital gains. We believe these changes go too far. Our original proposals were designed to prevent excesses rather than fundamentally alter such tax treatment. Accordingly, we recommend retention of the 6-month holding period, as contrasted with the extension to 1 year in H.R. 13270. In addition, we favor retention of the maximum 25-percent rate on capital gains, except in cases of very large gains relative to ordinary income. In these instances, which would affect a relatively small number of individuals, the rate could rise as high as 32½ percent, or to half the new top bracket rate of 65 percent."

Lengthening the capital gains holding period from 6 to 12 months is not in the national interest. Such a change in the tax laws is certain to reduce the availability of venture capital and inhibit economic growth. Investors who are now willing to place their savings in high risk ventures are going to be more reluctant to make such investments. We do not agree with the House Committee's report that the 6-month holding period does not properly carry out the intent of Congress to provide special tax treatment for investment as distinguished from speculative gains. The 6-month period is ample to eliminate both those who make a living from short-term sales and those engaged in highly speculative short-term ventures. It may be true there is a bunching of transactions at the end of 6 months, but this is to be expected from any length of holding period provided in the law.

It is important that the tax laws not discourage the free flow of capital from one investment to another. Extending the holding period would have the effect of doing just that. Investors would find their capital frozen into investments, and would be deterred from switching to better investment opportunities during the extended holding period. Instead of placing less emphasis on the tax consequences of business transactions, anyone making an investment would have to be fully aware of the tax results of such a lengthy holding period.

Tampering with the holding period could have serious long-term effects on the industrial and technological growth of the country. The financing of new plants and equipment is in large measure dependent on funds provided from the issuance of corporate securities. The effect of this provision would be to discourage investment in such securities and to increase financing costs.

The repeal of the alternative rate for individuals also produces similar problems. While it is true that this primarily affects a relatively small number of taxpayers in the higher income brackets, it is this group that provides much of the risk capital. Again we see an instance in which the tax laws could have the effect of freezing investment capital. The national chamber also opposes increasing the alternative capital gains tax rate for corporations.

The interest on State and local government securities has been exempt from Federal income tax since the tax was adopted in 1913. The exemption does not apply to certain industrial development bonds which were made taxable as a result of the Revenue Expenditure Control Act of 1968. In almost all tax-reform hearings since the adoption

of the income tax, elimination of the exemption of interest on State and local government securities has been discussed, but Congress has chosen to retain it.

State and local governments are highly dependent on bond isues to finance schools, colleges, hospitals, highways, and other capital improvements. Any abridgment of this bonding power can result in a greater load being placed on the already overburdened property tax. In addition, many State legislatures are already finding difficulties in locating new sources of revenues to meet increasing costs of State and local government. Neither the states nor the local governments can afford to be saddled with needless additional costs of government.

It is the view of the national chamber that any change from the present tax treatment of interest on State and municipal securities would not be in the best interests of the Nation and of maintaining the independence of the States and municipalities. Granting States and municipalities the option of issuing taxable bonds and having the Federal Government pay the additional interest costs involved by subsidies to the States and municipalities is another step toward greater Federal domination.

Under the proposals of this legislation, the choice of issuing taxable or tax-exempt bonds appears to be left to the State or municipality. However, where a premium is offered to those issuing taxable bonds, it seems that the practicalities are diluted. If most of the new bonds are issued as taxable by "choice," then it will only be a short time before it is concluded that the tax-exempt choice is no longer needed. A new avenue is then opened for more intervention by the Federal Government in the affairs of State and local governments. It offers the opportunity for strings to be placed on the subsidies.

The long-run effect of this legislation is to remove the tax-exempt status of State and municipal securities and to make the States and municipalities more dependent on the Government in Washington. This provision should be removed from the legislation.

The need for housing in the decade ahead presents an acute problem. With the construction industry playing such a vital role in the economy and in the solution of so many of our social problems, it is difficult to rationalize the restrictions being proposed on accelerated depreciation at this time.

Under the bill the 200-percent declining balance and the sum of the years digits methods of real estate depreciation are limited to new residential housing. Other new real estate is to be limited to the 150-percent declining balance method. For used buildings acquired after July 25, 1969, only straight-line depreciation is to be allowed. These provisions are sure to have a devastating effect on the construction industry.

Accelerated depreciation for real estate is often referred to as a tax shelter, and those who use it often are referred to as speculators. Those who make such references often fail to point out how many people are living in new housing because these provisions are in the tax law. They fail to point out how many blighted areas have been changed with the construction of new buildings by those who used these tax provisions. They fail to point out how much new construction has been added to the property tax rolls to share the cost burden of local government.

The House report suggests the prime reason for the changes in this area is to prevent tax avoidance. Certainly the tightening of the recapture provisions of section 1250 is the better method of attacking this problem. Such an approach will not have the effect of discouraging investment that some of the proposed changes in the law in this bill will have.

The national chamber opposes the proposed changes in the current tax treatment of nonqualified deferred compensation plans. Deferred compensation has been used by both large and small companies for a number of years to attract executive talent. This bill would have the effect of discouraging the use of certain types of executive compensation. It would tax compensation at rates applicable to compensation when earned, rather than at rates applicable at the time the compensation is received.

In effect, deferred compensation is a promise by the company to pay a sum of money in the future, under circumstances where there is not constructive receipt. Certainly to tax this income as though it were received is not in keeping with the concept of taxation of income on a cash basis.

Subjecting deferred compensation to a minimum tax on deferred payments over $10,000 in a year will add greater complexity to the code. While such complexity may be necessary for the sake of equity, it appears that this provision is certain to require very complicated computations for a number of taxpayers.

The bill does not consider deferred compensation as earned income for purposes of the 50 percent maximum marginal tax. As a result, future deferred compensation payments that are thrown back to 1970 and thereafter, can be subjected to a tax in excess of 50 percent, but the same income under the terms of the bill would have a maximum rate of 50 percent if it were not deferred. This difference in treatment accorded earned income and nonearned income does not appear to be equitable.

The national chamber is opposed to provisions in the bill which would eliminate the present capital gains treatment accorded lump-sum distributions from qualified employee plans. These changes could have the effect of almost doubling the employee's tax on employer contributions by taxing those contributions at ordinary rather than capital gains rates. This would result in employees having less money available at the termination of employment than they had anticipated. Most of those who would be hurt by what is being proposed are employees with modest incomes. Many of them have built their plans for retirement around profit-sharing plans. The increased tax burden would have depressing effects on their future economic welfare. The burden is not eliminated by the averaging formula proposed.

This proposal to eliminate the capital gains treatment of lump-sum distributions is also certain to have an impact on Federal revenues. The incentives for greater productivity of the employee who participates in a profit-sharing plan will be diminished by the greater tax burden inflicted by this legislation. This reduced economic productivity is certain to have the effect of reducing Federal revenues.

The provisions of H.R. 13270 would tax receipt of restricted stock when the risk of forfeiture is removed. Thus, taxpayers could be taxed

immediately on property which they might not be able to sell to pay the tax. This presents the serious problem of requiring taxpayer liquidity upon receipt of a nonliquid asset.

The chamber recommends two limitations to the current restricted stock provisions which would eliminate abuse in this area without destroying their basic usefulness. First, the stock used should be limited to company stock or stock of an affiliated group. This assures that the employee's future is directly tied to his employer's. Second, the issuance of the stock must be tied to employment. In this way it cannot be used for payment to independent contractors.

It is most important to encourage employee stock ownership. This is best achieved through the use of stock options and restricted stock plans. Key employees must be retrained by a company and tend to increase the productivity of that company. Increased productivity is an important factor in fighting inflation, and any disruption of a company's employee compensation practices may reduce that company's output.

With regard to the provisions in the legislation relating to the limit on tax preferences, then national chamber recognizes the problem that exists and that some individuals can avoid paying taxes. But the chamber does not endorse the LTP. This change in the tax laws is exceedingly complex. It places an emphasis on gross income, and could very well become the forerunner of a gross receipts tax on all taxpayers. New taxes often are designed to affect only a few individuals, but as the need for revenues increase the temptation is to enlarge their scope to include everyone.

Other sections of the bill directly affect the same so-called preference areas included in LTP. This treatment is the preferred approach if changes are to be made.

The chamber opposes the provision relating to the disallowance of allocated deductions in H.R. 13270. Again the complexity and administrative problems associated with this proposal are enough to cause second thoughts about its wisdom. If this provision is enacted few, if any, investment decisions will be made by individuals without the guidance of an expert tax advisor. The purpose of this provision is to tax income indirectly which is not taxed directly. Many of the tax problems in existence today are due to attempts to do indirectly what would better be done directly.

The national chamber supports the elimination of the unlimited charitable contribution.

The national chamber believes that the attainment and maintenance of a sound domestic mining industry requires more ample recognition in the tax laws that mining is unique. It is unique in that it exhausts its assets in the course of its operation; that exploration for and discovery and development of new mining deposits continually grow more difficult, more costly and financially more hazardous; and that a recovery of capital and return on investment commensurate with the risks is essential to induce venture capital to enter this hazardous financial field.

To meet the required national needs and to assure adequate continuance of the industry by the replacement of exhausted mineral assets, the tax laws should provide that all nonrenewable natural resource

industries be granted adequate depletion allowances. In addition, provision should be made for the current deduction of research prospecting, exploration and development costs or, at the election of the taxpayer, such deferment as the taxpayer deems most appropriate in each case, without the now-existing limitations.

Tax laws must recognize that rising energy demands in this Nation require the constant development and maintenance of a healthy petroleum industry. Exploration and development of petroleum resources grow more difficult, more costly, and financially more hazardous. Venture capital will continue to be attracted in this field only if the reward for success is commensurate with the risks involved. Therefore, to meet National needs and to assure development of oil and natural gas produced for energy use, the chamber believes the tax laws must continue to provide adequate depletion allowances.

It has been recommended at these hearings that nonbusiness State gasoline taxes no longer be deductible. State gasoline taxes paid by an individual are presently deductible for Federal income tax purposes, even though they are not business expenses. The national chamber believes that this is correct and that such deductions should be permitted so long as deductions are allowed generally for State taxes paid.

Presently, amounts paid in satisfaction of treble damage antitrust claims under section 4 of the Clayton Act are fully deductible as business expenses for Federal income tax purposes. There has been some discussion that changes might be made in the tax reform bill to prohibit deduction of two-thirds of such treble damage payments where the taxpayer has been convicted of violation of the antitrust laws or has entered a plea of guilty or nolo contendere in such litigation.

Where the purpose behind the statute compelling the wrongdoer to make payments is remedial in nature and is intended to provide a formula for the reparation of a private injury—such payments properly constitute allowable deductions. Where a law is intended to punish a wrongdoer, punishment would be mitigated by the allowance of an income tax deduction. Actions that are brought under section 4 of the Clayton Act are remedial in nature, since the purpose behind that section of the act is to allow the victim a method of recovering the damages inflicted and not to punish the wrongdoer. To disallow the deduction of treble damages would amount to ignoring the remedial characteristic of that part of the law and inflict punishment by use of tax laws.

The tax laws should be used for the purpose of collection of revenues to meet the necessary costs of Government. Their purpose should not be extended to inflicting punishment for violations of nontax laws.

The antitrust laws are very complex. It is often difficult for those in the agencies of Government who enforce the laws to agree on whether a violation has occurred, and the courts have often experienced difficulty in determining whether the law was violated. This difficulty of interpretation means that there will be businesses subjected to treble damages even though they have made every effort to avoid violating the antitrust laws. In such cases, treble damages provide remedial relief for the injured party, and the tax laws should not inflict a fine in such cases.

As a result of the Supreme Court decision known as the *Clay-Brown* case, some tax-exempt organizations have become involved in certain

business activities completely unrelated to their exempt purpose. Situations have occurred where a tax-exempt foundation acquires the stock of a corporation by agreeing to pay the former owners a percentage of the profits up to a specified total. The corporation is then liquidated and its assets leased to a new company for a rental somewhat less than the installment payment obligations of the foundation. The rental payments create deductions for the new company, thus reducing its tax liability, while the rental receipts are tax free to the recipient exempt organization. The former owners are subject only to capital gains taxation.

The national chamber supported the original tax on unrelated business income of exempt organizations. It so testified in 1950, when this legislation was first before Congress. The chamber supports the provisions in H.R. 13270, which would expand the unrelated business income tax to include the unrelated debt-financed income of exempt organizations where the organization obtains such income from property acquired or improved with borrowed funds.

The bill provides that advertising income of an exempt organization is unrelated business income even though carried on in connection with activities related to the organization's exempt purpose.

The national chamber has consistently supported taxing unrelated businesses of tax-exempt organizations. However, the chamber opposes taxing revenues of tax-exempt organizations unless derived from an unrelated business.

In 1950, Congress enacted the provisions to tax the unrelated business income of certain exempt organizations. The action was taken because some exempt organizations were engaging in businesses totally unrelated to their exempt purposes. Examples cited in congressional hearings in 1950 included some colleges and other institutions engaging in a variety of business undertakings such as the production of automobile parts, chinaware, and food products, and the operation of theaters, oil well, and cotton gins. These businesses were totally unrelated to the exempt purposes of the organizations involved and were rightly made subject to tax. They did nothing to further the exempt purposes of the exempt organization other than to provide a source of funds. Thus, Congress enacted the tax, generally equivalent to the tax on corporations, to apply to the income derived by exempt organizations from an "unrelated trade or business".

After the enactment of the 1950 tax on unrelated business income of tax-exempt organizations, advertising income of tax-exempt organizations continued to be exempt. Interpretation of the law by the Internal Revenue Service, by Treasury, by exempt organizations, and by taxpayers in general was that advertising income of such organizations was exempt by law. Then in 1967, 17 years after the enactment of the unrelated business income tax, the Treasury Department decided that it would adopt new regulations and tax advertising income of exempt organizations. This interpretation of the law by the Treasury regulations was contrary to the legislative history of the 1950 statute and the intent of Congress in its enactment.

Although it was discussed at the hearings of the Internal Revenue Service, the question of competition is not the issue. The law makes no reference to competition, does not use it as a test, and as a matter of fact

it would be impractical to do so. An unrelated business of a tax-exempt organization is taxable whether or not it is competing with anyone else. A related business is not taxable under the law—whether or not it is competing.

Practically every tax-exempt organization competes in a business way. The monthly church dinner competes with the restaurants, the annual benefit show of the local boys' club competes with private theaters, the swimming pool of the local civic association competes with commercial swimming pools. No one suggests these activities should be taxed when they are an integral part of the exempt purpose of the tax-exempt organization—they are related businesses. They may be separate businesses and they may compete—but that is not the test.

The test is whether there is a business and whether it is related. Congress knew this in 1950, understood why this had to be the test, and this is what was enacted in the law.

The code applies the unrelated business income tax only to the income from an "unrelated trade or business." If an exempt organization publishes a magazine containing advertising, the trade or business is obviously publishing the magazine. Selling advertising is merely one integral activity in the overall operation of publishing the magazine. What the regulations say is that even though publishing is a business and is related, and therefore exempt, advertising is a separate business and is taxable as an entity, and this is what the proposal in the bill would tax. This runs contrary to the general principles of taxation which treat a trade or business as the integrated sum of its various activities.

The Supreme Court of the United States has recognized that you cannot fractionate advertising from editorial content. In the case of *Grosjean* v. *American Press Company, Inc.*, 297 U.S. 233, the Court recognized that taxing advertising is taxing the entire publication.

Practically all of the State and local chambers of commerce and trade and professional organizations affiliated with the Chamber of Commerce of the United States issue some type of regular publication. These publications explain to people in this country and around the world the workings of the free enterprise system, the American way of life, and our form of government and economy. These publications should not be discouraged. Certainly some of these publications including advertising—it makes them attractive and assists in paying the cost of the publications. Everyone agrees the tax revenues to be obtained from taxing their advertising income is small.

The national chamber has consistently fought for the principles of free enterprise. It will not refrain from fighting for the maintenance of the publications of its affiliated organizations which advance the cause of free enterprise.

A further problem exists with the fact that the new code section 513(c) proposed by section 121(c) of the bill, is headed "Advertising, Etc., Activities". If the provisions of this section are to be enacted, it is urged that heading be corrected so there will be no need to litigate the meaning of "Etc., Activities".

The national chamber is aware of the problems which arise from special farm provisions. This is true with respect to receiving capital gains on the sale of items whose cost was an ordinary deduction. How-

ever, the chamber believes that the excess deductions account is too complex and should not be used as a method of solving the problem.

In addition, applying the excess deductions account provisions to only those individuals who have nonfarm income in excess of $50,000 discriminates against those farmers who are investing in other areas because farming may not be as profitable as it used to be.

It is unfortunate that this legislation does not contain needed depreciation reform. If the investment tax credit is to be repealed, then this legislation should provide the kind of permanent capital recovery tax system this country must have if its industry is to compete with the products of other industrial nations. The Treasury Department is making studies in this area. We urge that reform in this area be given priority. It is important that efforts be made to write permanent depreciation rates and allowances into the law, instead of requiring a dependence on the depreciation guidelines, which can be changed at any time by administrative action. We also urge that this committee take action to eliminate by law the unfair and highly complex reserve ratio test.

On behalf of the national chamber I wish to again thank you, Mr. Chairman, and the members of the committee for this opportunity to testify on the wide range of provisions in H.R. 13270. Your committee is to be commended for holding these hearings and demonstrating your concern for the vital problems of tax reform. We hope we have been helpful in presenting the views of the business community to the committee.

The CHAIRMAN. Thank you very much for your statement, Mr. Winter. I am interested to know that you feel there should be a 50-percent limit on personal income tax, and that is based, I take it in considerable degree on the fact that when you get beyond the 50-percent tax rate you pass the point of diminishing returns?

Mr. WINTER. I think we look at it more as a question of equity in this area. As you get to the 50-percent bracket, we think that is the top bracket that there should be on individual income. It has been the position of the chamber for many, many years.

The CHAIRMAN. At the time a person gives you half of what he makes assuming he is paying it virtually on everything he is making, he pays you half of what he is making, you feel that that is enough, that that is fair if he gives you half?

Mr. WINTER. Yes; we do think that after you get beyond the 50–50 split with the Government that is perhaps going a little too far and is not equitable to the taxpayer.

The CHAIRMAN. Thank you very much, sir.

Mr. WINTER. Thank you.

The CHAIRMAN. Thank you very much for your statement, Mr. Winter. I am interested to know that you feel there should be a 50-percent limit on personal income tax, and that is based I take it in considerable degree on the fact that when you get beyond the 50-percent tax rate you reach the point of diminishing returns?

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The CHAIRMAN. At the time a person gives you half of what he makes assuming he is paying it virtually on everything he is making, you feel that that is enough?

Mr. WINTER. We do think so. It can tie in with your income averaging. I think there is a real appeal for that. We get into bunching of income. We put in the income averaging provision. This is along that same line I think. You get in the areas of the deferred compensation, where you can support that. Yes, we do think that after you get beyond the 50–50 split with the Government that that is perhaps going a little too far and is not equitable to the taxpayer.

The CHAIRMAN. Thank you very much, sir.

Mr. WINTER. Thank you.

The CHAIRMAN. The next witness is Mr. Harold Ketelhut of Freeport, Ill.

STATEMENT OF HAROLD KETELHUT, A MEMBER OF THE UNITED AUTO WORKERS INTERNATIONAL UNION, FREEPORT, ILL.

Mr. KETELHUT. Mr. Chairman and members of the Finance Committee:

My name is Harold Ketelhut, and my home address is 915 South Chippewa Avenue, Freeport, Ill. I am employed by Twin Disc, Inc., of Rockford, Ill., and I am a member of Local 765, United Auto Workers International Union. I have been a continuous union member since 1941, and from 1953 through 1958 I served as a local business representative for the International Association of Machinists on a full-time basis.

In 1958 I helped organize the employees of a company in Monroe, Wis. Contract negotiations with the employer began after the IAM was certified as the legal bargaining representative of the employees. The international union sent one of its representatives to Monroe to assist the new local union's bargaining committee—or so we thought.

In the absence of members of the local bargaining committee, this international representative offered management a deal. He said, in effect, "If you will agree to include a 'union shop' clause in the contract so we can collect dues from all the employees, I will permit you to set the wage rates."

The company's spokesmen accepted this offer. As a result, all employees were compelled to pay dues to the local union, and the local bargaining committee had no voice in determining the wage rates. I have good reasons for believing that some union officials are more concerned about collecting dues than about getting higher wages for the employees they are supposed to represent.

I will not pretend that I have read, or that I understand, every section of this 368-page tax bill. But I have read section 101(b), which proposes taxation of tax-exempt private foundations which engage in political activities. As I understand it, and the language seems quite clear to me a 100-percent tax would be levied on any amount of money spent by a foundation for political purposes.

For example, that tax would be applied to a sum of money used by a foundation to sponsor a voter registration drive.

In my opinion, the political activities of all tax-exempt organiza-

tions should be curbed—including the political activities of tax-exempt labor unions.

In order to earn my livelihood as an employee of Twin Disc, Inc., I am paying union dues against my will. I resent the fact that the UAW has used my dues money in efforts to defeat political candidates I support. Last year it opposed the reelection of the late Senator Dirksen, who was a member of your committee.

A few years ago Senator Dirksen wrote an article which was published in the DePaul University Law Review. I quote the following from his article:

> It is well known to everyone that American unions have for the past many years been highly active in politics . . . Large armies of union staff personnel are assigned to work in political campaigns at the precinct level in getting out the vote for union-endorsed candidates; union newspapers and other publications are heavily devoted to promoting favored candidates, and union funds derived from membership dues and fees are liberally distributed to such candidates.

And then Senator Dirksen asked a question which applies to me and millions of other wage-earners:

> Where does this leave the individual worker who is required under a compulsory unionism agreement to pay his dues and fees into the union as a necessary condition to holding his job?

I am one of many UAW members who have been vocal in objecting to partisan politicking by officials of our union. We are not paying these union officials to tell us we should vote for certain candidates for public offices; we are paying them to serve as our collective bargaining agents.

The uproar from rank-and-file members became so loud that the union hierarchy felt something should be done during the international union's last convention to pacify us. With the strong backing of the international's officers, delegates to the convention voted to amend the UAW constitution. In theory, at least, the new amendment permits a member who objects to the union's political program to designate a portion of his dues for a charitable institution of his choice.

By urging this action, UAW officials admitted they have been using some of the dues money for political purposes. Last March I wrote the first of several letters to an official of my local union and to the international union's secretary-treasurer. I requested that the portion of my dues which was used for political purposes be allocated to a crusade on behalf of handicapped children.

I finally received a letter early this month from the crusade director thanking me for a $75 pledge. Obviously, the union does not intend to refund the money which was taken from me in the past and used in support of political candidates and causes I and many other union members oppose.

I suppose the union will earmark a portion of my future dues for the handicapped children's crusade, but I do not know whether the $75 pledge will be fulfilled during the next 12 months or during the next 5 years. The union officials I have written to have not bothered to let me know.

According to the union newspapers I receive, this tax bill is the greatest thing to come down the pike since the Wagner Act. Walter Reuther and George Meany disagree on many subjects, but they ap-

parently agree this is the kind of tax reform the country needs. Well, they are not speaking for me on this issue.

To me, "tax justice" means that all individuals and organizations would be treated justly and equally by the government. Preserving tax loopholes for unions that spend their members' compulsory dues for political action would be a great injustice to the working people of this country. That is my opinion and the opinion of almost very worker I have ever met.

I understand that the bill before you proposes to tax the income received by churches from investments in unrelated businesses. I know that at one time the International Association of Machinists was one of the bigger stockholders in Sears, Roebuck and Company. I know the IAM owns a sizable office building here in Washington.

I do not know whether the unrelated business income of unions is now taxed. But if it is not, it should be—especially if Congress decides to impose a tax on the unrelated business income of the churches.

In my opinion, it is unfair to deny a tax exemption to one organization on the basis of its political activities and wink at the political activities of another tax-exempt organization. What is sauce for the goose is still sauce for the gander. I earnestly hope you will vote to deny tax exemptions to all organizations which use any part of their income for any kind of political activity. This would serve to discourage the misuse of money earned by workers to support the political whims of union officials.

I thank you for your attention and the valuable time you have allocated to me.

The CHAIRMAN. Thank you very much, sir.

Senator MILLER. Mr. Chairman, I want to commend this witness for his courageous testimony. I am concerned about part of his testimony. Now, as I understand it, a great amount of political activities by the AFL–CIO are financed out of the funds of the committee on political education known as COPE. Do I understand correctly that the contributions made by union members to COPE, are voluntary?

Mr. KETELHUT. My experience with COPE is that they will offer you a lottery, a form of lottery ticket or a chance to win a television set and so on. You contribute *x* dollars by the number of chances you get. That is part of the money that goes into the political action, yes.

Senator MILLER. Of course, that would be a voluntary matter for a union member to buy some chances. He does not have to that, does he?

Mr. KETELHUT. Well, another thing in my experience has been on the IAM staff for 6 years, every staff conference that I attended that was a head of an election, a national election or a big State election coming up, if it happened to be a national election I was asked to donate some dollars, and if I didn't I would not remain on the staff very long. If it was a State election I would attend the State labor convention and be told the same thing. It was voluntary to the extent that if you did not contribute your international office frowned upon you.

Senator MILLER. Well, take the rank and file who are not members of the staff, just somebody who has been in the union for 6 months. He does not have to pay money into COPE if he does not want to, does he?

Mr. KETELHUT. The UAW constitution provides—I did not bring it along but it provides—that if a member—right in our constitution—if a member objects to his money, money from his dues being spent politically, they will——

Senator MILLER. I am not talking about dues, though.

Mr. KETELHUT. About what?

Senator MILLER. I am not talking about dues. I am talking about contributions to COPE.

Mr. KETELHUT. Yes.

Senator MILLER. Because my understanding is that the financing of COPE does not come out of dues. It comes out of contributions or purchasing chances on lotteries and things like that.

Mr. KETELHUT. I would have to go along with you. I cannot question you on that. All I know is that with my experience that is the way I have been approached on it. Whether or not they get additional funds from the general treasury I do not know.

Senator MILLER. Forgetting about the Committee on Political Education funds, and assuming that contributions by individual members are voluntary—as I have long understood to be the case, let us turn our attention to union dues. You have testified that some part of the dues has been used for political purposes by some unions. I assume by political purposes you mean partisan purposes.

Mr. KETELHUT. Yes!

Senator MILLER. Can you tell us how?

Mr. KETELHUT. I will give you some example, since I have a few moments to refresh my memory. I recall that when I served on the IM staff of 1953 through 1958. Senator Douglas was our Senator from Illinois. At election time International would send out a man and he would have his car loaded down with printed campaign material for Mr. Douglas. This material would be distributed to the area Democratic headquarters in my district. This man would inform me that I should keep quiet and not tell everybody that he was doing this on union time as he was a staff member of the IM.

Senator MILLER. The point you make here is that union dues which are used to pay the salaries of staff members of the union were diluted to the extent that the staff member took time away from his staff duties with the union and participated in a partisan political campaign?

Mr. KETELHUT. That is right.

Senator MILLER. Can you tell us how long this particular staff member took off to engage in the partisan political campaign?

Mr. KETELHUT. At different times when this man came through my area on these political excursions, I would ask him to stay over and assist me on local union problems as he was also a capable negotiator. He told me that he could not offer any assistance because he was ordered to spend all his time on seeing that Mr. Douglas was reelected.

Senator MILLER. You have given us an example. Do you know of other examples?

Mr. KETELHUT. Yes I do. The machinist union, as an arm of the organization which they refer to the machinists union partisan political league. They would encourage local lodges to put on parties and dances, and furnish lunch and refreshments, which may cost a local $300, $400, or $500 out of its local treasury. Then a collection would be

made amongst the union members at this party who were told that they were contributing to the machinists nonpartisan political league.

Senator MILLER. What you are saying then is that the financing of the so-called nonpartisan political league was handled through parties of this nature with the local union's treasury, which had been funded by union dues, being used to pay for the expense of the parties and the parties being used as a vehicle for raising "voluntary" contributions to the league.

Mr. KETELHUT. That is right.

Senator MILLER. Were the activities of the so-called nonpartisan league genuinely nonpartisan?

Mr. KETELHUT. Let me put it this way, that the nonpartisan slogan was to elect our friends—defeat our enemies.

Senator MILLER. That is an interesting slogan, but the real question is whether those designated as friends represented mostly or entirely the candidates of one political party.

Mr. KETELHUT. I would say that their activities, 98 percent of the time, supported the candidates of one party.

Senator MILLER. And which party?

Mr. KETELHUT. The Democratic Party.

Senator MILLER. Can you give us another example of how union dues were used for partisan political purposes?

Mr. KETELHUT. During the last presidential election when Vice President Humphrey held his parade in Chicago, the Local 765 of the UAW, of which I am a member, took two bus loads of members, paid for the loss of time from their jobs, and paid for the bus fares and meals and lodging to participate in the Humphrey program in Chicago. This was done by the sizable UAW local in Rockville, which had the funds to support it.

Senator MILLER. You are saying that these payments were made from the union treasury into which dues had been paid, and not from a fund which was supported by voluntary contributions.

Mr. KETELHUT. That is absolutely right. UAW locals cannot have funds other than from dues.

Senator MILLER. In other words, the entire union membership through their dues, really paid for the expenses of the bus loads of union members going to and from Chicago, remaining in Chicago over night, and the loss in wages incurred by their absences from their employment.

Mr. KETELHUT. That is right.

Senator MILLER. I have heard that in some cases a local union's treasury, funded by union dues, has been used to reimburse union members for taking time away from their employment to actively work in getting out the vote for candidates endorsed by the union in partisan political elections. Do you know of any such practices in your experience?

Mr. KETELHUT. Yes, I do. In Illinois, approximately I would say 1954 or 1955, somewhere in the State legislature election, we had a man that was endorsed by the international union office in Chicago, to run against the incumbent State legislator.

Senator MILLER. Where?

Mr. KETELHUT. In the Freeport, Ill., district. The international office in Chicago requested that our IAM local in Freeport support and as-

sist this man in every way. The local set up a committee. The members of this committee took time off to check the voting record at the county court house in the district. As many of our members were scattered in two or three counties, it was necessary for the members of this committee to take time off from their employment to encourage members that were not registered to vote to become registered, and this same committee, for a few days before the election, made up car pools to contact members at their homes and to get them to vote. We had many night-shift people who could only be contacted in this way. The members of this committee were reimbursed by the local union for wages lost by their activities.

Senator MILLER. Are you saying that their activities were directed at the support of the partisan candidate endorsed by the international office in Chicago?

Mr. KETELHUT. That is right.

Senator MILLER. Can you tell us how union newspapers are financed?

Mr. KETELHUT. I can tell you this. In my experience with the Machinist Weekly paper, it is not supported by advertisement. In their international audit reports they do list the expense of publishing this paper.

Senator MILLER. When you say they list the expense of publishing the paper, are you referring to a listing in connection with the international union's treasury, which is supported by union dues?

Mr. KETELHUT. That is absolutely right. This audit is conducted by a committee selected from the entire rank-and-file membership, and they audit the funds of the international secretary-treasurer.

Senator MILLER. I want to get this clear. It has been my observation that some union newspapers carry advertising, and I would presume that the paper you referred to, on some occasions at least, did carry some advertising. But the point is that any deficit in operations of the newspaper was paid out of the treasury, which was funded by union dues.

Mr. KETELHUT. That is absolutely right.

Senator MILLER. Was it your observation that the union newspaper endorsed certain candidates in partisan political races?

Mr. KETELHUT. Very much so.

Senator MILLER. Were these outright endorsements indicating that the members should vote for or against certain candidates?

Mr. KETELHUT. Yes it was.

Senator MILLER. Was there any reason furnished the readers of the union newspaper for voting for or against certain candidates?

Mr. KETELHUT. Yes there was.

Senator MILLER. Can you amplify on this?

Mr. KETELHUT. The union paper would list a candidate they endorsed. They would list the candidate they were opposed to. They would list each candidate's voting record on issues they felt vital to labor.

Senator MILLER. When you say "they" to whom do you refer?

Mr. KETELHUT. It would generally carry the endorsement of the international officers—they would list their names.

Senator MILLER. What about the voting records to which you refer. Were these shown in a manner which would indicate that the candi-

date supported had voted right on the issue, and candidates opposed had voted wrong on the issue?

Mr. KETELHUT. That's the way it was handled.

Senator MILLER. Who determined whether a wrong vote or a right vote had been cast on the issues?

Mr. KETELHUT. It would have been the international officers who endorsed the candidates.

Senator MILLER. Does this mean that the officers, in their evaluation of such votes, were speaking for the individual members of the union? Or only for themselves?

Mr. KETELHUT. They were not speaking for the individual member, they were speaking namely for themselves, using the union paper to promote candidates of their own choice. Because as a union official, I received much criticism from rank and file union members for the international using our paper for partisan political purposes.

Senator MILLER. Thank you.

The CHAIRMAN. The next witness will be Mrs. J. M. Ford of Lawrence, Kans. I am pleased to welcome you here, Mrs. Ford.

I am pleased to welcome you here, Mrs. Ford.

We are ready to hear from you.

STATEMENT OF MRS. J. M. FORD, ILU MEMBER, LAWRENCE, KANS.

Mrs. FORD. I want to thank you, Mr. Chairman and members of the committee, for allowing me to come to Washington to give you my little tale of woe.

I am Mrs. M. Ford, of 1941 Emerald Drive, Lawrence, Kans. Mr. Ford and I had two sons in college and we are very much interested in tax reform, especially if tax reform will provide us tax relief.

Both my husband and I are employed. Our employer is Hercules Inc., which operates the Sunflower Army Ammunition Plant. I work in the laundry department where all coveralls are washed and folded and all personnel employed in the production of this product must wear these for their protection.

I have been employed by Hercules for the past 4 years.

As I understand it, the tax reform bill approved by the House of Representatives will levy a tax on the income received by churches on their investments in unrelated businesses. I do not object to that feature of the bill. But I do object to the failure of the House bill to propose a tax on the unrelated business income of labor unions.

I also object to the favored treatment unions receive with regard to political activities. The bill will impose a severe tax on tax-exempt foundations if any of their money is used for any kind of political program—including voter registration campaigns. But I cannot find anything in this bill which says labor unions will also be taxed if they spend money for voter registration drives or other political activities.

I want to ask after I read an excerpt out of the Laborer which I get, and then I want this to go in the record; please, sir:

"House group starts to plug tax loophole," and one paragraph down here:

> Severe limitations would be placed on the right of foundations to make direct grants to individuals, to prevent self-dealing between a foundation and its founder and to prevent hoarding of income. One section that is being carefully studied

by labor lawyers is that preventing foundations from engaging directly in voter registration drives, although it is unlikely that this section would affect union registration campaigns.

Now, that is in the magazine that I receive.

(The article referred to by Mrs. Ford for inclusion in the record follows:)

[From the Laborer, June 1969]

HOUSE GROUP STARTS TO PLUG TAX LOOPHOLES

The House Ways & Means Committee has approved "tentatively" a series of tax reform measures designed to plug some of the tax loopholes that now exist.

For the most part the proposals are in line with what organized labor has suggested in the less controversial areas of tax reform. They do not, however, touch on major tax reform proposals such as capital gains, oil depletion allowances, tax-exempt bonds and relief for low and middle income brackets. Presumably, these will be touched on in later installments of the Committee proposals in the months ahead.

The Committee's proposed "first installment" of tax reform touches such areas as conglomerate mergers, "hobby" farm losses, charitable contributions, moving expenses and private foundations. Moving expenses have been liberalized—a gain for workers—but tax treatment of the other areas has been tightened to a significant degree.

Conglomerate Mergers: The Committee's proposals would reduce the tax advantages that grow out of mergers of one kind or another which are carried out through the issuance of certain bonds or debentures. In general, corporations would not be allowed to claim deductions for interest paid on these bonds. Labor economists are carefully studying the impact of this proposal.

"Hobby" Farm Losses: The Committee's proposal would reduce sharply claims of "excessive" farm losses which now can be written off against other income. In general "hobby" farmers would be expected to prove that they are in business to make a profit and to be limited in the amount of loss they can claim.

Charitable Contributions: The present tax provisions that allow unlimited deductions for charitable contributions would be repealed gradually through 1975 with especial reference to those contributions which involve property that has increased in value between the time it was acquired and the time it was contributed. This would particularly affect works of art and other types of collections that have a way of increasing immensely in value when they are contributed to museums or universities.

Foundations: Tax treatment proposals for foundations are largely in response to the growing list of abuses that have begun to surround the creation and activities of private foundations. The Committee would impose a 5 percent tax on net investment income of private foundations, would include capital gains and would not permit deductions for dividends received.

Severe limitations would be placed on the right of foundations to make direct grants to individuals, to prevent "self-dealing" between a foundation and its founder and to prevent hoarding of income. One section that is being carefully studied by labor lawyers is that preventing foundations from engaging directly in voter-registration drives, although it is unlikely that the section would affect union registration campaigns.

Mrs. FORD. Why are the labor unions entitled to preferential treatment?

One thing can be said in defense of the political activities of foundations: at least they are using money which has been given voluntarily.

The unions, on the other hand, are financing their politicking with funds taken from workers who are victims of compulsory unionism.

This is an outrage, and I hope you gentlemen on the committee agree it is an outrage.

In Kansas, recently, the Emporia Gazette criticized this bill because it has tax loopholes benefiting labor unions that earn income from

business investments and also support politicians who find favor with the union hierarchy. The Gazette said:

It is now time for the public—union members included—to join in the crusade to close all tax loopholes.

I am a union member who says "Amen!" to that.

Mr. Chairman, I ask that the Gazette editorial be made a part of the record of this hearing.

The CHAIRMAN. We will include that in the record at this point.

(The article referred to follows:)

[From the Emporia, Kansas, Gazette]

BIG ONE GETTING AWAY

Even before the nets can be closed on the slippery fish who have been avoiding federal taxes, the best catch of all has his nose through a big loophole. Unless the public raises a loud cry, the big one will get away.

The prize in this case is Big Labor. (Not the small locals of the working men who produce for American enterprise, not them; this big fish is the labor hierarchy made up of those who get rich and play politics with union dues.)

A tax reform bill—described as the most sweeping in history—has passed the House by a lopsided vote of 394 to 30. Now the bill is before the Senate where it still may be changed before final approval.

Among the reforms in the present bill are: 1. a minimum tax on persons of high income, many of whom now escape all taxes; 2. a reduction in the oil depletion allowance from 27½ to 20 per cent; 3. stiffer capital gains tax rules for people in high brackets; 4. repeal of the 7 per cent investment credit for corporations; 5. restrictions on rapid-depreciation tax writeoffs; 6. curbs on abuses of charitable contributions to escape taxes; 7. restrictions on the use of foundations as tax-evasion devices; 8. a 7½ per cent tax on incomes of foundations from investments; plus several others.

Two of these reforms that ought to affect Big Labor are No. 7 and No. 8—restrictions on the use of foundations, and a 7½ per cent tax on incomes of foundations.

The nation's big labor unions—like some major churches—have millions invested in private businesses. Dividends from these operations are exempt from income taxes. But the Union Hierarchy uses its profits to support political causes and politicians who find favor.

As it is now written, the Reform Bill preserves the favored status of labor unions while imposing taxes on the income from nonrelated businesses of churches and other organizations.

But there is hope. Sen. Paul Fannin of Arizona has promised that "in my position on the Senate Finance Committee, I expect that we shall be looking into the tax-exempt status of these empires built by union moguls with the compulsory dues of the workers." Also, the National Right to Work Committee has started a campaign to stir up an investigation into the matter.

It is now time for the public—union members included—to join in the crusade to close all tax loopholes.—R. C.

Mrs. FORD. Recently I also read in the newspapers that the National AFL-CIO president appeared before this committee to speak for what he called "tax justice." I cannot see any justice in compelling workers like me to pay dues to a tax-exempt union that spends our money to elect political candidates we workers are against.

Earlier this year our State legislature passed a bill favored by every worker I know. But the union officials were fighting it, so Governor Docking vetoed the bill. Later we found out the Governor received a total of $30,000 in contributions from Kansas AFL-CIO officials during his last campaign, it is pretty clear to me that Governor Docking is not going to side with us in the future if the union officials are against the things we workers are for.

Just 1 year ago this month I was approached in the laundry department of the Sunflower Plant by an official of Local 605 of the International Laborers Union. She told me the company had agreed to include a "union shop" clause in its new collective bargaining agreement with local 605. She said I would be fired from my job if I failed or refused to sign a card authorizing the deduction of monthly union dues from my paychecks.

The loss of my income would have hurt, in fact we could only have sent one son to college last year instead of two. We still have one in now. So I reluctantly signed the card, and ever since my employer has been checking off union dues from my wages.

I believe—and most of the Sunflower employees I know believe—that during the contract bargaining sessions last year officials of local 605 eagerly accepted a meager wage increase for the employees in order to induce the company to agree to their demands for a compulsory "union shop" clause.

It should be obvious to everyone that some workers want to join and support labor unions and other workers do not want to join and support labor unions. Why aren't the rights of both groups respected? Why aren't the union officials willing to rely on persuasion to enlist new members? Do they have such a low opinion of the services they offer that they are convinced many employees would not support the unions voluntarily? Or do they think most of us are so dumb that we must be compelled to do what they think is the right thing to do, not what we think is right.

A year ago I did not know I was being lied to when I was told I would have to sign a dues checkoff card in order to keep my job. Since that time I have learned because I was sent a statement by the union, that a worker cannot legally be compelled to authorize the deduction of union dues from his paycheck. We can be compelled to pay dues, but we cannot be required to sign the checkoff authorization form.

Officials of local 605 used other forms of pressure in an effort to get the signatures of sunflower workers on the checkoff form. The union's initiation fee was $38.75, and a lump-sum payment was demanded from employees who balked at signing the form. On the other hand, the union accepted the fee in installments from those workers who signed the checkoff form. Some of the Sunflower employees were dragged into the Teamsters Union, and they were compelled to pay a $75 initiation fee.

I am reasonably certain the income received by the local chamber of commerce in Lawrence, Kans., is tax exempt. Let's suppose its board of directors decided to compel every businessmen to pay dues to the chamber as a condition of operating this business in our community. The directors might say:

> The services of our chamber benefit every business in Lawrence. Some of these businessmen have been taking a "free ride" at our expense, and we are going to put a stop to it. They will either join the chamber and support its program, or we will run them out of town.

I strongly suspect the Lawrence Chamber of Commerce would quickly lose its tax exemption if it attempted to coerce nonmembers in our business community. There is nothing hypothetical about the coercion used by labor unions. Congress will be shirking its duty if it

fails to tax unions' unrelated business income and also if it fails to lift tax exemptions of unions using compulsory dues money to support political candidates and causes.

By being here today, I am risking reprisals by vindictive union officials, and I think you all realize this.

I sincerely hope it is not wishful thinking when I assume the members of this committe are willing to run the same risk.

Thank you.

The CHAIRMAN. Thank you very much.

Senator MILLER. What local are you a part of?

Mrs. FORD. Local 605 of the Laborers' International Union of North America, located at Sun Flower, Kans.

Senator MILLER. Does this union have a union shop contract with the management?

Mrs. FORD. Yes, sir, it does.

Senator MILLER. In other words, you must belong to the union to hold your job?

Mrs. FORD. Yes sir.

Senator MILLER. And, of course, you pay dues to the union.

Mrs. FORD. Yes sir, I do, and it is deducted from my pay check.

Senator MILLER. Do I understand that part of these dues are used by the union for partisan political purposes?

Mrs. FORD. As far as I know. I have in my hand a copy of an article that was in the Johnson County Herald on March 12, 1969, referring to the contributions reported in last fall's gubernatorial campaign in Kansas.

Senator MILLER. I note that the article refers to an F. E. Black as having contributed $10,000 to the "Docking for Governor Club," and that Black is believed to be a leader in the AFL-CIO in Kansas. The article also lists other Docking contributors to include the Amalgamated Meat Cutters, the Communications Workers of America, the International Brotherhood of Boiler Makers, and other unions. Is this the basis for your belief that some part of union dues has been used for partisan political purposes?

Mrs. FORD. Yes, sir, this is one of the reasons that I believe this. Another reason is that we were working on a bill to put teeth into the Kansas right-to-work law, and we thought that had accomplished this because we had a good majority—76–40 in the legislature. Then Governor Docking vetoed it.

Senator MILLER. Is the main thrust of your criticism your understanding that a part of your union dues, which you must pay in order to hold your job, is used for partisan political purposes?

Mrs. FORD. Only partially because there are millions of people in my shoes in the United States who are forced to support candidates whom they oppose just as I.

Senator MILLER. Thank you.

The CHAIRMAN. Thank you.

We will next call Mrs. Edna Anish, of Pittsburgh, Pa.

I think it might be well to include at this point a very thoughtful statement of Senator Inouye. It is certainly relevant to the testimony we will be receiving from some of the following witnesses.

(The statement referred to follows:)

Statement of Hon. Daniel K. Inouye, a U.S. Senator From the State of Hawaii

Mr. Chairman, I wish to thank this committee for the opportunity to speak about what I consider a serious deficiency in H.R. 13270. I urge that the present bill be amended to include a provision for special tax exemptions for the disabled.

Currently, there is legislation before the Senate, S. 1069, and the House, H.R. 424, which would accomplish this objective. S. 1069, introduced by the distinguished senior Senator from New York, would provide the handicapped an income tax deduction of up to $600 to cover transportation to and from work, as well as allowing the disabled the same $600 deduction now provided the blind.

I have more than a passing interest in this legislation. I am a member of that group called the handicapped. In my own case, the loss of my arm is a relatively minor inconvenience. I receive compensation from the government and can drive to work without any difficulty. No special prosthetics are required by me nor do I need special shoes or other clothing. My musical talents have not flowered, but otherwise I have led a full life that has left me with a sense of deep personal satisfaction. Hundreds of thousands of individuals have not been so fortunate, and it is because my concern for their plight that I serve as an honorary member of The Joint Handicapped Council.

Severely disabled individuals often find it impossible to utilize cheap public transportation, such as buses and subways, because they must use braces, crutches, wheelchairs and prosthetic devices. Daily expenses are further increased by special or extra clothing. Orthopedic shoes, for example, can cost as much as between $250 to $400 per pair, and in these inflationary times, the price of some special shoes has doubled in a year. There are many other expenses that must be borne in many cases: help to perform simple tasks the non-handicapped find easy to do; special furniture and fixtures; medical and insurance expenses; and other expenses that drain a limited budget.

H.R. 424 and S. 1069 are important not only because of the direct monetary benefit to the handicapped but also because it will serve as a psychological and financial incentive to the disabled. It is good business to hire the handicapped. Aware of their limitations and stirred by pride of accomplishment, the disabled make conscientious workers. They are more anxious than the average worker to prove themselves productive members of society.

All too often, however, their good intentions are dashed soon after they enter the job market. They face not only doubt but also the hard economic reality of the expenses I mentioned earlier. Frequently they find that the total cost exceeds their income, and they are compelled to withdraw into an empty existence by becoming welfare wards of society and their relatives. Every year our country wastes millions of dollars in rehabilitation costs to train men and women who are later disappointed by the denial of job opportunities by the uneven hand of the tax collector. More millions are spent for welfare for the disabled who would prefer to work to earn a living. The handicapped want opportunity—not charity.

The total cost to the Federal Treasury will be minimal. It has been estimated that some 300,000 individuals would qualify at a maximum cost of $40 million. Stringent controls are built into S. 1069–H.R. 424 by the requirement that only those suffering from a loss of one or more extremities or 40% or more loss of ability as defined under the Schedule for Rating Disabilities of the Veterans Administration would qualify for the $600 exemption. Further, the disabled would obtain the additional exemption for which only the blind now qualify.

I believe that an amendment to H.R. 13270 in the form of S. 1069—H.R. 424 would be economically enlightened in addition to being a humanitarian concept. By encouraging these individuals to work, we shall make better use of welfare and rehabilitation expenses. I hope that my colleagues in the Congress will give their favorable consideration to this deserving amendment when it is offered.

STATEMENT OF EDNA ANISH, EXECUTIVE SECRETARY, PITTSBURGH, PA.; ACCOMPANIED BY MRS. MARGARET LEE WALGREN, LEGISLATIVE ADVISOR, OPEN DOORS FOR THE HANDICAPPED

Miss ANISH. Thank you, Mr. Chairman.

I am Edna Anish, executive secretary of Open Doors for the Handicapped, 1013 South Third Street, Pittsburgh, Pa. Accompanying me today is Mrs. Margaret Walgren, our legislative adviser.

Over the past 14 years upwards of 490 bills—15 in the 89th Congress alone—have been referred to Congress seeking tax relief for the physically handicapped. Not one has been enacted. A cynical explanation might be that all these bills, being so uncontroversial, were merely for home consumption.

Of course, countering this interpretation is the fact that the visually handicapped—the blind—were granted a $600 tax exemption in 1950. You believed then that the low income of this group should be subsidized because of difficulties in finding and qualifying for employment.

But problems of working and the expenses of living for the orthopedically handicapped are as burdensome, if not more so, than those of the visually handicapped. The same rationale for tax relief should therefore be applied to both categories. Elimination of this obvious inequity in the present tax structure is long overdue.

So that you may better understand why we seek tax relief such as the $600 exemption now given to the blind, we bring to your attention the expenses incidental to a disabled person's way of life. Unquestionably, the normal day-to-day activities that the able-bodies take for granted are far more costly in time, energy, and money for us.

Our organization, Open Doors for the Handicapped promotes the independence of the disabled. This independence costs money. For example:

Transportation: Public transportation is largely inaccessible to the disabled. The average income of a rehabilitated orthopedically handicapped person is $3,400 a year. A clerk typist who goes out to work will spend about one-half of his annual earnings on taxicabs. The breakdown of the earnings of a single full-time employee in Pittsburgh is as follows:

Annual Earnings	$3,400.00
Less taxes:	
Internal Revenue	402.00
Surtax	30.00
Social Security	163.20
Local City Tax	68.00
	663.20
Total	2,736.80
Taxicabs (annually)	1,560.00
Net Income	1,176.80

This, gentlemen, is what our Government calls poverty. The "Tax Reform Act of 1969" uses $1,100 as the poverty level. We agree! We are paying our Government for the privilege of going to work. If this

same person did not have the drive and determination to go out to work, he would vegetate at home and collect $1,296 Social Security Disability. Then, the total loss to the Government is three times what it would gain in taxes if the disabled were to remain employed.

Under our present tax structure you are only losing tax revenue, the country is losing our talents, but we are losing our independence, dignity, and emotional stability.

Employment. Unemployment among the disabled is doube that of the able-bodies. The disabled earn less because of the following conditions:

(1) The kind of work they are limited to;

(2) The period aspect of that work;

(3) The need to work in sheltered workshops where minimum wage scales do not apply;

(4) They are—or are thought to be—bad risks;

(5) They are unable to enter the competitive labor market and are often exploited by do-gooders; and

(6) Discrimination still exists.

The Federal Government spends more than a billion dollars a year for vocational rehabilitation. It is said to recover, in direct taxes, $10 to every $1 it spends. Yet it ignores our need for income tax relief. We are being rehabilitated for jobs we cannot afford to keep. The disabled do not want charity or welfare doles; they want to be self-sustaining, self-sufficient citizens. But the disabled person seeking employment faces many problems—primarily financial. With the cost of living rising at a rate of 6 percent a year, our plight borders on desperation.

Education: Your next question might well be: Could the disabled get better jobs if he had higher education? Yes! But often he is neither financially nor physically able to attend a college of his choice. Only 14 or more than 2,500 colleges and universities in this country meet most of the minimum requirements for accommodating disabled students.

Housing: Another area which drains our pocketbooks is housing. We cannot live in old housing because of the number of steps. We must live in new apartment buildings or specially designed houses. We therefore have higher rental and housing costs. If a disabled person is lucky—yes, lucky—and earns less than an annual income of $3,400 then he is eligible for Federal Housing. But, in reality, he is only eligible for a waiting list because the senior citizens receive priority in these facilites.

Domestc Help: What of the severely disabled? Not all are fortunate to be able to live at home where family members can lend a helping hand. Very often only slight assistance is necessary, but it is crucial; for example, help in getting from bed to wheelchair in the morning and back at night. Yet, this type of help is not tax deductible for the disabled.

Recreation: The disabled, especially, needs recreation. But what enjoyment is possible on a low, heavily-taxed income? Those seats at concert halls reserved especially for the disabled are the most expensive. Also, the disabled must buy first floor theater seats because they cannot get to the less expensive balcony seats.

Other: Other nondeductible expenses incurred by the disabled are hand-controls for specially equipped cars for disabled drivers, custom-

made clothing, and heavier tipping so often needed for a helping hand.

Without further documentation, we think you will agree that we have made a case for extending a tax subsidy of a $600 exemption to the orthopedically handicapped. The precedent for this subsidy was set 20 years ago on behalf of the blind.

It has been argued that the technical difficulty of defining and limiting the population who would be eligible for tax relief was so difficult that the problem was better off deferred and ignored. We feel we have come here with an adequate definition of the disabled individual which will be an answer to your dilemma.

Paraphrasing a foremost authority in rehabilitation, Dr. Howard A. Rusk, who quotes from a National Health Survey, we submit the following:

An orthopedic impairment is defined as a permanent disability of some portion of the skeletal system which has been lost, crippled, paralyzed, or deformed, severely affecting mobility. Lobbying obviously is a real hardship for us—both physically and financially—so you have not seen us often!

We are speaking here for those persons in wheelchairs, persons using braces, crutches, and prostheses; the palsied and the arthritic. We are not asking for a gift: we are simply asking for reasonable and equitable tax relief for orthopedically handicapped Americans; we want to become taxpayers not taxeaters.

Thank you.

The CHAIRMAN. Thank you very much. I will instruct the staff to take a good look at this problem and see if we can help.

Miss ANISH. May I ask permission to have Mrs. Walgren make a statement?

Mrs. WALGREN. I am too smart a woman to realize you do not keep hungry men from lunch. I would like to mention, however, that one of the primary considerations that we were told that you would be taking account of is the cost to the Federal Government, and we think that the cost is extremely minimal. We have figured out for Pennsylvania, for instance, that there might be 3,000 people falling under this category of being rehabilitated a year. If you figure the Federal returns would be 10 to 1 on the money that you are spending on rehabilitation in Pennsylvania, in Pennsylvania alone the Treasury Department would be getting $50 million in return. I would like to say this: That this is such a minor problem of yours that it certainly could easily be overlooked. I understand we are asking very little of Washington for this. But on the other hand the tax bill itself says on the first page that what you are aiming to do is provide a fair and equitable system so that you can continue the self-assessment aspect of taxation in America, and we feel that here we have a specific example of a small but very prominent unfair aspect to the system, and we hope you will take it into consideration.

The CHAIRMAN. Thank you very much.

Senator WILLIAMS. There are amendments introduced to this bill pending which deal with this subject and I can assure you they will be considered.

Mrs. WALGREN. I certainly hope so.

(The committee subsequently received the following statements for the record, relative to the preceding testimony:)

Statement of Helena Carey, Chairman, Consultant, for the Handicapped

SUMMARY

Transportation*	Travel
Maintenance of orthopedic equipment	Purchase of orthopedic equipment
Maintenance of equipment for self-employment	High cost housing
General Services	Personal services for health
Recreation	Increase in tax deductions

Mr. Chairman, my remarks today concern an exceptional group of people. They are the handicapped of this Nation. A minority, it has always known exclusion.

Note the contents of Bill H.R. 13270—and we beg, we humble beg to be included in the liberalized tax reform bill.

Reason No. 1. Transportation deductions,* $1,000 ($3 times five days a week equals $750). (Please note that Saturday and Sunday are not included, that would be another $280).

Reason No. 2. Wheel-chair-crutches-braces, etc., $1,000.

Reason No. 3. Maintenance for wheel chairs, crutches, braces, etc., $1,000.

Reason No. 4. Minimum assistance—inclement weather, emergency situations, etc.

Total deductions in tax reform bill H.R. 13270, $4,000.

Statement of Katherine S. Fossett, Co-Legislative Chairman, Nation's Capital Chapter, National Association of the Physically Handicapped, Inc.

Mr. Chairman and members of the committee, as a member of Nation's Capital Chapter, National Association of the Physically Handicapped Inc., I wish to affirm that my chapter will heartily support federal legislation making provision for an additional exemption of $600 at least for the disabled taxpayer and his wife, if she has a physical disability, and also federal legislation providing for income tax deduction up to $600 on transportation to and from work of physically handicapped persons, preferably the severely handicapped. The former exemption is now applicable to the blind and elderly. Hence, an amendment of the 1954 Internal Revenue code (section 151), and part VII of subchapter B of chapter 1 of the same code, is recommended. These deductions would provide us with more money to meet the increased expenses incurred because of our handicapping condition.

There are many persons in our chapter with varying degrees of disability. I am of the opinion that the failure to provide additional exemption for the physically disabled results in inequity. In general we announce our full support of legislation which offers more liberal tax deductions for the many handicapped of our nation. Tax "breaks" are urgently needed for physically handicapped persons. Therefore, we urge favorable consideration for the enactment of such enabling legislation.

Since no specific provisions for additional exemptions or tax deductions have been made so far in the 1969 Tax Reform Bill H.R. 13270 for this group of taxpayers, we should like these considerations incorporated into the above bill.

May I add that I am of the opinion that we as handicapped citizens are entitled to more liberal tax deductions entirely on the basis of our disability.

Even after his rehabilitation, a severely physically handicapped person looking for employment discovers that his salary is not adequate to meet the costs of transportation, his living expenses, and his payroll deductions.

Because of the excessive transportation expenses, and the inability of the more severely physically disabled to use such public facilities as the bus, subway train ,etc., they must depend on taxicabs or other expensive means of private transportation.

It is true that severe disability creates extraordinary expenses that are not deductible, as are medical expenses. The cost of transportation to and from the place of employment or generally elsewhere, constitutes one of the major expenses. The transportation expenses in the Washington Metropolitan area are much higher for some severely handicapped persons than for the able-bodied. Transportation poses many problems for the more severely physically disabled

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*Please note that transportation and expense for personal reasons are not included.

in that they sometimes earn less and when expensive transportation problems are incurred, they often lose the incentive to look for employment.

The following are some of the so called extraordinary expenses incurred by the severely disabled by virtue of their disability, other than transportation costs, which should be included in H.R. 13270, as tax deductible items, when enacted.

1. Deductions for the purchase, upkeep or wear and tear and maintenance of orthopedic appliances, such as wheelchairs, crutches, walkers, specially built orthopedic shoes, braces, etc., and prosthetic devices, artificial arms and limbs, automobile hand controls, and correction surgery also the cane and seeing eye dog for the blind.
2. Wear and tear on special clothing because of rubbing against an orthopedic appliance such as a wheelchair.
3. Special parking facilities near our respective homes and businesses.
4. Certain aspects of housing. It is sometimes necessary to pay higher apartment rentals because it is necessary for some who are physically handicapped to rent apartments on the ground floor level or rent apartments close to the elevator. In general, housing costs are often higher since the physically disabled cannot live in the less expensive buildings without elevators because of the stair climbing problem. The latter is especially true of coronary cases. In the case of paraplegics, ramps and wider doorways must be built to facilitate entrance to and exit from apartments or housing units. We should also consider additional costs for special equipment in the kitchen and bathrooms.
5. Special office equipment to facilitate greater mobility.
6. Special services. Often some handicapped persons have to hire people to do simple tasks which the able-bodied can do without incurring extra expenses. For example, hiring someone to clean house and do job repairing etc., soliciting the services of a taxi driver in delivering a package etc., somewhere, and other services.
7. Higher insurance costs, especially for automobiles.

In conclusion, the need for the previously-mentioned deductions is very urgent, since more liberal deductions would keep more people off tax rolls, and hence, we are of the opinion that the above additional tax exemptions will help the physically handicapped and their families to have more economic independence.

Finally, the Nation's Capital Chapter NAPH Inc., sincerely hopes that H.R. 13270 will be enacted during this Ninety-First session of Congress, and contain some, if not all, of the exemptions and deductions requested.

Senator WILLIAMS. Mr. Chairman, before we adjourn I think there is one witness, Dr. John A. Perkins, president of the Wilmington Medical Center. I might say Dr. Perkins is also the former president of our State University in Delaware. I am pleased to welcome him before the committee.

STATEMENT OF JOHN A. PERKINS, PRESIDENT, WILMINGTON MEDICAL CENTER, WILMINGTON, DEL.

Mr. PERKINS. Thank you, Senator Williams.

Wilmington Medical Center, Wilmington, Del., is a nonprofit, charitable corporation which operates three short-term acute hospital facilities and one long-term rehabilitation hospital. These facilities provide approximately 80 percent of the total hospital service for New Castle County, Del., and approximately 60 percent of the total hospital services for the State of Delaware.

As can be seen from an article appearing on page 1 of the Wilmington Morning News of September 24, 1969 (exhibit "A" attached hereto) any public or private action which might inhibit or otherwise reduce contributions to the Wilmington Medical Center will directly affect the quality and quantity of hospital services which Wilmington Medical Center can render to the community it serves. Further, since the Wilmington Medical Center, within the next 10 years, must obtain

and expend $80 million to $90 million in capital expenditures ($35 million of which is needed by 1972 for new construction) in order to continue to provide the present quantity and quality of hospital services for the community it serves (which presently is 500,000 and by 1980 should be 700,000), its trustees feel that it must express opposition to those provisions of H.R. 13270, tax reform bill of 1969, which might tend to prevent the Wilmington Medical Center from meeting the demands for hospital services thrust upon it by the community.

Section 101(a) of H.R. 13270 provides that the net investment income of a "Private Foundation" shall be subject annually to a tax of 7½ percent thereof.

In H.R. Report No. 91-413 (pt. 1), 91st Congress, first session, (1969), the general reason stated for proposing such tax is that the benefits of government are available to all and, thus, "the costs thereof should be borne at least to some extent by all of those able to pay." Then said report goes on to state that this is true for "Private Foundations."

Certainly, the Wilmington Medical Center would not argue that there have not been any abuses in the private foundation area which clearly need to be corrected by sanctions prohibiting such abuses in the future. However, Wilmington Medical Center does feel that a tax on investment income goes beyond what is a justified sanction for the abuses engaged in by a limited number of private foundations.

It is Wilmington Medical Center's understanding that, in part, the philosophy behind the adoption of a law permitting a deduction for Federal income tax purposes of contributions to "charitable organizations" (including in such favored treatment "private foundations") was to reduce the costs of government by providing an incentive for that portion of the general public with resources to do so to fund activities which would otherwise have to be undertaken by governmental bodies. It was assumed that if the government were to undertake these activities, the cost would be greater than the revenue dollars lost by granting such a deduction. To tax the investment income earned by private foundations does nothing more than take away in part the ability to reduce costs of government.

Wilmington Medical Center's primary concern with respect to the proposal to tax net investment income of private foundations is that such a tax is an indirect tax on certain portions of the income of eleemosynary institutions, such as hospitals, universities and other community service organizations now not subject to income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1954, as amended. Current and accumulated income of private foundations is ultimately distributed to tax-exempt organizations, most of which are exempt under section 501(c)(3) of the Internal Revenue Code of 1954, as amended (hereinafter referred to as code).

In its own case the Wilmington Medical Center is dependent heavily on contributions from private foundations. For example, in the 7 years ending with 1968, hospitals comprising part of the Wilmington Medical Center conducted two major building fund campaigns. One of these resulted in receipt of approximately 6.6 million, 26 percent of which ($1,700,000) came from private foundations located in the Wilmington metropolitan area. In the second campaign, $3.25 million

was received, 16 percent of which ($508,000) came from private foundations located in the Wilmington metropolitan area.

In addition to soliciting for capital funds, the Wilmington Medical Center conducts annual fund-raising campaigns to provide continuing support to the operations of the center. In the past few years, the annual fund raising has raised approximately $1,350,000, 40 percent, or $540,000, of which has been donated by private foundations. As can be seen from exhibit A, projecting an operating deficit of $3.5 million before application of approximately the $1.7 million of endowment income for fiscal year 1970, the Wilmington Medical Center must, in the future, rely heavily upon donations from all sources to continue to provide for present operating needs.

Thus, Wilmington Medical Center's concern with the proposed tax on private foundation's investment income is obvious. If an income tax of 7½ percent is levied on the income of private foundations, it is equivalent to levying a tax of 7½ percent on the donations of private foundations to the Wilmington Medical Center. Frankly, in a period of time of rising operating and building costs, eleemosynary institutions, such as Wilmington Medical Center, cannot afford any reduction in sources of funds. In this regard, it should be noted that operating costs at Wilmington Medical Center have risen approximately 10 percent per year for the past 3 years (typical of similar hospitals throughout the country). Also, it should be noted that hospital construction costs are presently rising at the rate of 1 percent per month.

The significant support provided by private foundations is not a situation unique to the Wilmington Medical Center. Personnel at the center polled all the hospitals in the State of Delaware, as well as hospitals in Pennsylvania and Maryland adjacent to the Wilmington Medical Center service area. These hospitals echoed our experience with respect to raising funds and the support received from private foundations in their campaigns.

The response of these hospitals was as follows (all of which were approximations):

(1) *Chester County Hospital, West Chester, Pa.*—This hospital reported that it had had two building fund drives. One in 1960 dealing with a building, the cost of which was $400,000. Private foundations contributed 90 percent of the cost of $360,000. The second building fund drive was in 1965 to support a building program costing $1,200,000. Private foundations contributed $471,000, or 39 percent of the cost.

(2) *Milford Memorial Hospital, Milford, Del.*—This hospital reported that it is presently undertaking a building program of $3.5 million. At the time of the report, the only contributions which had been received were $275,000 from two private foundations. We understand that $1.7 million will be borrowed, $500,000 will be raised from a community fund-raising campaign and the balance hopefully financed from an accumulation of operating income derived by including prospective funding in patient's charges.

(3) *Kent General Hospital, Dover, Del.*—This hospital reported total contributions of $1.1 million in connection with its building program of which $211,000, or 19 percent was received from private foundations.

(4) *Nanticoke Memorial Hospital, Seaford, Del.*—This hospital reported total contributions from 1965 through 1969 of $482,000, all of which came from private foundations.

(5) *Kent and Queen Anne Hospital, Chestertown, Md.*—This hospital reported a building program of $1.4 million, $900,000 of which was contributed, including $100,000 from one private foundation.

(6) *Beebe Hospital, Lewes, Del.*—This hospital reported two foundation grants of $55,000 toward the total cost of $1,474,000. Hill-Burton funds were secured in the amount of $425,000. An additional $500,000 was borrowed with the balance coming from contributions.

In addition to providing current direct financial support to eleemosynary institutions, such as the Wilmington Medical Center, private foundations perform an additional task which under the laws of the State of Delaware, such institutions cannot perform for themselves. Delaware laws do not grant such institutions the right of eminennt domain to acquire land for either current or anticipated future needs.

Fortunately, the Wilmington Medical Center recently received from a local private foundation approximately 200 acres of land to use for building expansion necessary to keep the center's facilities current with the growing population. The land was purchased with great foresight at an earlier date by the foundation and held for the purpose of donating it to an eleemosynary institution as the need arose. An additional 390 acres adjacent to the tract is still held by the foundation in reserve for use by other eleemosynary and public institutions as the community needs develop for further expansion of such organizations. In effect, the acres still held by the private foundation are a land bank for community purposes. By its action, this foundation performed a unique and important contribution in a small territory such as Delaware. In our State which is growing rapidly open land in the metropolitan areas is becoming nonexistent.

It should be pointed out that up to the present, taxes in the State of Delaware and its political subdivisions have not been inordinately heavy. In a large part this is owing to the existence of local private foundations and generous individuals. The proposal to tax investment income of private foundations will reduce their ability to continue to support community programs (such as hospital services) in the amounts they had in the past. It is folly to reduce these sources of funds at a time when rising costs and increased indigent patient loads necessitate our turning to governmental sources for additional funds for both operational expenses and capital outlays.

Any provision which may tend to discourage contributions to eleemosynary institutions, such as the Wilmington Medical Center, should not be given favorable consideration by the Senate Finance Committee. The provision dealing with taxes on failure to distribute private foundation income falls in this category.

This provision requires the annual payout of all the net income of a private foundation but not less than 5 percent of its investment assets.

While this provision permits accumulation for specific projects with prior approval by the Internal Revenue Service, it appears to leave private foundations at the mercy of a subjective determination by an Internal Revenue agent rather than with individuals responsible for

and knowledgeable of the intents and purposes for which the foundation was created.

Further, as can be seen from the illustrations already given in II above, at least in Delaware, private foundations acquiring acreage as a land bank has proven extremely beneficial to the entire community. To discourage such functions by either forcing untimely distributions or taxing retention of property does nothing more than force eleemosynary institutions, such as the Wilmington Medical Center, to look to the Federal and State Governments to provide the resources formerly provided by the private foundation sector.

Consistent with the position taken by the Wilmington Medical Center in opposition of legislation discouraging charitable contributions as set forth in II and III above, the Wilmington Medical Center opposes section 201(a) of H.R. 13270 to the extent that it does not permit deduction of contributions of appreciated property up to the increased limitation of 50 percent of adjusted gross income. If the intent of the provision is to increase the incentive to make charitable contributions, the nature of the asset to be given to charity should not inhibit the donors' incentive to give to charity. In our experience, a large percentage of the contributions received by the center have been in kind rather than in cash.

The provision of section 201(c) of the bill dealing with the donor of certain types of appreciated property to private foundations tends to do nothing more than inhibit charitable contributions and thus reduce the source of funds for such eleemosynary institutions as the Wilmington Medical Center.

For the reasons stated heretofore, Wilmington Medical Center also wishes to go on record opposing those other provisions of H.R. 13270 which would inhibit rather than encourage charitable contributions. The provisions to which reference is made are:

(1) Section 201(a). Disallowance of charitable deduction for gift of use of property.

(2) Section 201(f). Elimination of the set-aside deduction presently allowed estates and trusts.

(3) Section 201(g). Repeal of the 2-year charitable trust rule.

(4) Section 201 (e), (f), (h), and (i). Requiring that charitable remainder trusts be either an annuity trust or a unitrust.

(5) Section 201 (a) and (h). Requiring that charitable income trusts provide an annuity to charity or a fixed percentage of annual fair market value and requiring that the grantor is taxable on the income unless all the interests in the trust are given to charity.

(6) Sections 301 and 302 to the extent that such sections have the effect of reducing the benefit received by a donor from a charitable contribution of appreciated property and require the donor to allocate a portion of the charitable contribution to nontaxable income thus reducing the amount of the deduction.

In a period of time when operating and construction costs of eleemosynary institutions are escalating at a rapid pace, Federal and State Governments should adopt legislation which encourages rather than discourages charitable contributions to such institutions. Otherwise governmental bodies will need to provide the services themselves. We believe that this would be at a cost much greater than the revenue dollars lost by granting incentives to give to charity.

I would like to include in the record this article.

The CHAIRMAN. Certainly, sir.

(The article follows:)

ENDOWMENT TURNS INTO DEFICIT—CHARITY-CARE COST DRAINS MEDICAL CENTER

Charity care will bring an operating loss of more than $2.25 million to the Wilmington Medical Center for the fiscal year that will end Tuesday.

Dr. John A. Perkins, president, told the center's executive committee yesterday that the loss lends new urgency to the suggestion made by Ralph K. Gottshall, board chairman, that the center re-examine its policy of providing free care.

The direct result of the loss, Perkins said, is that the center is confronted with a deficit of $500,000 after endowment income of $1.7 million has been applied to reduce the loss.

"Our operating deficit is solely due to the fact that we are being asked to provide upwards of $3 million a year in free care to persons who cannot afford to pay for themselves," Perkins said.

Projections indicate that next year the operating deficit will be $3.5 million on a conservative estimate. Gottshall projected a figure $200,000 less than the $2.25 million total in a report to the center's trustees a week ago. He spoke before a final accounting had been made for the month of August; August showed a sharp rise in the operating deficit.

"It is not right that charity cost should more than eat up the Wilmington Medical Center's endowment income," Perkins said. "In most other respects, the government, federal, state or local, pays basic welfare costs. Private charity became a supplemental source of welfare support as long ago as the mid-30's. Yet nonprofit hospitals are asked to continue this ever heavier burden that has exceeded the ability of private resources to shoulder.

"The medical center's modest endowment income is badly needed for other purposes. As long as it must be diverted to cover the cost of nonpaying patients, the medical center will be unable to make all the advances in general patient care, education and research, and the renovation of existing structures and the building of new ones that are necessary to achieve the stated purposes of merger set forth in 1965."

At this point Perkins told the executive committee of the urgency given Gottshall's suggestion, made to the trustees a week ago. At that time Gottshall said:

"New Castle County has withdrawn its limited support to the charity programs of hospitals and the state has undertaken to assume the county's obligation to the extent of $510,000 per year. The fact that the money comes from a different source does not affect the fact of this inadequacy of income in relation to the problem as it exists in the medical center.

"The question has to be raised as to what other steps might be taken if state, county and city support in realistic amounts is not forthcoming.

"As matters stand, to a considerable extent, some of this problem of financing charity and education is passed on to the paying patient, but 65 per cent of our patients are covered by third-party contract agreements which limit or prohibit allocating to them the full amount of these charity costs.

"I am sure that none of us agrees with the concept that the paying patient should carry the community burden of the indigent patient, which in a sense is a form of hidden taxation, but the money must come from somewhere * * * How we resolve this problem will be a large measure affecting the role of the medical center and the program it has tentatively outlined for itself."

The CHAIRMAN. Thank you, sir. We will have to recess now until 3 o'clock this afternoon. If someone else wishes to submit his statement and make perhaps a 1-minute statement at this time I will receive it for the record.

(No response.)

The CHAIRMAN. We will continue with our list of witnesses when we return this afternoon at 3 p.m. in this room.

Thank you, gentlemen.

(Whereupon, at 12 noon the committee recessed, to reconvene at 3 p.m. on the same day.)

AFTERNOON SESSION

Senator TALMADGE. The committee will please come to order.

Mr. Max Lupkin, executive secretary, Joint Handicapped Council, New York, N.Y.

Let me tell you, as you probably already know, Mr. Lupkin, that your full statement is already printed in the hearings of today, and if you would summarize it and make it as brief as possible.

STATEMENT OF MAX LUPKIN, EXECUTIVE SECRETARY, JOINT HANDICAPPED COUNCIL, NEW YORK CITY

Mr. LUPKIN. I will give you oral testimony which will take less than 10 minutes.

Senator TALMADGE. The Senate is in session and you will understand if I have to dash away to vote.

Mr. LUPKIN. I understand.

Chairman Long and distinguished members of the Senate Finance Committee, my name is Max Lupkin, I am a volunteer, the executive secretary and public relations consultant for the Joint Handicapped Council, and I am here today to represent this organization at this hearing, a nationwide legislative, service, and educational organization, a federation of 40,000 members and organizations. Our headquarters are located at 720 West 181st Street, New York, N.Y. 10033. I live at 40 First Avenue, Suite 5A, New York, N.Y. 10009.

Here are the reasons why H.R. 424 (Mills) and S. 1069 (Javits) must be enacted into law now.

Precedent has already been established, on the need for an additional exemption (Internal Revenue Code of 1954; also see U.S. Senate Committee on Finance, hearings on the Internal Revenue Code of 1954, pp. 276–277, on the need for additional exemption for the handicapped).

In order to become productive taxpayers, and produce an income, the enactment of H.R. 424 (Mills) and S. 1069 (Javits) will enable hundreds of thousands of the rehabilitated employable severely handicapped to go to work, and pay taxes, instead of remaining on the welfare rolls to vegetate.

The enactment of H.R. 424 (Mills), and S. 1069 (Javits) will create a work incentive to these handicapped—many of whom are now on public assistance—by giving them more take-home pay because of lowered taxes, and helping them to overcome their high cost living, due to many special and extraordinary expenses not encountered by the nondisabled—the severely handicapped taxpayers expend as much as $50 weekly for transportation to and from work, as against the nondisabled handicapped taxpayer for transportation to and from work at $4 a week using buses and subways.

The severely handicapped taxpayer expends vast sums of money regularly, year in and year out for braces, prosthetic appliances, wheelchairs, wear and tear of the same and replacement of parts, plus the cost of a new pair of custombuilt-orthopedic shoes at the cost from $250 to $400 and plus for the repair of these shoes, in order to locomote to and from work.

Our motives are both humanitarian and economical. And in the case of Vietnam disabled veterans—amputees—who also desire the opportunity for employment, and become taxpayers, will be included in these bills.

Our present system of taxation of the handicapped is unfair, unjust, and inconsistent with our tax treatment of the blind and the aged. We are not asking for any special treatment for the handicapped and/or the disabled amputee veterans, only a fair chance for them to make their contribution to our society, without being penalized by unfair and unjust income tax provisions of the Internal Revenue Code.

In 1964, the full U.S. Senate passed an amendment, introduced by Senator Sparkman of Alabama (S. 201), to H.R. 8363, encompassing all the features of H.R. 424, but did not become law due to certain technicalities, namely, cost of bill, have overcome in the bills H.R. 424 (Mills) and S. 1069 (Javits) of 1969: namely, the definition of "disabled" is clear, specific, and meets with the approval of the Treasury Department.

The handicapped taxpayer must have a 40-percent disability under the schedule for rating or disabilities of the Veterans' Administration, Federal Register, volume 29, No. 1, part 2.

Cost is only $40 million maximum. The rehabilitated employed and employable severely handicapped and the Vietnam amputee disabled veterans would be paying taxes to the Treasury Department, and become an asset to the Nation instead of a vegetable.

It was pointed out, by Senator Carlson, in the Senate-House committee discussions on Senator Sparkman's amendment, encompassing all the features of H.R. 424, that "in the committee there was no disposition to be opposed to the amendment in regard to the expenses of transportation of the disabled * * *" (Congressional Record, February 1964, p. 3402).

Further, Senator Long, now chairman of the Senate Finance Committee, stated on page 3402, pertaining to Senate amendment S. 201 (Sparkman): "* * * I am in sympathy with the amendment."

In order to live above the poverty level in today's high inflationary costs, the severely handicapped and the Vietnam amputee disabled veterans must earn an income of over $10,500 in the New York City area, only because of their many everyday living expenses, which are far and above those of the nondisabled.

I must repeat, "We are concerned with removing hundreds of thousands of severely handicapped and Vietnam amputee disabled veterans from public and private welfare rolls by getting them employment and granting them the dignity and self-respect that comes from gainful employment—which is the principal aim of H.R. 424 (Mills) and S. 1069 (Javits)."

I must repeat: "We are not asking for any special tax treatment for the severely handicapped and the Vietnam amputee disabled veterans, only a fair chance for them to make their contribution to society, without being economically penalized by unfair and unjust tax provisions of the Internal Revenue Code."

I must repeat: "In 1954, a precedent was established for H.R. 424, granting the blind and those over 65 an additional exemption for income tax purposes."

Prominent nationwide organizations with a membership of over 60 million people endorsed H.R. 424 including 30 Governors, 13 members of the Ways and Means Committee, National Council of Churches of Christ (40 million), Methodist Church, U.S.A. (10 million members), the Tax Committee of the Chamber of Commerce, National Grange, National Farmers Union, et cetera.

Thank you.

Senator TALMADGE. You make out a very good case and I think the committee will be sympathetic with your position. It is my understanding that Chairman Long has already directed the staff to look into the matter and see if we can include it in the bill pending before the Senate.

Thank you, sir.

Mr. LUPKIN. The handicapped of the Nation would be most appreciative for everything that the Senate and the Ways and Means Committee have been trying to do.

Senator TALMADGE. Thank you very much.

Mr. LUPKIN. Thank you very much, Mr. Chairman.

(Mr. Lupkin's prepared statement follows:)

STATEMENT OF MAX LUPKIN, EXECUTIVE SECRETARY, JOINT HANDICAPPED COUNCIL

The Joint Handicapped Council strongly urges that H.R. 424 (MILLS) and S. 1069 (JAVITS) be enacted into law at this session of Congress. In 1964, a companion bill passed in the U.S. Senate but failed to pass in the Joint Committee of both Houses. This legislation is long overdue.

As a group those employed and employable(s) handicapped with severe orthopedic disabilities are in a sub-marginal income bracket requiring federal assistance.

This group is one in which dire poverty is an everyday feature, and total despair and hopelessness their bleak future.

In the past twelve (12) years over four hundred and eighty (480) bills seeking tax equity for the severely orthopedically employed and employable(s) handicapped taxpayers have been introduced in Congress.

H.R. 424 (Mills) and S. 1069 (Javits), introduced these bills in Congress because for the pressing need for this legislation. It will provide a $600 tax exemption for income tax purposes in the case of a severely orthopedically handicapped taxpayer suffering from a 40% or more loss or loss of use of one or more extremities under the "Schedule For Rating Disabilities of the Veterans' Administration" (Federal Register, Volume 29, #101, Part II). Deductions of up to $600 for special transportation expenses in going to and from work are also included in this bill. H.R. 424 (Mills) and S. 1069 (Javits) will grant tax assistance to those physically handicapped individuals most in need of it.

It can root out some of the inequities for the disabled currently existing in our Internal Revenue Code.

The problems of the disabled can be better visualized if we examine some known facts. According to the Vocational Rehabilitation Administration of the Department of Health, Education, and Welfare, 173,594 disabled persons were rehabilitated during the year of 1967. 47% of those rehabilitated in 1965 had one or more dependents while 34% needed surgery and treatment.

Each year there is a backlog of 70% of referrals for vocational rehabilitation in 1967, and these 173,594 individuals mentioned above were accepted, while 396,313 were not rehabilitated, under our rehabilitation laws.

Some of the expenses the handicapped are subjected to are as follows:

The average nation-wide cost of prosthetic devices in 1963 was $172 per rehabilitant, according to the U.S. Vocational Rehabilitation Administration. In 1964, The Joint Handicapped Council, 720 West 181st Street New York, New York, claimed that the average person does not obtain prosthetic devices at such modest prices. In the New York City area at that time the going rate was $500 for the cost of a full artificial leg, $450 for an artificial leg below the knee, etc. Other typical costs for the rehabilitant include bilateral brace $350 (for

brace extended to trunk add $50) ; brace above the knee $250–$350; brace below the knee $100; standard wheelchair $200; special custom-made-orthopedic shoes averaged $120–$175 for the first pair and $85–$100 for the second pair.

Out of their meager earnings, the orthopedically handicapped, by reason of their disabilities, are forced to expend large sums of money they can ill afford to maintain their rehabilitated status.

According to The Joint Handicapped Council, the most frequently recurring expenses the handicapped are subjected to are:

1. Those expenses made for the purchase, repair and replacement of orthopedic and prosthetic devices which are entirely deductible under the medical deduction provision of the income tax law. Special-custom-built-orthopedic shoes fall in this category.

2. Unusual wear and tear of clothing caused by constant friction of orthopedic and prosthetic devices, crutches and by falling.

3. Additional expenses often include higher cost of apartment rentals due to need for ground floor quarters or elevator apartment accommodations.

4. Many disabled persons find it necessary to take taxicabs daily going to and from work. In the New York City area, the average cost for this type of transportation is about $50 weekly.

5. In approximately 10% of the cases, the disabled, as defined in H.R. 424 (Mills), and S. 1069 (Javits) find it necessary to purchase automobiles to give them mobility in going to and from work, etc. These automobiles, of necessity, must be kept in top condition (entailing more expenses) to avoid mechanical failure. Hand controls have to be installed in a majority of instances.

A business man is permitted to deduct the cost of his motor vehicle as well as vehicular expenses for the production of income, *while his physically handicapped employee who needs his car for production of income cannot,* despite the fact that he might be in a wheelchair, wear heavy braces, use crutches, be an amputee, for some other extenuating reason.

6. Paraplegics often find it necessary to purchase homes which are specially equipped with fixtures installed at lower levels. Ramps and wider doorways must be built to allow for ingress and egress to and from their homes.

7. The physically handicapped are frequently compelled to hire someone to do the household cleaning and repairing.

8. Due to discrimination in hiring practices the disabled are frequently forced to accept lower wages and salaries. This is a hidden expense not apparent to the eye.

9. Those handicapped individuals who can afford life insurance to protect their loved ones are considered sub-standard risks and as such are required to pay higher life insurance premiums.

The handicapped are also frequently rejected for health and accident insurance, and as a result have to pay higher medical and hospital expenses than the average taxpayer. These insurance policies do not as a rule cover chronic conditions existing prior to the issuance of such policies, and as a result, corrective operations for physical improvements are not covered.

When one considers the aforementioned problems confronting the physically handicapped and then ties them in with the current high cost of living, one is amazed at the obstacles which they must surmount. Despite heavier expenses, the handicapped are forced to pay the same tax, with the same deductions as the able bodied.

Often, after rehabilitation, the handicapped, confronted by a combination of low wages, high cost of living, high cost of going to and from work, soon become disillusioned with the high cost of maintaining their rehabilitated status. Many are thus driven into staying at home, since their low income, less the above mentioned expenses, gives them lower net income than if they stayed at home as a welfare recipient.

According to the United States Statistical Abstract, issued in September 1968, job placements through public employment offices of handicapped workers during 1967, amounted to 1.9% of the total number of placements made in the United States in the last 20 years. However, 1.9% is apparently too high a figure when one considers that the handicapped are rarely placed through private employment agencies, and since, percentage wise, public employment offices place a much higher percentage of handicapped workers.

By taking 1.9% of the 77,847 total civilian labor force for the year of 1967 we get a theoretical total of physically handicapped working population of

1,469,593 including every type of disability. However, in 1967, out of 173,594 rehabilitants, approximately 37% included muscular, skeletal, and amputees. If we multiply 1,469,593 by .37 we get 543,375, of the 543,375 approximately 14.4% of the 37% includes severe cases, and approximately 22.6% of the 37% includes less severe cases, so that a further breakdown reveals that of the 543,375 muscular, skeletal and amputee cases, 211,392 represent severe cases and 331,768 represent less severe cases. Allowing for a possible 100,000 borderline cases between severe and less severe to possibly qualify under H.R. 424 and S. 1069, we can assume that approximately 311,392 handicapped individuals would qualify under this legislation.

Even if all 311,392 disabled taxpayers claimed the $600 exemptions with a savings of $120 each, the total savings in income taxes, for the disabled taxpayers would be $37,366,040. If as many as 15% of the 311,392 disabled taxpayers took advantage of the transportation deductions allowable under H.R. 424, it would save them a total of $5,604,960. The grand total for both types of income tax savings would be a maximum of $42,971,000. The $42,971,000 total will be further reduced by tax reforms affecting the low income bracket.

This bill is intended to include severely disabled employable veterans of present and past wars as well as those employed and employables who have been severely handicapped by disease, amputation and other causes.

In 1963, it cost the government an average of from $479 to $544 to rehabilitate an orthopedically handicapped person. For the balance of his or her life, the rehabilitated individual will have to purchase, place and repair all sorts of prosthetic devices specially custom-built-orthopedic shoes, specially built braces, crutches, wheelchairs, hand controlled automobiles, to say nothing of additional corrective surgery. Granting tax aid under H.R. 424 (Mills) and S. 1069 (Javits) would lighten somewhat the heavy burden borne by the employed handicapped taxpayer.

Some years ago, the U.S. Tax Court denied handicapped taxpayers deductions for transportation expenses to and from work, holding that these are merely commuter expenses. The orthopedically handicapped person who must use his car for going to and from work, is using it for the production of income. *He cannot produce income without using his car for mobility.* H.R. 424 (Mills) and S. 1069 (Javits) would aid him by allowing deductions of up to $600 where they are presently disallowed.

And, to sum up, enactment of H.R. 424 (Mills) and S. 1069 (Javits) in this legislative session, is both necessary and crucial for the severely handicapped.

[From the New York Times, Sunday, Apr. 16, 1967]

TAXING THE HANDICAPPED—PRESENT SYSTEM IS CALLED UNFAIR TO THE DISABLED WHO ARE EMPLOYED

(By Howard A. Rusk, M.D.)

Tomorrow's deadline for Federal, State and local income tax payments for 1966 again highlights the inequities of our present tax system, which discriminates against the severely handicapped.

Currently our nation spends more than $1-billion a year for rehabilitation services for our handicapped fellow citizens.

Our motives are both humanitarian and economic.

We are concerned with removing these people from public and private welfare rolls and giving them the dignity and self-respect that comes from gainful employment.

These efforts have become increasingly effective. In the last fiscal year the state-Federal vocational rehabilitation program rehabilitated a record total of 154,000 disabled men and women into employment. The goal for this fiscal year is 190,000.

About three-quarters of those rehabilitated were unemployed when accepted for service and most were dependent upon welfare or the largesse of their families and friends.

10-TO-1 PROFIT RATIO

Based on previous experience, it is estimated that for every Federal dollar invested on their rehabilitation the Federal Government will receive from direct taxes approximately $10.

Certainly this is an economically enlightened as well as humanitarian concept.

But our tax treatment of these disabled workers is far from enlightened. They are not permitted to deduct the extraordinary expenses they have as a result of disability.

There is no doubt that severe disability creates extraordinary expenses over and above those that are now deductible as medical expenses.

Major among these is the cost of transportation to and from employment. Since they cannot use public transportation, many disabled persons must rely on taxicabs or chartered car services.

It is not unusual to find a severely handicapped worker paying out half of his weekly salary for transportation.

Those who own cars with such special equipment as hand controls are not even permitted to deduct the cost of such equipment.

To permit deduction of extraordinary transportation expenses by the handicapped would be consistent with basic tax principles. These permit other categories of wage earners or the self-employed to deduct certain expenses they incur as essential to their income-producing activities.

Clothing of the disabled is subjected to unusual wear and stress. Many disabled persons require custom-made clothing or special alterations on ready-to-wear clothing.

Housing costs are frequently higher as disabled persons cannot live in the less expensive, nonelevator buildings. They often live in ground floor apartments at higher rents. There may also be added costs for ramps or special household equipment, particularly in the kitchen and bathroom.

Amusement costs are frequently higher as the disabled person must use the more expensive orchestra seats in theaters and concert halls and usually must have an escort or attendant.

Many medical, labor, health, welfare, veteran and other groups have supported legislation to create the parity and equality which the disabled seek on taxes.

In the last 12 years there have been 480 bills seeking such equity introduced in the Congress.

In introducing such legislation in the Senate last month, Senator Jacob K. Javits estimated that some 300,000 disabled persons would qualify under the legislation at a maximum cost to the Government of $40-million.

Under the New York Republican's proposal the disabled taxpayer, in order to qualify for an additional $600 exemption, must suffer from the loss of one or more extremities or 50 per cent or more loss of ability as defined by the Veterans Administration.

In addition, both the blind and disabled would qualify for an additional tax deduction of up to $600 for expenses of going to and from work.

In 1964, Senator John Sparkman, Democrat of Alabama introduced such an amendment to a general tax revision amendment. It was passed by the Senate but died in the Senate-House conference

Among one of a number of groups actively lobbying for such legislation is the Joint Handicapped Council, 720 West 181 Street, New York, N.Y. 10033.

MILLS CALLED SYMPATHETIC

The council reports a delegation of its members met last year with Representative Wilbur D. Mills, Democrat of Arkansas, and he seemed sympathetic to their views. Mr. Mills is chairman of the House Ways and Means Committee.

Later this month—at the annual meeting of the President's Committee on Employment of the Handicapped, April 27–28—the group will return to Washington to attempt to stimulate support for the legislation.

When a severely disabled person completes his rehabilitation, he enters the job market with high expectations.

Frequently, he finds his hopes dashed in that his salary is not sufficient to meet his costs of transportation, his payroll deductions and his living expenses.

He has no other alternative but to go back on public assistance

The result is that the several thousands of dollars and frequently innumerable hours of professional and volunteer services have been wasted.

Even more important is that added to his physical problems are the frustrations and disappointments of being able and wanting to work and be self-sufficient, but being denied that opportunity because of discriminatory taxation.

JOINT HANDICAPPED COUNCIL—PARTIAL LISTING OF ORGANIZATIONS AND INDIVIDUALS, AMOUNTING TO OVER 60 MILLION PEOPLE, ENDORSING H.R. 424

Mrs. Eleanor Roosevelt, Hon. Adlai Stevenson, former United States Ambassador.
Hon. Herbert H. Lehman, former Governor and U.S. Senator.
Hon. Averell Harriman, former Ambassador-at-Large, and Governor.
Hon. Brooks Hays, Congressman, and also former President of Southern Baptist Convention.
Former Senator Potter (Mich.) Hon. John J. Sparkman, Senator.
Hon. Jacob Javits, Senator. Bruce Barton (Advertising Executive).
Dr. Frank H. Krusen, Senior Consultant, Mayo Clinic.
Floyd Kramer, former President, Washington Heights Savings Bank.
Hubert Kinney Shaw, Librarian, General Society of Mayflower Descendants.
Dr. Howard A. Rusk, Associate Editor, New York Times.
Hon. B. B. Hickenlooper, Senator (Iowa).
Mayor Tate of Philadelphia.
Mayor Lindsey, New York City.
Mayor Collins, Boston.
Mayor High of Miami.
Newspapers and Magazines:
- The Sioux City Journal
- The Christian Herald
- Christian Science Monitor
- The Electrical Union World.
- Daily News
- New York Times
- America
- "My Day", column in New York Post.

State Legislatures: New York, Illinois, California
Women's Organizations: The General Confederation of Women's Clubs (represents 2 million)
Governors: 30 Governors since 1956, some of whom are: Joe Foss (S. Dak.), G. Mennen Williams (Mich.), Hughes (N.J.), Tawes (Md.), Brown (Cal.), Wallace ,Ala.), Faubus (Ark.), Combs (W. Va.), Harriman (N.Y.), Del., Florida ,Texas, Tenn. (Clement), Illinois, N.H., etc.
Farm Organizations and Publications: The National Farmers Union; National Grange, the Progressive Farmer.
Fraternal:
- Grand Lodge, Free and Accepted Masons (New York State)
- Grand Lodge, Independent Order of Odd Fellows (New York State)

Labor:
- AFL–CIO (14 million members)
- International Assoc. of Machinists, AFL–CIO
- International Brotherhood of Electrical Workers, AFL–CIO
- Labor's Non-Partisan League
- Transport Workers Union of America, AFL–CIO
- United Automobile Workers Union of America, AFL–CIO
- American Federation of State, County, Municipal Employees, AFL–CIO

Health and Welfare Organizations:
- National Assoc. of Social Workers
- National Foundation of Polio (March of Dimes)
- National Multiple Sclerosis Society
- United Cerebral Palsy Society, Inc.
- National Muscular Dystrophy Society, Inc.
- Jewish Community Services of Long Island
- Hillsborough County (Fla.) Society for Crippled Children & Adults
- Southwest (Texas) Poliomyelitis Respiratory & Rehabilitation Center
- National Society for Crippled Children and Adults

Medical:
- American Academy of Compensation Medicine
- American Academy for Orthopedic Surgeons
- Clinical Orthopedic Society
- American Congress of Physical Medicine & Rehabilitation
- Cuyahoga County (Ohio) Medical Society
- New York State Medical Society
- American Physical Therapy Assoc.
- Maine Medical Society

Law Groups:
- New York Workmen's Compensation Bar Association
- Committee on Retirement of the American Bar Association

Religious Groups:
- National Council of Churches of Christ, USA (40 million members)
- International Convention Disciples of Christ
- American Council of Christian Churches
- United Church Women
- United Lutheran synod of New York & New England
- Methodist Church, USA (10 million members)
- Methodist Church (Board of Social & Economic Relations)
- Presbyterian Church of the USA (Health & Welfare Assoc.)
- American Baptist Convention
- Whitmore Methodist Church (Whitmore, South Carolina)
- National Catholic Welfare Conference

Veteran Organizations:
- Veterans of Foreign Wars, USA
- American Legion (New York and Mo. Departments)
- Disabled Veterans of America
- Army & Navy Union, USA (New York County Council)
- Military Order of the Purple Heart
- Jewish War Veterans, USA
- Catholic War Veterans
- Disabled Officers Association
- American War Dads, Inc.
- Division of Veterans Services, State of New Jersey
- Amputee Veterans of America, Inc.
- Paralyzed Veterans of America
- National Assoc. of Veterans Employment Councils
- Italian American War Veterans.

Old Age Pension Groups:
- National Institute for Social Welfare (200,000 nationwide members)
- California Institute of Social Welfare
- Old Age and Public Assistance Union of Illinois
- Rocky Mountain Institute for Social Welfare

Organizations:
- American Congress of Parents and Teachers Assoc., USA (10 million members) (in sympathy with HR424)
- Daughters of the American Revolution (in sympathy with HR424)
- Taxation Committee, Chamber of Commerce, USA ("good, incentive legislation")
- The Cooperative League of the USA
- Los Angeles Council for Handicapped

Individuals:
- J. A. Bruton, Jr., Assistant Chief Scout Executive, National Council of the Boy Scouts of America (in sympathy with HR424)
- J. D. Dorsett, General Manager, Assoc. of Casualty and Surety Companies
- Eugene F. Rinta, Director, Council of State Chambers of Commerce
- Lucius Smith, III, Secretary, "Million Self-Employed, Inc."

Governor's Committee on Employment of Handicapped:
- Arkansas Governor's Committee on Employment of Handicapped
- Hawaii Committee on Employment of Handicapped
- Illinois Committee on Employment of Handicapped
- Ohio Governor's Committee on Employment of Handicapped

Senator TALMADGE. The next witness is Mr. H. Francis DeLone, chairman, Clayton Act Committee, section of antitrust law, American Bar Association, Philadelphia, Pa.

Mr. DeLone, as you know your full statement is already in the record and if you will summarize it as briefly as possible we will be grateful.

I also think we should include this statement of Mr. Becker, relative to your testimony.

(The statement referred to follows:)

MANUFACTURING CHEMISTS ASSOCIATION,
Washington, D.C., October 6, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Manufacturing Chemists Association wishes to present its views regarding the provisions of S. 2631, a bill "Relating to the income tax treatment of treble damage payments under the antitrust laws and certain other payments." This bill would disallow as a deduction two-thirds of any amount paid or incurred on any judgment entered against a taxpayer or in settelment of any action brought against him under Section 4 of the Clayton Act.

The Manufacturing Chemists Association is a nonprofit trade association of 174 United States company members representing more than 90 percent of the production capacity of basic industrial chemicals in this country.

Under existing law, the Internal Revenue Service has ruled that amounts paid or incurred in satisfaction of treble damage claims are fully deductible as trade or business expenses under Section 162 of the Internal Revenue Code of 1954 (Revenue Ruling 64-224, 1964-2 C.B. 52). The Service cited four Supreme Court cases in support of its view that actions brought under Section 4 of the Clayton Act are remedial in nature since the purpose of the statute is to provide the victim with a means of recovering damages inflicted, and not to punish the wrongdoer.* The ruling recognized circumstances where the allowance of a deduction for payments of penalties would frustrate sharply defined public policy. However, this question was not at issue inasmuch as the treble damage payments were held to be remedial and not to be penalties.

The Supreme Court in *Commissioner* v. *Tellier*, (383 U.S. 687 (1966)), clarified the violation of the public policy test as grounds for disallowance by holding that "policies frustrated must be national or state policies evidenced by some governmental declaration of them." It seems clear that the reasoning of the Tellier Case supports the rationale of Revenue Ruling 64-224 in recognizing the deductibility of antitrust treble damage payments.

In 1965 a staff study of "Income Tax Treatment of Treble Damage Payments Under the Antitrust Laws" was prepared for the Joint Committee on Internal Revenue Taxation. This study concluded that the Supreme Court probably would not hold that any part of treble damage payments are nondeductible penalties and while recognizing uncertainties surrounding the public policy doctrine (this study antedated the Tellier decision), it found nothing improper in Revenue Ruling 64-224 under the public policy doctrine. From this study and other evidence there is no indication under existing law that treble damage payments were ever disallowed as deductions by the Internal Revenue Service.

We endorse the position of the American Bar Association disapproving any proposed legislation which would make nondeductible for Federal income tax purposes any part of payments made in satisfaction of treble damage judgments or claims. The Joint Report of the American Bar Association Section of Antitrust Law and Section of Taxation submitted in January, 1969, warrants serious consideration in connection with any proposed legislative action on this matter.

It is the opinion of this Association that the concepts and philosophies developed over the years as set forth above should be adhered to and that the presently established Federal Income Tax treatment of treble damage payments should not be changed. The following points are presented in support of this position:

I. FEDERAL INCOME TAX IS A TAX ON NET INCOME, NOT A SANCTION AGAINST WRONGDOING

By limiting the deductibility of treble damage payments S. 2631 is objectionable as a matter of basic tax policy. It is generally agreed that tax policy should not encourage the use of tax provisions to achieve social goals. Any exception to this policy should be rare, should be clearly vital to the best interest of the United States and should be explored thoroughly with full consideration of the proposal through public hearings at which the views of the Executive Branch and of affected taxpayers are presented.

**Huntington* v. *Still*, (146 U.S. 657, 677 (1892)). *Chattanooga Foundry & Pipeworks* v. *City of Atlanta* (203 U.S. 390 (1906)). *United States* v. *Cooper Corporation* (312 U.S. 600 (1941)). *Overnight Motor Transportation Co.* v. *Missel* (316 U.S. 572 (1942)).

The Supreme Court adverted to tax policy principles in the Tellier case with the following language:

> "We start with the proposition that the Federal income tax is a tax on net income, not a sanction against wrongdoing. That principle has been firmly imbedded in the tax statute from the beginning . . . During the Senate debate in 1913 on the bill that became the first modern income tax law, amendments were rejected that would have limited deductions for losses to those incurred in a 'legitimate' or 'lawful' trade or business. Senator Williams, who was in charge of the bill, stated on the floor of the Senate that
>
> > 'The object of this bill is to tax a man's net income; that is to say, what he has at the end of the year after deducting from his receipts his expenditures or losses. It is not to reform men's moral characters; that is not the object of the bill at all' . . ."

If it is considered that the amount of damage payments for antitrust violations should be increased, then the appropriate procedure is to amend the antitrust laws and not the income tax laws. If quadruple or quintuple damages are sought instead of treble damages, this should not be accomplished by indirection through tax legislation such as S. 2631.

Consistent with this concept, other payments related to infractions of the law have been held to be deductible.* As a matter of equity and uniformity, it does not seem proper to single out treble damage payments for more onerous treatment and thereby penalize business taxpayers more severely where antitrust laws are involved than other taxpayers making somewhat similar payments where there have been more clearly defined infractions of the law. Moreover, interpretations of the antitrust laws are still being developed by administrative action and court decisions and considerable uncertainty in application continues to exist.

II. INEQUITABLE ECONOMIC CONSEQUENCES

Provisions for recovery of treble damages were included in the Sherman Act when first enacted in 1890, many years before the enactment of the federal income tax laws as presently known. Thus, in concept, the treble damage payment consists of compensatory damages and an additional 200 percent thereof as further damages. In the original concept, the payor had a net cash cost and an economic loss equal to 200 percent of the net benefits originally derived from transactions considered to be violations. For example, before income taxes were a factor, if the defendant profited to the extent of $100.00, a treble damage payment would have required repayment of $100.00 plus an additional $200.00, and his net economic loss would have been 200 percent of the original benefit.

After income taxes became a significant factor (with the corporation tax presently at approximately 50 percent) an antitrust violation such as over-pricing in the amount of $100.00 would give the taxpayer a net after tax benefit of $50.00. Compensatory damages are recognized as deductible and payment of $100.00 would, after taxes, exactly offset the original net benefit of $50.00. Additional damages of $200.00 would, under current law, also be deductible so that the economic detriment to the taxpayer is $100.00 net, or again, 200 percent of the original improper benefit, just as occurred in years before income taxes were so significant.

The present legislative proposal (S. 2631) would allow a deduction for the compensatory payment but the additional two-thirds would be nondeductible. Applying this concept to the preceding illustration, the taxpayer who improperly benefited to the extent of $100.00, or $50.00 net after taxes, would repay the same amount plus $200.00 which would be nondeductible. Thus the full impact on the payor would be 400 percent of the original benefit ($200.00/$50.00). An analysis of the cash loss or economic detriment to the payor shows that he would be out $250.00 in the year of payment more than offsetting his original benefit in an earlier year of $50.00 for which damages are sought. This is clearly a quintuple damage payment and not a treble damage payment. Surely, this burdensome substantive change in the treatment of antitrust treble damage payments should be examined for its antitrust policy implications and not be adopted hastily and by indirection as an amendment to the income tax laws.

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*Kickback payments by opticians to doctors, *Lilly* v. *Commissioner*, 343 U.S. 90 (1952); treble damage payments for price ceiling violations, *Jerry Rossman Corporation* v. *Commissioner*, 75 F. 2d 711 (1949); rent and wages paid by operators of a gambling enterprise, *Commissioner* v. *Sullivan*, 356 U.S. 27 (1958); fees and expenses paid in unsuccessful defense against an administration fraud order, *Commissioner* v. *Heininger*, 320 U.S. 467 (1943).

Additionally, little has been said about the private party receiving the damage payments. S. 2631 would continue to tax the entire treble damage payment — completely inconsistent with the proposed tax treatment of the payor. Other legislative proposals disallowing deductions for two-thirds of treble damage payments (S. 2156 and H.R. 2170 introduced in this Congress) would tax one-third of the damage payment to the recipient but would propose to exempt the other two-thirds payment in the hands of the recipient. Thus, the recipient's net receipt is five times the net damage he suffered and he would benefit by 400 percent. While this has the virtue of consistency in treatment with the proposal, with respect to the payor of treble damages, no justification has been made or is conceivable which would support this new treatment providing the damaged party with a windfall equal to five times the damages originally sustained.

III. POSSIBLE ADVERSE EFFECT FROM STANDPOINT OF ANTITRUST POLICY

In submitting views of the Department of Justice to the staff of the Joint Committee on Internal Revenue Taxation (staff study, page 60), Nicholas deB. Katzenbach, Acting Attorney General, expressed concern that the income tax laws not impose an obstacle to the speedy redress of damages suffered by victims of antitrust violations. Thus, from the antitrust policy standpoint the Antitrust Division seemingly favored tax deductibility for treble damage payments in the case of settlements to encourage prompt and full redress of wrongs and minimize court congestion and legal fees which might otherwise ensue.

Recognizing the economic effect summarized in the previous section, Mr. Katzenbach stated (staff study, page 62) that under present circumstances "in view of the potential disruption and expense of complex legal proceedings, it is unlikely that the allowance of deductions will make potential antitrust violators feel that a treble damage suit is a business risk to be assumed lightly."

The staff study made a further point on this matter (page 10), as follows:

> "From the standpoint of antitrust policy, it is not clear, however, that in all cases it is desirable to deny the deduction of treble damage payments. Representations were made to the staff of the Joint Committee on Internal Revenue Taxation both by some members of the electrical industry and also by representatives of some utilities that the failure to allow a deduction for the treble damage payments in the case of some of the companies might either drive them out of business entirely or substantially weaken them as a competitive factor in the industry."

We believe that the risk of paying treble damages for a violation when added to the potential fine and possible imprisonment which may be imposed in criminal proceeding for antitrust violations, acts as a significant and sufficient deterrent to violation of these laws, notwithstanding the fact that the right to a tax deduction does mitigate somewhat the burden of paying the treble damages. If, however, he Congress believes that the deterrent should be increased, the simple and direct method to deal with the matter would be for Congress to increase the fines imposed for violation of the Sherman Act, as it did in 1955 when the fine for each violation was increased from $4,000 to $50,000.

IV. RETROACTIVITY OF PROPOSED LEGISLATION

The amendments proposed by S. 2631 would be applicable with respect to amounts paid or incurred after December 31, 1967. Other bills (S. 2156 and H.R. 2170) would be applicable with respect to amounts "paid or incurred, or received" after the date of enactment of such act.

Since the effect of legislation which would make any part of treble damage payments nondeductible is to exact a penalty from violators, and to intend the penalty as punishment and as a deterrent to antitrust violations, it is retroactive if applied to any violations occurring prior to enactment. Such legislation is not consistent with its avowed purpose as a deterrent, and is patently unfair. Furthermore, during July, 1966, Assistant Attorney General Turner suggested that there may be constitutional problems by retroactively increasing sanctions (hearings before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary).

The Joint Committee Staff Study (page 13) proposes that any bill to disallow treble damage payments not be made retroactive and apply only with respect to antitrust violations occurring after the date of enactment.

The Manufacturing Chemists Association believes that the public interest is properly and adequately served by the tax rules presently applicable to treble damage payments and urges that no change in these rules be made by Congress. If hearings are held and it is determined that as a matter of antitrust policy additional penalties are required, any legislation to this effect would have no deterrent effect on prior violations and should be effective prospectively only. Therefore, any legislation which would make treble damage payments nondeductible should apply only to treble damage payments made with respect to antitrust violations which occur after the date of enactment of the legislation.

Sincerely,

G. H. DECKER.

Senator TALMADGE. Please proceed.

STATEMENT OF H. FRANCES DeLONE, CHAIRMAN, CLAYTON ACT COMMITTEE, SECTION OF ANTITRUST LAW, AMERICAN BAR ASSOCIATION, PHILADELPHIA, PA.; ACCOMPANIED BY SCOTT P. CRAMPTON, CHAIRMAN, AMERICAN BAR ASSOCIATION, SECTION OF TAXATION, WASHINGTON, D.C.

Mr. DELONE. Thank you.

I am chairman of the Clayton Act Committee, antitrust section of the American Bar Association. With me is Mr. Scott Crampton who testified this morning and who is chairman of the tax section.

We appreciate this opportunity to testify. We are here pursuant to resolution of the house of delegates of the American Bar Association to voice its opposition to two proposed bills, S. 2631 and S. 2156, which have been referred to this committee, and to any similar bill which may be considered by this committee, whether in connection with the tax reform bill or otherwise.

The two proposed bills would overturn the current income tax deductible status of payments made in settlement or satisfaction of private treble-damage antitrust claims or judgments. In general such payments are currently deductible to the payor, and taxable to the recipient.

In 1964 the Internal Revenue Service gave full consideration to the status of such payments, and ruled that they are deductible. In 1966 the house of delegates of the ABA considered the subject and, on the recommendation of the antitrust and taxation sections, indicated its support of the Internal Revenue Service position by expressing its disapproval of legislation designed to overturn the revenue ruling.

In 1968 the ABA again studied the subject through its antitrust and taxation sections and, on their recommendation, adopted the resolutions which are set forth on the first page of the statement which I have filed with the committee.

In essence, the resolution opposes legislation designed to deny deductibility to treble-damaged payments.

The statement which I have filed and which I understand is made part of the record is, with minor technical revisions, the joint report of the antitrust and the taxation sections of the ABA to the ABA House of Delegates.

Both the bills which have been referred to this committee would make two-thirds of treble-damage payments nondeductible to the payor. Senate 2631 would apply only with respect to payments related

to violations as to which the taxpayer had been convicted or pleaded nolo contendere.

Senate 2156 would apply to all treble-damage payments, and would also make two-thirds of the payment nontaxable to the recipient.

In considering the proposed legislation, it is important to keep in mind the nature of the antitrust remedy. It is a remedy provided to persons injured by violations who are entitled, in a private suit, to receive three times the damage they have suffered. This private recovery must be distinguished from fines in criminal antitrust proceedings or from recovery by the Government under section 4(a) of the Clayton Act, both which are currently nondeductible.

The antitrust laws are necessarily quite general and imprecise, so that their interpretation has changed and developed over the years. Changing concepts and changing economic analysis have often made it difficult to predict with any reasonable certainty what conduct will ultimately be held to be violative of the antitrust laws. Nor are treble-damage claims under these laws by any means limited to claims in connection with alleged price-fixing violations.

The point is illustrated by the recent Supreme Court case of *Simpson* v. *Union Oil.* There the Supreme Court recently invalidated consignment contracts which established resale prices, even though such contracts had been held valid 32 years earlier and many business enterprises had utilized them in reliance on the earlier Court ruling.

Simpson's treble-damage claim is still being litigated today and, under one of the proposed bills, if she should recover a judgment, then the payment that would be made would not be tax deductible to the payor, even though it had relied on a 32-year-old precedent, established by earlier Supreme Court cases.

I think perhaps the problem of this legislation, as the ABA sees it, can be illustrated by an actual case, or at least drawn from facts in an actual case with which I am familiar. There was an investigation by a Federal grand jury for 3 years, two successive grand juries in fact, into uniform pricing of fungible products sold by a number of major companies.

After 3 years of investigation the staff of the Antitrust Division, which was conducting the investigation, recommended that indictments be handed down. The Antitrust Division ended up recommending and filing only a civil suit. Some of the defendants in that case, rather than contest the charges, elected to agree to a consent decree which in effect said they would not in the future do what the civil suit charged.

If the Government had elected, instead, to proceed by the criminal proceedings route, those same defendants, rather than litigate, might well have sought leave to file nolo contendere pleas.

After the consent decrees were entered there was a flood of treble-damage private litigation. Many of those cases have since been settled, not on a basis that is related to the merit of the claim, but on what is truly a nuisance value settlement.

Now, under the proposed legislation, the defendants in those cases would not have been in a position to plead nolo contendere because some of the legislation, at least bill S. 2631, makes the tax consequences depend on whether there has been a criminal case and whether

there has been a nolo contendere plea. Moreover, they would not have been able to make nuisance-value settlements without adverse tax results.

Senator TALMADGE. Let me see if I understand you correctly. If it is a criminal case and a criminal fine, the payment of the fine would not be a deductible expense?

Mr. DELONE. That is correct. That is the law as it is today.

Senator TALMADGE. But if it is a plaintiff and a defendant under the civil remedies and the defendant loses his case and pays the damages, then it is deductible?

Mr. DELONE. It is deductible today, that is correct.

Senator TALMADGE. And you support the continuation of that policy?

Mr. DELONE. We do support it.

Senator TALMADGE. In other words, if he has committed a crime and paid a penalty for a crime it would not be deductible?

Mr. DELONE. The penalty for the crime is not deductible, that is correct, but the private recovery, the treble-damage recovery to recompense the person allegedly injured by the violation of a law, that we contend should be deductible to the person that has paid it and taxable to the one who receives it.

Senator TALMADGE. Because it penalizes the taxpayer twice, once on his fine and again on the recovery procedure?

Mr. DELONE. Well, it would penalize him twice. The theory basically is that once the taxpayer has parted with whatever profit he derived from the alleged conspiracy by way of a settlement or by way of paying a judgment, either one, the profit has been put into the hands of the person who would otherwise have made it, and it is taxed to him, as matters stand today. That seems to us right.

Senator TALMADGE. I think I understand your point.

Mr. DELONE. And there are many other instances in the law which are comparable. where deduction is allowed: kickback payments, treble-damages for price ceiling violations, multiple damages for Fair Labor Standards Act violations, payments in connection with fraud cases and security laws violations, even expenses of illegal gambling establishments. Deductions are allowed for all those items, and we do not understand why the treble-damage area should be singled out as a peculiar exception to the general concept of the tax laws which is to tax net income.

These payments we are talking about are clearly business-connected payments, and if we are going to have a tax on net income, it does not seem to the ABA to make sense to say that treble-damage payments shall not be deductible.

I think I should comment on one feature of both bills that are before this committee, and that is the retroactive feature. Both bills contemplate that if payments are made—in the case of 2631, payments made any time after December 31, 1967, in the case of 2156—payments made after December 31, 1968—they contemplate that those payments will be nondeductible, even though the payments may be made because of violations which occurred years before, so that if you look on this proposed legislation as a deterrent, if you will, you cannot justify making it have really a retroactive effect insofar as the past violations are concerned.

Our view basically is that if there are deficiencies in the antitrust laws, if the penalties are not severe enough today, then the remedy is to modify the antitrust laws themselves, and not try to approach the problem through tax legislation.

I should mention that just last week Mr. McLaren, the current head of the Antitrust Division, testified in support of raising the fines in antitrust cases tenfold, the maximum fine from $50,000 to $500,000. I am not authorized to take any position specifically on such legislation, but we do think the approach is sound: If there is something wrong with the antitrust laws then it ought to be remedied by dealing with the fines under the antitrust laws rather than through the back door so to speak through manipulation of tax legislation.

Senator TALMADGE. Thank you for a very fine statement, Mr. DeLone.

(Mr. DeLone's prepared statement follows:)

STATEMENT OF H. FRANCIS DELONE, AMERICAN BAR ASSOCIATION

SUMMARY

The American Bar Association opposes legislation to make non-deductible payments in satisfaction of private antitrust treble-damage claims or actions because:

1. Such claims or actions are remedial, not punitive. Payments to satisfy them are "ordinary and necessary expenses" deduction for which should be allowed since such deduction does not "frustrate sharply defined national" policy.
2. The tax laws should not be manipulated to achieve, indirectly, antitrust goals which can and should be achieved directly through the antitrust laws and amendments to them.
3. Similar payments are deductible.
4. The antitrust laws are necessarily imprecise; their interpretation depends on complex and difficult economic analysis, allowing a wide range of culpability, so that inequities will result from any blanket rule of non-deductibility of such payments.
5. The proposed legislation creates possibilities of double taxation and, perhaps, windfall tax treatment, and would contribute to further court congestion.
6. The proposed legislation raises problems of retroactivity and *ex post facto* application which cannot be justified on the basis of any claimed deterrent effect.

STATEMENT

In January of 1969, the House of Delegates of the American Bar Association adopted the following resolutions:

Resolved, that the ABA disapproves any proposed legislation having the purpose to make non-deductible for federal income tax purposes all or any portion of payments made in satisfaction of anti-trust treble-damage judgments or claims; and further

Resolved, that the Section of Antitrust Law and the Section of Taxation are authorized to urge the views of the American Bar Association in this regard upon the Joint Committee on Internal Revenue Taxation and other appropriate committees of Congress.

These resolutions were adopted on the basis of a report submitted to the House of Delegates by the Sections of Antitrust Law and of Taxation of the American Bar Association. The balance of this statement consists of that report, with certain technical revisions made necessary by events which have occurred since the report was originally prepared.

REPORT

The starting point for a discussion of this matter is Revenue Ruling 64-224, issued July 24, 1964.[1] That ruling *allows* income tax deductions for amounts paid

[1] 1964-2 C.B. 52.

or incurred to satisfy claims for damages as well as for amounts paid or incurred for legal fees and directly related expenses in connection with private treble-damage suits under Section 4 of the Clayton Act. Additionally, the Ruling *disallows* deductions for amounts paid or incurred in satisfaction of damage claims by the United States under Clayton Act Section 4A. This had continued to be the announced position of the Revenue Service, consistent with *Tank Truck Rentals, Inc.* v. *Commissioner*, 356 U.S. 30 (1958).[3] Also, the Ruling disallowed deductions for legal expenses incurred in unsuccessfully defending actions under Section 4A—a position implicitly overruled by *Commissioner* v. *Tellier*, 383 U.S. 687 (1966), and subsequently modified by Revenue Ruling 66-330, 1966-2 C.B. 44.

Revenue Ruling 64-224 was issued as a result of the so-called *Philadelphia Electrical Cases*,[3] which resulted in hundreds of millions of dollars in treble-damage recoveries by private plaintiffs. Prior to this time, the Internal Revenue Service had evidently never denied a taxpayer a tax deduction for such treble-damage payments;[4] and the closest published precedent, regarding treble-damage payments under the Emergency Price Control Act of 1942, allowed a deduction.[5] In 1961 the Service considered opposing such an allowance for antitrust treble-damage defendants. However, the Service conducted conferences and extensive further studies extending into 1963. Based on the findings of this extensive study, the indications that Section 4 of the Clayton Act was intended to be remedial rather than to punish defendants,[6] and the Supreme Court's unwillingness, except in rare instances, to disallow business expense deductions on "public policy" grounds,[7] the Service ruled that treble-damage payments in antitrust cases are deductible.[8]

The American Bar Association recommends that any legislation designed to make antitrust treble-damage payments in whole or in part non-deductible for federal income tax purposes be disapproved for the following reasons: (1) enactment of such legislation would fail to reflect the remedial rather than punitive nature of treble-damage actions; (2) basic tax principles delineating federal taxation as a tax on net income and not a sanction would be disregarded; (3) payments similar to treble-damages are fully deductible; (4) the economic analysis of antitrust questions frequently makes interpretation of the statutes difficult, allowing for a wide range of culpability, to which such legislation is not responsive; (5) inequitable tax effects would be created; and (6) any possible retroactive effect would be unfair.

1. Treble-damage actions as remedial or punitive: Public policy considerations

To the extent that Revenue Ruling 64-224, in allowing deduction of treble-damage payments, was founded on the determination that Clayton Act Section 4 actions are "remedial" rather than criminally punitive, both its rationale and its conclusion appear to have been supported and confirmed by the Supreme Court's reasoning in *Commissioner* v. *Tellier*, *supra*, decided March 24, 1966. In fact, this case, by strictly delineating "violation of public policy" as the test for disallowance of deductions, would seem to diminish the importance of the "remedial-penal" dichotomy.[9] In all events, that Section 4 of the Clayton Act is remedial and not penal is apparent both as a matter of statutory construction and legislative history. Recoveries inure wholly to benefit the injured party; other Sherman Act sections specifically punish by fines and prison terms; and the legislative history emphasizes a purpose of encouragement of private actions rather than punishment of antitrust offenders. Moreover, the Supreme Court has described Section 4 as a "remedial provision for redress of injuries," *Eastman Kodak Co.* v. *Southern Photo Materials Co.*, 273 U.S. 359, 373 (1927), and as a

[2] Statement of Sheldon S. Cohen, Commissioner of Internal Revenue, Hearings Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 89th Cong., 2d Sess. (1967) [hereinafter cited as "Hearings"], p. 85.

[3] Staff Study of Income Tax Treatment of Treble Damage Payments Under the Antitrust Laws for the Joint Committee on Internal Revenue Taxation, Committee Print 1965 [hereinafter cited as "Staff Study"], p. 21.

[4] Statement of Mortimer M. Caplin, Hearings, p. 62.

[5] I.T. 3627, 1943 C.B. 111, held that treble-damage payments to a private party by a violator of the Emergency Price Control Act of 1942 were tax deductible since the payments were considered remedial in nature.

[6] *Contra, Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955) (dictum).

[7] But see, *Tank Truck Rentals, Inc.* v. *Commissioner, supra*.

[8] For a full discussion of these developments, see Statement of Mortimer M. Caplin, Hearings, pp. 59-63; and Statement of Sheldon S. Cohen, Hearings, pp. 84-88.

[9] See generally, Staff Study, pp. 2-5.

"right of action granted to redress private injury," *United States* v. *Cooper Corp.*, 312 U.S. 600, 608 (1941). The weight of judicial authority likewise affirms the compensatory nature of treble-damage provisions. *E.g., Bruce's Juices, Inc.* v. *American Can Co.*, 330 U.S. 743 (1947).

Tellier holds that legal fees and related expenses incurred by a taxpayer in the unsuccessful defense of a business-related criminal prosecution (action for fraud against a securities dealer) are deductible as ordinary and necessary business expenses under § 162 of the Internal Revenue Code. A subsequent Revenue Ruling based on *Tellier* reversed that portion of Revenue Ruling 64–224 which had disallowed such fees and expenses in antitrust damage actions by the Government.[10]

The Court in *Tellier* primarily addresses itself to the "public policy" issue. In the present context that issue is specifically whether the deduction of treble-damage payments would frustrate any sharply defined policy that Congress had in mind in allowing antitrust plaintiffs to recover treble instead of actual damages; whether the "sting" of Section 4 of the Clayton Act is thereby lessened.[11] The Supreme Court has always been reluctant to deny business expense deductions on grounds that their allowance would frustrate national or state policies proscribing particular forms of conduct, and in a number of cases has found this "public policy" argument inapplicable. See *Commissioner* v. *Sullivan*, 356 U.S. 27 (1958) (deduction for rent and wages paid by operators of a gambling enterprise sustained, although both the business and the specific payments were illegal); *Lilly* v. *Commissioner*, 343 U.S. 90 (1952) (deduction for amounts kicked-back by opticians to doctors to obtain prescription business allowed, although in violation of Section 1 of the Sherman Act); and *Commissioner* v. *Heininger*, 320 U.S. 467 (1943) (deductions allowed for attorney's fees in the unsuccessful defense of an administrative mail fraud order).

Contrariwise, the Court has denied business deductions on the ground they frustrated "sharply defined public policies" in only two categories of cases: payments of fines and penalties to governmental bodies, *Tank Truck Rentals, Inc.* v. *Commissioner*, *supra*, and *Hoover Motor Express Co.* v. *United States*, 356 U.S. 38 (1958); and payments, such as lobbying expenses, specifically prohibited by longstanding Treasury Regulations, *Textile Mills Sec. Corp.* v. *Commissioner*, 314 U.S. 326 (1941), and *Cammarano* v. *United States*, 358 U.S. 498 (1959).

The Court in *Tellier* has enunciated a "sharply limited and carefully defined category" for the role of "public policy" in determination of proper business expense deductions, in the following terms:

> Deduction of expenses falling within the general definition of § 162(a) may, to be sure, be disallowed by specific legislation, since deductions "are a matter of grace and Congress can, of course, disallow them as it chooses." . . . The Court has also given effect to a precise and longstanding Treasury Regulation prohibiting the deduction of a specified category of expenditures; . . . But where Congress has been wholly silent, it is only in extremely limited circumstances that the Court has countenanced exceptions to the general principle reflected in the *Sullivan*, *Lilly* and *Heininger* decisions. Only where the allowance of a deduction would "frustrate sharply defined national or state policies proscribing particular types of conduct" have we upheld its disallowance . . . Further, the "policies frustrated must be national or state policies evidenced by some *governmental* declaration of them." . . . Finally, the "test of nondeductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction." 383 U.S. at 393–94.

It seems clear, therefore, that the rationale of Revenue Ruling 64–224 on the deductibility of antitrust treble-damage payments has been confirmed by the reasoning enunciated in the *Tellier* case. We feel that a statutory amendment to preclude such deductions, either in whole or in part, is not warranted by any possible effects on antitrust policy. Rather, it would be unwise as a matter of both tax and antitrust considerations.

2. Basic tax policy considerations

Any proposed legislation designed to limit or deny the deductibility of treble-damage payments is objectionable as a matter of basic tax policy on the ground that manipulation of tax provisions should not be used to achieve social goals in other areas. There is virtually no disagreement that any departure from this

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[10] Revenue Ruling 66–330, 1966–2 C.B. 44.
[11] See Staff Study, p. 6, pp. 25–27.

position should be made only if it is otherwise necessary and meritorious; only for clearly valid and carefully considered reasons.[12]

The Supreme Court in the *Tellier* case case has reiterated this position, stating: "We start with the proposition that the federal income tax is a tax on net income, not a sanction against wrongdoing. That principle has been firmly imbedded in the tax statute from the beginning." 383 U.S. at 691. The Court cites statements of the late Randolph Paul, as well as the original 1913 floor-debate statements of Senator Williams, to the same effect. 383 U.S. at 691–92 and n. 11, p. 695.

Tax legislation to accomplish a non-tax societal purpose deemed meritorious should be utilized only when it is not "possible to achieve that goal more efficiently, directly, and fairly through other measures which lie outside the realm of the tax system."[13] We do not think that the tax collector need be made the antitrust enforcer, or that the tax laws need be changed in order to achieve further and greater dollar punishment. Certainly here there is another way to solve any enforcement deficiencies within the legal context of the substantive area of concern. The antitrust laws themselves present the direct and manageable opportunity for increasing penalties, if such is deemed necessary. Simply quadruple or quintuple damages, if the deterrent is not currently enough, before abrogating basic policies by interfering with the tax deductibility of damage payments.[14]

3. Payments similar to treble-damages are deductible

We have noted that the Supreme Court in *Tellier* has reemphasized its reluctance to find that the allowance of an otherwise tax-proper business expense deduction would "frustrate sharply defined national or state policies proscribing particular forms of conduct," citing many of its own previous decisions wherein the deductibility of payments similar to antitrust treble-damages have been upheld. The enactment of legislation on this subject would be particularly inadvisable to the extent that it singles out antitrust treble-damage payments for interference with their tax deductibility. Both the courts and the Internal Revenue Service have long held similar, if not identical, payments deductible. These include "kickback payments" clearly in violation of Section 1 of the Sherman Act: payments made in settlement of treble-damage actions for price ceiling violations under the Emergency Price Control Act of 1942; multiple damages paid to an employee for violations under the Fair Labor Standards Act; payments made in connection with violations of the law in the sale of securities; various fraud case payments; and the rent and wage expenses of an illegal gambling operator where these expenses were themselves a separate violation of a state law.[15]

Tellier, of course, has clearly settled any issue regarding the deductibility of legal and related expenses in defense of any such actions, criminal or otherwise.[16]

To reverse the basic tax policy noted above and as reaffirmed in *Tellier*, that federal income taxes should be on net income and not contorted to implement various regulatory statutes or to punish wrongdoing, is the prerogative of Congress. But one situation should not be singled out for such special treatment. Only after a thorough consideration of a broad range of items affecting enforcement of public laws and policies should legislation of this type come before the Congress.

4. Interpretation of the antitrust statutes is frequently and generally difficult, allowing for a wide range of culpability, and resultant inequities under the proposed legislation

The antitrust laws are dynamic in nature and their boundaries are often imprecise. Our antitrust laws are as equally economic, social and political as they are legal. Antitrust is involved in the sensitive area of what is good for the

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[12] See collection of language to this effect in Staff Study, pp. 11–12, and again in *Commissioner* v. *Tellier, supra.*

[13] Remarks by Hon. Stanley S. Surrey, Asst. Sec. of the Treasury, before the Tax Executives Institute, March 7, 1965.

[14] See Statement of William Simon, representing the American Bar Association, Hearings, pp. 35, 43, 45.

[15] Respectively, *Lilly* v. *Commissioner, supra*; *Jerry Rossman Corp.* v. *Commissioner*, 175 F. 2d 711 (2d Cir. 1949); I.T. 3762, 1945 C.B. 95; *Ditmars* v. *Commissioner*, 302 F. 2d 481 (2d Cir. 1962); *Lauren M. Marks*, 27 T.C. 464 (1956); Rev. Rul. 61–115, 1961–1 C.B. 46; *Helvering* v. *Hampton*, 79 F.2d 358 (9th Cir. 1935); *Heininger* v. *Commissioner, supra*; *Commissioner* v. *Sullivan, supra.*

[16] These cases and Rulings, including *Sullivan, Lilly* and *Heininger, supra*, are analyzed in Statement of William Simon, Hearings, pp. 35, 37–41.

economy. Certainly businesses and governmental agencies have made unforeseeable mistakes, and the courts themselves have experienced great difficulty with the economic analysis necessary to determine whether a violation has occurred.[17]

Businesses are going to become subject to treble-damage actions in spite of every effort to avoid antitrust violations. In *Simpson* v. *Union Oil Co.*, 377 U.S. 13 (1964), the Supreme Court held that a consignment agreement providing a resale price limitation violated the Sherman Act, although the Court approved a similar consignment agreement 38 years earlier; thus, its decision raises "the distinct possibility that an untold number of sellers of goods will be subjected to liability of treble damage suits because they thought they could rely on the validity of this Court's decisions." 377 U.S. at 30 (Justice Stewart dissenting). In 1967, the Court, in *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), again indicated that consignment agreements and agency arrangements *may* properly be used by a manufacturer, within certain limits, to control the distribution of his product. In *FTC* v. *Fred Meyer, Inc.*, 390 U.S. 341 (1968), decided on March 18, 1968, the Court held "for the first time, 32 years after the passage of the Act," that Section 2(d) of the Robinson-Patman Act, which requires equal promotional allowances by suppliers to all customers, uses the word "customers" to include persons who did not purchase directly from the supplier but bought through intermediate wholesalers. In so defining "customers" to include "noncustomers whom the Court thinks need protection," (see dissenting opinion, 341 U.S. at 361), the Court adopted a theory neither party proposed.

The very governmental agencies enforcing the anti-trust laws experience difficulty in determining whether a violation has occurred. In 1963, the Justice Department found itself in disagreement with the Federal Trade Commission as to whether price-quoting cooperative advertising by independent retail druggists constituted illegal price-fixing under the Sherman Act.[18] In *Purolator Products, Inc.* v. *FTC*, 352 F. 2d 874 (7th Cir. 1965), *cert. denied*, 389 U.S. 1045 (1968), the Solicitor General filed an *amicus* brief opposing the Federal Trade Commission position.

Finally, the courts themselves have had admitted difficulty with the economic impact of business arrangements in reaching a conclusion regarding their classification under the antitrust laws. See *White Motor Co.* v. *United States*, 372 U.S. 253 (1963).

Within the above context, denying deduction for treble-damage payments, either in whole or in part, would arbitrarily impose "a burden in a measure dependent not on the seriousness of the offense," *Tellier, supra*, at 695. It has traditionally been the province of the courts to fit the punishment to the crime in the imposition of sentences. This can be particularly important when offenses can be inadvertent or less than deliberate. As noted by the chief counsel for the Senate Subcommitee on Antitrust and Monopoly, in all of the price ceiling treble-damage cases the courts had discretion regarding damages.[19]

Obviously, the tax collector is and should be blind to whether and to whom social good comes or doesn't come from the collection of taxes. The Antitrust Division, of course, properly exercises certain discretion in how it enforces the laws it is charged to uphold. But just as certainly, it should not be within the province of the Antitrust Division to further determine against whom the tax laws should be made available to inflict an additional penalty, as would be true under the provision of legislation which would limit the denial of a deduction to cases where there has been a criminal indictment resulting in a judgment of guilt or a *nolo contendere* plea. This allows the tax effect to the violator to be too much the result of prosecutor discretion[20] in light of the fact that civil injunctions of *per se* antitrust violations require much the same showing by the government as do criminal proceedings, and that criminal convictions can be obtained without direct evidence of intentional wrongdoing. Making the deductibility of subsequent treble-damage payments dependent on the government's choice of a civil or criminal enforcement route seems illogical when that choice is not necessarily reflective of the relative "hard-coreness" of the violation.[21]

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[17] See Statement of William Simon, Hearings, pp. 35, 41–42.
[18] See H.R. Report No. 690, 88th Cong., 1st Sess. 1 (1963).
[19] Hearings, p. 55.
[20] See letter from Asst. Prof. Meade Emory to Senator Hart, Aug. 2, 1966, with excerpt from article, Hearings, pp. 109, 110–112.
[21] In this regard, note the refusal of the Justice Department to give reasons why it brought a civil instead of a criminal acton even in the face of a Court order to produce. *United States* v. *Venice Work Vessels, Inc.*, April 4, 1968 (ATTR No. 356, May 7, 1968, p. A-2).

5. Inequitable tax effects

Legislation in this area creates possibilities of double taxation and perhaps even windfall tax treatment on the other side—unjust but inevitable when alterations are imposed on the basic policy of taxing net income.

We have noted the defficulty of equating "wrongdoing" with treble-damage awards or settlements. Certainly it is at best arguable whether the profits made by a treble-damage defendant bear any necessary relation to damages he may be required to pay as a result of suits brought against him. However, to the extent he has so profited from his alleged wrongdoing, the treble-damage defendant has paid tax on this additional income. To the extent damages represent a repayment of such profits, it would seem that denial of a deduction to defendants would result in double taxation.

Additionally, we note that the actual increase in deterrent value of any such legislation is subject to question. The then Acting Attorney General Katzenbach noted in 1965 that with the present corporate tax rate of almost 50 percent, an adjudicated treble-damage violator, even with deductions, will be out-of-pocket approximately 150 percent of actual damages in a situation where it has already paid income tax on any income derived from the violation. That figure, in addition to the expense and business disruption occasioned by the legal proceedings, he suggested, means that even with deductions a potential violator will not likely risk a treble-damage action.[32]

Moreover, if nondeductibility is limited to cases with respect to which there was a criminal judgment or *nolo* plea, defendants clearly would be discouraged from entering *nolo* pleas which would then make them vulnerable to tax sanctions in subsequent treble-damage litigation. The effect would be especially onerous to smaller companies upon whome the high cost of litigation would often be seriously burdensome, if not fatal, to their ability to compete.[33] And to so discourage *nolo* pleas would add to the burden of already congested court calendars.

Under present procedures the character of a treble-damage recovery determines its tax treatment.[34] Amounts received above actual damages are taxable as ordinary income. Recoveries representing single or actual damages are not taxable if they can be shown to represent a return of capital, but are taxable to the extent that they represent lost income or profits. If this rule is changed by legislation to provide, for example, that the two-thirds portion of treble-damages which is nondeductible by defendants is non-taxable to the plaintiffs, a tax windfall for treble-damage payments is created to the extent such damages represent lost income or profits. In addition, these consquences would be undesirable since they would, to some extent, remove an incentive for treble-damage plaintiffs to settle for single damages.

6. Retroactivity of any proposed legislation

We also disapprove of the retroactive effect of any proposed legislation in this area. It was the recommendation of both the Joint Committee[35] and the Department of Justice[36] that such provisions should only apply respecting *violations* occurring after the date of enactment. At minimum, this retroactive feature would result in unfairness without serving the asserted basic purpose of such legislation as a deterrent to antitrust violations. Although it may be settled that retroactive tax legislation is generally constitutional, Assisant Attorney General Turner clearly suggested at the 1967 Hearings that constitutional problems would here be raised where you are dealing with "criminal law and sort of the criminal type sanctions."[37] Certainly a bill which would impose additional sanctions only on taxpayers who have been convicted or pleaded *nolo* on criminal antitrust violations would seem to have such a relation to criminality and would in effect be exacting additional punishment against a person or class of persons so as to create *ex post facto* problems.

CONCLUSION

For all of the above reasons, the American Bar Association opposes any amendment of the Internal Revenue Code which would disallow in whole or in

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[32] Letter from Acting Attorney General Katzenbach to Laurance N. Woodworth, Chief of Staff, Joint Committee on Internal Revenue Taxation, Feb. 8, 1965, Staff Study, pp. 61–62.
[33] See Staff Study, pp. 38–39.
[34] Rev. Proc. 67–33, 1967–35 I.R.B., p. 26.
[35] Staff Study, pp. 18, 15–16.
[36] Hearings, pp. 27–28, 33.
[37] *Ibid.*

part the deductibility of treble-damage payments. Such payments, arising as they do in the context of a civil action based on business conduct, should continue to be deductible in their entirety as ordinary and necessary business expenses under Section 162 of the Internal Revenue Code.

Senator TALMADGE. The next witness is Dr. N. R. Danielian, president of the International Economic Policy Association.

STATEMENT OF DR. N. R. DANIELIAN, PRESIDENT OF THE INTERNATIONAL ECONOMIC POLICY ASSOCIATION, ACCOMPANIED BY CHARLES J. KERESTER, TAX COUNSEL

Mr. DANIELIAN. Mr. Chairman, I appreciate this opportunity.

Senator TALMADGE. The Chair notes with much pleasure that you have with you as a witness a former employee of the Joint Committee on Internal Revenue Taxation, Mr. Charles Kerester.

Mr. DANIELIAN. I was going to mention that, Mr. Chairman. I am pleased to have him with us. He has helped to prepare the statement and he is here to help answer questions.

In the current controversy over tax reform we have lost sight of the fact that it all started with the proposal to extend the 10-percent surcharge, and one of the primary purposes of the surcharge enacted in 1968 was to reestablish confidence abroad in the U.S. dollar, the standing of which in international markets had been weakened because of persistent balance of payments deficits.

It is pertinent, therefore, to address oneself to this original purpose of the surcharge and to suggest ways in which the balance of payments of the United States may be improved by means of appropriate tax treatment of foreign trade and investment income.

I have just returned from a month's survey of European opinion concerning the international flow of short-term capital, long-term investments, the U.S. balance of payments, and the standing of the dollar in the opinion of finance ministries and bankers. On more than one occasion the suggestion was made to me by officials, as well as private bankers, that the United States could help itself in encouraging the reflow of earnings from abroad by a more lenient tax treatment of foreign source income.

We have now tried on two occasions a punitive approach; first, in the Revenue Act of 1962, and now in the direct foreign investment controls of the Department of Commerce. There is no evidence that these approaches have been very successful. In the accompanying paper which, with your permission, I would like to submit for the record, we make typical suggestions of ways by which this can be accomplished.

Senator TALMADGE. Without objection it will be inserted in full in the record.

Mr. DANIELIAN. Another area in which tax reforms are long overdue is in the treatment of exports. Ever since 1960 it has been Government policy to solve our balance-of-payments deficits by encouraging exports. In all these years, almost a decade, not one single constructive proposal has come up to Congress from the executive department to use tax incentives to this end, in spite of numerous studies and reports recommending such action. In the meantime, we have allowed other countries, particularly the European Economic Communities

and Japan to use tax incentives in promoting their exports in our markets.

I shall not here recite, for it is well known to you, the evolution of the Common Market's turnover taxes. It is a fact that as late as 1962 we allowed a clarification of the GATT regulations to permit the rebate of turnover taxes and prohibit similar treatment for income taxes. Ever since, we have had our hands tied.

Mr. Chairman, we must find a way of liberating ourselves from this self-imposed restraint and give our exporters at least the same effective percentage of tax concessions as our trading partners. We make recommendations in the accompanying paper to achieve this purpose.

There are other means whereby our earnings from exports and from investments can be enhanced and the repatriation of earnings encouraged.

A country with the responsibilities that the United States has assumed in maintaining stability in world conditions will continue to have substantial expenses abroad. Trade policies of other countries being what they are, we may not achieve the necessary surpluses in foreign earnings solely in the area of sales of goods. A large portion, an essential part, in fact, must come from investment and services income. It behooves us, therefore, to encourage rather than discourage profitable investments abroad, because the United States will ultimately become the beneficiary of the earnings from such investments. This part of our international accounts has been the most encouraging—in fact, the only—element in our external accounts that has been making a net contribution to our balance of payments. Therefore, we must eliminate unnecessary hindrances to the expansion of this most important source of income.

We make a number of specific suggestions in the accompanying memorandum on ways to achieve this objective.

A third objective of the U.S. Government has been to encourage investments in less developed countries, and we make a number of suggestions also to accomplish this purpose.

Mr. Chairman, this concludes the summary statement. We have made specific suggestions with reference to the Internal Revenue Code, the revisions that we suggest in the accompanying memorandum.

Senator TALMADGE. Thank you very much, Mr. Danielian, for a very fine statement and we will look into the suggestions which you have made.

I share your views that our Government ought to do everything possible to encourage investments abroad and earnings wherever possible, and particularly on trade with balance of payments involved.

Thank you very much.

Mr. DANIELIAN. Thank you, Mr. Chairman.

(Dr. Danielian's prepared statement follows:)

STATEMENT OF DR. N. R. DANIELIAN, PRESIDENT, INTERNATIONAL ECONOMIC POLICY ASSOCIATION

SUMMARY

Mr. Chairman, in the current controversy over tax reform we have lost sight of the fact that it all started with the proposal to extend the 10 percent surcharge, and one of the primary purposes of the surcharge enacted in 1968 was

to re-establish confidence abroad in the U.S. dollar, the standing of which in international markets had been weakened because of persistent balance of payments deficits. It is pertinent, therefore, to address oneself to this original purpose of the surcharge and to suggest ways in which the balance of payments of the United States may be improved by means of appropriate tax treatment of foreign trade and investment income.

I have just returned from a month's survey of European opinion concerning the international flow of short-term capital, long-term investments, the U.S. balance of payments, and the standing of the dollar in the opinion of finance ministries and bankers. On more than one occasion the suggestion was made to me by officials, as well as private bankers, that the United States could help itself in encouraging the reflow of earnings from abroad by a more lenient tax treatment of foreign source income. We have now tried on two occasions a punitive approach; first, in the Revenue Act of 1962, and now in the direct foreign investment controls of the Department of Commerce. There is no evidence that these approaches have been very successful. In the accompanying paper which, with your permission, I would like to submit for the record, we make typical suggestions of ways by which this can be accomplished.

Another area in which tax reforms are long overdue is in the treatment of exports. Ever since 1960 it has been government policy to solve our balance of payments deficits by encouraging exports. In all these years, almost a decade, not one single constructive proposal has come up to Congress from the Executive Department to use tax incentives to this end, in spite of numerous studies and reports recommending such action. In the meantime, we have allowed other countries, particularly the European Economic Communities and Japan, to use tax incentives in promoting their exports in our markets.

I shall not here recite, for it is well known to you, the evolution of the Common Market's turnover taxes. It is a fact that as late as 1962 we allowed a clarification of the GATT regulations to permit the rebate of turnover taxes and prohibit similar treatment for income taxes. Ever since, we have had our hands tied. Mr. Chairman, we must find a way of liberating ourselves from this self-imposed restraint and give our exporters at least the same effective percentage of tax concessions as our trading partners. We make recommendations in the accompanying paper to achieve this purpose.

There are other means whereby our earnings from exports and from investments can be enhanced and the repatriation of earnings encouraged.

A country with the responsibilities that the United States has assumed in maintaining stability in world conditions will continue to have substantial expenses abroad. Trade policies of other countries being what they are, we may not achieve the necessary surpluses in foreign earnings solely in the area of sales of goods. A large portion, an essential part, in fact, must come from investment and services income. It behooves us, therefore, to encourage rather than discourage profitable investments abroad, because the United States will ultimately become the beneficiary of the earnings from such investments. This part of our international accounts has been the most encouraging—in fact, the only—element in our external accounts that has been making a net contribution to our balance of payments. Therefore, we must eliminate unnecessary hindrances to the expansion of this most important source of income.

We make a number of specific suggestions in the accompanying memorandum on ways to achieve this objective.

I am pleased to state for the record that I am accompanied here today by Mr. Charles J. Kerester, Tax Counsel, of the law firm of Jones, Day, Cockley & Reavis, of Cleveland, who is prepared to answer technical questions.

STATEMENT

Introduction

The International Economic Policy Association, consisting of a number of U.S. corporations engaged in worldwide trade and investment operations, has been concerned with the continuing deterioration of the U.S. balance of payments.

Because of the seriousness of the U.S. deficit in the balance of payments, it has been assumed that the private sector must bear the greater part of the brunt for offsetting the huge government expenditures abroad which have placed us in deficit. American companies engaged in foreign operations, however, have been subject to restrictions, regulations and increased taxes which seem designed to discourage rather than to help in the responsibilities which have been imposed

upon them. Mandatory controls have been placed on investments overseas, the returns from which have been one of the chief sources of U.S. income from abroad. American companies have been compelled to return liquid assets from abroad, without regard to the needs of their operations or the tax consequences. In spite of the burdens which have been imposed on private industry, there have been no effective measures to encourage U.S. exports or foreign investments which are the principle sources of income in achieving a favorable balance of payments.

The Association recommends that the Committee consider the following proposals to encourage U.S. exports and U.S. overseas operations:

A. REPATRIATION OF FOREIGN EARNINGS

1. Impact of OFDI controls

The current program of controls on direct investments compels U.S. companies to limit their investments abroad and to repatriate funds to help our balance of payments position. In addition to the serious problems confronting U.S. companies in complying with the controls, the program has caused them to be subject to taxation on amounts repatriated under compulsion.

Transfers of funds to a U.S. company from an affiliated foreign corporation in compliance with the direct investment controls are treated as taxable dividends. There is no provision in the Internal Revenue Code which would allow an exemption from tax even if these amounts are segregated into special accounts.

It seems highly unfair that U.S. companies with investments abroad, because of their efforts to comply with the onerous requirements imposed by the OFDI regulations, should be subject to taxation on the funds which they repatriate under the program. Reasonable means should be established whereby they could repatriate funds to improve our balance of payment account without incurring tax liability.

2. Removal of deterrents to investment in the United States by a foreign affiliate

Section 956 of the Internal Revenue Code provides that loans to a U.S. parent company and most investments in U.S. property by a U.S.-controlled foreign corporation, with limited exceptions, are subject to a tax on the U.S. shareholder of the foreign corporation as though a dividend had been distributed.

Section 956 effectively militates against bona fide transactions that could improve our balance of payments. Under the mandatory program for the control of foreign investments, the results impose special difficulties on American companies operating abroad.

Our balance of payments problems have been with us for a long time and it does not seem likely that they will disappear very soon. We believe that this disincentive to investment in U.S. securities by foreign affiliates should be removed. The Association recommends that the Committee seriously consider repealing section 956, or at least revising the section to take into account the realities of our present difficulties resulting from mandatory regulations under the Foreign Direct Investment Controls, by amending the section in such a fashion that bona fide loans to or a bona fide investment in a U.S. direct investor by its foreign affiliate would not be considered constructive dividends and subject to U.S. taxes.

Also, U.S. direct investors may find it necessary to transfer funds from one foreign affiliate to another to meet investment and working capital needs, thereby obviating the need for transfer of funds from the United States. The law should make clear that such transfers from one foreign affiliate to another, under terms and conditions similar to those prevailing between independent third parties, should not be considered as failing to meet the test of an arm's length transaction, resulting in a constructive dividend to the U.S. direct investor, merely because the transfer is between related parties.

3. Adoption of incentives for repatriation of foreign earnings

Some concept similar to the Western Hemisphere Trade Corporation's special tax deduction should be applied to dividends paid by controlled foreign corporations doing business in less developed countries. Such a deduction for earnings from less developed countries would provide an incentive to U.S. companies to establish and expand business operations in those areas, thereby providing the means for improving local economies. We suggest that this approach may be more preferable than outright financial grants now being made by the U.S. Government.

B. EXPORT TAX INCENTIVES

It is recommended that the Committee consider a permanent export incentives proposal. To encourage the export of U.S. manufactured products, it is suggested that a lower rate of corporate taxes be imposed on the export business of U.S. corporations. The Internal Revenue Code should be revised so that a taxpayer would pay a lower tax on income derived from the sale of exported goods. This may be done either by the creation of an export corporation restricted solely to export business which would qualify for the lower tax rate, and/or by extending the lower rates to the export business of domestic corporations.

We are aware of problems involved in tax incentives and of our obligations under the GATT agreement. Under GATT rules, direct taxes, such as sales taxes or the value added taxes which all members of the Common Market are adopting, can be exempted on exports and added onto the price of imports, but indirect taxes such as our heavy corporate taxes cannot be so computed. This means that under existing GATT rules U.S. manufacturers bear the full weight of U.S. taxes on their exports, and on the other hand, must compete with imports from the Common Market that have been exempted from a large portion of their domestic tax burden. Along these lines, H.R. 13713 introduced by Chairman Mills of the House Ways and Means Committee on September 10, 1969 is a recognition of this problem.

The present interpretation under the GATT rules relating to direct and indirect taxes should be renegotiated with our GATT partners so that the tax burdens on exports and imports should be computed in the same way. Whether or not our partners will agree to a renegotiation of GATT arrangements is uncertain, probably unlikely. We feel that some U.S. program for export incentives is the most effective means of improving our export trade performance and placing us in a position to compete on an equal basis with the numerous devices used by foreign countries in the trade field. An increase in U.S. exports to a position that will yield a substantial export surplus is imperative if the United States is to maintain freedom of international movement of people, goods and security forces.

C. ALLOCATION OF EXPENSES

Sections 861, 862 and 863 of the Internal Revenue Code define income from sources within the United States, income from sources without the United States and income partly from within and partly from without the United States. These sections require that there be deducted from a class of gross income a ratable part of any expenses which cannot definitely be allocated to some class of gross income.

Sections 861, 862 and 863 of the Code and Treasury Department regulations promulgated thereunder permit the Internal Revenue Service to require the allocation of a share of corporate general and administrative expenses to foreign source income. This allocation is made even though the expense may have only a remote connection with the production of the foreign source income. The result is, of course, to reduce the foreign source net income and thereby increase the effective foreign tax rate. This, in turn, increases the likelihood that the foreign tax credit may be reduced.

If an item of expense is incurred in order to produce foreign source income, it is reasonable to allocate it to that source. But to allocate merely because it has some vague relationship to foreign source income seems quite unreasonable. We suggest that sections 861, 862 and 863 be amended to make it clear that allocations of expenses to foreign source income are to be made only when the expense was incurred in the production of such income.

D. EXTENSION OF DEEMED-PAID FOREIGN TAX CREDIT (SECTION 902)

Under the present law, credit for foreign taxes paid by a foreign corporation can be had by a U.S. corporation only if at least 10 percent of the stock of the first-tier foreign corporation is owned by a U.S. taxpayer, and in the case of a second-tier foreign corporation, if at least 50 percent of the stock of the foreign subsidiary is owned by the first-tier foreign corporation. Under present law, the credit is not available for foreign taxes paid by third-tier or subsequent tier foreign affiliates.

Many foreign countries are insisting that alien ownership be limited to a minority interest. A revision of the section would encourage U.S. minority

participation in additional ventures, attract local participation in joint ventures and stimulate the development of private enterprise in many less developed countries. Joint ownership is often required by local law or foreign government policy, and U.S. corporations cannot always maintain the degree of ownership required for such foreign tax credit under present U.S. law.

It is recommended that section 902 be amended so that the 10-percent ownership requirement for first-tier foreign corporations should be reduced to 5 percent, and that the tax credit should be extended to cases where there is an indirect ownership of 5 percent or more in second-tier, as well as in third- and subsequent-tier foreign subsidiaries.

E. EXTENSION OF EXISTING FIVE-YEAR CARRY-OVER PERIOD FOR UNUSED FOREIGN TAX CREDITS TO TEN YEARS

Section 904 of the Internal Revenue Code now permits a two-year carry-back and five-year carry-over for unused foreign tax credits. It is recommended that this carry-over period for unused tax credits be extended to ten years. U.S. foreign investors, especially in less developed countries, can anticipate extreme fluctuations in their losses and earnings and the resulting tax base. Congress has recognized the difficulties of foreign investments in adopting the carry-back and carry-over period. An extension of this five-year carry-over period to ten years would give added stimulus to investments in less developed countries, especially by small investors with limited financial resources. A ten-year carry-over period would permit a U.S. company greater opportunity to utilize any excess foreign tax credits resulting from the adverse effect a loss attributable to the worthlessness of an investment in a foreign subsidiary may have on the limitation on the foreign tax credit in the year the investment becomes worthless.

F. LIBERALIZATION OF DEFINITION OF CREDITABLE TAXES

Section 903 of the Internal Revenue Code now permits a credit for any foreign tax paid "in lieu of a tax on income. . . ." Treasury regulations and administrative practice have so restricted this that an "in lieu tax" can only be creditable if (1) the foreign country has an income tax in force, (2) the taxpayer would be subject to such income tax absent some special provision and (3) he pays a substituted tax in lieu thereof.

It is recommended that the "in lieu" provision be broadened to give recognition to the realities resulting from the reliance of other countries on other than income taxes. Consideration should be given to permitting other foreign taxes to be creditable against the U.S. income tax, where the foreign tax is a bona fide tax.

G. WORTHLESS SECURITIES IN FOREIGN CORPORATIONS

If a foreign subsidiary becomes worthless or is destroyed through expropriation, insurrection or other disaster, section 165(g) recognizes this loss and allows a deduction, either capital or ordinary.

The section as it is now applied, however, involves only complete abandonment or destruction and does not extend to depreciation, deterioration, or other extreme changes in value short of worthlessness. The section should be revised to give some relief in cases other than complete worthlessness. (The Code presently gives recognotion to partially worthless debts.)

At the present time, a number of factors are causing concern on the part of potential investors in developing countries. It is in those countries where economic development and private enterprise are most needed. Adoption of the above revision in section 165(g) and a ten-year carry-over period for the utilization of excess foreign tax credits, so that any excess credits arising because of losses under section 165(g) due to worthlessness of investments in foreign subsidiaries, would aid in our declared government policy of encouraging investment in those countries.

H. CONCLUSION

The foregoing recommendations are intended to call attention to the fact that the United States is confronted with certain policy imperatives which need much more attention in our Revenue Code than they have received heretofore. Specifically, we stand in need of increasing the volume of income from foreign oper-

ations, the amount of exported products from our shores, and investments in less developed countries. These recommendations are designed to serve these major policy objectives of the U.S. government.

SUMMARY OF RECOMMENDATIONS

1. Reasonable means should be established whereby U.S. companies could repatriate funds from abroad to improve our balance of payments account without incurring tax liability.

2. As an incentive for improvement in our balance of payments, section 956 should be repealed, or at least amended so that bona fide loans to or a bona fide investment in a U.S. direct investor by its foreign affiliate would not be considered constructive dividends and subject to U.S. taxes. Arms length loans of funds between foreign affiliates should be encouraged by making clear that such transfers are not constructive dividends to the U.S. parent.

3. Some concepts similar to the Western Hemisphere Trade Corporation's special tax deduction should be applied to dividends paid by a controlled foreign corporation doing business in less developed countries.

4. To encourage the export of U.S. manufactured products, the Code should be revised so that a taxpayer would pay a lower tax on income derived from the sale of exported goods. This may be done either by the creation of an export corporation restricted solely to export business which would qualify for the lower tax and/or by extending the lower rates to the export business of domestic corporations.

5. Sections 861, 862 and 863 of the Code should be amended to make clear that allocation of expenses to foreign source income is to be made only when the expenses are incurred in the production of such income.

6. Section 902 should be amended so that the 10-percent ownership requirement in first-tier foreign corporations should be reduced to 5 percent, and the tax credit should be extended to cases where there is an indirect ownership of 5 percent or more in the second-tier as well as third-tier and subsequent-tier foreign affiliates.

7. Section 904 of the Code should be amended to permit unused excess foreign tax credits to be carried forward for a ten year period instead of only a five year period.

8. The provisions of section 903, which now permit a credit for foreign taxes paid "in lieu of a tax paid on income," should be amended so that other foreign taxes may be creditable against U.S. income taxes where they are bona fide taxes.

9. The Code should permit a deduction for partially worthless securities rather than only for those securities which are completely worthless.

Senator TALMADGE. The next witness is Mr. John J. Carroll, chairman of the National Foreign Trade Council Tax Committee, who is accompanied by Robert T. Scott, vice president of the National Foreign Trade Council, Inc.

We are pleased to welcome you, gentlemen, and look forward to hearing your testimony.

STATEMENT OF JOHN J. CARROLL, CHAIRMAN, NATIONAL FOREIGN TRADE COUNCIL TAX COMMITTEE; ACCOMPANIED BY ROBERT T. SCOTT, VICE PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL, INC.

Mr. CARROLL. Mr. Chairman, my name is John Carroll and I am appearing today as chairman of the Committee on Taxation of the National Foreign Trade Council. I am also vice president of EBASCO International Corp., A. Boise Cascade Company.

I am accompanied by the vice president of the council, Mr. Robert T. Scott.

The council was organized in 1914 to promote and protect American trade and investment. The council has a nationwide membership of over 1,000 corporate members comprised of manufacturers, merchants, exporters and importers; rail, sea and air interests; bankers, insurance underwriters and others interested in the promotion and expansion of the Nation's foreign commerce.

The National Foreign Trade Council has already submitted a detailed statement to this committe expressing the views of the council on the taxation of foreign income as proposed in H.R. 13270 and the Treasury recommendations thereto.

We have also suggested certain reforms in other sections dealing with the taxation of foreign source income.

The National Foreign Trade Council is in accord with any effort made to do away with improper tax avoidance and tax evasion wherever it exists. However, the National Foreign Trade Council believes that the tax reforms relating to foreign source income embodied in H.R. 13270 should not be enacted. The case has not been made that alleged loopholes in the present foreign tax credit provisions of the code exist. Section 321, 432, 452, and 501 of H.R. 13270 and related Treasury proposals we consider to be inequitable and discriminatory and should be rejected.

These sections of H.R. 13270 attempt to indirectly limit the full effect of deductions heretofore granted by the Congress as they pertain to the foreign business operations of a U.S. national, and thus discriminate against foreign source income. All deductions allowable to U.S. nationals deriving U.S. income should also be permitted to be taken by U.S. nationals deriving income from foreign sources.

The foreign tax credit provisions should not be used to increase the cost to a business enterprise of sustaining a loss in business operations. The proposals to add additional complex sections to the foreign tax credit provisions of the code, which are already complicated enough, will only add to the growing uncertainty of the tax burden that must be undertaken by U.S. nationals willing to venture abroad.

Without going into every section of H.R. 13270 as it relates to foreign source income, I would like to refer to some particular sections. Section 431 provides for a recapture of U.S. tax where a U.S. national sustain a loss from operations in a year in which the per country limitation has been elected. The loss is to be allowed as a deduction from other taxable income in the year but the tax effect of such a deduction must be paid back in future years when operations in the same loss country become profitable. The Treasury has indicated they would like to see this extended to taxpayers sustaining an overall foreign operations' loss. This is unprecedented.

In addition, if the taxpayer is unfortunate enough to dispose of this loss operation, the deductible loss of prior years must be included in taxable income whether or not there was any reduction in U.S. tax payable in the loss year. It would appear that, if enacted, a taxpayer would have to pay a tax because he incurred a loss in his business operations.

A loss is a loss wherever it is incurred. So long as the United States continues to assert the right to tax worldwide income of its nationals, fairness dictates that such income continue to be subject to deductions

wherever incurred. Denial of the tax effect of otherwise proper deductions will result in outright discrimination against U.S. nationals operating abroad as compared to those operating solely within the United States.

The restriction imposed by section 431 is inconsistent with and departs from basic U.S. principles of taxation since it could result in the taxation of foreign source income at a higher U.S. rate than that applicable to domestic income. Under the so-called recapture provisions of section 431, the prior tax loss will reduce the foreign tax credit otherwise allowable. Any such reduction in foreign tax credit, where the foreign tax rate is in excess of 50 percent of the U.S. rate, would result in the imposition of an additional U.S. tax on foreign source income. The degree of this penalty for a loss increase with the amount of the foreign tax rate, producing a further discrimination.

Thus, foreign source income would be taxed at a greater overall rate than comparable income of other taxpayers who never sustained a prior year's loss in foreign operations.

Section 431 far exceeds the basic function of section 904 of the code which is to insure that foreign source income will be taxed at no more than the higher of the U.S. or foreign tax rate.

Since section 431 applies upon the disposition of property related to the operation producing the foreign loss, this section would have the effect of permanently locking taxpayers into a foreign loss situation resulting in an uneconomical allocation of resources. This adverse treatment would not, of course, apply to the sale of a domestic business.

The Treasury proposal to apply this so-called recapture provision where there has been an overall loss while using the overall limitation should be rejected. Instead of removing the alleged double tax benefits, the Treasury proposal would provide a double tax penalty for taxpayers experiencing an overall loss while using the overall limitation: one, in the loss year foreign taxes applicable to other foreign source income which have been laid or accrued will not be creditable; and two, as operations turn profitable foreign taxes otherwise creditable will be reduced by the loss recapture provisions in violation of the traditional U.S. policy of taxing foreign source income.

Section 432, another section, provides that the foreign tax credit limitation is to be separately applied with respect to foreign mineral income arising from sources within the foreign country from which the income is derived.

This section and the Treasury's alternative thereto should not be enacted. The council would also oppose disallowance of foreign tax credits, as suggested by the Treasury merely because the foreign tax was imposed at a rate greater than the U.S. rate. If a foreign income tax has been paid, it should be creditable, within the present limitations, regardless of the foreign tax rate imposed.

Section 432 and the Treasury's alternative thereto should not be enacted. The council would also oppose disallowance of foreign tax credits, as suggested by the Treasury, merely because the foreign tax was imposed at a rate greater than the U.S. rate. If a foreign income tax has been paid, it should be creditable, within the present limitations, regardless of the foreign tax rate imposed.

Section 432 and the Treasury's alternative thereto would require that the foreign tax credit of a U.S. national deriving foreign mineral

income be computed on a per country and per item basis even in cases where the overall limitation was otherwise elected. This would result in fragmenting foreign income for purposes of computing the limitation and would result in the U.S. taxing foreign source income at varying rates.

By imposing this new per item limitation, the enactment of section 432 would go a long way toward nullifying the present equitable alternative per country and overall foreign tax credit limitations in the code.

Through this indirect discrimination against a particular type of business activity section 432 would seriously depart from U.S. principles of tax neutrality. Moreover, such discrimination would create an undesirable precedent which could be used against other types of business activity in the future.

Today the mineral interests are to be curtailed. Tomorrow who can say what foreign business operation will be considered undesirable.

The Treasury proposals would further erode the principle that foreign tax credits are computed on the taxpayer's entire taxable income from either a particular country or worldwide, as long as such foreign tax is not credited against U.S. tax attributable to U.S. source income.

If present statutory deductions are the problem, in this area, they should be examined separately rather than being indirectly attacked through the foreign tax credit provisions. The fact that the foreign income tax law does not precisely mirror the Internal Revenue Code should not be significant as long as such foreign tax is an income tax, or a tax in lieu thereof.

Under a full foreign tax credit system of preventing double taxation, the fact that a U.S. national may have been faced with a tax in excess of 60 percent (or other arbitrary percentage) does not justify the denial of such excess as a foreign tax credit against the U.S. tax on foreign source income.

Such a denial is also contrary to the principle of the overall limitation, which is to permit the averaging of high and low foreign tax rates where a U.S. taxpayer has an overall business operating in many foreign countries.

Section 452* would amend section 312 of the code, to add back to "earnings and profits" of corporations the excess of accelerated depreciation over straight-line depreciation. The stated purpose of the amendment was to obviate the payment of tax-free dividends by public utility and real estate corporations from funds derived by claiming accelerated depreciation.

Section 452 as it is presently written, extends far beyond the receipt of such "tax-free" dividends from public utility and/or real estate corporations. It would have particularly harsh effects with respect to the foreign area in general and foreign tax credits in particular. It does not appear that these implications have been fully comprehended or intended by the Ways and Means Committee, at least from the House report on it.

The council recommends that section 452 of the bill should not be enacted. If enacted, its application should be limited to the distribu-

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*See p. 5322 for subsequent statement of the National Foreign Trade Council addressed to this section.

tion of "tax-free" dividends. It should not apply under any circumstances to the determination of earnings and profits for purposes of computing foreign tax credits, minimum distributions or when such determination is otherwise required under section 964 of the code.

Section 452 would arbitrarily increase the earnings of foreign subsidiaries for purposes of calculating the deemed tax credit under section 902 of the code, which would further dilute the foreign tax credits allowable against income received from such subsidiaries and, in effect, denies to these foreign operations the benefits of reduced tax cost provided by the foreign country.

Enactment of section 452 of the bill could alter the computation of the required minimum distributions under section 963 of the code. It could increase the earnings and profits of a controlled foreign corporation, and decrease the effective foreign tax rate and thus increase the required minimum distribution and would be inconsistent with the relief provisions which were deliberately put into the Revenue Act of 1962 by this committee.

The determination of allowable tax credits, the inclusion in gross income of a U.S. shareholder of earnings of a controlled foreign corporation, the allocations of distributions from controlled foreign corporations and the determination of taxable gain on the sale of stock as provided for in sections 956, 959, 960 and 1248 of the code could all be adversely affected by the enactment of section 452 of H.R. 13270.

This section should not be enacted since it represents a further attempt to diminsh foreign tax credits properly allowable against the U.S. tax or foreign source income.

Mr. Chairman, I was going to comment on section 501 which had to do with the depletion allowance but I am sure you have heard much about that already.

Section 501 which would limit percentage depletion applicable to oil and gas wells located in the United States should be rejected.

As stated, the United States asserts jurisdiction to tax the worldwide income of its nationals. Denial of a deduction attributable to foreign source taxable income is inconsistent therewith. U.S. firms producing abroad are subject to the same income tax laws as domestic producers and are entitled to the same depletion deduction allowed domestic production. This policy of tax neutrality should be continued.

Although elimination of depletion on foreign production of oil and gas might initially result in some additional residual U.S. tax, such tax would soon be "sponged up" by foreign governments increasing their tax rates. As a consequence, foreign tax payments and the foreign tax credit could be expected to increase, and no additional taxes would be paid to the United States.

The net effect would be a reduction of profits available for paying taxable dividends to U.S. stockholders in an amount equal to the additional foreign taxes collected, and eventually a reduction in U.S. tax revenue.

Mr. CARROLL. Thank you.

Senator TALMADGE. I appreciate your very fine statement, Mr. Carroll. The committee will give it due consideration when it starts to mark up the bill.

Mr. CARROLL. Thank you very much.

(Mr. Carroll's prepared statement and subsequent statements addressed to sections 367 and 452 of H.R. 13270 follow:)

STATEMENT OF JOHN J. CARROLL, CHAIRMAN, TAX COMMITTEE, NATIONAL FOREIGN TRADE COUNCIL, INC.

SUMMARY

The National Foreign Trade Council believes that the "tax reforms" relating to foreign source income embodied in H.R. 13270 should not be enacted into law. Alleged loopholes in the present foreign tax credit provisions do not exist. In addition, sections 431 and 432 of H.R. 13270 and related Treasury proposals are inequitable and discriminatory and should be rejected. Likewise sections 452 and 501 should be rejected for the same reasons.

The National Foreign Trade Council believes that enactment of these sections of H.R. 13270 would create undesirable precedents for the future. It has been a longstanding principle of the U.S. that its nationals are taxed on worldwide income, i.e., that all income be included and all deductions be allowed in determining the net income subject to tax. Rather than exempting foreign source income, the U.S. has provided a credit for foreign income taxes imposed on such income. This has worked in the past to prevent confiscatory double taxation and to protect the U.S. tax properly payable on U.S. source income. All deductions allowable to U.S. nationals deriving U.S. source income should also be permitted to be taken by U.S. nationals deriving income from foreign sources. The foreign tax credit provisions should not be further restricted by adding complex sections which will only add to the growing uncertainty of the tax burden that must be undertaken by our nationals willing to venture abroad.

Section 431 attempts to exact a U.S. tax payment on a loss from operations abroad. Section 431 would depart from the principles of tax neutrality and would complicate the conduct of foreign operations. This recapture provision would penalize nationals conducting operations in underdeveloped nations or risk areas where the possibility of a loss from nationalization or expropriation is greatest. A loss is a loss whether it is incurred in the United States or in a foreign country and a national taxable on worldwide income, should not be deprived of the tax effect of such an allowable deduction.

Section 432 would segregate and fragmentize income from foreign operations and apply U.S. tax on a per item basis rather than treat such income, either worldwide or from a particular country, as a unit. In addition to discriminating against one industry, the petroleum industry, enactment of section 432 could create an undesirable precedent for the taxation of other types of business income. Section 432 and the Treasury recommendations thereto complicate already complex tax laws without justification for such a departure in the taxation of foreign source income.

Section 452 should not be enacted. It could discriminate against particular industries. Among other things, enactment of section 452 could decrease foreign tax credits otherwise allowable and detract from the relief provided by this Committee in enacting the minimum distribution provisions of subpart F of the Code.

Section 501 discriminates more heavily against the foreign operations of one particular industry than it does against the domestic operations of the same industry. The Council agrees with the Treasury recommendation that section 501(a) should not eliminate percentage depletion with respect to foreign oil and gas production but does not believe that the Treasury's alternative to limit foreign tax credits allowable on a specific type of foreign business income is sound or equitable.

Section 231 should be liberalized to eliminate the $2500 limitation with respect to moving expenses incurred in connection with overseas assignments.

Section 444 should be enacted, but the favorable treatment afforded foreign deposits in U.S. banks should be made permanent and not merely extended through 1975 to avoid the continual threat of withdrawal of foreign funds from U.S. banks.

Section 902 of the Code dealing with direct foreign tax credits should be extended to apply to dividends received from any foreign corporation regardless of the number of tiers of ownership.

Section 367 of the Code relating to advance rule requirements with respect to certain transactions involving foreign corporations, should be repealed.

Statement

INTRODUCTION

The existing foreign tax credit provisions contains no loopholes and accordingly require no tax reform. Therefore, the foreign tax credit provision, which serve as one of the cornerstones of U.S. trade and investment, should not be amended as contemplated in H.R. 13270 or in the Treasury amendments thereto.

Former Assistant Secretary of the Treasury Stanley S. Surrey stated in his testimony at Hearings before the Senate Foreign Relations Committee with respect to the proposed U.S.-Brazil income tax treaty:

"American investment would not proceed at all without the foreign tax credit because then, as the Chairman pointed out, two taxes would be imposed and the overall burden of two taxes would be so great that international investment would practically cease." (Senate Ex. J., 90th Cong., 1st Sess., 19, 20.)

Thus, as is widely recognized, the foreign tax credit has, over the years since its adoption in 1918, proven workable and provided the intended relief from double taxation, despite its inherent complexities.

Further complexities have been added since 1962 to the conduct of international business by the enactment of Subpart F of the Internal Revenue Code, sections 951 through 964, and the Interest Equalization Tax, sections 4911 through 4921, and more recently with the promulgation of the regulations under section 482 of the Code and the Foreign Direct Investment Regulations by the Commerce Department in 1968. These laws and the implementing administrative rules have drastically curtailed the freedom of choice of the American investor, and created an environment in which his ability to compete with investors of other developed countries can no longer be taken for granted.

The changes in the foreign tax credit now proposed in H.R. 13270, the Tax Reform Act of 1969, as well as the related Treasury proposals, continue these shortsighted policies of adversely restricting and penalizing the conduct of international business. Contrary to the practice of other industrialized nations which overtly encourage foreign operations on the part of their nationals, the U.S., as evidenced by certain of the provisions of H.R. 13270, is continuing to hamper the conduct of international business on the part of its nationals.

While directed at the U.S. petroleum industry, the proposed changes would overturn longstanding U.S. principles of taxation, the effects of which would extend far beyond the U.S. international petroleum companies. In addition, if enacted, the proposed changes would then serve as boot strap precedent for future attempts to fragmentize and segregate foreign source income and to tax such income on a per item rather than a net income basis. Moreover, by increasing the tax cost of doing business abroad, the contemplated changes would surely have an adverse impact on our balance of payments in the private international trade and investment accounts—the one sector that has traditionally provided a balance of payments plus for the U.S.

I. U.S. PRINCIPLES OF AVOIDING INTERNATIONAL DOUBLE TAXATION AND TAXATION OF FOREIGN INCOME

Certain of the provisions of H.R. 13270 as well as the Treasury's alternatives thereto proposed by Assistant Secretary, Edwin S. Cohen, at the commencement of these Hearings along with the Council's recommendations relating thereto as well as to other recommendations with respect to the taxation of foreign income should be examined in the light of traditional principles employed by the U.S. in avoiding international double taxation and in taxing foreign income.

International double taxation

International double taxation occurs when a national of one country receives income from abroad which is subject to tax both in the country of nationality and in another country.

This problem is becoming increasingly serious, particularly for those countries, such as the United States, which traditionally have had a vital interest in world trade and investment, as foreign income tax rates range up to and beyond the U.S. rate. Assuming a 50 percent U.S. corporate income tax rate, a U.S. corporation doing business directly in another foreign country such as France, with a tax rate of 50 percent would be subject to confiscatory double taxation. Under these conditions foreign trade and investment could not long endure.

Recognizing this, the industrialized countries of the world, committed to a policy of international trade and investment, have adopted one of two methods for elimination of international double taxation.

One method, based upon the principle of territoriality, is for a country to exempt foreign source income realized by its nationals. The National Foreign Trade Council has long endorsed the exemption method and continues to believe that such method is the more desirable.

The other method is to tax the worldwide income of citizens, residents and domestic corporations but to grant a credit for the foreign income taxes paid or accrued with respect to foreign source income. Since the Revenue Act of 1918, the U.S. has traditionally attempted to eliminate international double taxation through the use of the foreign tax credit mechanism.

It should be strongly emphasized that both the exemption method and the credit method recognize and give effect to the prior claim of the country of source to tax income arising within its borders.

U.S. taxation of worldwide income

As a country of source, the U.S. asserts primary jurisdiction to tax the income of non resident aliens and foreign corporations derived from carrying on a U.S. trade or business and permits taking deductions provided for under the Code attributable thereto. As a country of nationality, the U.S. asserts jurisdiction to tax the worldwide income of its citizens and corporations. Heretofore, the U.S. had adhered to a policy of not taxing a U.S. national's income derived from overseas operations at a greater rate than that applicable to similar income from domestic operations.

Consistent with its assertion of jurisdiction to tax worldwide income of its nationals, the U.S. permits such nationals to apply all deductions otherwise allowable under the Code against such income. Thus, tax equality is preserved vis a vis those U.S. nationals choosing to do business solely in the U.S. and those doing business both at home and abroad. Both are treated alike.

U.S. elimination of double taxation

However, while asserting its jurisdiction to tax the worldwide income of its citizens and corporations, the U.S. very early in the history of its income tax law recognized the problem of international double taxation. Since the country of source has always the primary right to tax income arising therein, the U.S. under section 901 permits its citizens and corporations having fiscal responsibilities to two national jurisdictions to credit against the U.S. tax the tax paid to the other tax jurisdiction, subject to limitation as to amount under section 904. As long as the foreign tax is considered an income tax or a tax in lieu of an income tax, the U.S. has never required that the foreign taxing system be identical to the U.S. system as a condition of granting a foreign tax credit.

Section 904 of the Code provides for a limitation on the foreign tax credit which prevents any foreign tax paid to another country from being credited against the U.S. tax payable on U.S. source income.[1] The U.S. concept of eliminating international double taxation under section 904 results, in effect, in foreign source income being taxed at the greater of the U.S. or the effective foreign tax rate. Double taxation is eliminated because the U.S. taxpayer bears the burden of only one tax. The U.S. revenues are protected since the U.S. tax attributable to U.S. source income can never be reduced by any foreign taxes paid on foreign source income.

For example, where the tax rate of country X is 40 percent, a U.S. corporation whose only income is from country X will pay a foreign tax of $40 on taxable income of $100. Assuming a U.S. rate of 50 percent, double taxation is eliminated

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[1] The United States permits its nationals to elect the computation of the foreign tax credit on the basis of either the per country limitation or the overall limitation. The per country limitation imposed by section 904(a)(1) restricts the amount of credit allowable against the U.S. income tax for taxes paid to any single country to the amount of tax imposed by the United States on the income derived from that individual country. Section 904(a)(2) provides an alternate overall limitation on the foreign tax credit. The overall limitation restricts the amount of credit allowable by permitting taxpayers to treat the taxes of all foreign countries collectively (rather than separately for each country) in calculating the total amount of credit allowable against the U.S. income tax on total foreign source income.

Under either system, the U.S. taxpayer must allocate a portion of U.S. expense against foreign income—further reducing allowable foreign tax credits so that the credit for foreign tax is limited to the foreign tax attributable to the net foreign source income, determined under U.S. standards.

since the U.S. corporation's $100 of income is taxed at the higher U.S. rate. The corporation credits the $40 country X tax against its U.S. tax of $50, paying $10 to the U.S. Treasury, or a total of $50 tax on taxable income of $100.

If, in the above example, the country X tax rate was 60 percent, the U.S. corporation would credit $50 of country X tax against its U.S. tax of $50 satisfying its U.S. tax liability in full. Double taxation is thus prevented; the total tax of $60 on foreign source income is imposed at the greater of the U.S. or effective foreign tax rate, or at the rate of 60 percent on taxable income of $100.

From the foregoing, it is apparent that the U.S. tax liability with respect to the foreign source income of a U.S. national doing business abroad in countries imposing tax at rates equal to or greater than the U.S. rate may be satisfied by payment of the foreign tax. This is entirely proper under the credit system of preventing international double taxation where the country of nationality asserts jurisdiction to tax worldwide income of its nationals.

Given the scope and diversity of U.S. business and the firm U.S. policy of insuring that foreign taxes not reduce U.S. tax on U.S. source income, the present U.S. concept of relieving international double taxation through the operation of an elective per country or overall limitation is economically sound and consistent with the policy of tax neutrality.

Since the expansion of international trade and investment is an important national policy, and since such policy can only be attained under adequate protection from international double taxation, any further change in the foreign tax credit system should have the effect of eliminating rather than creating international double taxation. Otherwise foreign trade and investment could not continue, unless of course the U.S. were to adopt an exemption system.

H. H.R. 13270, Sections 431, 432, and 501

1. In general

While sections 431, 432 and 501 of H.R. 13270 are apparently aimed at the extractive industry, they are of much broader impact and could present an unwise precedent for future discrimination against other industries. Enactment of such provisions would produce distorted results which are contrary to the long established policy adopted by the United States of relieving all of its citizens and corporations from the effects of international double taxation. These provisions would result in the U.S. imposing a higher rate of tax on foreign source income than on domestic source income. Moreover, these provisions, if enacted, would further add to the complexities of the U.S. taxation of foreign income.

2. Section 431. Per country limitation restrictions

Section 431 of H.R. 13270 provides for a recapture of U.S. tax where a U.S. taxpayer sustains a loss from foreign operations in a year in which he has elected the per country limitation under section 904(a)(1). For purposes of applying the foreign tax credit limitation in a subsequent year when income is realized from the country in which the loss was sustained, the taxable income from the country in which the loss was sustained (or the taxpayer's foreign source taxable income if the overall limitation is being used in the subsequent year) is to be reduced by the amount of the loss previously sustained. Thus, taxpayer would be denied up to one half of the credit for foreign taxes actually paid which would otherwise be currently allowable.

The Treasury would propose to extend the operation of section 431 of the Bill to taxpayers on the overall limitation experiencing an overall foreign loss even though in the year of loss no foreign tax credits would be allowed.

Section 431 of the bill also provides for a recapture of the so-called tax saving from a loss sustained in a foreign country where property, which is used in the trade or business from which the loss arose, is disposed of by the taxpayer prior to the time the loss has been recaptured under the rules discussed above. The amount of the loss not previously recaptured is to be included in income for the year in which the disposition of the property occurred, provided the property disposed of is a material factor in the realization of income or loss in the business in which it was used or where the property constitutes a substantial portion of the assets used or held for use in the carrying on of the business. A loss could become taxable income.

Recommendation

For the reasons set forth below, the Council recommends that section 431 not be enacted.

No double tax benefits

As set forth in House Report No. 91-413 (Pt. 1), 91st Cong., 1st Sess., 116, section 431 purports to eliminate two ostensible tax benefits which are said to arise when a taxpayer on the per country limitation experiences losses in a foreign country. The claimed double tax benefits are:

(1) such losses reduce U.S. tax on domestic income; (2) when the business operations in the loss country become profitable, a credit is allowed for foreign paid taxes to that country against what otherwise would be the U.S. tax on the income from that country. Under the U.S. system of taxation, such results can not be labeled "double tax benefits" and do not justify enactment of section 431.

Inconsistent with U.S. taxation of worldwide income.—As stated, the U.S. asserts jurisdiction to tax the worldwide income of its citizens and corporations and correspondingly permits such nationals to apply all deductions otherwise allowable under the Code against such income, recognizing that incurring such deductions is essential to the realization of such income.

If the U.S. continues to assert the right to tax worldwide income of its nationals, fairness dictates that such income continue to be subject to deductions wherever incurred. To do otherwise is not to curtail a so-called "tax benefit" but rather to adopt a "heads I win, tails you lose" philosophy of taxation, inconsistent with principles of tax neutrality heretofore adhered to by the United States.

In denying the effect of deductions attributable to foreign source income of U.S. nationals, section 431 results in outright discrimination against income earned abroad. And this will be so at a time when most other industrialized nations are taking positive steps to encourage and increase foreign trade and investment.

Inconsistent with foreign tax credit.—The rationale for the foreign tax credit as a method of preventing confiscatory double taxation is that the country of nationality, while taxing worldwide income, gives credit for foreign income taxes actually paid a foreign country on foreign source income. It is difficult to consider the granting of full foreign tax credit up to the amount of U.S. tax on foreign source income a so-called "tax benefit" which should be curtailed.

If one of the reasons for section 431 is that the foreign tax credit should not alleviate double taxation unless the foreign tax is imposed on the identical income as is taxed by the U.S., this is not sound. The foreign tax credit provisions have always recognized that foreign income tax laws cannot be expected to be exactly like the U.S. law, and that foreign income taxes will be computed under differing rate structures, and definitions of taxable income. What counts in a practical sense is the dollar amount of the tax burden in the respective countries. Income taxes paid to two countries on the same business operations constitute double taxation regardless of differences in the structure of the tax laws under which the taxes are paid.

Recognizing that foreign income tax laws do not and cannot precisely reflect the U.S. Internal Revenue Code, the rule of existing section 904 limits the foreign tax credit solely to U.S. tax on foreign source income and thereby affords full protection to the revenues. This rule remains adequate today.

The simple fact is that when foreign operations turn profitable, both a U.S. and foreign income tax will be paid on the same income—and under the foreign tax credit system of alleviating international double taxation, such foreign tax should be credited against U.S. tax, subject to the protective limitation of existing section 904. There is no justification to reduce the foreign tax credit allowable against the U.S. tax on foreign source income because a business operation in a particular country suffered a loss in a prior year. A loss should not create a further tax penalty.

Section 431 would penalize foreign income

The restriction on the per country limitation imposed by section 431 of H.R. 13270 is inconsistent with, and departs from, basic U.S. principles of taxation since it could result in the taxation of foreign source income at a higher rate than that applicable to domestic income. See Table No. 1, *infra* p. —. The recapture provisions would reduce the numerator, but not the denominator, of the

section 904 fraction (taxable income from country where prior loss arose over entire taxable income) which is multiplied by the U.S. tax in order to determine the amount of the limitation on the foreign tax credit. The reduction is the amount of the prior year's foreign loss which was allowable under the Code. It is apparently intended that the use of the prior year's loss will reduce the foreign tax credit otherwise allowable against the U.S. tax on foreign source income of the current year.

Any such decrease in foreign tax credits, where the foreign income tax rate is in excess of 50 percent of the U.S. rate, would result in the imposition of an additional U.S. tax on foreign source income to the extent of such decrease. Thus, foreign source income subject to section 431 of the Bill would be taxed at a greater overall rate than comparable income of other taxpayers who never sustained a prior year's loss in foreign operations.

To illustrate, assume that in 1968 Corporation X, a United States corporation, generated U.S. source income of $100 and income from Country Y of $100 and suffered a start-up loss in Country Z of the same amount. Assume further that Country Y and the U.S. imposed income tax at the rate of 50 percent and Country Z at 30 percent, and that Country Z does not allow a loss carryover. Under the overall method of computing foreign tax credits, Corporation X would be considered to have no foreign source taxable income and therefore would be entitled to no foreign tax credits. The $100 of net income would, of course, still be subject to United States income tax of $50. The total tax bill under these circumstances would be 100 percent of the net income ($50 to the U.S. and $50 to Country X). It is this result that the per country limitation prevents.

Applying the per country limitation under existing law, Corporation X would be entitled to a foreign tax credit of $50 with respect to its $100 of income from Country Y. This credit for $50 of the $50 paid to Country Y offsets the U.S. tax on Country Y's income. The total tax bill under these circumstances would be 50 percent of the net income.

Assume that in the next year taxpayer realized $100 from Country Z and all other facts remain the same. Under existing law, the effective tax rate on Corporation X's income would be 50 percent. If it is further assumed that section 431 applied, the effective tax rate on Corporation X's income for such following year would be increased to 51.6 percent. If on the other hand Country Z's tax rate was 50 percent, Corporation X's effective tax rate for the year following the loss year would, under the application of section 431, be increased to 58.3 percent. Thus, section 431 severely penalizes foreign source income whenever the foreign income tax rate is in excess of 50 percent of the U.S. rate. The degree of penalty depends upon the amount of the foreign tax rate.

Section 431 far exceeds the basic function of section 904 which is to insure that foreign source income will be taxed at no more than the greater of the U.S. or effective foreign tax rate. Moreover, foreign source income will continue to be subject to the penalties of section 431 even though the operation giving rise to the loss has long since been abandoned or is unrelated to the profit operation. Thus, such losses will reduce foreign tax credits arising from unrelated profitable operations within the same country.

Underlying premise incorrect

The complexity of section 431 is illustrated by the fact that the so-called tax benefit recapture provision applies where a foreign loss was sustained in a year when the per country limitation was in effect even though the taxpayer had no income from U.S. sources against which the loss could be deducted. See Table No. 2, *infra* p. 5306. This is contrary to a statement made in House Report No. 91–413 (Pt. 1) 91st Cong., 1st Sess., 116.

The "recapture" provisions also apply in other situations where the foreign loss can result in no possible U.S. tax benefit. The provisions of section 431 apply where, in the typical case, the foreign country permits a loss incurred in one year to be carried over against income earned in a subsequent year. This carryover, of course, reduces both the amount of foreign tax paid in the later year to the source country as well as the U.S. foreign tax credit, thereby increasing the amount of tax actually received by the U.S. Treasury. Nonetheless, except in the rare case where the income in a country in a year subsequent to the year of loss is twice as much as the amount of the foreign loss in the earlier year, section 431 will operate to reduce foreign tax credits in subsequent years even where the effect of the foreign loss carryover provisions was to increase residual U.S. taxes. See Table No. 1, *Infra* p. 5305.

Recapture on disposition of property

Section 431 applies upon disposition of property which was materially related to the operation producing the foreign loss. Section 431 would appear to apply even where an unsuccessful foreign venture is abandoned without producing any income. In addition to adding further complexities to the foreign area, this provision is extremely unjust and may have the effect of permanently locking taxpayers into a loss situation, or creating income where in reality income exists, resulting in an uneconomical allocation of resources. This provision represents a significant departure from existing principles of tax neutrality, since a comparable operation in the U.S. could be sold off without tax penalty.

Treasury proposals

The Treasury proposal to apply the so-called "recapture" provision where there has been an overall loss while using the overall limitation is subject to the criticism set forth above with respect to the loss recapture on the per country limitation. Under the present overall limitation, a loss in one country offsets income from other foreign countries, thereby reducing the numerator of the section 904 fraction (taxable income from foreign sources over total taxable income) which is multiplied by the U.S. tax, so that foreign tax credits otherwise available are lost. Thus, the Treasury proposal provides a double tax penalty for taxpayers experiencing an overall loss while using the overall limitation. Firstly, foreign taxes applicable to foreign source income which have actually been paid or accrued will not be credited. This is the result under the present law. Secondly, as operations turn profitable foreign taxes otherwise creditable will be reduced by the loss recapture provisions in violation of the traditional U.S. principles inherent in the taxation of foreign source income.

Illustration showing that foreign loss produces no U.S. tax benefits

Table No. 1, set forth below, shows that there is no unwarranted benefit under present law from the deduction of foreign losses by a taxpayer using the per country limitation, and that the proposed provision for recapture of any U.S. tax saving from such deductions of foreign losses would be in fact produce international double taxation contrary to the fundamental purpose of the foreign tax credit provisions.

Table No. 1 compares the effect of a loss sustained in a new business and deducted from income of a business in the U.S., followed by income from the new business in later years, under the present law and under the proposed change, according to whether the new business is domestic or foreign and whether the foreign tax law allows or does not allow a net loss carryover. For convenience, it is assumed that both the U.S. and foreign rates are 50%.

Table No. 1 shows that the per country limitation under present law, permitting foreign losses to be in effect deducted from U.S. source income, results in an over-all tax burden of 50% of the cumulative net income over the period during which a foreign loss is sustained and offset by subsequent foreign income, whether the new business is in the U.S. or in a foreign country. When both businesses are domestic, this results from the application of the 50% U.S. rate to actual net profits. When the new business is foreign, this results under present law from a 50% U.S. tax on the net income over the period, reduced by credit for the 50% foreign tax during the same period. Under the proposed change, the over-all tax burden would be in excess of 50%, the excess being equal to the recapture of the U.S. tax benefit from the loss.

While variations in the U.S. and foreign rates would produce more complicated tables, they would still show the same violation, under the proposed change, of the principle that the net U.S. tax, under the foreign tax credit system of avoiding international double taxation, should represent no more than the excess of the U.S. rate over the foreign rate. The same effect would be shown if there were operations in other foreign countries.

Under column V, the foreign country, as is usually the case, grants a net loss carryover. The foreign tax saving resulting from the net loss carryover automatically produces a "recapture" by the U.S. of the prior U.S. tax benefit of the loss; nevertheless the proposed change in law would exact a second "recapture". When the foreign country does not grant a net loss carryover (column IV) the U.S. recapture results in U.S. tax on income which has been taxed by the foreign country where it was earned.

TABLE 1.—COMPARISON OF EFFECT OF PRESENT LAW WITH PROPOSAL FOR "RECAPTURE" UNDER SEC. 431

[Assumed U.S. rate, 50 percent; assumed foreign rate, 50 percent]

	Case I: Both businesses in United States (unaffected by proposed change)		Present U.S. law: Case II: Business A in United States; business B, foreign; no foreign loss carryover		Present U.S. law: Case III: Business A in United States; business B, foreign; loss carryover allowed under foreign law		Proposed U.S. law: Case IV: Business A in United States; business B, foreign; loss carryover not allowed under foreign law		Proposed U.S. law: Case V: Business A in United States; business B, foreign; loss carryover allowed under foreign law	
	United States	Foreign	United States	Foreign	United States	Foreign	United States	Foreign	United States	Foreign
1970										
Business A income	$100		$100		$100		$100		$100	
Business B income	(100)		(100)		(100)		(100)		(100)	
U.S. taxable income	0		0		0		0		0	
U.S. tax before credit	0		0		0		0		0	
Creditable foreign tax		0		0		0		0		0
U.S. tax after credit		0		0		0		0		0
1971										
Business A income	100		100		100		100		100	
Business B income	100		100		100		100		100	
U.S. taxable income	200		200		200		200		200	
U.S. tax before credit	100		100		100		100		100	
Foreign tax		0		$50		0		$50		0
Proposed reduction of credit limitation per sec. 431							(25)		(25)	
U.S. tax after credit		$100		50		$100		75		$100
1972										
Business A income	100		100		100		100		100	
Business B income	100		100		100		100		100	
U.S. taxable income	200		200		200		200		200	
U.S. tax before credit	100		100		100		100		100	
Foreign tax		0		50		50		50		50
Proposed reduction of credit limitation per sec. 431							(25)		(25)	
U.S. tax after credit		100		50		50		75		75
Total U.S. and foreign taxes on $400 net income over 3-yr. period		200		200		200		250		225
Total effective tax rate (total tax/3 year net income) (percent)		50		50		50		62.5		56.25

Table No. 2, below, graphically illustrates that the so-called tax benefit recapture operates to disallow foreign tax credits and correspondingly increases the U.S. tax on foreign operations where taxpayer *never had* U.S. source income which could be offset against the foreign loss. As previously stated, such disallowance results in the U.S. imposition of an additional tax on foreign source income. It is again assumed that the foreign tax rates are 50 percent. As set forth in Table No. 2, a U.S. taxpayer operating in countries A and B, and experiencing a loss in country B in 1970 will, depending on whether a foreign loss carryover is or is not allowed, be subject to a total effective tax rate of 75 percent and 68.75 percent, respectively, over the 3-year period up to and including 1972. Under existing law such taxpayer would be subject to a total effective tax rate of 50 percent regardless of whether a foreign loss carryover is allowed.

TABLE NO. 2.—EFFECT OF PROPOSED SEC. 431 UNDER PER-COUNTRY LIMITATION WHERE NO U.S. SOURCE INCOME

	Both businesses in foreign countries, No U.S. business, no loss carryover allowed under foreign law				Both businesses in foreign countries, no U.S. business, loss carryover allowed under foreign law			
	Amount	Foreign tax	U.S. tax	Total tax	Amount	Foreign tax	U.S. tax	Total tax
1970:								
Business in country A	$100	$50			$100	$50		
Business in country B	(100)	0			(100)	0		
Total foreign tax		50				50		
U.S. taxable income	0				0			
U.S. tax before credit			0				0	
Creditable Foreign tax			$50				$50	
U.S. tax after credit			0				0	
Total U.S. and foreign tax				$50				$50
1971:								
Business in country A	100	50			100	50		
Business in country B	100	50			100	0		
Total foreign tax		100				50		
U.S. taxable income	200				200			
U.S. tax before credit			100				100	
Proposed reduction of credit limitation per sec. 431	(25)				(25)			
U.S. tax after credit			25				50	
Total U.S. and foreign tax				125				100
1972:								
Business in country A	100	50			100	50		
Business in country B	100	50			100	50		
Total foreign tax		100				100		
U.S. taxable income	200				200			
U.S. tax before credit			100				100	
Proposed reduction of credit limitation per sec. 431	(25)				(25)			
U.S. tax after credit			25				25	
Total U.S. and foreign tax				125				125
Total U.S. and foreign taxes on $400 net income over 3-year period				300				275
Total effective tax rate (total tax paid/total taxable income) (percent)				75				68.75

Even in cases where the foreign loss did not prevent the United States from receiving its full tax on U.S.-source income because of lower effective foreign tax rates in other countries, section 431 would operate to reduce foreign tax credits in later years. This is shown in Table No. 3 in which it is assumed that all countries have a 50% rate of tax, except that country A's rate is reduced to 20% in order to act as an incentive to attract needed foreign investment and Country B does not allow a loss carryover.

TABLE NO. 3.—EFFECT OF SECTION 431 ON LESS DEVELOPED COUNTRY TAX INCENTIVES

	Income or (loss)	U.S. tax	Foreign tax	Actual tax rate (percent)
1970—				
U.S. business	$500	$250		50
Business in country A	500	250	$100	20
Business in country B	(100)	(50)	0	50
Total	900	450		
Foreign tax credit		−100		
Net U.S. tax		350		
1971—				
U.S. business	500	250		
Business in country A	500	250	100	
Business in country B	200	100	100	
	1,200	600		
Foreign tax credit:				
For country A tax		−110		
For country B tax		−50		
Net U.S. tax		450		
Total taxable income		2,100		
Total tax paid:				
United States		800		
Foreign		300		
Total		1,100		
Total effective tax rate (total tax paid/total taxable income), 57 percent.				

Thus, the taxpayer is penalized by a reduction in the limitation on the credit for 1971 country B taxes, and $50 of the credit otherwise allowable for those taxes is disallowed by reason of the $100 loss in that country in 1970, even though the U.S. in that year received its full tax of $250 on the U.S.-source income of $500.

It is common for many of the underdeveloped countries to attempt to attract much needed foreign investment through various tax incentive programs, which have the effect of lowering the tax rate on business operations conducted in that country by foreigners. Under present law, since the U.S. does not recognize the tax sparing principle, any benefits granted by the local tax law will not be realized by the U.S. national but will be sponged up by the U.S. Treasury. Thus, under proposed section 431, thes U.S. will exact an additional tax on foreign source income (because of lost foreign tax credits otherwise allowable) even though the loss in country B did not offset U.S. tax on U.S. source income because of incentive tax reductions offered the U.S. taxpayer in his country A operations.

3. Section 432. Separate mineral income limitation

Section 432 of H.R. 13270 provides that the foreign tax credit limitation is to be separately applied with respect to foreign mineral income arising from sources within the foreign country from which the income is derived. This separate limitation is to be applied whether the taxpayer otherwise uses the per country or the overall limitation on the foreign tax credit. The separate foreign tax credit limitation is to be imposed in the following situations:

(1) where the foreign country requires the payment of a royalty or bonus with respect to the property from which the foreign mineral income is derived;

(2) where the foreign country has substantial mineral rights with respect to property from which the foreign mineral income is derived; or

(3) where the foreign country imposes an income tax on foreign mineral income at a higher effective rate than the tax imposed by the country on other types of income.

Foreign mineral income means taxable income from mines, wells, and other natural deposits within a foreign country, but only to the extent that the income is considered "taxable income from the property" for purposes of the percentage depletion provisions of the code. Dividends received by a U.S. taxpayer from a foreign corporation with respect to which a deemed-paid foreign tax credit may

be claimed are to be treated as foreign mineral income to the extent the dividend is attributable to this type of income. A partner's distributive share of the partnership's foreign mineral income also is to be considered foreign mineral income in the hands of the partner for purposes of the limitation.

House Report No. 91–413 *supra*, indicates that the sole reason for the separate mineral income limitation on the foreign tax credit is to isolate those cases in which it is likely that the income taxes represent, at least in part, royalties because of the difficulty in distinguishing a royalty payment from a tax payment.

The Treasury has recommended that proposed section 432 in its present form should not be adopted.

The Treasury has recommended that excess foreign tax credits resulting from the allowance of percentage depletion by the U.S. should not be available against other foreign income. This recommendation of the Treasury is based on the assumption that percentage depletion will not be denied to the mineral industry operating abroad. The Treasury has also suggested that a method of handling foreign income taxes imposed at rates in excess of the U.S. rate would be to disallow foreign tax credits to the extent of any foreign income taxed at a rate in excess of 60 percent.

Recommendation

The Council concurs with the Treasury recommendation that section 432 should not be enacted. The Council does not concur in the Treasury's alternative to section 432.

Accordingly, for the reasons set forth below the Council recommends that section 432 and the Treasury's alternative thereto not be enacted. The Council would also oppose disallowance of the foreign tax credit merely because the foreign tax was imposed at a rate greater than the U.S. rate.

Violates principle of tax neutrality

In the past, the Council has opposed computing the foreign tax credit separately in respect of different types of business income. For 50 years the foreign tax credit provisions have always been applied uniformly to taxpayers regardless of the type of business from which income is derived. As a matter of tax policy, it is wrong to depart from this basic principle by imposing a separate limitation on particular items of income or on particular industries. To discriminate against a particular type of business activity is to create a dangerous precedent which can be used against other types of business activity in the future.

Such tax discrimination has been rejected by Congress. The President's 1963 Tax Message recommended that the foreign tax credit be limited to prevent excess foreign tax credits arising from oil, gas and mineral operations abroad from being used to offset U.S. taxes on other forms or sources of foreign income. The Congress rejected this proposal.

The Council opposed the 1963 proposals, and continues to oppose the creation of a separate limitation on foreign mineral income.

Fragments income

The present U.S. system of avoiding international double taxation is premised upon providing a credit against U.S. tax for foreign tax applicable to the foreign source income of a U.S. national. The effect of section 904 of existing law is to insure that the U.S. national is subject to tax on *all* foreign source income, computed on either the per country or overall basis, at the greater of the U.S. or foreign tax rates. The U.S. heretofore has not attempted to impose tax on various items of foreign business income at varying tax rates. The requirement of section 432 of H.R. 13270, along with the proposed Treasury alternative thereto, limiting the foreign tax credit of a U.S. national deriving foreign mineral income under the prescribed circumstances to a per country and per item basis, results in fragmenting foreign income for purposes of computing the limitation on the foreign tax credit. This will further complicate the U.S. taxation of foreign income.

The principle of existing law is that all foreign source income of a taxpayer, either within a country or worldwide, is taken as a unit in assuring that the total tax burden shall not be less than the higher of the U.S. or the foreign taxes. It is wrong in principle to segregate these operations and abandon tax neutrality.

Effect on section 904 election

Section 432 of H.R. 13270 is contrary to the principle affirmed by Congress in 1960 when it enacted the overall limitation as an alternative limitation on the foreign tax credit. Section 432 would go a long way toward nullifying the present equitable alternative per country and overall foreign tax credit limitations by imposing a new per item limitation.

Rationale obscure

The Council does not understand why segregating the foreign tax and royalty payments should present difficulties of a type with which the Internal Revenue Service cannot adequately cope. The Council agrees with the statement of Assistant Secretary Cohen appearing on pages 47 and 48 of his September 11th testimony before this Committee that:

"* * * we do not feel that it is proper to characterize all foreign taxes on mineral income in excess of U.S. taxes on such income as disguised royalties."

It should be stressed that, contrary to the implication set forth in House Report No. 91–413 *supra*, such royalty payments are by no means minimal and/or incidental. Rather, as set forth below in Table No. 4, petroleum royalty payments are substantial in relation to the tax rate of the foreign country wherein the minerals are produced.

TABLE NO. 4.—COMPARISON OF FOREIGN ROYALTY AND STATUTORY INCOME TAX RATES

[In percent]

	Petroleum royalty rate	Statutory income tax rate
United States	12½ to 16⅔	[1] 52.8
Venezuela	16⅔ to 25	52.0
Iran	12½	50.0
Kuwait	12½	50.0
Saudi Arabia	[2] 12½ to 19	50.0
Libya	12½	50.0
Nigeria	12½	50.0
Canada	12½ to 16⅔	[1] 51.5
United Kingdom	12½	45

[1] Includes surtax.
[2] A fixed amount per barrel resulting in such percentage range.

Increases complexity

Furthermore, the complexities of the foreign tax credit provisions would be compounded were it necessary for a company to divide its operations into separate functions and then to determine the amount of foreign income tax which might be considered paid in respect of the various functions in order to compute a separate limitation on the credit for such tax. This increasing complexity will greatly increase the problems of taxpayer compliance and government tax administration.

National policy

The separate mineral income limitation violates the long standing policy of the United States to further the economic development of less developed nations. This policy has been manifest in our foreign assistance program, as well as in the various provisions of the Internal Revenue Code which encourage investment in less developed areas. See, for example, sections 902(a)(1), 954(b), 1248(d)(3), and 4916.

Consistent with this policy, large investments by American industry have been made in less developed areas of Asia, Africa and South America. For instance, heavy direct investments in less developed countries by the natural resources industry have been a significant factor in raising the living standards of those nations where mineral wealth has been discovered. Accordingly, it would be inconsistent with such national policy to single out a particular industry for adverse tax treatment which would discourage worldwide investments which such policy is designed to promote.

Foreign competition

The separate mineral income limitation will make U.S. companies less competitive. As a result of their predominant position in worldwide business, U.S.

companies have been able to make significant contributions to the U.S. economy in general and to the U.S. balance of payments in particular. However, it must always be borne in mind that U.S. companies and citizens who venture abroad are in direct competition with large, strong, and aggressive foreign companies. Many of these foreign companies enjoy tax benefits under the laws of their countries which aid them in their foreign ventures. Moreover, some of these companies are direct agencies of foreign governments. To our knowledge, none of these foreign governments embrace, either directly or indirectly, a policy of penalizing foreign operations.

Section 904(f) no precedent

Finally, while there is a separate limitation applying to certain interest income under section 904(f), this separate limitation for interest income in the Revenue Act of 1962 was a special measure to discourage artificial and temporary shifting of short-term investments in interest-bearing securities from the United States to foreign countries principally for the purpose of utilizing excess foreign tax credit. This provision applies only to portfolio type investment interest and was expressly made inapplicable to investments directly related to an active business of the taxpayer. Investments in foreign mineral producing properties clearly are not temporary tax-avoidance arrangements but rather represent investments in an active business and in resources in which the United States has a vital national interest.

Treasury proposals

As set forth above, the foreign tax credit provisions have long recognized that foreign tax laws do not, and cannot be expected to, mirror the U.S. tax law. Nevertheless, the Treasury proposes that excess foreign tax credits which result from the allowance of percentage depletion by the United States should not be available against other foreign income. The Treasury also suggested that foreign taxes imposed at some arbitrary rate in excess of the U.S. rate might be disallowed as a credit against U.S. tax.

The Treasury proposals would dilute the effect of the foreign tax credit as a means of avoiding international double taxation. These proposals would further erode the principle that foreign tax credits are computed upon the taxpayer's entire taxable income from either a particular country or worldwide, depending upon whether the per country or overall limitation is elected, as long as such foreign tax is not credited against U.S. tax attributable to U.S. source income. The fact that the foreign income tax law does not precisely mirror the Internal Revenue Code should not be significant as long as such foreign tax is an income tax, or a tax in lieu thereof. The fact that taxpayer may have been faced with a tax in excess of 60 percent (or other arbitrary percentage) should not justify the denial of such excess as a foreign tax credit against the U.S. tax on foreign source income. Such a denial is contrary to the principle of the overall limitation, which is to permit the averaging of high and low foreign tax rates.

4. Section 501. Elimination of percentage depletion on foreign oil and gas production

Section 501 of H.R. 13270 would limit percentage depletion applicable to oil and gas wells to wells located in the U.S., its possessions, Puerto Rico, or on the outer continental shelf.

Recommendation

The Council recommends that this provision of section 501(a) not be enacted for the following reasons:

Violates tax neutrality

Section 501(a) would discriminate against foreign oil and gas production and would be contrary to the principle of tax neutrality that is the justification for United States taxing income world wide. Although a strong argument can be made for taxing only income that is earned in the United States, Congress has rejected this alternative on the theory that the income of a U.S. firm should be taxed on the same basis irrespective of where it arises. So long as that principle is followed by our country, Congress should not discriminate against income from foreign sources. Elimination of percentage depletion on foreign oil and gas production would do just that.

At present, U.S. firms producing abroad are subject to the same income tax laws as domestic producers and are entitled to the same depletion deduction allowed domestic production. This policy should be continued.

Would reduce U.S. tax revenue

Athough elimination of depletion on foreign production of oil and gas would result initially in residual U.S. tax, such increase would be a strong inducement for foreign governments to increase their effective tax rates. As a consequence, foreign tax payments and the foreign tax credit would be expected to increase, and no additional taxes would be paid to the U.S. The net effect would be a reduction of profits available for paying taxable dividends to U.S. stockholders in an amount equal to the additional foreign taxes collected, and eventually a reduction in U.S. tax revenue.

In some 24 counties the tax laws contain some type of percentage depletion deduction provisions. Most of these provisions are modeled after the U.S. law. Obviously, we could not expect those provisions to remain in force if the U.S. were to eliminate percentage depletion on foreign production. In at least one country there is provision for automatic nullification of the depletion deduction in the event a foreign producer loses its right to a depletion deduction in its home country. In any event, whether the increase in foreign taxes takes place under an automatic provision in the foreign tax law, or follows gradually by legislation, the result will be the same—any appreciable increase in revenues to the U.S. will eventually disappear and be replaced by a reduction in U.S. tax revenue as a result of the lower profits available for paying taxable dividends to U.S. stockholders.

Place U.S. companies at competitive disadvantage

United States petroleum companies compete with companies from other developed countries for the opportunity to develop and operate foreign fields. Many of these are strong and aggressive companies which are owned by their governments, or which, where privately owned, enjoy special tax considerations from their governments. The Soviet government engages directly in oil production and exports about one million barrels daily, adding to the competitive forces which U.S. companies must meet. Many of the Western European countries and Japan now provide tax incentives for national companies exploring overseas and this is now being considered by the European Common Market.

Companies from these developed countries are in direct competition with U.S. companies producing petroleum abroad. It is ironic that at the same time foreign governments are maintaining or increasing incentives for local companies to acquire foreign oil interests, the U.S. is considering action which would increase the tax burden of its companies engaged in foreign exploration and production,.

Risks greater abroad than in the United States

The search for oil and gas is as inherently uncertain abroad as in the U.S. Congress in adopting the depletion provision gave recognition to the particular risks in the oil and gas business both at home and abroad. American companies producing oil in foreign countries have added risks of losses through war, expropriation and nationalization not faced by domestic producers.

Adverse effect on balance of payments

American companies account for 56 percent of the Free World's oil produced abroad. The operations of these companies contribute substantially toward a more favorable balance of payments. The expected increase in foreign taxes as an offset against the gain in U.S. tax from elimination of foreign depletion would have an adverse effect on our balance of payments position.

Ownership of foreign crude oil reserves by Americans is important

Oil consumption in the U.S. is over a third of the Free World total, but domestic reserves are only one-tenth of the total in the Free World. American ownership of foreign oil resources is essential to assure an adequate future supply for both national security and economic strength. The absence of U.S. control of these foreign reserves will result in those who do control them turning to their own nationals rather than American companies for technical assistance, construction and operating equipment.

Foreign oil investments contribute to U.S. goals

Investments of American oil companies abroad serve to increase U.S. trade with those foreign countries and to contribute substantially toward making them less dependent on U.S. gifts and aid.

III. OTHER TAX REFORM MEASURES

1. Clarification on the U.S. income tax status of the continental shelf

In his testimony before the Senate Finance Committee, Assistant Secretary, Edwin S. Cohen, recommended that the U.S. income tax status of the continental shelf areas of the world be clarified by amending the definition of "United States" in the Code to include the continental shelf of the United States with respect to the exploration for natural resources and defining the term "foreign country" as used in the Code to include the continental shelf which pertains to the foreign country concerned. While the Council recognizes the need for clarification of the law in this area, the Council believes that the proposal set forth is consistent with the position taken by taxpayers and the Internal Revenue Service in past administration of the U.S. income tax law. The Treasury Department recommendation is also consistent with the position of the National Petroleum Council with respect to the policy which the U.S. should follow regarding the area of the continental shelf over which the United States should exercise jurisdiction.

In connection with the proposed definition of the term "foreign country" we think that it is important to define the term so that it includes any part of the Continental Shelf adjacent to a foreign country with respect to which that foreign country exercises jurisdiction to grant licenses or permits to conduct operations, whether or not the rule applied in determining the area with respect to which jurisdiction is to be exercised or the degree of jurisdiction to be exercised is the same as that applied by the United States with respect to the Continental Shelf adjacent to the United States. Unless such a definition is used, a taxpayer carrying on operations on the Continental Shelf of a foreign country which exercises jurisdiction with respect to that Continental Shelf might be subjected to international double taxation if the U.S. income tax definition of the term "foreign country" were not broad enough to include the area in which the taxpayer carried on operations.

Recommendation

Accordingly, the Council recommends that the tax status of the continental shelf be clarified along the lines of the Treasury proposal. However, the definition of the continental shelf adjacent to a foreign country should clearly include any portion thereof over which the foreign country exercises jurisdiction to grant licenses or permits to conduct operations.

2. Section 452. Earnings and profits

Section 452 of the Bill would amend section 312 of the Code, to add back to "earnings and profits" or corporations the excess of accelerated depreciation over straight-line depreciation. The stated purpose of the amendment is to obviate the payment of tax-free dividends by public utility and real estate corporations from funds derived by claiming accelerated depreciation. H. Rept. No. 91-413 (Pt. 1), 134.

Earnings and profits as defined in section 312 of the Code is relevant to other Code sections dealing with the foreign area in general and with foreign tax credits in particular. The implications of section 452 of the Bill may extend far beyond the receipt of "tax-free" dividends from regulated public utility and/or real estate corporations. It does not appear that these implications have been fully comprehended or intended by either the Ways and Means Committee or the Treasury Department.

Recommendation

Section 452 of the Bill should not be enacted. If enacted, its application should be limited to the distribution of "tax-free" dividends.

It could be provided that if a company makes a distribution which it considers is not out of earnings and profits, such company must revise its earnings and profits for a specified period of years to add back accelerated depreciation in excess of straight-line depreciation. This last suggestion might be useful in permitting the Treasury to counter abuse situations while freeing corporations not having this situation from the voluminous record keeping requirements and unintended effects which would be involved in the present proposal.

In any event, section 452 should not apply to the determination of earnings and profits for purposes of computing foreign tax credits, minimum distributions or when such determination is otherwise required under section 964 of the Code.

Code sections affected by section 452

A. Section 902

Under section 902, a domestic corporation upon receipt of a dividend from a 10 percent or more owned foreign corporation is deemed to have paid that proportion of the taxes paid or deemed to be paid by the foreign subsidiary to any foreign country or U.S. possession on or with respect to the accumulated profits out of which such dividends were paid.

Enactment of section 452 in its present form, which would add back to earnings the excess of accelerated depreciation over straight-line depreciation, would have the effect of increasing the earnings of foreign subsidiaries for purposes of calculating the deemed paid tax credit under section 902 of the Code, thereby decreasing the allowable foreign tax credit. Such procedure would be contrary to the trend of industrialized nations to permit some form of accelerated depreciation in reducing taxes otherwise payable to their Government. Increasing the earnings of foreign subsidiaries in this manner if this is intended would dilute the foreign tax credits allowable against income received from such subsidiaries and in effect denies to these foreign corporations the benefits of reduced tax cost provided by the foreign country.

B. Section 963

Enactment of section 452 of the Bill could alter the computation of the required minimum distributions under section 963 of the Code. Section 963 is a relief provision added to the Revenue Act of 1962 by this Committee which attempts to ameliorate the harsh results of the provisions of subpart F. Under section 963, if a domestic corporation elects to receive a "minimum distribution" it is not required to include in its gross income its share of subpart F income. Broadly speaking where the effective foreign tax rate is less than 90 percent of the U.S. rate, a minimum distribution, stated in terms of the foreign corporation's earnings and profits, will be required in order to avoid subpart F treatment.

Section 452 of the Bill might increase the earnings and profits of a controlled foreign corporation, and decrease the effective foreign tax rate and thus increase the required minimum distribution and could be inconsistent with the relief intended by Congress in 1962.

C. Other sections

Section 960 of the Code provides for a foreign tax credit with respect to the inclusion of subpart F income in the gross income of a shareholder in a controlled foreign corporation. Enactment of section 452 of the Bill could present problems under section 960 which are similar to those discussed above under section 902.

Section 956 of the Code provides that any increase for a taxable year in the earnings of a controlled foreign corporation invested in U.S. property must be included in the gross income of a U.S. shareholder in a controlled foreign corporation to the extent such amount would have constituted a dividend if it has been distributed. The determination of such amount could require a computation of the earnings and profits of the controlled foreign corporation and as such could be affected by the enactment of the section 452 of the Bill.

Section 959 prescribes ordering rules with respect to the allocation of distributions from controlled foreign corporations which in turn are related to earnings and profits concepts which could be affected by the enactment of section 452.

Since section 1248 provides that gain recognized upon the sale or exchange of stock in a controlled corporation shall be treated as a dividend attributable to such stock under prescribed circumstances, this section may be affected by section 452 of the Bill.

3. Liberalization of indirect credit

In view of the growing demand for local participation and the necessity to participate in consortiums through foreign subsidiaries at various levels, the Council considers that it is now the appropriate time to broaden the relief afforded by Section 902 by extending the indirect credit beyond the second tier. There should be no administrative problems in extending the benefits of Section 902 beyond the second tier since the acquisition of as little as a 5 percent direct or indirect interest must be reported to the Internal Revenue Service together with current financial information. The Internal Revenue Service must review these documents in the course of any audit of a U.S. corporation with an interest in foreign subsidiaries. In addition, the domestic corporation has the ultimate burden of substantiating any foreign tax credits cleamed.

Recommendation

The indirect credit should be extended to apply with respect to dividends received from any foreign corporation, irrespective of the number of tiers of ownership, provided the domestic parent has an overall stock ownership of 5 percent in the chain of foreign corporations through which the dividend is distributed.

4. Section 367

Section 367 of the Internal Revenue Code of 1954, first enacted in 1932, provides that unless the taxpayer obtains an advance ruling from the Commissioner that tax avoidance is not a principal purpose of certain types of transactions involving the organization, reorganization or liquidation of a foreign corporation, such foreign corporation will not be treated as a corporation. Where such advance clearance is not obtained, any gain, which would otherwise not be recognized under the provisions of subchapter C of the code, had domestic corporations been involved, will be recognized. It therefore becomes essential for the taxpayer to obtain an advance Section 367 clearance from the Commissioner whenever the types of transactions set forth above are contemplated. See Rev. Proc. 68-23, IRB 1968-22, 33.

Under Rev. Proc. 68-23, Section 367 is being administered in an arbitrary manner to exact costly "toll gate" charges from taxpayers as the price of obtaining the favorable ruling essential to the consummation of an otherwise bona fide business transaction. In addition, the present advance ruling procedure is fraught with costly delays for taxpayers even where the toll gate charge is to be exacted.

More importantly, transactions described in Section 367 occurring between foreign affiliates are often consummated without the knowledge of the U.S. parent so that an advance ruling is not obtained. In such cases, a tax must be paid with no recourse to judicial review, even in cases where it is obvious that tax avoidance is clearly not present and where an advance clearance would have been granted as a matter of eventual routine on the part of the Commissioner.

(1) In view of the present information reporting requirements and the array of other code sections and judicial precedent upon which the Commissioner can now reply in preventing tax avoidance, the Council recommends the repeal of Section 367.

(2) At the very least, Section 367 should be amended retroactively to all open years, to eliminate the advance ruling requirement. This would be consistent with the tax treatment now afforded the realignment of domestic corporations. Thus, the facts of any given transaction as finally developed would be determinative of the tax treatment afforded such transaction. Consistent with other areas of the tax law, this recommended change would restore to taxpayers that fundamental right of having legitimate differences as to taxpayer's motive resolved by the court rather than by the Commissioner, who by statute, now sits as appellate judge and jury in Section 367 cases.

5. Section 231. Moving expenses

Section 231 of the Bill provides for the deduction of additional categories of moving expenses subject to an overall limitation of $2500.

The Council agrees in principle with the liberalization of deductions for moving expenses. However, a dollar limitation on indirect expenses to protect against abuses will act unfairly in cases where expenses are reasonable in amount but exceed the limitation. Moreover, because of possible inflation, a reasonable dollar limit today might be completely inadequate in the future. If a dollar limitation is to be provided, it should be applied only to moves within the United States. Moving expenses in respect of overseas assignments generally involve more indirect expenses and can vary greatly as between countries. Where the move is requested by the employer and the expenses are the employer's, an attempt to tax the employee will only result in additional costs to be borne by the employer.

Recommendation

Accordingly, if a limitation will be placed on the amount of moving expense which will be allowed as a deduction, the Council recommends that such limitation shall not be below $2500 in the case of transfers within the U.S. However, such limitation should have no application in respect of moving expenses incurred in respect of overseas assignments where the amounts involved vary

so greatly that it would be quite inequitable to restrict the deduction to a specified amount.

On taking an overseas assignment many people sell their U.S. home but do not purchase home in the foreign country because of exchange risks, and the like. The Council therefore recommends that the 1-year period to purchase a new home under section 1034(a) not commence to run in such case until the employee returns to, and takes up residence in, the U.S.

6. Section 444. Foreign deposits in U.S. banks

In April of this year President Nixon indicated that his Administration will review existing regulations and tax policy to assure that foreign investment in the U.S. is not discouraged. By way of specific example, the President stated that we should move now to eliminate from our laws the prospective taxation of interest on foreign held U.S. bank deposits. In this connection, President Nixon proposed the immediate repeal of the portion of section 861 of the Internal Revenue Code which would tax the interest paid to foreign depositors after December 31, 1972 in respect of U.S. bank deposits unrelated to a trade or business. It was similarly proposed to retain the present exemption of such deposits from estate tax.

Section 444 of the House Bill does not implement the President's proposals but merely defers the U.S. income and estate taxation to 1976. As recognized by the Administration and by every major commercial body which has expressed itself on these subjects since introduced through the Foreign Investors Tax Act, the provisions of present law tend to discourage the investment of funds in the United States and places a direct drain on the U.S. balance of payments.

Recommendation

The Council recommends that President Nixon's proposals be supported by the immediate and complete removal of the expiration date of the relief provisions found in present law.

NATIONAL FOREIGN TRADE COUNCIL, INC.,
New York, N.Y., October 10, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: The Council appeared before the Senate Finance Committee on October 3rd to present testimony with respect to H.R. 13270. Among other things, the Council recommended repeal of section 367.

In this connection, we enclose herewith a technical memorandum of the National Foreign Trade Council setting forth suggested statutory recommendations to the Internal Revenue Code which may be considered appropriate if section 367 is repealed.

The Council respectfully requests that this statement be made a part of the hearings on tax reform.

Very truly yours,

ROBERT T. SCOTT, *Vice President.*

SUPPLEMENTAL MEMORANDUM OF THE NATIONAL FOREIGN TRADE COUNCIL TO ITS MEMORANDUM SUBMITTED TO THE FINANCE COMMITTEE OF THE U.S. SENATE

REPEAL OF SECTION 367

Section 367 of the Internal Revenue Code of 1954, first enacted in 1932, provides that unless the taxpayer obtains an advance ruling from the Commissioner that tax avoidance is not a principal purpose of certain types of transactions involving the organization, reorganization or liquidation of a foreign corporation, such foreign corporation will not be treated as a corporation. Where such advance clearance is not obtained, any gain, which would otherwise not be recognized under the provisions of subchapter C of the Code, had domestic corporations been involved, will be reorganized. It therefore becomes essential for the taxpayer to obtain an advance Section 367 clearance from the Commissioner whenever the types of transactions set forth above are contemplated. See Rev. Proc. 68-23, IRB 1968-22, 33.

Under Rev. Proc. 68–23, Section 367 is being administered in an arbitrary manner to exact costly "toll gate" charges from taxpayers as the price of obtaining the favorable ruling essential to the consummation of an otherwise bona fide business transaction. In addition, the present advance ruling procedure is fraught with costly delays for taxpayers even where the toll gate charge is to be exacted.

More importantly, transactions described in Section 367 occurring between foreign affiliates are often consummated without the knowledge of the U.S. parent so that an advance ruling is not obtained. In such cases, a tax must be paid with no recourse to judicial review, even in cases where it is obvious that tax avoidance is clearly not present and where an advance clearance would have been granted as a matter of eventual routine on the part of the Commissioner.

In view of the present information reporting requirements and the array of other code sections and judicial precedent upon which the Commissioner can now rely in preventing tax avoidance, the Council recommends the repeal of Section 367 and that section 1248 be amended, as set forth below.

ACQUISITION BY U.S. PERSON OF ASSETS OF A FOREIGN SUBSIDIARY OR STOCK IN A DOMESTIC CORPORATION

The heart of the Council's proposals with respect to amending section 1248 lies in the area dealing with domesticating transfers, i.e., where the shares of a controlled foreign corporation (hereinafter referred to as a CFC) are transferred by a U.S. person without immediate recognition of gain, either in exchange for stock of a domestic corporation pursuant to the reorganization provisions, or in exchange for th eassets of a foreign subsidiary pursuant to a complete liquidation of the foreign subsidiary. Under present law, section 1248 only applies to gain from sales or exchanges of stock in a CFC which is otherwise treated as long-term capital gain. It does not apply to exchanges of CFC stock, or transactions that are treated as such, on which gain is not immediately recognized. Thus, if such stock can be exchanged tax free for either stock in a domestic corporation pursuant to a reorganization, or for the CFC's assets in a tax-free liquidation, section 1248 will not apply and ordinary income treatment of the gain could be permanently avoided. Under present conditions, such avoidance of ordinary income treatment is prevented by application of section 367.

However, the recommendations described below will insure eventual ordinary income treatment of such gain, consistent with the Revenue Act of 1962, but without the disruptive consequences of section 367, as presently applied. At the same time, the Council's recommendations will continue to permit the readjustment of corporate structures pursuant to Subchapter C as are required by business exigencies and which effect only a readjustment of continuing interest in property under modified corporate form.

Recommendations

1. Section 1248(a) should be amended to apply to section 332 to impose an immediate section 1248 tax on the gain arising from the liquidation of a foreign corporation into a domestic corporation attributable to earnings and profits accumulated after taxable years beginning December 31, 1962. However, corporations which are organized in or under the laws of a U.S. possession and which meet the requirements of section 957(c), or would have met such requirements if the Revenue Act of 1962 had been in effect, should continue to be permitted to liquidate tax free under section 332, without application of section 1248 thereto amended as suggested herein.

2. Section 1248 should be amended to cover situations where the United States shareholder of a CFC (either individual or corporate) receives stock in a domestic corporation:

   (a) solely in exchange for stock in the CFC which is tax free under section 354, pursuant to a "B" reorganization, or

   (b) in exchange for stock of the CFC which is tax free under sections 354, 355, or 361, pursuant to a "C", "D" or "F" reorganization or a section 355 distribution which is treated as an exchange

to provide that the stock received in the domestic corporation will become tainted with the amount of the section 1248 liability which would have been due had the stock in the CFC been sold or exchanged in a transaction governed by section 1248(a)(1).

Such taint would survive other lifetime tax free exchanges of such tainted stock by the holder of such stock or his donees.

Explanation

Assuming the repeal of section 367 as suggested herein, section 1248 could be avoided where stock in a CFO is exchanged by a U.S. person in the situations which are the subject of recommendations 1 and 2 above since section 1248 is not applicable. See Regulation section 1. 1248–1(c). Thus, such a U.S. person can sell stock in the domestic corporation received in the tax free exchange at capital gains rates and moreover if the U.S. person is a domestic corporation it can take a dividends received deduction under section 243.

FOREIGN TO FOREIGN TRANSFERS

Where substantially all the assets of a CFC are acquired by another CFC in amalgamations described in section 332 (tax free liquidations), or section 368 (a)(1)(C) or (D) but only if section 354 applies (the acquisition of substantially all the assets of one corporation by another corporation), or (F) (reincorporation), the earnings and profits of the acquired corporation will carry over pursuant to section 381(a) and (c)(2). Similarly, in divisive reorganizations under section 368(a)(1)(D) a portion of the earnings and profits will carry over and be allocated to the separated business pursuant to Regulation section 1.312–10(a).

Regulation section 1.1248–1(a)(1) provides that upon a taxable sale or exchange of stock in a controlled foreign corporation gain shall be included as a dividend to the extent of the earnings and profits attributable to such stock:

"* * * during the period or periods such stock was held (or was considered as held by reason of the application of section 1223) by such person [disposing of such stock] while such corporation was a controlled foreign corporation."

In the foregoing asset acquisitions, the holding period of the acquiring corporation with respect to the acquired assets would be governed under section 1223(2). The earnings and profits of the acquired CFC carry over to the acquiring corporation under section 381(a) and Regulation section 1.312–10 and presumably would be considered attributable to the stock of the acquiring corporation.

Where the CFC, the assets of which have been exchanged for stock in another corporation, is immediately liquidated by the U.S. shareholder, the revenues appear to be adequately protected. One, the amendment to section 1248 set forth above will apply with respect to any domesticating transfers of the stock of the acquiring corporation. Two, if the shareholder ultimately disposes of the stock in the acquiring corporation (CFC) in a taxable transaction, section 1248 could apply. Upon liquidation, the former shareholder of the acquired corporation will have a substituted basis under section 358 and therefore a substituted holding period under section 1223(1) for the stock in the acquiring corporation. Thus, a portion of the post 1962 earnings and profits of the acquired corporation could be attributable to the stock in the acquiring corporation, if such corporation is a CFC and the stockholder owns 10 percent of such stock.

Where such CFC is not liquidated but remains in existence as a holding company, and its stock is thereafter sold, section 1248 could apply to both the earnings and profits which were carried over to the acquiring corporation pursuant to the above described asset amalgamations, as well as earnings and profits of the acquiring corporation earned subsequent to the date of acquisition. This could only occur under section 1248(c) which would attribute such earnings and profits to the stock of the holding corporation when sold or exchanged. Section 1248(c) would apply where the acquiring foreign corporation was a CFC but only if the stock interest in the acquiring corporation held by the holding company amounted to 10 percent of its outstanding voting power. Accordingly, section 1248(a)(1) could be avoided in foreign to foreign asset acquisitions where section 1248(c) did not apply, i.e., where the acquiring foreign corporation was not a CFC or where less than 10 percent of its stock is held by the holding company at the time of the sale of such company's stock.

There should be no problem where a CFC liquidates a lower tier subsidiary under section 332 since its earnings and profits carry over to the CFC. Other U.S. persons who own 20 percent or less of the lower tier subsidiary will be subject to section 1248 as it presently exists.

With respect to "B" reorganizations involving exchanges of stock in foreign corporations, both of which are CFC's, section 1248(a) amended as suggested herein will apply. If the acquiring corporation is not a CFC, section 1248 will be avoided upon the sale or exchange of such stock by the former shareholders of the acquired CFC.

Recommendations

1. Taint the stock of the acquired corporation (which remains as a holding company) whose assets were acquired by a foreign corporation in asset amalgamations described above, to insure that the section 1248 exposure of the stockholders of the acquired corporation up to the date of the exchange will be ultimately paid by them or their transferees upon a disposition of the acquired corporation's stock under section 1248(a) (amended as suggested above).
2. Taint the stock of the acquiring corporation where the acquired corporation is liquidated.
3. Where the U.S. shareholders in a CFC, including a CFC the stock of which has been tainted in recommendation 1 above, exchange substantially all of their stock for stock in another foreign corporation pursuant to a "B" reorganization, the taint provided in 2 above applies.

The taint suggested in recommendation 1 and 2 would apply regardless of whether the acquiring corporation is a CFC and/or the acquired corporation or its shareholders receive more than 10 percent of the stock in the acquiring corporation.

The taint suggested in recommendation 1, 2 and 3 above should be made broad enough to encompass preferred stock received in a recapitalization reorganization described in section 368(a)(1)(E), as well as in "C" or "D" reorganizations. This is because it would be possible in certain instances to receive preferred stock in "C", "D" or "E" reorgainzations which would not qualify as section 306 stock (because not the equivalent of the receipt of a) stock dividend within the meaning of section 306(c)(1)(B)(ii)) and would not be subject to section 1248 as presently written because, for example, the recipient no longer has 10 percent of the voting power in the CFC or where the attribution rules applicable to section 1248 do not apply.

EXPATRIATING TRANSFERS

The major concern with respect to expatriating transfers is in the section 351 area. Here present Treasury policy, as reflected in its administrative rulings, see Rev. Proc. 68-23, *supra*, exhibits a clear disregard of the overriding policy of subchapter C to facilitate the readjustment of continuing interests in property under modified corporate form. Such policy is neither warranted by the legislative history of section 367 nor necessary for the protection of the revenues.

At present, a tax must be paid as the price of obtaining a favorable section 367 ruling involving certain transactions where enumerated types of property are to be transferred under section 351 by a U.S. person to a foreign corporation. These arbitrary charges represent the Commissioner's unilateral judgment as to what is necessary to prevent a diversion of income from U.S. taxation. Such toll charges, imposed automatically on a transactional basis without consideration of whether a given section 351 transfer is "in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes", are in open disregard of the plain wording of section 367. The Commissioner thus looks to arbitrarily defined transactions for purposes of presuming a principal purpose of tax avoidance, rather than examining the broad plan of which the transaction is but a part, as envisaged by section 367. Analysis of the legislative history accompanying section 367 leads to the conclusion that no arbirtary, automatic test was envisaged when that section was first enacted as section 112(k) of the Revenue Act of 1932.

Section 112(k) (as well as sections 901 to 904 of the Revenue Act of 1932, now sections 1491 through 1494) was primarily enacted to prevent the transfer of appreciated securities tax free to foreign corporations controlled by U.S. persons in order to avoid U.S. and foreign tax with respect to such appreciation on sale thereof. See H. Rept. No. 708, 72d Cong., 1st Sess., C.B. 1939-1 (Part 2), 471 which also indicated that the Courts probably would not hold the bold tax avoidance schemes contemplated in the report to be tax free. This prediction proved accurate, since shortly thereafter the landmark decision of *Gregory V. Helvering* 293 U.S. 465 (1935), was rendered along with the decision of *Kaspare Cohn Co., Ltd.* 35 B.T.A. 646 (1937). These cases, along with section 1491, provide ample authority for the Commissioner to attack schemes involving the use of close corporations to dispose of appreciated securities outside the U.S. by U.S. citizens in order to avoid U.S. income tax, which was one of the principal reasons for the enactment of section 367.

In addition, sections 61 and 269 are becoming increasingly important in combating tax avoidance and apply with equal force in the foreign area. Section

482, as implemented by the recently promulgated regulations thereunder, imposes detailed rules with respect to the conduct of ordinary business between related entities. Finally, the provisions of subpart F and section 1248 provide that income earned through the conduct of business abroad through foreign subsidiaries will be subject to ordinary income tax treatment in the U.S. either currently or when the investment in the foreign subsidiary is disposed of. The amendments to section 1248 suggested herein will insure this treatment.

Recognizing that the U.S. taxes income realized by a citizen or resident from all sources and cognizant of the various statutory and judicial safeguards which would insure that the U.S. obtain a fair measure of income tax generated from foreign operations, the Council has concluded that the automatic tollgate charges imposed under section 367 upon section 351 transfers by a domestic corporation to a foreign corporation are unnecessary and inconsistent with such regime of global taxation. Appendix A, attached hereto, sets forth some of existing statutory regulatory, and judicial precedent which afford adequate protection to the revenues upon expatriating section 351 transfers but which nonetheless do not operate automatically either in favor of Treasury or taxpayer.

The same considerations discussed above with respect to section 351, are equally applicable where assets in a domestic corporation are transferred to a foreign corporation pursuant to a "C", "D" or "F" reorganization.

The exchange of substantially all the stock of a domestic corporation by U.S. persons for voting stock in a foreign corporation, pursuant to a "B" reorganization, should not present substantial problems. As a general rule, the existing guidelines under section 37 assume that no tax avoidance purposes are present if shareholders in a domestic corporation do not obtain more than 50 percent of the voting power of the acquiring foreign corporation pursuant to a "B" reorganization. This assumption should remain valid. On the other hand where a U.S. shareholder gets more than 50 percent or more, the acquiring corporation will generally be a CFC. If section 1248 is amended as suggested herein the revenues will remain protected.

There is little chance under present law of the U.S. collecting a tax upon a liquidation of a domestic corporation by a foreign parent whether or not it obtains an advance section 367 ruling. The foreign parent will not be subject to U.S. tax on the income realized from the liquidation if, as is generally the case, it is not engaged in trade or business in the U.S., or if so engaged, the acquired assets (or the stock in the U.S. subsidiary) are not effectively connected therewith. Moreover, the foreign parent is not subject to U.S. withholding tax with respect to the liquidating distributions even if the income realized upon the liquidation is considered to be from U.S. sources since such income would not be fixed or determinable, annual or periodical income. Neither is the domestic corporation subject to U.S. tax upon liquidation because of section 336. See also Regulation section 1.336–1.

Appendix A. Application of Section 482 to Section 351

Present rule

The procedures for obtaining a favorable section 367 ruling from the Internal Revenue Service upon a transfer by a domestic to a foreign corporation otherwise qualifying under section 351 of the Internal Revenue Code are provided under section 3.02(1) of Revenue Procedure 68–23, I.R.B. 1968–22, 33, hereinafter referred to as the "Guidelines".

Section 3.02(1) of the Guidelines sets forth general and specific requirements for the issuance of a favorable section 367 ruling in connection with a section 351 transfer of property to a foreign corporation controlled by the transferor. In general the Guidelines contemplate that such property is to be devoted by the transferee to the active conduct of a trade or business abroad. It is further contemplated that such transferee will have need for a substantial investment in fixed assets in such business or will be engaged in the purchase and sale abroad of manufactured goods.

More specifically, section 3.02(1)(a) of the Guidelines provides that a favorable section 367 ruling will *not* be issued for an exchange described in section 351 of the Code where the property to be transferred to the foreign corporation is one of the following kinds of property:

(i) Inventory or property held for sale to customers or copyrights and similar property;

(ii) Accounts receivable, installment obligations, and similar property in respect of which income has been earned;

(iii) Stock or securities (except stock in a less developed country corporation transferred to a controlled less developed country corporation holding company and except for stock in a controlled foreign corporation transferred to another controlled foreign corporation incorporated in the same foreign country);

(iv) Property transferred for the principal purpose of sale or disposition by the transferee foreign corporation.

Section 3.02(1)(b) of the Guidelines provides that a favorable section 367 ruling *generally* will not be issued for an exchange described in section 351 where the property to be transferred to a foreign corporation is one of the following kinds of property:

(i) Property in respect of which the transferor is a lessor or licensor (except where the transferee foreign corporation is the lessee or licensee);

(ii) Property transferred for the purpose of licensing or leasing by the transferee foreign corporations;

(iii) United States patents, trade-marks and similar intangibles to be used in connection with (1) the conduct of a trade or business in the United States or (2) the manufacture in the United States or a foreign country of goods for sale or consumption in the United States;

(iv) Foreign patents, trade-marks and similar intangibles to be used in connection with the sale of goods manufactured in the United States.

Notwithstanding the foregoing, section 3.02(1)(d) of the Guidelines provides that a favorable section 367 ruling will be issued if other properties to be used in the active conduct of a trade or business of the foreign corporation are also transferred to the foreign corporation and the transferor includes in its gross income as a so-called tollgate charge, an appropriate amount to reflect realization of income or gain with respect to the transfer of properties which would not be afforded a favorable ruling.

It is evident that section 3.02(1) of the Guidelines is primarily directed at anticipatory arrangements for shifting income abroad which has been earned in whole or in part but not yet realized in a tax sense at the time of transfer.

Section 482

Regulations.—The regulations under section 482 are expressly applicable to section 351 transfers. Regulation section 1.482–1(d)(5). Thus, the Commissioner may make an appropriate section 482 allocation with respect to a section 351 transfer of property of the type described in section 3.02(1) of the Guidelines where such transfer would result in the realization of income abroad which in fact had been earned in the U.S. However, under section 482, the Commissioner must establish that such allocation "is necessary in order to prevent evasion of taxes or clearly to reflect the income [of the domestic transferor corporation]."

Cases.—The case law surrounding the transfer of property pursuant to a section 351 exchange, of the type specified in section 3.02(1) of the Guidelines, affords adequate protection to the Commissioner, either directly or by way of analogy, in insuring that the income of transferor and transferee is clearly reflected. In the main, these cases permit the Commissioner to allocate income which has already been earned although unrealized at the time of the transfer in appropriate cases.

In *Central Cuba Sugar Co., v. Commissioner* 198 F2d 214 (2d Cir., 1952) cert. den. 344 U.S. 874 (1952), a parent transferred all of its growing crops to its subsidiary and attempted to claim the planting and growing expenses as a deduction and carry back the resulting loss. The court upheld the allocation of the deductions to the subsidiary in order to clearly reflect income. A similar result was reached in *Francis L. Rooney* 305 F2d 681 (9th Cir., 1962), aff'g. 189 F Supp 733 (D.C. Cal., 1961) where individual taxpayers transferred growing crops to a corporation in a section 351 type exchange and attempted to claim the expenses of growing such crops as a deduction on their individual returns.

In *Standard Paving Co., v. Commissioner* 190 F2d, 330 (10th Cir., 1951) a wholly owned subsidiary was liquidated tax free into its parent which received among other things long term construction contracts, the income from which was being reported on a completed contract basis. The court upheld the Commissioner's allocation to the subsidiary of that portion of the total profit received by the parent equal to the percentage of completion as of the date of liquidation. See also *Jud Plumbing & Heating Co., v. Commissioner* 153 F2d 681 (5th Cir. 1946).

A similar result was reached in *Dillard-Waltermire, Inc., v. Campbell* 255 F2d 433 (5th Cir., 1958) where a corporation engaged in drilling oil and gas wells and reporting income on the completed contract basis, sold some of such partially completed contracts to a partnership composed of its stockholders. The contracts were completed by the partnership which reported all the profit attributable thereto. The Commissioner's allocation of a portion of the profits equal to the percentage of the contract completed by the corporation was upheld.

In *National Securities Corp. v. Commissioner* 137 F2d 600 (3rd Cir., 1943) cert. den. 320 U.S. 794 (1943) a parent transferred high basis low value stock to its subsidiary which sold the stock and attempted to claim a loss. The Commissioner successfully allocated the deduction to the parent.

In *U.S. v. Lynch*, 192 F2d 718 (9th Cir., 1951) a corporation distributed a dividend in kind consisting of inventory which was subsequently sold by the corporation on behalf of its shareholders. The court upheld the Commissioner in disregarding the dividend distribution and attributing the sale to the corporation.

In the foregoing cases, the Commissioner invoked section 482 to insure that the taxpayer earning income would be taxed thereon. In addition it is possible for the Commissioner to allocate to the transferor income earned subsequent to the transfer of property where the transaction is lacking in bona fides.

In *Ballentine Motor Co.* 39 T.C. 348 (1962), aff'd. 321 F2d 796 (4th Cir. 1963), the businesses of profitable corporations were shifted to a related loss corporation by way of sale of inventories to the loss corporation at fair value, a transfer without consideration of the profit corporation's facilities, and a transfer of employees. The transferee corporation operated the transferred businesses long enough to absorb its operating loss and thereafter transferred such assets to another related entity. In upholding the Commissioner's allocation of income to taxpayer pursuant to section 482 and 601, the court stated:

"We therefore hold that when, as here, assets from which income is expected are transferred from one business to another business (both controlled by the same interests) and the *primary* object of the transfer is tax evasion by the shifting of anticipated profits, as it was here, that section 482 is not rendered inapplicable merely because the profits to be shifted have not yet been realized."

Ballentine is important in that the Commissioner allocated income earned subsequent to the transfer. Significantly however, the Commissioner would have to establish a lack of business purpose in the *Ballentine* situation before an allocation and a tax exacted. An automatic tollgate change such as now imposed would not suffice. See also *T. Jack Foster* T.C. Memo 1969-273 where a parent corporation transferred houses which it had constructed to its subsidiaries which immediately resold the properties to unrelated parties, reporting the income against their net operating losses. The Commissioner's allocation of the gain back of the parent transferor was upheld.

Summary and conclusion

Under section 482, the existing regulations and applicable case law, the Commissioner asserts authority to make appropriate allocations under section 482 with respect to transfers of property specified under section 3.02(1) of the Guidelines. However, contrary to the existing arbitrary practice under the Guidelines, taxpayer will be able to establish after the fact that the transfer does not have as its principal purpose the avoidance of Federal income tax and that income is clearly reflected.

1. Income realized on the subsequent sale by the transferee of section 1221(1) property (inventory and property held for sale to customers), section 1221(3) property (copyrights), stock or securities, may be allocated to the transferor. *Ballentine Motor Co.; T. J. Foster; Central Cuba Sugar Co. v. Commissioner.*

2. Income realized and attributable to transferred accounts receivable or installment obligations, or income from property in respect of which the transferor is a lessor or licensor, may be allocated to the transferor. *Standard Paving Co. v. Commissioner; Jud Plumbing & Heating Co. v. Commissioner; Dillard-Waltermire, Inc. v. Campbell.*

3. Income realized attributable to property transferred under circumstances which make it reasonable to believe that the property transferred will be licensed or leased by the transferee or that its sale or other disposition by the transferee is one of the principal purposes or intangibles described in sections 3.02(1)(b)(iii) and (iv), may be allocated to the transferor. *U.S. v. Lynch.*

NATIONAL FOREIGN TRADE COUNCIL, INC.,
New York, N.Y., October 15, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: The Council appeared before the Senate Finance Committee on October 3rd to present testimony with respect to H.R. 13270. Among other things, the Council recommended that section 452 of the Bill not be enacted.

Inasmuch as the Treasury Department's conclusion that it would be proper to apply section 452 to the foreign area was not reached until the closing days of the Hearings on Tax Reform, the Council did not have adequate time to respond thereto. Accordingly, the National Foreign Trade Council encloses herewith a technical memorandum in support of its recommendation with respect to section 452 of the Bill.

The Council respectfully requests that this statement be made a part of the Hearings on Tax Reform.

Very truly yours,

ROBERT T. SCOTT, *Vice President.*

ADDITIONAL COMMENTS OF THE NATIONAL FOREIGN TRADE COUNCIL WITH RESPECT TO SECTION 452 OF H.R. 13270 IN SUPPORT OF ITS MEMORANDUM SUBMITTED TO THE FINANCE COMMITTEE OF THE U.S. SENATE

In its Statement presented to the Finance Committee on October 3, 1969, in connection with the Hearings on The Tax Reform Act of 1969—H.R. 13270, the Council recommended that section 452 of the Bill not be enacted. In no event should it be made applicable to the foreign area. Section 452, which would add back to earnings and profits the excess of accelerated depreciation over straight line depreciation, ostensibly is directed at problems arising from the receipt of so-called "tax-free" dividends from regulated public utilities and/or real estate corporations.

Problem

In the Technical Memorandum of Treasury Position submitted to the Committee on Finance on September 30, 1969, the Treasury Department has concluded that it would be proper to apply section 452 to the foreign area. This unsupported conclusion was not reached until the closing days of the Hearings on Tax Reform. As a result, the Council did not have adequate time to respond thereto.

Extension of section 452 as proposed by the Treasury Department, represents an over reaction to a problem that does not exist in the foreign area. A poll of a representative cross section of the Council's Tax Committee indicates that the receipt of "tax-free" dividends from foreign operations is extremely rare and should not present problems for Treasury. However, as indicated below, extension of section 452 to the foreign area would discriminate against and create complex and serious problems for those U.S. taxpayers doing business abroad through a foreign subsidiary, which in many cases is required under local law.

Accordingly, the Council reiterates its recommendation with respect to section 452 of H.R. 13270, made at the Hearings on Tax Reform.

Dilutes foreign tax credit

Application of section 452 of the Bill to the foreign area would increase the effective tax rate on foreign operations by diluting the effect of the deemed paid foreign tax credit for foreign taxes actually paid and otherwise considered creditable under section 902 of the Code.

Under section 902, a domestic corporation upon receipt of a dividend from a 10 percent or more owned foreign corporation is deemed to have paid that proportion of the taxes paid or deemed to be paid by the foreign subsidiary to any foreign country or U.S. possession on or with respect to the accumulated profits out of which such dividends were paid.

Enactment of section 452 in its present form, which would add back to earnings and profits of foreign subsidiaries the excess of accelerated depreciation over straight-line depreciation allowed under the tax laws of the foreign country, would increase the earnings of foreign subsidiaries for purposes of calculating

the deemed paid tax credit under section 902 of the Code, thereby decreasing the allowable foreign tax credit. As set forth in Table No. 1, below, the enactment of section 452 will increase the effective tax rate on foreign operations, but only where such operations are carried on through a foreign subsidiary. Further, such disallowed foreign tax credits representing otherwise creditable foreign taxes actually paid, as a practical matter, will probably never subsequently be available as credits against U.S. tax.

The deemed paid foreign tax credit under section 902 of the Code is designed to afford relief from international double taxation for those U.S. corporations operating abroad through a foreign subsidiary which is similar to that obtained by U.S. corporations operating abroad directly through a branch of a U.S. corporation. In both instances, the U.S. revenues are protected since credit for foreign tax may only be taken against U.S. tax attributable to foreign source business income. Credit may not be taken against U.S. tax attributable to U.S. source business income.

The mere fact that additional tax dollars may be obtained by curtailing foreign tax credits through the operation of section 452 of the Bill, which was never designed to apply to international operations, does not seem reasonable. Rather, such result is ill conceived and should be rejected.

Would eventually reduce U.S. tax revenues

Under existing law, Treasury receives a benefit where foreign subsidiaries of U.S. corporations claim accelerated depreciation for foreign tax purposes. As a result, foreign taxes are decreased, resulting in a smaller foreign tax credit claimed, thereby increasing U.S. tax revenues on dividend distributions.

However, it should be recognized that if the U.S. were to deny the benefits of claiming accelerated depreciation granted to foreign subsidiaries, by the local foreign government, it could be expected that such government would promptly eliminate such tax benefits by changes in their tax laws and thus sponge up any tax saving which would accrue, not to the taxpayer, but to the U.S. Treasury. As a conseqeunce, foreign tax payments and the foreign tax credit could be expected to increase, and no additional taxes would be paid to the U.S. The net effect would be a reduction of profits available for paying dividends to U.S. stockholders in an amount equal to the additional foreign taxes collected, and result in a reduction in U.S. tax revenue.

Complexity

In addition to increasing the tax cost of foreign operations, section 452 would vastly increase the complexity of operating abroad through a foreign subsidiary inasmuch as all overseas depreciable assets would have to be restated to a straight line basis in computing the indirect foreign tax credit as well as for other purposes discussed below. This will raise another difficulty in explaining U.S. tax provisions to foreign personnel. Moreover, it can be expected that in those cases where a substantial minority position in a foreign subsidiary is held by foreigners, compliance with the rule of section 452 will be actively resisted.

Treaty considerations

It is doubtful that U.S. treaty partners in negotiating income tax treaties ever contemplated that the "appropriate amount" of foreign tax paid, granted as a credit against U.S. tax under the treaty, would be diluted to the extent contemplated by section 452. Therefore enactment of section 452 would violate the spirit, if not the letter of income tax treaties to which the U.S. is a party.

Illustration

The inequities and resultant distortions of the existing foreign tax credit provisions which would be created by enactment of section 452 of the Bill can be illustrated by a simple example. Table No. 1, set forth below, compares the tax effects on a U.S. corporation of carrying on the identical manufacturing operations in the U.S. and in a developed foreign country through a branch and wholly-owned foreign subsidiary under existing law and under proposed section 452. It is assumed that both the U.S. and foreign tax rates are 50 percent, that both the U.S. and the foreign country permit the use of accelerated depreciation in calculating taxable income, that the foreign subsidiary is in a capital intensive industry, and the excess of accelerated depreciation over straight line depreciation amounts to $900.

TABLE NO. 1.—COMPARISON OF EFFECT OF PRESENT LAW WITH APPLICATION OF SEC. 452 TO FOREIGN OPERATIONS

	Present U.S. law			Proposed sec. 452: Foreign subsidiary
	Direct U.S. operation	Foreign branch	Foreign subsidiary	
Income	$100	$100	$100	$100
Foreign tax at 50 percent		50	50	50
Net income		50	50	50
Dividend to U.S. parent			50	50
Income		100	100	100
Adjustment for accelerated depreciation				900
Less foreign tax		50	50	50
Accumulated earnings and profits		50	50	950
U.S. taxable income (dividends grossed up)	100	100	100	52.63
U.S. tax at 50 percent	50	50	50	26.32
Credit for foreign tax [1]	0	50	[2] 50	[3] 2.63
Net U.S. tax	50	0	0	23.69
Total U.S. and foreign tax	50	50	50	73.70
Effective tax rate (percent)	50	50	50	73.7

[1] Dividend/accumulated profits times foreign tax.
[2] $50/$50×$50=$50.
[3] $50/$950×$50=$2.63.

Note: The remainder of the otherwise creditable foreign taxes actually paid, $47.37, ($50 —$2.63) as a practical matter, will not be utilized.

Discussion

Table No. 1 clearly shows that application of section 452 to the foreign area would grossly discriminate against those U.S. taxpayers doing business abroad through a foreign subsidiary rather than a branch. It is therefore difficult to appreciate how Treasury has concluded that such results are proper.

Increasing the effective tax rate on the foreign subsidiary's operations from 50 percent to 73.7 percent increases the tax cost of doing business abroad. Application of section 452 of the Bill would permit utilization as a credit against U.S. tax of only $2.63 out of the $50 of foreign taxes actually paid and otherwise considered creditable. Thus, foreign tax credits in the amount of $47.37 will, for all practical purposes, be permanently lost. These results certainly do not seem reasonable and proper. This is particularly true when there does not appear to be any abuse in the foreign area resulting from the receipt of "tax-free" dividends.

Locked in effect.—Many U.S. corporations have either choosen or were required to do business through a foreign subsidiary. Despite the adverse effects of operating under section 452 through a foreign subsidiary this section may preclude such U.S. corporations from changing their method of operation. The U.S. parent could not avoid the inequities illustrated in Table No. 1 by liquidating its wholly-owned foreign subsidiary tax-free, and thereby continuing operations in branch form. Such a tax-free liquidation would require a favorable section 367 ruling, and as a condition thereto, the Commissioner of Internal Revenue requires that accumulated earnings and profits for *all* taxable years be considered distributed as a dividend, thus bringing into play and magnifying the results discussed above.

If the U.S. corporation owned less than 80 percent of the foreign subsidiary, and desired to effect a taxable liquidation in order to resume operations in branch form, section 1248 of the Code would require that the gain recognized be included as a dividend to the extent of earnings accumulated after December 31, 1962. Under section 452 such earnings would be increased to include the excess of accelerated depreciation over straight line depreciation.

If, because of section 452 of the Bill, the U.S. parent decided to sell the stock in the foreign corporation, section 1248 would apply in the manner described above.

Section 963.—Section 452 of the Bill would also vitiate the relief provided by the minimum distribution provisions of section 963 of the Code. Section 963, added to the Revenue Act of 1962 by this Committee, provides that subpart F income need not be included in gross income if taxpayer elects to receive a minimum distribution, the amount of which varies inversely with the effective foreign tax rate.

In the illustration presented, the foreign subsidiary's effective foreign tax rate under existing law is 50 percent ($50/$100) requiring a zero minimum distribution. Under section 452, the effective foreign tax rate would become 5 percent ($50/$1000) requiring a minimum distribution of 90 percent of earnings and profits. However, such earnings and profits would not be the actual after tax profits of $50, but rather would represent phantom profits of $950. Apparently, a distribution of $855 would be required in order to satisfy a first tier minimum distribution if section 452 were enacted and made applicable to the foreign area.

Inclusion of the subsidiary in a chain or group election for minimum distribution purposes would produce similar results with a corresponding elimination of the relief provided by Congress from the operation of subpart F.

Senator TALMADGE. Next and I believe the last witness for today is Mr. William J. Nolan, Jr., who is chairman of the Committee on Taxation, U.S. Council of the International Chamber of Commerce, Inc.

STATEMENT OF WILLIAM J. NOLAN, JR., CHAIRMAN, COMMITTEE ON TAXATION, U.S. COUNCIL OF THE INTERNATIONAL CHAMBER OF COMMERCE, INC.

Mr. NOLAN. Mr. Chairman, my name is William J. Nolan, Jr.

Senator TALMADGE. As you know, Mr. Nolan, your statement is inserted in full in the record, and if you will summarize it, please.

Mr. NOLAN. This will be brief. I am director of taxes of American Metal Climax, Inc., and I am appearing today as chairman of the Committee on Taxation of the U.S. Council of the International Chamber of Commerce.

The U.S. council represents American business interests within the International Chamber, which in turn represents the international business community in some 75 countries.

Our committee on taxation has had the privilege of presenting its views on tax matters to the committees of Congress on many occasions, and we particularly appreciate the opportunity to appear today. Others before me have testified in detail on points made in my formal statement, and I shall not waste the committee's time by rearguing them. However, there are some general points which I should like to make briefly.

The U.S. council—and for that matter the International Chamber—have long advocated that, in order to avoid the evils of double taxation, income should be solely taxed in the jurisdiction where produced. We believe that the present system under which the United States asserts ultimate jurisdiction over income earned abroad by American companies is not the appropriate basis for taxation, even with the foreign tax credit as an effort to avoid the evils of double taxation.

The U.S. council believes the whole subject of tax policy in respect to foreign income is urgently in need of reexamination by the appropriate committees of Congress, and we are pleased to learn from

Assistant Secretaray Cohen's statement before your committee on September 4 that the Treasury is currently making an overall review of the U.S. tax policy in respect of foreign source income, and that its comprehensive proposals will be presented to Congress.

That being the case, we question the need for or desirability of making changes at this time in the specific areas encompassed by sections 431 and 432 of the tax reform bill. Specific amendments inevitably take the form of patchwork in an already heavily patched tax law, and I might say an unbelievably complicated one which would be further complicated by the House version of H.R. 13270.

The objections to section 431 of the House bill have been ably stated heretofore and we concur in those objections. Section 431 could well cause double taxation of income and thereby injure the status of American business abroad.

Section 432 is objectionable on the basic ground that it would discriminate against particular industries. Such discrimination would undoubtedly favor foreign competition over U.S. interests in the very necessary efforts being made to assure our domestic economy of an adequate supply of basic minerals.

We do not believe that equity is to be achieved by fragmentizing or compartmentalizing various types of foreign income. However, if the Committee on Finance decides to propose legislation affecting foreign source income, the U.S. Council urges for consideration legislation in the following additional areas:

One. An extension of the foreign tax credit to "third tier" foreign corporations. Presently it only goes to the first two tiers of foreign corporations.

Two. A broadened definition of what foreign taxes may be creditable where a foreign jurisdiction does not rely to the same extent as the United States on an income tax as a major source of tax revenue.

Three. Restraint by the United States in taxing foreign income where the foreign jurisdiction has authorized exemption from tax or has reduced the tax liability in order to encourage foreign investment. In other words, a recognition of "tax sparing."

Four. An adjustment in the foreign tax credit computation to prevent distortions in the case of abnormal losses.

Thank you very much, Mr. Chairman.

Senator TALMADGE. Thank you very much, Mr. Nolan, for your very fine statement.

Senator Williams, do you have any questions?

(No response.)

Mr. NOLAN. Thank you.

(Mr. Nolan's prepared statement follows:)

STATEMENT OF WILLIAM J. NOLAN, JR., CHAIRMAN, COMMITTEE ON TAXATION, U.S. COUNCIL OF THE INTERNATIONAL CHAMBER OF COMMERCE

SUMMARY

1. The U.S. Council believes that there should be a full scale review of what the tax policy of the United States should be with regard to international activities of U.S. corporations. The great expansion of international investment since the end of World War II compels this review.

2. The U.S. Council believes that taxation of income should be based on the premise that the jurisdiction where the income is produced has the exclusive right of taxation.

3. Pending that reexamination of policy and in light of the Treasury's announcement that it will be making recommendations to Congress on "comprehensive proposals relating to the U.S. taxation of foreign source income," the U.S. Council urges that at this time there be deferred any legislation in the foreign tax area.

4. The proposals contained in Sections 431 and 432 of H.R. 13270 (and the Treasury recommendations for their revision) are injurious to foreign business and will hamper the development of foreign resources by U.S. nationals to the long-run detriment of the U.S. economy.

5. The U.S. Council strongly protests against the singling out of a particular industry for restrictive tax legislation with respect to its foreign income. We do not believe that if foreign income is to be taxed by the United States, it should be treated, for purposes of depletion or otherwise, differently than similar domestic income.

6. If the Committee on Finance decides to propose legislation affecting foreign source income, the U.S. Council urges for consideration legislation in the following additional areas:

(a) An extension of the deemed foreign tax credit to "third tier" foreign corporations;

(b) A broadened definition of what foreign taxes may be creditable where a foreign jurisdiction does not rely to the same extent as the United States on an income tax as the major source of tax revenue;

(c) Restraint by the United States in taxing foreign income where the foreign jurisdiction has authorized exemption from tax or reduced the tax liability in order to encourage foreign investment—in other words, a recognition of "tax sparing";

(d) An adjustment in the foreign tax credit computation to prevent distortions in the case of abnormal losses;

(e) The elimination of the advance ruling requirements under Section 367 of the Internal Revenue Code for transactions involving foreign corporations;

(f) A tolling of the one-year period under Section 1034 of the Code (relating to the deferral of the taxation of gain because of the reinvestment of proceeds from the sale of the taxpayer's principal residence) while the taxpayer is resident abroad on assignment by his employer.

STATEMENT

My name is William J. Nolan, Jr., and I am appearing today as Chairman of the Committee on Taxation of the United States Council of the International Chamber of Commerce. The U.S. Council represents American business interests within the International Chamber, which in turn represents the international business community in some 75 countries. As some of you may recall, our Committee on Taxation has had the privilege of presenting its views on tax matters to the Commitees of the Congress on many occasions.

Our Committee has had a series of meetings and has discussed at length the revision of the Internal Revenue Code proposed to be made by Sections 431 and 432 of H.R 13270. We do have some specific things to say about these proposals which I will turn to very shortly. But first I would like to say that we feel strongly that the proposed changes raise policy issues concerning what the Government's basic approach to the international activities of U.S. companies ought to be. In examining the proposals, we found ourselves continually returning to the question of whether the effect would be to carry our tax policy in a direction generally consonant with the new and rapidly growing importance of our international investment and production.

Inevitably specific proposals take the form of patchwork on an already heavily patched tax instrument. This is inevitable in the amendment process as experience with given taxes indicates the need for change, but at some point we are inhibited by a sense of diminishing returns and find ourselves faced with the impossible task of trying to create a new approach by modifying an old one.

My Committee's most significant reaction to the proposed changes, is, then, that they are modifications in a foreign tax program which itself is in serious need of reappraisal. In this connection we are most pleased that in his statement before this Committee on September 4, Assistant Secretary Cohen has indicated that an over-all review of foreign tax policy is being made by the Treasury. It goes without saying that the Council's Committee would like to

make its experience and expertise available in any way that it is felt would be helpful in this constructive review.

The present system of foreign tax offset in its very nature implies the continued exercise of primary tax jurisdiction by the country where production takes place. This prior right has long been recognized in U.S. tax policy on the grounds that it is the host country that provides the infrastructural services and the political and social framework. But under the present system the ultimate and perhaps he crucially important tax jurisdiction is exercised by the parent company's country. In the typical instance this means that this latter country decides such important issues as the desirable level of total taxation. This decision clearly has a very important bearing on the competitive position of our producing activities abroad. Furthermore, the parent company's country, in exercising these important responsibilities, is motivated by considerations that almost certainly are tangential to the question of the growth and competitive strength of these activities. The present approach to the taxation of our foreign-based business treats the income very much like a windfall profit unaffected by the character of the tax, whether or not the effect of the policy is detrimental to the growth of such income. It should be noted in contrast that this last consideration—the integrity and growth of income—is the key consideration in our domestic tax philosophy.

In the pre-World War II period international production tended to be so limited that its relevance to national economic policy was small. But since the Second World War there has been an enormous growth of international production—10% a year on the average since 1950 for a five-fold increase. This is an expansion far more rapid than the 4 and 5 percent GNP rates familiar in national growth, as fast even as the so-called "miracle" growth rates reached in some years in Germany, Italy, and Japan.

In fact foreign business activity is no longer merely a peripheral activity of American business, nor one raising only incidental problems of taxation. In our close following of the trends of internationalized production at the U.S. Council we now work with a figure of estimated U.S. production abroad of $200 billion, and foreign production in this country estimated at $90 billion. Just to emphasize the order of magnitude here, we are talking about goods and services that compare with the size of the Japanese and German economies combined.

Internationalized production is clearly and by far the most important link between this country and world markets and is the principal means through which we exert an upward influence on world income. It has only started to be recognized that these producing activities are five times more important than exports as a means by which we reach foreign markets. Looking ahead a little, it is clear from the vigor of international enterprise that somewhat more than half the production of the world will be internationalized in the next 15 years or so.

Internationalized production has been brought to its present impressive importance through international investment that has taken place since the end of World War II. The United States has taken the lead in these trends, which clearly have had a transforming influence on the structure and productivity of world economic activity.

U.S. participation in international production typically involves a melding of U.S. capital and management with the management, capital, resources and labor of the foreign country, with foreign imputs ordinarily far in excess of US. ones. The result of this melding of productive contributions has been a better international allocation of resources, a dynamic growth of production worldwide, and a glimpse of the beginnings of a world economy. Fundamental tax policy questions that could be reasonably put off at earlier stages of growth must now be faced directly, because tax policy directly affects the productivity of resources.

With this in mind it is our belief, and that of the worldwide International Chamber of Commerce, that tax jurisdiction ought to be exclusively in the hands of the authorities that prevail where the production is taking place. The present system under which the U.S. asserts ultimate jurisdiction over income earned abroad by American companies is subject to at least two sweeping objections. It disregards the effect of taxation on desirable allocation of resources from a production standpoint and, beyond this, it is almost unmanageably complex.

In the long run United States tax revenues are bound to increase even though confined to income produced within its geographic jurisdiction. This is a necessary consequence of the higher production resulting from a better international allo-

cation of resources, through which process U.S. resources are more efficiently utilized in adaptation to the broader world market. The American experience in the last decade seems to be a dramatic confirmation of the advantages in terms of production that accrue to this country as it has in fact geared its production to a worldwide basis. No one who has studied the experience of the growing number of the country's international companies would question the dramatic upward thrust that "going international" has imparted to domestic as well as overall operations. A company with coordinated producing bases distributed throughout world markets increases not only its total production but also the productivity of each of the bases. These advantages appear in the realistic form of lower costs and higher yields—one might add, higher taxable yields. International differentials in after-tax income should be accepted as being the primary guides to the flow of resources into their most productive uses in exactly the same way that after-tax differentials within the domestic jurisdiction operate.

In preparing our specific comments we have tried as far as possible to apply these international perspectives which we believe should underlie the taxation of international production now and in the future. At the same time we recognize in our review that the questions at hand would not actually arise if the United States were operating under the basic policy here recommended, namely that tax authority be exercised only with respect to income produced within the national borders of the sovereign authority. Pending this move nations imposing taxes on income earned outside their jurisdiction should seek to minimize any negative effect on the competitive strength of these producing activities abroad and in general should weigh questions of tax policy with explicit, deliberate regard for its international implications.

We question the need for, or the desirability of, making changes at this time in the specific areas encompassed by the proposals contained in Section 431 and 432 of the Tax Reform Bill when the Treasury Department has underway the development of "comprehensive proposals relating to the U.S. taxation of foreign source income" which it has announced it will present to Congress. Our Committee suggests that further patchwork in the area of the taxation of foreign income is inadvisable and may even be pointless when viewed in the light of the decisions which will flow from the Treasury's comprehensive recommendations.

However, if this Committee determines that there is need to legislate in the foreign tax area at this time, we desire to put before it our views as to the inadvisability of the adoption of the provisions presently incorporated in the House bill at Section 431 and 432 and the suggestion as to other items which should be considered for action.

Section 431—Per-country limitation

Section 431 of H.R. 13270 provides that where a taxpayer has elected the per-country limitation for foreign tax credit computations, he must carry forward losses incurred in a foreign country and use them to reduce income from that country in subsequent years before computing the limitation of the foreign tax credit to be allowed for income taxes paid to such country. The theory for this unusual proposal as expressed in the House Ways and Means Committee Report is that under present law the taxpayer receives a double tax benefit under such circumstances.

We believe that the Ways and Means Committee was mistaken in its view that a double tax benefit exists. That view must have been premised on the belief that foreign countries ordinarily do not allow loss carrybacks or carryforwards for purposes of computing income taxes. That is plainly erroneous for many countries allow losses to be offset against future income. Moreover, the taxpayer certainly receives no double tax benefit even if the foreign host country does not allow losses to be carried back or forward. He is paying full taxes and under the theory of Section 431 he would be additionally penalized—for there would be a doubling up on his aggregate tax bill.

The Treasury's proposal that the provisions of Section 431 be expanded so as to be applicable to a taxpayer on the overall limitation who has an overall foreign loss could well result in double taxation. First, taxes paid on income in Country A would not be creditable where losses in Country B offset that income. This is the case under present law. Then, under the loss reception rule of Section 431 when the operation in Country B became profitable, foreign taxes otherwise creditable will be reduced.

Section 432—Separate limitation for mineral income

Section 432 of the House bill (which the Treasury has recommended to this Committee be substantially altered) would apply a separate limitation on the foreign tax credit with respect to foreign taxes attributable to foreign mineral income. The theory underlying the limitation, as expressed in the report of the Ways and Means Committee, is to isolate cases where "income taxes represent, at least in part, royalties." The three tests are whether the foreign country:

(1) requires payment of a bonus or royalty,

(2) holds substantial mineral rights with respect to the property, or

(3) imposes any income taxes on mineral income at an effective rate higher than on other income.

We do not believe that the above three tests represent a valid basis for a conclusive statutory presumption that certain income taxes actually represent royalties. The fact that a royalty is paid to a foreign government is a strange basis for holding that income taxes paid to that government also contain a royalty element. But even assuming the validity of the tests, we question the desirability of fragmenting foreign income for the purpose of computing the foreign tax credit limitations.

We do not believe that it is proper tax policy to impose a separate limitation on certain items of income or on particular industries and thereby discriminate against a business activity.

Not only is a separate mineral income limitation discriminatory but it runs contrary to United States policy aimed at furthering the economic and social development of the less developed countries of the world. Further, such discrimination will undoubtedly favor foreign competition over United States interests in the very necessary efforts being made to assure our domestic economy of an adequate supply of basic minerals.

The Treasury has recognized before this Committee the discriminatory aspects of Section 432 of the House bill in treating mineral companies in a different fashion from all other U.S. taxpayers with foreign operations. The recommendation of the Treasury that, in lieu of the complex and unfair provisions of 432, there be substituted a provision denying the averaging of foreign tax credits where excess credits from one country arise out of the allowance for percentage depletion. While my Committee feels that the Treasury proposal is far better than the House provision, nevertheless we view that restriction as being contrary to the often proclaimed theory of tax neutrality as between United States investments and foreign investments.

The Treasury proposal would clearly discriminate against foreign mining opportunities.

That Treasury proposal is substantially similar to one presented to Congress in 1963 and rejected. The U.S. Council does not endorse the proposition that foreign source income should be penalized. For this reason, among others, my Committee opposes the provision of Section 501 of the House bill which would deny percentage depletion to income from certain foreign oil and gas wells. The U.S. Council is pleased to note that the Treasury also felt this discrimination to be unfair. Different rates for depletion on domestic income and foreign income are by nature an unfair discrimination.

For reasons fully explained earlier, the U.S. Council strongly urges that revisions in the area of taxation of foreign source income be deferred until the Treasury has presented its recommendations based upon its current full scale study. Otherwise changes made now may prove to have been unwise on an overall review of taxation and, even worse, will lead to additional complexities under an already complex system for the tax treatment of foreign source income.

Other areas involving taxation of foreign income recommended for legislation

If the Committee on Finance concludes that legislation is desirable at this time in the area of the taxation of foreign income, then the U.S. Council desires to recommend for consideration certain additional matters which we feel are deserving of prompt legislative attention and action.

Third tier foreign corporation

The U.S. Council urges that there be a broadening of the limitations of Section 902 so as to extend the foreign tax credit under certain circumstances to a third

tier foreign corporation. In the last few years several bills have been introduced to accomplish this purpose. Under the present statutory provision, credit for taxes paid by a foreign corporation can only be had if (a) at least 10% of the stock of the first tier corporation is owned by the U.S. taxpayer and (b) in the case of a subsidiary of such first tier corporation, at least 50% of the stock of the subsidiary is owned by the first tier corporation.

In the past, there apparently has been some feeling on the part of Treasury that the extension to a third tier foreign corporation made the auditing problem too great. This cannot now be a valid objection. First, with the additional reporting requirements adopted over the past several years, there is ample information available to the Internal Revenue Service to check out thoroughly any claims for foreign tax credit. And second but most important, a credit is not available unless proved. If the taxpayer is not in a position to support his claim, then he has no credit!

In some foreign jurisdictions an alien may not hold more than a minority interest. Recent developments have clearly indicated a determination on the part of foreign governments that they or their nationals must own a majority stock interest in corporations engaged in business in their jurisdictions. A maintenance of the ownership formula under Section 902 at 10% by the U.S. corporation in the first tier foreign corporation but a change to a 25% interest (now 50%) by that first tier foreign corporation in the second tier foreign corporation and the extension of the benefits of a credit to dividends received from a third tier foreign corporation owned at least 25% by the second tier foregn corporation would greatly help U.S. business in organizing its affairs in foreign lands. In addition, it is our thought that such revision of the statute could lead to a broadening of foreign participation in those operations.

In addition to the above, the U.S. Council recommends a change in the statute to allow a foreign tax credit where related parties—say U.S. parent and U.S. subsidiary—own between them the requisite percentage ownership of a foreign corporation although neither one holds 10% in its own name. Obviously, the information on verification of any credit claims is just as available in this situation as it would be if either one of the U.S. corporations owned the 10% directly.

It is our belief that these changes would not cause any loss of revenue but would very dramatically ease the problems of foreign corporate organization for overseas operations of U.S. corporations.

Broaden definition of "tax" for which credit is given

Section 903 now permits a credit for any foreign tax paid "in lieu of a tax on income." Although this provision was intended to be broad in scope when included in the 1942 Revenue Act, the Treasury regulations and administrative practise have so restricted it that an "in lieu tax" can only be creditable if (a) the foreign country has an income tax in force, (b) the taxpayer would be subject to such income tax absent some special provision and (c) he pays a substituted tax "in lieu" thereof.

This type of restriction permits no credit for taxes imposed by a foreign country which has not adopted the income concept of taxation even though such taxes are at least as burdensome as would be an income tax. The failure to grant a credit in this situation certainly does not further tax neutrality as between foreign and domestic income.

The U.S. Council recommends to your Committee that some form of credit be adopted in respect to a country's principal tax even though it is not an income tax. Under our concept of taxation—such a tax would clearly be *in lieu of* an income tax. The Treasury Department itself in 1954 recommended a broadening of the "in lieu" provision along this line and we hope its current study will bring similar recommendations for corrective legislation.

Tax sparing

The U.S. Council urges this Committee to reexamine the concept of "tax sparing." Much has been said of the irritation of less developed countries in attempting to induce investment by some form of tax benefit only to see such benefit gobbled up by the U.S. Treasury. If the foreign land—and let us assume we are only talking about less developed countries—wants to encourage investment by forgiving taxes, then why not recognize tax sparing? The other side

of the coin is that without tax sparing or some equivalent restraint in taxation of foreign income, the foreign jurisdictions are faced with pushing their tax rates up to the U.S. level. Has anything been gained by them or by the United States in that type of action? Have we helped to develop the foreign country's economy? Moreover, if the United States does not recognize the concept of tax sparing, it is then penalizing its nationals in foreign operations against those of other countries with more realistic bents. One of the evils of Section 432 of the House bill is that it further encourages foreign countries to increase their tax rates and to do away with their own tax incentives. If the United States is going to nullify through its tax system, such advantages, the foreign jurisdictions will be quick to cancel out benefits being offered for U.S. investments.

Effect of worthless securities loss upon foreign tax credit limitation

Losses from the worthlessness of foreign stocks and securities (Section 165(g), IRC) during the taxable year affect the limitation of the allowable foreign tax credit in an arbitrary and capricious way to the disadvantage of many taxpayers. It is proposed that such losses be deemed to have a U.S. source in computing the limitation on allowable foreign tax credit (Section 904, IRC).

For example, assume that the foreign source income taxable to a corporate taxpayer in a year is $1,000,000 and assume that foreign income taxes paid and "deemed paid" on this income in various foreign countries aggregate $500,000 and the taxpayer has elected the "overall" limitation. Further assume that the U.S. tax rate is 50% so that the gross U.S. tax before foreign tax credit is $500,000 against which may be credited the $500,000 foreign income taxes paid and deemed paid. No U.S. tax is therefore payable on the taxpayer's foreign source income because the income has borne foreign income taxes at an effective overall rate equal to the U.S. rate.

Now let us assume that in a particular year the assets of a wholly-owned foreign subsidiary of the U.S. corporation are destroyed in an insurrection, and the taxpayer experiences a loss from the worthlessness of the stock of this foreign subsidiary which stock has a cost or other U.S. tax basis of $1,000,000. The loss reduces the U.S. corporate taxpayer's taxable income in the amount of $1,000,000. Under the present position of the Internal Revenue Service, however, the loss is deemed to be from a foreign source and thus reduces the numerator of the fraction limiting allowable foreign tax credits. In our example, the $500,000 of foreign income taxes paid is not creditable against U.S. income taxes in the year of loss and, if the taxpayer incurs foreign taxes at rates comparable to the U.S. rate in the two years available for "excess" foreign tax credit carryback and in the five years open to carryover, the $500,000 will never be allowed as a credit against U.S. taxes. The result is that in the year of worthlessness the taxpayer's overall income from operating abroad is zero (i.e. $1,000,000 less $1,000,000 loss from the worthlessness of stock), yet the taxpayer has paid $500,000 of foreign income tax which will never be allowable as a credit against U.S. taxes.

It is submitted that the proper result would be to consider the loss on the worthlessness of the stock or securities to be from U.S. source, thereby *not* decreasing the numerator of the foreign tax credit limiting fraction and allowing credit for the foreign tax paid or deemed paid in our example.

A loss on worthless stock or securities in a foreign corporation may be an infrequent item, but of severe consequence. For example, if a foreign subsidiary becomes worthless because of expropriation, insurrection, natural disaster, or simply because of business failure, the loss in the year of worthlessness may be sizeable. The Internal Revenue Code recognize this loss and allows a deduction (either capital or ordinary, Section 165(g), IRC). However, this deduction can be negated, as in our example, by denying the credit for foreign taxes paid in a manner we are confident was not contemplated by the Congress. We submit that it should be the aim of Congress to encourage investments abroad through full tax recognition of loss on the failure of such an investment. (Such losses are often in the developing countries where risk of loss is the greatest and where there have been frequent indications of Congressional intent to encourage investment.)

We believe the proposed change is particularly appropriate at this time because regulations of the Office of Foreign Direct Investment may require repatriations of income carrying foreign tax credits which would be limited by such losses. These regulations narrow any opportunity of the U.S. taxpayer to minimize the loss of foreign tax credit by suspending the payment of dividends in the year of loss, and this, in turn, has the effect of increasing the severity of the loss from a U.S. tax point of view without justification. Even if the Foreign Direct Investment Regulations are ultimately suspended, it would be in the best interest of the U.S. balance of payments to adopt the proposed change in computing the foreign tax credit limitation so as not to discourage repatriation of dividends from foreign sources.

Advance section 367 rulings

My Committee urges that there be some modification in the requirement that a ruling under Section 367 of the Internal Revenue Code must be secured *in advance* of the transaction involving foreign corporations if the non-recognition of gain provisions of the Code are to apply to such transaction. We suggest that if the particular transaction involving foreign corporations is determined on audit to meet those non-recognition provisions, then the fact that an advance ruling had not been secured should be immaterial to the tax treatment.

The kinds of tax abuse that Section 367 was intended to counter when enacted in 1932 are no longer present. Moreover, the Internal Revenue Service has used the advance ruling requirement as a club to force its views in areas where there exists considerable doubt. The time lag now faced by taxpayers in securing a ruling would also be avoided with the elimination of the "in advance" requirement. There is also the very real problem of a U.S. taxpayer even knowing about a transaction involving a foreign corporation in advance of its consummation much less in time to attempt to see that a ruling is requested. For these reasons we recommend the elimination of the "in advance" ruling requirement of Section 367 where it can be shown that avoidance of United States income tax was not one of the principal purposes of a particular transaction involving foreign corporations.

Nonrecognition of gain on sale of residence

Under Section 1034 of the Internal Revenue Code a taxpayer who sells his principal residence at a gain will not be taxed currently on that gain of the proceeds of sale are reinvested within one year in the purchase of a new residence. My Committee would like to suggest that there be a suspension of the running of the one-year period of reinvestment in the case of any employee who has made the sale of his residence because of an assignment abroad by his employer. The suspension period would cover the period of residence abroad. To protect the revenue the sale could be treated as taxable in the year of sale with the right of the taxpayer to claim a refund if, on his return to the United States, he fulfills the requirements of Section 1034.

(There follows, communications received expressing an interest in the subject of foreign tax credits:)

ARTHUR ANDERSEN & CO.,
Chicago, Ill., September 19, 1969.

COMMITTEE ON FINANCE,
New Senate Office Building,
Washington, D.C.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

DEAR SIRS: (1) Section 431 should be deleted because—

(*a*) Elimination of flexibility now allowed a taxpayer to choose between the "per country" limitation and the "overall" limitation would result in double taxation in many instances.

(*b*) The workings of the Section effectively disallow losses on unsuccessful foreign operations, but tax income from profitable ones, an obvious inequity.

(2) Section 432 should be deleted because, when coupled with the disallowance of percentage depletion, the further limitation of the foreign tax credit on mineral income effectively penalizes the extractive industries.

BASIS FOR COMMENTS

(*1*) *Section 431*

This Section should be deleted.

The existence of the right to choose between the "per country" and "overall" limitation for foreign tax credit computations recognizes the myriad of international business situations which can, through inequities in the credit system and consequent double taxation, be very costly to taxpayers unless maximum flexibility is given. This flexibility should be expanded, rather than reduced, as would be the case if Section 431 is adopted.

Computations under Section 431 show that application of the provisions ultimately result in taxation of foreign source income at penalty rates as compared with domestic source income. Even more harsh is the fact that the tax effect of foreign source losses must be recouped completely where the assets of the underlying operation are sold. The effect of these provisions is to disallow losses on foreign operations entirely where they are unsuccessful and subsequently sold, but to tax the income from those operators at penalty rates if they are ultimately profitable. Provisions of this type do not belong in our taxing system.

If enacted, this Section will:

(1) Discourage investment in less developed countries,

(2) Aggravate the U.S. balance of payments positions through reduction of repatriation of overseas profits in this situation,

(3) Reduce the competitive position of U.S. business abroad.

None of these is desirable.

(*2*) *Section 432*

With respect to this Section, the proposed limitation on credits coupled with the complete disallowance of percentage depletion on foreign oil deposits creates a disadvantage for the extractive industries. To be excluded from percentage depletion is harsh enough, but that coupled with a severe limitation of the availability of the foreign tax credit will result in discriminaton against a major U.S. industry.

If there is abuse in the "royalty-tax" area where mineral deposits are owned by a foreign government, it would seem better to attack that problem directly. If there is a problem, why not provide for some method of arriving at an arm's length standard with respect to the taxes or royalty payments as has been done in other areas? Another responsibility would be to place the burden of proof on the taxpayer to show the proper relationship between royalties and taxes. To merely sweep the problem under the rug rather than attack it directly seems less than desirable.

Above all, if either Section 431 or 432 are to be adopted, they should be applied only to new acquisitions or business interests and not to existing ones where the legal and business arrangements are fully solidified and cannot be changed. Investment decisions have been made based on rules in existence at the time of those decisions. They should not be materially altered by subsequent changes in tax laws. Merely providing for a new election with respect to the foreign tax credit is not sufficient to counter the new problems created.

CONCLUSION

This statement is submitted as part of a series of letters, each dealing with a particular area of the proposed legislation. It is intended that the comments and

recommendations contained herein be made part of the record of testimony relative to the legislative changes contemplated for foreign tax credit. We shall be pleased to discuss these matters further with you or the Committee, either in person or by telephone. Please call us collect at 312—346-6262 if necessary.

Very truly yours,

JOHN MENDENHALL,
Director of Taxes.

CHRYSLER CORP.
September 2, 1969.

Re H.R. 13270—The Tax Reform Act of 1969.
Subject: Section 431—Foreign Tax Credit.

Hon. RUSSELL B. LONG, *Chairman, Committee on Finance, U.S. Senate, New Senate Office Building, Washington, D.C.*

GENTLEMEN: Chrysler Corporation ("Chrysler") welcomes the opportunity to submit a written statement presenting its views with respect to those provisions of H.R. 13270 (The Tax Reform Act of 1969) dealing with the Foreign Tax Credit (Section 431).

Section 431 of the bill, dealing with Foreign Tax Credit Reduction in Case of Foreign Losses, is inequitable and should be eliminated from the bill. This is because foreign branch profits would continue to be subject to U.S. tax, whereas losses of foreign branches would in effect be only temporarily recognized. If this proposal is to be enacted in some form, however, any tax advantage recouped by the Treasury should be reduced by any U.S. tax paid on income from such country during the three preceding taxable years (comparable to a net operating loss carryback under Section 172).

During the past several years, many taxpayers and associations have suggested (and elaborated on the justification therefor) that the "deemed paid" foreign tax credit provided under Section 902(b) of the Code be extended to dividend distributions from foreign subsidiaries below the second tier in which the U.S. parent owns directly or indirectly at least five percent of the voting stock. Chrysler urges that any tax reform bill enacted in this Congress include such a provision.

Yours very truly,

BRIAN T. O'KEEFE,
Assistant Comptroller.

BANKERS' ASSOCIATION FOR FOREIGN TRADE,
August 20 1969.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee, U.S. Senate,
Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: I am addressing this letter to you on behalf of the Bankers' Association for Foreign Trade. Our association, whose membership is composed of those commercial banks that are actively engaged in the international field, is recognized as the spokesman for U.S. banking on matters of foreign trade and finance. The BAFT was established in 1921 and its 133 bank members represent a broad geographical coverage of our nation.

It is our understanding that your Committee will soon hold hearings in connection with its deliberations on the Income Tax Reform Bill recently reviewed by the House Ways and Means Committee. Our Association is particularly concerned with the *Foreign Investors' Tax Act of 1966 which is included in the Tax Reform Bill.* Provisions of this act will, undoubtedly, be taken up for scrutiny by your committee at this tire.

With this in mind, I am enclosing a copy of our Statement of Policy which was adopted May 21, 1969 at our Annual Meeting held at Boca Raton, Florida, In particular I wish to draw your attention to that section of our statement reading:

"We commend President Nixon for his recent initiative (through the Department of the Treasury) in recommending the repeal of those provisions of the Foreign Investors Tax Act of 1966 under which interest on deposits belonging to nonresident alien individuals and foreign corporations in commercial banks in the United States will be subject to federal income tax and withholding after January 1, 1973. If not repealed, this tax will result in an outflow of deposits from the United States to the banks of many other countries whose governments will continue to exempt such interest from taxation and will have an adverse balance of payments effect.

"We urge prompt repeal of the above change scheduled to become effective in 1973 under present law.

"With equal urgency, we also recommend the repeal of certain other provisions of the Foreign Investors Tax Act of 1966, relating to estate taxes which, if not repealed, will require that all U.S. bank deposits belonging to nonresident alien decedents be included within their taxable estates, whether or not such deposits are related to the conduct of a U.S. trade or business.

"The potential increased revenues from these two tax sources are insignificant when compared with the detrimental effect on the United States balance of payments and the position of the United States as a financial center. We strongly recommend that action be taken immediately by the Officers of the Bankers' Association for Foreign Trade and the American Bankers' Association towards repeal."

The time deposits held by BAFT member banks in the name of foreign residents reach very substantial proportions. In the face of threatened imposition of income and estate taxes in the future, those interest-bearing accounts now carried by foreign depositors with domestic banking institutions, will be withdrawn and redeposited abroad with consequent unfavorable impact on this country's balance of payments. Additionally, there will be a detrimental effect on the position of this country as an international money market. We, therefore, strongly favor the rescission of those sections of the Foreign Investors' Tax Act of 1969, that would subject to income and estate tax those deposits of the type described.

As you know, the House Ways and Means Committee has published its findings concerning the Tax Reform Bill. As concerns the Foreign Investors Tax Act, the Committee recommended that the current exemptions be continued through the end of 1975. This action is helpful now, but is only a temporary solution. Therefore, we continue to urge repeal of the subject provisions and respectfully request that your Committee in the course of its deliberations keep in mind our position as well as the official recommendations of the Treasury Department and American Bankers Association which we support.

We are grateful for the opportunity to present by means of this letter the BAFT viewpoint on this matter. If, in the course of your proceedings, you would like further elaboration of our position, we would be glad to hear from you.

Very truly yours,

KENNETH P. KINNEY, *President*.

Enclosure.

BANKERS ASSOCIATION FOR FOREIGN TRADE

STATEMENT OF POLICY

At the Annual Meeting of members held May 21, 1969, the principles and policy recommendations set forth in the following statement prepared by the Policy Committee, were discussed and adopted by the members. Accordingly, the statement will provide guidance in the year ahead to the Directors and Officers of the Association in their efforts to further the aims of the Association and its membership.

THE U.S. D[illegible] THE WORLD MONETARY MECHANISM

During the past 1[illegible] [illegible] en at least four currency crises which could properly be characterized as "majo[illegible] e imme[illegible] promises more difficulties. The causes for the present lack of confidence in international [illegible] system are complex. This system has served the free world well since its creation at Bretton Woods, New Hampshire, in 1944. But rising uncertainties, conflicting national policies, protectionism, inflation in some important countries, and possible weaknesses in the international monetary system itself, threaten disruption and call for new policies and procedures.

The Bankers' Association for Foreign Trade is concerned by the fact that the dollar, the keystone of the international monetary system, is being questioned as a monetary reserve asset. However, since cooperation among the major countries is essential to the successful solution of certain basic problems, we hope that bankers and business leaders in other nations will also undertake an active role in their respective countries to urge whatever changes are necessary for the restoration of full confidence in the monetary mechanism, a prerequisite for continued steady economic progress in the world.

We believe that world trade can continue to grow and expand only on the basis of a stable international monetary system, and in view of the vital role of the U.S. dollar as the peg to which all free world currencies are tied, our hope for such stability depends to an important extent upon the soundness of the dollar. To insure such soundness, the United States must take vigorous steps to combat inflation, to moderate excessive stimulation of the economy, and to eliminate budgetary deficits. We support the continuation of the income tax surcharge and monetary policies of the Federal Reserve System aimed at imposing a reasonable credit restraint upon the domestic economy as necessary elements of monetary, fiscal, and budgetary policies intended to insure the soundness of the dollar, and to gain control over a balance of payments deficit which has existed every year since 1950 (except for 1957 during the Suez crisis).

BEST AVAILABLE COPY

Many proposals have been advanced during the past year for dealing with the world monetary system. We recommend that further study be given to these and other proposals to determine whether they can provide realistic and workable alternatives. We strongly believe in the need for fixed and stable exchange rate parities. However, the system must have sufficient flexibility and strength to make orderly adjustments – over extended periods of time – to strains resulting from differing rates of increase in national incomes, prices, and costs, as well as from the varying impact of changing technologies.

Since it is doubtful that gold and dollars will be adequate and in sufficient amounts for world reserves in the future, we should provide for increases in the world reserve pool needed for a sustained expansion of world trade and production. We would welcome the introduction in adequate amounts of the proposed Special Drawing Rights under the International Monetary Fund for this purpose.

U.S. TRADE POLICY

During 1968, our trade surplus dropped from $4.1 billion to $835 million, the lowest level since 1959. This decline may be attributed in large measure to the upward spiral of rising wages, costs, and prices and must be met, as previously emphasized, with a rigorous attack on the fundamental problem of domestic inflation.

We must not endeavor to improve our position by short-sighted measures to curb imports, but rather by devising means to expand our exports. The Report to the President, submitted by the Special Representative for Trade Negotiations in January, 1969, entitled *"Future United States Trade Policy"* points toward freer trade through various measures, particularly the reduction of non-tariff barriers on a reciprocal basis. The five Task Force Reports of the National Export Expansion Council submitted to the Secretary of Commerce, recommend specific courses of action in many areas which have not yet been implemented and which would receive the support of members of the Association. Especially hopeful is the emphasis on the five-year export expansion program announced by the President, with the export goal of $50 billion to be achieved by 1973. We also commend the President for reactivating the Cabinet Committee on Export Expansion, comprised of representatives of all relevant government agencies, and for the appointment of a Special Representative for Trade Negotiations who will be directly responsible to the President on important trade matters in the year ahead. The members agree with this general approach of the Administration and are ready to assist in this important effort toward expanding world trade.

We urge that all U.S. banks engaged in international banking take an even more active part in stimulating exports from their areas, through support of their Regional Export Expansion Councils, through contacts and educational activities on the part of their business development departments, and through advertising and public relations emphasizing their desire and ability to increase exports.

VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM AND FOREIGN DIRECT INVESTMENT CONTROLS

We believe the Voluntary Foreign Credit Restraint Program is a serious barrier to and restraint on the expansion of this nation's foreign trade, and recommend that the *program be terminated as soon as possible.*

We regard the changes made toward the liberalization of restrictions on foreign direct investment which were announced on April 4, 1969, as an encouraging sign that the Administration will indeed take effective steps toward full termination of the controls. We urge that this be done as quickly as possible.

FINANCING OF U.S. EXPORTS

A reversal in the serious deterioration of the foreign trade position of the United States is imperative. This will require better cooperation between government and business in many areas; export financing, export promotion, and foreign investments, to name a few.

Banks have received strong encouragement to maximize export financing as part of the government's

program of export promotion. Some of the efforts undertaken by the banks were subsequently found to have been in vain; the encouragement has been vitiated by the slow development of practical government support for export financing, by the impact of tight money policies on the export sector and by the proliferation of controls and restrictions on foreign lending.

We have concluded that in order to enable our exporters to compete effectively against the foreign supplier who benefits from incentive programs now being offered by many foreign governments and in order to expand United States exports to achieve national goals, certain incentives are required, including among them special interest rates on commercial bank credits for exporters and assurances of the availability of credit for the financing of exports. It is recommended, therefore, that the Federal Reserve Board provide rediscounting facilities applicable to export credits at special rates to assist American exporters.

We urge that a government agency at the highest level be given authority and responsibility for the coordination of the policies and practices of the various government departments and agencies in the general area of foreign trade financing. We feel that such coordination would provide essential and defined channels of government policy through which more banks may develop a capability to provide support for potential as well as existing export industries.

EXPORT-IMPORT BANK OF THE UNITED STATES

We urge the Export-Import Bank to contribute more effectively to increased commercial bank participation in export financing operations because of its positive impact on our balance of payments. We are gratified to note the fine spirit of cooperation that has existed between Export-Import Bank officials and the commercial banks in recent years. In this connection and in line with the avowed purpose of the Export-Import Bank to complement and not to supplant commercial bank financing activities, we wish particularly to urge the earliest government action with respect to improved financing of jet aircraft and other capital goods. The Private Export Financing Corporation (PEFCO) proposal, originated within the framework of the Bankers' Association for Foreign Trade and now under review by government authorities, points to a partial solution. PEFCO's lending activities will have direct participation by the commercial banking industry and institutional lenders using Export-Import Bank guarantees rather than a direct outlay of funds by the latter institution. We strongly recommend that immediate and affirmative actions be taken by the Government in approving PEFCO plan so that this corporation can be established without further delay.

We urge the more imaginative use of the $500 million Export Expansion Facility which would facilitate the penetration of the new markets and help us regain our position in the traditional ones. Liberalization of other aspects of the guaranty program must also be considered in order for U. S. exporters to be competitive.

INCOME AND ESTATE TAXATION OF FOREIGN DEPOSITS IN THE UNITED STATES

We commend President Nixon for his recent initiative (through the Department of the Treasury) in recommending the repeal of those provisions of the Foreign Investors Tax Act of 1966 under which interest on deposits belonging to nonresident alien individuals and foreign corporations in commercial banks in the United States will be subject to federal income tax and withholding after January 1, 1973. If not repealed, this tax will result in an outflow of deposits from the United States to the banks of many other countries whose governments will continue to exempt such interest from taxation and will have an adverse balance of payments effect.

We urge *prompt* repeal of the above change scheduled to become effective in 1973 under present law.

With equal urgency, we also recommend the repeal of certain other provisions of the Foreign Investors Tax Act of 1966, relating to estate taxes which, if not repealed, will require that *all* U.S. bank deposits belonging to nonresident alien decedents be included within their taxable estates, whether or not such deposits are related to the conduct of a U.S. trade or business.

The potential increased revenues from these two tax sources are insignificant when compared with the detrimental effect on the United States balance of payments and the position of the United States as a financial center. We strongly recommend that action be taken immediately by the Officers of the Bankers' Association for Foreign Trade and the American Bankers' Association towards repeal.

WORLD ECONOMIC DEVELOPMENT AND PRIVATE ENTERPRISE

We urge our Government to continue to lend its support in assisting the economic development of those nations which are conscientiously striving to improve the welfare of their people.

A new federal agency, The Overseas Private Investment Corporation, is being created to reorganize and administer U.S. Government incentives to invest American capital and know-how in developing countries. Its financing plans and operating criteria are still matters under discussion. We endorse *in principle* this effort to mobilize the use of private capital and skills in developing countries. This new agency promises to facilitate the use of government guarantees, insurance, and funds in conjunction with private enterprise in a more effective manner than heretofore.

EAST-WEST TRADE

We continue to support any action that would facilitate East-West trade within the framework of our national security and economic interest. In this connection we oppose restrictions on Export-Import Bank guarantees for export loans, providing they cover trade based on these principles.

MERLE R. CROCKARD, *President*
Bankers' Association for Foreign Trade

Senator TALMADGE. That completes our list of witnesses scheduled to be heard by the committee today.

The committee will now stand in recess until 9:30 Monday morning.

(Whereupon, at 3:45 p.m., the U.S. Senate Committee on Finance recessed, to reconvene at 9:30 a.m., Monday, October 6, 1969.)

TAX REFORM ACT OF 1969

MONDAY, OCTOBER 6, 1969

U.S. SENATE,
Committee on Finance,
Washington, D.C.

The committee met, pursuant to recess, at 9:30 a.m. in room 2221, New Senate Office Building, Senator Herman E. Talmadge presiding.

Present: Senators Long (chairman), Talmadge, Ribicoff, Harris, Byrd Jr. of Virginia, Williams of Delaware, Bennett, Curtis, Jordan of Idaho, Fannin, and Hansen.

Also present: Senators Bayh, Cranston, and Percy.

Senator TALMADGE. The committee will please come to order.

This morning the committee begins its final 3 days of public hearings on the Tax Reform Act of 1969. These last 3 days will be devoted to the tax treatment of private foundations.

Our first witness this morning consists of a 19-man panel, which will present the foundations' coordinated testimony. Subsequent witnesses will address themselves to the effect of the bill on educational TV, the effect on conservation, the effect on voter registration, and other problems of a more specific nature confronting various private foundations.

The first witness this morning in the foundations' coordinated testimony is Mr. Irwin Miller, chairman, Cummins Engine Co.

Senator Hartke had a statement here he wanted to make in introducing you, sir, and without objection his statement will be placed in full in the record.

(Senator Hartke's statement follows:)

Mr. Chairman, it is an unusual privilege and pleasure for me today to introduce to the Senate Finance Committee one of the truly remarkable Americans of our era, Mr. J. Irwin Miller, of Columbus, Indiana.

Industrialist, philanthropist, religious and political leader, Irwin Miller is the finest example of a real Renaissance man—Hoosier style.

As industrialist, he is president of the dynamic and progressive Cummins Engine Company, with headquarters in Columbus and plants and offices throughout the world.

As philanthropist, Irwin Miller has contributed handsomely to such institutions as Butler University, the Christian Theological Seminary, and Indiana University, and he has stimulated and presided over an extraordinary architectural flowering in his own city of Columbus.

As religious leader, he has not only long been active in the affairs of his own church but is a recent past president of the National Council of Churches.

As political leader, Mr. Miller was chairman of last year's Rockefeller for President campaign.

His voice is the voice of reason and generosity, and I urge my colleagues on the Committee to pay most careful attention to his counsels.

Mr. Chairman, I am honored to present to the Senate Finance Committee a great Hoosier, Mr. J. Irwin Miller.

33-865 O—69—pt. 6——18

Senator TALMADGE. Was Senator Bayh to be here?
Thank you, you may proceed, Mr. Miller.

FOUNDATIONS' COORDINATED TESTIMONY GROUP [1]

STATEMENT OF IRWIN MILLER, CHAIRMAN, CUMMINS ENGINE CO.

Mr. MILLER. Thank you, Mr. Chairman.

May I add a few words of explanation to the description of the coordinated testimony. According to the list that you have before you Father Hesburgh, president of Notre Dame and I were to discuss the role of the foundations in American life. I will speak briefly on that and Father Hesburgh will lead the panel on the effect of legislation on beneficiaries.

The original printed testimony which you received is accurate, except in respect to a few absentees. President Herman Wells of Indiana University is unable to be here.

Senator TALMADGE. Those statements will be inserted in full in the record.

Mr. MILLER. Dr. Wells is in the hospital and has sent a letter to the committee. We will distribute copies of that letter.

Senator TALMADGE. Without objection the letter will be inserted in the record of the hearings at this point.

Mr. MILLER. Thank you.

(Letter follows:)

INDIANA UNIVERSITY,
Bloomington, Ind., October 1, 1969.

HON. RUSSELL B. LONG,
Chairman, U.S. Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: I deeply regret my inability to appear before this committee. However, my physician at the Duke Medical Center in Durham, North Carolina, where I am presently a patient vetoed the suggestion of releasing me temporarily for this hearing. While respecting the veto, I wish nonetheless to take this opportunity to thank the committee again for the privilege of submitting testimony.

In my written testimony I attempted to show by many examples the vital importance of foundation support to our Indiana institutions, public and private. I had hoped to include a figure for the extent of that support in the last five years, but the time required to collect the data from each institution delayed a final summation until now. With your indulgence, I should like to append the statement that approximately 460 private foundations have given $50,454,821 in the last five years (and pledged a significant amount more) to Indiana's public and private higher educational institutions.

I have tried to make the case in my testimony that the existence of our private institutions in Indiana would be seriously jeopardized by a diminution of foundation funds and, too, that a lessening of foundation support would adversely affect public institutions which have counted on this resource for underwriting the programs, projects and staff needs that make the crucial difference between their merely carrying on customary work and being enabled to infuse it with the quality of distinction. It is through the grants which our public institutions have received from private foundations that much of their distinguished achievements have been made possible.

I wish that I had sufficient eloquence to convey to the members of this committee my belief that the encouragement of private philanthropy in all of its forms—and particularly in the form of the private foundation—is essential to the continued vitality and progress of higher education. I have long believed that our dual system, private and public, and our variety of types of institutions,

[1] The prepared statements of members of the group commence at p. 5433.

with a diversity of purposes and controls, are most important guarantees of freedom and objectivity in higher education. I am just as certain as I can be that, if philanthropic support for higher education is eliminated or substantially reduced, we will soon lose this variety and with it, we will lose something very precious in our academic tradition.

Throughout the years, our private and public institutions have exercised considerable ingenuity in developing multiple sources of support. I would not wish Indiana University to receive its support wholly from the State, nor would I consider it advisable for a private institution to be dependent upon a single source of financing. The healthiest situation, it seems to me, results from a variety of funding sources and attendant controls.

Speaking for private support, without which the dual system cannot be maintained, I do not mean to imply at all that there is anything improper or undesirable in public support of higher education. I wish that there were more of it. But I think that the private sector must be protected in order to give us the kind of varied, imaginative and innovative structure which only diversity and differing points of control can ensure.

Above all else, I would plead that nothing be retained in this legislation which would discourage the creation and continuance of private foundations. The American private foundation is a remarkable invention, providing the means by which great personal fortunes can be transmuted into an instrumentality for benefitting society at large and promoting progress. Without it, the economically fortunate individual would have difficulty in giving away a portion of his wealth for such purposes. Moreover, it is vital to the health and welfare of higher education in America.

I know that the members of the committee are aware of the importance of our dual system, that they understand the significance of variety and differing kinds of control, and that they share with me a concern for freedom of enterprise in higher education as well as in other aspects of society. But I simply wish to raise my voice again, as one who has worked a long time in higher education, to emphasize the significance of these factors, to urge the committee to do all in its power to encourage philanthropy in its many forms, including through the private foundation, and thus to help our higher educational institutions better serve youth and society. In the long run this will save the taxpayer money.

If there are questions which are raised by my testimony, I shall be glad to receive them and file a written reply.

I am aware of the difficult problem faced by the committee and I realize that all of its members are committed to seeking as satisfactory a solution to this problem as possible.

Again, my thanks for the privilege of participating in this discussion.

Respectfully submitted,

HERMAN B. WELLS,
University Chancellor, Indiana University.

Mr. MILLER. Mr. Ben Heineman, chairman of the Chicago and Northwestern Railway Co., is unable to be here. He would have been present in September, but cannot be here today.

Mr. Elvis Stahr cannot be here. Mr. Kermit Gordon is in the hospital.

With these exceptions the list as given to you is accurate.

(The committee subsequently received the following letter from Mr. Ben Heineman:)

NORTHWEST INDUSTRIES, INC.,
400 West Madison Street, Chicago, Ill.,
October 2, 1969.

Hon. RUSSELL LONG,
U.S. Senate.

DEAR RUSSELL: As you are undoubtedly aware, I was scheduled to testify on September 9 before the Senate Finance Committee as part of the Foundations' coordinated testimonial group. But the rescheduling of this testimony to October 6, because of the death of your colleague and my friend, Everett Dirksen, means that I will now be unable to attend. I regret this, as I had looked forward to discussing these important issues with you and your fellow Committee members.

However, even though I will not attend the hearings personally, I should like briefly to give you my general views. I am in complete substantive agreement with the position taken by the Foundations appearing before you on October 6 that H.R. Bill 13270, as passed by the House, represents a substantial threat to a unique American institution. I am certainly aware of—and not unsympathetic to—some of the current criticism of foundations. Some have, indeed, served principally as "tax loopholes." Some have, unfortunately, acted in inappropriate ways. For these reasons, they are an entirely proper, even necessary, topic for Congressional consideration and action.

But the vast majority of foundations, and certainly the Nation's largest and best known foundations, are not mechanisms for tax avoidance but, rather, support and buttress activities and institutions all of us would regard as entirely appropriate. You are undoubtedly aware of many more of these activities than am I; but I have substantial experience with the significance of foundation involvement in at least one important area. As Chairman of the Illinois State Board of Higher Education for seven years, I saw time and time again the enormous contribution foundations made to higher education. By providing fellowships, by helping to build university endowments, by supporting faculty salaries and by underwriting new areas of study, foundations continually play a critical part in the development and improvement of education. If the activities of foundations are curtailed, then educational institutions must inevitably turn to government for support.

But I view the spirit with which discussion and legislation regarding foundations is approached as more critical than particular clauses in the Bill. There has been much criticism of the "controversial", "political" activities of foundations and substantial consideration given to means of curbing these. I would hope that these discussions take the values of diversity and experimentation into account. Foundations are most valuable in my view—not when they support an activity of acknowledged significance—but when they provide risk capital and support to new activities, new approaches and new, even unpopular, ways of doing things. These are also precisely the areas where the risks of failure are greatest. Therefore, the most valuable activities of foundations are often likely to be the most controversial.

In my judgment, the Nation needs vital sources of pluralism. I believe that the major foundations serve this need in a responsible manner. I would hope that your Committee's considerations of foundations and their activities would view them in this light also.

I enjoyed seeing you—although too briefly—the other evening and look forward to talking with you again.

With every good wish and warm personal regards, I am,

Sincerely yours,

BEN W. HEINEMAN.

Mr. MILLER. My purpose in introducing this panel, is to discuss with you briefly and generally the role of foundations in American life, and to answer any questions that you would like to raise.

To identify myself, I am a businessman who lives in a county seat town in Southern Indiana. My interest in foundations arises out of the established American tradition that each individual citizen ought to be concerned about his country, and ought to give money in support of his concerns, and ought to give his time and his talents insofar as he is able.

In our own company we have plants around the world as I travel to visit them I have been struck with the fact that one of the truly unique characteristics of the United States is the broad concern for charitable giving which has for a very long time been actively encouraged and supported by government. I know of no other country where this is the case. As I go through the towns and cities of other countries where we have plants, the lack of concern in these communities for the welfare of their society is remarkable when compared to the United States. We have a country in which the individual citizens care about their schools, care about their hospitals, care about their municipal government. They give money and they give time and

they give energy. And all this is supported and encouraged by our government. It is clearly to me one of the great virtues of the United States in today's world.

Now, this charitable giving is done primarily by the man on the street.

Over $16 million of money is given every year to charitable enterprises and research operations in this country. Of this over 80 percent is done by individuals. Foundations account for about 8 percent. Foundations are a part of this tradition, but they are one of the smallest parts of them.

We live today in the time when the private sector's contribution is being heavily emphasized. Government is trying in many ways to encourage private citizens to take a bigger share of the load, to put less of the burden on the Federal Government in Washington. It, therefore seems quite important that the government ought now to encourage and not to discourage giving or to discourage people associating themselves to give.

There are two broad ways, I think, in which the government should encourage private giving. The first clearly is to correct any abuses that exist. All of us who are here before you today support the correction of abuses. We support those provisions in this bill which prohibit self-dealing. We support those provisions in this bill which prohibit the unreasonable accumulation of income. We support those provisions which prohibit the use of a foundation simply and solely as a tax shelter. Persons who use foundations in these ways are not concerned with charitable giving. They are concerned merely with using the foundations for purposes of their own.

We also support the increasingly vigorous endorsement and administration of present laws regulating charitable giving and foundations.

We are however very seriously concerned about those additional provisions in the law, which curtail the effectiveness of foundations and which seem to give a signal to the American people that charitable giving and associating to give money is a bad thing.

The first of these is the proposed tax on foundations. In our opinion this is not really a tax on foundations, it is a tax on the recipients of foundation funds. We support a fee for the more effective regulation of foundations, and are happy to work to make this an effective one.

Our stand on the proposed tax on foundations and the fee as proposed by the Treasury witnesses will be discussed in detail by a panel which we have here for that purpose.

A second feature of this bill which we feel will limit the effectiveness of foundations in serving the public is found in those provisions which relate to program limitations and to proposed penalties. The program limitations may well tend to keep the foundations out of those areas which are most important in solving the great future problems of the society. The penalties proposed are so severe that many of the ablest Americans will simply be financially unable to accept service as trustees of a foundation.

We are opposed to those portions of this bill which define the characteristics of private foundations, feeling that many of the oldest and most respected organizations in the country which serve the national need would probably be so restricted that they could not perform their major functions.

Perhaps on a long-range basis the most serious aspects of these proposals is that they give a signal to the public that private giving is a bad or suspect thing——

The CHAIRMAN (presiding). Sir, if I might just interrupt you, would you mind explaining to me what is so good about people getting a 70-percent tax exemption. In other words, why should anyone escape a 70-percent tax while not giving anything to charity or the like? What is good about that?

Mr. MILLER. I don't believe that a person can get a tax deduction and keep the money for himself. He has to give it to the public in some legitimate and approved form.

The CHAIRMAN. Well, right now he can just give his income to his own foundation and thereby escape taxes. Isn't that about the size of it?

Mr. MILLER. I would not defend at any time the creation of a foundation merely to accumulate money, merely to retain control and not for a serious charitable purpose. None of the people here today would support that. We support the prohibitions of self-dealing, unreasonable accumulation and the intent to use foundations as tax shelters. We support these provisions.

The CHAIRMAN. Then, fine, you support the same things I am supporting. Where a man is giving his income to his own foundation the mere fact he declares a charitable purpose and does nothing about it should not make him eligible for complete tax exemption.

Mr. MILLER. It is that last portion, and does nothing about it which I cannot support.

The CHAIRMAN. All right.

Well now, are you aware of the fact that this kind of thing has happened in some of these foundations?

Mr. MILLER. My judgment on that is that this is a very minor abuse. It should be corrected, but we should not tamper with the enormous services done by the vast majority of foundations. We should correct very carefully the minor abuses without stopping the genuine good done by the majority, people who are not up to anything, who are seriously trying to help the society.

I don't think that we should somehow take the risk-taking out of giving. We are in a period of enormous change. We need a great deal of experimentation and innovation, and in the giving of money there are bound to be some failures, because we are treading on new ground. We should not create too much fear and too much caution about innovative giving or we will not make the kind of contributions to our problems that we need.

In my own business, I am highly involved in technical research. If we hit 1 out of 10 we are doing well.

The foundation's success rate is far better. Their record is excellent and they should be encouraged rather than discouraged in innovation and risk-taking for the national good. Experimental giving is an area for which government, whether it is municipal, State or Federal, has a hard time finding funds. Private funds can help all aspects of the government to show the way.

I think that it is bad if the Government passes a bill which somehow has an implication that the creation of future foundations are

somehow not welcome. The total assets of foundations, as I said, a little earlier, as a percent of gross national assets have been declining for 10 years. The total giving of——

The CHAIRMAN. Can you tell me what is that percentage?

Mr. MILLER. All private foundations in 1968 held assets worth approximately $21 billion. These assets were about eight-tenths of 1 percent of the net equity and debt instruments of the otal U.S. economy.

The CHAIRMAN. What is the source of those figures?

Mr. MILLER. Senator, we will give you the total U.S. net debt and equity, stocks and debt instruments: $2,502 billion. Of these $21 billion are the assets of foundations or 0.84 percent.

Senator TALMADGE. Will the chairman yield at that point?

Mr. Miller, Congressman Patman says that foundations have about $50 billion, and maybe there are as many as 100,000 of them in existence. I believe you testified that assets of about $21 billion and that there are about 22,000 foundations in existence. How do we really know what the correct information is when so many of these foundations don't file any reports of any kind?

Mr. MILLER. I will have to defer to the panel that has the source material for this, and if the answers that we have here are not complete we will be glad to give you the total amount of our figures for your study on it.

(The Committee subsequently received the following additional information:)

SOURCES OF DATA, CITED IN THE FOUNDATION CENTER MEMO ENTITLED "SIZE AND GROWTH OF PRIVATE FOUNDATIONS"

1. The estimates on the total market value of all foundation assets at five year intervals from 1938 through 1968 were assembled under Foundation Center auspices. These are the sources used in developing these new estimates:

(a) Tabulations of asset values published in the *Foundation Directory;* editions of 1960, 1964, 1967.

(b) Preliminary estimates on balance sheets for all foundations for the years 1953 through 1968 prepared by Ralph L. Nelson at the National Bureau of Economic Research.

(c) Tabulations on the size of foundations from *American Foundations and Their Fields;* estimates covering the years 1930, 1931, 1934, 1937, 1940.

(d) Estimate on the size of the foundation field for the year 1944 published in *American Foundations for Social Welfare.*

(e) A sample of 30 major foundations which hold over 40% of the total foundation assets. The survey covered the period from 1938 to 1968 at five year intervals; it was conducted by telephone under Foundation Center auspices in September, 1969.

2. Total U.S. debt & equity is net public and private debt at end of year (bonds, notes, mortgages, etc.) plus market value of all corporate stocks. From *Federal Reserve Bulletin* and *Economics Department at Morgan Guaranty Trust Company of New York.* Partly estimated.

3. Total national wealth is the estimated aggregate value of all tangible U.S. non-military wealth including land, structures, equipment, inventories, and livestock. Partly estimated; based on *Goldsmith & Kendrick* data for the National balance sheet. (Goldsmith & Kendrick have produced, under private sponsorship, the most definitive estimates of the nation's wealth. Some years in the series shown were developed from extrapolation, others from interpolation.)

Mr. MILLER. I would now like to discuss income relationships.

The CHAIRMAN. Well, the reason I asked you about that is I have never seen a precise figure—and we ought to get it sometime—on the

net worth of all assets in the United States. I have never seen it. I know you will never get it by assessed valuation. It certainly wouldn't approximate that in my State.

Mr. MILLER. I think we excluded real estate in the figure I just gave you, this figure contains only common stocks and debt instruments because that was the figure that was obtainable.

The CHAIRMAN. Well, in my State I think the average assessment is less than 18 percent of value.

Mr. MILLER. Inclusion of real estate and properties would tend to make the percentage of foundation assets even lower.

The CHAIRMAN. Yes.

If you are not including real estate I suppose it would. But when you are describing foundation assets are you including the real estate that is turned over to foundations?

Mr. MILLER. You would have to do it in the case of foundations because this is reported as their assets.

The CHAIRMAN. Good.

Mr. MILLER. So this probably is an unfavorable report as far as the foundations are concerned.

The CHAIRMAN. Well now, what is the source from which you got that?

Mr. MILLER. There I am going to have to defer to our staff and I will get the source and provide you with that information.

The CHAIRMAN. Good.

Mr. MILLER. I have it in summary form, but I don't have the back-up material.

The CHAIRMAN. I have it in summary form, but I don't have the back-up material.

The CHAIRMAN. I think your percentage figure would be lower than that.

Mr. MILLER. I think it would.

Income is another way of measuring foundation standing. The total amount of expenditures of all foundations is two-tenths of 1 percent of the gross national product. However, more important than that small figure is the trend. For the last 10 years foundation expenditures as a percent of GNP has been declining.

In the case of the largest foundation of which I am a trustee, its size is approximately one-half the percent of the gross national product today than it was when it began operations. This percentage is declining every year. We have a summary of these figures and we would be glad to give you the source material.

The CHAIRMAN. Fine; thank you very much. We will include that in the record.

(The committee subsequently received the following additional information:)

THE FOUNDATION CENTER SIZE AND GROWTH OF PRIVATE FOUNDATIONS

Questions have been raised about the size and growth rate of private philanthropic foundations in the United States. We have had a study made and here are the findings:

Foundations have never owned a significant proportion of financial instruments (stocks, bonds, mortgages, etc.) and own a smaller proportion now than ten years ago.

Foundation assets have never been a significant proportion of U.S. wealth and are now a smaller proportion than ten years ago.

Available data indicate that foundations are a very small sector of the economy and that they are growing relatively slowly. Indeed, aggregate foundation assets have grown more slowly than Gross National Product, more slowly than U.S. financial assets, and more slowly than national wealth during the past decade.

In 1968, all private foundations held assets worth approximately $21 billion. Total foundation assets were therefore only about eight-tenths of one percent of net debt instruments and corporate stocks in the U.S. economy. They were about seven-tenths of one percent of the value of all tangible U.S. wealth. Total foundation assets were less than the market value of at least two of the largest American corporations (A.T. & T., General Motors), and were less than ten percent of the aggregate assets held by domestic insurance companies.

The accompanying tables covering the period from 1938 to 1968 have been assembled at the Foundation Center. The data about all foundations are necessarily estimates. But the estimates are improvements over earlier figures because of the recent collection of more precise market values of assets for a number of major foundations for the period 1938 through 1968, and are believed reliable.

Total *expenditures* of all foundations now run at an annual rate of about $1.5 billion. This is considerably less than two-tenths of one percent of gross national product and is only nine percent of total charitable giving in the United States. their pets, about one quarter as much as national spending on toiletries and cosmetics, about one sixth as much as national spending on tobacco products, and about one tenth as much as national spending on alcoholic beverages.

TABLE 1.—FOUNDATION SHARE OF TOTAL U.S. DEBT AND EQUITY, 1938-68, AT 5-YEAR INTERVALS

[Dollar amounts in billions]

	(A) Estimated total market value of assets, all foundations	(B) Total U.S. net debt and equity [1]	Foundation assets as a percent of debt and equity (A divided by B) (in percent)
1938	$1.4	$258	0.54
1943	1.8	390	.46
1948	3.5	539	.65
1953	6.5	761	.85
1958	12.5	1,187	1.05
1963	17.5	1,669	1.05
1968	21.0	2,502	.8

[1] Net public and private debt at end of year (bonds, notes, mortgages, etc.) plus market value of all corporate stocks. From Federal Reserve Bulletin and economics department at Morgan Guaranty Trust Co., of New York. Partly estimated.

TABLE 2.—NATIONAL WEALTH AND FOUNDATION SIZE DATA: 1938-68, AT 5-YEAR INTERVALS

[Dollar figures in billions]

	Estimated total market value of assets, all foundations (A)	Estimated total national wealth [1] (B)	Foundation assets as a percent of national wealth (A+D)
1938	$1.4	$384	0.36
1943	1.8	523	.34
1948	3.5	928	.38
1953	6.5	1,259	.52
1958	12.5	1,703	.73
1963	17.5	2,328	.75
1968	21.0	5,036	.69

[1] Aggregate value of all tangible U.S. nonmilitary wealth including land, structures, equipment, inventories, and livestock. Partly estimated; based on Goldsmith and Kendrick data for the national balance sheet.

Mr. MILLER. I have covered the general thrust of our testimony. I would like to make one personal comment in relation to the proposed tax and fee. In the present bill the tax is proposed to be 7½ percent. I think the concept of a tax is in conflict with the concept of charitable giving, and our panel will speak at length on that.

The alternate proposal for a tax at 2 percent of income to cover examining expenses. It is interesting to compare this with the charge of bank examiners for examining banks because this proposal is the same kind of a fee, namely a charge for examining thoroughly the whole activities of foundations in order to improve public accountability.

In our State (I do not have national figures) the State examination fee is 3 cents for each $1,000 of assets. A 2 percent fee on income, assuming income is 5 percent, would amount to $1 per $1,000 of assets, or 33 times as much as the bank examiners charge. So this is quite a fee.

My own feeling is that it would cover substantially more than the cost of examination.

Now, I would now like to conclude with a few general comments and then I will be glad to respond to such of your questions as I have the information to respond to.

In the first place not everybody in the United States establishes foundations. They are relatively few in numbers, and they are declining in dollars as a percentage of the national wealth.

My second point is that, contrary to general opinion, foundations are formed by rich people and poor people alike, not only by rich people.

I would like to mention my own town of Columbus, Indiana, which has a population of 25,000. I can think of four foundations in that town, two of them founded by wealthy families. There are two other foundations. One of them is the Columbus School Foundation which was founded by a group of concerned housewives and parents, who had no money to put into it, but who wanted to create an instrument to which the whole community could give, in order to provide fellowships for further education of elementary and high school teachers during summer vacations. The founders had no money to put into this foundation. They have since got the majority of their support from two or three local corporations, and they hand out the money in 15 or 20 fellowships of travel every year to high school teachers.

That foundation would probably under this bill be restricted from receiving any more money.

Another foundation in our town was called the Laws Foundation, named after a Presbyterian minister who founded it. He discovered that over the last 15 years in our town, no Negro graduate of the local high school had gone to college.

This was quite simply for lack of money. The founders didn't have any money to put into the foundation but they established it and he solicited contributions. They now have six or eight fellowships every year. In addition to soliciting funds working with Negro children at the elementary school age to motivate them to go to college.

So here are two foundations founded by people without any money at all. Because their major source of funds again is from a small number of industries, these foundations would probably not be qualified to

receive money under this bill. I think there are very many cases of foundations founded this way, by persons who have a public concern but no money themselves. At first these persons usually get only one fellow or two to bankroll, but then ultimately they may obtain a broad base of public support.

A third point I would like to make about foundations is that, on the one hand, the list of their accomplishments is absolutely staggering. It is so impressive and it is the envy of every nation in the world.

The man who was going to speak with me, Dr. Herman Wells, said he recently spoke to the President of Pakistan. He said "Dr. Wells, how do I get some foundations started in Pakistan to start some of the pioneer enterprises in health, hospitals, homecare that we so desperately need. I can't get this done through government."

The list of accomplishments is impressive because of its influence on health, on education, and religion—where the government cannot enter. It is major in poverty, in art, in the development of public policy. This kind of private money is one of the things that makes this country the envy of the world.

The second thing to consider is then in the sum of the ventures, of all the foundations in the United States, the number of mistakes made are to me astonishingly few in number, and even smaller in dollars. I would have expected a substantial and continuing number of failures, just as in bank lending. If a banker makes loans and doesn't have any losses at all, he is not serving his community, because he is not taking reasonable risks.

The same is true in the foundation world. If you don't have some failures you are not really serving your society. But the number of failures to date is surprisingly small.

Finally—what is the alternative in this country if private charitable giving is restricted and if innovation is curtailed? The only alternative is for the Government to take over, and that means for each citizen to feel less responsible for what is going on in the society. I don't think this has ever been a good answer anywhere at any time. If it results in a nation of citizens who don't care then I would fear for this country. I have been in countries where the citizens don't care. Generally speaking the citizens of France and Italy and even to a certain extent the United Kingdom, have a strong feeling that they can do nothing about their problems. They take no care for the schools in their own town nor for elimination of poverty, nor for health of the oncoming generation. They think all this is somebody else's job. The contrast between those countries and the United States is very great, and it should make us tremendously proud of what we have in this country.

We have a valuable and priceless tradition. We should deal with this tradition very carefully indeed. We should correct the abuses continually and constantly. But above all, Government should remain in the posture of encouraging the individual citizen to care for his country, to give his money to it and to associate with others in order to give to it.

The Government should encourage the individual citizen to take risks, to experiment, to innovate, but above all, to accept a personal responsibility for the welfare of this country, the responsibility to do more than the law requires of him and to do it voluntarily.

Thank you very much for hearing me. I would be happy to respond to questions.

The CHAIRMAN. I just want to say one thing, Mr. Miller, and please understand I don't challenge the good work that the foundations who are worthy of the name do. I don't challenge that at all.

You have made the statement that the only alternative is for the Government to do the same thing. You are aware, are you not, that it is completely within the ability of these donors to give directly to the university or a church without ever giving it to a foundation at all?

Mr. MILLER. That is quite true.

The CHAIRMAN. So there is more than one alternative.

Mr. MILLER. Yes.

But there are many answers to the business of giving. I think it is the American genius for organization that has developed in the foundation one of the good devices for charity. It is, however, not the only one. I think we need not just one answer but many foundations are one answer and a very useful one.

Senator TALMADGE. Mr. Miller, is there any good reason why foundations should exist in perpetuity?

Mr. MILLER. I think so.

Senator TALMADGE. Corporation charters expire and must be renewed, people die. Insofar as I know the only thing on earth man can create and exist in perpetuity is a foundation. What would be wrong with having some termination date for foundations?

Mr. MILLER. In my opinion, you do have an effective termination date—in this sense: Human beings don't live forever. If the same board of trustees were immortal that would not be good, but foundations' boards of trustees probably turn over every 10 to 12 years. Their emphasis, if their charters are broadly drawn, change continually. They start a new life every decade because they have a new group of people, with new opinions, new directions and new responses. When you have a situation in which the total assets of foundations are diminishing as a percent of the total assets of the country, I don't see a good reason to accelerate this trend and to drive foundations out of existence.

Senator TALMADGE. Your response brings up my next question now. I agree with the Chairman that most foundations do outstanding work, I have seen the results of it in my own State. No one argues about the merit of the contributions to higher education, hospitals, cancer research, things of that nature. But recently many foundations have gotten themselves involved in areas that are really quasi-political. Some of them are subsidizing research in school busing, birth control, and one foundation even went to the extent of subsidizing a former Senator's staff in a trip around the world. Why should the taxpayers of our country subsidize these questionable activities? What I am asking is if the Congress should draw some distinction between a true educational, scientific, charitable research effort and those that get themselves involved in quasi-political contributions——

Mr. MILLER. I would like to speak out of my own experience. Let's take some grants that my own small family foundation has made. They are in the area of influencing public policy. In the little town of Columbus, Ind., we were very far behind in building schools. About 12 to 15 years ago we made an offer to the school board. We suggested two

of the most eminent architects of the country, and asked them to prepare a list of eight to 10 of the best young architects. We said to the school board, if you will pick any one of these architects to do your buildings we will pay his fee. We won't say which architect to use; nor will we determine the design. Our aim was to build school buildings that were thoughtfully designed and advanced in concept. We hoped they would last one or two generations longer and set the pace of the country. Now, that influenced the decision of a political body.

I think we will be barred from doing that under the proposed law.

We have also at the request of our mayor, contributed to a study on overall recreation planning for our community. The mayor selected the person and the organization that he wanted to do the study. He had no funds for it in his budget. So he came to us as a foundation to ask would we finance this study.

The problems of the city today are enormous, and the amount of research they need to do in order to decide which way to go, is tremendous. The results of research are very problematical, many of them are failures. As a result, when the budget comes up, research projects usually go to the bottom of the list and are not funded.

More and more mayors are coming to foundations to say "help me." I think this is a proper area for foundation response. I think that the country would be poorer without it.

Senator TALMADGE. I see no objection to the things your particular foundation has subsidized but I can see objections to foundations making gifts to public officials, for instance, Justices of the Supreme Court, and things of that nature. Where are you going to draw the line? How can you correct the abuses?

Mr. MILLER. This is a very vague area. Nobody should make a gift to any public official. But public officials are not persons of great wealth, and reasonable reimbursement of travel expenses and out-of-pocket costs in the interests of an important national or international meeting, are quite proper. This is a matter of judgment and good honesty.

Senator TALMADGE. What about voter registration drives, would you permit a foundation to do that?

Mr. MILLER. I live in a part of the country where a high percent age of the people are registered voters. As a citizen of a democracy, however, I feel that it is highly desirable that all persons who are eligible to vote be registered and encouraged to vote throughout the whole country. The higher the percent of our citizens that go to the poll, the more representative our democracy is. Voter registration should, however, be a continuous and nonpolitical activity.

Senator TALMADGE. I agree with your conclusion on that but as you know political parties vie with each other, politicians on the local level, State level and national level, vie with each other, as to the particular voters that they think are most likely to vote for them. In the final analysis a voter registration drive can be the most partisan political activity there is, depending on who selects the people that that drive is going to be motivated toward. Would you agree with that?

Mr. MILLER. I live in a very political State, and I know what you are talking about. But I don't think that the answer is to do nothing. I think the answer is to move carefully, nonpolitically, and do it all the time and not just in the spurts.

Senator TALMADGE. It seems to me that the answer might be to be a little more restrictive in what really constitutes educational, charitable, philanthropic, scientific and things of that nature, because there is no doubt in my own mind that some of our foundations have gotten far, far afield, and I think that some of the creators, if they could see what has happened to their foundations today, would turn over in their graves.

Mr. MILLER. I inherited a foundation that was created by my elders, I am sure I am not doing exactly the same things that they would have done in their time, but I tell myself that I am responding to the principles which they had in mind and then I am trying to respond in a way that is appropriate to the needs of today, needs which they couldn't have foreseen.

Senator TALMADGE. Thank you, Mr. Miller. Thank you, Mr. Chairman.

Thank you very much, sir.

The CHAIRMAN. Thank you, sir.

We will call next on the Reverend Theodore M. Hesburgh. Senator Bayh wanted to be here to hear Mr. Miller, and he also wants to hear Father Hesburgh's testimony. Senator Bayh.

STATEMENT OF HON. BIRCH BAYH, A U.S. SENATOR FROM THE STATE OF INDIANA

Senator BAYH. Mr. Chairman, I appreciate the opportunity to share this distinguished rostrum in such distinguished company, and I certainly accede to my senior colleagues. I certainly wanted to be here to introduce both Mr. Miller and Father Hesburgh. You are aware I am conflicting duties and I had expected to be here at 10 o'clock, and I apologize to the committee as well as to the witnesses.

I would just like to say before returning to another committee that we have with us Congressman Hamilton who happens to be the Congressman from the district which Mr. Miller represents, and I am sure that he would share my assessment of the fact that there are few citizens in our State who have done more to shed light in certain areas that need this type of attention than Mr. Miller and Father Hesburgh. It is not necessary for me to add vocally to the record that they have already compiled before the committee but I did by my presence want to suggest I have talked to both of them and feel that their assessment of this whole business of dealing with the problems that certain organizational aspects of foundations present in the tax structure should not tempt us to treat other aspects of the foundations in such a way as to be punitive and I think both of these gentlemen will articulate this particular problem, as Mr. Miller has, much more precisely and with personal experience than I, but I just wanted to have this chance to join you in welcoming them and thanking them for bringing this matter to our attention because both of them have given this matter a tremendous amount of personal experience day to day attention which they have given it to themselves in a manner in which I think we can all be extremely proud.

Mr. MILLER. Thank you.

The CHAIRMAN. Thank you.

Let's call Father Theodore M. Hesburgh, president of the University of Notre Dame. We are very happy to have you, Father. Will you proceed, sir?

STATEMENT OF REV. THEODORE M. HESBURGH, PRESIDENT, UNIVERSITY OF NOTRE DAME

Father HESBURGH. Senator, thank you very much for the opportunities of being with you and also for your courtesy in allowing Senator Bayh, our Senator, to introduce us this morning, sir.

Mr. Chairman, I would like to introduce the gentlemen who are with me here. First of all, I will say for myself, I am Fr. Theodore M. Hesburgh, in my 18th year as president of the University of Notre Dame. I think I am overage in grade at the moment.

The gentlemen with me on my left, your right, is Dr. John A. Cooper, president of the Association of American Medical Schools. And on my right, your left, Dr. Frank C. Ervin, Jr., chairman of the board of regents, University of Texas System, and on his right Dr. Felix C. Robb, director of the Southern Association of Colleges and Schools.

Mr. Chairman, we are here this morning not to represent any foundation or any particular interest of a foundation per se, but we are here as bystanders to this controversial issue regarding private foundations. We are not completely disinterested bystanders because collectively we represent a broad variety of institutions, institutions which over the years have derived great support from foundations.

These institutions include private colleges and universities, State and municipal universities, medical schools and in particular here, some educational institutions in the South.

We think that there are two aspects that we might focus upon this morning, one contained in the legislation, and one proposed outside of this particular House tax bill, and perhaps if we focused on these two points we might sharpen our own testimony.

I would like to summarize what we have said about these two points in our written testimony which I trust will be part of the record, and then ask each of my colleagues to supplement what I have said in summary of their remarks.

The first point that we find ourselves in rather complete disagreement with is that point in the House tax bill which would impose a 7½-percent tax on foundation investment income, and the second point which is not included in the House bill, but which has been recommended by some critics of foundations is that foundations should either terminate their existence or lose their tax exemption after a period of years. Some mentioned 25 years, some 20, 15, 10.

We believe that the first of these measures would diminish the current funds with which foundations carry out their important work, by which they support a wide range of charitable and educational institutions, and it would diminish these funds initially by about $65,000 a year—excuse me, $65 million a year—I keep forgetting I am in Washington, not Notre Dame——[Laughter.]

Father HESBURGH (continuing). And it is supposed that very shortly this amount of diminution of their funds would go to $100 million eventually.

We believe that over time this second proposal is perhaps more deleterious than the first but we think that both proposals are dangerous from our point of view because we believe that the——

The CHAIRMAN. Father Hesburgh, if I might just interrupt you there to be sure I am following you——

Father HESBURGH. Surely.

The CHAIRMAN (continuing). You say one proposal would cost you $100 million a year, that is universities and colleges——

Father HESBURGH. That is right.

The CHAIRMAN (continuing). Over a period of time. Which proposal is that?

Father HESBURGH. That is the 7½-percent tax on investments income of all foundations.

The second proposal we say over time might even be more difficult because the foundations we believe are one of the bulwarks of the society and facing each year the kind of changing challenge that society meets. Somewhere in the whole structure of this society we have to have the force that is flexible, open, generous and has the means of getting at these problems which very often can't be gotten at and financed in their study from any other source.

The points that I would like to make for myself are that the foundations on their simple record, and I am not talking about all foundations, here, sir, but the foundations that we know in educational institutions, that these foundations on their record have done some enormous things for the growth of the private sector of our country.

I would like to say by way of parentheses that I just returned from a trip around the world in which I visited about 25 universities and university systems in some 20 or 30 countries in the world. The one great difference I noticed in all of these countries, in all of these university systems, was that they are different from ours. Ours has traditionally since the founding of Harvard in 1636 been a dual system of education, public and private. We have learned to live with each other in great harmony and concord. But as a member of the Carnegie Commission for the future of our education I think we have identified the greatest problem facing private institutions today and that is simply a problem of survival under the financial structures that face us. We have over the years been required to do more and more in the public interest in widening educational opportunities, facing the crises in our cities and indeed in space and we believe that never before have higher educational institutions been asked to do more with less funds, and that one of the very few resources we have to help us in this endeavor are the great foundations that give much of their assets to higher education.

I would like to say in a historical context that one of the Rockefeller Foundations in the general education field in the early 20's gave large sums of money to some private institutions in this country to help them develop endowment, to make their work a little more financially viable. If you were to go over the list of those universities that in those days received this money, I believe by any man's accounts they would have to be listed today in the top 20 universities in this country.

It was a generous thing to do and it was done as only a foundation could do it and I think it has justified itself over the years.

In more recent times the Ford Foundation had a program called a special program in education in which they gave matching funds to a wide variety of private universities and colleges, in an effort to help them stimulate through matching grants other funds from private sources.

This program, and I speak from some experience because Notre Dame was part of it, by giving a relatively small amount of money but large in our eyes, like $12 million, enabled us to use this to raise from other private sources some hundred million dollars over a period of 10 years and, as a result, we were able to do in 10 years because of the stimulus and the challenge that was presented to us by this magnificent gift, what normally would have taken us 30 years. We have a great library to show for it that cost $12½ million, impossible otherwise; a great computing center, a new engineering course, a new freshman year of studies that cut freshman attrition from 30 percent down to less than 2 percent. All of these things were done innovatively, creatively, and positively because of the impetus given us by a foundation grant in a very imaginative way.

I know of no place on earth where this happens except in this country. I know of nothing closer to the mystique or the spirit of this country than the stimulation of private concern and private generosity to create great private endeavors in the field of higher education and indeed in the field of elementary and secondary education. It would seem to me, gentlemen, and Mr. Chairman, especially, that this particular mystique of our country should be encouraged in every way possible and should in no way be endangered, and I think it would greatly be endangered if out of this rather limited resource we have in the field of great private foundations they were taxed so that at a time when all of us in the private sector need more rather than less, something would be done both to discourage foundations from continuing their work in this field or to somehow limit their assets or diminish their assets.

I would like to say at the same time that all of us, the four of us here, are totally and enthusiastically in favor of the provisions in this bill to get at malpractice in the area of foundations, using foundations for private interest or using them as a tax refuge or using them for any purpose that is not consonant with the public interest or with honest administration or public accountability. We are not only in accord with these provisions but we are enthusiastic about them for this reason that we would very much dislike to see the great record of the great foundations of this country diminished by allegations of impropriety that we think are probably justified, in the case of some foundations that have used these laws to avoid taxation rather than to do good.

On the part of my colleagues, and I am going lightly over this because I think they would like to speak for themselves, we identify the great field of foundations in medical education. I know that you gentlemen know from your other experiences in Government, that there is no field of education that is more costly and more in danger today than the field of medical education. The increasing of medical technology, the provision of more doctors, more medical services, more research technicians, more nurses, more delivery of health serv-

ices, this is a field which defies most university administrators by its cost and discourages them by the resources available, and for many of these programs there is no real adequate resource available except the private foundations.

One can say in all honesty that in improving and sustaining medical faculties there has been no force in this country equal to the foundations. We can say that the medical education we have today was thoroughly revolutionized following the Flexner report which was sponsored by the Carnegie Foundation. I think the Carnegie Foundation is following this tradition today by its 5-year study of the future of higher education across the board, public and private, State and local; in establishing new medical schools by the Kellegg Foundation which has inspired the founding of seven medical schools in our recent past; in helping schools with great financial difficulties, especially schools that cater to members of minority races, you can point to an instance where a school would have gone under without the enormous help from a private foundation.

In developing techniques of medical education, new curricula, new methods relating to the medical facilities for the public need and welfare of our citizens, certainly in these areas the hundreds of millions of dollars spent annually by the foundations to deliver these benefits to our country would certainly be diminished if the funds available to foundations were diminished. Parenthetically, here on the second point of focus I mentioned earlier I would like to say that health problems as well as scientific environmental problems change from decade to decade and from generation to generation, and it is for this reason that perhaps anticipating a question I would like to speak a word for the continuity of foundations, not the continuity as if their mission were always exactly what it was when they began but that they are sensitive to the challenges and to the opportunities of each new age.

There was a day when the Rockefeller Foundation spent considerable money for, to eliminate, yellow fever through its great virus program. Today there is another kind of problem facing the world, namely adequate food for all of the people of the world, and it is an amazing thing that with the expenditure of a relatively small amount of money in the past 10 years the Ford Foundation linked up with the Rockefeller Foundation to develop a new rice seed which in 1 year of its use developed a rice crop $1,200 million more in volume than the crop raised the year before with the same land, the same farmers, the same sunshine but with a seed not as well developed. It is projected with new seeds in the coming year that the crop will be $3 billion in excess of the crop of 2 years ago. And this is the kind of new challenge met today by resources available, by a current board of trustees which looks at this problem and directs the foundations attention to it. And for this reason I like to think there would be in our society this continuing force in the private sector that can face these problems quickly and with great flexibility and with great dedication to the public welfare.

In the area of medical education, since Dr. Cooper will say a few words, I will now stop. As to the foundations and the public institutions, foundations are not simply dedicated to the private sector. I

think most people misunderstand the fact that great State institutions in his country, the great land-grant colleges and others, that they too have a certain lack of flexibility because of the kinds of budgets they have from the State legislatures and therefore need additional funds for innovation and for new creative activity, for the kind of research that a region needs. For example, in the Southwest the foundations have sponsored research as distinct as beef production or mineral recovery have provided funds for new kinds of innovative skills in consumer needs in the region, for programs to help linguists and to develop new language skills for people who don't speak the current language of this country or don't speak it well, to develop new kinds of communicative techniques and to develop industry in the region, and to develop agriculture. Each program could be studied in detail, and I think you will find the greatest contributions are the great breakthroughs which, subsequently caught up by the public moneys, were initiated in a kind of catalytic way by the imaginative grants of foundations to these great public institutions who simply could not initiate these kind of activities with their normal budgets.

The last point, about which Dr. Robb will speak more at length, is that there are certain areas of our country that have special needs. We feel that the South with an enormous number of children to educate and a small amount of dollars to do it with would be especially vulnerable to a public policy that would limit the flow of free foundation money to southern institutions. Dr. Robb is involved in over 9,000 such institutions, and I am sure he can give chapter and verse much better than I can to illustrate this particular point. We feel there is another point that should be made in the same area and that is with the South's growing economy it is beginning to produce indigenous wealth and this is not the time to produce any kind of legislation that would restrict the creation of new foundations that could be dedicated to the growth of this region, particularly its educational and research growth and its industrial growth as well, which follows from it, too.

In summary, gentlemen, we feel that there are many talented youngsters who should have life opened up to them for new educational opportunity, that we have the institutions to do this but we would like all kinds of things, like scholarship money, like innovation in the educative process, libraries, textbooks, museums, research facilities, and all the rest, and we believe that the foundations are one of the great hopes we all have educationally, and I must add here that we as educators stand together, public, private, North, South, East, West in our dedication to making America a better place in which to live.

We think well of the motivation of the foundations we know. I have spent a considerable number of years as a trustee of the Rockefeller Foundation, and I haven't see any endeavor in my life that has been run by more responsible men, where I have met more responsible people dedicated, with high integrity, trying to get something done for mankind. I would like to say from the vantage point we speak of as bystanders to the controversy but yet as those who benefit by the total work of foundations that we are most hopeful that you gentlemen will look with favor on the elimination of this tax which eventually would take as much as $100 million a year from these great resources dedicated now to so many good causes.

At the same time we make the correlative point that we do not believe that every foundation is a candidate for sanctity or a citizenship medal, and we believe that the cure is quite simple.

It would be quite easy to put in legislative proposals that would limit the inequities or eliminate the malpractice that takes place in relatively few foundations but we hope this might be done without injuring or limiting or in a sense discouraging the enormous great good that comes from the foundations whose record is impeccable over many decades, and we hope will be impeccable over many decades yet to come.

Could I, Mr. Chairman, please call briefly on Dr. John A. Cooper, the president of the Association of American Medical Colleges, for a word?

STATEMENT OF DR. JOHN A. D. COOPER, PRESIDENT, ASSOCIATION OF AMERICAN MEDICAL COLLEGES

Dr. Cooper. Mr. Chairman, and members of the committee, as Father Hesburgh has said, I am the first full-time president of the Association of American Medical Colleges which has as its membership 105 medical schools of this country, their faculties and 359 of the major teaching hospitals.

The members of this association are dedicated to improving the health of people of this Nation, and they do this through their education of health professionals, through the research they do not only in biomedical sciences, but in the development of more effective, efficient ways to provide health care, to increase its quantity, its quality, and its equality.

The contributions of the foundations to these efforts have been very important in the past, and because of the limitations in support which are now facing us from Federal sources, will be even more critical now and in the future. The members of the association have expressed deep concern over the implications for the foundation programs of the legislation which this committee is now considering.

We are convinced that there is need to correct some of the abuses that Mr. Miller and Father Hesburgh talked about but we too hope in correcting these abuses that we do not limit the ability of the foundations to continue to make their very substantial contributions in the whole field of health and the provision of health care. We hope that the baby is not thrown out with the bath water.

Father Hesburgh has talked about the contributions of the foundations to research and these have been very important over the decades when there was not money available from Federal sources. They still are important in specific areas. In many cases, the support given by foundations points the way for programs which later are supported to a much greater extent by Federal funds.

I would like to discuss briefly the support of medical education, which is a very critical matter these days. The AAMC as far back as the fifties, pointed out that this country would face a severe shortage of physicians and made attempts to increase the numbers of medical students and other health professionals educated. Unfortunately, we did not have wide support for this viewpoint. In spite of this, we did

move ahead, as Father Hesburgh has said, with the help of some of the foundations who recognized with us this need. They provided funds to stimulate and to help in the establishment of new medical schools by universities that did not have them at the time. They also helped significantly existing institutions substantially increase their output of physicians. Through their fellowship and other support, they have helped us to provide the faculty which is so important to maintaining the quality of American medical education and to meet the needs of the growing number of medical students.

Father Hesburgh has also pointed out that foundations have made substantial contributions to a number of medical schools that were on the brink of financial collapse. It is through this support that these schools, all private, have been able to survive. Given the situation now with regard to Federal funding, we hope that this may be a continuing and important aspect of the foundations' activities.

They have also helped to provide these matching funds for the construction of educational facilities for the medical schools, facilities badly needed to take care of the expanding responsibilities for students and also to replace facilities which are now becoming very old, antiquated, and inappropriate for educational programs which extend into the community.

As I said the support is becoming even more critical at present because the costs are rising, and we don't have adequate funds to meet them, particularly in the private schools, where we have almost reached the limit of our resources.

The medical schools are also being asked to undertake increasing responsibilities, to assume a greater role in the community, and to extend themselves outside their own walls. This is very difficult for many schools to do, largely because of the precariousness of their financial situation.

The foundation support is also increasingly important because of diminishing Federal support. We, in essence, have had no increase in dollars for research since about 1966. For many areas of medical education, there are not adequate funds from Federal sources available.

So I would like to close by saying that our medical schools are facing an extremely serious situation. Some may not be able to survive, most will be unable to meet the expectations society has of them because of the precarious state of their financial situation. We need every source of support that we can get to maintain present programs and to expand our involvement with the very pressing problems related to the delivery of health care. The foundations have been and will continue to furnish a critical part of this support. Thank you.

Father HESBURGH. Mr. Chairman, could I ask one of my associates, Mr. Frank C. Erwin, Jr., chairman of the board of regents, University of Texas system, to say something about foundations and public institutions of higher learning?

STATEMENT OF FRANK C. ERWIN, JR., CHAIRMAN, BOARD OF REGENTS, UNIVERSITY OF TEXAS SYSTEM

Mr. ERWIN. Mr. Chairman, and members of the committee, I shall not repeat but shall merely adopt the comments Dr. Cooper and Father Hesburgh have made because they apply equally to the publicly sup-

ported colleges and universities. Here today I would like to say only a word on behalf of the public junior colleges and public senior colleges and universities, because they have a unique problem which is slightly different from those in the private sector. These public schools have the job these days of trying to take care of the rapidly increasing student enrollment, which cannot be taken care of by the private schools.

Let me give you one example which specifically applies in Texas but which also applies throughout the United States. This past month we have increased the number of students at the University of Texas at Austin by more than 3,500.

Now this is a tremendous increase, almost a 10-percent increase, in enrollment in 1 year. There are not enough buildings, there are not enough teachers, there are not enough research facilities to take care of them, and yet what do you tell parents, taxpayers, when you tell them that you can't take care of their children, that there just aren't any places for them to get a college education. We can count in the public schools in Texas this year, from the 12th to the third grade existing students, who will be in college in the next 10 years and if we apply only the percentage of college attendance of high school graduates that occurred last year, the same percentage of high school graduates who went to college last year, in 10 years we will have twice as many students in the public universities and colleges in Texas as we have today. It is a frightening and staggering statistic and when you say it so quickly it is hard to understand and appreciate the consequences of it.

It is State and local taxes that principally support those public institutions and, although these taxes are essential, it is difficult to believe that we can get adequate financial support from those sources alone to take care of the increasing student bodies.

The only other two apparent sources that we can turn to or at least the ones that we have had to turn to, are Federal support and the private foundations.

Yet at this time when we are faced with this greatly increasing student body, for reasons completely unrelated to the needs of higher education the Federal Government is withdrawing dramatically its support of higher education both in facilities construction and in the support of other activities.

And we are dismayed to see that simultaneously with this reduction in Federal support, there is a suggestion that measures be instituted which would greatly diminish the support we can receive from private foundations.

Now, as Dr. Hesburgh and Dr. Cooper have said, we do not condone in any respect any malfeasance or misuse of foundation funds for purposes other than to support truly charitable activities. But we all know from our own personal experience that the great majority of foundations, both in number and in dollars, are engaged in highly commendable work, work that is essential to higher education of we are to continue to meet our problems, and we beseach you that you do nothing in this law, and certainly that you eliminate several suggestions in the House bill, which would seriously diminish the ability of these good foundations to continue the outstanding work that they

have done, because in the absence of such continued support I simply do not know how we are going to meet the responsibilities that are placed upon us. Thank you very much.

Father HESBURGH. Mr. Chairman, our final speaker is Dr. Felix C. Robb, director of the Southern Association of Colleges and Schools. In a sense he speaks for more than any of the rest of us because he has 9,000 institutions from Virginia to Texas under his association.

STATEMENT OF FELIX C. ROBB, DIRECTOR, SOUTHERN ASSOCIATION OF COLLEGES & SCHOOLS

Mr. ROBB. Mr. Chairman, and gentlemen of the Senate Finance Committee, I wish to add my word of commendation to the Congress for your concern about tax reform, including any clampdown on tax dodgers and self-dealers that may exist. It is not about that, but about the tremendous and vital contribution of philanthropic foundations to southern education that I would like to speak.

I have lived my life in the South and I am now working for institutions from Texas through Virginia. I know that the South has borne a tremendous educational burden for this entire country. We are, in a sense, are the seedbed of the Nation. Shortly after the Civil War, George Peabody of Massachusetts created the first great philanthropy in America in his fund that literally created the South's free public school system. That was followed by Andrew Carnegie's gifts which created about as many public libraries as there are court houses in our Southern States. Along came the Rosenwald Foundation and helped create 5,000 schools for Negro children, followed by the Rockefeller Foundation which has done much for the advanced education of our educational leaders. This tradition of magnificent assistance to the South has been followed by such modern foundations as Ford and Denforth.

This is the tradition about which I wish to testify. It is the tradition which reputable foundation are following today.

I would like to say that our Southern colleges and universities in the private sector in many cases have their backs to the wall and this past year for the first time are running deficits. Thus, they urgently need every gift dollar as well as every other dollar they can acquire.

I would like to give two or three illustrations about how the public sector of education also benefits from these dollars.

At the University of Georgia, several years ago, the Kellogg Foundation of Battle Creek, Mich., made a multi-million dollar grant to the University of Georgia for the Continuing Education Center, and I don't know anything that has helped in generating improvement of life in the South and particularly in Georgia more than has that wonderful gift which came from outside our region.

Similarly I would like to tell you what a small gift in Louisiana is doing. Louisiana State University, like many public universities, has its own private foundation. They gave a small grant for research in the transforming of sugar cane into a protein that could be used for synthesizing food. This caused the Rockefeller Foundation to be interested and give $44,000 to help that research.

Their progress stimulated the interest of the U.S. Public Health Service to give $150,000 and now something which can benefit us and

the world has been created in that State through that original initiating grant from a campus-based foundation.

I would like to tell you also about Meharry Medical College in Nashville, Tenn., an institution which has educated almost half the Negro physicians in the United States. It has literally been saved on more than one occasion by foundation dollars.

These are home of the contributions that mean a great deal to us, and so, gentlemen, I plead for a strengthening and a supporting of the foundation dollar and for the deep concern and the conscientious efforts of legitimate foundations to help the South and our southern institutions. In 22 years of dealing with foundations not once have I ever found anything but integrity and also a willingness on the part of these foundations, once they make a grant, to allow the institution to administer that grant without interference.

I think what you do will have a great precedent for our local governments and our State governments that tend to follow your lead. I wish there had been more publicity for the good works of the great foundations and the foundations of integrity than has been the case. These hearings will help greatly in that regard. Thank you.

Father HESBURGH. Mr. Chairman, all of us are deeply grateful to you and your associates for your impartiality and patience in listening to us on these points. We speak with great sincerity and great hope because we have all seen those institutions in which we have spent our lives supported, sustained, led forward and enthused and given hope by the work of great foundations, and we would hope that this might continue while full correction is applied to those foundations who are not following the laws as they should.

The CHAIRMAN. Father Hesburgh, and members of your panel, permit me to say this about this subject: I believe every member of this committee favors the kind of fine work that many foundations such as the Rockefeller Foundation are doing, and the fine contributions that have been made in research efforts at LSU and at the University of Georgia—we heartily approve of that.

But may I say that the Rockefeller Foundation itself has people on that board who have encouraged an inquiry into what some of these foundations are doing, and I am led to believe that those who are trying to find out what the other fellow is doing are shocked at some of the things they are finding out themselves just as I am somewhat shocked about some of the revelations that have occurred.

Now, when we started out looking at this matter I am one of those who rejected the idea that the Federal Government should do nothing. I believe I told Mr. Rockefeller that you are going to find enough abuses in this area that the case will be made that the Federal Government ought to do something about it, and it will help with the fine work that you are doing if we can see to it that the 20,000-odd foundations about which you know very little are doing the kind of quality work that some of the better foundations which you are associated with should be doing.

You are aware, of course, of the fact that the 100 percent unlimited charitable deduction resulted from the case of a Philadelphia nun who was giving her money, in fact, to charity. Since that time every big taxpayer in America has been trying to find some way to qualify him-

self as the same Philadelphia nun even though he doesn't have the same qualifications. That is corrected in this bill that we have before us, but this bill also has something that you haven't referred to and I am sure you approve of it. That makes more liberal what one can contribute as far as charity and education is concerned, so we are really trying to see what you are trying to achieve is fostered, not that it is hurt in any respect and we want to see to it that no one takes unfair advantage of something in the law that was not intended to be used that way. I am happy to see that you did agree with some of the things that are recommended in this House bill.

Father HESBURGH. Yes.

The CHAIRMAN. Thank you.

Father HESBURGH. Thank you very much.

Senator WILLIAMS. Mr. Chairman, I have no questions to which I am expecting an answer now but I am wondering if you gentlemen would furnish for the record a breakdown showing for the last year the amount of your budget revenues which was derived from foundations, the amount which was derived from grants of other sources, from the Federal Government, the State government and the amount from the students.

Father HESBURGH. I am sure we can provide that, Senator, and will do so.

Senator WILLIAMS. I appreciate it.

(The committee was subsequently informed that the material was forthcoming, but had not been received at the time of printing.)

Senator TALMADGE. Mr. Chairman, I have no questions but I do want to associate myself with the remarks of the chairman and comment on Dr. Robb's remarks. He made reference to the State of Georgia, the Peabody Foundation grant of which I have personal knowledge and also the Kellogg grants which occurred during my administration as Governor of the State. The Kellogg Foundation matched State funds to build the Continuing Education Center in the University of Georgia. They also matched State funds to build the Rock Eagle Boys Camp, a 4-H club camp endeavor which we think is the finest youth camp in the world. I have no quarrel with the financing of operations of that type. It is where foundations get themselves involved in political activity that Congress needs to take some corrective action.

Senator HARRIS. I didn't get to hear all of your testimony, Father Hesburgh, but I did the others. I wonder, did your group attempt to take any position on the various aspects of this bill? I know there was general comment by you and others on some things needed to be done, the tightening of it. Did you attempt to take a position item by item in the House bill?

Father HESBURGH. No, we did not, Senator. The thing we felt would be most useful was to deal with those things with which we were personally acquainted, and being on the receiving end of foundations we felt that anything that would lower the amount of that at a time when more rather than less is needed and in the case of all of our institutions, public, private, north, south, that this would be a bad move.

Now, we also are somewhat concerned, although we didn't go into it at great length, that the very mention of taxing a foundation establishes a precedent for a State and a local tax, and in a sense it drives at

the heart of something that has made this Nation great, I think, and strong in a way that no other nation has been. I mentioned before you came in, that if one goes around the world, as I do very often, and looks at educational institutions one is struck by the enormous difference of spirit in our country and theirs. Most of these educational institutions abroad, and I am thinking of the great developing areas of the world, have a terrible time getting started, because even local people with money aren't concerned, they aren't socially responsible. They don't give their resources to these local institutions whereas if you go back into the history of our country every great private institution in this country has somehow the long shadow of generous men, and it has survived because there have been very many intermingled shadows over the years, and if you do anything that discourages that or abridges it or diminishes it I think it would be a bad thing for the country generally.

I would like to see something done about the very real problem of people who abuse the tax laws regarding foundations. I think that this can be cleared up very quickly and very simply with three or four points of legislation. But this legislation should not harm foundations which are generous, which do work that can't really be done otherwise, at least historically in our country it hasn't been done except through philanthropy; these foundations should be increased, should be blessed, and somehow should be encouraged.

Senator HARRIS. That is all I have.

Senator CURTIS. Mr. Chairman, I want to thank the panel for being here. You may not realize it but I think you are helping to save the Congress from itself. If we pass the House bill, as it relates to foundations and charitable giving, we will have changed the way of life in America. I am thoroughly convinced of that.

Mention has been made here of the good work of the Kellogg Foundation. It is true, it is one of many. The Kellogg Center at the University of Nebraska. The provisions of the House bill would have done material damage to the Kellogg Foundation, to require a change of its portfolio if it hadn't gotten a special exemption. There are hundreds of foundations, some of them smaller and less known who will likewise be dealt a severe blow, some of them will wind up by the provisions requiring them to divest if they own more than 20 percent.

If we enact that provision of the House bill, the amount of revenue that comes to the Federal Treasury is zero and that is admitted by them. I don't want to put words in your mouth, Father Hesburgh, but would it be a fair statement to say that in searching to find out what foundations are worthy and what foundations perhaps were doing some things that perhaps should be curbed that the basic test is are they doing a maximum amount of good with the assets that they have?

Father HESBURGH. I would agree with you, Senator, I would add one more thing they should be publicly accountable for these, these are the trusts.

Senator CURTIS. Very much so.

Father HESBURGH. I think if you should have a required public accountability—open accounting for everything that is done—and a requirement that a foundation spend a considerable portion of income every year. The only foundation I know very well, the Rockefeller

Foundation, every year I have been on it they not only spent all its income but went into the capital by $10 or $15 million a year. The Rockefeller Foundation has given away over $1 billion in the last 50 years and have fortunately some more to give away. This kind of thing is a reflection of this country, it has grown with the country and it has been in so many areas, agriculture, medical education, health. It would be impossible to figure what this country would be like without it; I would hate to think. Of course, others have done it with greater assets; Carnegie, Sloan, and all the rest. But I would say as a simple-minded fellow in this area why not take the great foundations the way they have operated, the way they have accounted publicly, the kind of work they have done, granting they have made a mistake now and then because we all do, but take that as the norm, and establish the same kind of norm for everyone and then I think you avoid the trouble of tax-dodging, self-serving and all the rest.

Senator CURTIS. Would you agree this might be a safe procedure also that where there is an undisputed glaring abuse such as self-dealing, that we meet that and similar abuses, that by a minimal tax of maybe 1 percent these returns can be audited and then after 3 or 4 or 5 years the Congress will have knowledge upon which they can act? They will then have facts so they can say here is a practice that is in the public good or here is a practice that has led to abuses? Don't you feel that it would be well after we do our best to take care of the glaring abuses of which there is no dispute, to study the matter before we do great damage to this pluralism that we have in our culture?

Father HESBURGH. Yes, sir, I do.

And I think the great foundations have nothing to hide.

Senator CURTIS. That is right.

Father HESBURGH. Those that have something to hide are very easily taken care of.

Senator CURTIS. Don't you also agree that there are some very dedicated small foundations, small compared to the biggest ones?

Father HESBURGH. No question about it.

Senator CURTIS. Yes.

And have wonderful unselfish records and they are eager to do the maximum amount of good that they can.

Father HESBURGH. I am sure there are thousands of them.

Senator JORDAN. I have no questions.

Senator BYRD. Thank you, Mr. Chairman.

I feel that the chairman ably and effectively put in perspective the problems facing this committee. I have been impressed with the testimony of the panel today and I want to say I am particularly pleased to welcome Father Hesburgh to this committee. I have not had the privilege of knowing him but I have admiration for his public statements one of which I put in the Congressional Record, his statement to the students of the University of Notre Dame. I want to say that if more college presidents were to show the firmness and the wisdom of the president of the University of Notre Dame, I think we and our whole country would be in much better shape than it is today. It is a little off the subject but I didn't want you to be here without telling you frankly how I feel about the way you have conducted the problems that

face your university or potentially could face your university. Again, I think that the four of you have helped greatly to give this committee a keener insight into the problems which you face and which the Congress faces. Thank you, Mr. Chairman.

Father HESBURGH. Thank you.

Senator HANSEN. Thank you, Mr. Chairman. I would like to add my word of appreciation to this very distinguished panel. As a former member and president of a university board of trustees, I subscribe wholeheartedly to the statements you have made.

I have one question which may be parenthetical to our chief concern here this morning. I refer to the statement you made, Father Hesburgh, with relation to a grant to a small southern university whereby some new rice seed was developed down there that was very useful.

I have had the feeling that some of the larger foundations look with favor generally upon prestigious institutions and I am inclined to believe sometimes if the foundations had an opportunity to review the research program or the interest that is evidenced on university campuses throughout the country, it could very possibly be that some very important public benefits would accrue from lesser grants to smaller schools. Do you share this opinion?

Father HESBURGH. I think this; there is no question that the larger and more prestigious schools do get a little more attention because they have a great proportion of very talented people in them. But I would like to call attention to a grant that I had intended to mention, but I didn't, that was given by the Ford Foundation to every school in his country that was accredited in an effort to help them increase faculty salaries over a 10-year period or quicker because the money could be used right away. I think the net effect of that grant was a badly needed increase of 200 or 300 percent in faculty salaries because of the spurt that it gave.

In my own institution we got one of the largest, a billion and a half plus a million and a half bonus because we had shown evidence of going further, and that fund has grown through wise investment and through wise additions to some $14 million, and it just would have been non-existent without that particular grant at that particular time for this particular problem. Grants went to every school in the country and I have to say from my experience some of the smaller schools I know of got more of a boost out of the $300,000 they got than $3 million we got because their problems were much more crucial. The grants were a broad sweeping kind of thing, but they were enormously productive for the whole educational spectrum.

I think one broad thing like that, which cost the Ford Foundation several hundreds of millions of dollars puts in proportion the mistakes that are made from the foundations from time to time. We all make mistakes from time to time, I know I do.

Senator HANSEN. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you so much. May I say to members of the panel, I hope you understand our problem. We are trying to limit each Senator to about one question because we are under a deadline here to try to report this bill by October 31. Thank you very much for your statements today.

Father HESBURGH. Mr. Chairman, I have been requested to offer for the record a statement of Mr. Glickstein. He is the staff director-designate of the U.S. Commission on Civil Rights.

The CHAIRMAN. Without objection.

(The statement follows:)

STATEMENT OF HOWARD A. GLICKSTEIN, STAFF DIRECTOR-DESIGNATE, U.S. COMMISSISSION ON CIVIL RIGHTS

Mr. Chairman, I am pleased to have the opportunity to comment on the proposed restrictions on the financial support that private foundations may give to voter registration drives.

Before commenting on the provisions of H.R. 13270, I would like to note the long experience the Commission on Civil Rights has had in the area of voting. The Commission was established by Congress in 1957. Its duties as prescribed by Congress include investigating denials of the right to vote because of race, color, religion, or national origin. The Commission's first hearing, held in 1958, investigated denials of voting rights. It has conducted other hearings and issued a number of reports on voting since then. It has continued to watch voting procedures carefully since the passage of the Voting Rights Act of 1965. In 1968 the Commission issued a comprehensive report entitled *Political Participation*, which dealt with participation by Negroes in political activities in the southern States. Most recently it has conducted investigations and research in preparation of testimony on the extension of the Voting Rights Act of 1965.

H.R. 13270 creates a new section 4945 of the Internal Revenue Code which prohibits (by taxing at the rate of 100 percent) private foundations from financing voter registration drives unless the organization conducting the drive meets certain conditions. These condition are that the organization:

(1) is exempt from taxation under section 501(c)(3);

(2) has as its principal activity a nonpartisan political activity in five or more States;

(3) expends substantially all of its income directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated;

(4) is supported by other exempt organizations or by the general public as provided in paragraph (4) of section 4945(d); and

(5) does not receive contributions for voter registration drives subject to conditions that they be used only in specified States or other areas.

I consider this proposed restriction unwise and unfortunate.

While Congress has provided legislation safeguarding the right to register and vote, it has left to private organizations the affirmative task of educating and encouraging potential voters to register and exercise their franchise. This task is especially important in times of great social unrest when the racial and ethnic minorities and many young people perceive little evidence that the political process is a viable means for obtaining social reform and justice.

Restrictions on the financing by foundations by voter registration programs would add greatly to the problems encountered by concerned groups of citizens in their voter registration activities. In its investigations in the South the Commission has observed the importance of paricipation in the democratic process to the attainment by Negroes of full rights as citizens under the Constitution. Private voter registration efforts supported in part by foundations have contributed to increasing the number of Negroes registered to vote and have thus been the basis for their increased participation in political life.

According to the Report of the Ways and Means Committee of the House of Representatives the proposed section 4943 is not expected to interfere with the activities of the Voter Education Project of the South Regional Council. However, it is my expectation that it would seriously interfere with voter registration projects that have a more restricted geographic base and are not able to obtain funds from as many foundations. Thus an organization desiring to conduct a voter registration drive in a single city or State or which requires only the funds of a single foundation could not draw upon foundation support.

Registration of Negroes in the South is still disproportionately low. An end now of the effort to increase Negro voter registration would perpetuate the political inequality which still persists.

Table 1 gives the most recent voter registration statistics we have for these States.

TABLE 1.—VOTER REGISTRATION IN THE SOUTH, SPRING-SUMMER 1968

	Percent white registration	Percent nonwhite registration
Alabama	82.5	56.7
Arkansas	75.2	67.5
Florida	83.8	62.1
Georgia	84.7	56.1
Louisiana	87.9	59.3
Mississippi	92.4	59.4
North Carolina	78.7	55.3
South Carolina	65.6	50.8
Virginia	67.0	58.4

Source: "Voter Education Project, Voter Registration in the South," summer 1968.

Within the listed States there are many individual counties in which Negro registration is especially low. For example:

—In 27 of the 67 counties in Alabama, less than half the Negroes of voting age are registered. In five counties Negro registration is less than 35 percent.

—In 24 of Mississippi's 82 counties, Negro registration is less than half of those Negroes of voting age; in six counties it is less than 35 percent.

—In half of South Carolina's 46 counties Negro registration is less than half of those of voting age. It is less than 35 percent in three counties.

The failure of the Justice Department to send Federal examiners to most of the counties of especially low Negro registration under section 6 of the Voting Rights Act of 1965 makes the privately sponsored voter registration drive the only effective way of increasing Negro registration in these counties.

In its report *Political Participation*, published in May 1968, the Commission found that the highest Negro registration was in counties where there were both Federal examiners and a voter registration campaign. Next in percent of Negroes registered were counties with Federal examiners but without a voter registration campaign. Third were counties with a voter registration campaign but without Federal examiners. Lowest registration levels were found in counties with neither Federal examiners nor voter registration campaigns.

TABLE 2.—PERCENTAGE OF NEGROES REGISTERED TO VOTE IN PARTICULAR COUNTIES OF THE SOUTH

	Alabama	Mississippi	South Carolina
Federal examiners and voter education project	69.5	51.7	67.0
Federal examiners only	63.7	41.2	71.4
Voter registration project only	57.6	34.9	51.6
Neither	45.4	24.2	48.8

Source: "Political Participation," page 155.

It has been the position of the Department of Justice that local voter registration drives are the necessary and most appropriate way to increase voter registration.

In a memorandum to Attorney General Ramsey Clark dated January 12, 1967, John Doar, then Assistant Attorney General in charge of the Civil Rights Division, expressed the view that Federal examiners were not a substitute for "active local organizations" in accomplishing registration. The use of Federal examiners alone could be "counterproductive as far as bringing Negroes out of the caste system and making them viable participants in our political life." He stated that during 1967 the results of appointing examiners had been uneven, and that in some cases few Negroes had registered after an examiner was assigned to a county because there was no voter registration drive by private civil rights groups in the area. (*Political Participation*, page 156)

In a letter to the Commission, dated March 13, 1968, Stephen J. Pollak, Mr. Doar's successor, stated: "My experience would indicate that—at least after the first few months of experience with the Voting Rights Act—the key factor is the mounting of a drive for voter registration. The assignment of examiners

may help generate enthusiasm but its major significance is as a means to assure that full opportunities are available for registration where the State fails to meet its responsibilities." (*Political Participation*, page 155)

In *Political Participation* the Commission made several recommendations for action that the Federal Government could take to encourage political participation.

Among them, the Commission recommended an affirmative program to encourage persons to register and vote and a repeal of the 1967 amendment to the Economic Opportunity Act of 1964 prohibiting the use of funds for "nonpartisan voter registration activity." The affirmative program envisioned by the Commission would be a supplement to, but would not replace or make unnecessary private voter registration efforts. In view of the failure of Executive agencies to act in this area it is especially important that no new impediments be placed in the path of private voter registration activities.

One reason advanced for the value of the proposed restrictions on the financing of voter registration drives by private foundations is the belief that such drives support partisan political activity. I consider this belief unjustified. Section 501(c)(3) of the Internal Revenue Code already limits the involvement of tax-exempt foundations in political activities. The statute expressly prohibits participating in any political campaign on behalf of any candidate for public office. Further restriction, in my opinion, is unnecessary.

In testimony presented earlier in this Session of the Congress, the Commission strongly urged the extension of the Voting Rights Act of 1965. This action has not yet been taken by the Congress. In view of the uncertainty with respect to the extension of the Voting Rights Act, I believe it would be particularly unfortunate if legislation were enacted which could result in the total absence in the future of private voter registration activities.

The CHAIRMAN. We will next have a panel of Mr. J. George Harrar, president of the Rockefeller Foundation; Mr. Alan Pifer, president of the Carnegie Corp. of New York; and Mr. David Freeman, president of the Council on Foundations.

STATEMENT OF J. GEORGE HARRAR, PRESIDENT, THE ROCKEFELLER FOUNDATION

Mr. HARRAR. Mr. Chairman, and members of the committee. I am George Harrar, president of the Rockefeller Foundation. To my right is Mr. Alan Pifer, president of the Carnegie Corp. of New York, and to my left Mr. David Freeman, president of the Council on Foundations.

I would like to take this opportunity to submit my brief remarks. In the first instance, my own background of orientation is biology. For many years I was associated with the scientific activities of the Rockefeller Foundation; I later became vice president and in 1961 president.

During this period of time, I have had ample opportunity to examine the work of foundations such as our own and at the same time to see that of many others.

I would like to begin by saying that I think The Rockefellar Foundation, for which I speak, exemplifies the general purpose foundation devoted exclusively to the welfare of society. It is one of many, and it has over the years, I think, demonstrated the value of this almost American invention, a form of private philanthropy for the public good which has grown and become more and more sophisticated with time.

One of the reasons why foundations have had such success as they may have had is that Congress has supported the idea of private philanthropy through the provision of tax exemption over the years, with the support of the public.

I do not want to repeat what has been said before by those who have urged that the tax on foundations is simply a tax on its recipients. I think this has been said effectively by people who have made their case very well. We can only say we support this position.

I would like to explain some of the reasons why I think this is true from our own experience. In our own history, beginning over 55 years ago, we have found each year that new opportunities and new challenges and new demands presented themselves to us. We have had to evaluate and decide which of these opportunities we should attempt to assist, given our terms of reference. In so doing, past experience and demonstrable accomplishments, some of which are well-known, along with our possibilities for flexibility, stability, and continuity, have enabled us to engage in efforts for the public good for periods of time which assure progress toward established goals.

I would like to add that I think it is extremely important in our case at least that we have always had a highly professional staff. Our staff is composed of individuals who have had extended experience in a special field and are in position to interact and assess situations and problems and determine avenues of approach which they believe to be constructive and useful.

We are a self-renewing organization, as I see it. The trustees self-renew over a period of years with changes and additions. Our officers also self-renew through their own experience as they go forward in their professional careers and as they help younger people to get the same kind of background, experience and knowledge they themselves have acquired over a long period of time. So our staff is a career staff. We think of them not as being persons who come to us for a period of time, do a special task and leave. On the contrary, the vast bulk of our officers are those who are dedicated to a total professional career in private philanthropy. This to me is one form of private philanthropy, as I said, rather peculiar to America which has stood the test of time and I think has demonstrated a power to confront the many unmet human needs which we think are going to plague us in the future, against which we should all work together.

I think there has been excessive reticence by private philanthropy and private foundations—reluctance to do anything which might be called self-advertising. This reticence too often, I feel, has resulted in failure to communicate what we are trying to accomplish in a significant way to those members of the society that have an interest in knowing what we are trying to do and what our track record has been. I think we should have done a better job and the result has been, in my judgment, that a very small number of foundations have used the tax exempt privilege of private philanthropy in devious and unrealistic ways. Unhappily they have been the ones that have had the notoriety and have been the focus of much attention with the net result that in the minds of many there has arisen a tragic doubt about the public benefit derived from private philanthropy.

Our own foundation program may illustrate this point. As you know, our thrust has been upon a broad spectrum of human concern, including public health, education, food production, nutrition, and related interests. We have been deeply concerned about the spectre of hunger in many parts of the world and nutrition in those areas where

this has become a vital problem to large sectors of the society. We have emphasized education in all its aspects and our whole history has been one in which training programs have been associated with each of our projects. Fellowships and scholarships have always been a principal thrust and focus in support of all that we have done since 1913, and I believe this is the only way to obtain a multiplier effect in the form of people who are dedicated and devoted and wish to contribute their skill and expertise and their knowledge for the public welfare.

I would like to point out that over the years our efforts have been sharply focussed. We have selected for ourselves limited numbers of areas of concern which we think are most basic and most important and, of course, in this self-renewal process these evolve over the years so that we are not doing today exactly what we did in 1913. However, a great deal of what we are doing today we learned during the decades of experience since 1913.

We have tried to bring our program along in such ways that as the needs of society change and as the demands placed upon us change, we respond in a constructive fashion.

To me, on the basis of my experience, one of our most significant accomplishments has been the way in which we have been able, thanks in part to the public sector, to establish informal partnership with many other sectors of our own society toward common goals. We would hope to continue to work, informally or otherwise, in intimate association with other organizations such as our own, and in many instances with Federal, State, and other entities or agencies with similar concerns, such as food production, basic research, economic development, and all the other matters which are so pertinent, so important to society today and tomorrow.

I believe that this association enriches our national scene and is extraordinarily important. I believe it has demonstrated its value, and the fact that part of it is private and part of it public or semipublic simply makes it more meaningful. Therefore, I would hope that in the future this kind of partnership counld be enhanced and encouraged. We know very well that many outstanding scientific accomplishments have been achieved by Federal agencies, such as the Department of Agriculture, NIH, and many others. We too have contributed and we wish to continue to do so, in association with others, in the belief that together the several sectors can add up to more than the sum of their parts.

In conclusion, Mr. Chairman, I would say that we very strongly fear that the results of a tax upon private philanthropy would be negative in terms of human progress and our ability to contribute to it.

We do very strongly support, however, the thought that there should be an arrangement through which foundations by paying appropriate fees could ensure that surveillance was exercised on the least conspicuous of us as well as the larger foundation. We would do everything we could to cooperate to this end and would fully support any such arrangement for this as may be decided upon by the Congress. Thank you, sir.

If there are no questions, may I turn to Mr. Alan Pifer, president of the Carnegie Corp. of New York?

STATEMENT OF ALAN PIFER, PRESIDENT, CARNEGIE CORP. OF NEW YORK

Mr. PIFER. Mr. Chairman, I subscribe very strongly to all that Dr. Harrar has just said. I would like to say I am president of one of the older and one of the larger foundations in American life. The Carnegie Corp. was established in 1911 by Andrew Carnegie before the days of the income tax and, therefore, before the days of income-tax exemption. This was true of all the philanthropies which Mr. Carnegie established and he established quite a number of them.

We have today a capital funds of approximately $340 million, and we have annual income of approximately $14 million. All of that income is devoted to charitable purposes.

The purpose of Carnegie Corp. was established by the founder, Mr. Carnegie, and that was that the funds were to be used for the advancement and diffusion of knowledge. We are, therefore, in broad terms, an educational foundation and our programs over the years have been in those fields.

In 58 years of our history, I believe I can say that this Carnegie Corp. has been operated with no other purpose than to serve the public interest. There has been no private gain or personal gain to any member of the Carnegie family, to any trustee, to any employee of the foundation or to any other individual except fair compensation for services rendered.

Our program over the years has been in fields like the establishment of libraries in which the Carnegie Corp. and Andrew Carnegie in his own lifetime pioneered. We have had an active program in that field for many years. We have supported a wide variety of colleges and universities. I had a check made recently and discovered that the Carnegie Corp. in its history has made grants in every State of the Union, all 50 States.

We have had an active program in medical education. We have been interested in adult education over the years because we considered that very important.

We have done a lot in elementary and secondary education. And in the last few years we had a particular interest in the problems of preschool education, and we have some quite interesting programs we are supporting in that field.

And finally another area which we consider highly important is the strengthening of State and local government, and we have done a great deal, we think, in that field, a great deal comparatively, certainly, because this has not generally been an area in which foundations have been very active. We have had the privilege of supporting some excellent organizations in that field, the Citizens Conference on State Legislatures, the Education Commission of the States, the National Municipal League and many others.

You will be hearing later this morning, I believe, from Senator Arrington from Illinois who will talk about some of the work of the Citizens Conference on State Legislatures.

We have developed a strong opposition to an income tax on foundations as we have considered this matter in our foundation, and the reasons are the following: First, I think one needs to consider some-

thing of the history of income tax exemption in our society. It is part of a much longer tradition that goes back to Roman times in which private, charitable organizations, have been given certain privileges by the State in exchange for the functions they performed in private charity, that is functions such as relief of the poor, taking care of widows and orphans and that sort of thing, more recently in the medical field, in welfare and a variety of other areas. They are the traditional charitable functions which have always been performed by private organizations.

It is true that over the years it has become necessary for the State to move into many of these fields, but there remains a legitimate role for private philanthropy, and there is much we can do. You heard this morning from a panel of witnesses the kind of things foundations, as one part of the charitable field, still do, and these are important things.

In 1799 an income tax was levied in Britain for the first time, and in that year, at the time that act was passed, the income of charitable organizations, was exempted from tax. That seemed a perfectly natural thing to do because of the functions these charitable organizations were performing.

So, later, in 1913 in this country, when we had our first constitutionally based income tax passed, it also seemed natural to exempt the income of all charitable organizations from tax. And over the years since then the State has never made any attempt to distinguish between various classes of charitable organizations. They have all been considered equal under the law. There has been no such thing as a qualified, or limited, income tax. It has been all or nothing. The concept of income tax exemption has been considered indivisible.

Now, if an income tax is put on foundations by this bill you are considering, even if it is a very limited tax, if it is an income tax, then the Congress will have breached a long-standing tradition and indeed a public policy in this country since 1913. We feel that that is a major decision, not just a minor decision having to do with tax reform. It is a major decision about the nature of our society, because that decision will have set a precedent which might conceivably lead to the taxation of other classes of charitable organizations by some future Congress, and would certainly give encouragement to other levels of government to levy their own income taxes not only on foundations but on other classes of charitable organizations. So we think the precedent is a bad one.

We also feel that the tax would be discriminatory because it would fall on foundations but not on other classes of tax exempt organizations, and as many witnesses have already said this morning, the tax would be illogical because the burden of it would fall on the beneficiaries of foundations.

Finally, we think that the tax would be irrelevant to curing the real abuses that there are in the foundation field. Clearly measures are required, clearly the measures you are considering having to do with self-dealing are required. Clearly there should be a greater disclosure of the operations of foundations and, if I might express a personal opinion here, I would like to repeat what I said in my testimony before the Ways and Means Committee that I think there

should be obligatory publication of annual reports by all foundations; that even if it is very simply prepared material it should be available to anyone from the public who wants it, and I am disappointed in the House bill on that score.

In conclusion, just to summarize, I would like to say that we, at Carnegie Corp., feel that this tax would be harmful to the public interest. We believe furthermore that it would be unfair to many fine foundations such as our own that have operated through their history entirely in the public interest.

We also feel that if the Internal Revenue Service had done a good job of auditing tax exempt organizations over the years we probably wouldn't be sitting here today. It is certainly possible we would not be. A lot of our troubles spring from the fact that the IRS has not done a good job over the years and for this reason we have proposed, and my colleague, David Freeman, from the Council on Foundations will elaborate on this, that an annual fee be assessed on the assets of all foundations and that the proceeds of this fee be earmarked specifically for the auditing of foundation returns.

We feel out of that we would get the protection that we and foundations like ours need, and we feel this is a proper governmental function. We also feel that we have lacked that protection and we think the time has come for the government to do that for us.

Thank you very much.

Mr. HARRAR. Mr. Chairman, may I present Mr. David Freeman of the Council on Foundations?

STATEMENT OF DAVID FREEMAN, PRESIDENT, COUNCIL ON FOUNDATIONS

Mr. FREEMAN. Mr. Chairman, it is a pleasure to be here. I will attempt to speak very briefly on behalf of the smaller foundations, many of whom are included in our membership of some 425 across the country.

Small foundations, and the middle-sized foundations will be hit equally heavily by the 7½ percent tax on investment income.

Further than that, however, the organizations to which they traditionally give their support will feel this tax very immediately.

The small foundation typically has very small overhead. It is required under present regulations to expend substantially all of its income and, in fact, it is in every community of any size across the country one of the major sources of support for United Funds, the local welfare organizations and, of course, the educational institutions in those smaller cities.

The latest figures we have indicate 41 percent of foundation giving actually does go to education, and in response to the point that Senator Hansen raised earlier, I think it is fair to say that this is particularly true of the smaller foundations which are the ones most likely to be aware of the needs of the smaller educational institutions in their own areas. We can cite a number of examples, but I won't trouble you with those.

There is another aspect of the foundation giving which will be hit by this tax because, of course, the tax will mean that foundations have

less to give away, and that is the challenge grant which has been referred to by the earlier panel. This is a technique which is not limited to the large foundations. It is used also by individual givers and by smaller foundations, and the effect of this on the recipient has been proven time after time to be that at least the amount of the grant received from the foundation is triggered from other sources, and very often it may be doubled, so that one can argue that the effect of this tax on the kind of organizations, that seek capital funds and, therefore, seek challenge grants, will be much more severe than merely the 7½ percent figure.

I should add as relates to the smaller and middle-sized foundations that this tax will inevitably be received as a punitive measure because, as Dr. Pifer has pointed out, it does not discriminate between the good guys and the bad guys. It is a flat tax on everybody's income, and I am afraid it will be a major deterrent to the growth of the private foundation. I would urge the Senate to consider seriously the advisability of encouraging rather than discouraging this growth.

As earlier witnesses have indicated, far from eroding the tax base, the growth of foundations has just barely kept pace with gross national product and with other indices of economic growth. Thus, the tax will put a further squeeze on the private sector and force charitable and educational institutions to turn increasingly to Government for support.

Now, I would like to say a word about the alternative which is suggested to cover what we all recognize as the problem which IRS has had in obtaining sufficient funds and, therefore, sufficient staff to properly investigate foundations and audit the requirements.

We recognize the need for strengthened enforcement in the field. To curb the admitted abuses, we recommend that an annual fee be assessed against foundations and charitable trusts levied as an excise based on foundation assets. The assets can be readily determined and will not provide an added problem for IRS since another provision of the bill, the provision requiring distribution, does already require the determination of assets.

We feel that the funds collected should be made available to IRS for more adequate auditing and supervisory staff in the private foundation field.

We would like to make a special point of the fact that this fee should be assessed against assets rather than income. As Dr. Pifer has pointed out, we feel it is very important that the principle of tax exemption not be breached.

Regardless of the amount that might be fixed, if the tax is a tax on income, even though it may be given another label, it will be regarded by the public, and I am afraid by other taxing authorities at the State and local level, as an income tax. In fact, it could be argued, as I believe one of the Senators pointed out at an earlier hearing, that some States would automatically tax foundations once an income tax is imposed by the Federal Government.

We would argue further that assessing the tax against assets will provide a fairer measure of determining the appropriate supervisory costs, particularly in the case of foundations which have a portfolio of relatively low-yield stock and are, therefore, not giving away quite

as much as some others may be, but have real accounting problems in terms of determining how much should be given away under the distribution test.

As I have indicated, we do not believe that using the asset test would provide any additional burden on IRS, since that test must be applied in the distribution section.

Finally, we urge that the level of the tax be left to the determination of the Secretary of the Treasury. This will make clear that the funds received, whether or not specially earmarked, are intended to cover the costs of supervision of the private foundation area.

Thank you, Mr. Chairman.

The CHAIRMAN. I do want to ask one question, Mr. Freeman.

On June 4th, that was 4 months ago, I asked you to provide us with information that would give us some basis upon which to see just what payments have been made to public officials. You undertook to obtain that information. But the latest I had was a letter on July 25, 1969, and as of that date there were only 216 out of 404 of these foundations had reported and of those only a handful had given any information. I would assume somebody has something shocking to report, and if he has he will be the last man reporting. When are you going to hear from the rest of these people?

Mr. FREEMAN. I have an updating for you, Mr. Chairman. I had not mailed it to you because of the pressure of other events.

I think it is fair to say that we have had a reasonably good return now. You will remember that in our discussions, when we were discussing Senator Williams' proposed amendment I indicated that, of course, this would have to be a voluntary effort on the part of our membership.

We now have returns from some 300 of the 404 members to whom we addressed the poll, and of these 295 have indicated that as a foundation they made no direct payments; five have indicated they made direct payments, and I have the specifics as to those payments available for you.

The second part of the questionnaire related to the grantees of the foundations and, as I indicated to when we first discussed this, I anticipated that there would be a longer delay in obtaining this information. In fact, we now have 219 foundations who say that, to the best of their belief, none of their grantees made such payments. Seventy-four of the foundations that answered "No" for themselves have not yet replied for their grantees. We have 7 foundations with "Yes" answers from grantees, so that of the 300-odd who have responded, we have a total of 12 "Yes" answers.

Let me indicate to the other Senators that the "Yes" answers were an indication that these particular foundations or their grantees have made payments within a specific period of time to a Government official at a given level or above of salary for a journey to a particular meeting or for an honorarium to address the meeting or in a couple of instances awards to Congressmen and Senators for outstanding service in particular areas of interest to the foundation.

I will be glad to submit this information to you, Senator. I apologize for the delay.

The CHAIRMAN. You understand, I am not suggesting there is any-

thing wrong about these grants or awards. So far as I am concerned, I presume they are all completely justified.

Mr. FREEMAN. I think you will find the information will be helpful. It suggests to me one thing if I may take a moment on this, though it is out of order for our panel discussion, and that is that several of the "Yes" answers indicate the desirability of some flexibility in the present version of the Williams bill, if I may call it that, as it is contained in the House bill, with regard to foreign travel.

We have indications from these "Yes" answers of half a dozen senior Government officials who attended scientific conferences overseas because—with foundation support or with the support of a grantee of a foundation, because—as is spelled out in each case—they were just unable to obtain the necessary travel funds from their own departmental budgets, and I think the types of trips that were taken, and the types of meetings attended will be of real interest.

The CHAIRMAN. Let me say this, unless the committee wants to do so, I do not even plan to release the information you are providing to me. But I would like to know why it takes 4 months on part A which, from my point of view, any one of these people should have been able to give you the day after it was requested.

Why does it take so long for them to get the information in part A? "Did you make a payment last year or the year before to a Government official?"

Mr. FREEMAN. Part of the answer, Mr. Chairman, is another problem with which my council has been attempting to deal with, and which I am sure many of the members of your audience today can appreciate, and that is that smaller foundations across the country are typically not very fully staffed, and when we send out a questionnaire to them, particularly if we send it out in the middle of the summer, we cannot expect very prompt attention to the answer to that questionnaire.

I would also add, as we discussed before, where part B was involved, it was obviously going to be a longer process, but I can only beg forgiveness on the argument that the foundations in the middle of the summer are hard to get to in terms of paper work.

The CHAIRMAN. Now, if I recall correctly, our understanding was that part A would be simple enough to answer that, during the period January 1, 1968 through June 4, 1969, during the last 18 months is the date we are asking it, "Did your foundation make a direct payment or directly provide services or facilities in aggregate of $25, in excess of $25, to any Member of the U.S. Congress or Federal Judiciary, any member of the executive branch, the Federal Government, whose rank was equivalent to GS-16, which is $22,800 and above, or any Member of Congress or Senators' staff receiving a Federal salary of $15,000 or above, yes or no."

It would seem to me that if those foundations, those small foundations, had such inadequate managements that they can't provide you a yes or a no answer to that question in 4 months, that there are some serious doubts whether they ought to be granted tax exempt privileges just for lack of capacity to know what they are doing with their own money.

So 104 that have not responded, it would seem to me we ought to know from the other 104 what is the answer to part A. In part B we

want to know what happened indirectly, and if you made some payments, which there is some reason to think this might have been paid indirectly to some Government officials, we would like to know about that.

May I say that I can understand how some of this information could be embarrassing to someone even though there was nothing whatever wrong about the grants made. But I do think we are entitled to the information. You said we could get it, and we want it, we would like to know it.

On June 4, I said to you I would like to have that information before we acted on this big bill, and we still do not have it. This is 4 months later. When can we hear from the other 104 of your peaple?

Mr. FREEMAN. Senator, I cannot guarantee that you will hear from all the other 104 because you and I agree, this was going to be a volunteer activity. I have sent out reminders to our full membership. I will, of course, send out a further reminder. I suggest for a volunteer activity conducted chiefly during the summertime, a 75-percent return is not too bad.

But I think, the message here, really is to be sure that the members of the committee see the kind of "Yes" answers we have received because I think they are quite significant in indicating what it is that does lead foundations to make these payments to Government officials and for what purposes these funds are used. This is really the guts of the problem.

So I will again question the remaining members who have not yet replied. I will get the information to you as promptly as I can, and meanwhile I will be happy to turn this over to Mr. Vail.

The CHAIRMAN. Thank you.

(Information received by the committee on the points raised was made a point of the official files of the committee.)

Senator WILLIAMS. In connection with the statement of the chairman, we would assume that those who have something that they are going to cover up would be the most reluctant to answer the question.

However, since this is a voluntary program, I am going to volunteer this suggestion. You tell those that do not answer we are going to proceed on the assumption they are enthusiastically in favor of the bill. [Laughter.]

Mr. FREEMAN. Thank you, Senator Williams. I think that will have a strong effect on them.

Senator WILLIAMS. Yes, sir.

Now, the bill provides for an orderly liquidation of the assets, that is, foundations holdings of securities in any one company would be gradually reduced to a maximum of 20 percent. What are your views on that, Mr. Pifer.

Mr. PIFER. Did you mean that for me?

Senator WILLIAMS. Yes.

Mr. PIFER. This is a complex question that affects many foundations in different ways. There are many foundations that, in fact, own a good deal more stock in a corporation than 20 percent, where the income from that foundation has been used for nothing but charitable purposes. The Kellogg Foundation, I guess, would be a good example of this. I certainly feel that the primary test, as was suggested by Sen-

ator Curtis here, is how the money is, in fact, used, how the income is, in fact, used.

So I think another consideration here is that if there is going to be divestiture, the length of time, the conditions of divestiture, the percentage of stock a foundation can hold should be reconsidered. The whole idea of the timetable toward divestiture should also be reconsidered.

I think, in broad principle, if I could express a personal view—and this is simply a personal view and it is expressed within the context of the fact, as I have said, that there are many fine foundations that do at least own 20 percent of the particular stock in a company—that the active control of a business by foundation is, in principle, not a good thing.

This is because it is diversionary of the interests and energies of the foundation staff and of the foundation trustees.

Broadly, the purposes are, in the long run, different between a profit-making organization and a nonprofit organization. However, as I have said, this is a complex matter, and I would hope this is an area in which the Senate Finance Committee will study very carefully and not move precipitously to hurt any of the fine foundations which, in fact, do own a substantial proportion of the stock of a corporation, and yet are using these proceeds for wholly charitable purposes.

Senator WILLIAMS. All right.

Senator TALMADGE. Mr. Chairman, if I may, I would like to ask two questions. I would like to ask the first of Mr. Freeman. Mr. Freeman, you have suggested in lieu of an income tax on foundations that a fee or levy on the assets be charged.

In my judgment, that would be unconstitutional. The Congress does have the authority by constitutional amendment to levy an income tax. I think if we levied a capital tax, it would be a capital levy, I think that is probably unconstitutional.

The question that I have is this: in 1967, if the facts that I possess are accurate, 647 foundations, which included all of the major foundations, made contributions, gifts, and grants of some $754 million, but the accumulation of income in those same foundations during those same years was in excess of $2 billion. In other words, the contributions were less than half of what they received.

Don't you think we should levy an income tax on the income that they did not distribute?

Mr. FREEMAN. Senator Talmadge, let me try my hand very quickly at the first question. A paper has been prepared and submitted to Mr. Vail's staff and the others on the precise constitutional point that you raise.

It is the strong feeling of the lawyers who have studied this from the point of view of the foundations that an excise tax, or an excise more properly, would, in fact, be clearly constitutional. There is adequate documentation for this. I am not a constitutional lawyer myself, and I won't attempt to go further than to say that the point has been researched.

On the question of the accumulation, I think the difficulty with those figures which, if I recognize them, come from Congressman Patman's studies, is that they include donations to foundations and unrealized or realized capital gains.

If one takes the donations to foundations as an accretion of capital, which is the way the present regulations provide, then they do not fall within the scope of the word "accumulation" as it is used in the present statute.

In other words, if you create a foundation and give it several million dollars to get it off the ground, that is not considered an accumulation. That is an accretion of capital of the foundation, and it is the income which those millions of dollars then earn which must be paid out annually and which, under the present rules, must not be accumulated unreasonably.

So that I think the question of taxing the assets becomes one of whether this is the fairest way to assess the fundations or a service which the Government is providing and which we trust the Government will be able to provide more fully and effectively, and we would argue, for the reasons I have indicated, that the asset test seems to us to be much the fairest.

Senator TALMADGE. My own comment on it is that if I were a very rich man I would hate to see that precedent established, because if Congress can make a capital levy on foundations it could make a capital levy on citizens.

My next question is of Dr. Harrar. I am well aware of the many fine things the Rockefeller Foundation has done, some in my own state, but I have in my hand here a document and, incidentally, this does come from Congressman Patman's study. In the year 1966 the Rockefeller Foundation, according to this report, had compensation of officers of $1,400,000 plus, other wages and salaries, $1,300,000 plus; taxes, $64,000 plus; rent, $485,000 plus; miscellaneous expenses, $2,400,000 plus; total expenses, $5,763,354.

During that year you made total grants, contributions, gifts, scholarships, and so forth, of $30,586,000.

Now, a rough computation indicates that that would be about 17 percent administrative expenses. Isn't that rather high?

Mr. HARRAR. Yes, sir. If you will permit, I will not try to handle the figures because they are the responsibilities of others. But I can say that there is a substantial difference in interpretation of those figures between ourselves and the source of that report.

As I said earlier, our staff is professional. They are located in New York and in the field. We use them to work in professional association with leaders in the areas of public health, agriculture, nutrition, and so on. We consider the maintenance of this professional staff to be part of our philanthropic contribution. It is the basis of our philanthropy.

(The witness subsequently supplied additional information as follows:)

Senator Talmadge asked me to supply the Committee with an explanation of the statement made by Congressman Patman in one of his reports to his Subcommittee, that The Rockefeller Foundation had overhead costs of $5.4 million in 1966, which would have been 15.5% of the Foundation's total 1966 expenditures of $34.9 million.

The explanation is as follows: The amount spent by the Foundation in 1966 for administrative costs, as distinct from the amount spent on its charitable program, is shown in our 1966 Annual Report as $2,230,286. The $5.4 million figure that Congressman Patman used includes those administrative costs and also includes all the costs of planning and conducting—out of our New York office—the Foundation's national and international programs, including travel,

program officer's salaries, and consultants' salaries. In addition, it includes a nonrecurring payment of $958,000 to transfer to an outside insurance carrier a fund for vested pension obligations which had until then been maintained as an internal reserve fund.

Our 1966 administrative costs of $2,230,286 amount to 6.4% of our 1966 expenditures, which as stated above were $34.9 million.

Senator TALMADGE. Thank you, Mr. Chairman.

Senator CURTIS. In the interest of time, I will ask one question.

Mr. Freeman, about how many foundations have you had some contact with over the years, and of those numbers—and I do not want you to name names of the foundations—have you discovered instances where foundations have not acted in the general public interest?

Mr. FREEMAN. Senator Curtis, I have worked for three different foundations fulltime; I have been a consultant to two family foundations, and in my present position I am working with a number of foundations, certainly not all 420 members, but a wide variety of different types of foundations.

I would say that if I were to try to strike a percentage figure, certainly no more than 1 percent of the foundations that I have had any contact with, in my own judgment, have really gone outside the limits, as we understand them.

I would not want to say that every 990(a) form that I have examined has been what I would have submitted for that foundation. I think this bears on the question of audit. I think a number of foundations in preparing their 990(a)'s or having their CPAs or having their attorneys prepare them, have not understood the form fully, have not reflected adequately in the form what they are actually doing and, as a result, quite frequently I have been able to identify on their 990 (a) forms what I considered unreasonable accumulations of income which, on further exploration with them informally, have turned out to be just bad reporting on their part.

But in terms of really going off the reservation, really doing things that you and I would consider were unethical, were clearly self-dealing, I would say certainly no more than 1 percent of the foundations I have dealt with would fall within that general area.

Senator CURTIS. Thank you.

Senator JORDAN. Mr. Freeman, would you favor public disclosure of the operations of all foundations?

Mr. FREEMAN. Yes, Senator Jordan. Our Council for the first time in its existence last April took a public position. We had been a service organization. We never really tried to think through where we stood in terms of any specific issues in the foundation field.

We submitted a letter to the House Ways and Means Committee, a copy of which the Chairman of this Committee very kindly allowed to be introduced into the record during the hearings on the Williams' amendment, in which we strongly recommended full public disclosure and, if I may say so, I subscribe entirely to what Dr. Pifer has indicated.

We went further in that recommendation than the present House bill goes in that we would require that every foundation make available to the public some record of its own activities on an annual basis, whether only a mimeographed paper or listing of the grants from a 990(a) form or something, so that the general public, in trying to find

out about foundations—and this is a question of all the people in foundations have fired at them all the time, "Well, if you can't help us where should we go?" The general public would be a little better informed than by having to go to the relatively few places where 990(a)'s are available, and wade through them.

We would strongly urge this. We would think it would be a very helpful thing to put people on their mettle to make a good report and do a good job.

Senator JORDAN. Now, Dr. Pifer, you suggest that, perhaps, some of the abuses and malpractices of some foundations are caused by the inadequacy of the supervision of the IRS.

Do you think the alternative proposal that you have made here to supply a fund for more staffing in the Internal Revenue Service for this particular job would take care of that difficulty?

Mr. PIFER. Yes, Senator Jordan, I think it would go a long way toward taking care of it, provided there is adequate legislation against self-dealing and, of course, requiring full disclosure.

I think if those two things were done, and then if we had adequate supervision of the returns filed by the foundations we would have gone a long, long way toward solving the problems in this field.

Of course, this means the audit must take place frequently. We cannot have an audit every five years or ten years. It seems to me that ideal might be something like an audit every 2 years, for every private foundation.

Senator JORDAN. Have any of you calculated how many staff people might be required to do this job?

Mr. PIFER. We have not calculated that figure. We have heard a figure that has, we understand, been produced in the Internal Revenue Service, that might be something $17 million, but we have thought that was really the responsibility of the Commissioner of Internal Revenue and have, therefore, suggested that the Secretary of the Treasury be the one who would calculate the amount to be, of the fee to be, charged to each foundation, because only, with the help of the Commissioner, will he ultimately be in a position to know exactly how much money will be required to do the job.

Senator JORDAN. Thank you.

Thank you, Mr. Chairman.

Senator BYRD. Thank you, Mr. Chairman?

Mr. Pifer, you testified that the assets of the Carnegie Foundation totaled $340 million.

Mr. PIFER. That is correct, sir.

Senator BYRD. Do you happen to have the corresponding figure for ten years ago?

Mr. PIFER. I am afraid I do not have that in my head, Senator Byrd. I would be very happy to supply it for the record.

Senator BYRD. I would appreciate it if you would.

Mr. PIFER. I would be happy to.

(The Committee subsequently received the following information:)

MARKET VALUE OF CARNEGIE CORP. ASSETS

At the end of fiscal 1958, the market value of the Corporation's total assets was $253 million. At the end of fiscal 1968, the market value of total assets was $335 million, an increase of 32% in the course of the decade.

As shown on the attached sheet, in contrast with the 32% growth in Carnegie Corporation's assets, total national wealth increased about 78% in the same period, gross national product went up 94%, and total U.S. debt & equity went up approximately 111%.

Note: During most of the years from 1958 through 1968, common stocks accounted for a little over one-half of Carnegie Corporation's total investments (the percentage of investment assets in common stocks ranged from a low of 48.7% in 1960 to a high of 62.3% in 1967; the remainder consisted principally of bonds and mortgages). Counsel throughout the Corporation's history have advised that under the terms of the donor's deed of gift and the foundation's charter corpus may not be invaded. Capital gains have therefore been treated as capital and added to corpus.

CARNEGIE CORP., COMPARATIVE INCREASE IN VALUE OF ASSETS, 1958-68

[Dollar figures in millions]

	Total Carnegie assets	Percent increase	Total national wealth[1]	Percent increase	Gross national product[2]	Increase	Total U.S. net debt and equity[3]	Percent increase
1958	$253		$1,703,000		$447,300		$1,187,000	
1968	335	32	3,036,000	78	865,700	94	2,502,000	111

[1] Aggregate value of all tangible U.S. nonmilitary wealth including land, structures, equipment, inventories, and livestock. Partly estimated; based on Goldsmith and Kendrick data for the national balance sheet.
[2] From Department of Commerce, Office of Business Economics.
[3] Net public and private debt at end of year (bonds, notes, mortgages, etc.) plus market value of all corporate stocks. From Federal Reserve Bulletin and economics department at Morgan Guaranty Trust Co. of New York. Partly estimated.

Senator BYRD. Mr. Harrar, would you indicate the total assets of the Rockefeller Foundation?

Mr. HARRAR. Yes, sir. I think at the moment it is just under $800 million.

Senator BYRD. How does that figure compare with 10 years ago?

Mr. HARRAR. I just could not give you that figure. I would be glad to send it to you, but I could not give you what I would feel would be an accurate or responsible answer from my own memory.

Senator BYRD. Would you supply that for the record?

Mr. HARRAR. Yes, indeed, sir.

(The information referred to follows:)

Senator Byrd asked me to supply the Committee with the present and ten-year-ago market values of the holdings of The Rockefeller Foundation, and Senator Curtis suggested that the analysis show how much of the increase was the result of retaining income and how much the result of appreciation in value. The figures are as follows (in millions of dollars):

Market value of securities at Sept. 30, 1969	$787.8
Market value of securities at Dec. 31, 1959	584.5
Increase in market value during decade	203.3

EXPLANATION OF INCREASE IN MARKET VALUE

Appreciation in value of securities during decade	264.7
Contributions received	2.3
Deduct capital expended during decade	(63.7)
Total	203.3

During the decade the Foundation expended all its ordinary income—amounting to $274.1 million—and $63.7 million of its principal. From its inception in 1913 to the present the Foundation expended all its ordinary income—amounting to $784.7 million—as well as principal in the amount of $155.5 million.

Senator CURTIS. Would the distinguished Senator yield right there?

Senator BYRD. I would be glad to yield.

Senator CURTIS. I tihnk it would be helpful if the record shows how much of the increase, if you had an increase, is the result of retained earnings, and how much of it might be inflationary or growth.

Mr. PIFER. If I could add a word to this, Senator——.

Senator CURTIS. I did not mean to take the questioning away.

Senator BYRD. That is all right.

Mr. PIFER (continuing). In our particular case—and we are somewhat unusual here, but there are other foundations in our position—it has been the opinion of our legal counsel over the years that the Carnegie Corporation was not allowed to spend corpus; that is, to spend capital, so we have never spent capital gains, and our capital gains have been plowed into the corpus.

Now, this obviously—this bill is going to raise some difficulties for us, and it means that we are going to have to make an effort to get our charter changed. This will probably mean an act of the New York State Legislature, and if that becomes necessary, we are fully prepared to make that effort.

But I trust that in considering the figures of the growth of our corpus it will be noted that in our case our legal counsel has consistenly maintained that we were not in a position to spend capital gains.

Senator BYRD. For whatever the reason, I think it is important that the Congress be aware of the growth that has taken place in the total assets of all of the foundations of our Nation.

Now, in looking over some figures I find that 25 years ago the total assets were less than $2 billion, $1.8 billion. It was testified this morning, and the Treasury, on questioning by me, also verified that the total assets are more than $21 billion. So that in 25 years the total asests of the Nation's foundations have increased tenfold.

Now, if that continues another 25 years, that would be $200 billion, and I am just wondering whether the foundations will not become more powerful than the Federal Government.

The question I would like to direct to the two of you, and it is a friendly question [laughter], but do you feel that in the long-range interests of the Nation that there should be a terminal date put on corporations, or should there be permitted as it has been in the past, to be pertual?

Mr. PIFER. If I might take a crack at that one, Senator, I think this question of perpetuity is one that one has to consider in a broader context. There are other forms of charitable organizations, and they have their charters, and if a limit is put on the life of the foundations, as one form of charitable organization, again we have set a precedent in our society for someone to raise the question with regard to others.

Now, what about churches? Should there be a limit on the life of a church? Should there be a limit on the life of a college or a university? These are endowed institutions, like foundatons. They have boards of trustees, like foundations, and many classes of charitable organizations exist, and I think this again would be one of those very fundamental decisions which ought to be most carefully considered because of the precedent it might establish in regard to the entire charitable organization field.

Now, about the growth of foundation assets, the study which the group, the coordinated group has made and which, I hope, Mr. Chair-

man, we might have the privilege of entering into the record, I cannot remember whether Mr. Miller requested that, but if he did not, I would like to request it, that study shows that foundation assets, although they have been rising in relation to themselves, have been rising less rapidly than the rate of growth of the wealth of the country. In fact, we are now beginning to get a decline.

Foundations are declining relatively in relation to many other indices of the economy of the country and, therefore, we feel that anything which is done, such as limiting the life of foundations, which would tend to discourage the creation of new foundations and to discourage the whole field of philanthropy is going to cause simply a further decline in this curve.

The result of that inevitably will be that the private sector, the nongovernmental sector, will be less well-financed, and here again we come back to that very basic question about the nature of our society and the role played by nongovernmental organizations in it.

Senator BYRD. What are these figures that you are speaking of? These figures you want to submit for the record; what are the figures; what do they deal with?

Mr. PIFER. Here they are. Well, the conclusions, the principal conclusions, of this study were that foundations have never owned a significant proportion of the financial instruments, such as stocks, bonds, mortgages, et cetera.

Senator BYRD. Let me interrupt you for a minute, if you will.

I put this question to the Treasury Department, and I thought maybe you have the answer to that. The Treasury has not been able to give it to me. I asked the Treasury what were the total assets of the Nation's foundations in 1938, in 1948, in 1958, and in 1968.

Mr. PIFER. I have those figures, Senator.

Senator BYRD. I am glad you have those. You have even more power than the Federal Government. [Laughter.]

Mr. PIFER. Perhaps, Senator, this is a good illustration of our belief that the Federal Government has not been in the business of collecting adequate information about the entire nonprofit organization field.

The assets of foundations in 1938 were $1.4 billion; in 1948, $3.5 billion; in 1958, $12.5 billion, and in 1968 it was $21 billion.

Now, I could give corresponding figures for the total national wealth in those same years.

Senator BYRD. That is not of interest to me.

I find out now, though, that 30 years ago the total assets were $1.4 billion, 30 years ago, 1938.

Mr. PIFER. That is correct.

Senator BYRD. Is that correct?

Mr. PIFER. Yes.

Senator BYRD. And 1968 they are $21 billion; am I correct on that?

Mr. PIFER. That is correct.

Senator BYRD. Well, the only reason I raised this point is—and I want to add, and I would like to direct this question to the three of you—do you feel that in the long run there is a danger, there is a danger to our Nation, if we do not put some limit, time limit, or some other limit, on the amount of assets that private tax-exempt foundations can accumulate?

Mr. PIFER. Senator, if I might speak again, it seems to me the answer to that question must always be what proportion the foundation assets bear to the total wealth of the country.

Now, those foundation assets have never exceeded 1 percent of the total wealth of the country and, indeed, it is now falling.

It started at 0.36, and it went at the highest point, to 0.75, that is ¾th of 1 percent, and it is now down to 0.69. We estimate that it is going to keep falling.

So it seems to me it is not a question of absolute rise in foundation assets but where do they stand in the total picture. Are they an increasing portion of the wealth of the country.

Now, if they were a rapidly increasing proportion of the total wealth, then I think that would be serious cause for examination of possible corrective measures.

Seantor BYRD. You see, you do not—you do not feel that it is serious at the present time?

Mr. PIFER. I do not, because the proportion is falling.

Senator BYRD. Would you say something, Mr. Harrar?

Mr. HARRAR. I would have to support, because of the research we have done in the same field, the position taken by Mr. Pifer that this matter is more relative to the more basic figure of the economy of the Nation. Foundations are running ahead, far ahead, in numbers and, of course, numbers frighten a lot of people. The amount of national resources is increasing much faster than the assets of foundations. Instead of holding 0.68 percent of the Nation's asset's we could have foundations holding 2 percent. Then I would say it is a trend and a factor for major alarm. But it is not happening that way. I think private philanthropy has the validity which I believe it needs to keep pace with the general growth of the economy.

So far as perpetuity is concerned, sir, I have never cared for the word "perpetuity." It is a little bit like immortality, it is a little hard to come by, but I do feel, and I have said on many occasions in the past, that I think every instrument granted the privilege of tax exemption by reason of its objectives and goals has to re-earn its franchise regularly. This is not something we have forever because it was granted to us once. It is something that I think that those of us who have the responsibility, to ourselves, and to the public, must each year, each period, try to demonstrate, that the franchise is something we have earned, and continue to earn.

If not, then I think action should be taken.

Senator BYRD. Thank you, gentlemen.

Thank you, Mr. Chairman.

Senator HANSEN. I have no questions, Mr. Chairman.

Mr. HARRAR. Thank you for the courtesy and privilege of being with us.

The CHAIRMAN. Thank you for your presence here today.

We will next hear from a panel of witnesses on the effect of program limitations. They are Merrimon Cuninggim, president, Danforth Foundation; Homer Wadsworth, president, Kansas City Association of Trusts and Foundations, and the Honorable W. Russell Arrington, president pro tempore, Illinois State Senate, testifying for the Citizens Conference on State Legislatures.

Senator Percy, I believe, wanted to produce some constituents.

Senator PERCY. Thank you, Mr. Chairman. I will be testifying before this committee on Wednesday morning, but I would just like to say now before introducing Senator Arrington, I think these hearings are among the most important hearings the Congress has ever held, and having seen the consequences, and having been startled by the consequences of the action of the House, I can only say "Thank God we have a bicameral system and we can stop, look and see now about the effect being done by this tax bill, and have a chance to reevaluate what we are doing to America's society."

We are really asking ourselves what kind of a nation do we want to be, and what kind of a people do we want to become.

It was de Tocqueville who discovered in 1823 that a great deal is done in voluntary associations and in the private sectors.

Senator Byrd's question that he asked: can we place a limit on the assets of our foundations, we can if we want to place a limit on how much we want to do in the private sector and, gentlemen, let us not do all this in the public sector. But it does seem to me every single one of us sitting here that I can see of my colleagues is concerned about one thing. We are concerned about how much erosion of local and State government responsibility we have had, how much erosion of the private sector at the expense of the public, and how much more we are trying to take on in the public sector, and what we are trying to do when we created a new federalism, is move back some of these programs out of Washington, back into the private sector and back to local and State governments. This is why I am very happy to have the president of our own Illinois State Senate here today, Senator Arrington.

He has not only been my own State senator, in my own district in Illinois, but he has been president pro tem of our senate. He has dealt with other members of State senates across the country in the 50 States, and various groups, including the Citizens Conference on State Legislatures.

He has from a practical standpoint dealt with the problem of how do we make our State governments responsive and responsible, and how do we take back from the Federal Government some of the problems that have always been sent down to Washington.

As a specific case, if we had not had him as the head of the senate, we would not have had a State income tax. Now, I hope this does not provoke reaction in Illinois [laughter], but I can say without any hesitation if the State of Illinois did not impose the State income tax this year we simply would have been bankrupt as a State and bankrupt in facing up to the responsibilities of the 11 million people. We would have sent more problems to Washington, not less.

We now have a tax structure, as a result of the Governor and the speaker of the house, who is now a colleague, Ralph Smith, and the president of the senate working together to face up to what we need to do as a people.

Certainly you have done more than, I know, anyone else to bring young people into the Government, to have the State government responsive to our needs.

So I am very pleased, indeed, to be able to introduce him. I believe that he will be able to make, with his colleagues on his panel, a very

important contribution, and answer for us a question that plagues us: If this tax bill goes through, what would happen to the objective we have of the erosion of State and local government at the expense of the Federal Government taking over.

Mr. ARRINGTON. Thank you, Senator.

The CHAIRMAN. Thank you.

Will you now proceed as you planned, gentlemen.

STATEMENT OF MERRIMON CUNINGGIM, PRESIDENT, DANFORTH FOUNDATION

Mr. CUNINGGIM. Thank you very much.

Senator Arrington, Mr. Wadsworth, and I are to present the testimony concerning that part of the bill that imposes certain limitations on the programs of foundations.

We do not want to try your patience, sir, by needless repetition, for these matters have already been referred to briefly. We will try to keep our comments to a minimum, although we are open for any questions in this area.

There are four main points in the testimony of the three of us. We wish to point out that the bill as it now reads would prohibit "any attempt to influence legislation by a attempt to affect the opinion of the general public or any segment thereof." That is a quotation from the phrasing of the bill, and we believe that this prohibition will inhibit or prevent certain activities now approved which are very much in the general welfare.

We intend, secondly, to say a brief word about the partial prohibition that the bill now provides against grants to individuals.

Third, we wish to speak to the point of the definition of "expenditure responsibility" in the bill; and, finally, to point out that in our view the House committee's report indicates an intention in respect to the bill, with which we agree, and which, if followed, could repair the difficulties in the wording of the bill itself.

As for myself, I will speak briefly on the matter of grants to individuals, which is a relatively minor matter, and go on to the prohibition against any attempt to influence legislation.

My two colleagues will also speak to that point, from their different approaches.

It is always tempting in a situation like this, Mr. Chairman, to say a word about one's organization. I work for the Danforth Foundation, whose officers are in St. Louis.

We feel that we escape some of the limitations of horizon that some of our larger brethren necessarily possess by virtue of their being in the East.

We do make grants to nonprestigious institutions and, in fact, have contacts with more colleges than any other foundation in the country, and with more college people.

Our area of activity is education and urban affairs.

I want to say a word about the grants to individuals for, though this is a minor matter, it is still a matter of some concern to a number of foundations, not Danforth alone.

The CHAIRMAN. If I might just observe, I did not read that correctly. You are president of the Danforth Foundation. I have got

you confused with one of those eastern foundations, and I am glad to have you correct me.

Mr. CUNINGGIM. I would like to associate myself with the Eastern Ivy as much as possible but I am the Danforth Foundation president. I am afraid that you are not the only one who made a mistake. For as far as my name I regret that my immediate ancestor did not know how to spell. [Laughter.]

The Danforth Foundation is in the business of making grants to individuals. That is to say, we have 10 or a dozen national programs of fellowship, awards, and prizes, given for various kinds of activities that we believe serve the general welfare.

We were concerned deeply when the House committee, in its May 27 announcement, indicated that its tentative decision was to prohibit all grants to individuals. The bill, as finally passed, represents a considerable improvement over the tentative decision, we believe, for as you know, the bill now allow those kinds of grants to individuals that are part of defined programs and fellowships publicly announced in which selection processes are carefully worked out and which contribute to the general public good.

We believe that this is an improvement, but there are questions still remaining here. For example, what about the status of national awards and prizes, carefully decided? They do not really fit the field of fellowships, as such.

Now, I won't take your time to go into the details of how that particular matter could, in our view, be improved, for I have tried to cover this in my written testimony, I simply want to conclude by saying that in the view of a number of foundations, not Danforth alone, that are concerned with the matter of grants to individuals, there are ways of protecting the general public against the kind of abuse that the House measure was directed at, and yet of allowing the kinds of national fellowship and award programs, that serve the general welfare.

The most important part of the testimony of all three of us, Mr. Chairman, has to do with the wording of the bill that would prohibit "any attempt to influence legislation by an attempt to affect the opinion of the general public or any segment thereof."

This is a difficult matter to speak to for, at the very beginning I want to make quite clear, sir, that we do not believe in partisan political activity, lobbying, support of a particular candidate, or any such activities by foundations. We strongly support the effort of the House to indicate that these kinds of activities are inappropriate.

We believe, however, that the particular language used in that section is such as to call in question some part of the legitimate activities of nearly all foundations.

The wording "and attempt to affect the opinion of the general public," worries us. That is not a correct word. It does much more than worry us. In some degree it alarms us, for it would be, we believe, a challenge to the basic premise on which our foundation and other foundations operate. The premise I mean to refer to is that the work in which we are engaged possess both relevance and timeliness.

We want to make a difference in American life. We would like to feel that the programs we sponsor and the grants we make are pointed toward serious problems, not fluff, not superfluities.

We believe that it would be highly to the advantage of the general welfare if these problems were examined as carefully as could be by competent studies, by experts in the field and beyond that, if the results of those examinations were made available to and taken into account by the general public.

If, in almost any area of a foundation's activity, this process does, in fact, succeed, then sooner or later it is possible—it is more than possible, it is likely—that questions concerning that problem will come into the consideration of legislative bodies, local, State, and National.

It would be impossible, we think, to find any useful activity that would not be related to the problem of molding public opinion. Conservation of natural resources? Beautification of our highways? Air and water pollution? These seemingly innocent-sounding activities would sooner or later involve public opinion with the possibility of leading toward desirable legislation.

So we believe that in that particular wording the measure goes too far, since it would raise the question about the kind of nonpartisan activities, studies, reports, and programs which are to the public advantage.

I could list a great many individual grants, sir, that would illustrate this, not just from our foundation but others as well. Just to note a few that are related to people here this morning:

Mr. Felix Robb appeared earlier. We made a grant to the Southern Association so as to enable them to get started what they call the Education Improvement Project in many cities and rural communities across the South. This is a most ambitious program.

Other foundations have also aided it in large measure, and most of the boards of education of the States of the South are cooperating in that program.

It would be questionable whether we could now do so, in light of the fact that we hope a difference in the educatonal program in the South is going to be made by that program.

Again Mr. Pifer referred to the Educational Commission of the States. We have the honor to share with Carnegie, in support of this organization which encourages educators and legislators to pool their interests so that they can all work together on the kind of educational program they should undertake.

There are over 40 States that had to take legislative action to join that body.

The Carnegie and the Danforth Foundations joined equally in the sponsoring of that group, and by the bill's wording at the present time about influencing public opinion in legislative matters, we would not be able to do so.

Illustrations are legion. I won't take your time for more. If there is any question along that line I will be happy to try to answer it.

One further word before passing this matter to my colleagues:

The report suggests that the intention of the House committee was to prevent partisan political activity. The support of candidates, the lobbying for particular legislative measures—please let me say unequivocally that we support the intention fully to prohibit such things. We believe that the intention of the House committee report can be followed in the language of the final bill, and yet not cause the

difficulties in respect to the useful programs of the foundations related to public issues and public problems that the present language would represent. Thank you very much, Senator.

The CHAIRMAN. Thank you.

Mr. CUNINGGIM. Next will be Mr. Homer Wadsworth, president of the Kansas City Association of Trusts and Foundations.

STATEMENT OF HOMER WADSWORTH, PRESIDENT, KANSAS CITY ASSOCIATION OF TRUSTS AND FOUNDATIONS

Mr. WADSWORTH. Mr. Chairman and gentlemen, the particular point of view from which I look at the question of program limitations and expenditure responsibility is that of relatively small foundations that operate in American communities and, therefore, look at the problems that beset us where those problems are and in association with the people who live and work there.

I have done so in Kanasas City for 20 years, and have experience in this regard in a number of other communities throughout the country.

I think the terms of this particular section will do violence to what has grown up as a natural condition of many of our communities under the impact of the kind of problems we are dealing with.

What we find in our communities is that the people of those areas, those who have money to contribute to charitable causes, and units of government, have joined hands—sometimes in desperation, to deal with the many matters that press for attention. To be able to determine at what point public discussion, investigation, nonpartisan analysis will lead to legislation is a very difficult and complicated thing, indeed.

Let me mention a few examples. The Rosenberg Foundation in San Francisco, which operates primarily in the youth field across the State is engaged in a first-class analysis of the problem of how to deal with a young person who has taken drugs in cooperation with the youth authority of that State, and the public welfare agencies, and a number of voluntary agencies.

It would be most unwise to assume that some form of legislation will not proceed from this investigation.

In the city of Chicago at the request of the circuit court and a citizens committee appointed by the court, the Chicago Community Trust is sponsoring a thoroughgoing analysis of the function of the juvenile court of Cook County. From it may be expected to come recommendations that will be reviewed both by the county but also by the State, inasmuch as the court in that community operates under the jurisdiction of the State.

In the State of Texas, the Hogg Foundation for more than 25 years has devoted most of its attention to the problem of how to deal with the medically indigent person who is emotionally ill. From its effort has arisen one of our finest State systems for the care of those who are mentally ill, a system in which the facilities of the university, public support, voluntary support, foundation support, have been largely indivisible.

In the city of Cleveland, the Cleveland Community Trust is engaged at this time, in sponsoring studies that are directed toward improving

the curriculum of the police academy through which local police officers receive their basic training.

Or again in a circumstance in which Dr. Cuninggim and myself have been involved, in the State of Missouri, we are at this time financing studies that are directed toward the problem of how schools are organized and how schools are financed.

Now, I have no illusion about this effort and I am sure Dr. Cuninggim does not. Therefore, these studies will lead to proposals before the legislature of Missouri, and many of the people who take part in them will be witnesses before committees of the State senate and the State house in that State.

The watershed here would appear to be quite clearly that foundations have no business being involved in partisan matters, what the House committee report referred to as grassroots campaigning or electioneering or the support of individual candidates for office. That we can and must contribute to public discussion of essentially public questions, is, I think, mandatory.

My concern over a long period of experience with this is that very simply these provisions, if left in the bill, will numb foundation efforts and will drive foundation money away from those areas of American life which are of most concern to most people at this time.

Now, with references to expenditures responsibility, the act, as passed by the House would require that foundations be fully responsible for all funds that are made available to grantees.

Now, we are unable to determine, and we have asked many people, what "fully responsible" means. It is the current practice of all foundations to limit their grants to agencies that are adjudged by the Internal Revenue Service as qualifying under 501(c)(3) exemptions.

I do not believe that a granting agency should take over the functions of the Treasury Department, that is to say, to review the activities of tax exempt agencies or to insure that what they do is appropriate within the law.

Either the Treasury is capable of doing this or the Treasury is not, and I do not think it is possible for a foundation to maintain an army of lawyers and an army of cost accountants, to keep tract of every grant made. We ought to be able to presume that if an agency is tax exempt in the eyes of the Government it is qualified to receive a grant.

I know of no one in the field who objects to the notion that we should be reasonably diligent and proceed with care, is making grants and supervising them and that we should ask every grantee agency to submit regular reports. Frequently, and in almost all cases these reports should be accompanied by audits.

Those of us who make grants that extend beyond a single year are quite accustomed to making grants payable in the second or third or fourth year. subject to review of what happens during the course of the first year. This is standard practice.

I know of no one in the field who would object to sharing with officials of the Internal Revenue Service all of the information that we have on grantee agencies.

I do feel that the terms of expenditure responsibility as written, and especially in view of the very severe penalties that are inflicted both upon foundations and upon foundation managers will drive founda-

tions in this area, as well, to support of little more than a mother and home.

The CHAIRMAN. What?

Mr. WADSWORTH. Mother and home. I am in favor of that, certainly, but it seems to me we have a few things beyond that to trouble us, and which legitimately should be looked at, and it seems to me that there should be some clear recognition in the field of expenditure responsibility, that we should pursue reasonably diligently reporting and making that reporting available, and ourselves report to the public what we do in all respects. It protects the public interest in an important way.

Thank you very much.

Mr. CUNINGHAM. Senator Arrington.

STATEMENT OF W. RUSSELL ARRINGTON, PRESIDENT PRO TEMPORE, ILLINOIS STATE SENATE

Mr. ARRINGTON. Mr. Chairman and members of the committee, in addition to my legislative responsibilities, I want you to know that I am an attorney with offices in Chicago, and I am also vice president and general counsel and secretary of the Combined Insurance Co. of America, as well as the director, a director, of Alberto Culver Co.

As my Senator mentioned to you, I am president pro tem and majority leader of the Illinois State Senate, and also a member of the executive committee of the National conference of State Legislative Leaders, of the executive committee of the National Society of State Legislators, and I was tremendously pleased and happy over the appointment by the President of me as one of the three State legislators to the Advisory Commission on Intergovernmental Relations.

I might say that I have the honor of serving on that Commission with three of your fine colleagues, Senators Muskie, Mundt, and Ervin.

My purpose in coming here to discuss this matter with you is to point out what I believe to be the unintended effects of the language that is employed.

I am concerned more by the language than either of these gentlemen have alluded to.

I am here, too, on behalf of the Citizens Conference on State Legislatures. I am not a member of that organization, serve in no officership, never have and never expect to. But I am concerned about the frightening results the employment of this language will have on this association.

In effect, it will cause it to be extinguished because this conference derives 87 percent of its funds from foundations.

The other 13 percent is derived from business and labor, and the character of its work is too important to have that happen without at least detailing for you gentlemen the language that does it, and the rather broad implications that the language employed has, and I am sure it is not intended.

Under H.R. 13270, the Citizens Conference would be prohibited from carrying out propaganda or otherwise attempt to influence legislation, one, through an attempt to affect the opinion of the general public; two influence the outcome of any public election; and, three, influence legislation through private communication with any member or employee of a legislative body.

I do not join with these two gentlemen who just testified in the utter acceptance of the influencing the outcome of any public election. We, in Illinois, were very fortunate in including as a segment of a very extensive legislative implementation program, and to encourage the people of our state to authorize the calling of a constitutional convention. The same public commission which derived its funds as a tax exempt organization in urging the support of that action, in turn, took what everybody in our area thought was a very acceptable and public attitude by supporting some of the candidates just nominated last week to attend the convention.

I understand there will be a difference of belief in that, but I believe that type of action in a public election is perfectly all right. It was conducted on a nonpartisan basis, and is a desirable activity.

Then, as to influencing legislation through private communication with any member or employee of a legislative body; why, it is just unbelievable that a proposed piece of legislation would preclude that type of activity, especially of the type which is carried on by the Citizens Conference on State Legislatures.

Let me explain to you how I first came in contact with this organization, which is a relatively new organization.

Commencing in Illinois, I think we provided the leadership in elevating the image, capacity and the general ability of the Illinois State government. There was not much accumulated information as to what we could do. This organization, the Citizens Conference, had been formed the year before and had accumulated certain information and data that were informative, very helpful. It provided us immense assistance in setting the guidelines, and what ended up by the creation of a commission, which came to the 1967 session of the legislature with 87 recommendations for the improvement of legislative procedures and, unbelievably, more than 54 of them were implemented during that session, and more than 60 of them have been implemented now, and we are hopeful that by the calling of a constitutional convention in December we will be able to implement the other suggestions.

I would like to tell you about the Citizens Conference itself. I do not see how any activities they conduct, they are conducting, or propose to conduct, deserves extinction by the use of this language, nor does it reflect, I think, the intent of you gentlemen. The conference is a national nonpartisan, not-for-profit corporation. It encourages, assists and provides advisory and technical services for State citizen groups working to support and improve the effectiveness of their legislature. They conduct research or bring together comparative information about legislative improvement in the 50 States, and they conduct regional and single-State conferences which bring together State legislators with editors, publishers, broadcasting executives and civic leaders.

Their purpose is to provide a frank and candid exchange of views about legislative improvement.

I had word only this morning from Speaker Herring of the Delaware House of Representatives, who asked me to call to your attention what he considered to be the effective activity by this conference. In his own State, through arranging for a Baltimore news conference with outstanding leaders and citizens, by arranging for a legislative

facilities tour on the part of the Delaware Legislature itself through six States; and through a speech made by Ed Day, former Postmaster General, who is the chairman of this conference, he says that resulted in the accomplishment of things in Delaware that could not otherwise have been done.

He points out that as a result of those activities Delaware is in the process of making available a new legislative facility. They have already got longer legislative sessions, and they are in the process of reducing legislative committees, just to cite a for-instance.

Senator WILLIAMS. I might add, since you mention our State, our legislature has been in continuous session the year 'round, and some of us were not anxious to have it extended too much. That has nothing to do with your testimony.

Mr. ARRINGTON. The Governors never liked the legislatures around. But I can tell you if the legislature wants to watch its P's and Q's and wants to have a firm hand in the operation of government, it will have to do just like you fellows do, stay in session, and I am all for it. [Laughter.]

The CHAIRMAN. Since all of that started, may I say I am not for it, for a good reason. If we stay here all the time—and I have been here for 21 years—after a while we are representing Washington rather than representing the States that sent us here. We would represent bureaucrats rather than carry out the intentions of our citizens. When you are back home you learn what is on the mind of the people whom you represent.

Mr. ARRINGTON. I had the good fortune last week, as a matter of fact I came from New Orleans, after having attended an annual convention of the National Society of State Legislatures, and your Ed Lebreton there, who is chairman and retiring president, it may interest you to know, that among the main things that he thinks State governments should do is to establish annual sessions and stay in session longer, and to change your constitution so as to permit the legislature in that State to do an effective job.

The CHAIRMAN. I am not quarreling about them saying in session 60 days. I am quarreling about our staying in session 12 months.

Mr. ARRINGTON. Well, you ought to hear what the people back home say about that, too. [Laughter.]

Mr. ARRINGTON. This conference, in other words, has been operating with 16 States doing the type of work that I described, and it is my belief that the language that I read absolutely prevents them from doing it.

Also because of the penalty provisions they inhibit the foundation contributions to this Commission, so it will die for lack of a facility for raising funds.

Very hurriedly, I would like to make certain suggestions intended to be helpful, and suggest five possible safeguards that you might want to consider and which, in my opinion can be well maintained and still allow for useful operations on the part of organizations such as this.

I am quite agreeable that with all the witnesses who have testified that activities have to be nonpartisan in nature, have to be national in scope, in my opinion, should not engage in support or opposition to

candidates although, as I pointed out, there may be special situations where that may be entirely all right, but maybe in order to make the safeguards fully workable, you would have to limit it with respect to all types of elections, and I consider it perfectly all right, as in the case of a constitutional convention for actions to foster public sentiment; that the advocacy of legislation has to be with respect to legislation general in nature. But where they go to a State legislature and say you should have legislation to reduce the committees if they are subject to rule power or you can legislate as to the manner of sessions or the manner of operation of the legislature, I think it is a laudable thing to have citizens and associations join together in the general advance of government.

I think that is what is needed. I think that is what we have not had enough of, and that partisan election campaigns be avoided.

Here is another thing which has been alluded to here by several witnesses. I am confident that a great part of the ills that you are seeking to correct or eliminate can be handled by the disclosure techniques that you have discussed this morning.

I was stunned, it does not make much difference, but I think if you compel a disclosure and there does not seem to be any real opposition to that, that that might provide you with the greatest access to the information that you need in order to find out just what the foundations are doing.

Thank you very much.

The CHAIRMAN. Well, thank you very much, gentlemen.

Senator CURTIS. May I ask a question?

The CHAIRMAN. I would like to ask just one question about voter registration.

Rather than having foundations engage in voter registration, wouldn't it be better for the State or even the Federal Government, now that the Federal Government has gotten into the business, of just paying somebody to go down the road and register everybody who appears to be qualified? We can do that on a census basis every 10 years. Why can't we do it with voters? The big complaint about voter registration is the same thing. If someone spends money hauling voters, he hauls voters in the areas where he thinks he is going to win. He would be a fool to haul voters in areas where he thinks he is going to lose, because he will haul more votes against him than for him.

If one group or the other thinks one group that is not registered will cause the election to go for the candidate they want to be elected, would it not seem more appropriate for the Government to see to it that all qualified people are registered, and to pay the expense of doing it, either at State or Federal level?

Mr. ARRINGTON. Are you asking me?

The CHAIRMAN. Yes.

Mr. ARRINGTON. No. I agree with the advice of the gentlemen who appeared earlier on this progam. If you disabled the foundation or the tax-empt organization from actively supporting a candidate, I mean, as long as it will be without authority or power to take positions with respect to any candidate, I do not see why the good governmental objective of getting people who are entitled to vote to get on the rolls and express their voice in the operation of their Government, I see

nothing but laudable interests to be served, and I see nothing wrong with it. I see no justification for specifically disabling a foundation from engaging in voter registrations so long as it is general in character, it is nonpartisan in nature, and directed merely to getting qualified voters on the rolls.

The CHAIRMAN. Well, the philosophy nowadays seems to be that everybody ought to vote. Assuming that everybody who is qualified should be registered so he can vote, why should not they be registered just the way you would take a census? Just go down the road and register everybody who appears to be qualified at all, and then proceed to use the Australian system that inasmuch as the Government has now paid the people to register in order to vote if they are qualified under the law at all, then proceed to charge them a $5 fine if they do not show up and vote on election day, so you might get your money back or at least you would have a proper indication of how the people feel on an electoral proposition.

Mr. ARRINGTON. Are you asking that as a question?

The CHAIRMAN. Yes.

Mr. ARRINGTON. I do not think we are dealing with the proper alternative. I take nothing back of what I said in support of any legitimate endeavor to get the qualified voter on the rolls. Your suggestion that we have the Government do it would be quite an experience in the city of Chicago, I can tell you. We are trying to get them out of the graveyard now. [Laughter.]

The CHAIRMAN. We have made pretty good progress in taking those graveyard votes off the rolls in Louisiana.

Senator CURTIS. Before I ask my question, I might observe that if they will let us all define the words, "qualified voter", all right. My notion of qualified voters are those who vote according to my sentiments. [Laughter.]

How many colleges has Danforth Foundation helped?

Mr. CUNINGGIM. We have current intimate relations with between 800 and 1,000 colleges. We have helped that many and more, either through programs or through grants.

Senator CURTIS. What would be the range of that; what would be one of the smaller ones, and then one of the larger ones, in dollar amount?

Mr. CUNINGGIM. It would be the range in terms of institution, it would be from Nebraska Wesleyen to the University of Nebraska. [Laughter.]

It would be in dollar amount, sir——

Senator CURTIS. I do not know which end you began with. [Laughter.] I am a trustee at Nebraska Wesleyen, so I want to warn you before you testify.

My question was, these 800 colleges that you have helped, what is the range of the lesser amount in dollars and then the high, of your grants.

Mr. CUNINGGIM. The lesser amount would be a few hundred dollars to individual faculty members on campuses across the country to enable them to give larger attention to the students as individuals through a program we call the Danforth Associates, the purpose of which is to try to reduce the anonymity of college and university life.

The largest amount might be upward of a million or two in terms of some one or another institution that was sponsoring a program that we believed in and ought to support.

In respect to the particular colleges you were referring to, we made a recent grant to Nebraska Wesleyen to enable that institution to undertake an experimental program in the Nebraska State Prison so that people there who were qualified could undertake some college work.

I cheated, sir, on the matter of the colleges and universities to which the members of this committee went, for I looked it up before we came to this meeting, and so far as I am aware, the only institution with which the Danforth Foundation has not had some connection is the YMCA Law School in Nashville, Tenn., and I could wish for Mr. Gore's sake that we had had some relationship there, too. [Laughter.]

Senator CURTIS. Now, how many students has the Danforth Foundation helped, just in round numbers?

Mr. CUNINGGIM. Through fellowship programs?

Senator CURTIS. Yes.

Mr. CUNINGGIM. Through fellowship programs, we have——

Senator CURTIS. I mean, that have been channeled to the student as contrasted to the corporate entity of the college.

Mr. CUNINGGIM. Yes. It would now run something around 7,000 or 8,000 students whom we have tried to help directly with fellowships. In indirect help of various kinds, attendance at conferences or relationships with faculty on campuses, the number would be beyond my estimating.

Senator CURTIS. Well, I have remarked in these hearings a time or two, in my State of Nebraska the private colleges which happen to be all church colleges, carry 30 percent of the cost of higher education. But even our State university and our State schools depend to no small degree upon foundations and grants.

Senator HANSEN. I have no questions, Mr. Chairman.

Senator WILLIAMS (presiding). The meeting will stand adjourned until 2 o'clock this afternoon.

(Whereupon, at 12:50 p.m., the committee recessed, to reconvene at 2 p.m. this same day.)

AFTERNOON SESSION

The CHAIRMAN. The hearing will come to order.

We will next hear from a panel of witnesses, Mr. Julius Stratton, chairman of the board of the Ford Foundation; Mr. McGeorge Bundy, president of the Ford Foundation; Mr. Whitney Young, president of the National Urban League; and Mr. Whitney North Seymour, chairman of the board of directors of the Council on Library Resources and the International Legal Center.

STATEMENT OF JULIUS STRATTON, CHAIRMAN OF THE BOARD, THE FORD FOUNDATION

Mr. STRATTON. Mr. Chairman and gentlemen, I have with me, as you indicated, Mr. Whitney Young, Mr. Whitney North Seymour; my colleague, Mr. Bundy.

My part in this coordinated testimony is to comment on two particular aspects of the bill before you. First, on the definition of "private foundations" and, second, on the proposed concept of "qualifying distributions."

Now, the issues that are related to these two subjects are more complex, more technical in some ways, than some of those we have heard this morning, and yet the implications are very serious.

In the formal statement that I have submitted to your committee earlier, I have undertaken to deal with them in detail. But now I am going to be very brief, and shall attempt only to indicate the nature of the problems and the reasons for our concern, and then I shall turn to my associates here, with your permission, for some comments of their own.

One of the most striking additions to the Internal Revenue bill, or Internal Revenue Code proposed by the new bill, is a wholly new technical definition of the term "private foundation." Unfortunately, this new definition is so broad it will, I fear, encompass a multitude of organizations whose primary function is not that of making grants—organizations which have never been thought of as private foundations in the past, and which, on the basis of their activities, should not, in our judgment, be so classified.

It is easy to quote examples. I could cite such distinguished institutions as the Institute for Advanced Study at Princeton, about which you will hear later, I believe; the Brookings Institution, the Council on Library Resources, the Population Council, and a variety of others.

Now, you may ask what difference does it make that, perhaps, hundreds of organizations like these might be reclassified as private foundations? Well, the consequences could be very serious indeed.

First, such organizations would be subject to the proposed tax, with a corresponding reduction in funds available for their educational and charitable activities about which we have been hearing throughout the morning.

Second, they would be subject to the stringent regulations, program limitations, and penalties of the bill about which you heard from earlier witnesses.

But the most serious consequence, I believe, would be a far greater difficulty in obtaining essential support from grant-making foundations.

Let me take just a moment to explain why. This bill, as you well know, also contains provisions requiring private foundations to make prompt distributions of income, and that is a highly desirable objective which foundations, as a whole, support fully. But there are serious limitations on the kinds of grants that would meet this payout requirement, and there are serious uncertainties as to just which organizations would be eligible to receive the so-called qualifying distributions.

For example, it appears that such respected and effective groups as the American Council of Learned Societies, the Educational Facilities Laboratories, Resources for the Future, and I could name any number of them, would fail to qualify just because they happen to depend so heavily on a few foundations. Consquently, foundations in turn would

be reluctant to give them support. Of course, grants to such organizations are not prohibited—but they would not qualify or help a foundation to meet its own income distribution requirement.

I am sure you are all acquainted with the national merit scholarship program. I cite it because it offers a perfect example to illustrate how the present language of this bill might work to the serious detriment of some of our finest students.

This scholarship program was established in 1955 largely with the support of a single foundation. It was designed to identify, as you know, unusually able young people, to interest them in higher education, and to help as many as possible to attend the college or university of their choice. Under the proposed legislation, the National Merit Scholarship Organization would have been a private foundation at the time of its establishment, because the bulk of its support came from only one or two foundations.

Furthermore, it would not have been eligible to receive qualifying distributions. Now, today it does enjoy broader support, and it would qualify as a publicly supported charity. But the point is—under the proposed legislation such an organization would probably not have come into existence in the first place—and over 21,000 young men and women—from every part of the country would not have received the more than $70 million worth of scholarship aid that the program has made available over the years.

It seems to me that if productive activities of this kind are to be sustained that it is of crucial importance to write legislation that will encourage—rather than discourage—the continuing creation of organizations with new objectives, with independent boards of their own to meet new and changing situations in a dynamic society.

I might just remark in passing, to a certain degree that is the way philantrophy helps society in its quest for renewal by creating new institutions to meet new needs as they arise.

I am conscious, gentlemen, that I have been able to give you only the sketchiest outline of a complex problem and the serious difficulties that we forsee if changes are not made. In closing I should like to make three recommendations:

First, that a more precise definition of a private foundation be formulated. I have here a staff paper representing the joint effort of a group of foundations that may be helpful to you in such a formulation and, with your permission, I should like to submit it for the record.*

Second, that a simple test be established whereby foundation funds that flow promptly to legitimate charitable tax-exempt purposes would be deemed qualifying distributions. I am saying, in effect, that the idea of qualifying distributions is perfectly valid. If we can define in a simpler and more straightforward fashion what that is: that is what I recommend.

Third, it seems to me that the penalty provisions are excessively severe, out of proportion to possible offenses, and should be carefully considered. Left as they are, they will make it difficult for foundations to attract and hold the caliber of trustees and staff that are absolutely

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*See p. 5410.

fundamental for their effective operation. Just as importantly, I fear, that these penalty provisions will dampen the willingness and the capability to try new ideas and, thereby, tip the balance against innovation and experiment, and that is what foundations are about.

What we are really talking about here goes far beyond definitions and regulations—it goes to the very heart of the kind of society we wish to have. From the time of our founding as a Nation, the American people have sustained their faith in the value of a variety of forces—public and private—at work. I cannot stress too firmly my own conviction that philanthropic foundations serve one of our most cherished traditions in providing support for public purposes. If their efforts are to be fruitful, they must enjoy the freedom to encourage thoughtful experiment and constructive innovation.

Now, in saying this I do not equate freedom with license. I acknowledge the need for guidelines and standards of action that has been recognized by, I think, all of the witnesses who have come before you today. But, as I have indicated, I am deeply troubled by the lack of clarity in some of the provisions set forth in this bill. If enacted in their present form, it will be detrimental to the public good with consequences which I suspect were neither foreseen nor intended.

The years ahead are going to test more severely than any in our history the strength of our democratic institutions. This is hardly the time to restrict the capacity of the private sector to meet greater and greater challenges.

That, very briefly, is my statement, Mr. Chairman. Now, if I may, I will turn to my associates here and, perhaps, Mr. Young would care to make some remarks.

STATEMENT OF WHITNEY YOUNG, PRESIDENT, THE NATIONAL URBAN LEAGUE

Mr. Young. Thank you, Mr. Chairman.

I do feel very strongly about many features of this bill, and in expressing myself briefly here, I do believe I am expressing some of the anxieties and concerns of the civil rights people, human relations people, and social worker people who have the cause of social change and social reform foremost in their minds.

I am glad that I was introduced as Whitney Young. About half of the people in the building have been referring to me as Senator Brooke. [Laughter.]

Senator Bennett. That would not hurt you in this committee. [Laughter.]

Mr. Young. I just do not want to hurt him. [Laughter.]

I would not in any way try to presume to assess the intent of the authors of this bill, but there are features in here that clearly have had the direct result of making the black community particularly feel that it is a hostile bill, a bill that suddenly came into fruition with a purpose as much to intimidate as to legislate, a bill designed to discourage foundations who belatedly have found the field of social reform to be one in which they might gingerly tread, a bill to sort of caution and warn them.

I am not too sure that already some damage has not been done even by the introduction of the bill. There is some evidence that founda-

tions will become again very cautious, very conservative, turn only toward those absolutely noncontroversial things that they feel will remove them from any threat of reprisal, of punitive action, on the part of the Federal Government.

The black community feels in many ways like a people would feel if we were playing a baseball game and we were one run behind in the ninth inning and we loaded the bases, with two outs, and suddenly the umpires got together and changed the rules in the game and decided that two outs were all that were necessary to end the inning.

For years, for years, the white community has been able to organize different ethnic groups and regional groups, vested interest groups, and they have been able to use the resources of the private sector through foundations to address themselves to their problems as they saw them, educational problems, problems of the environment—whatever the problems might have been.

It has only been in very recent years that we have managed to acquire in our black community the kind of sophistication and know-how that makes it possible for us to organize and to make our requests for resources to help ourselves and to meet our needs. And to have at this point in the game suddenly to be told that the rules are changing seem to us—again to say to black people—that "the rules are changing only when you are about to be benefited."

I am not gainsaying that this was the intent; I am talking about the effect.

At the time that the Federal Government, the administration, says that "Due to the pressures of inflation and the efforts in our international activities, we find it necessary to reduce resources for local community action programs and local organizations," and we are encouraged to turn to the private sector, primarily to foundations, we are being told that here again the rules are changing, that no foundation can give more than 25 percent to any organization, or an organization cannot have more than 25 percent support from foundations or that it must have, say, five foundations or more supporting it. Such rules would have completely eliminated most of the earlier organizations I talked about, and would today eliminate for the black community many of these organizations that are just starting.

I am particularly concerned because we have, in fact, the daily experience of going into the black community that, as you know, is impatient and angry, and justifiably so; and we have tried to suggest alternative courses of action. We have been able to convince the large majority that the thing to do is to organize and to do the necessary research to make our presentations through the normal channels for change, through the political bodies—to express the concerns about garbage collection or schools that are inadequate or street lights or recreation.

There are always those on the sideline, however, who say this is old fashioned, this is not the way to go about it, that there is no point in trying to work these things out through the normal channels.

We have just about had the people believing we could do it, and foundations were about ready to experiment and to give us some money. Our organizations in the communities are ready to make an effort, knowing full well that some would fail. And we insist that we

have the right to fail as much as the right to succeed, and we are not a superior people, and it would be a reflection on white America if black America only succeeded, because certainly white Americans have sometimes failed, and I do not reflect on white Americans. But, at any rate, we are suddenly laughed at by the revolutionists.

When I first saw this legislation I had the feeling that if we had requested from Peking a kind of decision that would aid and abet the black revolutionists in our society, and to fulfill their predictions about how white America, just when we got organized, would lift from us the resources to pursue our own self-help program, I could not have gotten better features than in some of this legislation.

My first reaction almost was to suggest that certain features of this legislation be called before the Un-American Committee. I really felt that they were aiding a revolutionary effort. You and others ask the black community to be responsible, but you do not give us the resources with which we can assume responsibility.

You ask us to engage in self-help and self-discipline, but you do not give us the resources and the authority to exercise this. This is, at best, frustrating; it is at worst, deceptive, and we are dealing with a climate of young people who can no longer be deceived.

I know nothing that will undermine the attempt of those of us who try to be constructive and responsible leaders in this field than to pass many of the features of this particular legislation—about which I could be specific if you chose to ask. Nothing can undermine us more, and I say this knowing that my particular organization would be affected the least, in fact, in many ways we might be looking at it selfishly, helped the most—but this is not my purpose.

Ultimately, our problems will be resolved in the black community and not from external forces and pressures but from internal discipline and strength that can only come through having resources that today the private sector, the foundations are beginning to give.

So I do not demand of you, I appeal to you and your committee, I plead with you, that if you, too, are interested in giving support of this kind of leadership, if you are interested in making a liar out of the revolutionists, the black revolutionists, in this country, aided by young white revolutionists, then, in effect, you will quickly not only strike and greatly modify some of these features, but you will, in effect, urge these foundations whom you have before you to move, not with all deliberate speed, but forthwith, to shore up the kind of organizations that I am talking about.

Thank you very much.

Mr. STRATTON. With your permission, Mr. Chairman, I will call upon Mr. Seymour, former president of the American Bar Association.

STATEMENT OF WHITNEY NORTH SEYMOUR, CHAIRMAN, BOARD OF DIRECTORS, COUNCIL ON LIBRARY RESOURCES AND THE INTERNATIONAL LEGAL CENTER

Mr. SEYMOUR. Mr. Chairman and members of the committee, I am a practicing lawyer in New York. I was president of the American Bar Association. I am here because I am chairman of two organizations, the Council on Library Resources, and the International Legal

Center, which were started with generous grants from the Ford Foundation, and couldn't have been started otherwise, and have, I believe, served the public interest very well, and I think their continued independent existence is important to the public interest.

I am also on the board of several other organizations in somewhat related fields of education and research and public interest, and I will mention a couple of those.

The Council on Library Resources was established in 1956 to provide broad assistance to libraries in all kinds of problems which they were having, including the problem of moving in modern technology, and in the years since it was established it has made some 450 grants and has granted a total of about $13 million.

Many of these grants have been made to institutions, some of them public and private libraries, some of the Federal libraries. The council has given somewhat over a million dollars to the Library of Congress, and has been influential in assisting it to automate its activities.

The whole area of moving library services into an era of modern technology has been of great importance. One of the significant features of this has been that because of the importance of libraries and the interest in this subject, we have been able to recruit a very distinguished board, set forth in my full statement, of scholars and people interested in libraries, and the independent existence of that board to supervise the activities of the council, has been an important factor, I think, in its success.

We were able to draft Dr. Fred Cole from being president of Washington and Lee University, to become the president of the council, and he has put together a very able and expert staff, and that factor alone, which would be very difficult to accomplish if this whole thing had to be done within one foundation is, I think, an important aspect of the need to preserve this kind of independent action.

The International Legal Center was established in 1966 also with a Ford grant and that, too, has a very distinguished independent board of international experts in the legal field.

It is concerned primarily with helping to improve legal education and legal institutions, particularly in the newly developing countries, and to help establish an independent bench and bar, and improve the training for legislative and administrative work, and it is working around the world in some of the activities as set forth in my statement.

Again, the presence of an independent board to supervise this work, which would not be possible if the work had to be done from within one foundation, is an important factor.

Now, in addition, I am on the board of the National Legal Aid and Defender Association which has received a significant grant from Ford for improving defender services around the United States. It has put in defender projects in some places which did not have one, tuned up the projects where they did have one.

Finally, to mention here there is a relatively new organization under its present name called the Council on Legal Education for Professional Responsibility which succeeds an earlier organization called the Council on Legal Clinics, and its purpose is to expose law students in one way or another on an experimental basis to real life situations running all the way from Defenders to penal institutions, and so on,

with different law schools experimenting with different projects. But it is quite clear that the use of these clinical facilities in the law schools is now receiving very wide acceptance.

Now, the reason I mention those two particularly, is that our new Chief Justice, when he spoke to the American Bar in Dallas in August, singled out these particular programs, the improvement of defender services and the improvement of legal education, as especially significant, and referred especially to the fact that it was very important that these were provided by the private sector, and that that is the kind of development in the field of the legal profession and legal research and legal education which really should be encouraged.

I think I have only to add that I believe that all of these activities are in the public interest, well within the concept of exemption which Congress originally provided. We, too, support the idea that activities which are not of that character are things that Congress should deal with, but we would hope it would not chill the activities which are really significant and which are supported on such a very significant scale by the Ford Foundation and other foundations.

Thank you.

Mr. STRATTON. Thank you, Mr. Chairman.

May I turn to Mr. Bundy?

STATEMENT OF McGEORGE BUNDY, PRESIDENT, THE FORD FOUNDATION

Mr. BUNDY. Mr. Chairman, I will try to be very brief. I want to say, simply, that I strongly agree with the arguments that have been presented by my colleagues on this panel and, indeed, in the discussions this morning.

Let me take one sentence or two to underline each of the points that has been made just now. When Mr. Seymour talks about the importance of an independent board of trustees in a grant-receiving organization, he gets hold of one of the fundamentals of organized philanthropy, and one of the places where I think this bill does need most careful attention because to the degree—that the bill would tighten the control by a foundation over everything its grantee did—and it does that—it flies in the face of the tradition that independent boards of trustees and independent responsibility are better executors of the grants of foundations, in a great many cases, than the foundation itself.

The same proposition in another way applies to what Mr. Young was saying. To the degree that the bill makes it difficult to make sure that you will be within the letter of a new law when you make grants to an inexperienced organization or one which may not have a long fiduciary tradition, you are again discouraging the kind of activity which so many in this country think is more and more needed for the groups which are coming into their own in a country that we hope will be one of opportunity for all.

A special case, which I believe you are familiar with, Mr. Chairman, of an important kind, and a relatively new kind, of philanthropy, where the bill is not clear as it stands, is the opportunity which has developed in our foundation and in a few others for making what we

call program-related investments, which is a use of capital funds for people who are coming into the mainstream of our society, for investments you might not make as a banker or as an investment counselor just on their own terms, but which have a charitable value and a social value, which can make it, in the judgment of our board of trustees, a useful form of charitable activity.

Let me say finally, Mr. Chairman, that I do very much hope that the paper which we are submitting on the definition of PF's will be carefully studied, especially by your staffs, because there are literally dozens of organizations which, to the best of our knowledge, will find themselves private foundations unless the definitions in the House bill are amended, and which really have no idea that they are about to become under this kind of supervision and control.

Just as one supplementary note, because of the discussion this morning, of the rate of growth of foundations and of the foundation field generally. A general paper was submitted on that point this morning, but I have here, if you want it for the record, a 10-year summary of the investment portfolio of the Ford Foundation which shows that our net worth between 1959 and 1968 has, in fact, declined in absolute dollar terms from $3,100 million, to a little over $3 billion. It is now a little below that, because of what has happened in the market in the last year, and tha means, in light of the growth in our economy in the last 10 years, that the Ford Foundation, whether considered in terms of its capital assets or in terms of its grant-making capability, is one-half as large, in relation to society as a whole, as it was 10 years ago.

While you will get much argument over what the right rate of payout is for foundations in different circumstances, in our foundation the policy of the trustees has been to expend substantially beyond the annual income from realized capital each year and that, I expect, will be the continuing policy as far as I understand the trustees' purposes for the future.

(The documents previously referred to follow:)

H.R. 13270—Definition of Private Foundation

1. Organizations Inappropriately Defined as Private Foundations

The proposed tax reform bill (H.R. 13270) introduced a new term, "private foundation," into the Internal Revenue Code. The new definition will include hundreds of organizations which have never been thought of as private foundations and which, on the basis of their activities, should not be classified as private foundations. Yet these organizations would be subject to the stringent regulations, restrictions, and penalties of the bill. The ambiguities in certain provisions of the bill and the time required to obtain accurate factual data about a large number of organizations scattered throughout the country—many of whom are unaware of the potential impact of the bill upon them—make it difficult to identify with certainty those which would be inappropriately classified as private foundations. However, Appendix A contains some examples of national operating organizations which would apparently be so misclassified. Appendix B is a sample of local operating organizations which would also apparently be misclassified.

2. Contrasts Between Operating Organizations and Private Foundations

The operating organizations listed in the Appendices are not like private foundations in the following important ways:

They do not have substantial private endowments.—In the main, it is the private endowments of private foundations which gives them the independence which can be their great strength, but which also underlies the legitimate public concern about their activities. The operating organizations which have been listed do not have substantial endowments (in many cases they have none at all).

There is no sufficient reason to subject these recipient organizations to the same strictures as the endowed grant-making foundations from which many of them receive substantial support.

Operating organizations are directly and actively engaged in charitable, educational, scientific and religious activities.—Private foundations engage primarily in making grants to a variety of other philanthropic organizations. One of the wisest utilizations of the funds managed by them is to identify—sometimes to establish—and then to assist specialized operating organizations, with independent boards and staffs who are expert and interested in the area of that organization's philanthropic operations. Assuring prompt distributions to such organizations and thus prompt utilization of charitable funds is one of the primary purposes of the bill, but this purpose is not furthered by making the bill applicable to those organizations which are by definition actively and directly engaged in philanthropic activity.

These organizations are controlled by independent boards of trustees; they have not engaged in the fiscal abuses which the bill seeks to *correct*. One of the important purposes of the bill is to prevent certain fiscal abuses of private foundations. Operating organizations, without substantial private endowments and whose funds are promptly and directly employed for philanthropic operations, have not engaged in the fiscal abuses described in the Treasury Reports of 1965 and 1968. Moreover operating organizations can and should be specifically defined to include only those which, under a full examination of all the surrounding facts and circumstances in each case, are found to be independent and not controlled by private individuals or organizations.

These organizations pursue special, well-defined purposes.—Private foundations are primarily general-purpose organizations with wide-ranging interests; they seek to identify organizations with a worthy objective which, for one reason or another, need and merit special assistance. Operating organizations have more limited purposes. They generally have specific constituencies intimately and directly concerned with their activities; their performances can be measured from year to year, in relation to previously-established goals and purposes; their policies and activities are determined by expert professionals who are subject to the formal and informal direction and discipline of their respective fields. In these ways the specialized nature of their activities results in direct and indirect controls over the organizations which are not available to the same degree over private foundations.

3. ADVERSE EFFECTS OF THE BILL AND PROPOSED SOLUTION

The House Ways and Means Committee recognized the importance of these operating organizations; in its Report, the Committee stated its desire to distinguish and protect what it described as—

> "special-purpose foundations, such as learned societies, associations of libraries, and organizations which have developed an expertise in certain substantive areas and which provide for the independent granting of funds and direction of research in those specialized substantive areas. (See *Other Limitations*, above.)"—House Report No. 91-413 (Part 1) p. 42

The Committee introduced into H.R. 13270 the definition of an "operating foundation" (section 4942(j)(3)) intending thereby to encourage private foundations to give such organizations continued support. The definition of an operating foundation, when added to the new definition in the bill of a private foundation, is however both complex and ambiguous. Most importantly, even if the bill were modified so that all specialized operating organizations were clearly included within the definition of an operating foundation, this approach would unfortunately fall short of providing sufficient protection for such organizations. For, though they would be eligible for "qualifying distributions," they would still be unwisely defined as private foundations and therefore would still be subject to the tax, and other penalties and restrictions contained in the bill. The possibility of heavy personal liabilities would make it difficult for them to find and keep the directors and staffs they need, they would be subject to complex rules concerning their charters, their dealings with substantial contributors and public officials, and their "expenditure responsibility" for grants to other organizations. Their present freedom in obtaining funds, associating with other organizations, hiring personnel and engaging in program activities would all be sharply limited.

The more desirable and more logical course is to exclude such organizations from the new definition under the bill of private foundations. Our society needs

to encourage rather than inhibit such organizations, which at national and local levels supply expert services and pursue important public objectives in their specialized areas of competence.

Attached is a proposed Amendment to H.R. 13270 which would define these organizations as "special-purpose operating organizations" and exclude them from the definition of "private foundation" under the bill.

APPENDIX A

EXAMPLES OF NATIONAL OPERATING ORGANIZATIONS WHICH WOULD PROBABLY BE PRIVATE FOUNDATIONS UNDER H.R. 13270

1. *American Council of Learned Societies:* Advancement of humanistic studies in all fields of learning.
2. *Overseas Education Fund of the League of Women Voters:* International arm of League of Women Voters Education Fund.
3. *Social Science Research Council:* Advancement of research in the social sciences.
4. *Council on Legal Education for Professional Responsibility:* To support and encourage as part of law school education clinical and internship programs in the administration of justice.
5. *Council on Library Resources:* Research and demonstration toward the solution of library problems.
6. *Educational Facilities Laboratories:* Research, experimentation and the dissemination of knowledge regarding more economical and useful physical education facilities for schools and universities.
7. *Education and World Affairs:* Study, analysis, and assistance in strengthening the international teaching, research and service dimensions of U.S. colleges and universities.
8. *Center for Applied Linguistics:* Generally concerned with linguistics and language, including for example application of the results of linguistics research to practical language problems in the areas of teaching English as a second language and the teaching of foreign languages in the United States.
9. *International Legal Center:* Study and development of the role of law in the development of modern nations and the shaping of the world community.
10. *Resources for the Future:* Scientific research and study on the use and conservation of natural resources.
11. *Tamarind Lithography Workshop:* Devoted to the stimulation and preservation of the art of the lithograph.
12. *Woodrow Wilson National Fellowship Foundation:* Increasing the supply and quality of college teachers.
13. *International Theatre Institute of the United States, Inc.:* World-wide communication between artists and experts in professional theatre.
14. *Population Council:* Research, training, technical assistance, and information programs in family planning and reproductive biology.
15. *Lawyers Committee for Civil Rights Under Law:* Association of organized bar, for information, study and reform activities in area of civil rights.
16. *National Institute of Public Affairs:* Improving the quality of public service and providing technical assistance in development of public policy.
17. *Open Space Institute:* Preservation of open space in urban and urbanizing areas through educational and field consulting programs.
18. *Southern Regional Council:* The attainment of equal opportunity for all peoples in the South through research and action.
19. *Potomac Institute:* Social development projects and studies.
20. *Agricultural Development Council:* Training and research in agricultural economics and community development in Asian countries.
21. *American International Association for Economic and Social Development:* Program of agricultural development in Latin America.
22. *American Conservation Association:* Promotion of conservation by study and action.
23. *Atlantic Council of the United States:* Promotion of exchange of ideas on common problems among Atlantic community.
24. *Business Committee for the Arts:* Stimulation of greater corporate interest in and support of the arts.
25. *Center for Inter-American Relations:* Education of North Americans about Latin America.

26. *Associated Council of the Arts:* Clearing house for scheduling of artistic events, technical assistance in fund raising and distribution and dissemination of information concerning the Arts.
27. *Experiments in Art and Technology:* Encouragement of the working collaboration of scientists and engineers with contemporary artists.
28. *Fund for Theological Education:* Encouragement of college graduates to consider careers in the ministry.
29. *International Executive Service Corps:* Assistance to private businesses in developing countries.
30. *Interracial Council for Business Opportunity:* Encouragement of business opportunities for minorities.
31. *The National Academy of Education:* An organization to recognize distinction in education and to sponsor research and conferences on issues in education.
32. *Memorial Sloan-Kettering Cancer Center:* Research and teaching programs.
33. *National Committee for Children and Youth:* Program to initiate national action on the implementation of recommendations from the White House Conferences on Children and Youth.
34. *Youth Opportunity Foundation:* For education of Mexican-Americans and research on Mexican-American problems.
35. *National Trust for Historic Preservation in the United States:* Consultative services to local groups and agencies and education concerning preservation of national heritage.
36. *Academy of Religion and Mental Health:* Study of relation between religion and mental health.
37. *States Urban Action Center:* Services to states seeking to solve some of the underlying problems in the nation's cities.
38. *Urban Coalition:* Program to foster cooperative efforts by government and the private sector in attacking critical urban problems.
39. *National Citizens Committee for Broadcasting:* A group of citizens concerned with the quality of television and radio broadcasting.
40. *American Craftsmen's Council:* Promotes and heightens appreciation of fine design and the techniques for design.
41. *Conservation Foundation:* Gathering and dissemination of conservation information.
42. *National Information Bureau:* Study and reporting of financial information on non-profit organizations which solicit funds.

Note: The following organizations are now partially supported by government but they were established and supported for several years with foundation funds.

44. *The National Indian Youth Council:* For the first two years supported only by two foundations to do research on Indian problems and to support the training and education of Indians. Now have successfully obtained OEO and Bureau of Indian Affairs funds.
45. *National Assessment of Education:* Originally called the Exploratory Committee for Assessing the Progress of Education supported by two foundations for four years to develop tests to evaluate and assess American education.
46. *Children's Television Workshop:* Supported initially by two foundations and later by the Office of Education to design new television programs for nationwide use to teach pre-school children to count, read, and reason.
47. *The Education Commission of the States:* A compact between 42 states to bring governors, state legislators and educational leaders together for action projects to aid the states in education. Supported for two years by foundation funds and now supported by individual state contributions.

Note: The following organizations are momentarily "publicly supported" (they have government grants and small individual contributions) but such support is marginal so that a single foundation grant would make them a private foundation.

48. *The Council for the Public Schools:* A group interested in problems of education—particularly curriculum reform in grades one through twelve.
49. *The American Society on International Law:* One of the leading organizations in the world concerned with the problems of international law and organization; with a membership drawn from practicing lawyers, officials, diplomats, scholars, and students.
50. *United Scholarship Service:* Identify talented American-Indian and Mexican-American children, encourage them to finish high school and aid those children in admission to and finance of college and graduate school.
51. *Council on the Southern Mountains:* Programs, publications and projects to aid the people of Appalachia.

Appendix B

Examples of Local Operating Organizations Which Would Probably Be Private Foundations Under H.R. 13270

1. *Kansas City Citizens Committee for Public Education:* Organization and financing of public schools.
2. *Kansas City Citizens Committee on Judicial Reform:* Research and recommendations for judicial reform.
3. *The Switchboard* (in San Francisco) : An emergency telephone service for parents searching for run-away children and for children sending messages to parents.
4. *West-Oakland Legal Switchboard:* Organization of students at Berkeley law school, making available young volunteer lawyers for those arrested before appearing in court.
5. *People Pledged for Community Progress:* Women's group in Richmond, California to improve ghetto area in Richmond; establish playgrounds and recreation areas.
6. *Cleveland Development Foundation:* Physical development of City of Cleveland.
7. *The PATH Association:* Housing and neighborhood development in Cleveland.
8. *The PACE Association:* Improvement of public education in Cleveland.
9. *Citizen's Committee for Children of New York:* Devoted to child welfare.
10. *Minnesota Theatre Company:* Resident professional theater.
11. *Washington Center for Metropolitan Studies:* Urban research and training concentrating on District of Columbia metropolitan area.
12. *Kansas City Association of Trusts and Foundations:* The Association assists its Member Trusts and other grant-making agencies in evaluating and coordinating their support to various community activities in the Kansas City area and in suggesting project ideas for their consideration.
13. *New Detroit, Inc.:* Technical assistance in dealing with problems of social change in Detroit.
14. *The New York College Bound Corporation:* Identifies talented underachievers in high school, and encourages them to go to college and places them in colleges with scholarships.
15. *Brooklyn Institute of Arts and Sciences:* Working museum.
16. *Colonial Williamsburg:* Restored colonial village.
17. *Fund for Area Planning and Development:* City Planning in New York City.
18. *Hospitality Committee for the United Nations:* Arrangement of housing and other services for United Nations delegates and their families during their stay in the New York area.
19. *Jackson Hole Preserve:* Conservation.
20. *New York Urban Coalition:* Study and technical assistance concerning economic and social problems in the metropolitan area.
21. *Architect's Renewal Committee in Harlem:* Encouragement of minority group youngsters to pursue careers in architecture, design and planning.
22. *Cultural Council Foundation:* Receives and disburses funds from private foundations for cultural purposes in the City of New York.
23. *Real Great Society:* Program of training and performances for talented, disadvantaged youth on the Lower East Side.
24. *Studio Museum in Harlem:* Museum which serves as a creative intermediary between the local community and the artist.
25. *Youth Advocates:* Program for run-away and resident children in San Francisco.
26. *Real Alternatives Program:* Current equivalent of Big Brothers program in California.
27. *Elementary Institute of Science, San Diego, California:* Underprivileged children in San Diego in science research with cooperation of Salk Institute.
28. *Hospitality House:* Arts and crafts programs, dance, painting to take juveniles off of streets in Los Angeles.
29. *Crenshaw Community Youth Study Association:* Group studies about neighborhood in Los Angeles.
30. *Crenshaw Neighbors:* Assistance to public schools with information programs in Los Angeles.
31. *Dawn Today:* Anti-drug program for young people in Los Angeles.
32. *Urban Affairs Institute:* Studies in urban problems in Los Angeles.

33. *San Francisco Consortium:* Cooperation of institutions of higher learning in San Francisco to bring resources to bear on community problems.
34. *California Indian Education Association:* Indian men and women from different tribes working for Indian education.
35. *California Citizens Committee on Adoptions:* Comprehensive study of adoption laws and regulations concerning adoption.
37. *California Citizens Committee on Detention of Children:* Study of detention facilities for children in California.
38. *California Citizens Committee on Transient Youth:* Study and development of model law for dealing with problem of cooperation between states and across state lines.
39. *Teachers, Inc.:* Massachusetts public school teachers organized for curriculum reform.
40. *Puerto Rican Child Guidance Center:* Guidance, counseling and social services for local Spanish-speaking communities in New York City.
41. *Chicago Institute for Early Childhood Education:* Training institute to train outstanding teachers of preschool children.
42. *Community Renewal Society of Chicago:* Private work in low income areas for housing, welfare, industrial development, and the arts.

Note: The following organizations are now partially supported by government but they were established and supported for several years with foundation funds.

43. *Learning Institute of North Carolina (LINC):* A non-profit organization designed to start up innovational projects and special schools in education. For several years, operated only with foundation funds.
44. *Center for Urban Education:* Educational research in New York City.
45. *Kansas City Regional Council on Higher Education (also called "The Consortium"):* Research and technical assistance for higher education. In the current year probably receives sufficient federal support to be excluded from definition, but original and basic support from private foundations.
46. *Institute of Community Studies in Kansas City:* Regional social and cultural research, including public administration services, economics of public welfare and health care. In the current year probably receives sufficient federal support to be excluded from definition, but original and basic support from private foundations.
47. *Greater Kansas City Mental Health Foundation:* Research and education concerning mental health. In the current year probably receives sufficient federal support to be excluded from definition, but original and basic support from private foundations.

Note: The following organizations are momentarily "publicly supported" (they have government grants and small individual contributions) but such support is marginal so that a single foundation grant would make them a private foundation.

48. *Cincinnati Montessori Society:* Family organization for experimental program in preschool education.

H.R. 13270, 91st Congress, 1st Session, Calendar No. ——

IN THE SENATE OF THE UNITED STATES

September —, 1969

Ordered to lie on the table and to be printed

AMENDMENT

Intended to be proposed by Mr. ———————————— to H.R. 13270, an Act to reform the income tax laws, viz:

1. On page 16, on line 21 strike out the word "and" and on line 23 strike out the period and insert:

"; and

(5) a special purpose operating organization."

2. On page 44, on line 19 strike out the word "or" and at the end of the line insert; ", or (5)."

3. On page 57, after line 2 insert the following (and redesignate subsections (d) through (k) of section 101 as subsection (e) through (l)):

(d) Definition of Special Purpose Operating Organization—Section 7701(a) (relating to definitions) is amended by adding at the end thereof the following new paragraph:

"(35) Special-Purpose Operating Organization—the term "special-purpose operating organization" means an organization which is described in section 501(c)(3) and which—

(A) expends substantially all of its income or devotes substantially all of its assets directly for the active conduct of the special educational, scientific or charitable activities constituting the special purpose or function for which it is organized and operated:

(B) makes available (or permits and encourages the scholars and professional staff associated with it to make available) to the general public the results of its activities;

(C) is not controlled directly or indirectly by one or more persons who, if the organization were a private foundation, would be disqualified persons (as defined in section 4946) other than persons who, if the organization were a private foundation, would be its foundation managers (as defined in section 4946), and other than one or more organizations described in paragraph (1) or (2); and

(D) normally receives not more than one-third of its support in each taxable year from gross investment income (as defined in section 506(b)(2))."

TECHNICAL EXPLANATION OF AMENDMENT

The Amendment would add to new section 509(a) of the Internal Revenue Code, at pages 15–17 of H.R. 13270, a new paragraph (5) which would exclude from the definition of "private foundation" any organization which is a "special-purpose operating organization." The term "special-purpose operating organization" would be defined in a new paragraph (35) added by the Amendment to section 7701(a) (relating to definitions). The Amendment also makes a technical change on page 44 of the bill to make clear that these organizations will be treated like other excluded organizations for purposes of the expenditure responsibility rules.

The definition of "special-purpose operating organization" would apply to section 501(c)(3) organizations which satisfy each of four tests set forth in the Amendment in subparagraphs (A) through (D).

Paragraph (A) of the new definition requires that the organization be engaged, both actively and directly, through utilization of either substantially all of its income or substantially all of its assets, in the special educational, scientific, or charitable activities which constitute the special purpose or function for which it is organized and operated. Working capital received by way of gift, contribution or as proceeds for goods or services, when expended directly for an organization's activities, would be included as assets devoted directly to the active conduct of such activities. The "special-purpose" requirement is included to assure professionalism and expertise in an organization's activities and is illustrated by learned societies, associations of libraries, and specialized public research or technical assistance organizations. This test employs a principle already used in the Code in section 170(g)(2)(B) (relating to the unlimited charitable contribution deduction) and in the Bill in new Code section 4942(j)(3) (relating to operating foundations).

Paragraph (B) adds a test that ensures that the organization and its works will be exposed to or involved with the general public to a significant extent. The test requires that the organization make available (by publication or otherwise) to the general public the results and benefits of its studies or research or other activities. Where the organization engages the services of scholars and other professionals, it would be required to encourage them also to make such work products publicly available.

Paragraph (C) is designed to ensure that the organization will be independent and not be controlled or influenced in its operations by a particular person, family, organization or group, including a private foundation which is a substantial contributor to the organization. The test is put in terms of direct or indirect control of the institution by disqualified persons other than foundation

managers and other than publicly supported charities. "Control" means actual effective control and would be determined under all the facts and circumstances of each case. This test is based on one used in the Bill in new section 509(a)(3)(C) (page 16, lines 17–19 of H.R. 13270).

The test in paragraph (D) is the same as that provided in the Bill in new Section 509(a)(2)(B) and would prevent any organization with a substantial endowment from being included in the definition of a special purpose operating organization.

PROPOSED LANGUAGE FOR SENATE COMMITTEE REPORT

"The Bill defines for the first time in the Internal Revenue Code the term "private foundation." The new definition proceeds from a presumption that all organizations exempt under section 501(c)(3) (which are estimated to be numbered in the hundreds of thousands) are private foundations, and then excludes from the definition certain narrowly specified types of organizations. Your Committee believes that this definition would include many specialized operating organizations which are chiefly the receipients of private foundation support, which are not susceptible to the financial abuses of private foundations, and which should not be subject to the same assessments, regulations, restrictions and potential penalties as private foundations. The distinguishing characteristics of these specialized operating organizations are that they have developed professional expertise in the pursuit of specialized public purposes, they expend all of their income (or working capital in instances where they have no significant income) directly for the active conduct of their special exempt purposes, the results of their activities are available to the public, they are not controlled by any private individual or organization, and they do not have substantial private endowments. Learned societies, associations of libraries and public research or technical assistance organizations are examples of those intended to be excluded from the definition. The House Committee Report makes clear the Ways and Means Committee's recognition of the value of these organizations and the importance of excluding them from certain effects of the bill (House Report No. 91–413 (Part 1) pp. 26, 42). Your Committee believes that a more direct, more logical and an effective approach to this problem is not to include these organizations in the new definition of private foundations."

THE FORD FOUNDATION—10-YEAR SUMMARY OF INVESTMENT PORTFOLIO [1]

	1968	1967	1966	1965	1964	1963	1962	1961	1960	1959
Income:										
Dividend income from Ford stock	75.4	80.4	89.4	88.8	92.3	90.9	94.3	103.1	103.5	69.8
Other dividend income	21.8	17.4	13.5	10.5	7.8	5.3	3.0	1.6	.7	.2
Interest income	57.8	60.7	55.0	46.4	47.1	44.4	39.6	26.1	23.4	14.6
Total	155.0	158.5	157.8	145.7	147.2	140.6	136.9	130.8	127.6	84.6
Less investment expenses	.5	.4	.4	.3	.3	.3	.3	.3	.2	.2
Total income	154.5	158.1	157.4	145.4	146.9	140.3	136.6	130.5	127.4	84.4
Ford stock:										
Shares disposed of during year [2]	2.5	2.2	4.7	6.9	4.1	0.2	7.4	5.8	4.3	4.1
Market value of shares disposed of	127.6	96.9	238.3	352.1	203.1	8.9	358.4	227.8	169.2	112.6
Shares at yearend [2]	30.0	32.5	34.7	39.4	46.3	50.4	50.6	58.0	63.8	68.1
Percent of total outstanding	27	30	31	35	42	46	46	53	58	62
Market value at yearend	1,711.9	1,728.2	1,447.6	2,199.3	2,678.7	2,710.9	2,095.1	3,055.4	2,050.2	2,806.8
Diversified equities:										
Net purchases	123.5	100.9	97.0	68.3	75.3	59.3	70.6	33.3	32.7	10.2
Market value at yearend	891.4	712.6	468.7	433.7	349.9	231.6	132.8	89.7	44.3	13.1
Convertible debentures:										
Net purchases (sales)	53.4	48.7	17.7	16.0	3.1	(1.5)	6.4	4.2	(1.6)	0.3
Market value at yearend	157.9	103.5	45.2	34.0	15.3	11.5	11.9	6.3	1.7	3.3
Direct placements (at cost):										
New commitments	95.3	80.2	139.3	77.7	71.2	50.3	92.4	148.0	55.4	
Net purchases (maturities)	(25.1)	36.5	20.1	32.9	28.9	40.5	118.8	97.8	35.2	0.9
Average return (percent)	6.11	5.84	5.40	5.14	5.28	5.39	5.25	5.36	5.09	3.57
Value o fyearend	397.8	422.9	386.4	366.3	338.2	309.3	268.8	150.0	52.2	17.0
Fixed income securities:										
Net purchases (sales)	(131.1)	(139.4)	(90.6)	127.2	27.1	(128.3)	125.6	78.0	94.8	77.8
Market value at yearend	441.0	570.9	703.5	813.5	691.3	663.1	794.2	663.9	586.8	467.2
Total portfolio (at yearend market)	3,600.0	3,538.1	3,051.4	3,846.8	4,073.4	3,926.4	3,302.8	3,965.3	2,735.2	3,307.4
Less unpaid grants and appropriations	525.3	599.2	550.7	561.7	475.5	436.7	361.4	261.0	238.1	206.9
Total net portfolio	3,074.7	2,938.9	2,500.7	3,285.1	3,597.9	3,489.7	2,941.4	3,704.3	2,497.1	3,100.5
Cumulative excess of grants, projects, and expenses over income from establishment (1963) to end of year	1,212.5	1,156.8	1,052.3	847.5	693.4	598.8	512.5	415.7	393.5	352.9

[1] All figures are stated in millions of dollars, with the exception of percentages, or, in the case of Ford stock disposed during year and held at yearend in millions of shares.

[2] Adjusted for the 2-for-1 split in May 1962.

The CHAIRMAN. May I just say this to the panel of witnesses: while I know the Ford Foundation, for one, has been criticized for at least one of its projects, I personally approve of a foundation looking into areas that have not been explored before, to see if something can be done about it. Risk taking and innovation are part of our heritage. If one does not try anything new, how would he know whether it is a good or bad idea. I particularly applaud the Ford Foundation for its program of related investments. It seems to me if foundations have $25 billion, they can invest some of it in something beside Government bonds, putting some of it to help people start up their own businesses, and even if it is not the best undertaking in the world as far as moneymaking ventures are concerned, somebody ought to do that to help people get started and make something out of themselves. I hope you would consider some further low-interest rate housing loans in connection with some of your activities.

But I also would like to make this point. I think the foundations that are subject to the most serious criticism are those which have done nothing, just piled the money up and done nothing at all for a worthy purpose. I am pleased to say since we got involved in this area we have at least found certain areas where something ought to be done, and I appreciate the recommendations that Mr. Bundy and certain of you connected with some of the better foundations have had to make in this area.

Perhaps by the time we are through we will have not only a better tax law and better indications of what should be done, but we will have more people doing good work in the area. I hope that will be the result of it.

Senator Bennett.

Senator BENNETT. Thank you, Mr. Chairman.

I have listened to this discussion with a great deal of interest, as I have the many private conferences I have had on the problem of foundations.

It is a serious problem. It is almost as serious as trying to find the dividing line between right and wrong generally, because each of us defines and has his own standards of ethics, conduct and value. We in the Government have to try to find general standards that can be applied across the board.

I am not sure we will be able in writing the language of this bill to make that kind of a definition which will be so elastic as to permit all the worthy enterprises to be recognized, and screen out the unworthy ones.

But certainly that is what we are going to try to do. I am sure what you have told us today will be helpful, and I am sure that these hearings and the existence of the bill, turned a spotlight on the whole problem and forced the Congress to look at things that it took for granted for a long time without concern.

I am sure nobody is going to be pleased with what we finally turn out, but I am sure that the committee is going to do the best it can.

The CHAIRMAN. Let us hope they will be pleased.

Senator Ribicoff.

Senator RIBICOFF. I think, Mr. Chairman, you have made a very pertinent point when you said that what bothers you are the founda-

tions that do nothing. Frankly, I respect the foundations more for their failures as much as I do for their successes, because we do have many stresses in our society, and Government is timid, Government is afraid to take a chance either because the bureaucrats are afraid to take the chance or politicians do not have the courage to take a chance. But it is the foundations that do have the courage to go into new fields, whether they are in the social sciences or in the physical sciences, which is something that all of us must encourage, because you are not hedged about by restrictions. You are willing to take the changes that you may fail without having political consequences, and we should do everything to encourage the foundations that are bold instead of trying to penalize the foundations that are bold.

As far as I am personally concerned, there is much in the House bill that I think is very, very harmful for the future of our country, and in the field of where the foundations are concerned, I really think that the House bill has really stuck a blow against society advancing and trying to solve these problems instead of the other way around.

Thank you very much.

The CHAIRMAN. Senator Hansen.

Senator HANSEN. I have no questions, Mr. Chairman.

Senator WILLIAMS. I have no questions.

The CHAIRMAN. Thank you very much.

Mr. STRATTON. Thank you very much. We appreciate it very much.

I might simply add that we have made mistakes. I, too, feel we would be subject to criticism if we do not make them, but we are tying to learn by the mistakes we have made, and that is the important thing.

The CHAIRMAN. Thank you.

Next we will hear from Dr. James Killian, Mr. Dana Creel, president, Rockefeller Brothers Fund; Dr. Jonas Salk; and Mr. John J. McCloy of Milbank, Tweed, Hadley & McCloy.

Gentlemen, I would suggest that you proceed in your own way.

STATEMENT OF DANA S. CREEL, PRESIDENT, ROCKEFELLER BROTHERS FUND

Mr. CREEL. Mr. Chairman, I am Dana Creel, president of the Rockefeller Brothers Fund. This panel is to discuss certain restrictive effects of H.R. 13270 on the development of philanthropy and the operation of foundations.

The CHAIRMAN. Might I just stop you for a moment. I am pleased to see the Senator from California at the dais with you. If he wants to introduce one of the witnesses, or if he wants to testify, that is fine.

Senator CRANSTON. I want to introduce Dr. Salk.

The CHAIRMAN. Go ahead.

Mr. CREEL. I am privileged to share this assignment with Dr. James Killian, chairman of the board of trustees of Massachusetts Institute of Technology, on my right; Dr. Jonas Salk, director of the Salk Institute for Biological Studies; and Mr. John J. McCloy, partner in the law firm of Milbank, Tweed, Hadley & McCloy, on my right.

My role is to discuss the undesirable effects of the penalties and the administrative responsibilities imposed by the House bill, and suggest possible alternatives which would seem more properly to fulfill

what I believe are the Congress-stated objective in this area: that is, to provide a more rational relationship between sanctions and improper acts.

I think, in speaking for myself and for the discussion of the foundation group, there is no objection to sanctions but rather there is the desire to have them fit the situation.

I would like to put that word in now so that it does not start on a negative note.

The penalties in the bill are essentially a variety of monetary penalties applied against both foundations and foundation managers, and this means both staff and trustees.

It is not possible to summarize here, much less discuss each of the penalties. I think it is possible, however, to use a few specific examples to illustrate the shortcomings as well as the excessive nature of the proposed penalties.

For example, the foundation manager who violates the provisions of S. 4945 on expenditure responsibility or influencing legislation would be liable for a penalty equal to 50 percent of the grant, and the foundation would be liable for a penalty equal to 100 percent of the grant.

The ultimate purpose, it seems to me, of any approach to a system of sanctions should be to strengthen and promote the philanthropic endeavor in our society. This is the basis for a major objection to one whole segment of the proposed sanctions; namely, those penalties levied directly upon foundations. Penalties relating to wrongdoing should be imposed on the wrongdoer not on the foundation involved.

A monetary penalty against a foundation hurts philanthropy at large since that much less money will be available to some charitable organization.

The second major objection is that the penalty structure subjects foundation management, again both staff and trustees, to potentially very harsh liabilities.

In many cases, these liabilities would be entirely out of proportion to the transgression.

In general, the potential liability is such that the bill would greatly reduce the ability of foundations to attract the best caliber of trustees and staff.

The possiblity of a fine of $1,000 much less $5,000 would be a very serious matter, particularly as there is the possibility of more than one innocent error of judgment before there would be any identification or determination of an initial error.

The possibility of practically unlimited financial jeopardy of $25,000 to $50,000 or $100,000 or even more—because foundations deal in grants of $100,000 or even more—would be an awesome specter with which to live.

In short, the proposed monetary sanctions of the bill have an in terrorem effect and must be altered and reduced to a practical level.

I would like to propose that a substantially modified philosophy and system of sanctions be adopted, having the ultimate end of promoting and strengthening philanthropic endeavor in our society.

This proposal would recognize that while there have been some abuses in the foundation field, the vast majority of foundation managers, staff and trustees, are serious, dedicated persons, taking pride in their activities.

If the law is made clear as to what is expected, this vast majority will make a sincere effort to comply. The possible stigma of merely being adjudged in violation of any statute, quite aside from any monetary fine, would generally be a sufficient deterrent.

In the few cases where this deterrent is not effective limited monetary penalties applied by the Internal Revenue Service would be sufficient to assure compliance with the regulations.

Should there ever be a case of complete intransigence of repeated unlawful acts, the IRS always has available the possibility of revoking the foundation's tax exemption which, under the bill, would force the foundation to distribute its assets to public charity.

With the ultimate purpose of strengthening philanthropy I suggest that the system of sanctions in the bill be modified as follows:

1. Penalties should not be imposed on foundations but only on the wrongdoers.

2. Prescribed acts—or failures to act—should be defined with sufficient clarity to enable the decisionmakers to determine, without undue complexity at the time of decision, whether any act—or failure to act—constitutes a transgression.

3. A procedure should be established for providing notice of a proposed penalty by the Internal Revenue Service, with opportunity for correction within a reasonable period before application of the penalty.

4. The prescribed penalties should be flexible, reasonable in nature, with a maximum limit and appropriately related to the acts—or failures to act—which are penalized.

Generally speaking, a limit of $5,000 to $10,000 should be the maximum.

5. A reasonable statute of limitations should be made clearly applicable to the penalties.

If an approach along these general lines can be substituted in H.R. 13270, I believe that the Congress will come much closer to meeting the goal of developing sanctions that provide a more rational relationship to improper acts.

And in terms of the ability of private foundations to perform in the highest public interest, I believe such a change is crucial.

Thank you.

The CHAIRMAN. If it is all the same with you, we would prefer that each member of the panel make his presentation in chief and then we will ask, perhaps, one question from each Senator.

Mr. CREEL. I thank you.

Dr. Killian.

The CHAIRMAN. If I could have kept the questions down we could have heard you in the morning session.

STATEMENT OF JAMES R. KILLIAN, JR., CHAIRMAN OF THE CORPORATION OF THE MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. KILLIAN. Mr. Chairman, and members of the committee, I speak to you out of my experience as an officer of a private college where foundation grants and private philanthropy are decisively important to the institution.

I might add, in a phrase of Dr. Conant, that I am a member of the Mendicant Order of College Administrators in what I say today.

Over the past 20 years my institution has received 30 percent of its private contributions from foundations, or $108 million out of $305 million.

This 35 percent has been received from 673 different foundations in the form of 2,250 different grants and, incidentally, 50 percent of this foundation income has come in the last 5 years.

These grants have been profoundly important in maintaining the quality of our education and in advancing educational opportunity for both students and faculty.

The private giving which, in my judgment, would be discouraged by this bill has provided 80 percent of all of our academic buildings, as well as 100 percent of our endowment.

In our forward planning we have relied on the continuation of grants, gifts, and bequests, in amounts greater than we have been receiving in the past few years.

I, therefore, look with dismay on any curtailment of foundation or other private support now or in the future.

Clearly at a time when we are deeply concerned everywhere in the country about the funding of all higher education, and about the financial future of our private institutions, and where we are under great mandate to achieve much needed change in these institutions, we should be looking for ways to increase and not diminish the flow of the private funds, especially since the Federal Government currently is reducing its support.

We, who are struggling day in and day out to balance budgets and to find funds for student aid, for student housing, for faculty salaries, for improved teaching, and the new programs to deal with national needs, say to you with all of the emphasis at our command that this is no time to compound the problems of our universities by making it harder for them to secure private grants and gifts.

I would add to this the enormous importance of the universities being able at the present time to develop new programs that deal with the urgent social problems of our times, programs having to do with the urban problems that we face as a Nation, problems of pollution, of environmental control, transportation and many others. These domains are very inadequately financed by the Federal Government at the present time and, as we initiate new programs we badly need private funds to get them underway.

In its present form the bill would impair the existing functioning of foundations, as has been amply, I think, presented to you today, and would discourage the formation of new foundations, and this seems to me to be dangerous and shortsighted.

The provisions of the present bill appear to be so severe that if passed in its present form it would probably constitute the death knell of the foundations as we know them. Certainly the incentive to form new foundations will be lost.

Foundations make intangible contributions to our educational system, along with their financial contributions. I readily acknowledge that foundations provide institutions such as my own not only with needed funds, but with the stimulus of criticism and of fresh catalytic ideas, thus helping to maintain quality and to achieve needed change.

They make important contributions to the quality of our society by providing multiple centers of initiative, but their ability to serve as pathfinders and to support itself firmly and by their capacity to attract into the decisionmaking and finding process a wide spectrum of able men and women.

As others have already said, I think we need to be troubled by those provisions in the bill which would discourage able men and women from accepting posts of responsibility in foundations.

Indeed, the provisions in the House bill could reduce the officers and trustees of our responsible foundations to a league of intimidated men, their initiative, imagination and boldness dampened by excessive restraints and surveillance, and by confiscatory penalties for the innocent misreading of ambiguous provisions in the bill.

Although this discussion today is directed principally to those provisions, relating to private foundations, the true effect of the bill as a whole on future philanthropy cannot be reviewed or discussed in the foundation context alone, and one needs to look at the impact of the bill on the future of all philanthropy.

Unfortunately, speaking, as I have said, as an educational institution officer, there are many other provisions in the bill which may have adverse effects on contributions to institutions of higher learning.

For example, the restrictions on the gift of appreciated property may be the more serious, to the universities, than the restrictions on foundations. Those provisions having to do with limited preference and allocation of deductions are what I am talking about.

The fact is that in my own institution again, 38 percent of all individual giving, as we have understood it, has come in the form of appreciated property, and there are many other individual gifts doubtless representing appreciated property that we do not know the back history of.

The second aspect of the bill that will be very troublesome to us has to do with the limitation on trusts, particularly charitable remainder trusts and other forms of giving that have to do with bequests.

During the last 4 years, 60 percent of all individual giving to my institution, came through testamentary trusts and bequests. These aspects of the bill that affect this kind of individual giving can be catastrophic for our educational institutions.

So, as we look at the problem of the foundations as they would be adversely affected in this bill, we in the universities plead that these other considerations be given full attention, as I am sure you are doing.

In closing, let me emphasize my position as being in no way opposed to appropriate and equitable tax revisions but as deeply concerned lest irreparable harm comes to private institutions through oversight or inadvertence.

Thank you very much, Mr. Chairman.

Mr. Creel. Dr. Salk.

STATEMENT OF HON. ALAN CRANSTON, A U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator Cranston. Mr. Chairman and members of the committee, of the many vital matters that are before you through this tax reform measure, I am convinced that none surpass in significance the subject matter that you are considering today,

I take great pride in presenting to you a witness who will shed light from a different vantage point on the matter before you. He will speak not as the executive of a foundation, not as a man who has devoted himself to raising funds for the work of the foundations, but as a man who, with renowned success, has done the innovative and creative and constructive work that foundations make possible.

I have talked to Dr. Jonas Salk, who is here as director of the Salk Institute for Biological Studies in California.

I have talked to Dr. Salk about the work that he undertook that led to the end of polio as a threat to children and others in our land and elsewhere.

He learned in that experience that what he accomplished could not have been done without the assistance of foundations. He learned that work could not be, could not have been, done with simply the assistance of the Government. As a matter of fact, I think he learned that Government at certain stages of that great effort was more of a handicap than a help.

The CHAIRMAN. If I might just interrupt you for a moment, I would like to make a small experiment in electronics. I wonder if you would direct your mike in the other direction, Dr. Killian. We are trying to find out why we are getting a ring in the sound system.

Please proceed, Senator Cranston.

Senator CRANSTON. Dr. Salk is now undertaking a new effort that might surpass in importance what he has already accomplished in his new endeavor at the Institute. He is seeking to find the cause and cure of cancer, and in view of his record to date, I think I have great hope that he will be successful.

He is also working to discover how to deal with multiplesclerosis, with kidney disorders, and other disorders, physical and otherwise, in our society.

Again he is undertaking work that he could not have undertaken without the assistance of foundations, and in no other way could he have done or could he now be doing what he is doing, and he will speak to you from that standpoint.

STATEMENT OF DR. JONAS SALK, DIRECTOR, THE SALK INSTITUTE FOR BIOLOGICAL STUDIES

Dr. SALK. Thank you, Senator.

Mr. Chairman, in a way I am here to present a personal testimonial of my own experiences with foundations over the last number of years, and a personal testimonial to how I regard the future.

Since I look upon myself as a public servant and I ask what will happen to the work in which I am engaged that serves the public, and I also ask what role did foundations and philanthropy play in the past.

Senator Cranston has commented on some aspects of these questions. Perhaps, it is not necessary for me to do more than to state the conclusion that past work would not have been possible, nor will what I am now engaged in be possible, were it not for the existence of the foundation system.

I might say further, that from my experience universities and institutes require for their own existence the existence of foundations and other forms of philanthropy.

I want also to say further that the grants that are made to universities for work that the Government wants to have done, through grants from the National Institutes of Health, from the National Science Foundation, and other Government agencies, require the existence of these institutions which, as I have already indicated, in turn, could not exist in the absence of philanthropy and in the absence of the foundations. And, therefore, if we, in these institutions, are to serve the country, we, in turn, can function only so long as the American form of philanthropy and the American system of foundations, as it has developed, will exist.

All seem to agree that we should encourage generosity and control greed. This, in essence, is what I heard this morning. The private sector, in which foundations are included, it should be pointed out, are really intended to serve the public sector and not, as seems to be believed by some, to serve the private or the self-serving sector.

I would conclude, from what I have heard, that the problem is not foundations, but the problem is greed and, therefore, we must not try to eliminate foundations, but rather to eliminate greed. We should try to eliminate the disease and not the patient.

The objective, it seems to me, is to stop abuse and not use, and the objective is to encourage the generous spirit and abolish the greedy spirit. The generosity which is so characteristic of this country in essence is, as has been said before, the envy of the world.

I would worry very much if we were to deprive men of the opportunity to satisfy this generous impulse.

One can think of foundations as constituting for the Nation as a whole a prudently accumulated savings account. One can also think of foundations as institutions which are in the business of helping develop foresight. If we think of the foundation system as the patient and not as the disease, and if we think of remedies, we must keep in mind the hippocratic maxim—that "do not harm, do not maim or kill the patient."

I have put it this way because it is sometimes useful to think in this kind of analogy.

As I listened to the discussions this morning and to comments upon the remedies proposed in the House bill, I recognized that a new kind of profession has developed, a new kind of service, a profession and a service in a way analogous to the medical professor or the legal profession; it is the profession of those who serve and work in foundations. I wondered, therefore, in hearing of the desire for regulation and control on the part of foundation executives that these should be, perhaps, a professional association of foundations to develop and exercise methods of control of malpractices and that membership in good standing in such associations might become a requirement for tax-exempt status in the same way that hospitals are accredited, and physicians are accredited and licensed, and as are other specialists and members of the bar.

The Flexner report on medical schools, to which reference was made earlier, which was reported around 1910, at which times there was some 800 medical schools in existence, set up standards of acceptability and soon the bad ones quickly disappeared, and the good ones persisted. There are some 80 or so now, of which we need many more. The

idea of rearning the franchise that Dr. Harrar mentioned could, perhaps, be done by this kind of professional surveillance. It also occurred to me that if there were a voluntary fee, in the form of a grant made by the foundations to Government from foundation funds for auditing purposes, it seems to me that this would be in keeping with the most desirable aspects of the way in which this country tries to function—by the development of a measure of self-discipline.

I have touched upon the issue as I see it, as it would affect the work in which I have been, and am, engaged.

I have touched briefly on what could be thought of as remedies. The principle that is involved is not a trivial one and I want to emphasize it in closing. The principle in question is dualism or pluralism, as opposed to monopolism. Monopoly is equally bad, whether it be Government or private, and it is in defense of pluralism in part, that I am here.

I might say that we need a healthy foundation system if others like myself in this and later generations are to be able to serve this Nation, to use Senator Ribicoff's idea, by taking the chance that Government may be reluctant to take.

I also want to echo the comment of Dr. Killian of the desirability, in fact, the necessity, to encourage the development of new foundations as well to maintain the old. New foundations are needed to supplement the efforts of those who have already committed themselves.

I shall close at this point without touching upon some of the points that I made in the prepared statement submitted earlier. I felt that it was more meaningful to give the reactions that I had in the course of hearing the discussions this morning than to repeat what you will see in the text which I would like to include for this record.

Mr. Creel. Mr. McCloy.

STATEMENT OF JOHN J. McCLOY, ATTORNEY, NEW YORK, N.Y.

Mr. McCloy. Mr. Chairman and gentlemen of the Senate, I was introduced as being a member of a New York law firm, but I do not think I am properly here because of that fact. I am, in a sense a rather pitiful position of a lawyer without a client. I am not representing any foundation, though my firm does do some advising of foundations, but I was for many years a member of the board of trustees of the Rockefeller Foundation, and for a number of years, a good many years, I was chairman of the board of trustees of the Ford Foundation. It is through that experience that I am here today.

I was also a member of the board of trustees of a number of other foundations, but today I have no membership in any foundation.

I have arrived at the age of presumptive incapacity where an arbitrary age limit says that you should retire. [Laughter.]

I have made a statement, as the Senators are aware, and I have tried to make an outline and summary of it for the record. I have listened to this testimony today, and I have, of course, read the bill and I think I can sum up my impressions by saying that I am quite clear that this bill is shot through with a definite animus against private foundations.

There are a number of discriminatory provisions which relate only to foundations as such, and not to other charitable foundations.

There are many discriminatory measures, and I won't run over them because I think they have been touched on largely in the testimony that was given this morning.

I have the conviction that this is the wrong approach to this problem. I feel, and my experience has made me feel, that there is a great deal in this foundation world that we do not know very much about. In the first place, the audits of the International Revenue Service have only covered a fraction of the foundations.

There is a broad field there that has not been covered or audited, and I believe that the most constructive legislation that the Congress could adopt at this time is to give the authority and the means, the facilities to the Internal Revenue Service—and I would think it would be the Internal Revenue Service rather than some other agency—by which they could really introduce a comprehensive and objective and thorough-going national audit of the foundations in this country.

I think then we will begin to know something about what we now hear by rumor. There were some figures given this morning, and with all due deference to those who gave them, I would say that I am not sure that they are right. Some people have said there are $21 billion in the foundation assets, and Mr. Patman, I think, has said, there are $50 billion. We really do not know nor do we know the extent of the accumulated income or the improperly accumulated income.

If we can get the facts and have them before us or if the Congress can have them, then it will really be in a position to appraise what good the foundations do and some of the abuses of which they may be guilty. This would tend to, improve the character of the law governing charitable foundations, as well as to take care of the delinquents.

I believe the particular provision, by which an adequate audit could be financed was dismissed this morning. I think I was one of the first who suggested that we should not have a tax but that we should have some sort of a user fee comparable to the audits that are carried on by the Federal authorities in the supervision and audit of banks.

We are all a creature of our own experience. I was a banker once, and you and I know the provisions of the regulations or the law that require the audits of the banks to be given to—or put before the directors. The directors have to read them and have to respond to them. Those audits cover the lending policies of the banks, and since that provision has been in effect, with the audits financed by the banks themselves, but since that has been in effect, at least when I was the head of a bank, I noticed that the auditor tended to improve the tone of the lending. I would think that in case of the foundation, we might have something other than just a mere revenue audit, perhaps, have the IRS empowered to comment of grants get in the shady zone that we were talking about this morning.

You know that on those bank audits there is an item called "especially mentioned loans." It is a little red flag up in the corner, and almost invariably some member of the board of directors says "Well, how about this loan and how about that loan? Why does the Government pick that one up?"

I think some such type of sanction as that might be very helpful in connection with the general audit of which we are speaking. I am very clear in my own mind that this should take on the character of

the user fee rather than the character of a tax which has all sorts of connotations and implications in regard to it.

But above all, I would think that it was the duty of the Congress to eliminate from this bill the punitive and rather hostile provisions that clearly run through it. It should single out the abuses, tighten up some of the enforcement provisions—and I think that they can be tightened up—and then with the provision for such an audit as I am suggesting, we would not only know what is going on but we would know what type of regulation, what type of law should be adopted in order to see what the country really should have in the way of legislation.

I know that in the case of the banks that these audits have resulted from time to time in new laws, new regulations, which have generally tightened up the lending policies of the banks, and I believe that rather than to put to risk this flow and continuity of private foundation grants, rather than to put that to a risk what has become a real and vital factor on American philanthropy, I would think we ought to stop and take a look at this situation, get the facts, see what the abuses are, as I say, and also see what the benefits are, and on the basis of that, we will be much better equipped to deal with this problem than we are today.

This does not mean that we would postpone all action. There are some provisions in the bill that I think are very good, and I think some of the sanctions should be tightened up. But remove from this bill this philosophy, this note of animus or discriminatory practice, discriminatory provisions that, as I say, does run through the bill, and I think we would have a much more constructive approach to this subject.

This morning someone referred to deTocqueville. I have always been impressed by that young Frenchman who was over here in the 1830's. He was an extremely discerning young man. He saw the status we are now in vis-a-vis the Soviet Union in a very graphic prognostication, but he also pointed out the role that private philanthropy played in the American society, how deep it went. It is a very eloquent passage. It is not, I believe, in his book. It is in a letter that he sent to France when he was over here. But this is the concept of our society, this is the core of our society—it is also the tradition of the Congress, because the Congress approved these exemptions. The presumption is in favor of the beneficial aspects of the foundations; indeed, the Treasury is on record as saying they are convinced it is only a very small percentage of the foundations that do represent abuses.

On that basis, the presumption should be in favor of the foundations rather than against them and, as I noted, the opposite presumption runs through this bill.

Also, we have had testimony this morning of the looming deficit that is compending in this country in the effort to meet the educational needs and the social needs of the country.

We can see it coming down the road like an elephant on a towpath.

We know that we are not going to meet this gap solely by private philanthropy or solely by government action. It is going to take all the assets that we have to cope with these problems, and I believe at this stage in history to inject depressants rather than incentives to the

flow of private philanthropy would be improvident and not to the best interests of the Nation.

So I won't go into the other details of my statement. As I said, I made my statement when we were prepared to testify heretofore and I do not urge you all to read it, I do not say it is the last word, but I think it was a fairly good statement. I think that the conclusions that I have arrived at as the result of a study of this problem and hearing this testimony today are that I believe that if we removed the animus and hostile spirit of the bill and really went at it, established a basis upon which we could get the facts we would do everybody, do the Nation, a great service and that, I think, is the essence of what I would care to say at this time.

The CHAIRMAN. Well, thank you very much, gentlemen. I very much applaud the fine work that each of you has done in his own capacity, and I am sure I speak for the committee when I say that.

I fear that we will find that there are a lot of people in the foundation business, not because of benefits they hope to provide for humanity, but because they hope to avoid taxes. But, I do not believe that refers to anybody at this tale here. If others had fulfilled the purposes that are stated in their foundations organization papers, I do not believe we would be hearing you testify on this matter.

I want to thank each of you for the suggestions that have been made as to ways that we might act in the national interest with regard to foundations.

Since the subject came up, we have had a lot of very fine suggestions of things that could be done to see that foundations acted responsibly. I do not think that we have heard here today from any of those who would act in any other way than in a responsible fashion. We are particularly proud that you came here to talk to us, Dr. Salk.

We have some very fine people in my State, as you know, who are making an effort in the field of cancer, heart disease and other things, like Dr. Alton Oschner and Dr. DeBakey, and we certainly wish you all the good luck in the world in the endeavor you are making on behalf of humanity.

Senator CURTIS. I would like to thank the panel for their helpful suggestions.

Mr. McClory, I particularly applaud your idea that we should have this audit, let it run a few years, and legislate in the light rather than in the dark, and that is the essence of your message.

Mr. MCCLORY. That is the essence, yes.

Senator CURTIS. I do not know whether it has ever been called to your attention or not but there are some well-known foundations that have a splendid record. There are some small new ones that are likewise operating in the public interest.

Based on your experience as a banker and a lawyer, it is quite likely when an individual creates a foundation that he will give to the foundation that which he has, which may be stock in his own business; isn't that right?

Mr. MCCLORY. Yes, that is right.

Senator CURTIS. As the years go by just gradually they will get more diversification.

Do you believe the fact that the donor or his family have a—that their company securities are a major asset in the foundation that that

per se proves any wrongdoing or lack of operation in the public interest?

Mr. McClory. No. I do not believe per se it is vicious. I believe it may be rather praiseworthy because most of those, a good many of those, small foundations, wholly controlled foundations, are not on the eastern seaboard, they are in areas where, in the hinterland of the country, there is limited giving and the needs are great.

Senator Curtis. Yes.

Mr. McCloy. And this presents a very good stimulus to giving in that area, and I feel that the point at which to strike, is at the abuse, but I do not think, as you point out, Senator, that the abuse is per se in the amount of the stock that he gives to a foundation.

Senator Curtis. Well, I used the word "small." They are small compared to some of our major ones, but they are large enough that they give away a good many millions of dollars every year.

I know one foundation that later gave 160 percent of their income. I do not know whether you are aware of it or not, but in some instances the House bill imposes the regular corporate tax on foundations.

For instance, if you have a foundation and their asset is that they are the sole owners of the business, were they a holding corporation they would get an 85-percent credit for dividends paid from the operating company. If they were in the 50-percent bracket they would have 7½-percent tax, and here a foundation that someone has turned their business over to will be faced not with a small tax but with a tax equivalent to the regular corporate tax in that particular situation.

Mr. McCloy. Well, I am aware of that provision. I think it is classed as one of those things that I call punitive provisions that I do not believe strike the right note.

Senator Curtis. Yes.

I feel that what we do here is so far-reaching that it is my sincere hope that after we take care of those few glaring abuses that a remedy can be pretty well agreed upon, then we have exhaustive audits and find out where the bad practices are and what the right solution is, and that should take a little time, 2 years, 5 years.

Mr. McCloy. And that audit will tone up the grants because—when you get—when the controlling boards of these foundations get, the audit they see that there are some questionable practices that if dealt with will tend to improve the grants. Certainly that has been the experience with the banks which, I think, is a good parallel. But I believe that the prime necessity at this point is to have a comprehensive nationwide thoroughgoing audit.

Senator Curtis. I won't take any more time. I thank you all.

Senator Ribicoff (presiding). I thank all of you gentlemen—I am sorry, Senator Hansen.

Senator Hansen. I have no questions.

Senator Ribicoff. We are very appreciative of having your counsel here.

Senator Williams and myself, I mean, if you will pardon me, Senator Curtis, we have been discussing how complex this entire measure is, and with the more witnesses we hear we realize its complexity.

Thank you very much.

Mr. Creel. Thank you, Mr. Chairman.

(A contents directing the reader to the prepared statements of the witnesses from the Foundations Coordinated Testimony Group follows. Oral testimony of the next witness commences at p. 5520.)

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SUMMARY OF STATEMENT BY MR. IRWIN MILLER

A. The role of foundations as seen by a foundation leader

1. Foundation facts and accomplishments:
   (a) Facts:
      (1) Foundations constitute 8% of total philanthropy.
      (2) Annual foundation giving is $1.5 billion, or 7½% of the total assets of foundations.
      (3) There are 22,000 foundations, of which only a few hundred are the standard setters.
   (b) Accomplishments:
      (1) Pioneering roles, for example support by foundations for Dr. Jonas Salk and Dr. Robert Goddard.
      (2) Strengthening education and educational research.
      (3) Anticipating social and international problems.
      (4) Supporting development of writers, artists, and scholars.
      (5) Health, scientific and population research and programs.
2. Responsibility of Congress and public to examine foundations:
   (a) Foundations operate under public trust.
   (b) Foundations inevitably are found to raise questions, doubt and controversy.
   (c) Periodic examination of foundations by Congress and the public are both good and essential.
3. Proposed tax on foundations is inconsistent with purpose of tax exemption.
4. Proposed measures to curb fiscal abuses are good, and are supported by most foundations.
5. Proposed limitations on programs are unwise in that they attempt to eliminate "bad judgments" and in doing so allow for only the most bland kinds of judgments, and only the most bland kinds of activities, by foundations.
6. The tax and program limitations act as a signal to discourage private philanthropy—and thereby the whole private foundation sector of American life.
7. Foundations are in fact accountable to the public under existing conditions.
   (a) Existing law (if fully enforced).
   (b) Public disclosure and the press.
   (c) Broad-based boards of trustees.
   (d) "Market evaluation" by foundation recipients.
   (e) Congressional inquiry.
8. Each individual American citizen ought to feel and bear the responsibility to give and to act voluntarily on behalf of the continuing welfare of his country—and not only in response to the compulsion laws.

STATEMENT OF MR. IRWIN MILLER

Mr. Chairman and members of the Committee, in the time allotted to me this morning, I would like to sketch a background against which other witnesses will fill in specific detail. As I believe the agenda will indicate, a number of foundations and beneficiaries of foundations have coordinated their presentation so that all the major issues can be discussed and repetition avoided.

There will be six panels which in turn will cover (1) the role of foundations in American life, (2) the effect of the legislation (especially the proposed tax) on foundation beneficiaries, (3) the effect of the tax as seen by foundations, (4) the effect of the program limitation (including grants to individuals), (5) the effects of distribution requirements (including problems raised by definition of qualifying distributions, and (6) the restrictive effects on the development of philanthropy and the operation of foundations (including the effects of expenditure responsibility and heavy burdens on trustees).

Where as these presentations have been coordinated and consolidated, as was requested by the Committee in its August 12th press release, it should be noted that each witness will be testifying for himself and for the institution to which he is attached.

I speak this morning as an individual. But I am neither a disinterested nor an uninterested witness. To identify myself, I am a businessman who lives in Columbus, Indiana. Cummins Engine Company, which I serve as Chairman of the Board, created a foundation some fifteen years ago. Both directly and

through the foundation, the Company normally contributes the full five per cent of its pre-tax profits. I currently serve as President of its foundation. I also serve as an officer and director of a foundation created by my family, and I am a trustee of the Ford Foundation.

In respect to my personal life, my wife and I have for some years been in the process of qualifying for the unlimited charitable deduction. Further, we have raised our five children to believe that a responsible sense of concern for the well-being of society in which they live requires that they each contribute to philanthropy the full thirty per cent of their income each year. Finally, it should be noted that I serve as a trustee of a number of institutions which are often recipients of foundation grants.

I state all this to show my bias in this matter. Having done so, I now hope you will hear my opinions. In expressing them, I must note the enormous complexity of the Foundation Sections of the Bill in my own inexpertise in legal complexities.

Let me speak first to the American tradition of private giving and the important place it holds in our national way of life.

Our country today is unique in that our government, more than any other in the world, actively encourages citizens and corporations to concern themselves with the social problems of the nation and to accept personal responsibility for constructive change. This encouragement comes in good part by way of the charitable deduction allowance, and the laws supporting the establishment and operation of foundations.

In the face of great current pessimism, I believe that America will solve its pressing problems of race, poverty, education, urban congestion, and the like. A primary reason for such belief is that there exists a broader and deeper concern about these problems among the individual men and women of this nation, old and young, than can be found in any other country today.

If, as individuals, we should shrug our shoulders, decide there is nothing we can do, that it is all someone else's fault, that "they" ought to do something about it; if we cop out as responsible individuals by blaming government for not acting, and damn government when it acts and requires more taxes to pay for the acts, then we will surely go down the drain.

On the other hand, if each one of us decides he ought to do what he can in his own situation, in his own community, and is willing to change his old attitudes, to give time and money wherever he can see it will make a small difference for the better, then we Americans will very likely provide to the world a demonstration of national achievement which will be without parallel in history.

The government by its example, now has the opportunity to encourage such an active acceptance of responsibility for the welfare of all others by each citizen.

They have made invaluable contributions to American society, and they are capable of still more. They, however, are not the pivot of American society, nor are they omnipotent or without blemish. There is a lack of adequate knowledge and understanding about their place in American society.

Let me briefly sketch the dimensions of that place. Each year, some $16 billion in private wealth is given for philanthropic purposes. The greatest philanthropist still is the man in the street, the individual givers who account for nearly 80 percent of the total (even exclusive of bequests). The private foundations provide only about 8 percent of total philanthropy. Last year foundations gave $1.5 billion, or about 7½ percent of their total assets of some $20 billion.

There are about 22,000 foundations. Most of them are little more than incorporated channels for giving by individuals and in assets and influence they account for quite a small proportion of the field; more than 12,000 foundations, for example, make grants totaling less than $10,000 a year.

The potency and signficance of private foundations resides in the few hundred with sufficient skills and resources to support efforts toward the solution of problems important to American society. They also account for most of the funds in the field. More than two-thirds of all foundation assets are held by some 200 of the general purpose foundations. By and large these are the leaders and standard setters in the field.

"Tax free" and "tax exempt" are modifiers that have so commonly come to be used in front of the term foundation that there is a tendency to overlook their essential philanthropic nature. The Treasury Department, which ought to have as keen a sense of the relation between institutions and taxation as anyone, a few years ago portrayed the role of private philanthropy and the part played by foundations in these terms:

Private philanthropy plays a special and vital role in our society. Beyond providing for areas into which government cannot or should not advance (such as religion), private philanthropic organizations can be uniquely qualified to initiate thought and action, experiment with new and untried ventures, dissent from prevailing attitudes, and act quickly and flexibly.

Private foundations have an important part of this work. Available even to those of relatively restricted means, they enable individuals or small groups to establish new charitable endeavors and to express their own bents, concerns, and experience. In doing so, they enrich the pluralism of our social order. Equally important, because their funds are frequently free of commitment to specific operating programs, they can shift the focus of their interest and their financial support from one charitable area to another. They can, hence, constitute a powerful instrument for evolution, growth, and improvement in the shape and direction of charity.

While the proposals under discussion today are addressed to private foundations, their impact would be felt throughout the entire fabric of the voluntary sector of American life.

One of the philanthropic statesmen of this century, Abraham Flexner, said the level of a given civilization can perhaps be measured "by the extent of private initiative, private responsibility, private organization in all the fields open to human culture." Certainly the accomplishments of our society cannot be measured accurately, or as positively, without taking into account those achievements reached in whole or in part through foundation support.

Robert Calkins, former President of Brookings, summarized foundation achievements as follows:

"Foundations have pioneered and assisted pioneers, scientists, scholars, and innovators; they have helped to create and strengthen colleges, universities, research laboratories, research institutions, scientific and scholarly organizations, welfare and religious institutions; they have often anticipated social and international problems and mobilized knowledge for dealing with them. In doing these things, they have freed large parts of the world from the curse of diseases, such as malaria and yellow fever; have advanced the art of medical care and the treatment of illness; have provided knowledge for the control of population and the expansion of food supplies; have aided the development of emerging nations; have encouraged educational opportunities for military groups, and the establishment of area and language studies to afford a better understanding of other cultures. They have demonstrated the value of liberal support for basic research and encouraged large public support; have contributed importantly to our growing knowledge of physical and living nature, and of social organization; have made possible the development of new scientific instruments for studying the atom, the cell, the star, and the nature of life itself; have contributed toward a better understanding of social behavior and informed social policy; have helped to clarify the goal of humanistic scholarship, aided the arts, and broadened the cultural interests and enjoyments of millions of people. They have also supported the development of thousands of scientists, scholars, creative writers, artists, and professional personnel, as well as leaders for business, government, and education. They have encouraged informed approaches to domestic problems, promoted international understanding, and assisted in the search for peace. They have contributed to the international community of scholarship and learning, and built bridges of communication and mutual respect."

But the particular issues at hand cannot be resolved by a recital of the glories of foundations. I do not favor, nor do I think the American public favors, a granting of perpetual approval to institutions simply on the basis of past laurels. No matter how unsettling it may be to men and organizations convinced that they are doing the right thing in the public interest, it is healthy that the public periodically examines its institutions to judge whether they are still serving their avowed purposes, to determine whether anything has gone sour even with our most cherished practices.

For many institutions this is such a moment. There is not only a taxpayers revolt in the air but also, I believe, fundamental skepticism about many aspects of our public and private life. Men and women are not only asking where we are going but also who is in charge. They are concerned, it seems to me, about whether all the agencies in American life that are dedicated to public purpose—governmental and non-governmental—are really working in the public interest. They are calling for some sort of accounting and insisting on greater accountability.

The proposals related to private foundations seem to me to raise fundamental questions about the role of the private sector in affairs of public concern: Is it to be diminished or encouraged? Do the American people still believe in private philanthropy still important to the attainment of our needs and desires as a people? Or have our community needs and national problems grown so in scale and complexity that private efforts are basically too puny? Would the funds devoted to them best be diverted to government use?

There are several reasons these concerns have coalesced around private foundations. The purposes and ways of foundations are only vaguely understood. Also, while foundations are the post peculiarly American manifestation of the philanthropic impulse, they do not operate as simply as traditional charity; taking the long view, and working with professional skill, they have grown more sophisticated and specialized in their approach to problems and therefore they are less easy to understand. Further, they represent relatively large concentrations of wealth, and bigness in any form stirs suspicion in the American consciousness. Foundation have also concerned themselves with some of the problems that are deeply troubling our society, and almost anything one does in these fields is apt to stir passions. Finally, certain abuses in the field have become apparent, and questions have been raised about the judgment of foundations in certain activities.

These hearings constitute an examination of the obligations of foundations under their contract with American society. Parenthetically, it should be noted that this is the first opportunity foundations have had to testify on a number of the major provisions of this Bill. At bottom, foundations operate under a public trust agreement. Through exemption statutes, American society encourages the application of private wealth to public purpose. Society must be assured both that the privilege is not abused and that the responsibility to deliver a social dividend is met.

In the matter of private foundations, the record seems abundantly clear that the responsibility has been discharged. In terms of advances in education, community life, health, and artistic and cultural resources, the foundations have returned to society many times over what society has granted in the form of exemption from taxation. There is no doubt a point of diminishing return in this sort of *quid pro quo*. That point would certainly be at hand, for example, if foundation assets were growing at, say, double or triple the growth of the Federal budget or the Gross National Product. In fact, although the growth in the absolute numbers of foundations has been striking, the growth in foundation assets is not exceptional as compared to other sectors. The Treasury's studies confirm this.

It is equally important that the income produced by foundation assets flow continuously to charitable, educational and scientific purposes. For the most part this is so, and passage of certain features of H.R. 13270, coupled with more systematic enforcement of existing regulations, would provide the public a guarantee of a continuing flow.

Concerning the proposed tax on foundation income, I will be quite brief, not only because succeeding witnesses will treat it in detail but also because it strikes me as the most clear-cut of the several difficult decisions before you with respect to private foundations.

I regard a tax on private foundations as patently inconsistent with the reason society sanctions foundations at all. Whatever foundations earn from their principal is—by tradition, charter, and law—intended for distribution for philanthropic purposes, for the public well-being. To reduce these publicly-dedicated funds by any percentage is to diminish the value to society by just that amount. The judgment Congress and the public must make is whether, all things considered, foundations are likely to continue making valued contributions to American life. If the answer is yes, then why reduce the contribution? If the answer is no, then more fundamental measures than a limited tax are in order. The inference I am forced to draw is that the proposal to tax foundation income is actually punishment for presumed wrong-doing by foundations—a reaction that is both unjustified and unwise.

In contrast to the proposed tax, the bill's measures to curb and prevent fiscal abuses are necessary to the public interest and vital to the preservation of private philanthropy.

The public official who abuses his position casts shame not only on himself but on all that public service stands for. Misbehavior in private organizations

and institutions clothed with a public interest is quite as sordid. Society loathes the charity racket, and abuses in institutional philanthropy must also be rooted out. The Treasury has noted, "the preponderant number of private foundations perform their functions without tax abuse," but it has been clear for several years that some abuses exist, and even the few are too many. They include the use of foundations exclusively as tax shelters, the unreasonable accumulation of foundation income instead of regular distribution for philanthropic purposes, the use of foundations for self-dealing and other forms of personal or business advantage, and the concealment of foundation activities. Some of these abuses could be curbed by better enforcement of existing regulations. Others require additional legislation, and several of the proposals before you are effectively drafted to that purpose.

Speaking for myself and for the foundations with which I am associated, I say that both the new measures to curb such abuses and stricter surveillance and enforcement of existing regulations are long overdue. Many other leading foundations share this feeling, and have been on record to that effect. Better enforcement and passage of the abuse related provisions in the bill will probably have the effect of sorting out from the existing thousands of foundations those that are dedicated to philanthropic purposes and those that serve themselves rather than society. They will discourage future establishment of foundations whose donors enjoy tax advantages without a return in kind to society. At the same time, they will not hobble existing or prospective new foundations that conform to the high ideals of the philanthropic tradition.

But other parts of H.R. 13270 appear to be aimed not at fiscal abuses but at foundation activities. The nation's foundations each year make hundreds of thousands of grants. Not even the most passionate admirers of foundations suppose that some of these actions were not mistakes—for any number of reasons, ranging from the technical to the judgmental. What is remarkable to me is that so few errors occur, given the wide range of fields in which foundations are active—from the arts to community health, from manpower training to population problems. Nonetheless, neither the noble purpose nor good works of the vast majority of foundations exempt them from criticism and censure for errors when they occur. My own experience is that foundation trustees and officers are attentive to such criticism. They do not hide behind claims to virtue or infallibility.

Society deserves reasonable protection against the misfeasance of institutions it has given warrant to operate in the public interest. It is the responsibility of Congress to see to the fulfillment of that warranty. But some of the new proposals, ostensibly designed as airtight guarantees of sound judgment by foundations, are so drawn that they give no added protection over existing law, and indeed only do injury to the public interest.

One set of proposals, for example, would fence off private foundations from activity in areas of public policy. Existing regulations declare lobbying and partisan political activity out of bounds, and, while it is not always easy to draw the line between what is legitimate and what is not in these matters, there are remarkably few instances of foundations skating even close to the edge of the limits now established.

The barriers that the new proposals would erect could well impair, not improve, the judgment and effectiveness of private foundations. One on which I can speak with some intimate experience is the effect on foundation boards of trustees. The penalties proposed for violation of several of the proposed limitations—limitations that are necessarily imprecise—fall not only on a foundation as an institution but also heavily on individual foundation managers, including trustees. This could drive trustees and foundation officials into such an excess of caution that even innocent and benign activities that touch on public policy in such fields as education and conservation would be deprived of foundation support.

The proposals may stem in part from a presumed new aggressiveness of foundations to assist work in controversial fields and to venture into matters subject to pending or future legislation. Throughout most of their history, foundations have at one point or another supported work considered controversial by some segment of the population.

Foundations can inaugurate a teacher pension system, develop new curricula and teaching techniques, increase educational salaries and be applauded for all of these, but then should they support a controversial educational program such

as decentralization, the reaction is likely to be, "What are they doing sticking their noses into educational policy?" The irony of this situation needs to be recognized, for if we are to legislate away all possibilities for bad or controversial judgments, at the same time we will be legislating away all but the most bland kinds of foundation effort.

If foundations were the sole source of aid to the production of information, ideas, activity and opinion on matters of public concern, there would be legitimate reason to consider an exhaustive set of rules governing such activity. But that is not the case. The work supported by foundations on public issues is just one input into a vast marketplace, along with the voices—some tax-exempt, some not—of individuals, business enterprises, unions, churches, political parties, trade associations and other organizations, to say nothing of the press. To bar foundations from supporting such work would be to limit the diversity of activity that has strengthened our society.

I do not think the government is well advised to begin making other than the broadest categorical decisions as to what is "good" and what is "bad." Experiment and trial needs to be encouraged, and one "success" most usually outweighs a dozen failures.

These issues will be discussed in detail by later witnesses. Suffice it to say now that the legislative net which has been cast out to catch those judgments alleged to be bad, controversial or imperious will drag in with it far more good than bad fish.

Apart from these and other specific consequences, some of us feel that the proposed legislation in general is, quite plainly, a signal that future foundations are not welcome. These proposals should be scrutinized, therefore, in the light of whether society would gain or lose from the establishment of new foundations, some of which might in time make extraordinary contributions to American life, just as some foundations formed in the last few decades have superbly carried forward the tradition of the pioneering foundations of the late nineteenth and early twentieth centuries.

One may even ask, do some of these proposals signal the intent of Congress to discourage private philanthropy in general, particularly in matters that are also governmental concerns? On the face of it, such a supposition sounds alarmist, but it is not far-fetched if one regards the private foundation as an outstanding example of the American genius for organization applied to the age-old philantropic impulse. Those who regard foundations as a symbol of private initiative fear that the erosion of their flexible capability might mark the first step in a trend toward general containment and withering of private initiative as a whole. And that would be an exorbitant price to pay for the abuses that have blemished the good name of the private foundation and for the offense even some of the most respected foundations may have given at one time or another.

If those parts of the foundation-related proposals are so detrimental to the benefits society would enjoy from the continuation of foundation philanthropy, then how is the public to be assured that the power that foundations represent is not one day applied to mischievous ends, to political purpose, and in general against the public interest? To repeat, past performance is reassuring, but not enough. Nor are good intentions. The public clearly demands that major institutions affecting the public well-being be accountable to society, and foundations are no exception.

But governmental regulation is not the sole path to accountability, and a thick web of governmental guidelines and restrictions can impair the very flexibility and freedom of action that enable foundations and other voluntary and private philanthropic agencies to respond to changed conditions and needs.

The basic ingredients of a balanced system of accountability, it seems to me, are already at hand. For the government's part, laws to prevent abuses are already on the books. That they have not been sufficiently enforced is a defect that some of us are proposing be remedied by a foundation registration fee earmarked for full and continuing implementation; it would also apply to the necessary new abuse-related provisions. Outside the government, channels of accountability exist, despite the myth that foundations are untouchable. Let me cite a few of the major ones:

The majority of the leading foundations that account for the preponderant resources in the field recognize large public responsibilities, and may go well beyond the legislative requirements of reporting and public disclosure of their activities.

Furthermore, they have broad-based boards of trustees—men and women of unquestioned dedication to public service and enviable records of judgment and accomplishment. The presence on the boards of foundations of such trustees constitutes a power assurance that foundations will act responsibly and will be accountable in the broadest sense to American society.

Foundations are also open to review by the press.

Their performance also undergoes continuing "market evaluation" by academic and community institutions that cooperate with them. These beneficiaries are more objective than one might assume. Since foundation funds are rarely the major support for their ongoing needs, they are colleagues of the foundations rather than patrons and wards. Their collaboration is testimony to the worth of foundation programs for, in accepting their funds, they commit to them their own reputations and some of their own resources.

Finally, Congress does have and has exercised, since 1915, the right to inquiry into activities of foundations.

Altogether, the full exercise of the governmental and marketplace channels will insure that private foundations are accountable to the public for their behavior and performance to an extent fully equal to any other part of the private sector.

Despite my preoccupation with the dangers in some of the proposals before you, I want to state my firm conviction that the scrutiny under which the Congress and the Treasury have placed foundations has been salutary.

This has been a sobering and significant chapter in the history of private foundations. It is a vivid illustration of the principle that even institutions of great value to society must constantly review their responsibilities and examine their distant borders to insure that corrosive incursions are not under way.

I close by urging that you adopt those parts of the Bill that are directed toward crippling and preventing abuses, such as self-dealing or inadequate returns to charity, which undermine the public's trust in private foundations, and that you eliminate those measures, such as the tax and the program limitations, which would vitiate the capacity of the foundations to continue their productive service to the American people. This is a plea not for private privilege or for the preservation of any single institution, but rather for the reaffirmation of the responsibility which each individual American citizen ought to feel and bear for the continuing welfare of his country, the responsibility to give and to act voluntarily, and not only in response to the compulsion of laws.

Summary of Statement by Dr. Herman B. Wells

I. THE CONTRIBUTION OF FOUNDATIONS

Foundations early and continuously helped higher education with funds for scholarships (as more students without the ability to pay aspired to advanced education), with funds for facilities and equipment (*e.g.*, the expensive precision instruments of science), with grants for research (In this creative period, each new idea and each discovery opened possibilities to scholars who then sought sponsorship of their investigations.), and with support of a great variety of projects, designed to advance scholarship and society's interests. Often foundations came to the rescue when no other support was available, before government undertook support. In many instances (for example, scholarships), colleges and universities would have had to seek government appropriations—thus adding to the burden on the taxpayer—had not foundations supplied the support. The results of the programs, projects and research made possible by foundations have had beneficial repercussions far beyond the campus and region and will extend long past the present time.

II. DETRIMENTAL EFFECT OF THE PROPOSED TAX

Taxation of the foundations that can have no other effect than to reduce the funds available to higher education is a critical matter because *each* dollar—the last often more than the first—is important in launching a project, matching a grant, funding scholarships, etc. Furthermore, the size of the reduction is no measure of the potential removed by such an action. At a time of crisis in financing higher education, even the direction of such a move is disheartening. The amount that the tax would yield the Federal Government is relatively minuscule but its detrimental effect on higher education would be major. In

addition, once the principle of taxing the foundations is established, there is a strong likelihood that the percentage of reduction will be increased in succeeding years.

A question arises why foundations, which already serve society, should be taxed so that government can serve society. Inevitably, the mechanics of the transfer will involve a cost which need not have been imposed between the funds and their use in the service of society.

Punishment of the abuses of a few foundations should not be visited on the many. Legislation like the Prohibition Amendment which raises a barrier against a problem instead of treating the problem merely induces new forms of abuse. From my observation it seems to me that most foundations have an excellent record and that their staffs have been conscientious in their commitment to the public interest.

The prohibition against a private foundation engaging in any activities intended to influence governmental legislation has crucial implications for higher education. Much of the scholarship undertaken in such fields as business, education and the social sciences is prompted by a desire to reduce imperfections. That is, both the fact-finding *and* action resulting are contemplated. Otherwise the research would be an exercise in futility. The most disturbing aspect of the prohibition is the control it threatens over the unpopular idea, the investigation of controversial issues and the concept which is ahead of the times. It is equally important to society that cancer be cured and that poverty be eliminated. However, because the first is non-controversial, they would not be treated alike as research subjects seeking funding.

Foundations are an expression of free enterprise. In their support of higher education they encourage free enterprise in ideas. They provide opportunity to the unusual man and idea. They give vital aid to the small private institution which lacks qualifications or visibility to attract government support. They have stimulated private giving to colleges and universities through such means as challenge grants. They represent an important expression of the volunteer sector. It is patent that our present store of knowledge and many of the gains which have improved our quality of life would have been unrealizable without the encouragement and support of foundations.

Institutions with which I am connected receive support from many foundations, large and small, state, regional and national. (A range of examples from different types of institutions, showing the variety of ways in which foundations have assisted higher education to perform its service to society more effectively, follows in the Statement.)

America's system of higher education is envied by many institutions abroad because of its multiple sources of support which ensure independence of thought and action and freedom from undue influence from any source. The American foundation is one of the instrumentalities by which our independence and freedom are maintained.

Statement of Dr. Herman B. Wells

I appreciate the opportunity to appear before this committee. I appear here in the hope that the recounting of my experience with foundations will be useful to the members of the committee as they consider the provisions of H.R. 13270 relating to private foundations.

I speak for no one but myself. Nevertheless, I believe that my views are held generally by presidents of American colleges and universities and members of collegiate faculties.

As former President and now Chancellor of Indiana University, as a current member of the Boards of Earlham College, Howard University, and Indiana Institute of Technology, of the Malpas Scholarship Board of DePauw University and of the Board of Visitors of Tulane University, I wish to express my profound concern about the proposed tax on the investment income of foundations, because I believe that a substantial adverse impact on higher education would result from it.

As you are undoubtedly aware, in the last few decades higher education has had to respond to the need for educating as many qualified youth as possible, for sharing the talents of its academic personnel, and for facilitating investigation and experimentation. Yet, in making this response, colleges and universities have inevitably become involved in its consequences. Scholarships and fellow-

ships, new facilities and equipment, larger academic staffs, and special provisions for research, all had to be secured. Inflation and campus growth have magnified the problem.

We educators are grateful to Congress for the role it has played in providing colleges and universities with the means to respond. But, in candor, I must attribute much of the early and continuing support to the indispensable role of the private foundations. These foundations have performed a remarkable service of aid with scholarships and fellowships, grants to scholars, implementation of innovative programs, faculty salary supplements, facility and equipment subsidies, underwriting of conferences, incentive grants for private giving, encouragement of comprehensive evaluations and investigations—the list is much too long to detail. Parenthetically, I would point out that this role has in some measure relieved taxpayers of the need to support activities that would otherwise have required tax funds to conduct.

I have included in an appendix to this statement several representative illustrations of projects with which I am especially familiar that could not have been realized without the support of private foundations. The results have had an effect far beyond the campus and the state involved and will have an influence long past the present time.

When new knowledge, improved methods and extended opportunities for our youth are at stake, there are no ascertainable limits to need. Therefore, I find the threat of a reduction by taxation of the funding available to higher education very disturbing. I would be concerned even if assured that the taxable percentage would never be increased—an unlikely contingency. For the deflection of any income, relatively small though it may be, from its anticipated use at higher education's frontiers in this time of discovery and widening possibilities would be an ill-afforded move. Moreover, the germinal small grant has time and again proved so effective that it would be misleading to suppose that a small reduction of funds is of negligible concern to educators. The approximately $65 million which would be realized by the proposed tax in the first year are not critical to the Federal government nor to foundations. They are critical to foundation recipients.

Indeed, the proposition that an organization wholly devoted to opening new paths and encouraging experimentation for the ultimate benefit of society has an obligation to support the government in *its* services bears a nagging resemblance to robbing Peter to pay Paul. Ironically, a portion of the funds that might have been available for grants would of necessity be swallowed up by the mechanics involved in taxation.

There is a real crisis in the financing of higher education, as you are undoubtedly aware. It will not be lessened by diminishing the ability of foundations to contribute to educational income. A tax on the foundations will inevitably have this effect and, in fact, will increase the pressure on government to provide additional financing.

The motivation for such legislation seems to be, at least in part, a desire to eliminate abuse of privileges heretofore granted foundations. If a few students cheat on examinations, you would neither expect nor desire us to levy a fine on all students. Rather than dealing with the problem, an action of this sort quite clearly punishes the innocent without providing a distinguishable deterrent for the guilty. Legislation like the Prohibition Amendment which raises a barrier against a problem instead of treating the problem merely induces new forms of abuse. From my observation it seems to me that most foundations have an excellent record and that their staffs have been conscientious in their commitment to the public interest.

An abuse that has been often mentioned is the use of foundations as shelters from taxation. It has been my experience that most rich philanthropists are very ethical in making their gifts, careful always to seek no improper tax advantage. A single dramatic example will make the point.

Indiana University has a magnificent rare book collection which serves not only the immediate University community but scholars from coast to coast and throughout the world. Its core is the personal collection of the late J. K. Lilly and its development has been supported by generous annual grants from the Lilly Endowment.

When Mr. J. K. Lilly made the original gift of his collection, he instructed the appraiser to make a very conservative valuation to avoid even a suspicion of inflated value for tax advantage. The material in Appendix A proves conclusively

that the books were transferred at less than half of what they would have netted at auction. It is interesting also to note that in his collection there was a copy of the first printing of the Declaration of Independence which was given to us with a value listed at $15,000. The only copy that has come on the market since then brought $405,000.

Although some reform may in face be necessary, it can do more harm than good if it inadvertently results in deterring or hobbling the American institution of the foundations, which has contributed immeasurably to the enhancement of life in America.

There is another aspect of the proposed legislation which concerns my colleagues and me greatly. It is the absolute prohibition against a private foundation engaging in any activities intended to influence any governmental legislation. I believe it likely that the prohibition was introduced as the result of two or three projects which raised questions of improper influence and that it is aimed at preventing a repetition of such grants. But the wording has sweeping implications. Any study, any document, any project bearing upon a public issue which has a foundation subsidy could conceivably be called into question and very likely would be if its subject were controversial or its conclusions unpopular. A foundation-supported conference at Indiana University, or elsewhere, on a question of public policy could be deterred from gaining the benefits of a knowledgeable public official's views, lest his participation be interpreted as an attempt of the conference organizers to influence him in a legislative decision. The Educational Commission of the States, which receives a portion of its support from foundations and which has governors and state legislators among its membership, would surely hesitate henceforth to pursue one of its main objectives, the preparation of studies on education for use by state legislatures. The Carnegie Commission on Higher Education with its staff of experts and exceptional opportunity to assemble and report data never before available would most assuredly not be engaged in this mammoth undertaking without an intent of influencing decisions of governmental bodies.

The crux of the problem is the interpretation of "influence." As long as data made available to public officials through the activities supported by foundations are generally acceptable, no question is apt to arise. But let the facts be contraindicative of a viewpoint supported by any group or let them weigh against one side in a controversial issue, what is to prevent that group or side from invoking the provision against "influence"? It is equally important to society that cancer be cured and that poverty be eliminated. However, because the first in non-controversial and the second controversial, they would not be treated alike as research subjects seeking funding.

I sincerely believe that this prohibition will not only penalize all foundations for a very few projects to which objection has been taken but will in fact discriminate against foundation recipients, particularly in education, in their freedom to act and report on matters of public interest. Worse, it subjects them to the not insubstantial danger that a project in the course of its execution may become liable to penalty through some turn of events or opinion.

I hope that foundations will always be free to back new, non-conforming ideas, even though an idea may seem at the moment heretical. History teaches us that today's heresay may be tomorrow's truth. The earth proved to be round and the moon accessible from earth. Man-made barriers to discovery have deterred but never downed forever the progress of a well-reasoned idea. In the end, as the wise saying goes, truth will out—and we have learned little if, in this late twentieth century we still insist on depriving ourselves of the benefits which a later and more acceptant generation will reap from the ideas evolved in our time.

I have heard that there is some concern outside of the academic community with regard to the influence which foundations might have exerted on institutions. This is rather puzzling in view of the small portion of funding that they have supplied to the whole of any institutional budget. The multi-source funding of colleges and universities has, in practice, afforded them freedom of action, thought and experimentation.

It has been of vital importance to scholars to have a source of funding for pioneer ventures and for research that may be controversial. Let me cite a case or two in point that should give pause. When Dr. Robert H. Godard began his research into rocketry three decades or more ago, it was the Daniel and Florence Guggenheim Foundation which was his sole backer. We have all been made aware recently of the dramatic importance of that initial research.

The freedom which foundations have to move in advance of popular opinion, to encourage a wide range of initiative, and to respond rapidly and flexibly to ideas (or, remain "relevant," in the students' term) is precisely the virtue of private philanthropy and *that* freedom must be protected.

It has been no small function of foundation support to encourage the unusual man. In the humanities, a significant example is readily found in the Guggenheim grants, directed by an Indiana University graduate. Many of our leading Indiana University scholars have had an opportunity to accelerate their development as a result of Guggenheim grants. The recognition and promotion of unusual men and ideas have been one of America's greatest assets.

Although I don't agree with the late Herbert Hoover that bureaucracy is devoid of any progressive thought, I believe as he did in free enterprise in our economy, in the organizations of our society and in the commerce of our ideas. As he said, "Ours is a voluntary society. The fabric of American life is woven around our tens of thousands of voluntary associations. That is, around our churches, our professional societies, our women's organizations, our businesses, our labor and farmers' associations—and not least, our charitable institutions. That is the very nature of American life. The inspirations of progress spring from these voluntary agencies, not from bureaucracy. If these voluntary activities were to be absorbed by government bureaus, this civilization would be over. Something neither free nor noble would take its place."

American higher education—indeed, America—owes a great debt to private foundations and to the philanthropists who created them.

As an officer or trustee of educational institutions which have been the recipients of foundation aid, I cannot overemphasize the value it has been to them to receive the enabling grants, whether large enough to elevate the quality of the institutions or merely the little, extra amount that meant the difference between launching a project and abandoning it when almost in reach. Moreover, there is no question but what foundations have played a major role in stimulating private giving to colleges and universities. The challenge grant, which is a creative concept originated and used by foundations, has not only given the many institutions that have received such grants a new lease on life but has added a significant dividend in the form of instilling an understanding of higher education's needs among an appreciable portion of the private sector. In my experience, individuals and family foundations find pride and satisfaction in being identified with furthering educational and cultural progress. It is in the national interest as much as in every institution's interest that the incentives to voluntary support of higher education not be lessened, directly or indirectly. For many small, private colleges and universities, any dampening of the growth of philanthropic support would be critical. Because of their size they have difficulty in gaining the visibility or in meeting the qualifications necessary to attract government grants. The role of the private foundations in their support has therefore been especially vital, as is illustrated in the report of Earlham College, attached to this Statement as Appendix E.

In the last five years, my own institution has received annually an average in excess of $2.5 million in foundation grants. A variety of foundations, small and large—local, regional and national—and numbering nearly one hundred in any single year, have made these grants. This support has had a determining role in attracting other private donations, in accelerating the training of research scholars, in encouraging students to seek advanced training who otherwise would have been unable to, and in enabling the University to be adequately equipped to accept many Federal grants for projects furthering national interests and for training students in professional fields thought to be insufficiently manned for national requirements.

To illustrate the range, generating influence and educational significance of this funding, I shall cite a few examples from my own institution. Lilly Endowment, Inc, an Indianapolis foundation, donated $281,000 for a program to improve the teaching of American history in Indiana high schools through refresher courses for teachers. The Lilly Endowment also made a grant of $98,500 to our relatively new Program in the Study of Religion, making it possible among other things for us to appoint a scholar in the field of Old Testament and to hold a summer institute on the teaching of the Bible as literature in the public secondary schools. The same Endowment furnished $78,000 for fellowship support of persons whose interest lies in adult education in religious institutions. Further, the Lilly Endowment has provided substantial funds for the University to develop a program—and construct a building to house it—in the archaeology and anthropology of Hoosier and midwestern pre-history.

The Kress Foundation with a grant of $50,000 initially spurred the development of a graduate program in the history of art, which then attracted a $300,000 contribution from the Carnegie Foundation to provide fellowships, instructors, resource books and supplies. The Carnegie Foundation also funded in the amount of $230,000 a project for improving foreign language study in Indiana high schools. Bright junior-class students are selected to spend a summer in France or Germany, after which they become pacesetters in their language classes during their senior year. Funds are raised locally to finance students who cannot afford to pay or are furnished by such sources as the Indianapolis Foundation and the Cummins Foundation. This is a clear example of a beneficial program that would probably not have been possible without foundation aid.

A Rockefeller Foundation grant enabled us to begin our current program in genetics. This support made possible the assembling of a distinguished team o research scholars and teachers which has produced research of world-wide importance and has attracted so many students that the University has become a major center for the training of Ph. D's in the field, many of whom have won distinction and one of whom has recently won a Nobel Prize. The assembling and its initial support were fundamental in helping us to attract and utilize money from many sources, including the Atomic Energy Commission, the National Institutes of Health, and the National Science Foundation.

The Rockefeller Foundation has continued to support for many years the work of this genetics group. Dr. Hermann Muller, one of its members and a Nobel Laureate, did epoch-making investigations in a number of directions, not the least being the establishment of a finer scientific basis for our current understanding of the hazards of radio-active fallout and other forms of radioactivity. Dr. Tracy Sonneborn has opened up an entirely new field in genetics in showing the importance of the non-chromosomal material, that is, elements other than genes, in the determination of heredity. The work of the Indiana team has far-flung significance, not only for plant and animal improvement, including corn and other grains, but also for the betterment of human health.

At the other end of the spectrum, the Rockefeller Foundation has helped subsidize a strong Latin American music program in the I.U. School of Music.

The pioneering research of Dr. Leslie Freeman in the degeneration and regeneration of the central nervous system, with findings vital to the treatment of paraplegia resulting from war or other injury, received the steady support of the John A Hartford Foundation to the accumulated extent of $700,000. The Regenstrief Foundation of Indianapolis has contributed $272, 176 to research in health care.

In another area, the Kellogg Foundation has contributed $344,840 to provide for the distribution of programs from the film library at Indiana University to educational television stations.

The University programs funded by the Ford Foundation have been many and diverse. I shall cite only a few examples. Through a $742,000 grant, the School of Education developed a teacher education program combining theory, methods, simulation, practice in the use of closed circuit television and sequentially-ordered laboratory experiences with children, all culminating in a semester of paid "interteaching" and a master's degree. A project for encouragement of Non-Western studies in Indiana colleges, explained briefly in Appendix B, was instituted with the help of a $200,000 grant. The I. U. School of Business was enabled by a grant of $150,000 to assist Texas Southern University in developing the curriculum and strengthening the faculty of its School of Business to the extent that it became the first in a predominantly-Negro university to be accredited by the American Association of Collegiate Schools of Business.

Also funded by Ford, the Indiana Language Program for improving the teaching of languages in high schools (described in Appendix B) has been a remarkably successful project, justifying the $1 million in grants which have made it possible. A timely research program, designed to develop and test a practical system of low-cost tutoring as a supplement to classroom instruction, produced results through the aid of a $368,020 grant which have received immediate application in the Indianapolis school system.

The grants which have been most far-reaching in their effectiveness, increasing greatly our strength, capabilities and quality in international areas, were those made by the Ford Foundation in 1961 and 1965 in support of research in the problems of international and human resources development, and of the University's graduate programs in international business and in the following

foreign areas: Russia and East Europe, Western Europe, the Far East, the Near East, Africa and Latin America (See Appendix C). Totaling in all some $5.3 million, the largest portion of these grants has been devoted to the support of doctoral candidates, whose training will inevitably benefit numbers of others. Faculty research is a second, important purpose served by the grants. Also, salaries of certain new faculty members have been paid from the grants in whole or in part for periods of one to three years. A small percentage has been spent on library acquisitions. Mainly by these means Indiana University has been enabled to capitalize on potential developed initially on its own but requiring the major impetus of private funding for its realization and resultant distinction.

I have had an opportunity to observe another beneficial and multiplier effect of foundation grants in my position as Chairman of the Indiana Advisory Commission on Academic Facilities. This Commission, as the members of Congress will know, administers and makes recommendations for the projects eligible for Federal assistance in funding under the Higher Education Facilities Act of 1963 as amended. A condition precedent to any type of Federal assistance is a current capability of the institution to defray a minimum of 25 per cent of the cost. This 25 per cent has had to be raised from a variety of sources: alumni, friends, local corporations, and foundations. The local financing of a large majority of these projects depended in part on foundation funds, and in one instance, the Fort Wayne Art Institute and School of Fine Arts, all of the matching money was received directly from a foundation grant. In the case of Anderson College, grants from private foundations totaling $1.48 million were added to a federal facilities grant of $1,076,251 and funds from other sources to provide a sorely-needed general classroom and administration building costing in excess of $3 million.

Sixteen private and five state-supported institutions in Indiana have participated in and benefited from the program. To date it has resulted in construction of 65 new or, in a few instances, rehabilitated structures worth $125 million with a Federal subsidy of a little over $40 million. It is estimated that these facilities will help to accommodate over 45,000 additional students. It is a demonstrable fact that the program would have been substantially less successful, had it not been for the assistance of foundations. I feel sure that in each of the committee members' states, the story is much like Indiana's.

I wish to emphasize that the support from private foundations to Indiana colleges and universities is pervasive and widespread. In addition to the examples I have cited, the Lilly Endowment aids fourteen Indiana private colleges with substantial annual unrestricted grants. Mr. Herman Krannert of Indianapolis and the Inland Container Corporation Foundation have given major grants for needed buildings to both private and public institutions and for vital cardiac research. In fact, the examples I could cite are legion.

I have used these illustrations from the experience of Indiana University, but other institutions with which I am familiar have similar records of aid, supplied by private foundations, which has enlarged their capabilities, enhanced their quality and elevated their horizons. At Tulane University, for instance, where I serve on the Board of Visitors, early grants from the General Education Board were basic to the development of the institutions, I have been told. In the last five years, during which I have had an opportunity to observe the benefits of contributions made by foundations to Tulane, it has received $16 million from them, including grants for medical research, faculty salaries, educational programs at both the undergraduate and graduate level, addition of faculty to the School of Medicine, support of younger faculty members, development of the natural and physical sciences, and—most importantly—as a stimulation to fund-raising which produced more than three times the amount of the challenge grant. (See Appendix D.)

Similar challenge grants from the Ford Foundation have aided four private institutions in Indiana and the Indianapolis Symphony Orchestra, closely associated with a fifth private institution, to raise urgently-needed funds. Earlham College received a $1.6 million grant and raised $5,500,081. (See Appendix E for a summary of foundation support to this important Indiana Quaker college.) To a grant of $2 million, Wabash College was able to add $5,037,302. The University of Notre Dame raised $24,880,573 in response to a challenge grant of $12 million. And Depauw University supporters have just completed a drive, meeting the challenge of a $2 million grant with a total of $7,124,665 raised.

In the last three years DePauw has received grants totaling $1.6 million from 28 foundations, to be used in matching a $2.396 million government facilities

grant in the program to which I have already referred for the construction of a science center. Since laboratory facilities and library acquisitions are often difficult for small private universities to fund, this new center is crucial for the development of DePauw's science programs.

DePauw received foundation aid, too, in starting two now-thriving programs; a summer graduate program in American Studies for high school teachers, initially funded by the Coe Foundation, and an African Studies program, begun through a Ford Foundation grant.

The Ford Foundation also helped with the program undertaken by DePauw to improve the humanities background of its faculty members. Through the $50,000 grant from Ford the program can now be advanced to a stage at which DePauw will be better able to handle it alone.

In these diverse ways, three different types of educational institutions—a small and a large private university and a state university—have been enabled by foundation grants to improve their ability to serve scholarship and society.

All over the world, America's system of higher education is esteemed as the best ever developed in any land. Despite all of its insufficiencies, it is the envy of the world. Our system has several well-nigh unique features that have shaped its character and constributed to its world position. They are its emphasis on applied research and public service, first stimulated by the Morrill Act establishing the landgrant colleges, the dual system of public and private support and control, and the large number of institutions, making possible advanced educational opportunity for a significant portion of our American society.

Important as these are, I believe that the most important reason for this universal respect resides in what colleges and universities have been enabled to do as a result of the support of private foundations; the imaginative, creative, boundary-stretching, even revolutionary undertakings which have not only produced enormous immediate and potential benefits but have enlarged the possibilities for higher education in the future.

The face of America has been forever improved by the unique creation of philanthropic foundations that have assisted educational institutions to serve society in ways never aspired to in any other nation. Such a record deserves encouragement.

Surely a way can be found to remedy those imperfections which may have led to the proposed legislation without lessening the capability of private foundations to assist higher education in adding to that record in the future and without discouraging the patronage to be gained from the establishment of new foundations.

I earnestly hope, and urge the committee's concern, that this Bill in its final form will be free of provisions with reference to private foundations which would have a stultifying effect upon the scientific, intellectual, social and economic progress of our country.

Americans have ever been a dynamic and daring people. Dynamism has been our outstanding characteristic, the wellspring of the America we know that has been a pace-setter for the world. Foundation grants have helped keep us dynamic and moving forward. It is not pioneering, experimentation and hostility to new ideas that we have to fear but an excess of caution which could invert the face of America and ultimately relegate her to the indistinction of a static society.

APPENDIX A

APPRAISAL OF THE J. K. LILLY COLLECTION

How modest the appraisal of the J. K. Lilly collection for tax purposes was is documented by actual records of recent auction sales. Duplicates from his collection were sold by I.U. at auction at the Parke-Bernet galleries in New York City on November 8, 1962. Here is the record of five items:

	Cost	Appraisal	Selling price
No. 18 Chaucer	$17,500	$20,000	$47,500
No. 28 Copernicus	2,000	3,500	11,000
No. 34 Dalton	250	350	1,850
No. 44 Eliot Bible	4,500	7,500	10,500
No. 102 Newton	750	1,000	5,500

These items, which cost Lilly $25,000 were appraised at $32,350 and were actually sold for $76,350.

The recent Thomas Street sale of rare Americana contained fourteen items of which the Lilly collection has comparable copies. An analysis of these, comparing J. K. Lilly's costs, appraised for tax purposes, and prices the Streeter copies brought, was made by the Lilly librarian for the *American Book Collector* and published in its October, 1968 issue.

The fourteen items cost Lilly $24,275—the tax appraisal was $35,125. The comparable copies sold at auction in 1968 for $174,500.

The most drastic advance in prices was of the first printing of the Declaration of Independence of which only sixteen copies are recorded. Lilly's copy cost him $12,500 and was appraised for tax purposes at $15,000. A copy sold at auction in May for $404,000.

Twenty items from the Lilly collection, therefore, which cost him, during his thirty years of active collecting, $61,775, were appraised for tax purposes at $71,475 and comparable copies actually sold at public auction for $654,850.

It might further be mentioned that since its dedication in 1960 the Lilly Library has attracted as gifts, each year, material of more than double the value of the budget allocated to it from library funds. Appraisals of such material are made by competent outside appraisers and none has ever been questioned by tax authorities.

If the original gift were to be reappraised in the light of today's market, it would be worth well over $10,000,000. Additional purchases made possible by grants from the Lilly Endowment and other gifts attracted by the collection have brought the total value of the Lilly Library's present holdings to approximately $25–$30 million.

Appendix B

Statewide Impact in Indiana of Certain Foundation Assistance to Indiana University

Foundation help to institutions of higher education is crucial and unique in many ways. Our experience at Indiana University has demonstrated this in two important respects that are sometimes overlooked in assessing the value of foundation philanthropy to American education and society. For us, foundation assistance has provided, among other things, flexibility and a "multiplier effect" that are not possible with general funds from the state budget nor usually with federal grants. Indiana University has been able to develop and implement some original and exciting ideas that have influenced most of secondary and higher education throughout the state of Indiana. Two examples will illustrate this point.

First is *The Non-Western Studies Project, 1959–67:* As a result of the interest of several Indiana University faculty members and of the administrations and faculty of several Indiana private colleges, a program was developed to encourage more study of the non-Western world in undergraduate education throughout the state. An earlier survey had shown that the overwhelming majority of graduates of Indiana universities and colleges finished their education with no understanding of, or even acquaintance with, the history, cultures, and problems of the bulk of the world's population living in Asia, Africa, and Latin America. In view of the interconnected world of the last quarter of the twentieth century in which these young men and women would live in their careers, as citizens, as individuals, this seemed a grievous omission in their educational experience.

Over eight years, with very modest assistance from the Ford Foundation (under $200,000), the Non-Western Studies Project was able to enlist the cooperation and participation of three-fourths of Indiana's colleges and universities in order significantly to broaden both the curriculum and extra-curricular activities available to most undergraduates. Using the extensive resources of Indiana University in international studies and drawing on the enthusiasm and dedication of administrators and faculty in many colleges, the Project provided over 50 faculty fellowships for training in non-Western studies here and abroad, and for redesigning courses to include non-Western materials; it also sponsored or helped arrange over a dozen faculty and student workshops, institutes, and seminars; and it assisted institutions in acquiring library and visual materials on the non-Western world.

It is difficult, of course, to measure the full impact of such a cooperative effort, but it is clear that today many Indiana undergraduates have a wider and more

internationally-oriented education, one which should prepare them better for tomorrow's world.

The second example is *The Indiana Language Program, 1962–70*. In the general post-Sputnik atmosphere there was national concern about American deficiencies in the study of foreign languages. Nowhere was this felt more keenly than in Indiana, where despite the University's international renown in linguistics and in language and area studies, the elementary and secondary schools of the state were providing very limited and often totally inadequate instruction in foreign languages. Determined to close this gap and in hopes of providing a model of what could be done in one state, Indiana University developed a comprehensive program to improve the teaching of foreign languages throughout the state. Drawing on the University's extensive resources in this field and on its earlier initiative in appointing a full-time School Coordinator for Foreign Languages, the Indiana Language Program, with the assistance of just over one million dollars from the Ford Foundation, has sponsored intensive institutes for teachers, the retraining of Cuban refugees as Spanish teachers, a scholarship incentive program for young people interested in careers in foreign languages (including such difficult but crucial languages as Arabic, Chinese, and Japanese), study abroad opportunities for Indiana foreign language teachers, publications useful to students and teachers, and encouragement and guidance on language programs in the schools, including those in elementary schools.

Again, it is difficult to judge the long-run impact of such a program. It has, however, drawn nation-wide attention, study, and emulation, and there is no question that this cooperative effort has radically changed the situation in the state. Whereas in 1962 there were 73 secondary schools which offered no instruction in modern foreign languages, today there are only one or two. Enrollments of secondary school students have grown between 1960 and today some seven-fold in French, nine-fold in German, four-fold in Spanish, and fifteen-fold in Russian. Students entering the University are now so well-prepared that the introductory language courses at Indiana University have had to be drastically up-graded, and hundreds of new and able teachers well-versed in the latest techniques of language instruction have been trained. Moreover, the Indiana Language Program has been able to place a number of its activities on a nearly self-supporting basis which will permit the University and cooperating schools to continue them past the expiration of the Ford grant in 1970.

In summarizing these two examples I would like to stress two points. First, the foundation assistance involved, while very small compared to the effects obtained and to the share contributed by Indiana University and the participating colleges and schools in the state, was crucial both in permitting the University to use its resources with maximum impact and in extending the benefits of these programs throughout the state of Indiana, thereby influencing the education of countless Indiana citizens, most of whom had no direct contact with the University. Second, the modest sums required, which were not available from other sources, allowed the initiation of activities which are to be carried on and developed, thus continuing the process of improving education at all levels in the state.

It is apparent, I think, that in these cases the help of the Ford Foundation, building on local concern and initiative and supplementing existing institutional resources and personnel, was not only in the interests of education in Indiana but in the national interest as well.

LATIN-AMERICAN STUDIES

The $600,00 invested over a 5-year period (1966–71) in Latin American Studies at Indiana University under the Ford Foundation International II Grant provides dramatic evidence of how foundation support can double and triple university potential in a particular area at a crucial moment of development.

The university initially provided certain basic investments. Special allocations built a major collection of books and manuscripts dealing with Latin America in the Lilly Rare Books Library. Recruitment of several promiing faculty member also sparked interest within particular departments. It was foundation funds, however, which created the catalyst to launch the program in five major areas.

(1) Nearly one-third of the Ford grant matched by extensive funds from the university and library budget went into an impressive building program in library acquisitions.

(2) Ford funds supplemented department allocations for new faculty positions and research grants. In general, Ford funds paid the first two years' salary after which the department assumed the financial commitment. The number of faculty teaching subjects related to Latin America rose from 8, representing five departments, in 1963, to 40, representing fifteen departments, by 1969.

(3) More ample fellowships made possible from Ford funds in addition to the vastly expanded academic program enabled departments to attract topflight students with Latin American interests from all over the country into M.A. and Ph. D. programs. The number of students in such graduate studies rose from 25 in 1963 to 190 in 1969. In addition, for the first time, Indiana University was able to send promising Ph. D. candidates to the field in the summer of their second year of graduate work to map out dissertation topics. This extremely successful program resulted in considerable savings in time and money when actual dissertation research began and prepared students to compete advantageously at the national level for doctoral fellowships.

(4) Public lectures, art exhibits, and music performances largely backed by Ford funds stimulated new student and community interest in Latin America. Particularly significant was the impact of Indiana University's unique Latin America Music Center, first established in 1962.

(5) Finally Ford funds enabled Indiana University to explore and open new and exciting programs for student and faculty exchanges with a variety of Latin American institutions. Among the initiatives which bore fruit were the training of economics faculty at the Andrés Bello University at Caracas, Venezuela; the student exchange programs with San Marcos and the Catholic Universities in Lima, Peru, and the National University of Rio Grande do Sul in Porto Alegre, Brazil; the exchanges with the medical faculty of Guanabara University in Rio de Janeiro; the archeological explorations established with the University of Los Andes in Colombia; the radio and television assistance program to El Salvador; and an educational assistance program in Chile.

Indiana University now produces an average of ten Ph. D's and forty M.A.'s each year with specialization in disciplines related to Latin America, in contrast with less than one-tenth that figure six years ago. The University now holds a front rank in terms of library resources and faculty specialists, in contrast to its virtually unknown position in 1962. In sum, the investment of Ford Foundation funds has resulted in launching a major international studies program, has encouraged Indiana University to make long-range commitments, and has established a new role for the University in this vital world area of study and cooperation.

Foundation Support of Tulane University

Gifts and grants from foundations have shaped the destiny of Tulane University as much as any other single influence—the specific shape of the institution in terms of individual programs embarked upon and maintained over the years, as well as the general character of the institution. Foundation involvement with Tulane dates back to pre-World War II days when the General Education Board helped support a small and struggling institution in a variety of ways.

Between 1919 and 1939, the General Education Board made available the sum of approximately $4 million as endowment, which constituted a substantial portion of the endowment of the institution at that time. The income from the investment of these funds was devoted not only to the general support of the University but also to the support of the School of Medicine.

Other foundations which have played a significant role in Tulane's development over the years include the Ford Foundation, the Rockefeller Foundation, the Commonwealth Fund, the Sloan Fund, and many smaller but extremely important foundations. For example, the Schlieder Foundation, a locally oriented foundation, has made available to the University over the past 19 years approximately $1,700,000 for medical and other research. Likewise, the Stern Family Fund has supported Tulane generously over the years.

Certain specific grants assumed transcending importance at various stages of the development of Tulane University. For example, the General Education Board made available matching grants in 1946 and in 1951, totalling nearly $3 million, on condition that the University match those sums. This stimulated early fund-raising campaigns which otherwise may not have been embarked upon. All were successful.

The Ford Foundation endowment grants to the general support of the University and to the School of Medicine in 1957, totalling $6.2 million, made as a part of a distribution to most private institutions in the nation, gave a substantial impetus to the University at that time. The income from the investment of these funds was to be used to improve faculty salaries for ten years, at the end of which time the principal was free to be used for any institutional purpose. Tulane elected to use the principal of these funds in the further development of its educational programs.

Probably the most significant grant in the history of the institution was the Ford Challenge Grant offered in 1964. By terms of the grant, the Ford Foundation agreed to contribute $6 million if the University would raise $12 million from private sources. Stimulated by this offer, the University set a total fund-raising goal of $24.4 million and actually raised nearly $28 million. It can be said truthfully that the stimulation of the $6 million offered by the Ford Foundation produced an additional $22 million for current operating purposes, for physical facilities, and for endowment. This program supported the endeavors of the institution to increase faculty salaries from approximately a "D" average in the AAUP grading scales to a "B" average, assisted in the provision of an urgently needed Library and also a Science Building, and provided other stimuli to the forward movement of the institution.

Shortly after World War II, several Carnegie Corporation grants, followed by a General Education Board grant of $1 million, enabled the institution to greatly accelerate the development of its graduate program. The production of Ph. D.'s has increased from a few in 1946 to 119 this year. This has been of inestimable significance not only to this immediate region but the whole Nation as well.

A Ford grant of $500,000 enabled the University to develop a Latin American Studies Program, which has contributed greatly to the educational advancement of our neighbors to the South.

The Commonwealth Fund has provided grants to the School of Medicine which have been of tremendous significance in the development of that institution. A grant made in the 1950's of $750,000 on a matching basis permitted the institution to add $1.5 million to its spending level, primarily for faculty and faculty salaries. In recent years two large planning grants from the same Foundation have assisted the faculty of the School of Medicine in planning goals and objectives of the School and its future development.

Also of great assistance to the School of Medicine have been two grants from the Mellon Foundation, each in the amount of $250,000, devoted to the support of salaries of younger faculty members. The Sloan Foundation has made two grants in the amount of $250,000 for the support of science at the University. This has assisted the institution in matching larger grants from the National Science Foundation and has provided an important stimulation to the development of the natural and physical sciences.

Finally, the Rockefeller Foundation has made two grants to the institution, each in the amount of $250,000, for the support of underprivileged students. These grants have assisted Tulane in making available its educational opportunities to approximately 100 students a year, who otherwise would not have been able to afford to enroll in this institution.

In the past five years, foundation sources have provided gifts and grants of approximately $16 million.

Foundation Support at Earlham College

Over the last twenty years American higher education has undergone some of the most strenuous demands in the history of the country as we have had to wrestle with large increases in enrollment, costly improvements to keep abreast of developments in the sciences, the provision of educational opportunities for the economically less advantaged segments of our society, an endless spiral of inflation, and the increasingly evident need for drastic improvement in various aspects of teaching. Earlham College, like other institutions, has had to raise large sums of money every year—beyond its normal income from student tuition and endowment return—to continue day to day operations. We have also had to raise large sums for capital development plus special program development support outside the normal operating budget. With all of these needs we have been given invaluable assistance by a number of general purpose, company-sponsored and family foundations. Let me give some specific illustrations:

1. PLANT EXPANSION

In the building of approximately eight million dollars worth of new buildings during the past twenty years Earlham College received substantial funds from Lilly Endowment of Indianapolis, the National Automatic Tool Foundation of Richmond, Indiana, the Carnation Company Foundation of Los Angeles, the Kresge Foundation of Detroit, Michigan, the Baxter Foundation of Indianapolis, and the Ford Foundation of New York.

One of the most important aspects of these foundation gifts is that they provided the "challenge" funds which enabled us to launch general fund-raising drives among our alumni and the general public. Without the stimulus of the major foundation gifts there is real doubt if we would have been able to succeed in these important expansion and campus improvement projects.

2. IMPROVEMENT OF LIBRARY COLLECTIONS AND SERVICE

As at all other institutions, Earlham must continue to work to upgrade various of its normal programs. In this connection we have had important assistance for the improvement of our library through special grants from the Given Foundation of Pittsburgh, Pennsylvania, W. K. Kellogg Foundation of Battle Creek, Michigan, Lilly Endowment of Indianapolis and the Ford Foundaon of New York.

A good library is a central and tremendously important resource for any educational institution. There never seems to be enough money in the general budget to take care of the ever growing needs of libraries. Foundation support has for Earlham been of great significance in the building of the excellent library service we now have.

3. SCIENCE PROGRAM MAINTENANCE AND DEVELOPMENT

Work in the natural sciences is among the most costly aspects of the various programs of any general educational institution. The Defense Department and various other government agencies pour enormous amounts of money in the support of sciences at the large universities. The smaller undergraduate institutions—which produce a disproportionately large percentage of the undergraduates who go on in advanced study to become scientists—have considerable difficulty in attracting sufficient funds to acquire the physical facilities, equipment and staff needed to maintain a high level in research and teaching in the sciences. Though Earlham is now beginning to receive significant help from the National Science Foundation, during most of the period since the end of World War II we have been in very large measure dependent upon private foundation grants for the strengthening and enlargement of our science programs.

We are now well advanced in the planning stage of a $3,600,000 addition to our science facilities for which we have received a grant of $1,206,000 in federal funds approved by the Indiana Commission on Educational Facilities.

The new building will provide laboratory space for Chemistry and Biology. In order to make the most efficient use of building funds made available to us we are doing intensive research on mechanical facility location and access, partition location and re-location, furniture design and teaching methods.

This essential research, in which science faculty members, architects and engineers are participating, is sufficiently advanced to assure us that it will produce significant construction cost savings and a high degree of building flexibility, thus providing greater insurance against obsolescence as science knowledge multiples.

This important investment in educational improvement and obsolescence insurance was financed by grants from the Esso Education Foundation of New York and the Alcoa Foundation of Pittsburgh, together with valuable technical assistance from the Educational Facilities Laboratory, a subsidiary of the Ford Foundation.

We expect the research to be of such significance that one or more of the findings will be incorporated in the construction of science laboratories for colleges and secondary schools throughout the country, a fact which may produce meaningful savings for both the public and private sectors of education.

And because the general purpose foundations particularly are attracted by projects which have a multiplier effect, we are optimistic about major foundation support for our science building program.

Specific additional assistance with financing science projects has come to Earlham from the Kettering Foundation of Dayton, Ohio, Lubrizol Foundation of Cleveland, Research Corporation (a foundation) of New York, the Shell Companies Foundation, the Smith, Kline and French Foundation of Philadelphia.

4. SPECIAL PROJECTS IN THE NATIONAL INTEREST

From time to time the federal government establishes very clear educational objectives to serve the vital interests of the country. In some cases the serving of these special national interests are assisted by federal grants and contracts. Rarely, however, is such government funding complete. Moreover, most of these tax monies will have traditionally been allocated to large universities. Most of the smaller undergraduate institutions like Earlham have to secure much of their funding for such projects from private sources. Foundations have played an essential role for Earlham in the funding of two types of programs for which the United States government has given urgent encouragement.

a. Education of the disadvantaged

In order to carry its share of the load in dealing with the education needs of lower income families Earlham has had invaluable assistance from the Rockefeller Foundation of New York and the Cummins Engine Company Foundation and the foundations associated with it of Columbus, Indiana.

b. International education, particularly dealing with so-called non-western world

Earlham has been able to develop a very extensive program of international education—including study abroad programs in a number of countries and a special program in Asian studies, including the teaching of Japanese language—through grants received from the Ford Foundation of New York, Lilly Endowment of Indianapolis, and the Watumull Foundation of Honolulu.

c. Urban and rural development programs

Assistance with special programs in the fields of sociology, political science, and economics have been given by the Schwarzhaupt Foundation and the Seasongood Good Government Foundation of Cincinnati.

5. GENERAL EDUCATIONAL IMPROVEMENT

Innovation and experimentation in education—like research and development in industry—are essential if colleges and universities are to avoid stagnation and death. Earlham College has during the last twenty years been able to strengthen its educational contribution enormously through vigorous new developments in new methods of teaching in English, chemistry, psychology, physics, biology, mathematics and several other fields. Substantial assistance, without which most of the projects could not have been attempted, has been provided to Earlham by such foundations as Carnegie Foundation of New York, the Danforth Foundation, the Esso Education Foundation, Lilly Endowment.

6. NORMAL CURRENT OPERATING EXPENSES

Without very substantial private contributions our independent colleges and universities would disappear from the American education scene, and a very much greater burden would thereby fall upon the state and federal governments to provide substitute educational services through the public institutions. Here the role of private foundations has been of enormous importance to Earlham College and continues to be year after year. Among the foundations which have been conspicuously significant for Earlham in meeting these on-going needs are such foundations as the following: Conway Scholarship Foundation, the Doan Foundation, Lilly Endowment, the Charles E. Merrill Trust, Standard Oil Company Foundation of Indiana, The McGregor Fund, and literally scores of other less well known foundations attached to a variety of business concerns and families.

During our fiscal year ending June 30, 1969, foundations provided 27.3% of our gift income applicable to the current operating budget.

In the preceding ten years foundations provided $850,000, which we utilized for budget balancing purposes, 26.2% of our unrestricted gift income for the period.

The contributions of foundations, particularly general purpose foundations, to our overall gift income, that is both designated and undesignated, add up to an even more impressive figure.

During the ten years ending June 30, 1968, Earlham received foundation grants of $3,710,667, equivalent of 31.2% of total gift income for the period.

Thus it is apparent that any measure which will inhibit the giving of foundations or will divert any significant portion of foundation income will have a direct impact on the financial health of private educational institutions.

I want to emphasize that the leadership role of foundations in providing diverse types of support for Earlham College has been absolutely indispensable in our survival and in our continued growth and improvement. Most important has been the "challenge" and catalytic effect which foundation gifts have provided in stimulating other gifts from other types of private donors. We would earnestly hope that every encouragement would be given to the expansion of the legitimate role of foundations in helping to finance American higher education.

II. EFFECT OF THE LEGISLATION (PROPOSED TAX) ON BENEFICIARIES

Summary of Statement of Father Hesburgh, Mr. Erwin, and Drs. Cooper and Robb

Representatives of a broad variety of institutions which derive support from foundations—including private colleges and universities, state and municipal universities, medical schools, and educational institutions in the South—are seriously concerned about two legislative proposals affecting private foundations. One, incorporated in the House bill, would impose a 7½ percent tax on foundation investment income. The other—not included in the House bill, but recommended by some critics of foundations—would terminate the existence or tax exemption of all foundations after a period of years.

The first of these measures would diminish the current funds with which foundations carry on their work—and with which they support the work of other charitable and educational institutions—by at least $65,000,000 a year. The second would, over time, have even more drastic effects upon foundation functions. Because the accomplishments of private foundations have been of immense value to American society and, specifically, to the institutions which receive their financial support, representatives of those institutions strongly oppose both the proposals.

Review of the accomplishments of the foundations in several areas demonstrates the undesirable consequences which the proposals would have.

FOUNDATIONS AND PRIVATE UNIVERSITIES

Through a system of matching grants, the Ford Foundation's Special Program in Education has stimulated many colleges and universities to develop resources considerably in excess of the original grants. The Rockefeller Foundation, the Sloan Foundation, the Carnegie Foundation and many others have also made major contributions to our private educational system.

Without such assistance, there is serious question whether the independent sector of our dual, private/governmental system of higher education can survive. Yet a tax on foundation income would bring a major reduction of that assistance.

Congress should, then, legislate against any specific abuses in which certain foundations have become involved—but should take care *not* to diminish the funds with which foundations make their vital contribution to the private educational system.

FOUNDATIONS AND MEDICAL EDUCATION

In the field of medical education, too, the resources of private foundations have been of critical importance. They provide a continuing flow of support, which, in absolute terms, contributes substantially to the training of our doctors, research technicians, nurses and other medical personnel. Even more important, foundation funds have been of vital assistance in special areas of medical education for which it has proved difficult or impossible to obtain support from other sources.

Foundation support is, for example, of particular importance—
- in sustaining and improving medical school facilities;
- in establishing new medical schools;
- in assisting schools which experience financial difficulties;
- and in developing new techniques of medical education, new curricula, and new methods of relating medical facilities to the provision of health care for our citizens.

FOUNDATIONS AND PUBLIC EDUCATIONAL INSTITUTIONS

Foundations have also afforded key support to state and municipal colleges and universities. In the Southwest, for example, they have enabled such institutions—
- to experiment with problems as diverse as beef production and mineral recovery;
- to study inventive skills and consumer needs;
- to assist linguists and teachers to overcome language handicaps;
- to develop new techniques of modern communication for engineers and journalists.

THE SOUTH: FOUNDATIONS AND EDUCATION

The South, with an enormous burden of children to educate and fewer dollars to do the job than any other region, is especially vulnerable to any change in public policy that would limit the flow of private funds for education and make equalization of educational opportunity more difficult. Philanthropic foundations provide a critical margin—either for excellence or for survival—in many Southern educational institutions.

The South's growing economy is beginning to produce indigenous wealth and a new surge of local philanthropic interest in education. Taxation or undue regulation of legitimate foundations will discourage this development at a crucial time.

Educational improvement, innovation, pioneering projects, and needed research funded by national and local foundations are helping the South catch up with the rest of the nation. Important new public kindergarten programs and continuing education are two products of foundation support.

Efforts to transform talented but underprivileged youth from public liabilities to productive, educated citizens provide further dramatic evidence of the dividends accruable from strategic foundation investment in human development.

STATEMENT OF FATHER HESBURGH, MR. ERWIN AND DRS. COOPER AND ROBB

Mr. Chairman and members of the committee: I am Theodore M. Hesburgh, president, since 1952, of the University of Notre Dame. With me today I have Dr. John Cooper, who is the president of the Association of American Medical Colleges; Mr. Frank Erwin, who is Chairman of the Board of Regents of the State Universities of Texas; and Dr. Felix Robb, who is the Director of the Southern Association of Colleges and Schools.

The four of us appear before you this morning as representatives of institutions which are, in a sense, bystanders in the present controversy over legislation affecting private foundations. Although I am also a trustee of the Rockefeller Foundation, neither I nor my colleagues are appearing here to represent a "private foundation," or a group of foundations. No matter what definition you finally settle upon for that key term, all of the institutions which we represent will fall beyond it. We will, therefore, be beyond the direct effect of whatever rules you prescribe for foundations.

If we are bystanders, though, we are intensely interested ones. We are, also, a good deal more familiar with the subject of the controversy than bystanders ordinarily are. For both our interests and our knowledge, we are indebted to the very close relationship which foundations have to the programs of the institutions which we represent. Our institutions receive vital support from foundations; they work continually with foundations; and, in doing so, they have developed a broad experience with foundations' functions and characteristics. Moreover, as individuals, we have served as members or trustees of a considerable variety of private and governmental organizations—ranging from the National Science Board and the Carnegie Commission on the Future of Higher Education to

Governor Rockefeller's Select Committee studying private education in the state of New York—which are active in the fields in which foundations work.

Based upon our knowledge of private foundations—and the very considerable benefits which our institutions steadily derive from them—we are seriously concerned about certain aspects of the legislation proposed for foundations.

The four of us have observed the work of foundations from rather different points of view. In discussing the consequences of the proposed foundations legislation, I will draw upon my experience with private educational institutions. Representing the Association of American Medical Colleges, Dr. Cooper will explain the role of foundations in medical education. Mr. Erwin will speak to you of the relationship of private foundations to colleges and universities which derive their principal support from states or local governments. Finally, on behalf of the Southern Association of Colleges and Schoools—an organization with 9,000 member and affiliated colleges, universities, secondary and elementary schools serving eleven Southern States from Virginia to Texas—Dr. Robb will speak to you of the place of foundations in education in the South.

From these varied points of view outside the foundation world, we would like to tell you what we know of that world; how it affects the institutions which we represent; and why we are disturbed about certain parts of the legislation proposed for foundations. As we proceed, we will document our observations with concrete examples and with general statistical data. We will not, however, enter upon an examination of the technical details or ramifications of the House bill, or other specific legislative proposals. Other witnesses are more qualified for those tasks than we are.

At the outset, we would like to make it clear that the four of us wholeheartedly support legislation aimed at the financial abuses in which a minority of private foundations are reported to have become involved. We pretend to no expertise on foundation abuses, because the foundations with which we are familiar have not engaged in them. On the other hand, we recognize that the 1965 Treasury Department Report on Private Foundations and witnesses who appeared before the Ways and Means Committee this spring have made out a strong case for legislative proscription of foundation-donor self-dealing, unwarranted accumulations of income, and certain other practices. To the extent that such practices exist, we share the concern of the Ways and Means Committee about them, and we urge you to deal decisively and effectively with them.

Beyond such steps, however, we are deeply disturbed about one aspect of the House bill and one additional proposal which, while not incorporated in the House bill, has been advocated by critics of foundations in recent years. In brief, the proposals which concern us are these:

> The House bill would impose a 7½ percent tax upon foundation investment income. The Ways and Means Committee Report estimated that this tax will produce $65,000,000 of revenue in its first year of operation. According to the House estimates, the revenue effect of the tax would rise rapidly to an annual $100,000,000. Furthermore, as the next group of witnesses will explain in greater detail, the precedent which the tax would establish for state and local governments seems likely to have an additional substantial monetary impact on foundations.
>
> Several critics of foundations have recommended terminating the existence or exemption of foundations after a period of years. One proposal would fix a 25-year limit on foundations' tax exemption and qualification to receive deductible charitable contributions. Another would restrict the life of each private foundation to 25 years. Others would require foundations to distribute their assets at a sufficiently high rate to end their existence within a period of 10, 15, or 20 years.

We are deeply concerned both about the proposed tax on foundation investment income and about the adoption of any mechanism whose effect would be to terminate the existence or exemption of all foundations over a period of time. Our combined experience with foundations convinces us that their work has been of immense value to the classes of institutions which we represent and to American society. We are, therefore, strongly persuaded that any measure which diminishes the current funds with which foundations carry on their work and with which they support the work of other charitable and educational institutions—by an annual $65,000.000, $100,000,000, or any like amount—will have major undesirable consequences. For the same reasons, we are convinced that an endeavor—direct or indirect—to curtail the existence or tax benefits of foundations would be thoroughly unfortunate.

To explain the grounds upon which we base these views, we should like to review briefly the work which foundations have done in the four areas with which we are familiar.

A. FOUNDATIONS AND PRIVATE UNIVERSITIES

During more than seventeen years as president of Notre Dame, I have found one of my great preoccupations to be the financing of the University's educational, research and service programs. The progress that my University has recorded during this period can be attributed in no small measure to the support of private philanthropic foundations. Indeed, one major philanthropic organization, the Ford Foundation, looms as the largest single benefactor in Notre Dame's 127-year history.

I shall not presume to speak for my fellow college and university presidents, although I can think of none whom I know personally who would favor the foundation tax which we are discussing. I would like to say a word about how one foundation, the Ford Foundation, is helping Notre Dame accomplish in ten years what normally would have required thirty years. With equal force I could document what has been accomplished on our campus with support from the Rockefeller Foundation, the Sloan Foundation, the Carnegie Corporation and others.

Specifically, I shall speak about the Ford Foundation's Special Program in Education—perhaps the most magnificent philanthropic program in the history of American higher education—in which a significant number of colleges and universities have been helped to help themselves through challenging matching grants. In the case of Notre Dame, the whole vision of what the University might be has been startlingly, almost unbelievably, altered by two $6 million matching Ford Foundation grants. With the incentive of these matching grants, between 1960 and 1966, we were able to double or triple the money normally contributed to the University. There is no question in my mind that this gigantic stride forward was made possible by the matching provision. So, aside from what the grants themselves helped underwrite--for example, the 13-story Notre Dame Memorial Library—they have helped generate many additional millions of dollars in support from alumni, from friends, from corporations and even from other foundations.

The best thing about foundation support is, of course, that it is project-oriented for the most part and encourages a university to do new things, to undertake research and launch new educational programs that would be out of the question if one had to rely on operating income or even the gift support of alumni and friends. For example, the Carnegie Corporation made a capital grant to Notre Dame which underwrote the first, national study of Catholic elementary and secondary education in the United States. Support from the Kellogg Foundation has made possible a program of continuing education that has touched the lives of tens of thousands involved in more than 300 campus conferences each year.

The aid which the major foundations have provided in the years since World War II has proved to be a life-line to the independent half of our nation's unique dual, private/governmental system of higher education. There is serious question whether the independent sector can persevere and continue to provide an educational alternative. With inflation and the spiraling cost of living threatening to impair the philanthropic support of individuals, and with corporations, generally speaking, contributing less than 1 percent of their profits to charitable organizations when they are entitled by law to contribute up to 5 percent, the proposed tax on foundations—or any general measure to end the existence or exemption of foundations—will have the plain and necessary effect of driving our independent colleges into the arms of the government at a time when many feel there is already too much government involvement on the campus. I cannot believe that this is a prospect welcomed by members of this Committee or the Congress.

To state the matter somewhat differently, a 7½ percent tax levied on the investment income of foundations would, in effect, be a tax on Stanford and Johns Hopkins, Vanderbilt and Emory, Notre Dame and Denver and, indeed, on all the colleges and universities, great and small, in every part of this land, which benefit from the regular and substantial support of these foundations. It would result in *less* foundation support for the nation's colleges and universities at precisely the time when they are experiencing a financial crisis and need *more*. The revenue generated by the tax would be of little consequence to the government, but its collection would have the direct effect of reducing the funds nor-

mally available to colleges and universities by a similar amount, and the indirect effect of a proportional reduction of the individual contributions which these funds stimulate. Furthermore, it would seem inevitable, once the precedent is set, that the tax would be increased as the states and municipalities and future administrations seek much needed revenues, thereby further reducing the funds available to colleges and universities. Again I say that I cannot believe those results to be acceptable to this Committee or the Congress.

My plea, then, is to legislate against specific abuses which may have been discovered in the administration of certain foundations—but not to diminish the funds with which foundations make their vital contribution to the private sector's educational system. This is the time for the Congress to take steps to encourage even further private philanthropy to higher education. The proposals of which I have spoken would have exactly the opposite effect.

B. FOUNDATIONS AND MEDICAL EDUCATION

In the field of medical education, too, the resources of private foundations have been of critical importance. Review of the relevant data reveals that foundations provide a continuing flow of funds which, in absolute terms, makes significant contributions to the training of our doctors, research technicians, nurses, and other medical personnel. Even more important, foundation funds have been of vital assistance in certain special areas of medical education for which it has proved difficult or impossible to secure support from other sources.

The Association of American Medical Colleges conducts an annual survey of all medical schools in the United States to determine the sources of their funds and the purposes to which the funds are applied. In addition, to assist this Committee in its current inquiry, the Association has conducted a special canvass of several of the larger medical schools to obtain more detailed information on the amounts and purposes of foundation grants in recent years.

The data stemming from these investigations demonstrate convincingly that, overall, the contribution of private foundations to medical education and medical research has been an impressive one. Foundations have repeatedly granted funds to medical schools for operating budgets and capital construction. Such grants for general purposes, however, present only a partial view of the importance of foundation support in the field of medical education. In several specific areas, foundation funds have been of special significance.

Faculty salaries

While the federal government annually appropriates large sums for medical research it has proved exceedingly difficult to obtain government support for the maintenance and upgrading of medical school faculties. Plainly, funds committed to these purposes have major bearing upon the quality of medical practice and the state of medical knowledge throughout the United States. Yet, as a dean of the Harvard Medical School noted in a recent letter to the Association of American Medical Colleges, "We are especially dependent on foundations for teaching funds since the government has neglected this area."

Specific illustrations abound. In recent years the Mellon funds have made substantial grants for faculty support and expansion at Tulane. Vanderbilt, Northwestern, Chicago, Boston University, Brown, Case Western Reserve, Columbia, Cornell, Dartmouth, Duke, Emory, George Washington, Harvard, Temple, Tufts, Washington University (St. Louis), Yale, Johns Hopkins, Jefferson Medical College, Marquette, Pennsylvania, Pittsburgh, the University of Rochester, the University of Southern California, and Stanford.

The comments of administrators at several of the recipient schools provide insight into the importance of the grants:

> "Both the basic sciences and the teaching programs have been immeasurably improved by the infusion of funds. New appointments have been made and the entire faculty stabilized." (Tulane.)
>
> "The grant has proved to be one of the most timely and beneficial ones we have ever been privileged to receive. It has made possible the strengthening of various departments where the need was pressing." (Vanderbilt.)
>
> "To say that Mellon funds were invaluable to Northwestern University Medical School would be an understatement. They came at a time when personnel particularly in the basic sciences was in very short supply." (Northwestern.)

"The funds have been used to stabilize the position of several very promising young scientists, attract new ones, and to start new and important areas of teaching and research at a time when federal funds have become overly restrictive." (Johns Hopkins.)

"The assistance which we have received each year from the Mellon funds has enabled us to strengthen the faculties of the three departments which do most of the teaching in the first year of medical school." (Jefferson Medical College.)

"There would be literally no other way which faculty expansion and strengthening could have been financed." (Boston.)

"These funds have made it possible to bring in people who we would have found very difficult to support in any other way." (Case Western Reserve.)

"The grant has made it possible for us to maintain academic strength in all of our basic science departments." (George Washington.)

The Mellon grants have not been the only ones supporting the improvement of medical school faculties. During the period from June of 1962 through June of 1969, the Surdna Foundation made grants of $3,300,000 to the Harvard Medical School for general faculty support. Of that total, $2,500,000 was allocated to a fund which supports fulltime faculty members in the basic medical science and clinical departments. Six hundred thousand dollars has been used to establish a new professorship in pediatrics. An additional $200,000 has been used to complete funding of a professorship of preventative medicine. The Josiah Macy, Jr., Foundation has made annually-increasing grants to Washington University (St. Louis), Columbia, and Harvard to expand training in obstetrics. It has, in addition, established a major professorship in obstetrics and gynecology.

The examples could be multiplied at considerable length. Their point, however, should be evident: institutions of medical education are heavily dependent upon private foundations for the resources which support the faculties which train the nation's doctors and medical research personnel.

Establishment of new medical schools

As has been the case with the maintenance and improvement of the faculties of existing medical schools, in recent years the federal government has provided little operating support for the establishment of new medical schools. Here again, the need has been evident, and foundations have acted to close the financial gap. Moreover, in this area particularly, their action has carried an impact extending well beyond its immediate dollar effect; for foundation grants have stimulated contributions from a broad variety of other sources—both public and private, and often many times larger than the original foundation grant. In that way, foundation commitments have frequently had a plain and pronounced multiplier effect.

The Kellogg Foundation has given $8.4 million over the past nine years to establish new medical schools at—

the University of Connecticut;
Rutgers Medical School;
Brown University;
the University of Hawaii;
the University of New Mexico;
Michigan State; and
the University of Nevada.

Of the grant to Connecticut, the president of the university has said: "The foundation authorized a three-year grant to the University of Connecticut in the amount of $1,037,500 'to support the establishment of a school of the basic medical sciences * * *' It is no exaggeration to say that the foundation's grant has had an exciting catalytic effect upon our progress to date. * * * This grant is a classic example of what 'venture capital' assistance from a foundation can accomplish."

The business manager of the Rutgers Medical School has commented: "Without the stimulus of the foundation, Rutgers Medical School would still probably be a dream of the future."

Assistance to medical schools in financial difficulty

The demands upon our medical schools have been particularly great in the past several years. Financial pressures have increased correspondingly. It is hardly surprising, therefore, that a number of schools—particularly in the private sector—have come very close to financial collapse. Repeatedly, foundations have made timely grants to avert such failures.

One foundation has provided almost $4,000,000 over the past five years to 10 schools which were experiencing severe fiscal difficulties. Included were such schools as Creighton University, in Omaha, Nebraska, the University of Utah, Meharry Medical College, in Nashville, Tennessee, and the University of Vermont. The dean of one of the recipient schools has said: "I should like to once again comment on the extraordinary value of the * * * award to our developing School of Medicine. The award permitted a continued growth of the school during an exceptionally critical period in which the program was expanding far more rapidly than the allocations to the School of Medicine from state appropriations. Indeed, I seriously question whether the school could have avoided a substantial collapse. * * *"

Development of new techniques

If foundation resources have afforded crucial support for medical school faculties, the establishment of new schools, and the assistance of schools in financial difficulty, they have performed services of at least equal value in a different class of endeavor. Nowhere have the innovative capacities of foundations been more evident than in the development of new systems and techniques of medical education, improved medical curricula, and new methods of relating medical facilities to the provision of health care for our citizens. Here again, reference to particular examples is useful:

The shape of modern medical education owes as much to Abraham Flexner's 1910 report on the subject as to any other single factor. Made possible by a Carnegie grant, the Flexner report advocated—and produced—fundamental revisions in a variety of facets of our system of developing and training doctors.

In the academic year 1955–1956 the Harvard Medical School utilized a $1,000,000 grant from the Commonwealth Fund to test pioneering changes in medical curriculum. Based upon the knowledge developed in these initial experiments, major changes in the school's curriculum were adopted two years later. The innovations at Harvard were the basis for far-reaching changes in curriculum at Western Reserve—changes which were supported by the Commonwealth fund, and which have had great effects on medical education across the country.

Grants to Northwestern University by the John and Mary R. Markel Foundation and the Commonwealth Fund enabled the school to evolve a program which substantially diminishes the time required for the education of doctors. Under this program, Northwestern now admits students from high schools who are able to obtain M.D. degrees in a total of six years. Grants from the Commonwealth Fund to Boston University and Johns Hopkins University permitted the initiation of similar programs at those institutions.

The Rockefeller Foundation and the Macy Foundation provided the Harvard Medical School with funds to undertake the nation's first undergraduate program designed to assist members of minority groups to enhance their qualifications for graduate study in medicine and dentistry.

The Carnegie Corporation of New York has provided three-year funding for teaching, research, and administrative programs on the economics of health care.

The Ford, Rockefeller, and Avalon Foundations have committed themselves to provide a total of $5,200,000 for the development of a unique laboratory studying human reproductive biology in conjunction with the existing Center for Population Studies at the Harvard School for Public Health. According to a recent Harvard report, "Together these two programs will represent one of the nation's primary concentrations of talent and competence."

The Commonwealth Fund and the Surdna Foundation have, together, provided funds for the creation and operation of a pilot university-sponsored community health plan. Drawing on the facilities and personnel of the university's medical school, the program will make comprehensive medical service and health care available to the residents of the surrounding community.

Conclusion

Year after year, foundation dollars afford vital support for the nation's medical schools. In a number of respects, they fulfill needs for which there *are* no other dollars. Further, by stimulating other support, foundation grants often generate

resources which—even measured solely in monetary terms—are of far greater magnitude than the original grant. Finally, in at least one area foundation support has produced results which can only be described as unique; for without the creative impetus supplied by foundations' experimental projects, their studies of system and technique, and their programs for change, many of the advances of modern medical education simply would not have occurred.

With increasing demands being placed on the medical schools for an increased production of health manpower and greater involvement in meeting the health service needs of the country in the face of ever less adequate support from local and federal sources, foundations are a critical part of our effort to meet the expectations of society for a healthier life.

C. FOUNDATIONS AND PUBLIC EDUCATIONAL INSTITUTIONS

Nobody honestly concerned with American education condones illegality or irregularity in private philanthropy. Hence every representative of public higher education endorses all legislation assuring fairness and equity among taxpayers, donors, foundations, their institutional beneficiaries, and the government.

On the other hand, it is a simple historical fact that both established state universities and developing public institutions could not fulfill their missions without foundation support. Gifts, bequests, special grants under the law have enabled such institutions to grow, to increase their effectiveness, and to serve the whole population. By such means, private philanthropy has provided a tremendous variety of activities which often cannot be supported by government appropriations.

Thus foundations have encouraged innovation and experiment.

They have initiated creative work and kept it alive.

They have made possible new departures in multi-disciplinary study and research.

They have brought public and private institutions into practical cooperation.

They have broadened and strengthened activity aimed at the common welfare.

Drawn from the Southwest alone, the following examples are typical of thousands of similar projects in the United States. Each is recent. Each has the vitality to assure later effectiveness.

Innovation and experiment

In Texas, private foundations have brought engineering and medical schools to join in studies of the individual and his environment; numerous academic departments and business organizations to experiment with problems as different as beef production and mineral recovery; inventive skills and consumer needs; biological, mathematical, and space research opening new perspective on geophysics, the world and the solar system.

Creative work

By gifts of art and libraries, by support of humanities centers and the individuals working in them, foundations have brought to life creative work, which has involved both whole communities and smaller groups concerned with painting, music, and the theater, as well as general studies.

Interdisciplinary study

Private foundation gifts and grants have helped the scientific linguist and the classroom teacher to overcome the disadvantage of students with language handicaps; the biologist and the oceanographer to establish new methods in marine medicine; the engineer and the journalist to take advantage of modern communication; the computer scientist and scholars in a dozen fields to speed the acquisition and dissemination of knowledge.

Public and private institutions

In one state alone, more than thirty joint programs between privately-endowed and tax-assisted institutions have ranged from the single classrooms to the whole region.

Common welfare

Where taxes were unavailable, private foundations have made possible the initial operation of two medical schools and continuing programs of a major teaching hospital. Without foundation grants, the Anderson Hospital and Tumor Institute, host to the next International Congress on Cancer, could not have begun its work or maintained its distinction.

Immediate benefits of such programs are manifest. Taxpayers have been saved money; they have also been given benefits which taxes could not provide. Still more important, however, is the fact that in every such phase of higher education, the university has been assisted in getting ready for the future. In that future, it is not the experience of an institution which is at stake. It is the people's interest.

By relatively small sums afforded through tax relief this future prospect can be assisted. By depriving foundations of those funds—as the proposed tax would do—that prospect would be diminished or denied. In all institutions which are "public" in the broadest and truest sense, the present system of tax relief is essential to a base of planning now more than half a century old. To shut off or cut down that relatively modest independent funding would close innumerable doors on future educational progress.

D. THE SOUTH: FOUNDATIONS AND EDUCATION

This country desperately needs a strategy for *expanding legitimate philanthropy* as a vital component of free enterprise—and of the private-public balance in American life—*not* a precedent for reducing philanthropy through taxation or excessive regulation. If it is the will of Congress to equalize educational opportunity, then Congress should encourage and facilitate the work of reputable philanthropic foundations. Such encouragement is particularly important in the South.

The South lacks resources with which to provide adequate educational opportunity for its people. The entire nation has suffered as a consequence. But the gap between the South and other regions would be much wider except for the investment by national and regional philanthropic foundations in the development of human resources.

Any reduction in foundation support would be adversely felt in the South, with its huge number of children to educate and the fewest public dollars with which to do the job. Mississippi, which in proportion to income makes a greater per capita educational effort than any other state, spent only *$364* per pupil in public schools in 1967–68 compared to New York State's *$1,024*. If the South is ever to catch up, it needs *more* private philanthropy—not *less*.

Economic limitations have prevented most Southern educational institutions from having enough funds for operation; they have fallen far short of having enough funds for innovation, experimentation, and improvement.

All educational institutions serve best when they are strong, venturesome, and self-renewing. Consistently, ever since the Civil War, when we Southerners have had an educational problem requiring an innovative approach, we have sought and often received foundation support to test our idea, to demonstrate a new approach, or to finance needed research and programs. A substantial flow of money from large national foundations, along with our own regional philanthropies, continues to be essential to education in the South.

What would be the difference if a reduction of available foundation dollars were brought about through taxation?

(1) It would tend to discourage *new* philanthropy just at the time when the South's improving economy is developing indigenous private wealth that is increasingly flowing back to the public through local philanthropy.

(2) It would have serious impact upon at least two or three hundred key Southern colleges and universities—public and private—that look to foundations as their "margin for excellence," plus a number of smaller, weaker colleges facing deficits for the first time this past year. To them foundation grants are crucial.

Vanderbilt University's rise to national stature results substantially from foundation grants that stimulated local effort. Emory's great medical center could not have functioned well without Woodruff Foundation money to cover its deficits. As recently as August 22, the Kresge Foundation gave $1,500,000 to Meharry Medical College in Nashville for a badly needed library. This college—which has educated approximately half the Negro physicians in the United States—has been literally saved by foundation grants in the past decade.

Strategic grants are helping our colleges predominantly serving black students to improve their curricula, to develop their staffs, and thereby to move into the mainstream. The Carnegie Corporation of New York has underwritten one of

these programs over a 5-year period and the Danforth Foundation committed $5,000,000 over seven years to sustain the Southern Fellowships Fund.

(3) Reducing foundation funds would curtail the only money we can get with long-term commitments sufficient to stay with projects and evaluate their results. For instance, over the past five years the cities of New Orleans, Atlanta, Nashville, Huntsvile, Alabama, and Durham, North Carolina have received approximately $3,000,000 each from the Ford Foundation as "seed money" for a world of educational improvements. In Nashville the first public kindergartens were started with new ways of teaching young children. In New Orleans, schools were designated to show what can be accomplished when resources and flexibility to teach individuals are combined. In Durham, research of enormous value about infant and very early child behavior and learning was conducted. In Atlanta, better ways to prepare teachers were discovered. At Huntsville, because of new programs started with foundation funds, that city's school system was recently chosen for participation in a major national educational program.

(4) The Kellogg Foundation has done much to enrich life in Georgia through the creation of a dynamic continuing education center at the University of Georgia. The value of this program is incalculable, and it would not have been initiated without foundation funds.

(5) Taxing foundation resources would reduce one of the chief means of attack on the problems of disadvantaged people in poverty-stricken rural areas. For instance, the Danforth Foundation has underwritten three pilot projects in rural counties of Florida, Georgia, and Tennessee for a 5-year interval in the amount of $1,350,000. These counties—Wheeler, Overton, and Wewahitchka—would never have seen their educational potentiality for something better without foundation funds to show how teaching and learning can be improved with very few dollars.

(6) Project Opportunity, operating in Alabama, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Tennessee, and Virginia, is already identifying, motivating, and propelling toward college and fulfillment of their highest potentiality 3,000 bright, academically talented high school youngsters whose record of poverty and deprivation was pressing them into unproductive lives as public liabilities. This dramatic reversal, achieved largely through a system of testing and counselling, is producing constructive citizens who will, in turn, pay taxes. Ford and Danforth Foundations have invested approximately $2,000,000 in this joint effort by eleven colleges, the College Entrance Examination Board, and the Southern Association of Colleges and Schools. Dividends to the nation can be many times the money spent in the discovery and motivation of these young people. It would be a human tragedy of serious dimension to deny 7½ percent, or any, of these youngsters their chance to succeed.

(7) Regional foundations such as Z. Smith Reynolds, Mary Reynolds Babcock, Woodruff, Rich, Callaway, Stern, and the strategic Southern Education Foundation make an important difference in life in the South. They are taking a keen interest in elementary and secondary schools, and the aggregate of their support is a vital factor in the "growing edge" in Southern education. The public kindergarten movement in the South was initially fueled by foundations, as were many experiments on individualized instruction.

(8) Especially in a time of escalating costs and inadequate tax revenues at the state and local levels, it would seem unwise to reduce educational resources of the kind used for stimulus of local effort, for matching purposes (required in many federal programs), and for the kinds of innovation and long-term search for solutions to problems for which public funds are insufficient.

(9) In a dozen Southern cities, fine arts and music flourish precisely because of foundation support for our symphony orchestras, art museums, and concert halls. Without the help of national and local foundations, our cities would lose major cultural advantages.

The philanthropy of foundations operating in the South has been accomplished with competence, wisdom, and freedom to operate professionally once grants are made. Because these agencies have traditionally worked quietly, without fanfare, the American public is not fully aware of their great contribution. Thus it is necessary for those of us who live close to Southern education and who dream of its future to speak up and state how strongly we feel about our vulnerability to any change in public policy that—like the proposed tax on foundations—would limit the flow of private funds for education.

III. EFFECT OF THE TAX AS SEEN BY FOUNDATIONS

SUMMARY OF STATEMENT OF MESSRS. J. GEORGE HARRAR, ALAN PIFER, AND DAVID FREEMAN

A. INTRODUCTION

This statement represents the views of The Rockefeller Foundation and Carnegie Corporation, two of the oldest, largest and best know foundations in the country, and of the Council on Foundations, the principal membership organization in the field, representing mainly medium-sized and smaller foundations.

B. OPPOSITION ON THE TAX

We are strongly opposed to the proposed 7½ percent tax on foundation income and believe, for the reasons spelled out in the body of our testimony, that the decision Congress will make on it is a decision about the very nature of the American system.

C. THE ROLE OF INOME-TAX EXEMPTION FOR CHARITABLE PURPOSES IN AMERICAN LIFE

Income tax exemption is part of a centuries old tradition under which charitable organizations have been granted special privileges by the state because they relieve it of responsibilities it would otherwise have to meet with public funds. In the United States all 501(c)(3) charitable organizations have been exempt from income tax since such a tax was first established on a constitutional basis in 1913.

No distinction has ever been made in this provision between different kinds of 501(c)(3) charitable organizations. All have been considered equal by the federal government. Consequently, there has never been any such thing as a qualified, or partial income tax exemption in the charitable field. The concept has been considered by its nature to be indivisible.

The imposition of an income tax on foundations, however limited the rate, would destroy this principle and constitute a breaching of long-standing and well-proven national practice.

Furthermore, the tax would serve as a clear precedent for future taxation of other classes of charitable organizations, and it would encourage other levels of government to impose their own income taxes, initially on foundations but subsequently on charitable organizations generally. The tax might very possibly, therefore, lead to a substantial weakening of the private non-profit sector and further accretion of the power of government. It is pluralism that is really at stake in the decision on the tax and we believe it should be debated on these terms.

Finally, the tax poses a serious danger to the freedom of private institutions. A threat to raise the level of such a tax, once it is established, can be used as a convenient means of forcing charitable organizations to terminate activities that are arbitrarily disapproved by someone in authority. This is an extension of the authority of government that could stifle dissent, inhibit experimentation and break the spirit of voluntarism.

D. THE JUSTIFICATION FOR PRIVATE FOUNDATIONS

The private foundation is a development and extension of the individual philanthropic impulse into a more effective and capable form, the advantages of which include continuity, professional staffing, and assured availability of critical masses of funds for problems upon which individual philanthropy can have little impact.

As government moves increasingly into the field of social welfare, the work of private foundations becomes more necessary rather than less. Foundations can move more rapidly and operate more flexibly than government, and foundation-sponsored demonstrations of the need for and feasibility of undertakings in the public interest are a logical precursor of the allocation of substantial government funds to such undertakings.

The historic accomplishments of private foundations are matched by the evident need in the future for precisely the kind of philanthropic activity that they can carry out more ably than any other type of institution.

E. HOW THE TAX WOULD AFFECT THE ROCKFELLER FOUNDATION

The Rockefeller Foundation has appropriated all its income and more than $230 million of its principal toward philanthropic projects many of which have been precursors of government activity in the field of social welfare. The proposed tax on investment income would cost the Foundation's beneficiaries more than $3 million per year. It would also seriously hamper the overseas programs of the Foundation—whose charter commits it to the well-being of mankind *throughout the world*—by making it difficult or impossible for the Foundation to satisfy foreign governments of its tax-exempt status.

F. HOW THE TAX WOULD AFFECT CARNEGIE CORPORATION

Carnegie Corporation was created by Andrew Carnegie in 1911, before the days of income tax, for the "advancement and diffusion of knowledge" among the people of the United States and of certain British colonies. In the 58 years of its history its affairs have been managed by a self-perpetuating board of able and disinterested trustees, with no other consideration than promotion of the greatest possible public benefit.

Over the years the Corporation has supported a wide range of educational activities with grants totaling $400 million. These grants have been made in every state of the Union and in one way or another have benefited every American citizen. If there had been a 7½ percent tax on the Corporation's income since it was founded, some $40 million of private support would by now have been denied to a host of worthy institutions and talented individuals. The nation at large would have been the ultimate loser.

In view of Carnegie Corporation's outstanding record of public service, the rectitude with which its affairs have been managed and the keen competition for its grants and limited size of its funds in relation to the enormous opportunities for public good, a tax on the foundation is unwarranted, unfair and entirely contrary to the best interests of the nation.

G. HOW THE TAX WOULD AFFECT SMALLER FOUNDATIONS

Foundations across the country concentrate their giving on local educational and charitable institutions. Community chests, colleges, medical schools and other local voluntary organizations will bear the burden of the tax. This result is contrary to the intent of Congress, expressed in other legislation, to encourage strong local organizations through matching grants based on a partnership between the public and private sectors.

Foundations in every state are struggling now to meet the ever-increasing needs for scholarship funds, leadership gifts for capital campaigns, and innovative grants in fields such as health services. The tax will mean that fewer of these challenges can be met, and will heighten the fear, already felt by many, that the House bill signals the beginning of the end of private philanthropy.

H. FURTHER ARGUMENTS AGAINST THE TAX

1. The burden of the tax will fall on educational, health, and welfare agencies which receive the bulk of foundation support—even though the drafters intended that these agencies should remain fully tax-exempt.
2. The tax applies to all foundations indiscriminately, and thus will be ineffective in correcting abuses.
3. While insignificant in governmental budget terms, the tax will be a serious blow to private educational and charitable institutions. Though not justified as a revenue measure, it is in no sense a user fee.
4. The tax presents an inherent inconsistency—it is an invasion of the tax-exempt status formerly accorded all charities yet the bill insists that private foundations remain in the tax-exempt category for purposes of federal control over their programs and finances.
5. The tax cannot be justified by the argument that all organizations able to pay should carry some part of the expense of government—many classes of tax-exempt agencies will retain their freedom from tax, and only private foundations, which directly serve the public interest and relieve the government of some of its burdens, are singled out. The tax is a punitive measure—not tax reform.

I. A PROPOSED ALTERNATIVE

We recommend that an annual fee be assessed on foundations in proportion to their assets. The amount of this fee should be determined each year at a level sufficient to assure adequate supervision of foundations by the Internal Revenue Service and enforcement of the laws applicable to them.

STATEMENT OF MESSRS. J. GEORGE HARRAR, ALAN PIFER, AND DAVID FREEMAN

A. INTRODUCTION

In this statement we discuss the effects of the proposed 7½ percent tax on foundation income as seen by the Rockefeller Foundation and Carnegie Corporation of New York, two of the oldest, largest and best known foundations in the nation, and by the Council on Foundations, the principal membership organization in the field, representing mainly medium-sized and smaller foundations. We believe the statement also represents the views of a number of other large foundations which are coordinating their testimony before the committee.

B. OPPOSITION TO THE TAX

We are strongly opposed to the proposed 7½ percent tax on foundation income and believe that enactment of it by the Congress would be contrary to the national interest. We find no convincing arguments in favor of such a tax and many against it. The latter we believe to be so fundamental that the decision Congress must make is not simply a matter of tax reform but a decision about the very nature of the American system.

C. THE ROLE OF INCOME TAX EXEMPTION FOR CHARITABLE PURPOSES IN AMERICAN LIFE

The history of encouragement of private charity by the state through the granting to it of special privileges goes back to Roman times and has continued unbroken since then. The basic rationale for this arrangement has also remained unchanged, namely that private charity relieves the state of responsibilities it would otherwise have to discharge, and hence should be given every incentive to flourish. This concept was first given systematic legal recognition in England in the historic Statute of Charitable Uses, of 1601, a measure designed to improve the administration of charity and encourage its development by defining a number of specific charitable purposes which would be officially recognized as such by the state.

The intent of the Statute was to place primary responsibility for the amelioration and solution of economic and social problems in private hands, and its enactment proved to be a powerful stimulus to the expansion of private charity both in Britain and in the American Colonies over the next two centuries. After that, although primary responsibility for social welfare began gradually to shift to the state, there remained—and remains to this day—a clearly recognized place for private philanthropy, as it came to be called, in both countries.

When an income tax was first levied in Britain in 1799 it seemed perfectly natural to exempt charities from it, and it seemed equally natural to do so in the United States when, following passage of the 16th Amendment, the Revenue Act of 1913 established a federal income tax on a constitutional basis. This Act exempted from income tax any "corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual." These words, repeated in subsequent laws, have in the more than half century since 1913 remained the basic charter under which a wide variety of charitable institutions have enjoyed tax exemption.

No distinction has ever been made in the basic provision for income tax exemption between different kinds of 501(c)(3) charitable organizations, whether churches, educational institutions, welfare organizations or foundations. The state has never presumed to judge whether some charitable purposes were more deserving of tax exemption than others; all have been considered equal. Consequently there has never been any such thing as a qualified, or partial, income tax exemption in the charitable field. There has been total exemption or none. The concept has been considered by its nature to be indivisible.

The imposition of an income tax on foundations—no matter how limited the rate—would destroy the principle of indivisibility and would, thereby, constitute

a breaching of long-standing and well-proven national practice. It would, in effect, signify that foundations are now considered to be "less charitable" than other kinds of charitable organizations and therefore less deserving of full tax-exemption. The illogicality of such an assertion, of course, becomes obvious when one remembers that foundations are required by law to distribute their income to charity—for the very kinds of allegedly "more charitable," and hence "more deserving," purposes that would remain fully tax-exempt.

Aside, however, from the illogical and discriminatory features of such a departure from long-standing practice, its greatest harm would lie in the clear precedent it would establish for future taxation of other classes of charitable organizations—churches, colleges, voluntary hospitals, and so on. It would also inevitably encourage other levels of government to impose their own income taxes, initially perhaps only on foundations but subsequently on charitable organizations generally.

A federal income tax on foundations must therefore be recognized as a highly dangerous first step on the road toward the total disappearance from our national life of the traditional income tax exemption enjoyed by charitable organizations. Such an eventuality would of course greatly weaken the private non-profit sector and diminish the role it plays in our society in favor of further accretion of the power of government. It is in this sense that the decision Congress will make about an income tax on foundations can truthfully be said to be a decision in fact about the very nature of the American system. It is the pluralistic initiative and effort of our private institutions that is really at stake in the legislation, and we believe the issue of the tax should be debated on these terms.

In addition to the financial threat which the tax poses for the entire private, non-profit sector, it poses an equally serious threat to the freedom enjoyed by private institutions in our society. An income tax levied on charitable organizations can serve as a simple and highly effective means by which public authorities can arbitrarily punish them. All that is required to force certain organizations to terminate activities which someone in authority judges to be offensive is a threat to raise the level of their tax. This, we would submit, is a misuse of the income tax power and dangerous doctrine.

We recognize, of course, that there have been abuses by some individuals of the privilege of income tax exemption of foundations, and we favor specific measures to prevent these abuses, such as the prohibitions against self-dealing in the bill now under consideration. But we must at the same time urge every member of the Congress to consider most carefully the full implications for the nation of use of the income taxing power for punitive purposes. It constitutes an extension of the authority of government that could stifle dissent and criticism, could inhibit experimentation and could break the spirit of voluntarism in our society.

D. JUSTIFICATION FOR PRIVATE FOUNDATIONS

It has been said that the voluntary philanthropic system which has developed in the United States is the essence of free enterprise. This system appears collectively in many forms: the giving of individual time and talent to worthy causes; individual contributions of money for philanthropic, charitable, religious, and educational purposes; cooperation in common cause to create charitable community organizations; giving for charitable and philanthropic purposes by business corporations; and the creation by individuals of organized philanthropies.

Early in the history of this nation, social welfare was entirely in the hands of the private sector. Fortunately, in more recent years the government has increasingly entered the field in recognition of the growing needs and demands of a burgeoning society. There has resulted an informal partnership in which the government has become by far the major element in terms of resource investment. But the private contributor, corporate or individual, is senior in experience, demonstratedly innovative, and free to move promptly and flexibly in response to need. It is both desirable and proper for the government to take over increasing responsibility for important programs affecting all of its citizens. At the same time, the efforts of the private sector are clearly needed, and private philanthropy should be encouraged and cherished by society and its elected government.

Private philanthorpy derives from the charitable impulse of the individual, and for many years in this country the individual was the sole source of giving

for the benefit of others. Benjamin Franklin established a philanthropic fund as early as 1790, but the modern organized foundation did not appear until the beginning of the twentieth century when Andrew Carnegie, John D. Rockefeller, Mrs. Russell Sage, the Guggenheims, and others converted their personal resources into organized philanthropies.

It is noteworthy that these early foundations, which are still among the largest and most influential, were formed at a time when neither individual charitable giving nor the creation of a foundation provided any tax advantage. Rich men established foundations because they believed that philanthropy, like most other human activities, could be most efficiently carried out in an organized form.

Foundations are sometimes referred to as "middlemen" by people who see no reason for what they consider the interposition of an organization between a philanthropically disposed individual and his beneficiaries. The description is inaccurate if the term *middleman* is taken to mean a conduit or an unnecessary party in a transaction. Foundations are more effective philanthropic instruments than individuals just because of the advantages of organization. Those advantages include continuity, certainty of the availability of funds, the possibility of professional staffing, and the bringing to bear upon selected problems of larger sums of money—and therefore a broader and stronger array of talents—than individual efforts had theretofore been able to supply.

As the foundation phenomenon developed and matured, the organizational principle was adopted for community foundations, corporate foundations, and family foundations, and for the National Science Foundation which is supported by annual grants from the federal government. The achievements to which organized private philanthropy has contributed are well documented but not so widely known as they deserve to be. They include, among many others, the establishment of free public libraries; control of yellow fever, hookworm, malaria, and other major endemic diseases; the development of modern medical education; pioneering experiments in rocketry; polio vaccine research; the solution of the genetic code that controls plant and animal heredity; research in astronomy which has yielded extraordinary advances in our knowledge of the universe; and research in agriculture and its application to the problems of hunger in many of the less-developed nations. Other achievements include the support of medical research, the improvement of education at all levels, the establishment of fellowship and scholarship programs for the intellectually gifted and for those with leadership potential, and the support of research institutions dedicated to the study and solution of contemporary human problems.

Many areas of art, culture, science, and education, and many social institutions, have benefited enormously from or have been brought into being by the initiative of private foundations. Anyone who studies the record will recognize that private philanthropy has, by reason of its achievements, embedded itself solidly in the American free enterprise system. The bulk of philanthropic giving is by individuals: personal charitable contributions totaled nearly $16 billion in 1968. The total of foundation grants was less than nine percent of that figure; but because they are organized and professionally staffed, because they are flexible and can supply continuity of effort, and because they can provide critical masses of money when problems require them, foundations are the advance scouts of philanthropy.

It is sometimes argued that although foundations have been advance scouts in the past, the increasing activity of government in the field of social welfare has rendered them superfluous. It seems clear both that that argument is false and that the situation it presupposes would be undesirable if it existed. To be sure, a degree of experimentation is acceptable in the activities of government. But government is by definition consensual, in this country at least, and that means that what government does in the field of social welfare, as in other fields, should rest upon a common, or at least a widespread, public recognition that it is needed. Government therefore tends to be constrained in supporting those forms of experimentation, or pioneering research, that must precede such a public recognition. The role in which it most plainly fulfills its obligation to the electorate is that of providing official sponsorship, and massive funds beyond the reach of the private sector, once the work of private agencies has clearly documented the existence of a need and, if possible, the viability of a solution.

Looking toward the future, it seems evident that the larger participation of government in social welfare has not diminished the number or variety of

problems that most informed citizens see before the nation and the world. On the contrary, the increased rate at which we are able to answer certain kinds of questions about our lives and our universe simply increases the rate at which our answers ask new questions; and in the meantime certain types of problems—some of them indeed raising questions about the role of government—appear unusually intractable and increasingly stubborn. We are arriving at new realizations of the importance of certain problems of social organization and economics; of the effects of the numerousness of the human species both upon the sufficiency of the food supply and upon the quality of the environment; and of the risks and opportunities arising out of our increasing capacity to manipulate both the external environment and our personal environment—our physical selves.

We have not solved the problems of conflict between nations, and it appears increasingly that such conflict is a luxury the species can no longer afford. Many of our most perceptive young people are raising questions of national and individual purpose that do not seem to be satisfactorily answered by the old truths. In short, there is plenty to be done, and the need for private enterprise in the doing of it can only increase, rather than diminish, regardless of the extent to which government is able to expand its support of research and education. It must be hoped that government and private philanthropy will see themselves as essential partners in human progress, operating in harmony and mutual respect.

E. HOW THE TAX WOULD AFFECT THE ROCKEFELLER FOUNDATION

Long before there was any public participation in the solution of many of the ills which beset mankind, private philanthropy pioneering in these areas was shedding light through research on fundamental concerns and was taking vigorous action to alleviate conditions responsible for undesirable human conditions.

The Rockefeller Foundation was formed in 1913—before the income of United States citizens and business corporations was taxed—"to promote the well-being of mankind throughout the world." During the Foundation's earlier years, when government was relatively inactive in the field of social welfare, a good deal of the Foundation's effort went into projects designed to demonstrate that particular human ills were not inevitable but could be remedied by sufficient applications of energy and skill. Federal or state government often supplanted the Foundation as the primary source of funds for projects the importance and feasibility of which had been demonstrated under Foundation auspices, and the same tendency for successful projects to move from Foundation sponsorship to government sponsorship is observable today. It is probably safe to predict that a number of projects now being supported by the Foundation—for which government funding is inappropriate or unavailable—are of a kind that in the future will be felt to lie within the proper sphere of government.

The Foundation's first work was in the field of public health. Its success in the eradication of hookworm in this country and in many others overseas, and its campaigns against malaria, yellow fever and other widespread and devastating endemic diseases, are now classics in the annals of public health. Public health is now largely the province of government.

For more than a quarter of a century the Foundation has sponsored and participated in agricultural research and its application toward improving the quality and quantity of basic foods for the people of less developed countries in which food supplies have long been inadequate. The results have been spectacular: today the "miracle wheats" and "miracle rice" have achieved worldwide fame as basic to the so-called "green revolution." These long-range undertakings, carried on in association with other public and private agencies, offer for the first time the possibility that the world may in the foreseeable future meet its requirements for basic foodstuffs for all of its citizens.

From its earliest beginnings the Foundation has been committed to the philosophy of the reinforcement of educational institutions; the training of individuals with ability and leadership potential is fundamental to the success of its total program. Thus, over the years the Foundation has invested very large proportions of its income and indeed capital resources in its support of professional and general education in universities here and abroad. Simultaneously a scholarship and fellowship program has been developed which over the years has contributed to the academic, scientific and professional development of many thousands of young men and women in this country and overseas. Perhaps this

development of intellectual and leadership manpower has through its multiplier effect been the Foundation's greatest contribution to economic and social progress during its more than fifty-five years of existence.

Toward the costs of its philanthropic programs, many of which have relieved government of costs it would otherwise have had to bear, The Rockefeller Foundation has appropriated all of its income and more than $230 million of its principal. At the Foundation's current rate of receiving income and realizing capital gain, the proposed 7½ percent tax would cost it more than $3,000,000 per year. Because the Foundation disburses all its income, the effect of the tax would be simply to reduce the volume of work it is able to do. The burden would fall upon the Foundation's beneficiaries.

The tax would present another problem of special importance to The Rockefeller Foundation. The Foundation's charter, as quoted previously, commits it to the well-being of mankind *throughout the world*. The Trustees of the Foundation have interpreted that language as a mandate to operate not only in the United States but wherever need appears, having always in mind the fact that illness, poverty, and hunger elsewhere in the world affect also the well-being of American citizens. Thus a substantial fraction of the energies of the Foundation have been expended abroad, at the invitation of foreign governments and with the cooperation of indigenous institutions of research and higher education.

In qualifying, as a private American organization, to carry on philanthropic work in a foreign country, the Foundation has always had to rely upon its status as a tax-exempt entity in the United States. Were it not tax-exempt here, it might very well not be permitted to work in a number of the countries in which it has supported conspicuously successful programs. And in other countries, where it might be permitted to work, it would probably be denied local tax exemption, which would make the importation of scientific equipment and the assignment of staff prohibitive.

For the Rockefeller Foundation, then, the most important difficulty raised by the proposed income tax may be the question whether any foundation so taxed can continue to call itself a tax-exempt institution. Even if the Congress should include in the law language expressly reaffirming the tax-exempt status of private foundations, there is no assurance that foreign governments, observing the fact of taxation and noting also that private foundations are the only group of entities in the charitable sector to be so taxed, would give credit to the declaration.

There can be no denying the fact that the proposed tax would be a breach in the long-established and often-reaffirmed principle of tax exemption for charitable, scientific, educational, and other philanthropic activities. The work of The Rockefeller Foundation and other foundations would be severely hampered by it, and those we seek to aid would be the direct losers. Moreover, the gain to the government from the imposition of the tax would be a scarcely significant addition to the federal revenues. For all the reasons stated above, The Rockefeller Foundation strongly opposes the proposed tax on investment income of private foundations.

F. HOW THE TAX WOULD AFFECT CARNEGIE CORPORATION

Carnegie Corporation of New York was established in 1911 before the days of tax-exemption. There were, therefore, no tax advantages involved for Andrew Carnegie, the founder; nor had there been any for him in the many other philanthropies which he had set up previously, such as the Carnegie Institution of Washington, the Carnegie Foundation for the Advancement of Teaching and the Carnegie Endowment for International Peace. With the exception of a legacy for his wife and daughter, Mr. Carnegie gave away his entire fortune in his own life time.

Carnegie Corporation was the last of the great Carnegie philanthropies, the largest and the most general in its purposes. The income from its perpetual endowment fund was to be used over the succeeding years for whatever specific purposes the trustees thought best met the needs of those times, provided only that the purposes fell under the broad heading of "the advancement and diffusion of knowledge among the people of the United States." A smaller fund with similar purposes was set up under the administration of the same board of trustees for the benefit of the British colonies.

Mr. Carnegie believed that Carnegie Corporation would be best administered over the long run if he did not bind the trustees too closely by the terms of his

gifts. He selected the most able men of his day to constitute the original board of trustees and placed in their hands sole power to select their successors, on the assumption that able, public-spirited men would select equally good men to succeed them. No evidence has ever been adduced to indicate that the public interest might have been better served by some other system of governance than this self-perpetuating board. The successive members of it, all of whom have served without compensation, have given their time generously and have brought to the management of the foundation a wide range of experience and talent. In the 58 years of the foundation's history there has been not a single instance of any part of its income inuring to the private benefit of any member of the Carnegie family, any trustee, any employee or any other individual except for services rendered. No consideration has ever existed in the foundation's affairs except furtherance of the greatest possible benefit to the public.

Over the years the Corporation has pursued a variety of interests. It has provided scholarships, fellowships and travel grants to deserving individuals. It has supported research in the sciences, medicine, education and the social sciences. It has fostered education in the arts. It has supported experimental new programs in elementary and secondary education and more recently at the pre-school level. It has enabled a wide range of colleges and universities, both public and private, to try out new approaches to teaching. It has organized and supported independent inquiries into important aspects of the educational system. It has contributed to the training of teachers. It has fostered the development of libraries and adult education programs. It has supported projects aimed at the strengthening of state and local government. It has attempted through the support of language and areas studies in schools and colleges to enhance the nation's capacity to discharge its international responsibilities effectively. It has supported efforts to improve the delivery of health care to the American people and efforts to ameliorate the problems of the great cities. It has worked to improve race relations.

Altogether, in these and other ways, Carnegie Corporation has since 1911 spent $400 million. In the course of this period it has made grants in every state of the Union, and it would be no exaggeration to say that in one way or another it has brought some benefit to every American citizen—rural as well as urban, Southern as well as Northern, Western as well as Eastern, of ordinary circumstances as well as privileged, old as well as young, of one race as well as another.

Had there been a 7½ percent income tax on foundations since 1913 the loss to Carnegie Corporation would in total have been $40 million. But the burden of this loss would not, of course, have fallen on the foundation but on the recipient of its grants. All of the activities listed above would in fact have had to be reduced by the amount of the tax. Similarly, if a tax is now levied, the loss to education, broadly defined, in respect to Carnegie Corporation alone will over just the next ten years be at least $12 million and probably more. There is no other way this so-called tax on the foundation can be viewed than as private support denied to worthy institutions and talented individuals. In reality it will be a tax on them, and the American people at large will be the ultimate losers.

In view of Carnegie Corporation's outstanding record of public service, in view of the rectitude with which its affairs have always been managed, in view of the keen competition for its grants and the smallness of the funds it has at its disposal each year in relation to the enormous opportunities for public good, a tax on its annual income is totally unwarranted and grossly unfair to this foundation. Far more importantly, however, such a tax is entirely contrary to the best interests of the nation, and it is on these grounds that the trustees and officers of the foundation oppose it so strongly.

G. HOW THE TAX WOULD AFFECT SMALLER FOUNDATIONS

The tax on foundation income will limit the ability of foundations across the country to support local educational, health and welfare organizations. For example, it will reduce the amounts available to local charities in Providence, R.I., through the local community fund, by at least $100,000 a year. This is estimated to be the tax which would be levied on the Rhode Island Charitable Trust—all of whose income now goes to the Community Fund. Similar reductions will occur in foundation contributions to Chests and United Funds in hundreds of communities, where small and medium-sized foundations typically concentrate their giving. Thus, at a time when United Funds are struggling desperately to

keep up with the demands made, by rising costs and increased service loads, on their member agencies, the real impact of the tax will be felt by those same agencies.

Surely the Congress does not intend this result—legislation over the past several years, such as the Hill-Burton Act, the Community Mental Health Act, etc., has been based on the partnership philosophy, and has made the private philanthropic dollar, demonstrating the concern of local leadership, a prerequisite for federal contributions. Strong local organizations, with volunteer leadership, are vital to the survival of the private sector.

Another field where the impact of the tax will be particularly severe is medical education. The White House report issued this summer points out the current crisis in providing adequate health care services throughout our society, and Dr. Cooper's presentation on behalf of the American Association of Medical Colleges has highlighted the crucial role of foundation support. Three specific examples may help to underline the importance of private foundation activities in this field.

1. The Commonwealth Fund, for many years a major supporter of medical research and education, recently revised its policies to devote an even greater proportion of its income to the medical and health fields. Even so, and before the reduction in its resources which the tax will cause, it has been forced to decline proposals from major medical schools for development programs.

2. George W. Starcher, President of the University of North Dakota, one of several institutions receiving support for their medical schools from the Hill Family Foundation of St. Paul, Minnesota, writes in part:

"If we could feel that this money siphoned off through federal taxation would come back to the University through some grant from Washington, it would probably still not give us the strong support in new directions which we have received from the Hill Family Foundation. We have enjoyed great freedom and our scientists have made significant strides ahead because of the liberal conditions under which the grants have been awarded by the Foundation. Moreover, we have been helped by the continuous supervision, real interest, and concern expressed by officials of the Foundation."

3. The Dean of the College of Medical Sciences at the University of Minnesota, stressing the importance of broad foundation support during the formation of that institution's program in family practice and community health, concludes that anything done to impair the programs of the well-managed foundations will be a serious blow to medical education.

In a period when health services are becoming increasingly dependent on the tax dollar, chipping away at the remaining sources of private support for innovation and experimentation in the health field will inevitably force further dependence on the federal government.

Most foundations of modest size are active in support of higher education, through scholarships, research grants and gifts to capital needs. Programs such as those of the Markus Foundation in Cleveland, or the Sachs Foundation in Colorado Springs, provide financial support to enable disadvantaged students to attend the colleges of their choice—often by supplying the last five hundred dollars needed to complete a complicated package of loans, college aid funds and employment. The tax will mean that these foundations will be able to help fewer students—even though loan programs are seriously handicapped by rising interest rates and soaring operating costs are forcing colleges to increase their tuition fees almost annually.

Lest it be assumed that colleges are supported by only a few large foundations, it should be noted that, for example, Case Western Reserve University last year received grants totalling four and a half million dollars from more than 230 foundations, representing about 25 percent of all contributed funds. The tax will fall with equal severity on all these foundations, and others supporting their local schools and colleges in every state.

As has been pointed out earlier, the challenge or matching gift has proven to be a particularly effective device for encouraging broad support of capital campaigns conducted by educational and other private institutions. In such gifts each foundation dollar is instrumental in producing at least one additional dollar from other sources. The 7½ percent reduction in foundations' ability to make challenge grants will thus produce a double, or even larger penalty on the grant-receiving institutions.

Finally, many foundation representatives have expressed deep concern that singling out this one segment of the field for imposition of an income tax may

signal the beginning of the end of private philanthropy. Whether or not this fear proves well-founded, the immediate effect of imposing the tax, taken together with the other punitive measures contained in the House bill—particularly the treatment of gifts of appreciated property to private foundations—will inevitably be a slowing down of new funds into those foundations.

Available statistics show no appreciable difference in the rate of growth of GNP and the growth of foundation assets. If foundation growth rates are seriously curtailed, the private non-profit sector will again be the loser, for only a reasonable growth rate has enabled foundation dollars to keep up with inflation and the increasing need for the help which foundations provide.

H. FURTHER ARGUMENTS AGAINST TAX

The burden of the tax will fall upon the educational, health and welfare agencies which are the major recipients of foundation support. The effect upon a number of such agencies has already been described by earlier witnesses before this Committee. In Sections E., F., and G. of our presentation we have outlined the effects of the tax upon the Carnegie and Rockefeller Foundations, and upon the programs of a number of middle-size and smaller foundations across the country.

While it was plainly the intent of the drafters of the House bill to impose the tax upon private foundations and not upon the other classes of Section 501(c)(3) organizations, the foregoing discussion makes clear that in fact it will be the operating organizations which will bear the real burden. In the most recent survey of foundation giving, educational institutions received 41 percent of the foundation dollar. (Statistics for eight selected years on foundation giving for higher education totaling over $2 billion will be found in Appendix A.) Thus the tax, though levied upon foundations, would in fact be borne by the very organizations which the bill intended to benefit through continued complete exemption. Some further reasons are:

1. The tax applied without distinction to all private foundations indiscriminately and is therefore a totally ineffective means of correcting the abuses which exist in the field. While a number of provisions of the House bill are addressed to real and specific problems, the proposed tax by its nature is irrelevant to such matters as self-dealing and income accumulation.
2. While the revenue produced by the tax will have minimal effect on governmental budgets, it will be a serious blow to the educational and charitable organizations discussed earlier in our presentation. Thus, without producing any substantial advantage for government operations or materially reducing the burden on individual taxpayers, it will have serious consequences for key areas of private philanthropy. The tax will, however, produce considerably more revenue than could conceivably be utilized by the Treasury in strengthening its audit and review forces in the foundation field, and the receipts from the tax will become part of the general revenues. It is therefore not in any true sense a user fee or a filing fee such as the alternative measure we propose in the concluding section of this presentation.
3. The singling out of private foundations for taxation on investment income embodies a basic inconsistency. Tax exemption is not to be done away with; indeed, the House bill reaffirms and insists upon the tax-exempt status of private foundations even as it taxes them, and the exemption of other types of philanthropic and non-profit organizations is maintained in fact as well as in word. What the bill does is to impose a tax upon one type of organization, hitherto tax-exempt, which for that purpose is drawn forth from the broad family of Section 501 organizations. Yet for the purpose of maintaining federal control over that type of organization the bill insists that it remain tax-exempt. This inconsistency is the inevitable consequence of attempting to raise revenue from organizations which for other purposes the federal authorities wish to consider exempt from tax.
4. Finally, the case in favor of the tax is basically unsound. While proponents attempt to justify the tax by arguing that all organizations able to do so should contribute to the support of the government, in fact the proposal makes no effort to require such support from any other class of exempt organizations. A wide variety of tax-exempt organizations, such as trade associations, business leagues, cemetery companies, etc., will retain their freedom from federal income tax. Thus the principle of tax-exemption for charity is breached with regard to private foundations, even though their record of accomplishment demonstrates that they are clearly serving the public interest more directly than most other exempt

organizations and thereby relieving government of some of the financial burdens and responsibilities which it would otherwise have to meet.

The measure would, for example, require taxes to be paid from funds which would otherwise have supported cancer research; but it would require no payment at all from the very considerable financial resources of trade associations, whose sole objective is to advance the business interests of their members and which are permitted without limit to influence legislative and administrative decisions to accomplish that end. The tax would take money from the provision of scholarships for poor children; but it would take none from active and influential lobbying organizations exempt under Section 501(c)(4).

This provision of the House bill is surely not tax reform nor the plugging of a loophole. Rather, the tax is a punitive measure against an integral part of the philanthropic structure of our society—the private foundation. We submit that the foundation is a uniquely American phenomenon which does not merit this arbitrary treatment.

I. A PROPOSED ALTERNATIVE

It is our belief that the present lack of public and Congressional confidence in foundations would not exist had there been adequate supervision of tax-exempt organizations and enforcement of existing laws by the Internal Revenue Servise. Such supervision and enforcement would have prevented or reduced the bulk of the abuses now known to have occurred. It is our understanding that this inadequacy of supervision and enforcement resulted from a shortage of staffing in the Exempt Organizations Branch of I.R.S. occasioned by the fact that no substantial recovery of revenue would result from exposure of abuses in the tax-exempt organization field. We believe that to safeguard the public interest, and also to protect the reputation of the vast majority of foundations which fulfill their charitable mandate in good faith, funds for more adequate supervision in the field must be found.

It seems reasonable to us for foundations to contribute to the cost of their own supervision. We therefore propose that they be required to pay an annual fee for that purpose. We further propose that as a basis for arriving at an equitable distribution of the burden of this charge among foundations the amount payable by each foundation be proportional to its assets. The total to be collected from all foundations should be determined annually by the Secretary of the Treasury on the basis of his estimate of the cost to the Treasury of such supervision.

This proposal would provide a practical solution to the kinds of problems that have disturbed the public and the Congress. At the same time it would avoid the damaging consequences and inconsistencies we find in the proposed tax and have described in previous sections of this statement.

APPENDIX A. *Amounts contributed by foundations to U.S. colleges and Universities, 8 survey years* [1]

1956–57 (904 institutions)	$319,085,152
1958–59 (1,071 institutions)	88,337,037
1960–61 (1,032 institutions)	195,507,178
1962–63 (1,036 institutions)	212,719,999
1964–65 (1,064 institutions)	357,600,709
1965–66 (1,033 institutions)	304,107,178
1966–67 (1,042 institutions)	289,532,440
1967–68 (1,043 institutions)	320,982,109
Total	2,087,871,802

[1] Data are from the institutional questionnaire responses to the CFAE voluntary support of education surveys.

NOTE.—The 1956–57 total includes $199,522,710 attributed to the Ford Foundation faculty salary endowment grants.

IV. EFFECT OF PROGRAM LIMITATIONS

SUMMARY OF STATEMENT OF MR. MERRIMON CUNINGGIM

My testimony is confined to the subject of program limitations. Among the unfortunate and, we believe, unintended handicaps that H.R. 13270 imposes on the work of private foundations are:

1. Restrictions on programs of fellowships and awards: The present language of the Bill, though not the intention of the House Committee, would call in question some worthwhile programs, carefully defined, publicly announced and impartially administered. Modifications in the wording of the Bill could eliminate the difficulty.

2. Implications of the prohibition on "any attempt to influence legislation * * * .": Foundations are alarmed that if the present wording of the Bill in Sec. 4945, para. (b)(1) and (c) is retained, the effect will be that grants in any area of current social importance would be off bounds, because of the likelihood that sooner or later projects supported by such grants would point toward a need for new legislation. The House Committee seems to have intended only to make sure that foundations do not engage in partisan political action. (Report, Part 1, p. 33). This laudable purpose can be achieved, and proscriptions of worthy foundation activity can be avoided, by judicious changes in the wording of the paragraphs indicated.

Statement of Mr. Merrimon Cuninggim

Introduction

Mr. Chairman and Members of the Committee, this part of our testimony has to do with those portions of H.R. 13270 that, if finally adopted, would impose serious limitations on the programs of many foundations.

Three of us will speak to the *program limitations* implicit in the Bill: Mr. Russell Arrington, President Pro Tempore and Majority Leader of the Illinois State Senate, testifying on behalf of the Citizens Conference on State Legislatures, and Mr. Homer Wadsworth, President of the Kansas City Association of Trusts and Foundations, and myself, testifying concerning the effect on foundations.

My name is Merrimon Cuninggim, President of the Danforth Foundation of St. Louis.

We have *four major points* to make:

(1) The prohibition against "*any attempt to influence legislation * * **" would inhibit or prevent presently approved activities by foundations that would adversely affect their freedom to contribute to the general welfare. This is the most serious program limitation of the Bill, and from our different perspectives all three of us will speak to this point.

(2) The partial prohibition against *grants to individuals* might still handicap unduly some worthy programs of fellowships and awards. I will elaborate on this position.

(3) The definition of "*expenditure responsibility*" is either difficult or impossible to fulfill. Mr. Wadsworth will deal with this problem.

(4) The language of the Bill on these three subjects seems occasionally to be unclear and imprecise, though we feel that the Report reflects the intention of the House Committee. As all of us will indicate, it is our belief that modifications in the language of the Bill could make its provisions consistent with the purposes of the Committee as expressed in the Report, and thereby could eliminate the dangers we see.

To the extent to which representatives of various foundations feel that H.R. 13270 imposes serious program limitations on their work, they must of necessity speak not with one unified voice but as individuals, each having his own perspective. Most foundations are local or regional in their outreach, and the implications of the Bill are necessarily limited to the geographical and topical areas they serve. Even the national, "general purpose" foundations have their distinctive program emphases, and the testimony of each would differ from that of every other. Yet common threads of concern are discernible. I can speak with assurance only for the foundation I represent, but it is my hope to be illustrative rather than simply unilateral in the treatment of the matters I want to mention.

So that you may know the particular position from which I speak, let me say a brief word about the Danforth Foundation. Our work, since the Foundation's beginning in 1927, has been largely in the field of education. In the past year and a half we have become active also in the field of urban affairs, chiefly in the St. Louis area. No such limitation applies, however, to our educational efforts: for through our grants, fellowships, workshops, conferences, and by other means we have intimate contacts of one sort or another with eight hundred to a thousand colleges and universities, hundreds of secondary schools and other educational organizations, and upwards of fifteen thousand persons in educational occupa-

tions, all across the country. In market value of portfolio we rank 10th in size among national foundations; in amount of annual expenditures—a truer measure, we think, of a foundation's activity—we are 9th. Like many another similar foundation, we believe in and practice full public disclosure of our activities. If it hadn't been for these hearings our new Annual Report might already have been off the press!

Let me direct your attention, first, to the prohibition against *grants to individuals*, Sec. 4945(b) (3) on p. 44 and (e) on pp. 46–47 of the Bill. This section is less restrictive than, and thus in our view a considerable improvement on, the "tentative decision" announced by the House Ways and Means Committee in its press release of May 27. The "tentative decision" prohibited all grants to individuals, whereas the Bill as it now stands would allow such grants when the conditions of sub-paragraph (e), pp. 46–47, are met.

It appears to us, however, that the language of the Bill may still be more restrictive than fulfillment of the intention of the House Committee would require. The Committee means to put an end to grants "to enable people to take vacations abroad, to have paid interludes between jobs, and to subsidize the preparation of materials furthering specific political viewpoints." (Report, part 1, p. 33) We of the Danforth Foundation, along with other foundations that sponsor carefully planned and administered programs of fellowships and awards, would heartily applaud this aim. But the language of the Bill outruns this intention and may do considerable harm to reputable programs. I shall draw my illustrations from among the ten or a dozen programs that the Danforth Foundation sponsors or supports, though I beg you to remember that these are only a few among the scores, perhaps hundreds, of such admirable programs sponsored by other foundations.

The first problem is that the language might unintentionally force the cessation of useful programs of awards and prizes, given to recognize excellence or achievement in various fields. Such awards are indeed grants to individuals, and thus would fall under the prohibition of such grants; but they would not qualify as approved exceptions to that prohibition because they are not scholarships or fellowships and do not aim "to achieve a specific objective * * *." Recipients are not applicants, expected to "produce a report" or perform some other service, but are simply honorees.

For example, our own Harbison Awards for Gifted Teaching might have to be terminated, even though in recent times both the White House and the Office of Education have expressed keen interest in the Program and a desire to emulate it. These Awards, usually ten per year, are for $10,000 each; the purpose is not merely to honor teachers of unusual competence but also, and by that means, to emphasize the importance of teaching in the academic process. It is ironic that, whereas the Bill would seem to allow this Program to continue only if it is to "achieve a specific objective * * *" the Internal Revenue Service has ruled that the Award will be tax free to the recipient (under section 74(b) of the Internal Revenue Code), only if he does *not* have to fulfill some requirement of the Foundation. Perhaps a clause could be added at an appropriate place in the Bill, to indicate that awards coming within section 74(b) are to be excepted from this provision.

A second problem has to do with the wording in lines 22–24 of sub-paragraph (e), p. 46. We agree fully with the Bill's intention to allow approval of those grants to individuals that are "awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary or his delegate * * *." It occurs to us, however, that lest enforcement be more time-consuming and restrictive than was intended, something needs to be said as to how clearance could be secured in advance, how decisions could be reached rapidly when necessary, and what criteria should be used in making judgments. Clearance would be streamlined, to the benefit not merely of the foundations involved but also of the human needs they seek to serve, if the regulations were to spell out the kind of "procedure" that would be judged to be "objective and nondiscriminatory."

It appears to us that "objective" should mean that applicants will be judged on the basis of credentials submitted in compliance with publicly announced eligibilities and instructions; that the various steps in the selection process, also publicly announced in advance, will be such as to provide fair consideration for all applicants; and that final decisions will be in the hands of people, publicly identified, whether in or outside the foundation (and perhaps both), who are qualified by their own experience to make such judgments.

Similarly, "nondiscriminatory" should mean that no irrelevant distinctions of race, creed, color, sex or age will be imposed in the selection. The addition of "irrelevant" is important, for some worthy programs discriminate purposely in order to overcome some current imbalance. For example, our program of Graduate Fellowships for Women is directed to the lack of qualified women in college teaching; and a requirement that this particular program admit men would defeat its central aim. Taking note of this Program, the Advisory Council on Graduate Education of the U.S. Office of Education recommended this spring that the Office of Education explore the possibility of establishing a similar discriminatory program. Various programs by a number of foundations, Danforth included, on behalf of minority groups would also benefit from a clarification of "nondiscriminatory."

"Procedure" should mean that, on the one hand, "the Secretary or his delegate" will undertake to review only a defined program of grants, not the individual grants themselves; and that, on the other hand, foundations will not make episodic grants to individuals outside the framework of some defined program. As is true for all our fellowship programs, and for the host of excellent programs sponsored or supported by other foundations—Commonwealth, Guggenheim, Hazen, Markle, Woodrow Wilson, etc., etc.—the sponsoring agency would be quite prepared, and should be expected, to hold to the terms of its defined, publicly announced program and to refrain from subsidies to individuals, individually determined. Even the small foundation, making only a few grants to individuals, would not be handicapped if it were allowed to describe in advance the terms under which such grants would be made.

Lastly, "approved in advance" should mean that clearance will be expeditious and unequivocal. Long delays and peculiar requirements or conditions for approval would cut the nerve of foundations' efforts in this regard. Most helpful would be regulations stating that programs coming within the list of requirements enumerated therein need not have a separate ruling in advance. In those instances in which rulings must be sought, a time limit could be specified—say, six weeks—at the end of which, if the appropriate Government official had raised no objection, the foundation's program would be considered approved.

The final problem in respect to grants to individuals turns on the unnecessarily and, we think, unintentionally restrictive language of that part of para. (e) in lines 1–6 on p. 47. The wording provides that, to escape the prohibition, the grant must be "a scholarship or fellowship grant at an educational institution * * * or that the purpose of the grant is to achieve a specific objective, produce a report or improve or enhance a literary, artistic, musical, scientific or other similar capacity, skill, or talent." At first look the words seem to be broad enough to include any legitimate program; but on more careful examination such questions as the following arise: Must the recipient of a scholarship or fellowship be enrolled as a regular student? What about part-time? What about an auditor? What about study outside the United States? What about independent study? How specific must a "specific objective" be? Do the adjectives, "literary, artistic, musical, scientific," include any *educational* "capacity," the "skill" of the administrator or the "talent" of the teacher?

I do not mean to carp. Most of the fellowship programs of the Danforth Foundation as well as those of other foundations, are nicely covered by the Bill's enabling phrases as they now stand. Let me give two brief examples, however, of programs that might be adversely affected by the present language.

First is the Danforth Associate Program, an extensive effort to provide various forms of encouragement and support to faculty members on hundreds of campuses throughout the country, for the purpose of fostering what has been called "the personal dimension" in higher education. These faculty members are committed to the high aim of reversing the trend toward anonymity in campus life. The Foundation makes modest grants to them, to be used for the benefit of their students, and sponsors regional and national conferences for them for the discussion of pertinent issues. Competent outside evaluators have praised this Program for the understanding and constructive action it has quietly brought to bear on problems of student unrest in every section of the country. But those chosen to be Danforth Associates do not hold fellowships, are not expected to "achieve a specific objective," and the quality they "improve or enhance" is not so much peculiarly "literary, artistic, musical, scientific" as it is generally humane, related to their professional vocation as teachers and educators. On the basis of the Bill's present wording, what would happen to this Program is not clear.

Again our Program of Short-term Leaves for College and University Administrators would be suspect. To provide the kind of support that able, yet harried, university presidents need today, a fortification of body, mind and spirit, the Danforth Foundation insists that recipients, twenty per year, do *not* undertake "a specific objective" or "produce a report," or "improve or enhance" anything at all excepr their ability to cope with their immensely demanding duties. Recipients do not go on vacations, but undertake reading programs, write lectures, study the problems of other institutions, or otherwise fit themselves for the better performance of their own jobs.

Other foundations provide similar programs whose value often turns on the fact that their purposes, and their expectations of recipients, are less specific and more flexible than the language of the Bill now allows. The intent of the Bill, as we understand it, would be well served if modifications of language so as to take these considerations into account were adopted.

The second major limitation of program to which I wish to speak is the prohibition against "*any attempt to influence legislation*" as defined in section 4945(c), on pp. 44–45 of the Bill, and as commented on by the Report, part 1, p. 33. In my view, this is potentially the most serious issue raised for foundations by any part of the Bill. Each of my fellow witnesses will also testify on this matter.

A host of foundations are understandably and inevitably alarmed by the lan-
attempt to affect the opinion of the general public or any segment thereof" (lines
guage of the Bill as it now stands. The wording seems to suggest that "an
5–6, p. 45), on any matter that might relate to legislation, would be a taxable expenditure incurring heavy penalties. What, then is left for foundations to do? To play safe, they would feel that they must eschew working in any field of the social sciences, perhaps also the humanities, and even the natural sciences, at least in their applicability to human problems. Conservation of our national resources? Air and water pollution? Beautification of our highways? Such innocent-sounding activities would be too dangerous, for they would sooner or later touch on legislation.

Take the grants of the Danforth Foundation as a case in point. We work, by choice, in the fields of education and urban affairs, because we believe that problems in these fields are crucial for our time, and that even though our efforts are bound to be minuscule in comparison with those of government, it is important that private as well as public energies and resources be brought to bear. In our work we have in mind the molding of public opinion, local or national, not merely on behalf of the project itself that is supported by one of our grants, but also on behalf of the purposes or goals that the project seeks to serve. To support a socially purposeless project would be wasteful and thus preposterous. The pursuit of these purposes could and often does lead to a recognition that changes are needed in regional or national life, and thus eventually to new legislation. To disavow "an attempt to affect the opinion of the general public" would mean, for us, to withdraw from the fields of education and urban affairs, at the very time that private as well as public efforts in these fields are most needed.

To be explicit, let me mention a few of the recent grants of the Danforth Foundation, as representative of those of other foundations, that would be called in question by the current wording of the Bill:

> To the American Assembly, in cooperation with the American Bar Association, for a series of conferences, based on preparatory studies, of the theme, "Law and the Social Order." This program will undoubtedly result in numbers of specific recommendations by the Assembly for new, though non-partisan, legislation.
>
> To the American Bar Association, for support of a program of its Special Commission on Housing and Urban Development Law, to involve lawyers in solving urban problems and "to attack outmoded laws by working with federal, state and local legislatures."
>
> To the American Council on Education, in support of a National Conference on Law and Higher Education, to examine the adequacy of present understandings on the legal status of students, due process, and campus freedom and order.
>
> For the Cooperative School Board Project, involving four metropolitan school systems (Boston, Chicago, Los Angeles and New York), four neighboring graduate schools of education, and two other organizations to coordinate and disseminate the findings. This ambitious study of the present and desirable functioning of large city school systems will, we hope, have many repercusions, including legislative ones.

To the Education Commission of the States, a formal compact of over forty states for the purpose of bringing governors, legislators and other political leaders into closer association with educators, for the benefit of state systems of education at all levels across the country. Growing out of ideas advanced by Governor Terry Sanford, Dr. James Conant, and United States Commissioner of Education James Allen, the Danforth Foundation has shared equally with the Carnegie Corporation in furnishing the seed money for this organization, until such time as the states themselves assume its full support. The very establishment of the organization required specific legislative action in each participating state, to join and to appropriate its membership fee.

For the Governor's Conferences on Education in Missouri: We have joined with the Kansas City Association of Trusts and Foundations and other groups in supporting these state-wide, non-partisan gatherings to study and make recommendations as to desirable changes in the state's system of public education. Recent legislation on behalf of Missouri's public schools has been based directly on the work of these Conferences.

To the Missouri Bar Association, to provide for an examination of procedures in juvenile courts and, as a hoped-for result, beneficial changes in such procedures.

To the New York State Education Department: This was a many-faceted grant to enable the New York State Education Department to work cooperatively with both public and private institutions, large and small; Brooklyn College of the City University of New York, Colgate University, Cornell University, State University of New York College at Fredonia and Vassar College. The aim was to upgrade programs of teacher training and revise standards of certification for teachers, and expected results will call for changes in legislation or in decisions of governmental bodies affecting public schools.

To the St. Louis Board of Aldermen, to draw together all the leading individuals and agencies concerned with housing, both public and private, in the St. Louis area. Though the grant was made to the Aldermen, the planning committee for the two major conferences, and for the studies that went into their preparation, was composed of representatives from four universities and from other community agencies. If the recommendations of these conferences are to be accepted, changes in legislation will occur.

To the Southern Association of Colleges and Schools: For over ten years the Danforth Foundation has been working with the Southern Association on behalf of the upgrading of predominantly Negro colleges in particular and strengthening educational opportunities for minority groups in general. A particular series of grants to the Southern Association in recent years have been for the support of their Education Improvement Project, a program of many parts represented by projects in many places throughout the South, both urban and rural. Too complex to be described in a brief sentence or two, the EIP has received support from several governmental agencies, such as the Office of Economic Opportunity, as well as from many foundations; and since the boards of education of nearly every Southern state are cooperating, the result of this program will eventually be felt by legislatures and executive offices of government throughout the South.

These are only a few that might be mentioned. Illustrations could be furnished by countless foundations from many other fields of social concern and human endeavor—population, quality of environment, the arts, public broadcasting, regional planning, the administration of justice, and on and on. Rare would be the foundation, small as well as large, that could not give a multitude of examples —not the support of politically partisan efforts but of rational, impartial studies and projects. Such grants are not aimless but are directed toward making a difference. Differences are brought about in our society in many ways, to be sure, but one of the important ways which we would be loath to give up is through the changed attitudes and opinions of the public, which ought to, and do, get incorporated eventually in legislative changes, locally or nationally. It would be tragic for America if this kind of activity by foundations were to have to be discontinued.

It is my impression, however, that such an unhappey development for foundations in general was not the intent of the House Committee. In fact, in their Report, part 1, p. 33, they affirm a much more modest and realistic intention.

Referring to this provision of the Bill, they explain that it "applies specifically to expenses incurred in connection with grassroot campaigns or other attempts to urge or encourage the public to contact members of a legislative body for the purpose of proposing, supporting, or opposing legislation." In other words, the aim is to prevent foundations from engaging in partisan politics. With this aim we of the Danforth Foundation are in full accord; and we have reason to believe that the overwhelming majority of other foundations share this conviction. If the Committee's main purpose is to keep foundations from using the old substantiality test of Section 501(c) (3 in order to engage in propaganda, a purpose to which we gladly subscribe, then the dire results of the sweeping language of subparagraph (c), p. 45, can be escaped without doing violence to the laudable intention back of the language. That the Committee itself may have thought so is suggested by a further sentence from the Report, Part 1, p. 33: "This prohibition is substantially similar to the provisions of present law (Sec. 162(e)), which prohibits business deductions for grassroots lobbying activities." It is my conviction that modifications of the present provisions of sub-paragraph (c) could be made so as to enable the language to reflect more accurately the desires of the House Committee, and in the process to leave room for the legitimate functioning of foundations on behalf of the general welfare.

In closing my testimony I wish to reiterate that I do not believe the House Committee meant to impose severe program limitations on legitimate philanthropic agencies. That the Bill's wording in certain places does so is, in each case, an instance in which the language inaccurately reflects the intent. But, though the problem may be more semantics than substance, it is nonetheless serious in its implications for both foundations and their beneficiaries. I thank you gentlemen for the opportunity to present my concern to you.

Summary of Statement of Mr. Homer C. Wadsworth

I. Foundation effort marginal to government and to philanthropic giving of individuals. Therefore, foundations provide research and development assistance to agencies, public and private, seeking to advance knowledge and to cope with changing conditions.

II. Most foundations work with government agencies at all levels, and have continuous interchange with government officials—Examples.

III. Terms of H.R. 13270 section 4945(e) (1) and (2) give concern for following reasons:

A. Question of whether normal contact with government officials is prohibited.

B. Question of whether foundation officers and grantees may serve with federal advisory agencies.

C. Discrepancies, Ways and Means Committee and actual language of bill.

1. Report suggests prohibition of partisan activity; bill as written extends to grant support calculated "to affect the public opinion of the general public or any segment thereof".

2. Report states section 4945(c)(2) "does not extend to discussions of broad policy problems and issues with such members or employees". Bill reads prohibition of "* * * any attempt to influence legislation through private communication with any member or employee of a legislative body, or with any person * * *."

D. Lack of clarity and severe penalties will drive trustees and officers to to undue caution, numbing foundation effort and driving foundation effort away from areas of main national concern.

E. Use of term "knowingly", presuming that advice of counsel will protect against penalties, too thin a reed to lean on. Problem one of fact, not law, clarity rather than ambiguity.

IV. Comment on section 4945(f)(1) and (2) and (3): Expenditure Responsibility.

A. Main concern ambiguity; what does "fully responsible" mean?

B. Foundations need appropriate reporting mechanism, but should not interfere with freedom of grantees.

STATEMENT OF MR. HOMER C. WADSWORTH

The testimony which I wish to present relates mainly to those provisions of H.R. 13270 which define the limits of foundation effort in matters touching upon public policy. I wish also to comment upon those sections which define the responsibilities that foundations assume under the terms of this statute for the expenditures made by agencies receiving grants.

I do wish to associate myself and the parties I represent with the general position taken by other spokesmen on the main features of H.R. 13270. We do not oppose provisions of the bill that outlaw self-dealing. We do not oppose requirements that would assure that private foundations spend their income for charitable purposes. We do not oppose provisions that would require full disclosure of all foundation activities.

On the other hand, we object to the proposed tax on private foundations as fundamentally punitive and totally inconsistent with the effort of our government over many years to encourage private giving and private effort to accomplish worthy public purposes. We join others in support of a fee payment to provide the Treasury with sufficient funds to maintain an adequate staff for review annually of all foundation activities to assure compliance with the law.

The proposed changes in the law governing foundations, and especially section 4945(c)(1) and (2), seem strangely out of touch with the nature of things in this period of our history. Foundations exist to serve the public interest. Their justification derives from the view that the public interest is best served if private citizens and our agencies of government work together to meet human needs and to advance human knowledge. Thus, we have public and private universities and colleges; public and private institutions to serve the sick and the disabled; public and private agencies administering welfare services; public and private organizations that sponsor a broad range of cultural activities.

These agencies are by no means separate entities that may be distinguished from one another by the way they meet their bills. The contrary is the present condition. This era is marked by the rapid growth and development of mixed enterprises, each quite as dependent on various forms of public support as well as income from gifts and endowment and the like.

A few examples come quickly to mind. There is no longer to be found in this nation a purely private university. Our most affluent universities, each guided by private citizens serving as Boards of Directors or Trustees, receive from 30 to 50 percent of their income from governmental sources. Many of our medical schools, including those which function under church-related auspices, make up more than one-half of their annual budgets from government grants and contracts. Many of our symphony orchestras and art galleries and museums receive substantial and indespensable assistance from governmental sources, either directly or indirectly.

Foundation efforts are clearly marginal to governmental programs in most fields of endeavor. They are minor activities in dollar terms, too, in relation to private giving by individuals. The total spending of all foundations in the United States is much less than the annual budget of the Office of Education—a single office among many in the Department of Health, Education and Welfare. This is just as clearly seen at community levels as it is in national terms. HEW spends about 100 million dollars per year in Jackson County, Missouri (Kansas City); the total spending of our Association which is the only organized general purpose foundation group in the community is on the order of $750,000 per year.

The United Fund effort in Greater Kansas City produces $7,500,000 per year, to which must be added the considerable income of United Fund agencies from fees and memberships and the like. Therefore, foundation effort in local terms dwindles to very minor proportions—less than one percent of the spending of one Federal department among many; less than 10 percent of the amount available to United Fund agencies.

This condition in the country at large has forced many foundations, and especially those which work mainly in our communities, to regard their function as increasingly one of providing research and development assistance to programs designed to help all agencies, public and private, to better cope with constantly changing conditions. To accomplish this task we need full information about the range and quality of current effort. We need good working relations with those who carry the heavy burdens of community services, whether they be government officials or employees of private agencies. It is necessary frequently

for foundation officials to join with other parties to create new institutions to meet needs that go beyond the scope of existing programs.

Many examples come to mind from our experience along these lines in Kansas City over the past twenty years. The Association took the initiative in 1951 at the request of City authorities in creating a non-profit corporation to manage and develop the public services available to indigent persons in need of pyschiatric care. This effort has produced a wide range of coordinated programs now available to qualified parties in the western third of Missouri, and operates clinical, teaching and research programs on an annual budget in excess of five million dollars per year.

The successful management of the psychiatric program led the officials of Kansas City to request in 1961 that the Association take the leadership in creating another non-profit corporation to operate the City hospital system. This was accomplished under the terms of a contract between the non-profit corporation and the City government. The City's annual payment of seven million dollars has been doubled by drawing in private support as well as Federal grants for specified purposes. New buildings are under construction, aided by private gifts as well as state appropriations and Federal grants. The University of Missouri recently announced that it would develop a new medical school for the state as an integral part of the program, and has moved its dental school to a new location within the complex.

Quite frequently foundations make grants to public agencies to accomplish useful and important purposes best achieved in this way. For example, our member trusts made a grant of $480,000 to the School District of Kansas City, Missouri in 1962 to enable the District to operate a college scholarship program for young people from families with limited means. More than 500 students entered college through this program and many have returned to teach in the Kansas City system. The format and practices of the agency created to manage this activity have now been incorporated into a major Federal program.

Our member trusts created an independent social research agency in 1950, the Institute for Community Studies. This agency receives annual grants. It also performs a wide variety of research services for many parties—agencies of government at all levels as well as private, non-profit agencies. One of its recent contracts was with the Subcommittee on Employment, Manpower and Poverty of the Senate Committee on Labor and Public Welfare.

The foregoing indicates from our experience the basis for our concern with the changes in the tax law proposed in H.R. 13270, and especially Section 4945(c) (1) and (2). We work very cooperatively with many governmental agencies to accomplish useful ends. We find that precisely this kind of joint effort is needed to achieve the results desired. Quite clearly, many of the things we do through grant support are calculated "to affect the opinion of the general public or any segment thereof." Once a task is completed it often becomes legislation, for, in a government by law, acts, many times, must be ratified by statute or ordinance. In addition, every appropriation is an act of legislation. We do not live in a sterile world, and we doubt that any such world exists outside of research laboratories.

We are quite aware that there exists a wide range of opinion on many current public questions, and that foundations will be criticized for grants issued that provide for experimental effort along lines that some people oppose. We respect the open market-place for ideas, ask that others do so, too, and believe that the democratic system functions best under such conditions. We have always published full reports on what we do, and have made our records available to anyone who wanted to have a look at them.

Section 4945(c)(2) would restrict severely our contact with government officials. This portion of the bill reads as follows: "(taxable expenditures includes but is not limited to) * * * any attempt to influence legislation through private communication with any member or employee of a legislative body, or with any person who may participate in the formulation of legislation, other than through making available the results of non-partisan analysis and research." Are we to refuse to answer letters from legislators? Are we to exclude grantees from answering such letters or conversing with elected officials or "any other person who may participate in the formulation of legislation"? Are those of us who serve on Federal advisory councils—and I have served on many, and currently hold a seat on the National Advisory Health Manpower Council—to resign on the ground that our participation is in violation of this provision?

It seems to me that there are serious discrepancies between the report of the House Ways and Means Committee on this subject and the actual language of this section of H.R. 13270. The report states the following on page 33, beginning on line 10: "Your committee has determined that a tax should be imposed on expenditures by private foundations for various activities that it believes either should not be carried on by exempt organizations (such as lobbying, electioneering and 'grass roots' campaigning) or more appropriately are carried on by the other organizations."

I know of no private foundation that would take exception to this position. I know of no private foundation that would not subscribe to penalties for error in this regard. On the other hand, I see no correlation between this statement of purpose and the actual language of Section 4945(c) (1) and (2).

The same sort of discrepancy is to be noted between the Ways and Means Committee report and the Bill on the matter of communications with legislative officials and other persons. The Committee report states on page 33, beginning on line 22, that Section 4945(c)(2) "precludes direct attempts to persuade members of legislative bodies or governmental employees to take particular positions on specific legislative issues. *It does not extend to discussions of broad policy problems and issues with such members or employees.*" (emphasis mine). The section referred to does not make explicit this point. In fact, the language simply prohibits any attempt to influence legislation and by whatever means, and extends the prohibition to "any other person" other than legislators "who may participate in the formulation of legislation." Once again, it seems to me, a limited objective is taken with an arsenal of weapons sufficient to kill off all but the most hardy of foundation officers and grantees who dare to have an opinion that might conceivably play some part in the formulation of legislation.

The provisions of this section of the Bill together with the harsh penalties provided for failure to comply with the law, can only have the effect of numbing foundation effort and driving foundation money away from the areas in our national life that currently give us most concern. Trustees are quite human in that they tend to avoid areas of controversy in the normal course of events. They serve in most instances without any compensation, and give freely of their time to consideration of the matters that come before them in the form of requests for aid. They are not likely to risk penalties, nor are they likely to permit their officers to take risks in areas where the law and the regulations are distinctly unclear. This would appear to be the general situation that we shall confront if H.R. 13270 is passed without significant amendments.

I am aware that some of the officials of the Treasury Department do not believe that the penalties set forth in the Act will be operative unless private foundation trustees or their managers "knowingly" act in support of partisan ends. It has been suggested that having available an opinion of counsel will protect any foundation board or its officers from assault at this point.

This seems to me a very uncertain reed upon which to lean. Quite obviously, an opinion from counsel on such a point is arguable from the standpoint of the facts in the case rather than the law. I doubt very much that the use of the word "knowingly" in the statute will give any aid and comfort to either Trustees or officers faced with the kinds of decisions involved. As in the earlier instance cited, the normal disposition of Trustees faced with such a dilemma is more likely than not to do nothing rather than take the necessary risks—with or without the benefit of advice of counsel.

It is of some importance, I believe, for this Committee to take into account that much of the business that comes to foundation offices these days originates in legislative action in the Congress. Hardly a day passes without a petition for aid from an agency that is in a strong position to ask a Federal grant if local sources of support for the matching requirement can be cited. This applies to local agencies of government, and even to state governments on occasion, as well as private agencies in the health, welfare and education fields. I have a dozen such requests on my hands at this moment, ranging from requests for a rehabilitation agency program to the building plans of one of the leading medical schools in the nation.

The nub of this particular matter is simply that the Government must either permit private foundations and private persons to continue to serve public purposes to the maximum extent possible or the Government must revise its matching requirements and fund more generously the costs of facilities and services very much in demand. Tax reform as it relates to foundations will come down in the final analysis to simply this.

No foundation officer or trustee is opposed to prohibitions against *partisan* activity by private foundations or by grantee organizations. We are well aware that the present law prohibits lobbying, electioneering, and grass-roots campaigning. We know, too, that proper enforcement of the law as it now stands would root out quickly any infractions. We are confident that full disclosure of all foundation activity is the appropriate way to achieve the purposes set forth in the House Ways and Means Report, and without endangering the crucial role that foundations must play in our national and local affairs.

What is not so evident, and is entirely missed by both the House Ways and Means Committee Report and the text of H.R. 13270, is that private foundations and other exempt organizations have *less* sanction in present law and regulations for presenting their views to public bodies than business organizations. Mortimer M. Caplin, former Commissioner of Internal Revenue, offers the following comment on this matter:

"Today, the policy justification of the present limitations on exempt organizations' legislative activities is questionable. Since 1962, profit-making businesses have been permitted to claim income tax deductions—as 'ordinary and necessary' business expenses—for financing legislative appearances and related activities which are closely connected with their business operations. The 1962 amendment to the Internal Revenue Code overruled the well-established case of *Cammarano v. United States* (358 U.S. 498), which had previously denied income tax deductions for this type of lobbying. As the Senate Finance Committee pointed out, it was felt to be desirable 'that taxpayers who have information bearing on the impact of present laws, or proposed legislation, * * * not be discouraged in making this information available to the Member of Congress or legislators at other levels of Government.'

"Congress thus recognized in 1962 that it was legitimate for business entities and the trade organizations they support to participate in lobbying for legislation of direct interest to them. Yet, if this is true for business entities, why isn't it equally valid for education and charitable organizations? This 1962 income tax relief for business suggests that Congress should reexamine the entire area of legislative activities of exempt organizations with a view to granting them a broader measure of freedom in the legislative sphere." (Foundation News: November 1968, pp. 162–163.)

It comes down to this in the most simple and direct terms. Business interests may lobby for their ends, secure tax deduction for the expenses involved, and may live comfortably with the view of the Senate Finance Committee that it is desirable that they do so. Private foundations and other exempt organizations do not have comparable privileges under present law and regulations. If H.R. 13270 is passed without amendment the rights of such exempt organizations will be further limited, perhaps to the point where they cannot make a significant contribution to the national interest.

Section 4945(f) (1) (2), and (3) set up the terms of private foundation responsibility for funds issued to non-profit agencies other than public charities. Severe penalties are provided for non-compliance for such foundations and for their managers.

The terms of this section suffer mainly from ambiguity. To continue to make grants to many of the organizations which are now our grantees, the Bill would require us to exercise "*expenditure responsibility*". This means that "the private foundation is fully responsible—1) to see that the grant is spent solely for the purpose for which made, 2) to obtain full and complete reports from the grantee on how the funds are spent, and to verify the accuracy of such reports, and 3) to make full and detailed reports with respect to such expenditures" to a designated government official.

Foundations request reports from agencies receiving grants, and would not hesitate to share such information with Treasury authorities. Every legitimate foundation, of course, wants to know whether its money has been spent wisely and faithfully, in line with the purposes for which the grant was given. But the amount of follow-up and inspection which the Bill requires is excessive, and perhaps even impossible to provide. How could the foundation in every instance "verify the accuracy" of the "full and complete reports from the grantee"? Moreover, the provision is unwise, for what would such supervision do to the hallowed and sound policy of non-manipulation of the grantee that every well-run foundation practices? To fulfill this requirement in full, a foundation would have to exercise a degree of continuing surveillance of a grantee's affairs that

would be paternalistic and immensely expensive for any foundation and intolerable for any self-respecting grantee. It is surely a great way to enlarge foundation influence precisely at the point where foundations do not wish to exercise power.

Bearing in mind that the Federal Government and responsible foundations have a common goal—that of preventing irresponsibility—let us apply a rule of reason. Do not make up an insurer, with absolute liability for our grantee's conduct. Charge us instead with the responsibility of applying reasonable diligence to our relations with our grantees.

Summary of Statement of Hon. W. Russell Arrington

The thrust of Senator Arrington's testimony focuses on the problem of foundation supported groups that work to strengthen state government and in particular the Citizens Conference on State Legislatures. It is quite apparent that there is a national need for stronger and more effective state and local government.

The proposed section 4945 concerning influencing legislation may proscribe currently acceptable activities of the Citizens Conference. Senator Arrington stressed he was not an officer, trustee or employee of the Conference. Senator Arrington's interest is that the Conference's activities continue to be furnished to the state legislatures. Some of these activities include: 1) Provide advisory and technical services to some 16 state citizen commissions that study and recommend procedures for legislative modernization, 2) Conduct research and publish comparative information about legislative improvement, 3) Conduct media conferences to provide for an exchange between state legislators and editors, publishers, station owners and managers, and 4) Inform the public how the electorate has supported or rejected amendments concerning legislative articles of state constitutions.

H.R. 13270 will effectively prohibit these activities—even though these activities are non-partisan and do not involve elections for public office. If the "substantial activities" test is abandoned and section 4945 is substituted, the private sector may no longer be an impetus to bringing about legislative modernization.

Legislatures, by legislation, often request the Citizens Conference aid. That may be influencing legislation, even though the state asked for it. Every state legislator in the United States receives information from the Conference about the efforts to modernize. These activities may be prevented. The Conference brings the press and legislators together in the hope that they will influence one another. Undoubtedly legislation does get influenced in the process. Should this be proscribed?

Senator Arrington then goes on to make specific recommendations: 1) Distinguish between partisan and non-partisan and then go on to prohibit partisan activities and encourage non-partisan activities, 2) If legislation is procedural in the sense it affects structure of government encourage not prohibit involvement in legislative activities, 3) Use disclosure as the method of preventing abuses in the relationships between public officials and foundations, 4) Require foundations to be invited to testify or offer technical advice, and 5) Permit activities that are not engaging in support of or opposition to candidates that are general in nature rather than advocating particular legislation, and not partisan election campaigns.

Statement of Hon. W. Russell Arrington

Mr. Chairman, my name is W. Russell Arrington. For the record I am an attorney with offices in Chicago, Illinois. I am also Vice President and General Counsel of Combined Insurance Company as well as Director of Alberto Culver Company. I am President Pro Tempore and Majority Leader of the Illinois Senate, a member of the Executive Committee of the National Conference of State Legislative Leaders, the Executive Committee of the National Society of State Legislators and a member of the Advisory Commission on Intergovernmental Relations.

My purpose in being here is to discuss the possible consequences the "Tax Reform Act of 1969" might have to the Citizens Conference on State Legislatures and to the national effort to modernize state legislatures.

Let me assure you that I am *not* a trustee or officer of the Citizens Conference—nor have I ever been. I am here as a concerned state legislative leader to point out to you some of the unintended consequences HR 13270, and primarily Section 4945, might have on the private sector's role in strengthening representative government at the state level.

First, let me explain my past involvement with the Citizens Conference. In 1965, the Illinois General Assembly created The Commission on the Organization of the General Assembly composed of legislators and public members. The Commission was charged with the task of examining the entire scope of legislative procedures and structure in Illinois to derive recommendations for improving the General Assembly. We were one of the first legislatures to take this step. Of the 87 recommendations this Commission felt would improve the General Assembly, 58 were adopted. The efforts of this Commission were a major input into what we consider to be one of the most effective state legislatures in the nation.

One of our problems in the beginning was the lack of a source of information about what legislatures elsewhere had found to be effective in dealing with their work. Another troublesome spot was the lack of advice as to how to proceed to maximize the effectiveness of the Commission itself. These deficiencies were soon solved by the Citizens Conference, an organization which was formed in 1965.

Other state commissions—about 16—have received major assistance from the Citizens Conference. In addition, the Conference dedicated itself to informing the public about the need for strengthening state legislatures.

Let me briefly describe the activities and character of The Citizens Conferences' program.

1. They are national, non-partisan and not-for-profit.
2. They encourage, assist, and provide advisory and technical services for state citizen groups working to support and improve the effectiveness of their legislature.
3. They conduct research and bring together comparative information about legislative improvement in the fifty states.
4. They conduct regional and single-state conferences which bring together state legislators with editors, publishers, broadcasting executives and civic leaders. The purpose is to provide a frank and candid exchange of views about legislative improvement.

The Citizens Conference does not participate in the drafting or construction of particular legislation. They do not lobby for particular legislation. Neither do they participate in campaigns for public office nor do they become involved in voter registration.

I don't feel it necessary to make a strong statement about the need for stronger and more effective state government. Many hearings conducted by this body have documented the need. The urban crises and the prospects of revenue sharing are just two major forces which require the states to participate in a joint partnership with the federal government. The thrust of my testimony concerns groups which are working to strengthen state government—organizations of which the Citizens Conference on State Legislatures is exemplar.

I have described their activities and their program. I doubt anyone here questions either the worthwhileness of their objectives or the means by which they advance them. Yet HR 13270 will proscribe most of their program. The bill, as written, will effectively prohibit the private sector from working to improve government at any level.

My testimony, then, concerns the proper relationship of 501(c)(3) organizations vis-a-vis governmental bodies—in specific, the issues which are involved in influencing legislation and elections.

HR 13270 would not allow the Citizens Conference to "carry out propaganda, or otherwise attempt to influence legislation . . . (1) through an attempt to affect the opinion of the general public, (2) influence the outcome of any public election, and (3) influence legislation through private communication with any member or employee of a legislative body."

This represents quite a departure from current laws and regulations which concern activities of tax-exempt groups. The current law recognizes the difficulty of forbidding completely contact with government bodies by tax-exempt groups by providing an area of discretion—the "substantial activities" test which is now applied to the issue of influencing legislation. The House Committee Report (HR 91-413 at page 32) suggests a reason for abandoning the substantial activities test for most 501(c)(3) organizations, as follows:

"Moreover, a large organization, merely because of the substantiality test, may engage without consequence in more lobbying than a small organization; a well-endowed organization may engage in lobbying and, if it loses its exempt educational or charitable status may avoid tax on its investment income by becoming exempt under another provision of the law."

Gentlemen, the dilemma facing the Citizens Conference under the provisos of HR 13270 is a very real one—it is unlikely state legislatures will be modernized unless public opinion is affected and unless legislation is enacted.

Let me give you an example. The Citizens Conference has written to each of the 7,616 state legislators telling them about the Conference's willingness to help them in improving their legislature. The Conference enclosed materials, such as The Chamber of Commerce of the United States' publication, *Modernizing State Government*, which explains the kinds of structural and procedural changes which could be made to improve the way in which legislatures conduct their business. Undoubtably, legislation resulted from this kind of contact. This, I suspect, may be defined as influencing legislation—an activity which is to be barred to a private foundation.

Some legislatures have passed resolutions creating advisory commissions similar to the one in Illinois which I previously described. In these resolutions, the legislatures have expressly called upon the assistance of the Citizens Conference. Such commissions rely heavily upon the materials, advice and technical assistance of the Citizens Conference. Technical assistance provided to commissions include providing consultants on internal operations of the legislative process, such as systems for preparing fiscal notes or more effective bill scheduling; consultants on commission organization, material distribution, and public relations are also provided. The Conference's staff is well versed on the methods by which commissions can be most effective. This expertise has been gained by working with many commissions and is invaluable to a commission which is just beginning. At the end of the study phase, these commissions recommend changes in the legislature of their state. When such recommendations are adopted, legislation is offtimes required. This, I suspect, may be construed to be influencing legislation.

The Conference conducts regional and single state media conferences—for civic leaders, press, radio and TV executives and legislators. The topic is legislative improvement and a forum is provided for a frank and candid exchange of views between parties sometimes viewed as natural adversaries. Editorials often result which encourage the legislature to take steps to modernize its way of working. Both the legislators and the media participants certainly would be considered to be those "who may participate in the formation of legislation." Editorials which may occur as a result of the conference may be viewed as an "attempt to affect the opinion of the general public." The net result of these conferences may be legislation which is influenced.

Let me take this opportunity to call your attention to an apparent inconsistency in the proposed law. Results of non-partisan analysis and research are allowed to "influence legislation." This same right does not apply to influencing elections. If the proposed "influencing election" section is limited to candidate elections, I see no problem. If, however, the 501(c)(3) organizations cannot make available results of non-partisan analysis or research during non-candidate elections such as constitutional amendments affecting the legislative branch, then the public is deprived of a major source of objective analyses of the issues upon which they must vote.

We must differentiate clearly and precisely between the connotations of "partisan" and "non-partisan." Although they appear to be semantical opposites they are not, nor are they operationally polar extremes. As they concern us today, they describe goals not in conflict, but goals in concert. I hope now to describe the distinction between the two as I see it relating to the influencing of legislation and/or elections.

I speak to you as a partisan. I firmly believe in partisanship in government. Partisanship is a strong factor in every decision I make on substantive issues that come before me as a member of the Illinois State Senate. But decisions regarding the fundamental structure of our basic political institutions, it seems to me, are not of the same generic family. Partisanship within the American political system does not come to bear on questions of how long the state legislature is in session, how it organizes its committee throughout a session or in the interim between sessions, the professional staff assistance provided committees and members, the size of the respective houses, the regulations describing ethical conduct, or the annual compensation a member should receive.

In a partisan sense, one cannot determine that the Wyoming legislature should meet 40 days every other year and the Massachusetts legislature sould meet in continuous session every year. When and how often a state legislature should meet must be based upon the time needed for the particular legislature to make intelligent policy decisions regarding its state's activities. Likewise, providing professional staff assistance to the legislature to insure that it can consider the most complete range of alternatives for the immediate and long-range view, does not gainsay the operation of partisanship within the legislature.

Too many of our state legislatures are so fettered by these non-partisan deficiencies in structure and procedures that their partisan decisions are reactions rather than action to meet their problems. They are impeded from innovating solutions or cures and are forced instead to apply bandaids to cancers. To correct these structural and procedural weaknesses often requires the passage of some legislation—legislation which is not substantive policy taking us a step closer to the opportunity for a good life for all a state's citizens, but legislation perhaps to remove a constitutional prohibition against annual sessions, or a limit on the amount of annual salary a legislator may be paid. We are not talking about the decision as to what to do with an egg—whether to boil it, scramble it, put it in a cake, or make a custard—but only the decisions regarding and guaranteeing that the chicken will produce the best possible of eggs.

The above distinctions lay the groundwork, I believe, for a revised bill—a bill which will allow organizations classified as private foundations to mobilize public support to study, recommend and change, if need be, governmental units. Safeguards, of course, need to be maintained. I have alluded to some— that the activity be non-partisan in nature, national in scope, that it not engage in support of or opposition to candidates, that the activity be general in nature rather than advocating particular legislation, and that partisan election campaigns be avoided.

Another safeguard which could be adopted would be disclosure of all financial transactions between a tax-exempt organization and government officials. Barring modest honoraria seems to me to be unduly restrictive. When an organization, for example, deals with legislative reform it is not unreasonable to look to legislators themselves as speakers or participants on programs.

Disclosure could also be applied to the potential problems of private communication with public officials. If there is a fear that private correspondence defeats the purposes of national taxing policies, let me suggest that I have found disclosure brings light to most relationships. As a public official I would think this is not too great a price to pay to keep open channels of communication and information with tax-exempt organizations.

Please understand that I appreciate the problems of writing a fair and equitable tax law. In Illinois we just went through that; it's not an easy task. I am asking you to recognize the nation's need to make our federal system work. This is one reason I serve on the Advisory Commission on Intergovernmental Relations. The federal tax system should recognize and encourage the private sector's role in making government work at all levels. Foundations provide most of the seed money and project funds for many of the programs of this kind. Without foundation support, it is a safe bet that national organizations which provide the valuable cross-fertilization of ideas, research data and non-partisan analyses, advice and guidance about how to proceed could not sustain a program of either intensity or duration. We—all of us—benefit from these kinds of programs. Safeguards should exist to prevent possible abuses while encouraging maximum effort from the private sector.

The focus of my testimony has centered around the Citizens Conference and programs to improve our form of government. This, in large part, reflects my occupation, involvement and interests. I do not wish, however, to leave the impression that my complete concern is for just these kinds of organizations. I also want to point out other tax-exempt organizations provide a valuable service in other fields. Organizations who are concerned about the natural environment, criminal justice, regional planning, family planning, public health and housing need the same kind of consideration. We need to encourage public efforts in many fields.

Our pluralistic society needs vigorous discussion of issues. Such a process ought to be protected, even encouraged.

I trust that you, in the process of your critical evaluation, will arrive at these same conclusions. Current provisions may require some change. My concern is that the many do not suffer as a consequence of the acts of the few.

I thank you, Mr. Chairman, for the opportunity to present this testimony.

V. EFFECT OF DISTRIBUTION REQUIREMENTS (INCLUDING PROBLEMS RAISED BY DEFINITION OF QUALIFYING DISTRIBUTIONS)

SUMMARY OF STATEMENT OF DR. JULIUS A. STRATTON

This statement is addressed specifically to two aspects of H.R. 13270—the definition of a "private foundation" and the concept of qualifying contributions.

"Private foundation" is a term newly introduced to the Internal Revenue Code by the proposed legislation, lumping together for the first time as "private foundations" all 501(c)(3) organizations except certain specified categories. Because of this new definition, many important and worthwhile nonprofit institutions which are not primarily grant-making organizations, which depend heavily on foundation support, and which have never before been thought of as foundations may now be considered so and subject to the new restrictions in the bill.

There are three far-reaching consequences of such redefinition:

1. Such organizations would be subject to the proposed taxes, thereby reducing the funds available for their educational, research, and scientific activities.
2. They would be subject to the many other regulations and program limitations in the bill, limitations which earlier witnesses have discussed.
3. They would have far greater difficulty in obtaining support from philanthropic foundations.

Their difficulty in obtaining such support stems from another newly introduced term in the bill: "qualifying distributions."

Although the broad requirements of paying out current income would not cause serious problems for most foundations, difficulties arise because of the uncertainties surrounding who would be eligible to receive foundation grants and how these grants should be disbursed and managed.

Three general recommendations are made:

1. A more precise definition of "private foundations" should be formulated—a definition which would include only what have commonly and logically been regarded as philanthropic foundations.
2. A simple test should be established—based on a concept in the current Internal Revenue Code relating to operating foundations—under which grants that flow promptly to charity would be qualifying distributions.
3. The penalty provisions in the bill should be reconsidered.

Without clarifying changes of the sort suggested, the traditional role foundations have played in our national development may be seriously impaired.

STATEMENT OF DR. JULIUS A. STRATTON

Mr. Chairman and Members of the Committee: In his opening statement Mr. J. Irwin Miller outlined very briefly the plan of our presentation relating to those sections of H.R. 13270 pertaining to private foundations. For this presentation it has been suggested that my own remarks be focused upon certain aspects of the proposed legislation—particularly the implications of the broadened definition of private foundations" and the consequences of the new concept of "qualifying distributions."

Before speaking to these specific points, however, I should like to say a more general and very personal word about foundations. I come before you with a deep concern for the future of philanthropy in our country and for the viability of many institutions whose very existence depends upon funds from private sources—institutions whose ideas and ideals are basic to our American concept of a democratic society. My own perspective of the needs and benefits of philanthropy has developed over the years that I have spent in the field of education, as a former provost and president of the Massachusetts Institute of Technology, and as a trustee of various colleges and institutions cultivating the arts and the sciences. Then as a trustee of the Ford Foundation during the past fourteen years and as chairman of its Board since 1966, I have learned something at firsthand of the hazards and complexities as well as the satisfactions of giving. Out of this total experience I have come to the profound conviction that charitable foundations have an obligation to society that goes beyond a merely passive response to pleas for help. They have an obligation to search out new ways and means of meeting pressing needs in our society and supporting responsible institutions and organizations which have the impetence to help in resolving them. Foundations serve the highest national purpose in advancing our tradition of many roads to

progress. To this end they must enjoy the freedom to encourage thoughtful experiment and to stimulate constructive innovation.

In saying all this, I do not mean to equate freedom with license. Every witness here today, I am sure, acknowledges the need for clear guidelines and standards of action. We recognize as well that these must be reviewed and revised as the concept of foundations evolves. My particular concern, however, is that some of the rules and guidelines set forth in the bill before you are difficult to interpret, with implications which I can only believe were neither foreseen nor intended, and which if enacted in their present form would have a devastating effect upon the contributions of American philanthropy to the public good.

Consider first the proposed definition of a "private foundation." This is a term newly introduced to the Internal Revenue Code by the proposed legislation. It is not found in the present Code, although tax specialists have used it, in a generic sense, to describe an organization to which contributions may be deducted only up to 20 percent of an individual's adjusted gross income (whereas contributions to certain other organizations may be deducted up to 30 percent).

Those familiar with the field of private philanthropy will recognize that a technical description of this sort is not intended to nor does it of course describe philanthropic foundations as we have come to know them over the past 50 years. Indeed it may be useful at this point to set forth briefly and in a wholly nontechnical way—what those of us who have worked in the foundation field for many years regard as the characteristics of a philanthropic foundation:

It is a nongovernmental organization

It is a nonprofit organization

It has a principal fund of its own

It is managed by an independent board of trustees

It is established essentially to make grants in support of educational, charitable, scientific, and civic organizations serving the public welfare.

In a sense, the present Code comes closer to a useful description, for under it philanthropic foundations are classified as 501 (c) (3) organizations; 501 (c) (3) of course is that section of the Code that includes organizations that are operated exclusively for religious, charitable, scientific, literary, or educational purposes and for those purposes are tax exempt. It should be noted that except for the so-called "20 percent limitation," foundations have always been considered in the same category as all other philanthropies.

In contrast, under the proposed bill—and here I do my best to summarize the pertinent provision—a private foundation is defined as any 501(c) (3) organization other than (1) the so-called 30 percent organizations described in Section 170 (b) (1) (B)—basically educational institutions, hospitals, government agencies, religious organizations, and publicly supported charities; and (2) those organizations which *do not receive more than one-third of their support from their own investments* and which *do normally receive more than one third of their support from publicly-supported organizations or from individual contributions of less than $5,000.*

It should be noted that this proposed new definition of a private foundation does not set forth the positive characteristics of a foundation; instead it lumps together for the first time as "private foundations" all 501(c) (3) organizations except certain specified categories. Moreover, the proposed legislation establishes a legal presumption that in the event of any uncertainty as to whether a 501(c) (3) organization is or is not a private foundation, it is to be considered one.

Because of the way "private foundation" is defined in the bill, many important and worthwhile organizations which are not primarily grant-making foundations—organizations which have never before been thought of as foundations—may now be considered private foundations subject to the many new restrictions in the bill.

Under the proposed definition, such distinguished institutions as The Institute for Advanced Study at Princeton, the Brookings Institution, the Council on Library Resources, the Woodrow Wilson National Fellowship Foundation, and the Population Council—all of which have made contributions of lasting significance to our society—might be classified as "private foundations." Why? Because they are 501(c) (3) organizations which would not meet the explicit tests set forth in the bill for exclusion from that category—tests to which I referred earlier. Yet they are, in fact, non-profit institutions of unquestioned merit which depend heavily on foundation support. The Institute for Advanced Study, for example, would become a private foundation under the bill because it

does not have the specified characterists of an educational institution and it receives more than a third of its support from endowment income. As another example of the uncertainties as well as the problems created by the definition, let me quote from a letter which the Ford Foundation recently received from the American Academy of Arts and Sciences:

"We are uncertain about the effect of the bill on the American Academy. According to our performance over the past five years, we qualify as a "30%" organization on the basis of the "mechanical test" of the percentage of "public" support—which is about 40% of our income for each of the years during this period. The nature of our organization allows us also to qualify under the "facts and circumstances test" as a "30%" organization. At least our lawyers tell us that there is a high probability that we can be granted such an exemption. However, our sources of public support (most noteably, subscriptions to our journal, Daedalus) are relatively fixed or increase slowly. But we have been growing rapidly in terms of the number of projects and the percentage of our budget supported by private foundations, and consequently next year it is possible that much less than one-third of our income will come from public sources. *One large grant from a major foundation could make a significant difference in our ability to pass the mechanical test. Thus, we cannot rely on exemption by the mechanito pass the mechanical test.* Thus, we cannot rely on exemption by the mechanical test." (emphasis supplied)

One may ask, what difference does it make that hundreds of organizations like these might be reclassified as "private foundations"? The difference is quite tangible, with at least three far-reaching consequences. *First*, such organizations would be subject to the proposed taxes, thereby reducing the funds available for their educational, research, and scientific activities. *Second*, they would be subject to the many other regulations and program limitations in the bill, limitations which earlier witnesses have discussed. *Third*, they would have far greater difficulty in obtaining support from philanthropic foundations.

The difficulty they would meet in obtaining such support stems from another newly-introduced term in the bill: "qualifying distributions." Perhaps it is worth a moment to review the way in which the problem arises. H.R. 13270 contains provisions requiring regular and prompt distributions of income to charity. This objective is highly desirable, and responsible foundations support it fully. Indeed, taken as a whole, foundations last year paid out approximately 7.5 percent of their asset value.

We know of no one among responsible foundations who objects to the requirement of prompt distribution of income to charitable purposes, and there is also widespread agreement that some percentage of asset value, measured over some time-span, is a fair additional safeguard where investment income is very low in relation to capital assets. Moreover, in many cases—and the Ford Foundation is one—the proposed 5 percent rate is entirely acceptable, because the foundations concerned are already distributing, as the Ford Foundation does, at a substantially higher rate. But your Committee should be aware that there are a number of public spirited and effective foundations which would find it hard to meet a 5 percent requirement, especially when measured on a one-year basis, without a sudden change in investment policies whose long-run value for charity has been great. We do not believe that the 5 percent level has been adequately tested either by the Treasury or in the House against the real situation of such foundations, and we hope that the Committee will give careful attention to the arguments which it will receive from foundations which have a problem with the requirement as currently stated. It may well be that the main purpose of the requirement could be met more equitably by a slightly different rate, or by applying the rate to an asset value determined over a somewhat longer time-span.

In any event, it is clear that the broad requirement of paying out current income would not cause serious problems for most foundations. Rather, the problems arise because of the uncertainties surrounding who would be eligible to receive foundation grants and how these grants should be disbursed and managed. For having established the requirement that certain amounts be distributed each year, the bill then provides that only certain types of distributions will be considered to "qualify" for purposes of meeting the requirement—distributions in the main to "30 percent" organizations and to an imprecisely-defined new category called "operating foundation."

So far as we can tell from the pertinent provisions of the bill, it appears that grants to such organizations as the American Council of Learned Societies, Educational Facilities Laboratories, the International Legal Center, Resources for the Future, and the Social Science Research Council—organizations whose records of performance and accomplishment are widely known and respected—would fall outside the "qualifying distribution" category. This would have two harmful consequences:

First.—Grants to these organizations would not count in meeting the annual distribution requirements of a foundation.

Second.—Grants to such organizations would have to come out of a foundation's capital fund—the base of the income it uses for charitable purposes.

In the face of such economic constraints, foundations would clearly be reluctant to grant funds to such organizations. To be sure, such grants would not be prohibited; but they would not be qualifying distributions, and because foundations would be penalized if their qualifying distribution fell below the required level, the effect of the bill would be to discriminate against a newly created class of charities—organizations in our view illogically classified as private foundations.

Many other examples could be given. Individual foundations have developed special areas of philanthropic concern well known to all of us—like the Sloan Foundation's regular and substantial support of the Sloan-Kettering Institute of Cancer Research; the Rockefeller Foundation's assistance in the advancement of agriculture with the objective of increasing the world's food supply; the Carnegie Corporation's outstanding work in the field of education; the Guggenheim Foundation's encouragement of creative scholarship, research, and writing; the Markle Foundation's assistance in the development of medical education—and this is but to name a few. For many years, foundations have been the main support, often the sole support of productive activities of the kind I have cited.

The value in creating such philanthropic instruments for progress in human affairs is two-fold. Important work gets done through concentration on a single field, such as educational television, and secondly, the new entity provides an opportunity to develop a group of knowledgeable directors and specialists, completely independent of the donor foundation.

The "qualifying distribution" concept would also hamper philanthropic efforts to help communities, regions, and the nation as a whole meet new educational, cultural, and social needs. Experience has shown that it is often necessary to create new organizations and institutions to meet changing conditions and unforeseen challenges. On many occasions, it has been necessary for a single foundation, having embarked upon a particular course of charitable or educational development, to support a research center, an educational agency, or a specialized national agency for a number of years before it can muster wider support. This course might be substantially foreclosed under the bill, because one of the requirements in the definition of an "operating foundation" is that it must be supported by at least five philanthropies, with not more than 25 percent from a single source.

Let us look for a moment at a particular example, the National Merit Scholarships. This program, one of the most successful endeavors of its kind, was established in 1955 largely with the support of the Ford Foundation. It was designed to identify unusually able young people, to interest them in higher education, and to help as many as possible to attend the college or university of their choice. Through 1968, National Merit Scholarships valued at over $70 million have been awarded to 21,663 young men and women from every part of our country. Under the proposed legislation, the National Merit Scholarship organization would have been a "private foundation" at the time of its establishment because the bulk of its support came from one or two philanthropic foundations. Furthermore, in its early years this organization would not have qualified as an operating foundation. Today, National Merit has broader support and would qualify as a publicly-supported charity. But the point is that under the proposed legislation such an organization would probably not have come into existence in the first place. Surely this is not what the Congress intends.

Aside from their efficiency and effectiveness, new and capable institutions devoted to a well-defined purpose are also a means of assuring that control of innumerable operating organizations is not lodged in the larger foundations. That such foundations have voluntarily decentralized in this manner should

be noted as evidence of their conscious and affirmative intention to avoid excessive centralization even in the absence of legislation. Permit me to dwell another moment on the question of responsibility, which seems to be a recurrent thread of concern in many provisions of the bill. I speak to the subject from a personal standpoint, having been privileged, as I noted earlier, to serve as a trustee of a major foundation. Experience has taught me that there is no better way to insure responsibility in fund management and to develop innovative approaches to complex and unsolved problems than to establish a group of capable, dedicated persons devoted to such activity. A good example is the Council on Legal Education for Professional Responsibility, an organization which has done so much to advance clinical law teaching. The Council has on its board such distinguished lawyers as Edward Levi, president of the University of Chicago, Whitney North Seymour, William T. Gossett, and Orison S. Marden. Chief Justice Warren Burger in a speech given in San Francisco several weeks ago, described the Council as—

> A concept devised by lawyers, implemented by lawyers, and financed by the private sector including lawyers and Bar Associations and great philanthropic institutions. This is the American Way of progress and it is better and more enduring than ad hoc improvements imposed by acts of Congress or mandates of courts.

In the same way, Resources for the Future, an organization supported almost entirely by the Ford Foundation, has operated under the management of a board of able men deeply interested in the problems of preserving our natural resources.

I cite these examples to stress the importance of writing legislation that will encourage—not discourage—the continued creation of new philanthropic organizations, with independent boards of their own, to meet new and changing situations in a dynamic society. One advantage of foundations is their flexibility and capacity to respond to challenges promptly and responsibly. Not in the spirit of criticism but as a result of my own participation over the years in various governmental activities, I am convinced that in many important ventures foundations are in a position to act constructively and well in advance of government. The scale of support is necessarily more limited, but the significance of foundation involvement is often substantial. And what is quite telling in this respect is that government itself at all levels—federal, state, and local—recognized and values this capability in foundations. In many instances, ideas for foundation action have in fact come from legislators and government officials, and indeed from time to time government draws on the experience and expertise that professional staff members in foundations have acquired in particular matters. These advantages could be lost if the philanthropic foundations—confronted with the problem of qualifying distributions, a problem compounded by the definition of private foundations—were to take on huge staffs of their own and attempt to operate directly over a broad spectrum of program areas.

The foregoing and the points on which other witnesses have stressed the need for clarification underscore the need for a continuing effort to match the specifics of a crucial legislative action to the underlying Congressional intent. I make this judgment in respectful understanding of the vast labor already expended by the Congress in the whole of the tax reform bill and of the enormous tasks still ahead of you. But in conseqences for society, I earnestly believe these points deserve your close attention.

I may seem to have emphasized too much the problems which relate to the large foundations, but the questions which I have raised affect even the smallest of foundations. For instance, the decision of small foundations. For instance, the decision of a small foundation to make a reatively substantial grant in support of a symphony or library in a particular community might, under the proposed language, ironically create problems for the recipient. For one thing, the beneficiary of a major grant from the single source might then be in danger of slipping into the category of a private foundation and thus be subject to the proposed tax; further the beneficiary might become ineligible for "qualifying distributions" from philanthropic foundations. I do not believe these are results the Congress intends.

As possible guidelines for your review of the several provisions in the bill to which I have referred, I would respectfully like to make three general recommendations.

First.—I believe that a more precise definition of "private foundations" should be formulated. Without presuming to suggest the specific language of such a definition, I do state my belief that far too many organizations are included

in the definition as it now stands. I believe that language can be found to describe the nature and activities of such organizations as the Council on Library Resources, the Brookings Institution, and the Woodrow Wilson National Fellowship Foundation—language that will clearly distinguish them from grant-making foundations. In my view many of the difficulties in the present bill could be remedied by a more precise definition of "private foundations"—a definition which would include only what have commonly and logically been regarded as philanthropic foundations.

Second.—The objective of a prompt and regular flow of funds to charity might be more readily achieved—and without unintended and harmful consequences—by establishing a simple test based on a concept in the same section of the current Internal Revenue Code from which the definition of an "operating foundation" is derived. The basic principle of that provision is that grants to an organization which then promptly applies the funds to charitable purposes are "qualifying" contributions. Under such a provision, grants for endowment—that is, capital sums which are then invested by the grantee in income-producing securities and thus not promptly expended—would not constitute qualifying distributions (except for the "30 percent" organizations and publicly-supported charities) ; on the other hand, grants for operating funds would always qualify provided they were expended in some reasonable length of time for charitable purposes. Such a relatively simple test would, it seems to me, meet the justified concern of the Congress that there be a prompt and regular flow of foundation funds to charity.

Third.—The penalties imposed on the trustees and officers of foundations in certain instances are extremely severe and seem to me to be out of proportion to the possible offenses. For example, a heavy tax is imposed on any "foundation manager" who violates the vaguely-defined prohibition against investments that "jeopardize the carrying out of any of . . . (a foundations's) exempt purposes." Harsh penalties are also imposed on "foundation managers" when foundations take actions which may subsequently be interpreted as contrary to other provisions in the bill. I am concerned that the uncertainties that hang over what might otherwise seem the most proper and legitimate actions—combined with the severity of the potential penalties—will make it difficult for foundations to find and to hold the caliber of directors and trustees so essential to their well-being and effectiveness. And, perhap as importantly, I fear that the balance will be tipped against innovation and experiment. These institutions, with men of sound judgment and practical experience managing them, should be prized for their ability and willingness—after careful study and the exercise of their best judgment—to try new ideas. It is that invaluable asset—not found widely in our society—which seems to me to be threatened. Therefore, I strongly urge this Committee to reconsider the penalty provisions in the bill.

To sum up: Without some clarifying changes of the sort suggested, Congress may seriously impair the traditional role foundations have played in our national development. The restrictions are such that this nation might be deprived of resources which have yielded effective and sound approaches to pressing problems. The question has periodically been raised, why not let these tax-exempt funds revert to the Treasury and let government carry out these vital activities? The answer is imbedded in a deep philosophical vision of the kind of society we wish to have. From the time of our founding as a nation, the American people have sustained their faith in the value of having other forces at work besides the government. Diversity and pluralism have been more than symbolic words; these concepts have always had deep meaning to us as a people. Moreover, there is little evidence that government is always ready to seize the initiative and to take substantial risks in uncharted areas not only in science and medicine, but also in the social sciences and education.

I firmly believe that the times ahead will test, more severely than any in our history, the strength of our democratic institutions. This is hardly the moment to restrict the capacity of the private sector of our society to meet greater and greater challenges.

Summary of Statement of Mr. Whitney North Seymour

Mr. Seymours statement is directed primarily toward that portion of H.R. 13270 which deals with the definition of an operating foundation.

He describes the organization and work of the Council on Library Resources, an independent, non-profit organization established in 1956 for the sole purpose

of aiding in the solution of library problems. Qualifications of staff and Board are cited, to underscore the professional quality of the Councils work. He says that the Council conforms in every sense with the spirit of the proposed legislation. It engages in no self-dealing activities, all of its income is spent in furthering the purpose for which it was formed, it has no endowment, it controls no businesses, it owns no stock. He says it can best be defined in the words of the House Report accompanying H.R. 13270 to describe operating foundations: "organizations which have developed an expertise in certain substantive areas and which provide for the independent granting of funds and direction in those specialized substantive areas."

However, he fears that the language of H.R. 13270 defining operating foundations, eligible to receive qualifying distributions from other foundations, might mean that the Council might possibly be forced to terminate its greatly-needed activities. Although the Council meets unreservedly the provision that all of its income be expended directly for the active conduct of the activities for which it was organized, it cannot devote more than half of its assets to this purpose since it has no "assets" as indicated by the examples in the House Report, and its support comes entirely from one source, the Ford Foundation. Thus, although philosophically the Council is an operating foundation, it might not be considered so under the definition which seems to be established by the legislation.

Mr. Seymour expresses his concern on similar grounds in regard to the International Legal Center, and describes the Center's purpose and organization. He points out that its accomplishments would not have been possible without the initial underwriting provided by the Ford Foundation, that a non-profit service-type organization cannot become viable from inception or even launched without such financial backing. The Center, like the Council, might be placed in jeopardy by ambiguities in the provisions of the bill now before the Committee. In this connection, he asks the Committee to clarify that portion of the definition of an operating foundation which refers to assets, and to the word "directly" as applied to the use of assets.

The Congress' concern that some activities of some foundations may not have conformed with the intent of the original legislation is appreciated. Mr. Seymour expresses the belief that it cannot be the Congress' intent to disrupt the efforts in the public interest of organizations like the Council and the Center. He urges the Committee to consider carefully and rewrite the provisions he has cited in such a way as to eliminate the evils which called them into being, and at the same time clarify them so that the effectiveness of honorable and essential institutions may not be destroyed.

Statement of Mr. Whitney North Seymour

My name is Whitney North Seymour. I am a partner in the law firm of Simpson, Thacher & Bartlett, New York, a past president of the American Bar Association, and chairman of the Board of Directors of the Council on Library Resources. I also serve as chairman of the Board of the International Legal Center, an independent fund with a similar organization to that of the Council but, as is obvious, of different purpose. I am also a member of the Boards of other organizations concerned in the fields of legal education, research, and public service. We are grateful to the Committee for giving us the opportunity to present testimony directed toward that portion of H.R. 13270 which deals with the definition of an operating foundation.

The Council on Library Resources is a not-for-profit organization incorporated under the laws of the District of Columbia and qualifying as a tax-exempt institution under 501(c)(3) of the 1954 Internal Revenue Code. It is an entirely independent organization—maintaining its own staff, program, and headquarters—established in 1956 for the sole purpose of aiding in the solution of library problems, particularly those of research and academic libraries. An initial Ford Foundation grant of five million dollars was succeeded late in 1960 by one of eight million dollars for an additional seven-to-ten year period, and a third grant of five million dollars has recently been made for the three-year period ending June 30, 1971. These funds have been spent on a current basis and have not been available for an endowment.

For the most part the Council has carried forward its purpose through grants to institutions, supporting innovative programs which show promise of helping to solve some of the many problems that beset libraries, in a country and at

a time when demands upon them increase in almost geometric progression. We live in a world where information is an essential commodity; our libraries must be prepared to play a vital role in collecting and disseminating that information in a manner that keeps pace with the rate at which it develops.

In the years of its existence the Council has made grants of over thirteen million dollars to support approximately 450 projects. Recipients have included professional organizations and learned societies, public and special-purpose libraries, institutions of higher education, as well as a limited number of individuals with special qualifications. Agencies of the Federal Government have also been assisted by Council funds, for it is often the case that the best method for dealing with a problem area consists in helping or encouraging some Federal agency to take a needed action or to develop a needed service. Members of this important Committee understand better than most the necessary delays in the establishment of programs which are imposed by the legislative and administrative processes. We of the private sector may move more quickly, particularly in experimental or developmental activities. Thus support from the Council on Library Resources has in many instances made possible pioneering efforts in Federal libraries, efforts which have had important and far-reaching positive effects on the entire library community.

For example, the Council's assistance has been a principal factor in the automation efforts at the Library of Congress and, by extension, the libraries of this and other countries. As you gentlemen well know, the operations of all libraries are to a varying degree dependent upon those of the library of Congress. Ever since the establishment of the program to furnish catalog cards to libraries in the early part of the century, standardization of procedures and processes in libraries has depended upon its leadership. A 1961 grant to the Library for a general study of automation has been followed by others at each successive stage of development, and the Library is now engaged with Council help, in the important work of putting current and some retrospective bibliographic records into machine-readable form for the benefit and use of the entire library community. Similarly, a series of Council grants enabled the National Library of Medicine to develop MEDLARS, an outstanding example of automation applied to bibliographic and information retrieval tasks. The work of the National Archives and Records Service and of the National Bureau of Standards has also been furthered by the Council's help.

We have no wish to fill the record by describing at length the many other accomplishments achieved through Council grants. Perhaps a brief listing of some of the areas in which the Council has operated will provide an overview of its influence. Because of the Council's interest, important work has been accomplished in such fields as bibliographic apparatus and techniques, book selection and evaluation, development of permanent/durable paper, perservation and restoration of library materials, storage and retrieval of information, standardization of library techniques, interlibrary cooperation and coordination, administration and management . . . these are only a sampling. The projects have been carried out by over two hundred institutions and individuals, ranging alphabetically from the American Academy of Sciences to Yale University, and including such recipients as the American Library Association, the Southwest Missouri Library Service, the New York Public Library, the New England Board of Higher Education, the American Association of Law Libraries. Annual reports have been published for each year of the Council's existence, and we will be happy to furnish them to the Committee if it wishes.

One further point should be made here about the work of the Council, which goes well beyond the grant-making function. The counsel and advice given by the staff, in correspondence and in interviews, have been of inestimable value to library people beyond number. For much of the library community has developed the habit of turning to the Council on Library Resources for assistance in problem-solving even when no grants or projects are involved.

The staff which provides this counsel and advice is now and has always been a highly professional one, well qualified to evaluate, initiate, encourage, and monitor the innovative programs which have had such a beneficent influence. On the staff are men who have served as Deputy Librarian of Congress, Director of the National Agricultural Library, Director and Principal Librarian of the British Museum, Director of the study of the National Advisory Commission on Libraries. Dr. Fred C. Cole, who has been the Council's president since 1967 and a member of its Board of Directors since 1962, is a scholar of note and past

president of Washington and Lee University. Other staff members are expected in computers, systems development, and microforms—areas of prime importance in the constant evolution of libraries.

The Board of Directors is composed of distinguished professionals: librarians, scientists, educators. They provide a resource of incalculable value. Let me list them here:

Lyman H. Butterfield, Editor-in-Chief of the Adams Papers
Verner W. Clapp, former Deputy Librarian of Congress, past president of the Council
Dr. Fred C. Cole, president
James S. Coles, President of the Research Corporation
William S. Dix, Director of the Princeton University Library, President of the American Library Association
Frederick Hard, President Emeritus of Scripps College
Caryl P. Haskins, President of the Carnegie Institution of Washington
John A. Humphry, Assistant Commissioner for Libraries, New York State
Joseph C. Morris, physicist, Vice-President Emeritus of Tulane University
Philip M. Morse, Professor of Physics, Massachusetts Institute of Technology
Whitney North Seymour, Chairman
Robert Vosper, Director of the Library, University of California at Los Angeles, and Professor of Library Science
Frederick H. Wagman, Director of the University of Michigan Library
Herman B. Wells, Chancellor of Indiana University
Louis B. Wright, Vice-Chairman, Director Emeritus of the Folger Shakespeare Library

All, by profession and philosophy, are dedicated to the purpose for which this Council was formed.

Should the Committee wish, we would be pleased to furnish statements from the world's leading librarians, educators, and information scientists testifying to the Council's dynamic role as catalyst in the essential improvement of library services during the last thirteen years.

But under H.R. 13270, now before your Committee, the Council on Library Resources might well be forced to terminate its greatly-needed activities. The Council conforms in every way with the spirit of the legislation. We engage in no self-dealing activities. All of our income is spent in furthering the purpose for which the Council was formed. We have no endowment; we control no businesses; we own no stocks. The Council can best be defined in the words used by the House Report accompanying H.R. 13270 to describe operating foundations: "organizations which have developed an expertise in certain substantive areas and which provide for the independent granting of funds and direction of research in those specialized substantive areas."

However, as the bill is now written, it is possible that the Council might not be considered an operating foundation. The legislation provides that an operating foundation, eligible to receive qualifying distributions from other private foundations, is an "organization substantially all of the income of which is expended directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated." This provision the Council meets unreservedly.

But the bill then prescribes two further tests of eligibility. Such an organization must either (1) devote more than half of its "assets" directly to such activities or to functionally related activities, or both, or (2) receive substantially all of its support from five or more exempt organizations, or from the general public, and not more than 25 per cent of the support may be from any one such exempt organization. In regard to the first alternative, the Council on Library Resources has limited assets, other than intangible ones. It has its grant, which is received quarterly and expended currently, and it has the usual furnishings, equipment, books, supplies required for its daily operation. As concerns the second alternative, its support has come entirely from one source, the Ford Foundation. Thus, if the sections I have cited above were to be strictly interpreted, the Council might not be considered an operating foundation. The cost of its continued support by the Ford Foundation under these circumstances would be increased to a point where it might become infeasible.

I am also concerned on similar grounds with possible adverse effects on another organization of which I am also Chairman, the International Legal Center. The Center was established in late 1966, under a grant from the Ford Foun-

dation, as a non-governmental, non-profit organization. Its headquarters are in New York City and its activities are worldwide.

The primary objective of the Center is to cooperate with the developing countries in their efforts to reform legal education, to improve the competence of the legal profession, and to strengthen legal institutions, within the general framework of each country's legal system and tradition as well as its contemporary needs. The Center seeks as well to increase in the United States and in other developed countries knowledge of and competence in dealing with the legal issues inherent in the process of development. In brief, the Center believes that the time has come for a vigorous and systematic re-appraisal of the role of law and lawyers in the process of development and in the building of modern nations.

For the most part the Center's staff abroad are engaged in the fields of legal education and legal research. A few examples of activities may be in order.

Chile is engaged in a nation-wide effort to make legal education, the legal profession, and the substance of the law more relevant to its development needs. The Center is collaborating in this effort with the active participation of Stanford University and other law schools in the United States. Under the program, a number of Chilean law teachers, law librarians, and deans are brought to the United States, and several American lawyers spend up to two years in Chile improving their own skills and comprehension of the problems of law and development.

In Africa, new law faculties and other institutions of legal education are now being established or strengthened with the assistance of American and European lawyers. During 1968, the Center sponsored 23 such lawyers in 11 African countries, supported in the United States and Europe a number of African law graduates who were preparing for teaching careers, provided financial assistance to make possible continent-wide African Law Reports, and sponsored a summer program offered by the African Law Center at Columbia University.

The Center has just negotiated a contract with the US/AID for the purpose of strengthening Korean legal institutions and encouraging the participation of the Korean legal profession in continuing legal education activities. We are pleased that the US/AID is turning to the Center, as the Department of State has done in the past, to carry out projects for which the Center has a special competence.

It is important to recognize that all this would not have been possible without the initial underwriting provided by the Ford Foundation. A non-profit, service-type organization cannot become viable from inception or even launched without such financial backing. During the first year of operation, the Center was almost entirely financially dependent upon the Foundation. In the second year, this dependency was reduced to 95 per cent. The projection for the current year is that a further reduction to around 80 per cent financial dependency can be anticipated. In due course it is expected that the Center will no longer require underwriting.

It should be stressed that the Center is independent in character regardless of the origins of its financial support. This is a source of its strength in working overseas in such a sensitive field as law and development. The Center is governed by a Board of Trustees which includes, in addition to myself, the following individuals:

Aron Broches, General Counsel, International Bank for Reconstruction and Development
Sir George Coldstream, formerly Permanent Secretary to the Lord Chancellor and Clerk of the Crown in Chancery
Robert K. A. Gardiner, Executive Secretary, United Nations Economic Commission for Africa
Felipe Herrera, President, Inter-American Development Bank
John B. Howard, President, International Legal Center
Joseph E. Johnson, President, Carnegie Endowment for International Peace
Milton Katz, Director, International Legal Studies, Harvard University
Edward H. Levi, President, University of Chicago
Max F. Millikan, Director, Center of International Studies, Massachusetts Institute of Technology
Victor H. Palmieri, Lawyer and business consultant
Howard C. Petersen, Chairman of the Board, Fidelity Bank
Walter J. Schaefer, Justice, Illinois Supreme Court
Carl B. Spaeth, Chairman, Committee on International Studies, Stanford University

As in the case of the Council on Library Resources and other organizations to which reference has been made in these hearings, the future of the International Legal Center would be placed in jeopardy by a strict interpretation of the definition of an operating foundation as it appears in H.R. 13270. To qualify, the Center (and other similar organizations) must expend substantially all of its income directly for the activities constituting its exempt purposes (which it does) *and either* devote substantially more than one-half of its assets directly to such exempt purposes, *or* receive not more than 25 per cent of its support from any one organization.

At present, the Center receives more than 25 per cent from one organization. It is not likely that it could otherwise have come into existence. Therefore, to qualify as an operating foundation, it must meet the "assets test." The Center's assets consist solely of its working balances and its office equipment. If such assets can be considered as meeting the criterion that would qualify the Center and similar bodies as operating foundations, there would appear to be no difficulties except as might arise from the use of the word "directly". Such organizations should be able to carry out their exempt purposes, where that can be done best, through chosen instruments like universities. If such instruments would not be regarded as within the word "directly," some modification should be made so that such choice of instruments for carrying out exempt purposes would not prejudice the exemption. Either the proposed legislation should be clarified on these questions or there should be some statement on record providing the clarification as a matter of legislative history. At present, the ambiguity in the proposed bill is such that many worthy organizations could be put out of operation and others prevented from being started. I cannot believe that this is the intent of the drafters of this bill.

As a lawyer who has taken a particular interest in the improvement of the profession and the service it renders to the public, I cannot fail to mention here two other organizations which would find their activities in the public interest similarly jeopardized by the proposed legislation. Of one, the National Defender Project of the National Legal Aid and Defender Association, Chief Justice Warren E. Burger had this to say in a recent address:

"It has been good, very good . . . to see the American Bar Association and other legal bodies support the National Defender Program because the positive consequence is that we will ultimately have adequate public defender services provided wherever they are needed . . . One of the great things about the development of legal aid and defender programs and the post graduate seminars to train lawyers for these new tasks is that they are private and volunteer efforts of the Profession. The concept is one devised by lawyers, implemented by lawyers and financed by the private sector including lawyers and Bar Associations and great philanthropic institutions.

"This is the American Way of progress and it is better and more enduring than ad hoc improvements imposed by acts of Congress or mandates of courts."

At another point in this address, pointing up the need for further improvement in legal education, the Chief Justice emphasized that: "The recent development of law teaching through 'clinics' is one of the great new steps in legal education since Langdell's 'case method.' With Ford Foundation support, many law schools have begun to offer courses in various fields of law through the 'clinical method,' exposing students to the living problems of living clients as part of the learning process. Now Congress, in Title XI of the Higher Education Act of 1965, has authorized generous appropriations for similar programs in still other schools."

Since 1963 the Ford Foundation has made grants totalling $6.1 million to the National Legal Aid and Defender Association. In 1968 the Foundation's Trustees made an appropriation of $5.4 million over a five-year period for the establishment of the Council on Legal Education for Professional Responsibility, which is engaged in grant-making in support of clinical and internship law school programs. I have the privilege of serving on the Boards of both of these organizations.

We have not yet said, and will do so now, that we can understand the Congress' concern that some activities ofsome foundations may not have conformed with the intent of the original legislation. We heartily agree that such practices must be checked. We understand also that in drafting legislation some arbitrary standard or furmula must be established and some very fined lines drawn. However, it appears to us that if these particular guidelines are not reconsidered and broadened, a great many organizations that have made contributions of value

in almost every area of concern to this Congress and to this country may be in a very difficult position indeed. For of course the organizations I have mentioned are not the only ones with special expertise which might be affected by the legislation as written.

We cannot believe that in drafting these provisions the distinguished members of the Ways and Means Committee and the House of Representatives intended to disrupt the efforts in the public interest of the Council, the Center, and other similarly situated organizations. We earnestly urge that the members of this Committee consider carefully and rewrite the provisions in such a way as to eliminate the evils which called them into being, and at the same time clarify them so that the effectiveness of honorable and essential institutions may not be destroyed.

VI. RESTRICTIVE EFFECTS ON THE DEVELOPMENT OF PHILANTHROPY AND OPERATION OF FOUNDATIONS (INCLUDING EFFECTS OF "EXPENDITURE RESPONSIBILITY" AND HEAVY PENALTY ON TRUSTEES)

SUMMARY OF STATEMENT OF MR. DANA S. CREEL

1. The proposed sanctions in H.R. 13270 are excessive and:
   (1) Include very substantial penalty taxes on foundations which would have the ultimate effect of diminishing funds available for distribution to legitimate philanthropic activities;
   (2) Subject management, both staff and trustees, to very substantial personal liabilities, which would greatly reduce the ability of foundations to attract the best caliber of trustees and staff; and
   (3) Create onerous and in some cases impossible requirements on foundation administration.
2. It is suggested that a substantially modified philosophy and system of sanctions be adopted having the ultimate end of promoting and strengthening philanthropic endeavor in our society.
3. An approach along these lines is as follows:
   (1) Penalties should be imposed on foundations but only on the wrongdoers, recognizing that a foundation is inanimate and can function only by acts of individuals.
   (2) Penalties should be flexible, reasonable in nature, with maximum limit, and appropriately related to the acts (or failures to act) which are penalized.
   (3) Proscribed acts (or failures to act) should be defined with sufficient clarity to enable the decision-makers to determine, without undue complexity and at the time of decision, whether any act (or failure to act) constitutes a transgression.
   (4) A procedure should be established providing for notice of a proposed penalty, with opportunity for correction within a reasonable period before application of the penalty.
   (5) A reasonable statute of limitations should be made clearly applicable to penalties.

If an approach along these general lines can be substituted for the system of monetary penalties contained in H.R. 13270, I believe that the Congress will have come much closer to meeting its announced goal of developing sanctions which provide "a more rational relationship to improper acts". And in terms of the ability of private foundations to perform in the highest public interest, I believe that such a change is crucial.

STATEMENT OF MR. DANA S. CREEL

My role is to introduce the subject of the effect on philanthropy of certain of the penalties and administrative responsibilities imposed on foundations by H.R. 13270.

My purpose is not to review these provisions in any detail, but rather to discuss the overall effect of the prescribed penalties for their violation.

The announced objective of the Ways and Means Committee in enacting these penalties was to "provide a more rational relationship between sanctions and improper acts . . ."[1] without necessarily resorting to the revocation of exemp-

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[1] H. Rep. No. 91-418 (Part 1), p. 21 (1969).

tion, which is generally regarded as too extreme a penalty in the vast majority of situations.

I wholeheartedly subscribe to this stated objective of the Ways and Means Committee.

However, it would seem that the penalties and remedies proposed do not meet these stated objectives. They are excessive in many cases and tend to diminish the funds of foundations available for the support of legitimate philanthropy, instead of concentrating on preventing or rectifying the transgression. (See Exhibit A, attached, for summary of proposed sanctions.)

I believe that the proposed system of penalties has many shortcomings. To be specific, the sanctions:

(1) Include very substantial penalty taxes on foundations which would have the ultimate effect of diminishing funds available for distribution to legitimate philanthropic activities;

(2) Subject management, both staff and trustees, to very substantial personal liabilities, which would greatly reduce the ability of foundations to attract the best caliber of trustees and staff; and

(3) Create onerous and in some cases impossible requirements on foundation administration.

In conjunction with some of the questionable substantive provisions which others have discussed, these sanctions coupled with the lack of clarity as to what is prohibited and what is permitted will, in my judgment, drive foundations from the forefront of philanthropic endeavor, which is their logical arena, stultify management, foreshadow a diminishing role for foundations, with possible extinction an end result.

Let me illustrate by considering the effect of the proposed sanctions as they relate to the three headings I have mentioned before.

1. *Substantial penalty taxes on foundations would have the ultimate effect of diminishing the funds available to legitimate philanthropic activities.*—There are six types of proposed sanctions on foundations, ranging from a tax of 5 percent of the value of excess business holdings for each year held, up to an income tax on the termination of private foundation status equal to the entire net assets of the foundation. For the government to take away the assets of a foundation is not in the interest of philanthropy. It is the ultimate beneficiaries of the foundation funds that really suffer from this kind of punitive provision.

2. *Subjecting foundation managers, both staff and trustees, to very substantial personal liabilities would greatly reduce the ability of foundations to attract the best caliber of staff and trustees and will inevitably render them cautious and unimaginative.*—The proposed sanctions on foundations managers range from 2½ percent of the amount involved in a self-dealing transaction for each year until corrected (with a maximum of $10,000 per act) up to a tax of 200 percent or more of the amount involved if correction is not made within the 90-day notice period. Even more drastic, there is an overlap of "disqualified persons" and "foundation managers" in the penalty provisions on self-dealing which literally could be read to tax a foundation manager initially at 7½ percent and additionally at 250 percent.

An even greater personal liability is contained in the sanctions involved in connection with taxable expenditures, where the foundation manager is subject to a 50 percent penalty for each taxable expenditure. It is not unusual for a foundation to make grants of several hundred thousand dollars or more. For example, suppose that a foundation makes a grant of only $100,000 which is determined on audit to be a taxable expenditure affecting the legislative process. This would mean a tax of $50,000 on a foundation manager. This patently is an unrealistic penalty, particularly since it relates to the nebulous and uncertain definition of what is meant by "influencing legislation."

In this area, it is very easy to make a misjudgment. Consider for example, the question of what is non-partisan analysis and research. If the grantee is conducting "non-partisan analysis and research", a grant would be permissible. If not, a grant would be a prohibited taxable expenditure. The trouble is that grants are matters of judgment which can be second-guessed upon audit in the light of hindsight and subsequent developments over which the foundation manager has no control.

Another example of the unreasonableness of the proposed penalty structure relates to the making of an investment which is later determined after audit to have been made in such manner as to jeopardize the carrying out of *any* of the

foundation's exempt purposes. It is possible in such a case for the penalties to to pyramid in the following way: The basic penalty of 100 percent of the amount of the investment is to be imposed upon the foundation and presumably at the same time a 50 percent tax would be imposed on any foundation manager who "participated" in the making of such an investment if he had knowledge that the investment jeopardized any of the foundation's exempt purposes. The foundation might also be subjected to another 100 percent tax and the manager to another 50 percent tax if the amount paid or incurred in making the investment is held to be a "taxable expenditure" on the ground that the investment did not fulfill a purpose specified in § 501(c)(3).

Moreover, if the foundation manager has previously been liable for one of these taxes, a further penalty of 100 percent might also be imposed upon him and 100 percent penalty also could be imposed on the foundation under similar circumstances. As a final cap to the pyramid, if a foundation's investments giving rise to these penalties should be deemed "willful repeated acts", regardless of the amount invested, forced termination can be imposed and the assets of the foundation can be confiscated under the guise of a tax on termination of foundation status.

While it is quite true, with respect to a foundation manager, that the bill incorporates a subjective test of knowledge—whether actual knowledge or constructive knowledge is required is not clear—as a condition precedent to liability, this condition will provide little practical protection against penalties asserted with the benefit of hindsight. The circumstances under which any foundation portfolio is managed—particularly in the light of the pressures which will result for higher yield investments caused by the required percentage distribution rules—could produce hindsight judgments that a given investment did jeopardize the foundation's exempt purposes and, indeed, that the management had knowledge of this fact. Such a possibility is perilously real for those foundations which make investments in economically blighted communities as part of a laudable program of fostering free enterprise where normal credit lines are not available. Other more conventional investments are not immune from the same destructive scrutiny. In a word, every dollar of a foundation's assets becomes a target for devasting second-guessing as to purposes. The inhibitive consequences of this provision are too clear for further comment. These obviously would be awesome obstacles to the recruitment of the highest quality staff and the service of distinguished individuals as trustees.

These liabilities apply not only to professional staff but to trustees and other persons, and it must be borne in mind that in any acts involving these penalties which also involve a breach of fiduciary responsibility, "foundation managers" would also be subject to an additional liability through surcharge under state equity jurisdiction.

3. *The proposed sanctions would create onerous burdens of administration, in some cases impossible to achieve.* Additional administrative work is required to comply with the requirements of full disclosure and reporting, and with this there should be no question since it is a thoroughly legitimate requirement for a tax-exempt organization.

However, there are two requirements that are unreasonably burdensome, if not actually impossible of achievement.

The first of these relates to penalty taxes on "self-dealing" between a foundation and a wide range of "disqualified persons", other than foundation managers. An initial penalty tax of 5 per cent of the amount involved in a self-dealing transaction would be imposed on any disqualified person who participated in that transaction, for each year until the transaction was corrected. An additional tax of 200 per cent of the amount involved would be imposed on such a person if correction was not made with the 90-day period after notice from the Internal Revenue Service.

Aside from a question as to the reasonableness of the penalty involved, the greatest difficulty of this provision is that the definition of a "disqualified person" is so broad that it includes persons who are so remote from the foundation that as a pracical matter, there is no way of knowing whether they are involved in a proscribed relationship. (See Exhibit B, attached, showing "disqualified persons" as defined in Section 4946.) Further, the foundation managers are not in a position to know, ask—much less demand—revelation of information from such persons which would enable the foundation's manager to obtain the necessary information to insure conformity to these provisions. For example, how

could a foundation manager realistically be required to determine the total amount of stock held in all the corporations with which a foundation may do business by all "disqualified persons", including all substantial contributors, their ancestors, collaterals, lineal descendants, spouses, and corporations, partnerships or trusts, in which they may hold a 35 per cent or greater interest?

In attacking this specific penalty we are in no way sanctioning self-dealing, but rather pointing out the impracticability of complying with the provision based upon such an extensive definition of "disqualified persons".

The second requirement which places on the management of a private foundation a task which is likely to be impossible to attain involves "expenditure responsibility". This includes "full responsibility" to see that any grant (except those to a publicly-supported or other 30 percent charities) (1) "is spent solely for the purpose for which made", (2) to "obtain full and complete reports from the grantee on how the funds are spent and to verify the accuracy of such reports", and (3) to "make full and detailed reports with respect to such expenditures to the Secretary or his delegate".

Inevitably there will be cases where a grant, through no fault of the foundation, is spent in part, for purposes outside those for which the grant was made. Similarly, there may be cases where grantees, through no fault of the foundation, fail to report or where a given report is inaccurate. It is unfair to impose upon a foundation and foundation management liability in such a situation beyond due diligence. Otherwise the provision would constitute an incentive for foundations to engage in direct operations in areas where they otherwise would have funded another organization. To enlist a broader citizenship participation in the leadership and execution of a project than that which can be provided by the grantor foundation, a degree of dependence inevitably has to be placed in the grantee organization. There would be no objection to the "expenditure responsibility" provision if it were modified to require due diligence rather than absolute responsibility.

Up to this point, I have been discussing the detrimental and serious consequences for philanthropy which would arise from the sanctions contained in H.R. 13270.

As a basis for my following comments, I suggest that any system of sanctions should have the following four principal objectives:

(1) that foundation assets be properly invested to produce a reasonable income, which is in turn applied to legitimate philanthropic purposes;

(2) that foundation assets not be used to the personal advantage of those intimately related to its creation and management;

and compelled to make good any loss caused by violation of their fiduciary

(3) that those responsible for any violation of these objectives be penalized and compelled to make good any loss caused by violation of their fiduciary responsibilities; and

(4) that those responsible for any violation of proper limitations imposed by law be penalized.

The ultimate purpose it seems to me, of any approach to a system of sanctions is that it strengthen and promote philanthropic endeavor in our society. This is the basis for a major objection to one segment of the proposed sanctions, namely, those penalties imposed against the foundations.

Penalties relating to a wrongdoing should be imposed on the wrongdoer, not the foundation involved, for this only hurts philanthropy at large by withdrawing funds. I think you will agree that this is not a desirable result.

The question, and it is not an easy one, is to devise a system of penalties, restraints and corrective measures which will fit the transgressions and not, in the process, set up a rigid system which will have the undesirable derivative and *in terrorem* effects of those contained in H.R. 13270.

Assuming then that no sanctions should be applied against the assets of the foundations, attention should be turned exclusively to devising proper sanctions against the wrongdoer. It is here, I think, that the proposed sanctions exceed by far reasonable bounds and fail to take into account the fact that the vast majority of foundation managers, staff and trustees are conscientious and sincerely wish to abide by the law and what is expected of them as proper conduct. Just the stigma of being adjudged in violation is a very substantial deterrent and, I would venture, in more than 99 out of 100 cases would be ample reprimand.

I would suggest that a system of penalties be set up which would consist first of a notification of violation with a 90-day period for correction and that, if

appropriate corrective steps are not taken within that time, then the application of the minimum tax escalating with continued failure to correct or upon any further similar violation up to a given maximum. I would suggest, in this connection, that the maximum need not be a large figure because any repeating violator would, I am sure, be removed from office by his Board. There is always, of course, the ultimate sanction of revocation of exception.

Such a system should have flexible sanctions within a maximum limit of $5,000 to $10,000. It must be recognized that the sanctions would not be a wholly adequate remedy for a violation of self-dealing, misapplication of funds or any act which would wrongfully dissipate the assets of a foundation. This would be a situation in which the additional remedy must lie, as I see it, in the courts of equity to enforce restitution for a loss to the foundation which, in these cases, would be a breach of fiduciary responsibility. Some have suggested an equity procedure in the Federal District Courts. I see a system of sanctions combining penalties supplemented by equity actions initiated by state attorneys general, prompted if needed by the Treasury.

In this connection, I note that H.R. 13270 proposes cooperation with state attorneys general and this would seem to be a very desirable development. There are those, as I am sure you are aware, who have urged more adequate state supervision, believing that ideally the flexible remedies available through equity actions would be the most effective and desirable means of regulating foundations. Sole reliance on the states, however, is not a wholly satisfactory answer at this point, because of the failure of a number of states to undertake aggressive programs of enforcement. I, for one, believe that everything possible should be done to encourage the states to fulfill their responsibilities in this respect because I believe firmly that this is not only theoretically but, practically the proper means for the most effective regulation of foundations. But until the day comes when full reliance may be placed in the various states for the exercise of this responsibility, I must reluctantly concede to the necessity of a system of Internal Revenue Service sanctions modified along the lines I have suggested, which basically are as follows:

(1) Penalties should not be imposed on foundations but only on the wrongdoers, recognizing that a foundation is inanimate and can function only by acts of individuals.

(2) Penalties should be flexible, reasonable in nature, with a maximum limit and appropriately related to the acts (or failures to act which are penalized.

(3) Proscribed acts (or failures to act) should be defined with sufficient clarity to enable the decision-makers to determine, without undue complexity and at the time of decision, whether any act (or failure to act) constitutes a transgression.

(4) A procedure should be established providing for notice of a proposed penalty, with opportunity for correction within a reasonable period before application of the penalty.

(5) A reasonable statute of limitations should be made clearly applicable to penalties.

If an approach along these general lines can be substituted for the system of monetary penalties contained in H.R. 13270, I believe that the Congress will have come much closer to meeting its announced goal of developing sanctions which provide "a more rational relationship to improper acts." And in terms of the ability of private foundations to perform in the highest public interest, I believe that such a change is crucial. Thank you.

PENALTIES IMPOSED BY PRIVATE FOUNDATION PROVISIONS OF H.R. 13270

Acts or failures penalized	Penalties imposed on private foundations (and certain trusts)	Penalties imposed on disqualified persons	Penalties imposed on foundation managers
Termination of private foundation status (sec. 507).	Lower of (1) aggregate tax benefits, resulting from tax exemption, to the foundation (income tax savings) and to all substantial contributors (income, gift, and estate tax savings), plus interest thereon, or (2) the higher of (a) the value of the net assets of the foundation on the date action to terminate its exempt status was first taken, or (b) the value of the net assets on the date such status was terminated.		
	The tax may be abated if the foundation operates as a public charity for 60 months or distributes all its assets to public charities within 60 months.		
Liability for ch. 42, taxes (sec. 508(e))	Forced termination and liability for tax under sec. 507, above, for willful repeated acts or failures to act or a willful and flagrant act or failure to act.		
Self dealing (sec. 4941)		Initial tax of 5 percent of the amount involved for each year until corrected, imposed on disqualified persons who participated in the act of self dealing. Joint and several liability.	Initial tax (if a disqualified person is taxed) of 2½ percent of the amount involved for each year until corrected, imposed on any manager who participated in the act of self dealing knowing it to be such. Maximum of $10,000 per act. Joint and several liability.
		Additional tax of 200 percent of the amount involved if not corrected within 90 days after notice is mailed. Joint and several liability.	Addionalal tax (if a disqualified person is taxed) of 50 percent of the amount involved, impose on any manager who refused to agree to any part of the correction. Maximum of $10,000 per act. Joint and several liability.

Failure to distribute income (sec. 4942)	Initial tax of 15 percent of undistributed income for each year such income remains undistributed. Additional tax, if an initial tax is imposed, of 100 percent of undistributed income not distributed within 90 days after notice is mailed.		
Excess business holdings (sec. 4943)	Initial tax of 5 percent of the value of excess business holdings for each year during which such excess is held. Additional tax of 200 percent of the value of excess business holdings not disposed of within 90 days after notice is mailed.		
Investments which jeopardize charitable purposes (sec. 4944).	100 percent of the amount invested		If the foundation is taxed, 50 percent of the amount invested, imposed on any manager who participates in the making of the investment knowig that it is jeopardizing exempt purposes. Joint and several liability.
Taxable expenditures (sec. 4945)	100 percent of the amount of each taxable expenditure		50 percent of the amount of each taxable expenditure, imposed on any manager who agrees to the making of an expenditure knowing it is a taxable expenditure. Joint and several liability.
Repeated liability for ch. 42, excise taxes (sec. 6684).	100 percent of the ch. 42 tax if the foundation has, without reasonable cause, either (1) been liable for a ch. 42 tax previously, or (2) the act or failure to act giving rise to liability for the ch. 42 tax is "both willful and flagrant."	100 percent of the ch. 42 tax if the disqualified person has, without reasonable cause, either (1) been liable for a ch. 42 tax previously, or (2) the act or failure to act giving rise to liability for the ch. 42 tax is "both willful and flagrant."	100 percent of the ch. 42 tax if the manager has, without reasonable cause, either (1) been liable for a ch. 42 tax previously, or (2) the act or failure to act giving rise to liability for the ch. 42 tax is "both willful and flagrant."

EXHIBIT B

PERSONS OF ENTITIES WHO ARE "DISQUALIFIED PERSONS" AS DEFINED IN SECTION 4946

I. A private foundation will be subject to taxes under Section 4941 (self-dealing) if it engages in certain transactions with; under Section 4942 (failure to distribute income to qualifying distributees) if it distributes income to an organization controlled by; and under Section 4943 (excess business holdings) if it holds excess business interests, measured by the aggregate of its own holdings and those of the following:

SUBSTANTIAL CONTRIBUTORS, THEIR FAMILIES AND RELATED ENTITIES

1. Any person who (by himself or with his spouse) has contributed more than $5,000 to the foundation in any one calendar year, *plus:*

(*a*) The family of such person (and the family of his spouse, if the spouse has been a contributor), consisting of his (or their): Brothers (whole or half-blood) and their spouses; Sisters (whole or half-blood) and their spouses; Spouse; Ancestors; Lineal descendants and their spouses.

(*b*) A corporation in which such persons and their families own (including stock owned by others which is deemed constructively owned under Section 267(c)) more than 35% of the total voting power.

(*c*) A partnership in which such persons and their families own more than 35% of the profits interest.

(*d*) A trust or estate in which such persons and their families hold more than 35% of the beneficial interest.

2. Any person who (by himself or with his spouse) bequeathed more than $5,000 to the foundation, *plus:*

(*a*) The family of such person (and the family of his spouse, if the spouse has been a contributor), consisting of his (or their): Brothers (whole or half-blood) and their spouses; Sisters (whole or half-blood) and their spouses; Spouse; Ancestors; Lineal descendants and their spouses.

(*b*) A corporation in which such persons and their families own (including stock owned by others which is deemed constructively owned under Section 267(c) more than 35% of the total voting power.

(*c*) A partnership in which such persons and their families own more than 35% of the profits interest.

(*d*) A trust or estate in which such persons and their families hold more than 35% of the beneficial interest.

3. Any person who contributed the greatest amount (regardless of the amount) to the foundation in any one calendar year, *plus:*

(*a*) The family of such person, consisting of his: Brothers (whole or half-blood) and their spouses; Sisters (whole or half-blood) and their spouses; Spouse; Ancestors; Lineal descendants and their spouses.

(*b*) A corporation in which such persons and their families own (including stock owned by others which is deemed constructively owned under Section 267(c) more than 35% of the total voting power.

(*c*) A partnership in which such persons and their families own more than 35% of the profits interest.

(*d*) A trust or estate in which such persons and their families hold more than 35% of the beneficial interest.

4. The creator of the foundation, if it is a trust, *plus:*

(*a*) The family of such creator, consisting of: Brothers (whole or half-blood) and their spouses; Sisters (whole or half-blood) and their spouses; Spouse; Ancestors; Lineal descendants and their spouses.

(*b*) A corporation in which such person and their families own (including stock owned by oothers which is deemed constructively owned under Section 267(c)) more than 35% of the total voting power.

(*c*) A partnership in which such persons and their families own more than 35% of the profits interest.

(*d*) A trust or estate in which such persons and their families hold more than 35% of the beneficial interest.

FOUNDATION MANAGERS, THEIR FAMILIES AND RELATED ENTITIES:

5. Any officer, director or trustee of the foundation (including "an individual having powers or responsibilities similar to those of officers, directors, or trustees"), *plus:*

(*a*) The family of such officer, director, trustee or other individual, consisting of: Brothers (whole or half-blood) and their spouses; Sisters (whole or half-blood) and their spouses; Spouse; Ancestors; Lineal descendants and their spouses.

(*b*) A corporation in which such individuals and their families own (including stock owned by others which is deemed constructively owned under section 267(c)) more than 35% of the total voting power.

(*c*) A partnership in which such individuals and their families own more than 35% of the profits interest.

(*d*) A trust or estate in which such individuals and their families hold more than 35% of the beneficial interest.

6. Any employee of a foundation having authority or responsibility with respect to an act or failure to act, *plus:*

(*a*) The family of such employee, consisting of: Brothers (whole or half-blood) and their spouses; Sisters (whole or half-blood) and their spouses; Spouse; Ancestors; Lineal descendants and their spouses.

(*b*) A corporation in which such employees and their families own (including stock owned by others in which is deemed constructively owned under Section 267(c)) more than 35% of the total voting power.

(*c*) A partnership in which such employees and their families own more than 35% of the profits interest.

(*d*) A trust or estate in which such employees and their families hold more than 35% of the beneficial interest.

INDIVIDUALS OWNING INTERESTS IN ENTITIES WHICH ARE "SUBSTANTIAL CONTRIBUTORS", THEIR FAMILIES AND RELATED ENTITIES

7. Any individual who owns (including stock owned by others which is deemed constructively owned under Section 267(c)) more than 20% of the total voting power of a corporation which is a "substantial contributor" to the foundation, *plus:*

(*a*) The family of such individual, consisting of: Brothers (whole or half-blood) and their sponses; Sisters (whole or half-blood) and their spouses; Sponse; Ancestors; Lineal descendants and their spouses.

(*b*) A corporation in which such individuals and their families own (including stock owned by others which is deemed constructively owned under Section 267(c)) more than 35% of the total voting power.

(*c*) A partnership in which such individuals and their families own more than 35% of the profits interest.

(*d*) A trust or estate in which such individuals and their families hold more than 35% of the beneficial interest.

8. Any individual who is a general partner in a partnership which is a "substantial contributor" to the foundation, *plus:*

(*a*) The family of such individual, consisting of: Brothers (whole or half-blood) and their spouses; Sisters (whole or half-blood) and their spouses; Spouse; Ancestors; Lineal descendants and their spouses.

(*b*) A corporation in which such individuals and their families own (including stock owned by others which is deemed constructively owned under Section 267(c)) more than 35% of the total voting power.

(*c*) A partnership in which such individuals and their families own more than 35% of the profits interest.

(*d*) A trust or estate in which such individuals and their families hold more than 35% of the beneficial interest.

9. Any individual who holds more than 20% of the beneficial interest in a trust or unincorporated enterprise which is a "substantial contributor" to the foundation, *plus:*

(*a*) The family of such individual, consisting of: Brothers (whole or half-blood) and their spouses; Sisters (whole or half-blood) and their spouses; Spouse; Ancestors; Lineal descendants and their spouses.

(*b*) A corporation in which such individuals and their families own (including stock owned by others which is deemed constructively owned under Section 267(c)) more than 35% of the total voting power.

(*c*) A partnership in which such individuals and their families own more than 35% of the profits interest.

(*d*) A trust or estate in which such individuals and their families hold more than 35% of the beneficial interest.

II. For purposes of Section 4943 (tax on excess business holdings), a private foundation's excess business holdings are measured by the total holdings of itself and all the persons and entities listed above, *plus* the holdings of:

10. Any private foundation which is "effectively controlled (directly or indirectly) by the same person or persons who control the private foundation in question."

11. Any private foundation "all of the contributions to which were made (directly or indirectly) by the same person or persons described in * * * [paragraphs 1 to 9 inclusive, above], or members of their families [consisting of the persons listed in subparagraph a of each of paragraphs 1 to 9 inclusive, above], who made (directly or indirectly) substantially all of the contributions to the private foundation in question."

III. For purposes of Section 4941 (tax on self-dealing), a "government official" also is included.

SUMMARY OF STATEMENT OF DR. JAMES R. KILLIAN, JR.

1. Impact of the bill on the development of philanthropy and the importance of financial support of educational institutions by private foundations and of their contributions to society.

2. Expanding costs of education and the need for more private contributions.

3. Outline of principal provisions of the bill relating to private foundations.

(*a*) 7½ percent investment income tax.

(*b*) Penalty taxes for engaging in certain transactions, failure to distribute income, excess business holdings, and improper investments and expenditures.

(*c*) Application of private foundation rules to non-exempt trusts.

4. Penalty provisions indiscriminately applied and so severe as to threaten existence of private foundations.

5. Inequity of retroactive application of new rules to existing trusts and foundations.

6. Other provisions of the bill which will curtail charitable contributions.

STATEMENT OF DR. JAMES R. KILLIAN, JR.

Mr. Chairman and Members of the Committee:

My name is James R. Killian, Jr., Chairman of the Corporation of the Massachusetts Institute of Technology. It is a privilege to present this statement and to have the opportunity to express my grave concern about certain provisions of bill H.R. 13270 which affect foundations and other forms of private philanthropy. In discussing the restrictions on the development of philanthropy which would be imposed by this bill in its present form, I speak chiefly out of my experience as an officer of a private college where foundation grants and private philanthropy generally are decisively important to the institution. I hasten to add that I recognize the need for tax reform and the difficulty of accomplishing it. I also recognize the need for stopping the occasional misuse of tax-exempt foundations for purposes ulterior to true philanthropy. But these objectives must be reached with precision and care in ways that will not discourage—and perhaps dry up—philanthropic giving.

Educational institutions such as the one I represent derive a substantial portion of their contributions from organizations which meet the bill's definition of "private foundations." Over the past four years, MIT has received an average of 36% of its private contributions from these foundations. These grants have been profoundly important in maintaining the quality of its education and in enhancing educational opportunity for both students and faculty. The private giving which would be discouraged by this bill has provided 80% of all of our academic buildings, as well as 100% of our endowment. In our forward planning, we have relied on the continuation of grants, gifts, and bequests in amounts greater than we have been receiving in the past few years.

I, therefore, look with dismay at any curtailment of foundation or other private support now or in the future.

Clearly at a time when we are deeply concerned everywhere in the country about the funding of all higher education and about the financial future of our private institutions, we should be looking for ways to increase and not diminish the flow of private funds to education. We who are struggling day in and day out to balance budget and to find funds for student aid, student housing, faculty salaries, improved teaching, and new programs to deal with national needs, say to you with all the eloquence at our command that this is no time to compound the problems of our universities by making it harder for them to secure private grants and gifts in the years ahead.

In its present form, the provisions of the bill that would impair the functioning of foundations or result in the confiscation of their capital or discourage the formation of new foundations seem to me to be dangerous and short-sighted. The provisions of the present bill appear to be so severe that if passed in its present form, it will probably constitute the death knell of the foundations as we know them. Certainly, the incentive to form new foundations will be lost.

In contemplating the future financing of our private institutions, I am troubled by the reduction in available funds which will result from the proposed 7½% tax on investment income, but even more troubled by the breach of the tax-exempt principle on income. Should this tax be established, it would be tempting to increase it. I would also be troubled by the precedent created by taxation of foundations as implying the possibility of taxation of our tax-exempt educational institutions.

Foundations make intangible contributions to our educational system along with their financial contributions. I readily acknowledge that foundations provide institutions such as my own not only with needed funds, but with the stimulus of criticism and of fresh and catalytic ideas, thus helping to maintain quality and achieve needed change. They make important contributions to the quality of our society by providing multiple centers of initiative, by their ability to serve as path finders and to support experiment, and by their capacity to attract into the decision-making, planning and innovative process a wide spectrum of able men and women. I am profoundly troubled by any restrictions on foundations which would inhibit the initiative or innovative spirit we see in the strong ones. I am troubled about those provisions in the bill which could discourage able men and women from accepting posts of responsibility in foundations. Indeed these provisions could reduce the officers and trustees of our responsible foundations to a legion of intimidated men, their initiative, imagination, and boldness dampened by excessive restraint and surveillance and by confiscatory penalties for the innocent misreading of ambiguous provisions in this bill. This is one of the most serious possibilities affecting the future of philanthropy that one finds in this proposed legislation.

I have addressed my remarks within the context of this hearing to those provisions of the bill which relate to foundations. It is clear, however, that one needs to look at the impact of the bill on the future of all philanthropy, and as I indicate later in this statement, the preservation of the great American tradition of benevolence, of voluntary association, of diversity of support for our charities must be looked at in the round because the spirit of generosity is a seamless web, and damage to a part damages the whole.

Let me turn now from these comments to examine briefly some of the specific provisions of the bill which lead me to the general conclusions I have set forth.

The bill proposes the following new taxes on foundations:

1. A 7½ percent tax on investment income, including capital gains. This tax is imposed whether or not all of the income of the foundation is distributed to active charities. Although the present proposed rate is 7½ percent, experience shows that once a tax exemption is breached, almost inevitably progressively higher taxes are later imposed. At the very least, this tax cannot but reduce the giving to institutions by these foundations.

2. A tax on termination of private foundation status. This tax would be equal to the lesser of the net assets of the foundation or the aggregate tax benefits that have been enjoyed by the foundation and its substantial contributors since March 1, 1913, by reason of deductions or exemptions. I particularly deplore the provision for retroactive imposition of taxes that were legally saved under laws previously in effect.

3. A basic tax of 5 percent and a penalty tax of 200 percent if not corrected, on acts of self-dealing with foundations. This tax is automatically imposed on transactions with disqualified persons irrespective of the fairness of the terms of the transaction.

4. An initial tax of 15 percent and a penalty tax of 100 percent if not corrected, on the failure of the foundation to distribute all income. For this purpose, the bill would impose an obligation to distribute a fixed percentage of the fair market value of the assets irrespective of the actual yield.

5. An initial tax of 5 percent, and a penalty tax of 200 percent if not corrected, on the value of excess business holdings. As many private foundations have been funded by holdings in closely-held corporations, this provision will force liquidation of these holdings to the detriment of the foundations and the organizations to which they contribute.

6. A tax of 100 percent on speculative investments. Such investments are ambiguously defined as investments made in such manner as may jeopardize the carrying out of the charitable purpose.

7. A tax of 100 percent on certain expenditures which are deemed to be improper. This provision would in effect require the Commissioner of Internal Revenue to regulate the activities of foundations instead of performing his proper function of administering the tax laws.

In addition to the taxes outlined above, in each case other than the investment income tax and the termination of status tax, a tax up to 50 percent may also be imposed upon the foundation manager

While approving the objectives of the bill to eliminate occasional abuses of private foundations for non-charitable purposes, I feel that these penalties are too harsh and are indiscriminately imposed against both the offenders and the innocent. Indeed the provisions of the bill are so severe that if it is passed in its present form, it may well mean the end of such foundation. Certainly, no new private foundations will be formed, despite the urgent need for additional foundation support for higher education. The only safe course for existing foundations is to refuse additional contributions, retain their present investments, and distribute more than their income until they disappear.

The penalty taxes are applied not only to new organizations created after passage of the bill, but also to existing foundations that were established in reliance on present and past laws which encouraged their formation and operation. The tendency throughout the bill to impose taxes and penalties *ex post facto* is, in my opinion, one of the most iniquitous features of the bill.

Of equal concern to me is the proposed application of the private foundation taxes to non-exempt trusts. The bill would impose the 7½ percent investment income tax on trusts which have only charitable beneficiaries and would impose some of the same penalty taxes proposed with respect to private foundations on trusts where only a portion of the beneficial interests are held by a charity. Like many other provisions of the bill, these rules would be applied to trusts already in existence even though they were drawn (and in many cases cannot be changed) in reliance upon laws which afforded them freedom from such taxation and penalties.

As in the case of private foundations, the only apparent relief from these penalty taxes is a provision that the Secretary "may," not "shall," abate the unpaid portion of a tax if the trust distributes all of its net assets to specified types of charities.

Although this discussion is directed principally to the bills' provisions related to private foundations, the true effect of the bill on future philanthropy cannot be viewed or discussed in that context alone. Unfortunately, there are many other provisions in the bill which may have adverse effects on contributions to institutions of higher learning. Among these provisions are:

1. The 30 percent limitation on gifts of appreciated property, whereas other contributions are limited to 50 percent of the contribution base. Moreover, the 30 percent limitation apparently applies to the full value of appreciated property, rather than only to the amount of appreciation.

2. The treatment of appreciation of donated property as a tax preference and the allocation of deductions between tax preferred and taxable income. This combination cannot help but reduce the tax benefits of charitable contributions and in addition, it makes it impossible for a prospective donor to plan his giving because he cannot determine the tax effect of contributions in advance.

3. The income tax, estate tax and gift tax treatment of charitable remainder trusts, particularly as to the application of the new rules to existing trusts, many of which cannot be changed.

In closing, let me reiterate my position as being in no way opposed to appropriate and equitable tax revisions but as deeply concerned lest irreparable harm come to private institutions through oversight or inadvertence.

SUMMARY OF STATEMENT OF DR. JONAS SALK

I. This nation's Government and its private foundations are avowedly working together toward the attainment of common public goals. Each of these channels of philanthropy is supported by the people of the United States and each has developed distinctive characteristics. The question presented by the legislation under consideration is whether this dual system should be allowed to continue.

II. Both channels of American philanthropy are subject to shortcomings. Prior to attempting any objective evaluation one must examine the abuses of private foundations and the effect of such abuses upon their stated purposes. This question of abuse must be distinguished from the more basic question of whether our dual system of philanthropic funding should be preserved. Recent history provides innumerable examples of valuable research, initiated and supported by private philanthropy, which otherwise might not have been accomplished.

III. The dualism of foundations and government parallels the dualism found in living systems generally. In each instance, the dualism represents a difference in function and purpose rather than a mere division of labor. Just as the genetic system of living organism is concerned with the future survival of the species, the private sector of philanthropy (represented by foundations) is concerned with the long-range future of mankind; similarly, the somatic system is concerned primarily with the machinery for sustaining life in the same manner that government must deal with the short-range problems of mankind. Foundation endowments provide stable reserves from which exploration and change may be effected.

IV. Regulation and control constitute important functions for every healthy living system, from cells to organisms to human society. Reasonable controls over foundations can provide positive benefits, and will not be damaging. However, unduly severe strictures will limit the usefulness of foundations. Abundant evidence has been presented regarding the positive contribution to our society made by foundations, while the existence of certain abuses has likewise been established. This Committee is charged with the responsibility of distinguishing the necessary and the useful from that which is unduly restrictive.

Like a physician, the Committee must exercise extreme caution and discretion to avoid injuring or killing the patient. Absent such care, this nation might be deprived of a vital, innovative, and independent force for growth and for constructive change.

My relationship to American foundations is somewhat different from that of the other speakers you have heard thus far. I am not an administrator of a foundation, nor a member of any foundation board, nor have I ever been. Neither do I now hold a position with fund-raising responsibility for any institution. Rather, I come before you as an individual who has been enabled—through the American system of private philanthropy—to work in certain ways, toward certain goals, which would not have been possible had this system not existed.

Therefore, I bring a somewhat different perspective to the questions the Congress now faces. From my vantage point, I would like to examine these questions, and see if it is possible to draw some conclusions.

First of all, I see both the government and the foundations as having the same avowed end: that is, they are both intended to work for the benefit of the people—especially the people of this nation, and ultimately the people of the world—if the full destiny of this country is to be realized. The people of this nation support both the government and foundations. The government of this nation encouraged the growth of foundations through legal statutes, and within this framework foundations have evolved a certain character which we will examine in a moment.

I am, of course, aware that there is concern that foundations may be abusing their privileges, and that they may be "getting out of hand." This concern extends over a broad range of points, from whether or not foundations are accumulating excess wealth in tax-free shelters, to whether or not foundations are unduly influencing legislation, to whether or not foundations are mis-using their

tax-exempt status in a variety of other ways, such as operating businesses. So strong is this concern that the very existence of foundations is now being questioned.

Since foundations and the government work for a common purpose—for the benefit of man—one of the basic issues that needs to be resolved is whether two separate channels of philanthropy—one private, one public—should continue separately, or whether one should be eliminated. Thus, we must first ask ourselves, is the foundation system a disease to be stamped out, or is it a positive benefit to be encouraged?

It seems to me that before judgments can be made about the value of foundations—or, the reciprocal questions: can we afford them, or can we afford to do without them—you should have information about how much they cost and how much they give—how much wealth has accumulated in foundations compared to that accumulated by other tax-exempt organizations, and what are the relative amounts spent yearly from taxes and from philanthropic sources. You would also want to know the specifics about how often, and to what extent, foundations have abused their privileges and how often they have not. I imagine you would also want to know specifically, and not merely generally, how often, and to what degree, foundations attempt, or appear to be attempting to influence legislation, how often they have not, and how this relates to the activity of other tax-exempt organizations which have, as their openly avowed aim, the influencing of legislation.

I would remind you that regardless of advantages neither government nor foundations have been exempt from scandal in the past. No system, however well-intentioned, is perfect. And although abuse is certainly an issue, it ought not be confused with the deeper question of whether funding for philanthropic purposes, for health, for education and welfare, should continue to be conducted privately as well as publicly. Is a dichotomy between public and private funding useful?

I believe that it is not only useful but necessary and there is evidence in support of this opinion. There are innumerable examples of philanthropically initiated and supported research that would have been delayed—or would not have been accomplished at all—were it not for the American system of private philanthropy. For example, research that led to the development of polio vaccine was philanthropically funded. The government became active only when the time came to administer and control a vaccine. Studies that led to the development of vaccines for yellow fever were funded by foundations and the early work that led to the development of vaccines for influenza and measles also were foundation funded.

These are popularly comprehensible examples but an even more impressive record is in the clear fact as noted by George Beadle that "the remarkable twentieth-century flowering of experimental biology would not have been possible without the support of private foundations in key areas and at critical times." Up to 1965 no fewer than thirty Nobel laureates received Rockefeller Foundation fellowships before they won the prize.

The dualism of foundations and government has a parallel in the dualism that exists in living systems generally. For example, living organisms possess a genetic mechanism and a somatic mechanism, each separate and yet both interrelated and interdependent. This dualism is not merely a division of labor but rather a difference in function and therefore in purpose. In anthropomorphic terms there is a difference in emphasis, outlook, responsibility—a difference in attitude and even a difference in the value system applied in making judgments. By and large, the genetic system, which is concerned with heredity, is concerned with the future—with the survival of the species—with generations to come. The somatic system is concerned primarily with the machinery of life, with coping, with staying alive, with the here and now, and also with the preservation of the genetic system. This also describes the way in which foundations and government work together. Foundations can afford to be more concerned with the long range future and government, of necessity, is more concerned with the present and short range future.

As for dualism in this country, our nation was founded on diversity, and one of its great strengths lies in its tolerance of diversity. Few other countries tolerate it. Even fewer encourage it. Dualism precludes monoply and precludes dictatorship.

The foundations can, in a way, be thought of as equivalent to a savings account prudently accumulated for building the future. Foundation funds supplement

tax-derived government funds which can be thought of as borrowing from the future for use in the present. Foundations can use the income from their accumulated savings to finance innovative programs continuing over a period of years; the government deals with the more urgent necessities, and with crisis not yet forestalled by planning and foresight.

The foundations are in the business of developing foresight. They support, amongst other things, colleges and universities and other institutions of advanced and future-oriented research. Foundations with their endowments provide the stable reserves from which exploration and change can be effected.

We need both the stability and the change. Legislation which aims to reduce the life-span of foundations, to limit or discourage the development of new foundations, or to hamper the foundations' ability to influence change will have a deleterious effect upon those vital functions which operate now for the benefit of the nation and the world.

At the same time that I say this, I also agree that regulation and control are important functions which every healthy living system possesses, from cells to organisms to society. Our society now demands more regulation and control from all its institutions—and this is a healthy demand. Failure of regulation and control, on the cellular level, for example, leads to cancer. Failure of regulation and control in an organ or an individual leads to many kinds of disorder and disease. Something of the same sort is true in institutions.

Just as the public is now demanding more control over its government, so I think it should demand and have more regulation over foundations. Any reasonable regulation will not be damaging. It will be invigorating. I believe most foundations will favor, and will benefit from, a form of better auditing by the IRS, financed through a fee paid by foundations themselves. I think this is necessary and advisable, and can have positive effects. On the other hand, unduly severe strictures—either financial, or in terms of foundation activity in any sphere—will limit the usefulness of the foundations.

Determining what is necessary and useful, from what is unduly severe, is the job of this Committee and of the Congress. It is not an easy job, and I do not envy you the decisions you must make. In this respect, you are the "physicians" to the country who, in a sense, must make decisions on the basis of what may be insufficient evidence. Every physician does this. No physician enjoys it. But there is a maxim from Hippocrates which is appropriate here: "Above all, do no harm."

I think you have evidence, indisputable evidence from the past, of the advantages and value of foundations. I think you have indisputable evidence that in many areas, the foundations are supporting programs—such as grants and loans to higher education—which save the government expenditures it might otherwise have to make. I think you have evidence that the foundations have reduced tax burdens that would have arisen if work they supported had not been done. You are currently faced with the equally indisputable evidence of certain abuses and I would urge you, in treating this problem, to be quite certain that you do not maim or kill the patient, and that you do not deprive this country of what has been, for the past half century, a vital, innovative, independent force for growth and for constructive change in American life, and in the world.

Summary of Statement of Mr. John J. McCloy

Bill as now drawn embodies a series of provisions discriminatingly hostile to private foundations. These provisions are not supported by any reliable record of general misbehavior on the part of foundations which would justify them. The provisions in question can only be regarded as punitive and, as such, they ignore and would put to serious and unwarranted risk the continued flow of private foundations' grants to the educational, scientific, cultural and charitable well being of our society.

All such provisions which would discourage the creation and growth of private foundations should be eliminated from the Bill. While all measures reasonably designed to correct any abuses of the tax exempt privileges of the foundations should be retained with proper enforcement measures provided.

In accordance with the American tradition of encouragement of private charities, no tax or other discriminatory provisions should be imposed on the non-

profit charitable American private foundations. Provision should be made, however, for the assessment of an appropriate annual fee to be levied against all foundations based on a percentage of their assets which would serve to provide the means for a suitable Government agency (presumably the IRS) to conduct comprehensive and sustained audits of the affairs of the private foundations based upon full disclosure and reports.

No discrimination should be contained in the Bill against private charitable foundations in the treatment of gifts to them of appreciated value property. The present Bill is grossly discriminatory in this respect.

A review of the definitions as given in the Bill is required. A number of institutions not generally considered to have been private foundations are under the definitions contained in this Bill to be treated as if they were, and as such would become subject to the discriminatory provisions directed against private foundations. Even with the elimination of these discriminatory provisions, the definitions require review.

Certain of the enforcement provisions include penalties which appear quite excessive, particularly considering the ill-defined nature of some of the alleged offenses.

If the Bill is to impose new limitations on the amount of property which might be held by a private foundation coming from a single donor, an opportunity should be provided for the divestiture of any excess amount in such a manner as to avoid loss of values or the imposition of tax penalties.

Careful and sustained audits of the affairs of foundations are long overdue both from the point of view of protecting the law-abiding and dealing with delinquents. Comprehensive audits would be helpful to all concerned, and would serve as the basis for sound legislation and regulation of foundations as experience of such audits dictated.

The emergence of the Government in a large way into the welfare and educational areas of the nation does not justify limiting the flow of private philanthropy through private foundations. With the challenges the Government faces, all the help which the private foundations with their flexibility and flow of funds can give, will be needed to meet those challenges.

Statement of Mr. John J. McCloy

I have sought an opportunity to talk about this Bill which is before you primarily because it affects so profoundly institutions and activities with which I have been associated over a large part of my life. The Bill in its scope and depth seems to me to be one of the most important pieces of proposed legislation which has been in the Congress in recent years, and certainly the most important one in the tax field within that period.

I refer to the entire Bill and not only to the foundation aspects of it, though it is on these aspects that I would wish to concentrate my remarks today.

I might mention that among the institutions affected by the Bill with which I have been associated are The Rockefeller Foundation, of which I was a trustee for a number of years; The Ford Foundation, of which I was Board Chairman for a substantial period; Amherst College, of which I was also Board Chairman for a long time, and, to name one commercial institution with which I was associated, The Chase Manhattan Bank, of which I was also Board Chairman. There have been other foundations and corporations with which I have been associated, but I do not appear today on behalf of any of these institutions and I wish to express my views and thoughts on the basis of my general judgment and experience, free of any representation of a particular institution or client. For the sake of the record I perhaps should add that I am now practicing law in New York City.

There can be no question of the profound scope and impact of this Bill. I suppose the number of people and institutions which have sought to testify on the Bill, and the urgency with which they address themselves to it, is a convincing indication of the detrimental effect they believe the Bill in its present form could have on American cultural, scientific, social and educational life.

Before dealing with some of what I consider to be very serious defects in the Bill, I would like to make a few observations as to the atmosphere and timing under which the Bill was prepared because I think it explains in part the admixture of some very good and some bad features which I believe appear in it. As an outside observer, I gain the impression that the Bill was prepared under heavy pressure shortly following the election and the advent of a new administration.

The amount of work done on the Bill is most impressive, but it still gives signs of need for further thought. I have wondered whether the urgency for the extension of the surtax and its joinder with the regular tax bill may not have induced undue speed in the consideration of tax reform measures. During the consideration of the Bill, disclosures of abusive use of foundation funds appears, instances of complete or substantial Federal tax avoidance by individuals and corporations were given wide publicity and any form of tax exemption became extremely unpopular. These conditions, I am inclined to believe, account in part for the presence of a series of provisions relating particularly to foundations which run through the Bill and which seem to carry a persistently punitive note in their nature and import.

I think it is also fair to say that these factors, together with the somewhat unusual procedures adopted by those managing the House version of this Bill due to the time element, have led to an abrupt and too far-reaching reversal of a rather consistent Congressional and governmental principle or policy of encouraging the creation of charitable foundations through constructive tax incentives.

The traditional tax incentive in this country to encourage the creation of foundation and the stimulation of charitable grants has been a major influence in the striking progress of American private philanthropy. The American people carried over from their pioneer period a very strong instinct for private philanthropy. De Tocqueville writing to a friend in France in the 1830's referred to this tendency which so strongly contrasted with the habits of European society. This was long before there was an income tax, but the income tax provisions which favored the creation of charitable foundations simply continued and nurtured an already highly developed American instinct of private philanthropy.

I will not attempt to detail the benefits to American society which foundations have induced. They have been eloquently, if briefly, outlined by earlier witnesses. I believe that no comprehensive or objective study of the impact of foundation grants on our life has yet been made. I submit that those who contend that foundations have not been beneficial to this country should have the burden of proof and that no case has yet been made to justify the atmosphere of hostility to foundations which appears in the present Bill. I am aware that there is a sort of grand skepticism abroad in the land challenging our Government, our existing institutions and, indeed, many of our modes of life. But this, if we are to remain rational, does not means that we should first destroy everything we have built up and start with a clean slate. It does mean we should seek the facts of our needs, analyze them and adopt the procedures necessary to deal with them.

This Bill, as I read it, clearly embodies a condemnation of foundations. It singles them out from all other charitable organizations and imposes a tax on their investment income alone. I feel, as I gather does also Irwin Miller, that there is an inherent inconsistency in imposing a tax—any tax—on a non-profit organization such as a foundation if it serves a charitable or publicly beneficial purpose. If foundations are good, they should be stimulated—if they are evil, they should be extinguished. There is no logic in one-half or a 7½% killing of them and, quite frankly, I do not believe this administration or its predecessors have known, or now know, enough to assert with any confidence that the effect of foundations on our society has been bad or to what extent they have been partially bad or partially good. There is a very large field to explore before any such judgment can be reliably made. Some abuses have been disclosed, but the wide affirmative sweep of their benefactors have not been appraised. The foundations have certainly made significant contributions to our society and they have had the support of tax exemptions over a substantial period of our national life. Accordingly, I would start out by eliminating from the Bill this punitive or hostile philosophy which pervades the foundation provisions. I would strongly urge the Congress to impose no discriminatory tax on the income or assets of the private foundations as such at least until a solid case against them can really be made. No reliable record has been made which would justify the hostile attitude taken toward foundations which the proposed tax and a number of other provisions in the Bill embody. Singling out the private foundations from all other charities can only be read as a partial punishment for wrongdoing or suspicion of wrongdoing. The plain fact is that the administration and review of foundation affairs on the part of the Government has, until quite recently, been most inadequate and rudimentary. I imagine that this laxity has been in part based on the assumption and sincere belief on the part of Treasury officials that founda-

tions have been generally beneficial to the country and that such abuses as have occurred in connection with their administration have been limited to a relatively few of them. Indeed, I believe representatives of the Treasury have from time to time expressed such views.

The time has come, however, if only by reason of the exposure of abuses and the general skepticism of the times to provide the means for a comprehensive, objective and sustained review of the affairs of the foundations based on regular audits by the appropriate agency of the Government. I believe it can best be done by the IRS, suitably equipped and staffed for the purpose. We should know much more than we now do about the manner in which these foundation funds are distributed and spent, about the results achieved and the effect the withdrawal or diminution of these funds from our educational, scientific and charitable beneficiaries would have before we declare, as this Bill purports to do, that the growth and creation of private foundations should be actively discouraged.

This does not mean that we should have to await an audit or survey before we take any action. There are already on the books a number of provisions against abuses or practices inconsistent with the principle of tax exemptions. These, on the basis of such knowledge as we now possess, can and should appropriately be augmented by additional provisions in the present Bill and additional measures for enforcement of the purposes for which the foundations were created and their tax exemption granted. What it does mean is that at least until such audits and reviews have been made and studied no death knell to law abiding foundations should be sounded in the shape of a tax and other discriminatory measures. Until the Congress and the people of the country can intelligently appraise the validity of private foundations and their place in our society, any such hostile forms are out of order. I have had a good bit of experience in the observance of the operations of a number of foundations, large and small. I have seen mistakes made and frustrations of objectives occur, but I am convinced foundations have played, and continue to play, a most constructive and valuable part in the texture of our society. Indeed, I would say a most important part. My view may be subject to discount because of my former association with foundations, but I firmly believe from what facts are readily observable and from the attitude the Congress has previously taken toward them that the presumptions, at least, are strongly in their favor.

The course to follow, in my judgment, is to continue with the incentive for the creation of foundations on the basis of this presumption and our experience but to provide promptly all the facilities and means necessary to conduct sustained audits and supervision of the foundations by the appropriate Government agency. This should involve an annual fee to be charged the foundations, large enough to provide adequate audits and surveys based on full disclosures. It is important that this should take the form of an auditing fee and not a tax. It should not be a tax to provide revenue.

We have something of an analogy to follow in the form of the fees charged the banks for the Federal Reserve Audit. The banks of the Federal system are charged an annual sum, depending on the size of the bank, which finances the auditing of the banks by the Federal Reserve. The system over the years has worked out very well. Moreover, these audits have resulted from time to time in the introduction of a number of statutory and administration reforms in connection with the operation of the banks. They have stimulated legislators and the banks to pass sensible laws and adopt healthy banking practices. I understand the Internal Revenue Service and the Treasury abhor the establishment of any fund which does not constitute general Government revenue, but this is a bureaucratic objection which ought not stand in the way of the adoption of a sound principle. The size of the fee can and should be tailored to fit the need.

This is my principal and strongly held recommendation for the modification of this Bill as it affects foundations. It goes to the heart of the matter, as I realize, but I am convinced it embodies the sound approach for the Government to adopt with respect to foundations. The need for such an audit and survey is great. It is needed to protect the well conducted foundation and deal with the delinquents. Even if the abuses are few and far between, such an audit represents an imperative need and it is proper that the expenses of it should be defrayed by the foundations themselves. Such an examination of foundation affairs by a Government agency (and I believe the IRS is the best agency to make it), is, I repeat, long overdue. The foundations would not be handicapped

by it and the recipients of their grants would not be penalized as they would be by a tax on the foundation which if it followed the way of all taxes would be subject to increase and thus result in the diminishing of foundation benefits as they reach the beneficiaries. Indeed, I am convinced that the administration of foundations would be greatly improved by such action. It would encourage them to make their own audits and check their own procedures. Abuses could be identified and expeditiously corrected and efficiencies would be accomplished. Both the foundations and the public would know where the country stood in respect of their operations, suspicious rumors, prejudices and emotions in respect of foundations would be cleared up and the unappraised risks of impairing a significant flow of funds in American private philanthropy would be avoided.

There are many good features in the Bill such as those which provide for fuller reporting, elimination of self-dealing, undue accumulation of funds, better enforcement procedure by the Treasury, better cooperation with the State authorities to encourage the States to do their own policing, etc. These, together with the means to provide for good staffing and good auditing by the auditing Agency, could constitute this Bill the most positive and constructive piece of legislation affecting foundations that has yet appeared.

I have some further suggestions which would do little more than correct certain other features in the Bill that reflect this hostile philosophy toward foundations to which I have referred.

Prominently among such features is the provision which deliberately discriminates against private foundations in its treatment of gifts to them of property with appreciated value. I am referring to Section 170E of the Bill which would deny the donor the right of deduction for the full appreciated value of the property donated to a private foundation. His deduction under the Bill would either be limited to cost or he would have to pay a tax on the gain. If the donor gave it to any other charitable organization, not a private foundation as defined, he would be able to deduct the appreciated value. Is the Government prepared to contend on the basis of present evidence that a gift to a well run foundation is less beneficial than if it were given to a college, university, a church or any other charitable organization? This provision is clearly in the category of those designed to discourage the growth of existing foundations or the creation of new ones. Again it assumes that foundations are evil without proof. I see every reason to encourage those who have achieved wealth through their ownership of stock in growth companies to make gifts of such stock to foundations. Many prospective donors in this category are in areas of the country where foundations are rare but where the need for programs of sophisticated giving are very large. The combination of the proposed tax, the discrimination in respect to appreciated grants, the provisions regarding the qualifications for crediting grants against required distribution and the provisions demanding distribution of capital assets really all add up to a savage blow aimed unerringly at the continued vigor of American charitable foundations and these steps are proposed, I submit, without the benefit of any adequate record to support them.

In addition to the above features, there are some really draconian penalties on "foundation managers" (which would include trustees and the staffs of the foundations) for failure to observe the provisions of the Bill, some of which are not too clearly defined. I fear that in their present form these penalties can only discourage responsible participation in foundation management. In my judgment, these penalties should be reviewed and some suggestions as to their improvement have already been made. I recognize the need for improved enforcement measures in regard to foundations. Some other penalties and means of enforcement in addition to the withdrawal of the tax exemption are needed.

I have been very much interested in the attempts made by the drafters of the Bill to compel a just distribution of a foundation's assets. I observe that a distribution of 5% of the asset value of the foundation may be demanded in any one year. I can see how it would frustrate the charitable purposes of the tax exemption if all the property held by the foundation was in non-income or very low income producing property. If an arbitrary percentage or figure were chosen as the amount to be distributed in any one year, this, on the other hand, might force a slow but sure liquidation of the foundation. This would be more apt to be the case if some of the other provisions prejudicial to the growth of foundations to which I have referred were retained in the Bill.

What the foundation should distribute, and how rapidly, consistent with the purposes of the foundation, are properly matters for the trustees of the founda-

tion to determine and I believe that trustees generally are sensitive to their responsibilities in this respect. Some may be more so in the fact of comphehensive audits.

I was for a time on The Rockefeller Foundation Board of Trustees when Mr. Rockefeller, Jr. attended the meetings. I recall that at one time on his initiative the Board gave consideration to the wisdom of a mandatory program of liquidation for the Foundation. It turned out that the initial grants to the Foundations which totaled some $500,000,000 substantially increased due to the increased value of oil stocks held by the Foundation. It was not so very long after the Foundation had been set up that it had expended 500 million dollars in grants and it still had 500 million dollars in assets left to distribute. The Board weighed the pros and cons taking intc account the needs of the times and the interests of potential donees and they arrived at the conclusion that the Foundation ought not adopt a mandatory rule for its liquidation over any period of years. As I recall it, all the trustees accepted the principle that capital could be invaded and should be in the face of any pressing need. If the demand arose, it should be met even if it exhausted most or all of the assets of the foundation in one grant.

In the Ford Foundation during the period of my Chairmanship, in most years we spent much more than our income and the Board always felt that any real need which was presented to it should be met irrespective of the invasion of capital. Indeed, we adopted a regular program for doing so. I am told that foundations in the United States as a whole paid out last year over 7% of their asset value and this, of course, without any legal requirement that they do so. I have been associated with some foundations and I know of a number of others which have liquidated all their assets. I would imagine that a substantial percentage do so each year. I am entirely convinced that The Rockefeller Foundation has justified its continued existence. It has done some very imaginative and constructive things since the question of its possible termination first came up, a number of which were probably never in the contemplation of the original donors. I certainly can identify no deleterious effects on the country flowing from the continued existence of The Rockefeller Foundation long after the death of the original donors. I would at least postpone the inclusion of any provision which would lead to an enforced liquidation of a foundation until after we saw what the audits and the practices under the new law disclosed as to the growth of foundation assets. If they got out of line with the general growth of the country and its philanthropic needs, it would be time enough to move. I see no need for a self-liquidating provision now. I cannot object to a reasonable minimum of required distributions as I do not believe it is consistent with the principle of tax exemption for charitable purposes that non-income producing property be held interminably, or, indeed, for any substantial period of time without applying it to charitable purposes. I am told and believe the arbitrary requirement of 5% is too high certainly with the existing provisions relating to nonqualifying grants. If, as is now the case, income must be distributed within a reasonable period, I would leave it to the Secretary of the Treasury to determine the minimum figure to be distributed taking into account the reasonable return on capital to be expected, but without introducing any note of enforced liquidation.

I cannot see the advantage of limiting the amount of grants that any one foundation as defined under the Bill could receive from any single source. Nor can I follow the definitions which would identify worthy organizations as private foundations (which do not seem to have the normal attributes of private foundations) thus subjecting them to the severities of the provisions against private foundations (including the tax) contained in the Bill. There is something radically wrong with this part of the Bill. Mr. Stratton has treated this subject in his testimony, as have some others. If some imaginative and constructive project involving a foundation, as defined in this Bill, needs support, why preclude a private foundation from furnishing it all the support it requires? Why disqualify a grant to such an organization in determining the required distribution quotas of the granting foundation? I could name a number of highly meritorious institutions and projects which these provisions would inhibit. Mr. Stratton has only named some of them. I will not go further into this subject as it already has been dealt with by Mr. Stratton, but I do believe as the Bill now stands unwarranted and unwise prohibitions or impediments to some highly desirable foundation grants are created.

Nor do I see any particular vice in the gift by an owner of a business of stock in that business to a foundation devoted to charitable purposes even though this

may constitute the sole asset of the foundation. The vice occurs in any self-dealing or manipulation which results in a frustration of the fundamental charitable purpose of such a tax exempt foundation. Some of the abuses of the charitable purpose seem to center in this type of foundation. I sense that the drafters of the Bill have felt that some restriction on the amount of equity stock held by a foundation might be a desirable way of checking these abuses. If Congress wishes now to place a limitation on the amount of equity stock to be held by a foundation in any one company, this may be a reasonable exercise of its authority but I submit it would be unfair to well intentioned donors and their potential beneficiaries to compel the divestiture of such equity stock in excess of the limitation in such a way as to cause a substantial reduction of the values involved. If, let us say, in good faith the donor in the past had made a grant of equity stock in a closely held corporation which was legal at the time to a private foundation and he now finds that the foundation must divest itself of a certain portion of the stock to comply with the new law, some equitable device or mechanism for the sale or redemption of that stock under fair conditions and without tax penalties should be provided. There would be no problem for the corporation or the donor or the foundation if the stock consisted of readily marketable securities. It may be difficult to find the right mechanism and it would seem that in some cases the only way to insure an adequate price would be by way of redemption on the part of the corporation of the stock whatever the mechanism. Yet redemption may carry with it a threat of a high dividend tax to the donor or his estate or the corporation. The principle should be recognized that neither the foundation nor its potential grantees of the foundation nor the donors' legitimate interest should be prejudiced by the forced disposal of closely held stock due to newly imposed restrictions on the amount of stock (or other property) which may be held by a foundation.

I mention this situation because I believe the practice of an owner of a closely held business which he has built up of giving it by will or otherwise to a private foundation has been a rather prevalent one throughout this country. The practice is praiseworthy and should be encouraged rather than discouraged, but it will certainly be discouraged if the owner finds that the new restrictions on the amount of the foundation's holdings would compel divestiture by the foundation in such a way as to interfere with the realization by the foundation of the fair value of the excess stock or to expose the donor, his state, or the corporation to high tax penalties.

There are a number of other provisions in the Bill capable of clarification and improvement, most of which I believe have been referred to by earlier witnesses, but I wish to stress again my main point which is that the hostile and discriminatory measures poised against private foundations in this Bill should be entirely eliminated, leaving in only those that are well designed to deal with abuses of the tax exempt discretion, and that the means of instituting comprehensive and objective audits of the affairs of private foundations, with the cost defrayed by the foundations themselves, should be promptly instituted. I believe it to be unwise and imprudent on the part of Congress to incorporate in any tax reform bill provisions which would put to risk the steady flow of bequests for educational, scientific, cultural, medical and social purposes which the assets and operations of private foundations have thus far continuously and on the whole effectively and constructively afforded this country.

I find it quite paradoxical to observe at long last the adoption in Europe of the concept of American charitable foundations at just the time that this Bill containing provisions designed deliberately to discourage the creation and growth of American private foundations, appears in the Congress of the United States. The growth of such foundations in Germany and Italy particularly has to me been a very encouraging step in their advances in the field of private philanthropy. Incidentally, I believe that cooperation between the European and American private foundations could embody some most advantageous results in social, educational and scientific areas.

If it be urged that the need for private foundations in American life has now passed because the Government itself is becoming so heavily represented in the education and welfare field, I can only answer that, in my judgment, with the challenges this country faces the Government is going to need all the supplemental private help it can get and that without the flexibility and continued vigor of American private philanthropy of which the American private foundation has been such an important and outstanding factor since the turn of the century, those challenges are not apt to be met.

Senator RIBICOFF. John Macy, please. I am sure the other members of the Committee will give me the privilege of saying how I welcome my own constituent and close friend, John Macy. I am delighted to see you here, John. You may proceed, sir.

STATEMENT OF JOHN W. MACY, JR., PRESIDENT, CORPORATION FOR PUBLIC BROADCASTING

Mr. MACY. Thank you very much, Mr. Chairman and members of the committee. I would like to introduce my colleagues here at the witness table.

At my far left, Mr. James Day, the President of the National Educational Television and Radio Center, known as NET, the principal production center for public broadcasting, and on my immediate left, Mr. William Harley, who is President of the National Association of Educational Broadcasters, which represents the public broadcasting community, the stations and the professionals in that field.

Mr. Chairman, both Mr. Harley and I have filed previously full statements before the committee. Mr. Day had some additional points which he has included in a supplementary statement and, with your permission, I would like to request that that statement be added to the record of the committee.

Senator RIBICOFF. Without objection they will be included in the record.*

(Mr. Macy's prepared statement follows:)

STATEMENT BY JOHN W. MACY, JR., PRESIDENT, CORPORATION FOR PUBLIC BROADCASTING

SUMMARY

The public broadcasting system at both the national and local levels will be adversely affected by a tax on taxable expenditures as provided in the proposed Section 4945.

The adverse effect is believed *not* to be intended but will occur unless Section 4945 is clarified. A simple clarifying addition to Section 4945 is proposed to resolve this problem.

Also, as discussed by Mr. William Harley, President of the National Association of Educational Broadcasters, in his statement submitted for the record, problems of interpretation are presented by the definition of private foundations in proposed Section 509, and by certain other provisions of the bill.

As Mr. Harley's statement particularly makes clear, the Federal Government over an extended period of years has acted to encourage, develop, and finance public broadcasting in the public interest. In the absence of clarification the effect of H.R. 13270 will be to weaken the system Congress has been trying to establish and strengthen.

Private foundations both large and small have been a major source of financing for national organizations and local stations making up the public broadcasting system.

Without this foundation support the Federal Government would be required to increase its appropriations if public broadcasting is to be provided as stipulated in the Public Broadcasting Act of 1967.

Public broadcasting stations operate in accordance with law and FCC regulations and are specifically prohibited from editorializing or supporting or opposing candidates for elective office. Furthermore, they are bound by the fairness and equal-time doctrines. Thus public stations are already required by the nature of their licences and existing regulations to avoid the abuses against which the tax reform bill is directed.

The following language is proposed as amendment to section 4945 to clarify the intent of the legislation:

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*Mr. Day's prepared statement appears at p. 5536; Mr. Haley's at p. 5546.

"(g) PUBLIC BROADCASTING—

"Subsections (b)(1) and (b)(2) shall not apply to amounts paid or incurred for the production or distribution of public affairs programs which are broadcast over noncommercial educational broadcast stations as defined in Section 397 (7) of the Communications Act of 1934, as amended (81 Stat. 368; 47 U.S.C. 397(7).)"

STATEMENT

Mr. Chairman and Members of the Committee, my purpose for appearing before you today—not only on behalf of the CPB but also on behalf of all segments of the noncommercial, educational broadcasting community—is to discuss the debilitating impact of certain sections of H.R. 13270 on public broadcasting.

These sections as currently written pose a serious threat to a key role of public broadcasting—that of providing genuine public service to the community through the presentation of news, public affairs and discussion programming.

The irony of the situation, Mr. Chairman, is that I am convinced the drafters of H.R. 13270 never intended to pose any threat at all to individual public broadcasting stations, to state and regional networks, to the national production agencies, and to the Corporation, which was established by Congress itself.

In short, public broadcasting finds itself in a crossfire—by accident. Happily we can be removed from that crossfire without any change in the substance of the bill passed by the House. Some clarifying language can do the job.

To be specific, my concern is caused mainly by the proposed Section 4945—Taxes on Taxable Expenditures—as it will affect financial support of public broadcasting by private foundations.

I am advised by my counsel, Stephen Ailes, Esquire, of the firm of Steptoe and Johnson, that if this section becomes law as it stands, we must expect private foundations to discontinue giving financial support to public affairs programming. A copy of Mr. Ailes' discussion of the problem is attached to my statement.

It could be argued that the language in Section 4945 is not so restrictive as to prevent a private foundation from making a grant to a production facility or a qualified noncommercial educational station even though the station decides to use the money to present a news show, a panel discussion, or other public affairs programs.

But this is not the point. The problem is that private foundations will not take the very considerable risk and expose themselves to severe penalties if they do undertake financing which could possibly be interpreted as improper undr Section 4945. Obviously, a private foundation will avoid such risks and instead extend its financial support to other types of projects.

The practical consequence inevitably will be:

Withdrawal of millions of dollars of foundation grants from the already underfinanced public broadcasting system. A large part of this support—if not all of it—would be discontinued if Section 4945 stands as written. Furthermore, since much of this support typically requires matching funds, these funds also would be lost.

If such a substantial part of total financing is withdrawn, the American public would be deprived of a large and crucial part of the still very limited service they are receiving from public radio and television stations.

In the Public Broadcasting Act of 1967, Congress declared a Federal responsibility for developing and financing public television in the public interest. Any reduction in financing from private sources increases the amount of Federal financing required.

WHAT IS PUBLIC BROADCASTING?

There are today some 185 noncommercial television stations and 400 noncommercial radio stations in operation. A list of these stations is attached, and you will see these stations are dispersed in all parts of the country.

The development of public broadcasting began with the recognition that the air waves are a public resource and should be utilized at least in part in the public interest. The Federal Communications Commission has set aside frequencies to be used only by noncommercial educational radio and television broadcasters.

Adequate frequencies have been reserved to provide a full service for the public. However, actual broadcast operations utilizing these frequencies are considerably fewer in number. Limited resources have prevented the establishment of all the operations that are visualized as ultimately desirable.

Federal assistance in the establishment of noncommercial educational stations was first provided by the Educational Television Facilities Act of 1962. Under the terms of this act, Federal funds were provided under a matching formula for the purchase of broadcasting equipment and facilities. The Public Broadcasting Act of 1967 continued Federal support for facilities on a matching basis and additionally extended the Federal support to noncommercial radio stations.

As a result of the expenditure of more than $32 million of Federal facilities money, the number of public stations has been doubled since the 1962 act. It is estimated that total Federal expenditures have been accompanied by eleven times that amount in funds committed by state and local governments and private sources.

The existence of available frequencies and even the existence of physical facilities, however, does not provide the public service visualized as necessary and desirable by the Congress. The missing element is programs. Congress created the Corporation for Public Broadcasting (Title II of the Public Broadcasting Act of 1967) in order to provide the means of assisting stations in the program area.

As President of the Corporation for Public Broadcasting, my concern is for all aspects of public broadcasting, not only for the operation of the Corporation itself but also for the activities of organizational units that create and produce programs that may be used by the public stations as well as for the public broadcasting stations themselves.

The principal role of the Corporation, as I have indicated, is to assist stations in their efforts to provide the communities served by them with programs of diversity and excellence, by assisting them in program production, by facilitating program distribution, and by encouraging the development of national production centers.

The Corporation's initial operations have been financed by a $5 million Federal appropriation for fiscal year 1969. The Senate has acted to authorize $20 million for 1970, and the House Committee on Interstate and Foreign Commerce has favorably reported authorization of $20 million for 1970.

One of the aims of Congress in creating the Corporation was to provide a means of stimulating nonfederal financing for public broadcasting. The Senate report accompanying the legislation creating the Corporation recognized the need for substantial Federal financing for public broadcasting but expressed the hope that eventually the major part of the revenue would come from private sources.

We have been encouraged by the amount of private financing we have received to date. By the end of 1969, our $5 million of appropriated funds had been augmented by $2,725,970 of private financing. Our goal for 1970 is an additional $4 million of private financing.

Private foundations have been the major source of nongovermental financing for the Corporation and for other organizational units in the public broadcasting system. Now this source of private support would—at least to a large extent—be cut off as a result of the legislation before you. It is this unfortunate and, I am sure, unintended consequence that we ask you to prevent.

THE PUBLIC BROADCASTING STATION

The average public television station operates on a very small budget. (The median for operations in 1967 was $319,943.) A typical station broadcasts about ten hours a day with about five hours devoted to instructional television used in classrooms and the other five hours devoted to programs for reception in the home. The programs intended for home use fall into some general categories: programs for children, for continuing adult education, for public affairs, and for cultural affairs.

Most public broadcasting stations are operated by school systems, by city or state governments, or by universities. Thirty-eight public television stations are organized as nonprofit community stations, and these tend to be in the larger cities; for example, New York, Los Angeles, Chicago, New Orleans, and Washington.

Station revenues then come from various local governmental sources in the case of most stations, and from contributions from the general public in the case of the community stations. Additionally, stations to varying extents receive support from Federal agencies, from the Corporation for Public Broadcasting, and from private foundations, both the large foundations and many local or specialized foundations.

Arthur D. Little, Inc., analyzed sources of revenues for public television in the year ending June 30, 1967. Total station operating revenue was $44.8 mil- of which $26.8 million was supplied by local governments or universities for instructional programs for classroom use, and $18 million was for programs for reception in the home. Foundations provided $6.3 million of that amount for such local operations.

Foundations, particularly the Ford Foundation, through National Educational Television, have also largely supported programs made available to local stations by way of national distribution. Recently, such national programming has been generously supported by the Ford Foundation, the Carnegie Corporation, and the Sears Roebuck Foundation.

For example, a major source of such programs directed to preschool children is Children's Television Workshop. This workshop is financed in part by the Office of Education and by private foundations. "Misterogers Neighborhood", the outstanding prize-winning program for children carried by public television, has been continued as a result of a grant from the Sears Foundation.

Withdrawal of foundation support at both the station and national levels would materially affect the very nature of the public broadcasting service as we know it now and would move the industry backward instead of forward toward the fulfillment of its goal of service to the country.

MOST IMPORTANT CONCERN

A single simple solution in the form of clarification to H.R. 13270 will solve this problem.

Public broadcasting is subject to a body of law and regulation that is more stringent than the controls on commercial broadcasting stations. A public station cannot editorialize, for example; it cannot support a candidate for office nor advocate any candidate's cause. Together with commercial stations, the public station shares the responsibility for observing the fairness and equal time doctrines.

So here we would have an anomaly: a key information medium in the community, already required by the nature of its license and existing regulations to avoid the abuses the tax reform bill seeks to prevent, would be prevented from undertaking the activities for which it exists.

The proposed Section 4945 describes taxable expenditures by private foundations and imposes penalties in the form of taxes of 100 percent of any taxable expenditure on the foundation and 50 percent of the amount on the managers of the foundations who knowingly make taxable expenditures.

Subsection (b) states that "the term 'taxable expenditures' means any amount paid or incurred by a private foundation—

(1) to carry out propaganda, or otherwise attempt to influence legislation,

(2) to influence the outcome of any public election (including voter registration drives carried on by or for such foundation)."

Clearly the amount spent by private foundations to influence legislation or elections is subject to tax.

The question is whether a public broadcasting organization may be given a foundation grant without penalty to the foundation if the station then uses the grant to pay all or part of the costs of presenting news and public affairs programs.

The stations exist in part for that very purpose. Congress in the Public Broadcasting Act of 1967 acted to improve and develop these very public broadcasting stations and the program centers that serve them. The stations and such program centers must operate within a set of rules that assure their activities shall be devoid of the abuses that the tax reform bill seeks to cure. The local station manager has complete authority and responsibility over what programs are actually broadcast in his community.

It would seem, therefore, that a foundation grant made in support of public broadcasting—even in the public affairs area—would not be classed as a taxable expenditure.

Regrettably, this construction of the section is not the only one. I am advised that the foundations themselves view the situation quite differently. How the foundations conduct themselves is, of course, the critical issue. If the foundations believe that the present proposed language prohibits grants for public affairs, then, obviously, no grants are going to be provided. If foundation support is withdrawn, as I am advised it will be, then the public broadcasting system and the communities served by that system will be the losers.

In order to make clear that the intent is not to prevent public broadcasting stations from presenting public affairs programs, such as news programs, documentaries, panel discussions, political debates, and interviews, with the assistance of financial support from private foundations, I propose a simple addition to the proposed Section 4945 as follows:

(g) PUBLIC BROADCASTING.—Subsections (b)(1) and (b)(2) shall not apply to amounts paid or incurred for the production or distribution of public affairs programs which are broadcast over noncommercial educational broadcast stations as defined in Section 397(7) of the Communications Act of 1934, as amended (81 Stat. 368; 47 U.S.C. 397(7)).

The Communications Act defines "Noncommercial educational broadcast station" as meaning those stations licensed as such by the Federal Communications Commission and which are owned and operated by a public agency or nonprofit organization or those stations which are owned and operated by municipalities and which broadcast only noncommercial programs for educational purposes. All such stations are specifically required as a condition of their license to present public affairs programs but, equally, are forbidden by Section 399 of the Communications Act from engaging in editorializing or supporting or opposing any candidate for political office. Thus, this existing law which specifically regulates noncommercal stations, together with the requirements for fairness and equal time to which all stations are subject, already fully prevents noncommercial stations from committing the abuses to which Sections 4945(b) (1) and (2) are directed.

Before I close, Mr. Chairman, I would like to make a general comment about one other aspect of H.R. 13270 as it affects foundation operations.

H.R. 13270 imposes an annual 7.5% tax on the investment income of private foundations. We cannot help but believe that such a tax will result in a reduction in the amount of grants that the public broadcasting system may hope to get from private foundations—assuming we can clear the obstacles to getting grants. The amount of money available to the foundation for distribution will have to be reduced by the amount of the tax, and only the remainder will be available in the form of grants. In 1967 the total contribution by all foundations was $18 million. The proposed tax on this total would result in a shrinkage of $1.4 million. This tax, in other words, will actually be paid for by the public broadcasting

recipients of grants since we expect the grants to be reduced by the amount of the tax.

Returning to my main point, in summary, I find no evidence that the Members of the Ways and Means Committee or the Members of the House of Representatives intended that noncommercial, educational broadcasting stations be deprived of private foundation support for broadcasting services so vital as coverage of public affairs.

The foundations themselves, however, cannot be expected to take the risks and expose themselves to the penalties that they feel apply according to the present language of the bill.

The additional language that I have suggested would, I feel sure, in no way change the substance of the bill but would provide the clarification necessary to enable the private foundations to give grants to public broadcasting on their own merit.

I urge Mr. Chairman and members of the committee, to provide this vital clarification.

STEPTOE & JOHNSON,
Washington, D.C., September 3, 1969.

Mr. JOHN W. MACY, Jr.,
President, Corporation for Public Broadcasting,
Washington, D.C.

DEAR MR. MACY: At your request we have examined the proposed Tax Reform Act of 1969, H.R. 13270, with regard to its impact on the financial support of noncommercial educational radio and television broadcasting. Public broadcasting in the United States receives funds from a variety of sources including the federal, state and local governments, school districts, universities, business and private citizens. In addition, a substantial source of funds in recent years has been those organizations which under the proposed new section 509 are defined as "private foundations." Our analysis reveals that the proposed legislation includes provisions which could, if enacted without clarification, seriously hamper the ability of public, noncommercial broadcasting to continue receiving financial assistance from private foundations.

TAXABLE EXPENDITURES

H.R. 13270 proposes to amend the Internal Revenue Code by the addition of a new section 4945 which would impose a 100 percent tax on "taxable expenditures" by private foundations. This section also imposes a tax upon the foundation official responsible for the expenditure, for which tax the official is personally liable. "Taxable expenditure" is defined by section 4945(b) to mean, among other things, any amount paid or incurred by a private foundation—

(1) to carry out propaganda, or otherwise attempt to influence legislation, or

(2) to influence the outcome of any public election (including voter registration drives carried on by or for such foundation).

This definition of taxable expenditure may create a problem for noncommercial educational broadcasting by limiting the ability of this media to continue to engage in news and public affairs broadcasts. The purpose of public affairs and news broadcasts is to inform or educate—hence to "influence"—the viewer. The most objective presentations of current, newsworthy subjects will in this sense, "influence" the audience. In fact, the reason for such programming would cease to exist if it failed to educate and enlighten the viewer. Thus, it is clearly possible that the language of section 4945(b)(1) and (2) could be construed to include within the ambit of taxable expenditures noncommercial television or radio broadcasts treating with legislative issues or public elections.

There is, however, no specific indication that such an interpretation was contemplated by either the House of Representatives or its Committee on Ways and

Means at the time they considered and approved H.R. 13270. Further, there are substantial reasons why public affairs and news programming should not constitute taxable expenditures. Noncommercial educational broadcast stations, unlike their commercial counterparts, are already forbidden from engaging in editorializing or supporting political candidates by section 399 of the Communications Act of 1934, as amended, which provides:

No noncommercial educational broadcasting station may engage in editorializing or may support or oppose any candidate for political office. 47 U.S.C. § 399.

The legislative history of this provision, which was part of the Public Broadcasting Act of 1967, emphasizes, however, that the Congress did not intend to prevent educational broadcasters from engaging in public affairs programming. Rather, it appears that the Congress expected these stations to be the leaders in this area. For example, the report of the Senate Commerce Committee states:

Particularly in the area of public affairs your committee feels that noncommercial broadcasting is uniquely fitted to offer in-depth coverage and analysis which will lead to a better informed and enlightened public. S. REP. NO. 222, 90th Cong., 1st Sess 7 (1967).

And the House Committee on Interstate and Foreign Commerce observed:

Considerable testimony was heard that no noncommercial educational station editorializes.

Out of abundance of caution, the bill provides that "no noncommercial educational broadcasting station may engage in editorializing or may support or oppose any candidate for political office." It should be emphasized that this section is not intended to preclude balanced, fair and objective presentations of controversial issues by noncommercial stations. H.R. REP. NO. 572, 90th Cong., 1st Sess 20 (1967).

In addition to being subject to this prohibition against editorializing, noncommercial educational stations are also subject to the same Federal Communications Commission regulations, such as that imposing the doctrine of fairness (47 CFR § 73.123, see *Red Lion Broadcasting Co., Inc.* v. *Federal Communications Commission*, United States Supreme Court, October Term 1968, Nos. 2 and 717), and the statutory requirement regarding equal time (47 U.S.C. § 315, 48 Stat. 1088, as amended), as are commercial stations. Further, under present FCC policy, any station that fails to offer news and public affairs programs is in serious danger of having its license renewal application denied. *Report and Statement of Policy Re: Commission En Banc Programming Inquiry*, July 29, 1960, FCC 60-970, 25 Federal Register 7291.

Noncommercial, educational broadcasters, therefore, are already under a legal obligation to present public affairs programming that is free of both editorial comment and support (or opposition) for any candidate. The inclusion of public affairs and news broadcasts by educational stations in the concept of "taxable expenditure" is neither necessary for the control of abuses nor appropriate in view of the provision of the Communications Act and the regulations of the Federal Communications Commission. However, as long as the language of 4945(b)(1) and (2) is open to the broad interpretations discussed above, and as long as the tax penalty to be imposed is so severe, it follows that no private foundation funds will be available for public affairs programs by educational broadcasters unless an unequivocal clarification is obtained.

DEFINITION OF PRIVATE FOUNDATION

There are presently approximately 164 noncommercial educational television stations and 384 radio stations in the United States. A substantial number of these stations are owned by states, school districts or universities. It is probable that virtually none of these stations would be private foundations under the definition contained in proposed section 509 because they receive almost all of their support from government sources.

There are, however, a substantial number of stations known as "community" stations which receive funds from more diverse sources. It is possible that some

few of these stations may not qualify as an organization described in 170(b)(1)(B) of the Internal Revenue Code or under any of the other exemptions from the private foundation category. If clarification of 4945(b)(1) and (2) is not obtained, such a station, as a private foundation, would be prevented from engaging in any public affairs programming. As pointed out above, this would place a station in breach of its legal obligation to serve the public fully and could lead to the loss of its broadcast license.

TAX ON PRIVATE FOUNDATION INVESTMENT INCOME

H.R. 13270 includes a proposed new section 506 which would impose upon private foundations a tax equal to 7½% of its net investment income for each taxable year. This provision inevitably will result in an equivalent reduction in the amount of funds available for distribution by private foundations which quite possibly could lead to a corresponding substantial decrease in the funds received by educational broadcasting.

ALTERATIONS IN CHARITABLE CONTRIBUTION DEDUCTION

Section 201 of H.R. 13270 would amend existing Internal Revenue Code sections 170 and 1011 to eliminate certain advantages accruing to taxpayers who give or sell appreciated property to charity. Under present law a taxpayer who contributes property to charity is allowed a charitable contribution deduction for the fair market value of the property and he pays no tax on the amount of gain resulting from the appreciation. Further, if a taxpayer now sells property to a charity for less than its market value the proceeds of the sale are treated as a recovery of the cost and the seller is allowed a charitable contribution deduction for the appreciation in excess of the sale price. These provisions furnish a strong incentive for prospective donors to support charitable causes through conveyances of appreciated property. Their existence has undoubtedly been responsible for the flow to charitable organizations of a major portion of all contributions.

The new provisions would deny the donor a charitable deduction in excess of of his own cost in acquiring the property. This change would apply to all gifts of property to private foundations, all gifts of property the sale of which would have resulted in ordinary income or short-term capital gain, all gifts of tangible personal property and all gifts of future interests in property.

The television auctions conducted by many community educational stations for fund-raising purposes may prove a casualty of this change since it will substantially reduce existing incentives for making gifts of property to charity.

CONCLUSION

The taxable expenditure provisions in the proposed new section 4945(b)(1) and (2) of the Internal Revenue Code pose a serious threat to the ability of noncommercial educational broadcasting to continue to obtain substantial private funding. While there are no specific indications that the House of Representatives intended to prevent private foundations from giving funds to educational broadcast activities which engage in public affairs programs, the language of 4945(b)(1) and (2) is sufficiently broad and vague to lead to that result. Because of the substantial penalty imposed on taxable expenditures, it is likely that all doubts will be resolved against making grants to educational broadcasters who produce, distribute or carry news or public affairs programs.

It is also likely that the imposition of a 7½ percent tax on the net investment income of private foundations and the alteration of the charitable deduction provisions relating to the gift or sale of appreciated property will result in corresponding reductions of private contributions to noncommercial educational broadcasting.

Very truly yours,

STEPHEN AILES.

EDUCATIONAL RADIO AND TELEVISION STATIONS BY STATE, CITY AND CALL LETTER

To distinguish between radio and television operations, all educational FM radio stations in the following listing have been set in italic. TV stations have been set in roman, and AM stations have been set bold face.

ALABAMA

Birmingham .... *WVSU(CP)*
WBIQ
Dozier .... WDIQ
Mobile .... WEIQ
Montgomery .... WAIQ
Cheaha .... WCIQ
Huntsville .... WHIQ
Florence .... WFIQ

ALASKA

College .... *KUAC*

ARIZONA

Phoenix .... *KFCA*
KAET
Tucson .... *KUAT*
KUAT

ARKANSAS

Conway .... *KASC*
Jonesboro .... *KASU*
Little Rock .... KETS

CALIFORNIA

Angwin .... *KANG*
Arcata .... *KHSC*
Berkeley .... *KPFA*
KPFB
KALX
Davis .... *KDVS* (CP)
Claremont .... *KSPC*
LaCanada .... *KUNF*
LaSierra .... *KSDA*
Loma Linda .... *KEMR*
Long Beach .... *KLON*
KCLB
Los Altos Hills .... *KFJC*
KPSR
Los Angeles .... *KPFK*
KUSC
KCET
KXLU
Northridge .... *KEDC*
Pasadena .... *KPCS*
Redding .... KIXE
Redlands .... *KUOR*
Riverside .... *KUCR*
Sacramento .... *KERS*
KVIE
San Bernardino .... *KVCR*
KVCR
San Diego .... *KEBS*
KEBS
KSDS
San Francisco .... *KALW*
KCMA
KQED
KXKX
San Jose .... *KSJS*
KETH
San Mateo .... KCSM
KCSM
Santa Barbara .... *KCSB*
Santa Monica .... *KCRW*
Stanford .... *KZSU*
Stockton .... *KUOP*
Torrance .... *KNHS*

COLORADO

Colorado Springs .... *KRCC*
Denver .... KRMA
Fort Collins .... *KCSU*
Greeley .... *KCBL*
Gunnison .... *KWSB*

CONNECTICUT

Bridgeport .... WEDW
WPKN
Fairfield .... *WSHU*
Hartford .... WEDH
WRTC
Middletown .... *WESU*
Norwich .... WEDN
Storrs .... *WHUS*
Trumbull .... *WGES* (CP)
West Hartford .... *WWUH*

DISTRICT OF COLUMBIA

Washington .... *WAMU*
WETA
WETA
WGTB

FLORIDA

Coral Gables .... *WVUM*
Gainesville .... *WRUF*
WUFT
Jacksonville .... WJCT
Miami .... *WTHS*
WTHS
Pensacola .... WSRE
Orlando .... WMFE
Tallahassee .... *WFSU*
WFSU
WEDU
Tampa .... *WUSF*
WUSF
Winter Park .... *WPRK*

GEORGIA

Athens .... WGTV
Atlanta .... *WABE*
WETV
WREK
Chatsworth .... WCLP
Cockron .... WDCO
Columbus .... WJSP
Dawson .... WACS
Pelham .... WABW
Savannah .... WVAN
Waycross .... WXGA
Wrens .... WCES

HAWAII

Honolulu .... KHET
Wailuku .... KMEB

IDAHO

Lewiston .... *KLHS*
Moscow .... *KUOI*
KUID
Nampa .... *KCRH*
Pocatello .... *KBGL*

ILLINOIS

Carbondale .... *WSIU*
WSIU
Chicago .... *WBEZ*
WMBI
WMBI
WTTW
WXXW
DeKalb .... *WNIU*
Elgin .... *WEPS*
Elmhurst .... *WRSE*
Evanston .... *WNUR*
Flossmoor .... *WHFH*
Galesburg .... *WVKC*
Greenville .... *WGRN*
Naperville .... *WONC*
Kankakee .... *WKDC*
La Grange .... *WLTL*
Macomb .... *WWKS*
Morrison .... *WMHS*
Normal .... *WGLT*
Park Forest .... *WRHS*
Park Ridge .... *WMTH*
Rock Island .... *WVIK*
Urbana .... WILL
WILL
WILL
Wheaton .... *WETN*
Winnetka .... *WNTH*

INDIANA

Bloomington .... *WFIU*
WTIU
Carmel .... *WHJE*
Evansville .... *WEVC*
WPSR

Source: NAEB 1969 Directory and Yearbook of Educational Broadcasting

Franklin WFCI
Gary WGVE
Goshen WGCS
Green Castle WGRE
Hartford City WHCI
Huntington WVSH
Indianapolis WAJC, WIAN, WBDG, WICR
Muncie WBST, WWHI
New Albany WNAS
North Manchester WBKE
Notre Dame WSND
Richmond WECI
South Bend WETL
St. John WCAE
Terre Haute WISU
Valparaiso WVUR
Vincennes WVUT
West Lafayette WBAA

IOWA

Ames WOI, WOI
Boone KFGQ, KFGQ
Cedar Falls KTCF
Cedar Rapids KCOE (CP)
Davenport KALA
Decorah KWLC
Des Moines KDPS, KDPS
Grinnell KDIC
Iowa City WSUI, KSUI
Mt. Vernon KRNL
Pelle KCUI
Sioux Center KDCR
Waterloo KNWS, KNWS
Haverly KWAR

KANSAS

Baldwin KNBU
Emporia KSTE
Lawrence KFKU, KANU
Manhattan KSAC, KSDB
Ottawa KTJO
Parsons KPPS
Topeka KTWU
Wichita KMUW
Winfield KSWC

KENTUCKY

Ashland WKAS
Bowling Green WKGB
Covington WCVN
Elizabethtown WKZT
Georgetown WRVG
Hazard WKHA
Lexington WBKY, WKLE
Louisville WFPK, WFPK, WFPL
Madisonville WKMA
Morehead WMKY, WKMR
Murry WKMU
Owenton WKON
Pikeville WKPI
Rickmond WEKU
Somerset WKSO, WSCC

LOUISIANA

Lafayette KRVS
New Orleans WYES

MAINE

Augusta WCBB
Brunswick WBOR
Calais WMED, WMED
Orono WMEB
Lewiston WRJR
Presque Isle WMEM

MARYLAND

Baltimore WBJC
Takoma Park WGTS

MASSACHUSETTS

Amherst WAMF, WFCR, WMUA
Andover WPAA
Boston WBUR, WERS, WGBH, WGBH
Cambridge WTBS
Lowell WLTT
Milton WSCC
South Hadley WMCH
Springfield WSCB, WAIC
Waltham WBRS
Williamstown WCFM
Winchester WHSR

MICHIGAN

Adrian WVAC
Ann Arbor WUOM
Detroit WDTR, WDET, WTVS
East Lansing WKAR, WKAR, WMSB
Flint WFBE
Grand Rapids WVGR
Highland Park WHPR
Houghton WGGL
Interlochen WIAA
Kalamazoo WMUK
Marquette WNMR, WNMR
Mt. Pleasant WCMU, WCMU
Royal Oak WOAK
Southfield WSHJ
Spring Arbor WSAE
Warren WPHS
Waterford WTSD (CP)
Ypsilanti WEMU
University Center WUCM

MINNESOTA

Appleton KWCM
Collegeville KSJR
Duluth KUMD, WDSE
Mankato KMSU
Minneapolis--St. Paul KTIS, KUOM, KTCA, KTCI
Moorhead KSJN
Northfield WCAL
St. Cloud KVSC

Buffalo KBFL
Clayton KFUO, KFUO, KHRU (CP)
Columbia KWWC, KBIA (CP)
Joplin KOBC (CP)
Kansas City KCUR, KCSD, KSOZ
Maberly KMTS (CP)
Point Lookout KSOZ
Rolla KMSM
St. Charles KCLC
St. Louis KSLH, KETC
Warrensburg KCMW

MONTANA

Bozeman KGLT
Missoula KUFM

NEBRASKA

Alliance KTNE
Bassett KMNE
Kearney KOVF
Hastings KHNE
Lexington KLNE
Lincoln KUON, KUCV
Norfolk KXNE
North Platte KPNE
Omaha KGBI, KYNE

NEVADA

Las Vegas KLVX
Reno KUNR

Source: NAEB 1969 Directory and Yearbook of Educational Broadcasting

Educational Radio and Television Stations by State, City and Call Letter (Con't)

NEW HAMPSHIRE

City	Call Letter
Berlin	WEDB
Durham	WENH
	WUNH
Exeter	*WPEA*
Hanover	WHED
Keene	WEKW
Littleton	WLED

NEW JERSEY

City	Call Letter
Glassboro	*WGLS*
Hackettstown	*WNTI*
Hanover	*WHPH*
Newark	*WBGO*
South Orange	*WSOU*
Trenton	*WTSR*

NEW MEXICO

City	Call Letter
Albuquerque	KNME
	KUNM
	KANW
Las Cruces	*KRWG*
Las Vegas	*KEDP*
University Park	*KRWG*

NEW YORK

City	Call Letter
Albany	*WAMC*
Binghamton	*WHRW*
	WSKG
Buffalo	*WBFO*
	WNED
Canton	*WSLU*
Central Square	*WCSO*
Clinton	*WHCL*
Elmira	*WECW*
Floral Park	*WSHS*
Geneseo	*WGSU*
Hempstead	*WVHC*
Ithaca	WHCU
	WHCU
	WICB
Lake Konkovkoma	*WSHR*
Loudonville	*WVCR*
New York	*WBAI*
	WNYC
	WNYC
	WNYE
	WNDT
	WFUV
	WKCR
	WRVR
Oswego	*WRVO*
Potsdam	*WTSC*
Rochester	*WIRO*
	WRUR
	WXXI
Schenectady	WMHT
Springville	*WSPE*
Syracuse	*WAER*
	WCNY
Troy	*WAER*
	WHAZ

NORTH CAROLINA

City	Call Letter
Asheville	WUNF
Chapel Hill	WUNC
	WUNC
Charlotte	WTVI
Columbia	WUND
Concord	WUNG
Greensboro	*WUAG*
Greenville	*WWWS*
High Point	*WHPS*
Linville	WUNE
Raleigh	*WKNC*
Winston Salem	*WFDD*

NORTH DAKOTA

City	Call Letter
Fargo	KFME
	KDSU
Grand Forks	KFJM

OHIO

City	Call Letter
Akron	*WAPS*
	WAUP
Athens	WOUB
	WOUB
	WOUB
Berea	*WBWC*
Bowling Green	WBGU
	WBGU
Cedarville	*WCDR*
Cincinnati	WCET
	WGUC
Cleveland	*WBOE*
	WRUW
	WVIZ
Columbus	WOSU
	WOSU
	WOSU
	WCBE
Delaware	*WSLN*
DeGraff	*WDEQ*
Granville	*WDUB*
Kent	*WKSU*
Marietta	*WCMO*
New Concord	*WMCO*
Newark	WGSF
Oberlin	*WOBC*
Oxford	*WMUB*
	WMUB
Springfield	*WUSO*
Struthers	*WKTL*
Toledo	WGTE
Westerville	*WOBN*
Wilberforce	*WCSU*
Wooster	*WCWS*
Yellow Springs	*WYSO*

OKLAHOMA

City	Call Letter
Edmond	*KCSC*
Oklahoma City	*KOKH*
	KETA
	KOKH
Stillwater	*KOSU*
Tulsa	*KWGS*
	KOED

OREGON

City	Call Letter
Corvallis	KOAC
	KOAC
	KBVR
Eugene	*KRVM*
	KWAX
	KLCC
Klamath Falls	*KTEC*
Portland	KBPS
	KOAP
	KOAP
	KRRC

PENNSYLVANIA

City	Call Letter
Allentown	*WMUH*
	WLVT
Beaver Falls	*WGEV*
Easton	*WJRH*
Erie	*WQLN*
Grane City	WSAJ
Havertown	*WHHS*
Hershey	WITF
Indiana	*WIUP (CP)*
Lewisburg	WVBU
Mansfield	*WNIE (CP)*
Meadville	*WARC*
New Wilmington	*WKPS*
Philadelphia	*WPWT*
	WHYY
	WRTI
	WUHY
	WXPN
Pittsburgh	*WDUO*
	WQED
Reading	*WXAC*
Scranton	*WUSV*
	WVIA
Selinsgrove	*WQSU*
Telford	*WBMR*
University Park	*WDFM*
	WPSX
Wilkes-Barre	*WRKC(CP)*

RHODE ISLAND

City	Call Letter
Kingston	*WRIU*
Providence	*WDOM*
	WSBE
Warwick	*WBHS*

SOUTH CAROLINA

City	Call Letter
Allendale	WEBA
Charleston	WITV
Clemson	*WSBF*
Columbia	WRLK
	WUSC
Greenville	WNTV
	WMUU
	WMUU
Florence	WJPM

Source: NAEB 1969 Directory and Yearbook of Educational Broadcasting

SOUTH DAKOTA

City	Station
Brookings	KESD
	KESD
Rapid City	KBHE
Sioux Falls	KNWC

TENNESSEE

City	Station
Chatanooga	WDYN
	WVMS
	WTCI
Collegedale	WSMC
Henderson	WFHC
Knoxville	WKCS
	WUOT
	WSJK
Lebanon	WFMQ
Lexington	WLJT
Memphis	WKNO
Nashville	WDCN
	WPLN
	WNAZ

TEXAS

City	Station
Austin	KMFA
	KLRN
	KUT
Brownwood	KHPC
Dallas	KVTT
	KERA
El Paso	KTEP
Ft. Worth	KTCU
Houston	KUHT
	KUHT
Lubbach	KTXT
	KTXT
Odessa	KOCV
Plainview	KHBL
Richardson	KRET
San Antonio	KSYM
Waco	KWBU

UTAH

City	Station
Cedar City	KCDR
Logan	KUSU
	KUSU
Ogden	KWCR
Profo	KBYU
Salt Lake City	KUER
	KUED

VERMONT

City	Station
Burlington	WETK
	WRUV
Middleberry	WRMC
Northfield	WNUB
Rutland	WVER
St. Johnsburg	WVTB
Windsor	WVTA

VIRGINIA

City	Station
Charlottesville	WTJU
Chesapeake	WFOS
Hampton	WHOV
Harrisonburg	WEMC
Lexington	WLUR
Norfolk	WMTI
	WHRO
Richmond	WRFK
	WCVE
Roanoke	WBRA
Staunton	WVPT
Williamsburg	WCWM
Yorktown	WYCS

WASHINGTON

City	Station
Cheney	KEWC
College Place	KGTS
Ellensburg	KCWS
Lakewood Center	KPEC
Pullman	KWSC
	KWSC
Seattle	KUOW
	KCTS
Spokane	KSPS
Tacoma	KTPS
	KCPS
	KTOY
	KPLU
Yakima	KYVE

WEST VIRGINIA

City	Station
Bethany	WVBC
Buckhannon	WVWC
Huntington	WMUL
	WMUL
Morgantown	WWVU

WISCONSIN

City	Station
Appleton	WLFM
Auburndale	WLBL
Beloit	WBCR
Brule	WHSA
Chilton	WHKW
Colfax	WHWC
Delafield	WHAD
Highland	WHHI
Holman	WHLA
Madison	WHA
	WHA
	WHA
Marinette	WHMD
Menominie	WVSS (CP)
Milwaukee	WUWM
	WMVS
	WMVT
Oshkosh	WRST
Platteville	WSUP
Ripon	WRPN
Stevens Point	WSUS
Superior	WSSU
Hausow	WHRM
River Falls	WRFW
Whitewater	WSUW

WYOMING

City	Station
Laramie	KUWR

AMERICAN SAMOA

City	Station
Pago Pago	KVZK

PUERTO RICO

City	Station
Hato Rey	WIPR
Mayaquez	WIPM

Source: NAEB 1969 Directory and Yearbook of Educational Broadcasting

Mr. MACY. Mr. Chairman, we are here today, as your final witnesses after hearing from representatives of the foundations to talk about the impact of the House bill on a new industry, a new public service industry, public broadcasting.

We believe that the House bill would adversely affect the development of that industry in the public interest. We believe that the adverse effect was not intended by the House but that in the drafting of the legislation it encompassed in their language certain conditions which would injure public broadcasting.

We offer in a brief summary some proposed solutions which we believe will clarify the intent of the legislation and remove the inherent dangers that are involved in the language as it stands.

In order to do this, I plead for your indulgence for a few moments to describe what public broadcasting is. The airwaves are a public resource. Over the years the Government has acted to reserve at least a part of this resource for the public interest, to serve the needs of the American people in education and in other forms of public service.

Senator RIBICOFF. I do not want to interrupt, but as an oldtimer on the Hill you realize that bell was one bell for a vote.

Mr. MACY. I have heard that before.

Senator RIBICOFF. Yes. So we will recess until we have an opportunity to vote and then, if you will be patient, we will come back and allow you to finish.

Mr. MACY. Thank you, Mr. Chairman.

Senator RIBICOFF. We will recess for 15 minutes.

(Whereupon, there was a short recess.)

The CHAIRMAN. Mr. Macy, you were interrupted, and I would just urge you to continue your statement at the point where you were.

Mr. MACY. Thank you, Mr. Chairman.

As a result of Government action to reserve frequencies for educational broadcasting, as a result of legislation to assist local stations in financing facility construction and installation, and then most recently in 1967, the plant to finance program production and program distribution through the creation of the Corporation for Public Broadcasting, we have seen steps taken toward the beginning of a substantial public service in both television and radio.

Today there are some 185 public television stations, and 400 public radio stations in operation. These stations are all nonprofit organizations. Many of them are financed by State and local authorities, by school systems or by universities. Major television stations are nonprofit community organizations, mainly dependent upon private financing, including most importantly, foundation financing.

I emphasize that all of these stations are noncommercial, they do not sell commercial time. Therefore, they are totally dependent upon a combination of private financing and what they are able to receive from public sources.

The programs presented by the noncommercial stations tend to fall into several public service categories: Programs for children in the school and in the home, continuing education for adults, public affairs, cultural offerings in music, drama and other areas.

A substantial part of the public is now within the reach of the signals of public stations. From the information that we have before us

of 58 million television set owning families, 46 million are within the public television signal areas.

Typically, a public television station will be on the air 10 hours a day during the week. Five of these hours would be used for classroom instruction, and the other 5 hours for home reception in continuing education, public and cultural affairs.

Now, turning to the House bill, there are two sections that cause principal concern for public broadcasting. The first is proposed section 509, which defines private foundations; then, too, the proposed section 4945 which establishes a tax on taxable expenditures. Basically, 4945 is our central problem, and I am really focusing my principal attention on that.

Mr. Harley, on my left, has submitted a statement in the record and in his statement gives in greater detail the technical aspects that concern us with respect to the definitions in section 509.

Mr. Day, in his statement, refers to the issues involved in the legislation which particularly relate to the National Education Television and Radio Center. He also touches on significant constitutional issues which we believe call for close consideration by the committee members and the staff.

These lurking constitutional questions call for precise definition in order to avoid later challenge.

But turning to section 4945, this, as we heard today, prevents foundations from taking action that might affect the opinion of the public or any part of the public in ways that might influence elections or influence legislation.

Public affairs programs in public broadcasting influence opinion that might affect legislation or elections. So really a public affairs discussion, if it is to be significant in terms of the public interest may, usually by indirection, influence the opinion of those who view or listen.

Given the language of 4945 as it now stands, I am informed by counsel that foundations have concluded they could not make grants to public broadcasting either to a national production center, such as NET, or individual stations if those grants, directly or indirectly, resulted in the production of public affairs programs.

Now, it is understandable that the legislation would have that kind of chilling effect in view of the penalties in the form of taxation of 100 percent of expenditures on the foundation, and 50 percent on what is described as the managers of the foundations who knowingly make taxable expenditures.

This is so severe as to provide an unwillingness or motivate an unwillingness on the part of the foundations to take the necessary risk.

I am convinced from the conversations I have had with Members of the Congress that there was not an intent that this consequence result from that legislation. Therefore, it is our view that there is need for clarification of this fact in a revision of this language.

I think it is important to recognize the vital importance of foundation support in public broadcasting operations. Foundation grants provide at both national and station level significant support. In the early days of the development of public broadcasting, the foundations had provided the difference between development and no progress at all.

Public broadcasting has been the beneficiary of grants from large national foundations and from small local specialized foundations which have assisted the stations.

In total, this foundation support is significant. It is estimated to be $17.5 million in 1967. This is 28 percent of the total financing for public television broadcasting in that year. Withdrawal of this support would have serious consequences for NET in its production of important national programing and public affairs and for local stations in serving their audiences in their broadcast areas.

We feel that the intent of H.R. 13270 is to prevent abuses, abuses in influencing public opinion, influencing the outcome of elections.

Public stations, radio and television, exist in large part for the purpose of providing news, information, interpretation, public service to the citizenry, so that the public can more completely fulfill the responsibilities of citizenship. This is a means for enhancing communication with the American people so that they are in a better position to make the choices that must be theirs in a democracy on the key issues.

Public stations are controlled now by existing laws and by the FCC regulations for the purpose of preventing the very abuses that appear to be the concern of H.R. 13270.

The statutes provide, particularly section 399 of the Communications Act of 1934, that noncommercial educational stations may not engage in editorializing or supporting or opposing any candidate for any political office. That is already on the statute books.

Stations are required, as are commercial stations, to observe the fairness and equal time doctrine. Those are safeguards against any kind of abuse.

As a condition of the license granted by the FCC stations must provide public affairs programing. This is one of the standards that is viewed in considering a license application. So the statutory obligation apparently intended by the House in the bill is inherent in the purpose of these stations themselves.

Stations, to my knowledge, have avoided and will continue to avoid the abuses in section——

The CHAIRMAN. If you will permit me to interrupt you one moment, Senator Ribicoff is going to conclude the hearings today, but I just wanted you to prepare the amendments or else prepare a memo suggesting the amendments that you think are necessary to take care of your industry. You are talking about the educational television people.

Mr. MACY. Yes, sir.

The CHAIRMAN. And I will join with the Senator in seeing they are considered.

Mr. MACY. Thank you very much.

Senator RIBICOFF. I would be very sympathetic if you would sit down with those amendments, work them out and present them to me, my staff, and I will be glad to introduce them.

I think you make very pertinent points here.

Mr. MACY. Thank you, Senator. We have that language and we would welcome the opportunity to collaborate with you.

Senator RIBICOFF. I will talk with you later on and make some suggestions.

Mr. MACY. Fine.

If I may, I would like to provide a supplementary comment from Mr. Day and Mr. Harley, if that is agreeable with you.

Senator RIBICOFF. Perfectly all right. You have waited so long, the least I can do is wait for you.

Mr. MACY. Well, Mr. Day was commenting a moment ago that he hopes that the conditions in the room, the absence of an audience, was not symbolic of the future of public television. I am convinced it is not.

Senator RIBICOFF. I hope so, too.

I have a question sometimes, but I feel you have got a long row to hoe. I think you are doing a good job, and I trust the listening public will get to appreciate you more and more with each passing day.

Mr. MACY. Mr. Day will be very instrumental in achieving the kind of programing that will attract those audiences, and I am sure you will be interested in hearing from him. Mr. Day.

STATEMENT OF JAMES DAY, PRESIDENT, NATIONAL EDUCATIONAL TELEVISION & RADIO CENTER

Mr. DAY. Thank you, Mr. Chairman.

Although I have been president of NET, National Educational Television, for only 2 months, I have served for 16 years as the president and general manager of one of the 166 public television stations in the country that are served by this national programing service. The NET service amounts to 5 hours weekly and provides many of the most important and significant programs that are broadcast on the 166 public television stations affiliated with NET.

I think it is important to point out that each of these stations is independent and may run or may not run any or all of the programs as they choose.

My concern, of course, as president of NET is with those aspects of the law that would be nothing less than the death knell to at least part of our programing. At the moment half of our total program service is concerned with national and international issues, and we would be precluded from broadcasting such programs that would influence legislation or influence elections.

This, of course, we feel would be a deprivation for the American public which has the right to know, and we feel, of course, that public television has the obligation to provide that information.

It is also important to point out that if, by putting political candidates on the air, a program influences elections, then under the terms of the House bill NET would be precluded from offering free time to political candidates.

Finally, even if it were possible to exclude NET from those prohibitions placed upon private foundations it would still place NET in the position of having each of its grants from a private foundation examined to see whether, in fact, they would be spent to influence public opinion, and the consequence of this would be more control by foundations rather than less control, and we think this would be bad.

Thank you.

Mr. MACY. Thank you, Mr. Day.

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STATEMENT BY JAMES DAY, PRESIDENT, NATIONAL EDUCATIONAL TELEVISION & RADIO CENTER

Mr. Chairman and members of the Committee, I am James Day, President of the National Educational Television and Radio Center, known as NET. The purpose of my testimony is to discuss the problems posed for public broadcasting and for NET by the proposed Tax Reform Act of 1969 (H.R. 13270).

We are particularly concerned with the language presently contained in Sections 4945(b)(1), (b)(2) and (c)(1) of the proposed Act, which are designed to restrict the "legislation-influencing" and "election-influencing" activities of "private foundations." As I will discuss later in greater detail, it is our position that, if enacted, these provisions will seriously hamper, if not emasculate, the public affairs broadcasting activities of NET. [See Part III at page 9.] Since we believe that the Treasury proposal of September 30, 1969, does not solve the problems which we find in Section 4945,* we propose the following addition to Section 4945:

"(g) *Public broadcasting.*—Subsections (b)(1) and (b)(2) shall not apply to amounts paid or incurred for the production or distribution of public affairs programs which are broadcast over noncommercial educational broadcast stations as defined in Section 397(7) of the Communications Act of 1934, as amended (81 Stat. 368; 47 U.S.C. 397(7))."

We are also vitally concerned with the classification, under the proposed Act, of a foundation such as NET. Unless NET qualifies as a non-private foundation or as a private operating foundation as defined in Section 4942(j)(3), grants to NET will not be "qualifying distributions" under Section 4942 and, hence, foundation managers will undoubtedly discontinue all grants to NET. This will have the immediate effect of cutting off funding for the production of almost all national programs for public broatdcasting, a public service that Congress has repeatedly sought to strengthen. [See Part IV at page 30.]

We believe that it is crucial that both of these problems be solved in order to insure the continued functioning of NET, public broadcasting's major program source, and also the continued viability of the entire non-commercial educational television and radio system. The testimony of Mr. Macy, President of the Corporation for Public Broadcasting, and Mr. Harley, President of the National Association of Educational Broadcasters, explore the problems caused by the proposed Tax Reform Act to the other major elements in the public broadcasting system. NET endorses both of these statements.

I. OPERATIONS OF NET

NET is an Illinois non-profit corporation, incorporated in 1952, organized and operated exclusively for scientific, educational and charitable purposes. NET's primary purpose is to "promote the advancement of educational television and radio for the general welfare." In furtherance of this purpose, NET acquires and supplies programs to its 166 affiliated stations. In addition, NET provides essential advisory services for these stations which they could not otherwise individually afford. NET's sole function is to provide programs and services to its affiliated educational television stations.

Neither NET, nor its affiliated stations, may accept commercial sponsorship. NET is therefore completely dependent on such financial support as it receives from the United States Government and private foundations, the small amounts it receives from the general public and the small amounts in fees it receives from its affiliated stations. Since 1963, NET has received unrestricted annual grants of approximately $6 million from the Ford Foundation. NET also received funds from other sources. This year, for example, we received approximately $1.8 million from the Corporation for Public Broadcasting. All of our funds are spent annually.

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*Because the "substantial" test of existing law (Section 501(c)(3) of the Internal Revenue Code of 1954) is eliminated by Section 4945, it is critically important that that section be both clear and limited as to the activities which it covers. We believe that the Treasury's language is not sufficiently clear. While the Treasury states that its proposal to amend Section 4945(c) would limit it to existing law, this is not entirely clear from the proposal's language. Moreover, without the "substantial" test, even the language of existing law is not sufficiently explicit. Finally, the Treasury proposal does not amend the language of Section 4945(b)(2).

NET is a prime source of educational television programing intended for the general public. Nearly 50% of such programs are provided by NET. NET currently provides at least five weekly hours of original programing to its affiliated stations.

The programs supplied by NET constitute an important alternative to those offered by the major national commercial networks—ABC, CBS and NBC. Half of NET's schedule consists of public affairs programs such as news programs, documentaries, panel discussions, political debates, and interviews. The programs consider important current issues in foreign policy, politics, and government as well as other social and economic questions. "NET Journal," for example, is a thought-provoking weekly hour-long series that examines crucial domestic and international issues such as poverty, prejudice, problems of public and private education, the balance of world power, the Supreme Court and world hunger. NET programs deal in depth with events that commercial networks do not fully cover as well as other news items that may not otherwise be broadcast to the public. The balance of NET's schedule consists of programs of primarily cultural interest—dealing with the arts, drama, history, humanity and science—and children's programing. Some of these cultural programs may deal with public issues and in this sense are public affairs programs. Various national and international awards have been made to NET for its programs. For example, NET was awarded Emmy and Peabody Awards this year for two of its series.

Under Section 399 of the Communications Act of 1934, 47 U.S.C. § 399, the public noncommercial broadcasting stations affiliated with NET may not "engage in editorializing" and may not "support or oppose any candidate for political office." Further, Section 315 of the Communications Act, 47 U.S.C. § 315, and the Federal Communications Commission's fairness doctrine * require that these stations give reply time to opposing political candidates and for competing views on controversial public issues. NET insures that its programming complies with these requirements and with the recently adopted personal attack rules, requiring that individuals or groups which are personally attacked be afforded time to reply, 47 C.F.R. § 73.679. It does not offer programming that might be held to constitute political or legislative editorializing, and its programs are produced with strict adherence to objectivity and balance.

II. CURRENT TAX STATUS OF NET

At present, NET qualifies as an educational organization exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1954. Qualification as a Section 501(c)(3) organization has other, equally important, tax benefits to NET. Other private foundations can contribute funds to NET without fear of losing their own 501(c)(3) tax exempt status. Individuals contributing to NET can deduct the amount of such contributions up to 20 percent of adjusted gross income under Section 170 of the Internal Revenue Code of 1954.

NET must, to retain its Section 501(c)(3) status, insure that "no substantial part" of its activities consists of "carrying on propaganda, or otherwise attempting to influence legislation," and it cannot, even to an insubstantial degree, "participate in, or intervene in * * * any political campaign on behalf of any candidate for public office." Despite the ambiguity of the terms "attempting to influence legislation" and "substantial" and the lack of consistency in their interpretation by the Internal Revenue Service and the courts, we are certain that NET can continue under present law to present balanced public affairs programming dealing with topics that are the subject of current or potential legislation without jeopardizing its Section 501(c)(3) status. Further, we are confident that NET will continue to present balanced coverage of candidates and election issues without being held to have "intervened" in an election on behalf of a candidate.

III. PROBLEMS POSED BY SECTION 4945

1. Effect of Proposed Sections 4945(b)(1), (b)(2) and (c)(1) on NET

a. *Proposed changes from present law.*—H.R. 13270 proposes to amend the Internal Revenue Code by adding a new Section 4945(a) which would impose a 100 percent tax on "taxable expenditures" by a "private foundation" and a

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*Report on Editorializing by Broadcast Licensees, 13 FCC 1246 (1949); 47 U.S.C. § 315.

50 percent tax on foundation "managers"—including officers and directors—who approve such an expenditure. (In some cases a 100 percent tax would also be imposed on a foundation manager.) For reasons I will discuss later, NET would be held to constitute a "private foundation" subject to Section 4945. The consequence of this is that NET—and the foundations which support NET—are subject to the penalty tax if they make "taxable expenditures."

"Taxable expenditures" are defined by Section 4945(b) to include any amounts paid—

> "(1) to carry out propaganda, or otherwise to attempt to influence legislation, or
>
> "(2) to influence the outcome of any public election * * * ."

Section 4945(c) states that Section 4945(b) (1) expressly includes:

> "(1) any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof * * * ."

The proposed law does not contain the "substantial" test which presently allows a certain amount of direct or indirect lobbying on legislation to be carried on by an exempt organization without punitive consequences.

The coverage of Sections 4945(b) (1), (b) (2) and (c) (1) is very difficult to determine. Section 4945(b) (1), defining a "taxable expenditure", merely repeats the "attempt to influence legislation" language of present law (Section 501(c) (3)). As such, standing alone, it seems to cover only those "legislation-influencing" activities now covered by Section 501(c) (3). Ambiguity arises, however, because of the new language in sub-section (c) (1), which expressly includes in those activities covered by subsection (b) (1) "any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof * * * ." Section 4945(b) (2) also differs from present law by defining as a "taxable expenditure" any amount incurred "to influence the outcome of any public election". Both 4945(c) (1) and 4945(b) (2) seem to expand the scope of definitions in prior law of what will be considered "legislation-influencing" and "election-influencing" activities that certain 501(c) (3) organizations may not undertake in the following ways:

(i) *Restrictions on "legislation-influencing" activities.*—Subsection (c) (1) seems designed at least in part to clarify existing law by accepting the Treasury view that "grassroots" lobbying—urging the public to contact legislators—on particular legislation or legislative proposals is included within the present definition of "attempting to influence legislation" in Section 501(c) (3). See Treas. Reg. § 1.501(c) (3)-1(c) (3) (ii). It may also be designed to cover editoralizing (*i.e.*, taking an organizational position) on legislation, which the Treasury also interprets as falling within this phrase in Section 501(c) (3) *Ibid.* The language can, however, be interpreted to cover much more, and to restrict the educational activities of organizations defined as "private foundations" even though these efforts are factual and balanced. These efforts usually are carried on for the very purpose of "affecting public opinion", if only to affect the public by making it aware of the issues.

Certainly NET's public affairs documentaries, panel discussions, interviews, and in-depth news programs have this purpose, even though they are balanced presentations, satisfying the FCC's fairness and personal attack doctrines and the statutory prohibitions against editorializing by non-commercial broadcasters. Thus under the broadest possible interpretation of this statute, if NET presented a balanced program or series of programs on a current topic such as the ABM controversy, the draft, or the Vietnam War, it could conceivably be held to be "affecting public opinion" on present or possible future legislation dealing with these issues.

(ii) *Restrictions on "election-influencing" activities.*—Subsection (b) (2) also seems to go beyond present law by excluding another large segment of NET's activities that might technically be held to "influence the outcome" of an election. Just as even balanced educational reporting of legislative issues will inevitably "affect" public opinion, any balanced educational broadcasts dealing with election issues should have at least some minimal influence upon the "outcome" of that election. Again the very purpose of such broadcasts, which are subject to the equal time requirements of Section 315 of the Communication Act, 47 U.S.C. § 315, is to attempt to give the public the full facts and all viewpoints so as to stimulate thought and discussion of the issues among the electorate. If these programs were not successful in helping to create informed voters, there would be no reason for their existence.

b. *The proposed changes would severely curtail NET's public affairs programs.*—If Section 4945 is enacted without clarifying amendments, NET would be confronted with essentially two choices: (1) it could forfeit its tax exempt status or (2) it could cease to make "taxable expenditures". If NET were to adopt the first alternative, it would have to cease business entirely since approximately 75% of its current support is from "private foundations" which could no longer make qualifying contributions to NET.

Under the second alternative NET's "managers"—including its officers and directors—faced with the spectre of heavy personal as well as institutional penalties for a mistaken interpretation of the language of the section, will be reluctant to undertake public affairs programing on issues that have any remote link with current or potential legislation. NET might also have increasing difficulty in persuading highly qualified men to serve as trustees and officers in the face of such great potential liability. Further, even if NET and its managers were willing to risk the statutory penalties, NET would be forced to adopt a programming policy foregoing public affairs broadcasts in order to continue to get financial support from other private foundations. Prudent foundation managers would not make grants to NET if there were any possibility that they might ultimately be used for public affairs programing coming within the "taxable expenditures" definition of Section 4945.

2. *Reasons Why Section 4945 Should Be Redrafted To Exempt Public Broadcasting*

a. *None of the alleged abuses giving rise to section 4945 is in any way related to NET.*—None of the Congressional concerns which led to the provisions of Section 4945 of H.R. 13270 in any way relates to the activities of NET or public broadcasting. There has been no testimony before the House committee or this committee concerning any alleged improper activities by NET or any entity engaged in the field of public broadcasting. Moreover, none of the alleged abuses which led to Section 4945 relates to the activities of NET or public broadcasting.

The impetus for the expanded definition of "legislation-influencing" activities in Section 4945(b)(1) and (c)(1) is somewhat obscure. The House Committee on Ways and Means, after extensive hearings, noted in its report transmitting H.R. 13270 that "in recent years, private foundations had been moving increasingly into political and legislative activities". H.R. Rep. No. 91–413, 91st Cong., 1st Sess., pt. 1, 32 (1969) (hereinafter referred to as "House Committee Report"). There is, however, nothing in the report that clearly indicates exactly what the committee meant by "legislative activities". It is clear that it wanted to stop foundations from direct lobbying and "grass-roots" campaigns to urge the public to contact legislators, alleged abuses considered in its hearings, but whether anything beyond this was contemplated is uncertain.

Examples of "political activities" the committee wanted to curtail under Section 4945(b)(2) were more clearly stated in the report. The committee definitely wanted to stop voter registration campaigns in limited geographical areas that were designed to favor the registration of voters who would support certain candidates. It also wanted to prevent private foundations from spending their funds to "publicize the views, personalities and activities of certain candidates" and "to subsidize preparation of materials furthering specific political viewpoints." House Committee Report, pp. 32–33. None of these activities is or has been carried on by NET or any other element of the public broadcasting system. Although both NET and other public broacasters do present balanced coverage of elections, such activity, as before, was not the concern of the House committee.

b. *Restricting public broadcasting activities would be contrary to the public interest and congressional policy.*—More fundamentally, we strongly believe that it would not serve the public interest to restrict programming for the public broadcasting system. Public broadcasting supplies an important alternative source of public affairs programming in the United States. At present local noncommercial stations, lacking the technical and monetary resources, are not heavily engaged in program production. Educational stations rely strongly on NET to supply the public affairs programming that they must present to satisfy the conditions of their broadcast licenses* and to serve the interest of their viewing

*The Communications Act requires that all broadcasting stations, as part of their obligation to operate in the "public interest", 47 U.S.C. §§ 307(a), 309(a), "afford reasonable opportunity for the discussion of conflicting views on issues of public importance". 47 U.S.C. § 315(a); *see Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 392–95 (1969).

audiences. NET programming thus contributes substantially to the strength of non-commercial television and the diversity of programming that Congress and the FCC have sought to foster.

It is clear from past legislation that Congress desires to promote a strong and viable system of public television. The Educational Television Facilities Act of 1962, Pub L. No. 87-447, 76 Stat. 64, authorized thirty-two million dollars over a five-year period for the construction of various facilities for educational television stations. Moreover, the Public Broadcast Act of 1967 (47 U.S.C. § 390, *et seq.*, as amended) continued this program and gave a further Congressional mandate in support of public broadcasting which, Congress contemplated, would create programs "not only . . . supplementary to, but competitive with commercial broadcasting services", and programs which will be "responsive to the interests of people" and "an expression of diversity and excellence". S. Rep. No. 222, 90th Cong., 1st Sess. 6 (1967) ; 47 U.S.C. § 396(a) (4).

To this end, the Federal Communications Commission has reserved 623 station channels for educational television and, in adition, petitions may be made to the FCC for additional reservations. These stations are being licensed only to nonprofit educational organizations upon a showing that the proposed stations will be used "primarily to serve the educational needs of the community; for the advancement of educational programs; and to furnish a nonprofit and noncommercial television broadcast service". 47 C.F.R. § 73.621(a).

Not only has Congress demonstrated in the past its intent to strengthen noncommercial educational broadcasting in general, but has also indicated that it feels that the presentation of vigorous public affairs programming is one of the most important contributions that educational broadcasting can make. The legislative history of the Public Broadcasting Act of 1967 emphasized that Congress expected noncommercial educational stations to be leaders in this area. The report of the Senate Commerce Committee stated:

"Particularly in the area of public affairs your committee feels that noncommercial broadcasting is uniquely fitted to offer in-depth coverage and analysis which will lead to a better informed and enlightened public." S. Rep. No. 222, 90th Cong., 1st Sess. 7 (1967).

And the House Committee on Interstate and Foreign Commerce observed:

"Considerable testimony was heard that no noncomercial educational station editorializes.

"Out of abundance of caution, the bill provides that 'no noncommercial educational broadcasting station may engage in editorializing or may support or oppose any candidate for political office.' It should be emphasized that this section is not intended to preclude balanced, fair and objective presentations of controversial issues by noncommercial stations." H.R. Rep. No. 572, 90th Cong., 1st Sess. 20 (1967).

Thus, ironically, if Section 4945 is enacted as presently drafted, the portion of public broadcasting that was intended to be it strongest point, will become in fact its weakest link.

3. There Are Serious Doubts That Sections 4945(b)(1), (b)(2) and (c)(1) of H.R. 13270 Are Constitutional

Not only do we believe that the adverse effect upon the public broadcast system by §§ 4945(b) (1), (b) (2) and (c) (1) is unintended and unwarranted, but it is also our view that the potential breadth of the present language of those sections raises serious constitutional issues.

a. *Assuming that the section 4945 restricts balanced discussion of public issues by NET it may be unconstitutional.*—Discussion and debate of public issues is at the heart of the First Amendment. The Supreme Court has noted that "speech concerning public affairs is more than self-expression; it is the essence of self-government". *Garrison* v. *Louisiana*, 379 U.S. 64, 74-75 (1964). The primary purpose of the First Amendment is to protect our "profound national commitment to the principle that debate on public issues should be uninhibited, robust, and wide-open * * * ." *New York Times Co.* v. *Sullivan*, 376 U.S. 254, 270 (1964). "Suppression of the right of the press to praise or criticize governmental agents and to clamor and content for or against change * * * muzzles one of the very agencies the Framers of our Constitution thoughtfully and deliberately selected to improve our society and keep it free." *Mills* v. *Alabama*, 384 U.S. 214, 218-19 (1966).

Discussion of public issues by broadcasters has been specifically held by the Supreme Court to enjoy the protections of the First Amendment. In *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367 (1969), the Court stated at 390:

"* * * the people as a whole retain their interest in free speech by radio and their collective right to have the medium function consistently with the ends and purposes of the First Amendment * * *. It is the purpose of the First Amendment to preserve an uninhibited marketplace of ideas in which truth will ultimately prevail * * *."

The Court in *Red Lion* warned that the right of the public to access to social and political ideas through the broadcast media "may not constitutionally be abridged * * * by Congress." 395 U.S. at 390.

Such discussion and debate of public issues can be infringed not only by direct prohibitions, but also by the taxing power. The Supreme Court has said, "[p]lainly a community may not suppress, or the state tax, the dissemination of views because they are unpopular, annoying or distasteful." *Murdock* v. *Pennsylvania*, 319 U.S. 105, 116 (1943). The Court has held that a State cannot tax newspapers more heavily than other institutions, because this would reduce "the circulation of information to which the public is entitled." *Grosjean* v. *American Press Co.*, 297 U.S. 233, 250 (1936). The Court has also concluded that a State cannot penalize expression by denial of a tax exemption or deduction. *Speiser* v. *Randall*, 357 U.S. 513 (1958). *Speiser* clearly rejected the argument that "because a tax exemption is a 'privilege' or 'bounty', its denial may not infringe speech" (357 U.S. at 518) and held that the State could not deny an otherwise available property tax exemption to an individual who had refused to sign a statement on his tax return stating that he did not advocate the overthrow of the Government by force or violence. In a companion case, the Court held that an exemption could not be withheld from a church that refused to sign a similar oath, indicating that denial of a tax benefit to an organization like NET raises the same constitutional issues as denial of a deduction to an individual. *First Unitarian Church of Los Angeles* v. *County of Los Angeles*, 357 U.S. 545 (1958).

If the State had denied an exemption to the taxpayers in the *Speiser* and *First Unitarian Church* cases because they refused to sign statements agreeing not to engage in any discussion of public issues, it is difficult to believe that the results would have been different. The statute, we suggest, would have been equally unconstitutional, particularly if—as is the case here*—deductions were granted to some organizations and denied to others.

If we are correct in this conclusion, it would seem to follow that Section 4945 as presently drafted faces serious, if not unsurmountable, constitutional obstacles since it restricts organizational discussion of public issues. Unlike present law, Section 4945 cannot be justified on the ground that it is limited to the "lobbying" or "electioneering" activities. Cases like *Cammarano* v. *United States*, 358 U.S. 498 (1959), *United States* v. *Harriss*, 347 U.S. 612 (1954) and *United Public Workers* v. *Mitchell*, 330 U.S. 75 (1947)—sustaining restrictions on such activities—do nothing to support the broader restrictions of Section 4945.

In *Cammarano* v. *United States*, *supra*, it was held that Congress can deny a tax deduction as an "ordinary and necessary business expense" to a business for sums expended "to promote or defeat legislation" as a legitimate means of preventing the public subsidizing of lobbying. *United States* v. *Harriss*, *supra*, upheld other non-tax restrictions on lobbying, such as the disclosure and reporting requirements for lobbyists in the Federal Anti-Lobbying Act, 2 U.S.C. §§ 261–70. Neither the *Cammarano* nor *Harriss* opinions, however, suggested that similar restrictions could be placed on discussion of public issues not within the categories of direct lobbying or overt appeals to the public to contact legislators. The Court in *Harriss*, in fact, implied that a restriction that went further than this, and attempted to cover a broader class of technically "legislation-influencing" activity, would be invalid under the First Amendment. 347 U.S. at 625–26. And the Court in *Cammarano* clearly indicated that its holding there was not meant to undercut its holding in *Speiser* that tax legislation cannot reach broadly to suppress discussion of public issues. 357 U.S. at 513.

Both *Harriss* and *Cammarano* sustained restrictions on the basis that Congress had a legitimate role in passing legislation to help maintain the integrity of the legislative process, in one case to protect it from distortions caused by tax ad-

*Section 4945 does not apply to tax exempt organizations, like churches and colleges, that do not constitute "private foundations". Section 4945 would, through use of a support test, in effect, make, a value judgment that expression of ideas on public issues held by less than a certain number of contributors are less beneficial than those that are broadly held. Such discriminatory attempts to suppress minority viewpoints are, however, exactly what the First Amendment forbids.

vantages given to the lobbying activities of special interest groups, and in the other to allow Congress and the public to know exactly who is funding lobbying activities. Balanced educational presentation of public issues does not, however, undermine the integrity of the legislative process. Rather, it assists in preserving that process, by ensuring that the public is aware of legislation and the facts behind issues that may become the subject of legislation.

In *United Public Workers* v. *Mitchell*, *supra*, the Court, in sustaining Hatch Act limitations on partisan participation in political campaigns by federal employees, held that Congress may place reasonable restrictions upon participation in the electoral process. But the Court specifically noted that nonpartisan expression of views on public issues was not prohibited by the Act, implying that if it were, the Act would have been held unconstitutional. 330 U.S. at 100. And in *Mills* v. *Alabama*, *supra*, the Supreme Court specifically held that a state could not supress the discussion of controversial issues—in that case last-minute editorials—on the ground that this was necessary to prevent the electorate from being unduly swayed in a public election.

The fact that Section 4945 covers some activities which Congress can constitutionally regulate does not, of course, save it from constitutional attack. The constitutional doctrine of the "less restrictive alternative" requires that Congress, when it legislates in the area of speech, regulate only up to the minimum extent necessary to restrict the evil it wishes to control, with the least possible diminution of protected rights. *United States* v. *Robel*, 389 U.S. 258 (1967) ; *NAACP* v. *Button*, 371 U.S. 415 (1963).

b. *Even if section 4945 is not meant to cover NET's public affairs programs, it may be void for vagueness.*—Assuming that Congress cannot constitutionally tax the balanced, educational presentation of discussions on public issues, it is also constitutionally irrelevant that Congress may not have intended to penalize such presentations in its proposed enactment of Section 4945. The language of the statute is now drafted "in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application". *Connally* v. *General Construction Co.*, 269 U.S. 385, 391 (1926). It can be read to restrict large areas of discussion protected by the First Amendment.

Under existing case authority the vagueness and overbreadth of the statute are alone sufficient to raise serious questions as to its validity. The Supreme Court has held that strict standards of definiteness must be met by statutes having "a potentially inhibiting effect on speech". *Smith* v. *California*, 361 U.S. 147, 151 (1959). See also *NAACP* v. *Button*, *supra*, at 432–33, 438 (1963). In the area of free speech vague statutes are unconstitutional if they seriously inhibit discussion by forcing individuals to "steer far wider of the unlawful zone" (*Speiser* v. *Randall*, *supra*, at 526) and restrict "their conduct to that which is unquestionably safe" (*Baggett* v. *Bullitt*, 377 U.S. 360, 372 (1964)).

The principle that laws must give clear warning is particularly relevant when the offense is to be prescribed by regulation rather than by statute (*United States* v. *McDermott*, 131 F.2d 313, 316 (7th Cir. 1942), *cert. denied*, 318 U.S. 765 (1943)) or when the statute is subject to administrative enforcement which can result in discrimination against minority or unpopular views (*Cox* v. *Louisiana*, 379 U.S. 536, 556–58 (1965)).

We suggest that, because of its vague terms, Section 4945, as presently drafted, will unquestionably inhibit protected speech, and is therefore likely to be held unconstitutional.

One lower court has indicated that the "attempting to influence legislation" language already contained in Section 501(c) (3) might be held unconstitutionally vague if it were not limited more specifically by regulation and judicial decision to direct or "grassroots" lobbying, noting:

"In one sense, nearly every effort made by individuals or organizations in the public interest and for the betterment of government necessarily, has as an indirect result at least, some influence on legislation."

Seasongood v. *Commissioner*, 227 F.2d 907, 911 (6th Cir. 1955).

If the meaning of this language is still open to question, after decades of Treasury and court attempts at interpretation, the potentially even broader language of Subsections 4945(b)(1), (b)(2) and (c)(1) cannot possibly give sufficient guidance to those affected to enable them to regulate their conduct in the public affairs discussion area so as to avoid its sanctions. If this bill is enacted with its present ambiguities, foundation officers will be forced to protect themselves by restricting their educational activities. This is particularly so be-

cause extremely broad administrative discretion will necessarily have to be lodged with the Internal Revenue Service for its interpretation and enforcement, and foundation managers cannot predict how this discretion will be exercised.

Even assuming that the Treasury might at some future date issue limiting regulations or rulings that would give sufficient guidance to the interpretation of Section 4945, or that future court decisions might narrow its coverage, the delay in obtaining such standards would cause irreparable harm to educational broadcasting. NET would be forced to discontinue public affairs broadcasting in the interim, probably losing the services of many of its professionals who specialize in this area. Once private foundations, which have only limited resources, move out of the non-commercial broadcasting area and into other charitable or educational activities, it will be difficult to get them to return, even on the hopeful assumption of future regulatory or judicial clarification. Once foundations have entered other fields of philanthropy, there will be a natural tendency for them to remain there, since they have created funding expectations in those fields and will wish to follow through on initial efforts they have supported.

Thus, we believe, if Congress does not intend Subsections 4945(b)(1), (b)(2) and (c)(1) to apply to balanced presentation of public issues, it can not assume that these sections will be saved from unconstitutionality by narrowing regulations or judicial interpretations. This Committee should take positive steps to clarify the bill to insure that it does not inhibit discussions of public issues, particularly public affairs programming of the kind NET supplies to its affiliates.

In summary, in view of the unintended and substantial adverse effects that Section 4945 would have for public broadcasting and NET, the strong Congressional policy to support public broadcasting (including its public affairs programs) and the substantial doubts as to the constitutionality of the section as now written, we suggest that this committee should revise Section 4945 to exempt public broadcasting's public affairs programs, using the suggested language set forth earlier in my statement.

IV. CLASSIFICATION PROBLEMS

1. NET Should Be a Section 170(b)(1)(B) Organization

As indicated above, it is crucial that Section 4945 be amended as proposed. In addition, it is also crucial that NET be classified as a non-private foundation or a private operating foundation to avoid the ultimate demise of NET, noncommercial educational broadcasting stations' prime source of programming. (Even if NET were to qualify as a non-private foundation or an operating private foundation under proposed Section 509(a), it would still be adversely affected by the Act, insofar as private sources of funds may be eliminated unless the amendment to Section 4945 suggested above is adopted.)

Under proposed Section 509, a Section 501(c)(3) organization such as NET will be treated as a private foundation unless it comes within one of a series of specified exceptions. As currently funded NET will not come within any of the specified exemptions.

The current re-examination of the tax bill affords Congress an opportunity to help reach the goals set by Congress for public broadcasting by classifying NET as a non-private foundation.

To best carry out Congress's general intent of establishing a viable non-commercial educational broadcast system which has a broad base of public support that will complement funding from the Government, Congress may use this opportunity to give the public a tax incentive for support of this system.

By the inclusion of NET and the other elements of the country's non-commercial educational broadcast system within the 30 percent category [Section 170 (b)(1)(B) organizations] NET would have the following beneficial results.

First, by classifying NET as a Section 170(b)(1)(B) organization and thus a non-private foundation under Section 509(a)(1), it will be released from the provisions of the Act which create significant problems for the non-commercial educational broadcast system. For example, it would solve the problem of whether grants to NET will be "qualifying distributions" under Section 4942 of the Act. And it will eliminate the possibility that the working arrangements between NET and the other elements of the non-commercial educational broadcast system will fall under Section 4941—the "self-dealing" provision.

Second, by including the elements of the non-commercial broadcast system within the list of organizations described in Section 170(b)(1)(B), the system will be on an equal footing with schools and colleges, churches and other similar organizations designed to promote the general welfare. Most of the local stations already fit into this group and since all of the local stations and the other elements of the system are all working for the same end and carrying on in many instances the same functions, there is every reason to treat all of the elements of the system as qualifying for the charitable deduction prescribed in Section 170(b)(1)(B). To do this, Section 170(b)(1)(B) should be amended by adding a new subsection 170(b)(1)(B(vii) which would read:

"An organization which is a non-commercial educational broadcast station as defined in Section 397(7) of the Communications Act of 1934, as amended (81 Stat. 368; 47 U.S.C. 307(7)) or an organization referred to in Subsection (c)(2) which is operated exclusively for the production or distribution of programs which are broadcast over such non-commercial educational broadcast stations."

In the alternative this language could serve as a separate exception to Section 509.

2. Operating Foundation Status

Adoption of the proposed amendment to Section 4945 is crucial to NET's continued ability to produce programming for educational broadcasting. However, even with this adoption, if NET is not included within the category of Section 170(b)(1)(B) organizations, it must qualify as an operating foundation in over to survive. Under proposed Section 4942(j)(3) (A) and (B), a private foundation is *not* an operating foundation unless—

(1) substantially all [at least 85 percent]* of the foundation's income is expended directly for the active conduct of its tax exempt activities [the "income expenditure test"];

(2) either—

(i) substantially more than half [at least 65 percent]* of the assets of the foundation are "devoted directly" to the foundations' tax exempt activities [the "asset test"] or

(ii) substantially all [at least 85 percent]* of the foundation's "support" (other than gross investment income) "normally" comes from five or more exempt organizations or from the general public and no more than 25 percent of the foundation's support comes from any one exempt organization [the "support test"].

The crucial question is whether NET can satisfy the requirements of either of the additional tests—the assets test or the support test. The latter test—the support alternative—was described in the House Committee Report as follows:

"The * * * [support] alternative has been added because it has come to the attention of your committee that a number of charitable foundations are regularly used by many private foundations to funnel charitable contributions into certain areas. The operating foundations, in such circumstances, have developed an expertise which permits them to make effective use of the money through grant programs or otherwise." House Committee Report, p. 26.

"The support alternative is intended to focus primarily upon special-purpose foundations, such as learned societies, associations of libraries and organizations which have developed an expertise in certain substantive areas and which provide for the independent granting of funds and direction of research in those specialized substantive areas." House Committee Report, p. 42.

NET would appear to fit the Committee's picture of a special-purpose, funnel, expert foundation. It cannot, however, qualify under the support alternative since the bulk of its revenues comes in the form of grants, albeit unrestricted, from fewer than five foundations.

It may be, however, that NET satisfies the requirements of the asset alternative set forth in (B)(i) of Section 4942(j)(3) above. NET's furniture, equipment and supplies are presumably "devoted directly" to its tax exempt activities. At any given time, however, its assets in the form of cash (or short-term securities) for operating purposes are likely to be substantially greater than any physical

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*See House Committee Report, pp. 42–43.
**Ibid.*

assets. Such assets are, in one sense, as "devoted directly" to the tax exempt activities as are the typewriters and paper supplies. Such an interpretation would be consistent with the apparent purpose of the Act to impose special tax burdens on foundations which invest substantial portions of their support revenues and thus appreciably delay the charitable benefit resulting from such revenues and contributions. However, according to the House Committee Report, p. 42, the asset alternative was intended to "apply particularly" to organizations such as museums, Callaway Gardens (a horticultural and recreational area), Colonial Williamsburg and Jackson Hole, each of which has substantial fixed assets which are related directly to and physically used directly for their tax exempt purposes.

Therefore, in the absence of any change in this respect in the subsequent legislative history, it is possible that cash and short-term securities will be held not to be assets "devoted directly" to an institution's charitable purposes for purposes of Section 4942(j)(3)(B)(i) even though they are spent annually in furtherance of the organization's exempt purpose. If the asset alternative is interpreted in this manner, NET will not be treated as an operating foundation. If NET does not qualify as an operating foundation, private foundations will cease supporting NET.

Since under the Act a private non-operating foundation is subject to a tax on the failure to distribute income, such a foundation will be likely to make only "qualifying distributions" to avoid the tax imposed by Section 4942. One can assume, therefore, that the major consequence of failure to qualify as an operating foundation will be that NET will lose all of its foundation support. . . . .

We do not believe that Congress intended that the cash assets (possibly invested in short-term securities) to be expended during the year—and which are, in fact, expended during the year or succeeding year—should be deemed to be assets not "devoted directly" to charitable purposes. If read in this fashion, an anomalous situation is created thereby a grant-making foundation is entitled to make "qualifying distributions" directly for charitable purposes during the course of two years but may not utilize a specialized grant-making foundation to make a payment for the same charitable purposes within the same period of time.

Accordingly, we suggest that language be inserted in the committee report to make it clear that where contributions are made by a private foundation to a second private foundation to be expended directly for charitable purposes by the latter within the taxable year or succeeding taxable year, of the payee foundation, the expenditure by the latter will satisfy the "assets" test under Section 4942(j)(3)(B)(i).

Indeed, consistent with the long-established Congressional interest to foster and aid the development of a strong non-commercial educational broadcast system, the committee report should make it clear that NET will qualify as an "operating foundation".

Mr. Macy. Mr. Harley, would you pick up on that.

STATEMENT OF WILLIAM HARLEY, PRESIDENT, NATIONAL ASSOCIATION OF EDUCATIONAL BROADCASTERS

Mr. Harley. First, speaking for the educational television and radio stations of the country, I would like to associate myself with my two colleagues. We have a written statement which sets forth in some detail the adverse effect of this legislation upon educational broadcasting.

I would only emphasize one point, that without the help we have had so far from private philanthropy, most of the stations, or at least a great many, never would have come into being, and they could not continue to perform their essential public services without this help, and if we continue under this proposed legislation to perform our basic responsibilities in broadcasting discussions of public issues, the foundations under that bill might have to withdraw their support.

For us, this would simply be disastrous if we could not continue at the same time to perform our public service responsibilities and re-

ceive essential support that we need from the private sector. Because in public broadcasting the American people have on hand a device that can be put to great purpose, it seems unthinkable that at the very time that we are on the verge of bringing this into being as a really effective force in our society, that legislation might be passed that would substantially cripple its present operation and stifle its future growth.

We do not think that your committee or the Congress of the American people want that to happen.

Mr. MACY. In conclusion, Mr. Chairman, our belief is that at this particular point in time to reduce the support that has come from philanthropy for this new form of public service would be to reverse a very desirable trend, a trend which is supported by the Congress and which, in the days ahead, will, hopefully, match the trend that the Congress set in motion with the Public Broadcasting Act.

Senator RIBICOFF. Thank you, gentlemen, very much.

STATEMENT OF WILLIAM G. HARLEY, PRESIDENT, NATIONAL ASSOCIATION OF EDUCATIONAL BROADCASTERS

I am William G. Harley, President of the National Association of Educational Broadcasters. NAEB is the professional association of institutions and individuals engaged in educational radio and television broadcasting in the United States. Its membership consists of organizations which operate 175 educational radio stations, some 180 educational television stations, and over 100 non-broadcast instructional communications systems; and some three thousand individual producers, teachers, writers, directors, students, artists, engineers and others who are involved in various phases of educational radio and television throughout every part of the country.

Educational broadcasting stations are licensed by the Federal Communications Commission only to nonprofit educational organizations upon a showing that the stations "will be used primarily to serve the educational needs of the community; for the advancement of educational programs; and to furnish a nonprofit and noncommercial television broadcast service." (FCC Rules and Regulations, section 73.621.) The stations now operating are licensed to local school boards or systems, to public and private colleges and universities, to agencies of state government, and to private non-profit corporations organized locally for the purpose of engaging in educational broadcasting. Such licensees, including such private corporations as well as such public agencies, are all exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code, and contributions to them are deductible as charitable contributions under section 170 of the Code. In addition, some thirty of the states are planning or already operating statewide educational television networks, and there are cooperative regional networks in the Northeast, the South, the Midwest, the Great Plains states, the Rocky Mountain region, and the Pacific Coast. Most of the stations are affiliated with one or more of the independent program services which make available programs of national scope and interest; these national program services, like the stations, are tax-exempt organizations. By enacting the Public Broadcasting Act of 1967, the Congress created a private nonprofit Corporation for Public Broadcasting to assume responsibility for the nationwide progress of all of the system, finding that "it is in the public interest to encourage the growth and development of noncommercial educational radio and television broadcasting, including the use of such media for instructional purposes." (Communications Act of 1934 as amended, section 396(a)(1).)

Our members produce and broadcast programs to serve a wide range of public needs and interests. The typical educational television station develops and broadcasts programs of formal instruction and enrichment for children in the classrooms, and for children viewing at home before or after school hours, or who have not yet reached school age. Public and parochial school systems throughout the country constitute a major segment of the educational television audience. For the adult audience, stations concentrate on informal education: vocational training and rehabilitation for the disadvantaged, and continuing education for the professions, for example. For the general public, there are programs for the

development of new skills and interests, for the discussion of important local, regional or national issues, for the reflection of America's cultural heritage, and for other kinds of community service of every variety. The typical station broadcasts six to seven days a week, averaging over 56 hours of programming weekly. Slightly more than half of this is general audience or "public" television programming—public affairs programs (such as new programs, documentaries, panel discussions, political debates, and interviews), performing arts programs, children's programs, and others. The remaining time is allocated to "instructional" broadcasts during school hours. The stations themselves produce much of their instructional programming, and general audience programming of primarily local interest; but the majority of their general audience programming comes from one of the national program services, from the state or regional networks, from program exchange arrangements with their sister stations, or from other ouside sources.

During fiscal year 1967, state and local governments and state universities provided about 50% of the funds for educational television stations. Private philantrophy—foundations, businesses, trade unions, and individual viewer contributions—provided about 30%. Ten per cent came from the Federal Government, primarily in grants under the authority of the Educational Television facilities Act of 1962, and 10% came from other sources. Most of the state networks are supported entirely by funds from state government, and the regional networks are supported by the stations; the production of programs for national distribution, however, a keystone of the entire system, depends almost entirely on private philanthropy for its support. Because of their chronically limited resources, the stations alone would be nowhere near able to sustain the production of national programs of quality and excellence for their common benefit were it not for the assistance of the private foundations.

NAEB and its members are concerned about the effect which H.R. 13270 might have on their ability to continue to provide this service to the public. We are concerned that the bill could have a seriously inhibiting effect on the stations' ability to provide their present program service, and on the ability of private philanthropy to continue to support educational broadcasting activities. We do not believe that educational stations, either those operated by schools or state governments or by nonprofit corporations, have been guilty of any of the abuses which this legislation seeks to cure. Nor do we believe that any new legislation is necessary to prevent abuse by educational stations: they are already subject to an ample body of regulation under the Communications Act, as well as the Internal Revenue Code. But we fear that, because of the breadth of its language directed at real abuses, H.R. 13270 could have unforeseen and unintended consequences deleterious to the future of educational broadcasting.

We submit that such a result would constitute a sharp departure from the consistent public policy in support of the development of educational broadcasting. State and local government have traditionally been the major source of financial support for educational TV and radio stations. At the Federal level, the Federal Communications Commission has reserved 632 television channels expressly for noncommercial, educational use, and has made similar reservation of FM radio channels. The National Defense Education Act of 1958 provided funds for research into the uses of the broadcast media for educational purposes. The All-Channel Receiver Act of 1962 promoted the development of television tuners capable of receiving the ultra-high-frequency (UHF) channels on which most educational stations now broadcast. The Educational Television Facilities Act of 1962 initiated a program of Federal matching grants for improvement of the facilities of existing stations, and for construction of new stations. The Higher Education Act of 1965 provided funds for the purchase of television equipment by colleges and universities. The Public Broadcasting Act of 1967 extended the provisions of the 1962 Facilities Act, made that program applicable to radio as well as television stations, and established the Corporation for Public Broadcasting to promote the growth and development of public broadcast programming on those stations. The 1968 platforms of the two national political parties reaffirmed their support for the development of educational broadcasting. In the 91st Congress, the Senate has passed and the House of Representatives is soon to consider a bill, the Public Broadcasting Amendments of 1969, to authorize continuation of the facilities grant program, and to authorize a further Federal grant to the Corporation for Public Broadcasting.

Subsections (b)(1) and (b)(2) of the proposed Section 4595 of H.R. 13270 would represent a major impediment to this activity. First, a prudent station manager or program producer would avoid making expenditures for public affairs programs (such as documentaries, panel discussions, news programs, political debates, and interviews) for fear that such expenditures might constitute "taxable expenditures" under either subsection (b)(1) or (b)(2) of the prosposed Section 4945. Second, prudent foundation managers would also interpret this section as prohibiting them from making grants that might ultimately be used for such programs. We certainly do not quarrel with the position that expenditures by private exempt organizations for the purpose of influencing public opinion should be taxable expenditures. However, expenditures for public affairs programs carried over noncommercial educational broadcast stations are not, we are sure, intended to come under the language as it appears in proposed Section 4945. Nevertheless, the possible application of this section to public affairs programming, even if it is not intended to apply to such programs, would have a chilling effect on the willingness of educational broadcasters, production centers, and grant-making fundations to risk the penalties provided in Section 4945. The evils that Subsections (b)(1) and (b)(2) of Section 4945 are designed to guard against are already precluded in the case of educational broadcasting by the stringent controls imposed by Congress and enforced by the Federal Communications Commission. A qualifying amendment to the proposed Section 4945, as suggested by Mr. Macy for the Corporation for Public Broadcasting, would solve this potential problem and allow educational broadcasting to carry out one of its primary duties, which is to present public affairs programs to the public.

We support, therefore, the following amendment to Section 4945:

"(g) PUBLIC BROADCASTING.—Subsections (b)(1) and (b)(2) shall not apply to amounts paid or incurred for the production or distribution of public affairs programs which are broadcast over noncommercial educational broadcast stations as defined in Section 397 (7) of the Communications Act of 1934, as amended (81 Stat. 368; 47 U.S.C. 397 (7))."

We are further concerned that H.R. 13270 would, in other ways, create considerable uncertainty for some of our stations. In particular, the definition of "private foundation" as stated in the proposed Section 509 gives us concern.

Most of the 185 stations on the air are financed and operated by, and are integral parts of, public instrumentalities. These stations clearly meet one or more of the tests contained in Section 509 and, therefore, are not private foundations within the meaning of H.R. 13270. There are 38 other public television stations, however, operating as nonprofit community stations. The status of these 38 stations cannot reliably be determined under the language of Section 509. The ambiguity of the various "support" tests of this section admit to several ways of determining if the station qualifies, either under Section 509(a)(1) or Section 509(a)(2). One of the key problems is whether, for purposes of both these paragraphs, revenue received by the station from services rendered to school systems is to be counted as support revenue and as contributing to the one-third of revenue from exempt sources, whether it is to be counted in neither category, or whether it is to be counted in one category but not the other. We think under Section 509(a)(1), and more particularly Section 170 (b)(1)(B)(vi), that revenues from school systems should not be excluded from the definition of "support from a governmental unit" and, hence, that stations deriving more than one-third of their support from sources should be treated as "public foundations" under these provisions. See Regulations Section 1.170-2(b)(5)(ii)(c)(1).

Furthermore, we believe it clear, in proposed Section 509(a)(2), that an exempt organization which provides services for a fee in furtherance of its exempt purpose (which is not an unrelated trade or business) to any organization described in Section 170(b)(1)(B) will be deemed not to be a private foundation if the gross receipts from such services are normally more than one third of its support. This determination is based on our belief that reciepts from such exempt organizations which are in excess of 1% of the servicing organization's support are not excluded from the numerator of this fraction. However, we think these readings of the statute are not entirely free from doubt and we would hope that your Committee Report, at least, will make it clear that, for purposes of Section 509(a)(1), revenues from school systems are not excluded from the category of "support from a governmental unit"

and that, for purposes of Section 509(a)(2), receipts from any person in any taxable year that are to be excluded from the numerator of the fraction because they are more than 1% of the support of such organization for one year, do not include receipts from organizations described in Section 170(b)(1)(B).

If a public television station were found not to qualify as a public foundation under the definitions in proposed Section 509, serious problems would be presented. Particularly, if the foregoing recommended amendment to Section 4945 is not adopted, those of our stations which are treated as private foundations would, as we have indicated, be inhibited from presenting public affairs programs. In any event, those stations which must depend on the "public support" test to qualify as "public foundations" will be faced with great uncertainties from year to year and, in addition, uncertainties as to whether they constitute private "operating foundations" as distinct from private "non-operating foundations." Some of our stations are currently seeking endowment funds to be used to support their educational program. The growth of such funds may well cause these stations to be treated as "non-operating foundations." As such, they would possibly be presented with a serious impediment to carrying out their educational program, due to inability to receive private foundation grants.

These uncertainties seem unwarranted. All our stations perform identical educational functions, all are subject to the same federal controls with respect to programming and, we submit, should be treated alike for federal income tax purposes.

We suggest, therefore, that the exclusions from the definition of "private foundation" found in Section 509 contain, as an additional category, "a non-commercial educational broadcast station as defined in Section 397 (7) of the Communications Act of 1934, as amended (81 Stat. 368; 47 U.S.C. 397 (7))."

In the event the Congress does not rectify this problem by defining all educational broadcasting stations as "public foundations," the possible categorization of some of our stations as "private foundations" would result in certain particular problems that ought to be resolved on their own merits.

First, the proposed Section 4941 of the Bill would prohibit "self dealing" between private foundations and contributors thereto, such as private foundations making grants to our educational broadcasting stations. This prohibition is, we believe, reasonably designed to make sure that sums donated for charitable purposes are not diverted for the private interests of private parties. However, no such diversion can occur where the "self dealing" is between two organizations each of which is exempt under Section 501(c)(3).

Let me give you an example. A foundation such as National Educational Television and Radio Center (NET) renders substantial services for a small fee to our stations by producing educational programs for national distribution. In addition, NET may make grants to our stations to produce such educational programs and, indeed, it is not inconceivable that some of our institutions may make grants to NET. In such cases our respctive exempt organizations might technically be liable for the sanctions against "self dealing." Accordingly, we believe that, for purposes of the "self dealing" provisions of proposed Section 4941, the term "substantial contributor" in proposed Section 507(b)(2) should be amended to exclude an organization which is itself exempt from tax under Section 501(c)(3) of the Code, regardless of whether it is a "public" or "private" foundation.

Second, we suggest that the opportunity for an exempt organization to provide services in furtherance of its exempt purpose to other exempt organizations, without being subject to the 1% limitation, should include not only organizations described in Seciton 170(b)(1)(B) but also "operating foundations" as described in Section 4942(j)(3).

In our case, NET and other foundations provide services to our broadcasting stations. As I have noted, many of these, such as stations maintained by states, municipalities, or public school systems, are "public foundations" described in Section 170(b)(1)(B). Others, performing identical educational and community functions, are "private foundations," albeit possibly "operating foundations," if, in one year or another, as private nonprofit community organizations, they are not able to meet the "public support" tests contained in Sections 509(a)(1) or (2). It would be unfair to inhibit the capacity of an educational organization to provide educational services to operating foundations by imposing the 1% limitation on the services provided to those organizations. Therefore, we suggest

that the last two lines of proposed Section 509(a)(2)(A) (lines 1 and 2 of page 16 of the Bill) might be amended to read "any organization described in Section 170(b)(1)(B) or an 'operating foundation' described in Section 4942(j)(3)."

A further ambiguity is contained in Section 4942 of the Bill, imposing a tax on failure by a private foundation to distribute income. It is found in the proposed definitions of "qualifying distributions" and "operating foundations." In substance, this section would impose a tax on certain undistributed income of private foundations as determined after the foundation has made "qualifying distributions."

"Qualifying distributions" are, of course, amounts paid out for charitable purposes during the foundation's taxable year or succeeding taxable year and include payments made to "operating foundations". The definition of an "operating foundation", as contained in proposed Section 4942(j)(3)(A) and (B)(i), includes those foundations which spend substantially all of their income and devote substantially more than half their assets directly to charitable activities. A grant making foundation is included in this definition of "operating foundation" under Section 4942(j)(3)(B)(ii), where it derives substantially all of its support from five or more unrelated exempt foundations. Such grants when received by an "operating foundation" not only constitute a "qualifying distribution" to the payor foundation but also become a part of the corpus of the recipient, without being subject to further pay out requirements.

In some instances, as the Ways and Means Committee noted in its Committee Report, a grant making foundation possesses expertise in certain areas which permits it to make the most effective use of a grant. In such a case, a foundation such as NET and similar foundations may typically receive grants for immediate expenditure within areas such as educational broadcasting from a more general grant making private foundation. However, the former specialized grant making foundation will qualify as an "operating foundation" only if, under Section 4942(j)(3)(A) and (B)(i), in addition to expending substantially all its income for charitable purposes, it is also deemed to devote "substantially more than half" of its assets directly for charitable purposes.

We do not believe that Congress intended that the cash assets (possibly invested in short term securities) to be expended during the year—and which are in fact expended during the year or succeeding year—should be deemed to be assets not "devoted directly" to charitable purposes. If read in this fashion, an anomalous situation is created whereby a grant making foundation is entitled to make "qualifying distribtuions" directly for charitable purposes during the course of two years, but may not utilize a specialized grant making foundation to make the same payment within the same period of time.

Accordingly, we suggest that language be inserted in the Committee Report to make it clear that where contributions are made by a private foundation to a second private foundation to be expended directly for charitable purposes by the latter within the taxable year, or succeeding taxable year, of the payee foundation, the expenditure by the latter will satisfy the "assets" test under section 4942(j)(3)(B)(i).

Senator RIBICOFF. The committee will stand in recess until tomorrow morning at 9:30.

(Whereupon, at 4 p.m., the committee adjourned, to reconvene at 9:30 a.m., Tuesday, October 7, 1969.)

TAX REFORM ACT OF 1969

TUESDAY, OCTOBER 7, 1969

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 9:30 a.m., in room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Talmadge, Gore, Byrd, Jr., of Virginia, Williams of Delaware, Bennett, Curtis, Miller, Jordan of Idaho, Fannin, and Hansen.

The CHAIRMAN. The hearing will come to order.

This morning we are pleased to hear a panel on the impact of foundation provisions in the House passed tax reform bill on advanced study groups.

The committee welcomes Dr. Carl Kaysen from Princeton University, Dr. Robert Hartley, vice president of the Brookings Institution, Dr. Caryl Haskins, president of the Carnegie Institution of Washington, and O. Meredith Wilson, director of the Center for Advanced Study in the Behavioral Sciences.

Will you be seated, gentlemen.

STATEMENTS OF DR. CARL KAYSEN, DIRECTOR, INSTITUTE FOR ADVANCED STUDY, PRINCETON, N.J.; ROBERT HARTLEY, VICE PRESIDENT, BROOKINGS INSTITUTION; DR. CARYL HASKINS, PRESIDENT OF THE CARNEGIE INSTITUTION OF WASHINGTON; AND O. MEREDITH WILSON, DIRECTOR, THE CENTER FOR ADVANCED STUDY IN THE BEHAVIORIAL SCIENCES

Dr. KAYSEN. Mr. Chairman, members of the committee, we are here to explain the position of centers of advanced study and research and other academic institutions not organizationally connected with universities and colleges in relation to the legislation before the committee.

I am Carl Kaysen of the Institute for Advanced Study, and I will be followed by O. Meredith Wilson of The Center for Behavioral Sciences in Palo Alto, Robert Hartley of Brookings Institution, and Caryl Haskins of the Carnegie Institution of Washington.

We are speaking not only for ourselves——

Senator TALMADGE. Doctor, will you please speak into the mike. It is difficult to hear you.

Dr. KAYSEN. Excuse me, Senator. Thank you.

We are speaking not only for ourselves but for a number of other institutions. There is attached, a listing of institutions in a situation

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similar to ours. There are a number of others not represented also in this position.

All of these institutions are an integral part of the American system of higher education. The language of the House bill before the committee would give the status of educational institutions only to those organizations meeting the criteria set forth in section 170(b)(1)(B)(ii).

These criteria appear to exclude some of the organizations represented here and leave others in serious doubt as to their status. This definition does not correspond to the facts of the system of higher education of which our institutions form a part, and we believe the definition should be changed so as to reflect these facts.

The system of higher education in the United States is marked by a high degree of pluralism and extraordinary diversity. What are usually classified as institutions of higher education are the 3,500 separately organized nonprofit degree-granting institutions which provide posthigh school education. These range in size and character from small private junior colleges to great State universities.

The system as a whole performs a number of distinct functions: Provision of general education or liberal education; preprofessional training; professional education; postgraduate training for science and scholarship; the conduct of scientific and scholarly research; and finally public service which includes the transmission of specialized knowledge to the nonacademic public and its direct application to a wide variety of public problems.

The small institutions in this diverse system typically specialize in one or another function, like the 2- and 4-year colleges which provide liberal and general education. At the other end of the scale the great universities, public and private, usually cover the whole range of activities described above.

Scientific and scholarly research and postgraduate education are intimately related. It is impossible to carry on the effective training of scientists and scholars at advanced levels except in institutions which are actively carrying on research and scholarship.

Most of the research and a high porportion of the advanced training are concentrated in a relatively small number of universities. In these institutions the distinction between research and education is very difficult to draw, and the two activities are intermingled.

Traditionally the criterion of the granting of degrees has been taken as the mark that distinguishes an educational from a purely research institution. But with the intermingling of research and higher education this distinction becomes artificial, since candidates for the doctor of philosophy degree and other higher degrees are typically engaged in research programs as part of their training.

In the last several decades more and more holders of the highest degree continue their education and training in postdoctoral programs. This practice began in mathematics and the natural sciences. It is now increasingly frequent in the social sciences and humanities, and these postdoctoral programs further reduce the distinction between research and education.

The institutions here represented perform research and higher training functions or assist in their performance in a variety of ways.

Typically each one covers only a small part of the range of scientific and scholarly activities which are to be found in universities. They are special-purpose enterprises which have grown up to meet particular needs in our diverse system.

Our educational system is in a sense like our economics system, one of private free enterprise, and there is no master plan which allocates roles and functions. At the time each of the enterprises here represented was originated the particular function which it performed was not being well performed elsewhere in the system, or it was not being performed at all, and the need was hardly recognized.

The new institution succeeded by demonstrating it could serve a new and necessary purpose. It is more an accident of terminology than an essential feature of the processes of higher education that we associate the same functions with education when they are performed within the organizational boundaries of the university, and think of them as different when they are performed by independent institutions.

A more appropriate view would see all these functions and all the institutions which perform them as parts of our system of higher education.

It might be said that the institutions of the kind we represent are so small a part of the system as to deserve no special concern. This, I think, would be inequitable, but aside from that it would fail to take account of the tremendous leverage which the higher levels of advanced training and research have on the whole system.

The training and research programs of a relatively small number of institutions, among which we here are prominent, have played a major role in the change of the quality and international standing of American science and learning in the last generation, and the equally remarkable internal change in the United States in the same period.

Before World War II we in this country were for the most part still under the intellectual dominance of the universities of Europe and Britain in major fields of science and learning. In most fields first-rate graduate training and research of international quality were to be found only in a handful of institutions, hardly a dozen.

Now the United States is a world leader in many fields of science and scholarship, and the inferior of no nation in any. The number of universities with excellent programs of graduate training and significant programs of research has grown rapidly, and such institutions are to be found in every region of the country.

In this great process of change, the contribution of every first-rate institutions has been significant. And I think no committee of the Congress needs to be instructed on the importance of research and advanced training to the Nation.

The institutions here represented all began as pioneers; embodying the vision of some man or group of men, they acquired a staff and organization suitable to their purposes, and created an intellectual tradition.

Intangible as it is, an intellectual tradition is an important part of what makes for the success of any scholarly enterprise. It cannot be easily duplicated or transferred, and the costs of destroying or damaging the enterprise which embodies it are great, even though they may not be readily visible. Excellence is vital to research and scholarship,

and it still comes in small enough and few enough packages so that the country cannot afford to lose a single one.

Thank you. I will now ask Dr. Wilson to speak.

Dr. WILSON. Mr. Chairman, members of the committee, my name is Meredith Wilson. I am director of the Center for Advanced Study in the Behavioral Sciences. There is frequently some confusion about what the meaning of behavioral sciences might be.

I would like to refer you to page 83 in the printed document, where you will find a list of the disciplines that we generally invite to participate in the center. You will discover that they are mostly social sciences, but they do include biology, psychiatry, the biological segments of psychology, and they do include mathematics and statistics, which makes it difficult to list them only as the social sciences.

I am here, however, not only to speak about the Center for Advanced Study in the Behavioral Sciences, but rather about what I think is an important factor in American higher education, and to deal with the four institutions and the other allied institutions which are concerned about the present tax bill.

I think it useful to say that when the Internal Revenue Code of 1954 was written, the development of postdoctoral education in the United States was not really well recognized.

It is also I think useful to comment on the fact that there has been such a remarkable increase in our dependence upon technological and scientific skill that the development of postdoctoral education to take care of the explosion of knowledge has become a fundamental factor in the maintenance of our present trend.

The advanced study institutions that are represented here today are institutions that have had a tremendous impact on this country's development already. The Institute for Advanced Study at Princeton, for example, which Mr. Kaysen represents, is one with which you are familiar. It is the place where Mr. Einstein came to make his monumental contributions for science, the place where Von Neumann made the original developments in the computer which in many ways have had an effect upon all scientific work in this country. The Carnegie Institution, which Caryl Haskins will represent, gave to this country and to the world hybrid corn through its investigations into genetics of plants and the hybrid corn has been a major factor in the nutrition not only of this country but of all developing countries. It also did tremendous work on the proxmity fuse, on radar; it maintains astronomical laboratories in California. It is a constant continuing contributor to our advanced knowledge through laboratories here, in the Palo Alto area, in southern California and in New York.

The Brookings Institution is one which most of you are familiar with because it serves so well here in Washington. It is active in the area of government, foreign policy and economics, and has been one of the major contributors to the development of judgment and policy and to scientific development in fiscal matters.

These four organizations and indeed others in the country cover a wide range of advanced study and research. They are a distinct part of the system of higher education. They are a necessary complement to the colleges and the universities of the country.

In the state of the modern technological developments of this country, they and their post-doctoral contributions are absolutely essential

to leadership which Mr. Kaysen called to our attention as being a position which the United States now occupies either alone or with the scientific countries of the world.

A large factor in the success and the stability of these advanced study institutions has been their independent boards of trustees, and has been the congressional recognition of the importance of eleemosynary institutions, of foundations and other granting agencies in permitting their support and their maintenance of independence.

We think that it is of great importance to the American people and to American scholarship that these boards of trustees be allowed to continue independent. We think it is tremendously important that the foundation supports, that the gifts of charitable, wise and generous people to them be encouraged, in order that they can have the independent management of scholarship which until now has characterized them and has made tremendous contribution to the country.

During the 15 years the sileo center which I represent was founded, there has been tremendous innovation in the area of post-doctoral education. There will have to be continued innovation, and that innovation will have to depend on these institutions being allowed the independence which has been part of their tradition until now.

We hope, therefore, that you as Senators will help us by not putting undue blocks in the way of the financial support which we have acquired.

Mr. HARTLEY. Mr. Chairman and members of the committee. I am Robert W. Hartley, vice president for administration of the Brookings Institution. I am here today substituting for Mr. Kermit Gordon, president of the institution, who had an emergency operation about a week ago. He is recovering, but is unable to appear this morning. I hope I can be as helpful to the committee as Mr. Gordon would be if he were here.

The provisions of H.R. 13270 respecting private foundations if enacted in their present form would adversely affect the advanced study and research institutions. The problem begins in section 509 of the bill which, instead of attempting to describe in a positive manner the major characteristics of the organizations to be classed as "private foundations," uses the definition-by-exclusion approach.

The four exclusions in section 509 fail clearly to exclude from the bills covered many of the advanced study and research institutions because under the technical definition in the Internal Revenue Code they are not colleges or universities, and because their sources of support are such that they do not qualify as publicly and broadly supported organizations under the mechanical tests in the bill.

Furthermore, although these institutions are in every sense actively and directly operating in educational or scientific fields many of them are not included in the bill's definition of "operating foundations," because they have large endowments, or only a few major sources of support.

In brief, the bill in its present form sweeps into the definition of "private foundation" many of America's advanced study and research institutions which have never been regarded as foundations, and to the best of our knowledge have never engaged in the abuses at which the bill is directed.

If these institutions were to be treated as private foundations and subjected to the burdens and restrictions set forth in the bill, the proposed legislaion would have serious consequences for them.

First would be the financial burden imposed by the proposed 7½ percent tax on net investment income which would aggravate an already difficult financial situation for most of these institutions.

With rising costs, they must constantly increase their financial resources merely to continue their present activities, but they must depend for their support primarily upon their existing resources, and upon the future generosity of other persons.

The proposed tax would reduce the funds available to these institutions from their existing resources and cause a corresponding reduction in their educational scientific activities. For example, if the Brookings Institution had been subject to the 7½ percent tax for its fiscal year ended June 30, 1969, its tax liability would have been approximately $200,000.

Brookings has several education and research projects with a budget of less than $50,000 per year, and if the tax had been in effect, four or more of these projects would have been discontinued or other programs would have been cut back.

In other advanced study institutions, an existing program of study for say 100 mathematicians, economists or physicists could, if the tax were in effect, accommodate only 92 or 93. Instead of the tax, therefore, we support the recommendation made yesterday, that there be a filing fee sufficient in the aggregate to finance fully the costs of an operating unit in the Internal Revenue Service which would enforce the tax laws applicable to foundations.

Under the bill, other persons, the general public and foundations would in the future be less inclined or less able to be generous in their contributions to private foundations, and thus to the advanced study and research institutions, if they were treated as private foundations.

This would result from the bill's proposed changes with respect to the tax consequences of charitable contributions of appreciated property to private nonoperating foundations. Furthermore, a separate provision of the bill would in effect compound the financial problems of the advance study institutions by prohibiting private foundations from making grants except out of corpus to these institutions, if they are defined as private nonoperating foundations.

Another serious consequence for these advanced study institutions is created by the new "expenditure responsibility" rules in the bills. If and to the extent that private foundations make grants to these institutions the expenditure responsibility rules in the bill would require the granting foundations to exercise substantial control over the recipients' use of the funds. This obviously would impair the traditional independence and academic freedom enjoyed by these institutions.

Thus, the bill if enacted would, ironically, put them in the position where they would find it both more necessary and more difficult than ever before to obtain support from the grant-making foundations, and yet if they were to succeed, they would do so at the possible cost of impairing their independence.

Other parts of the proposed legislation create major problems for the advanced study and research institution. First we are concerned

by the broad and ambiguous restriction against activities that constitute an "attempt to influence legislation."

We agree that our institutions should not engage to any extent in direct lobbying or grass roots campaigns with respect to pending legislation, but the bill in its present form is very imprecise and would, we believe, be seriously inhibiting to many of our institutions.

For example, the Brookings Institution publishes scholarly analyses of public issues and public policies which seek to inform and assist the American public and the executive and legislative branches of government by clarifying the issues and by exploring policy alternatives. These studies sometimes contain recommendations of the author on matters that may sooner or later become the subject of legislation. We believe that the bill should be clarified to provide assurance that studies of this kind would clearly qualify as "nonpartisan analysis or research," even when the authors' conclusions happen to touch on matters in disagreement between the political parties.

Further the faculties and staffs of the advanced study institutions include many of America's leading scholars and experts in certain fields, and our Government is accustomed to seeking their views on pending legislation. Again it is not clear under the bill that this useful exchange would be permitted to continue, and we suggest accordingly that the language of the bill be modified.

Second, advanced study institutions by their nature have facilities such as offices, laboratories and libraries which are used by their own officers and trustees, persons who are defined in the bill as "disqualified persons." The present language of the bill may be interpreted as prohibiting these institutions from allowing such individuals to use their facilities in the future.

In other respects also the bill's prohibition against furnishing "facilities" to disqualified persons appears too broad. For example, the bill in its present form might be interpreted to preclude the Carnegie Institution of Washington from allowing top-level Government astronomers to use the Mount Wilson and Palomar observatories.

Finally, if the advanced study and research institutions were treated as private foundations, they would because of the severe penalties that might be imposed on foundation management be severely hampered in their ability to attract capable trustees and managers. This would result from the bill's broad sweeping prohibition of many activities in areas that are not clearly defined.

The result might be that these institutions in the future would be unable to attract capable trustees and managers which might lead in the long run to one of the bill's most unfortunate consequences of all.

Thank you, Mr. Chairman.

Dr. HASKINS. Mr. Chairman and members of the committee, I am Caryl P. Haskins, president of the Carnegie Institution here in Washington.

If I may, I would like to lay before you a proposal which we feel might go a long way toward meeting the difficulties which you have heard this morning for organizations of our type.

Before I do that, however, if I may I should very briefly like to underline and reiterate some of the things which have been said this morning, some of the things which we believe very strongly.

Perhaps primary among these is our belief that education at the highest level, that is postgraduate education, with its accompanying research, is as vital to the future of the Nation as any other sector of the educational effort. So, independent advanced studies and the structures, the organizations particularly dedicated to forwarding them, we feel do merit the active support of government, and do merit a guarantee of the freedom of operation characteristic of that granted to schools, colleges and universities at large specializing in broader and more elementary levels of education.

And we believe that such freedom and support can be greatly inhibited if such institutions do became classified as they would in the House bill as it stands as private or private nonoperating foundations.

Let me cite, for instance, specifics from the example that I know best, the Carnegie Institution of Washington.

The institution operates like and indeed is in effect an institution for advanced education and study, in many ways, for example, like the research operating portion of the Smithsonian Institution. Its whole effort is devoted to supporting its research staff which is in effect of course its faculty, its fellows who are in effect its students, and their supporting facilities to probe the outer limits of human knowledge about the natural universe.

For example, the work in exploring the outermost reaches of space, which has already been referred to this morning, done at the Mount Wilson and Palomar observatories where the institution is in partnership with the California Institute of Technology, or again work in in human embryology an in embryology in the broader sense, conducted at our laboratory on the Johns Hopkins campus in Baltimore, often working jointly with Johns Hopkins faculty members. Or again work in photosynthesis, that means by which the green plant makes sugar—the process which lies really at the base of our human economics, so to speak, conducted in our laboratories or the campus of Stanford University and often in collaboration with their faculty, or, at a more practical level, the development this year of an earthquake detector of a degree of sensitivity which has been unknown before.

Many other organizations of similar ilk operating in various fields like those which have been represented this morning are in a similar case to ours.

The current provisions to tax such groups by 7½ percent would inevitably erode their substance, as has already been pointed out, and their programs most seriously.

In our own case, we have reckoned the cost to us would be something on the order of $400,000 to $500,000 a year, which is the cost of one of our six departments. We would probably have to abandon one of those departments.

The Carnegie Institution has been operating in this general mode since the granting of its congressional charter in 1904, and each year it has made complete reports not only of its financial situation but also of its substantive investigations.

Other organizations have been established more recently for similar purposes, and we feel strongly that not only should they be supported but that the door should be kept open for new organizations of similar sort to arise as the national need requires it, and to serve those new purposes and those new needs as they appear.

Well, I come then, Mr. Chairman, to the proposal we would like to put. We urge, specifically, the adoption of a category that would accommodate advanced study institutions outside the category of private foundations as presently defined, and we believe that the best way to do this would be to modify the category of educational organizations in section 170(b)(1)(b) of the bill, or to add a separate category.

Such a move woud place our type of organization in the category of universities to which as I have said we believe ourselves comparable in intent and function and structure. It would assure that organizations of this category would not be classified within the definition of private foundations. But it would also categorize this group as 30 percent deduction organizations a provision of course as important for many of us as it is for the universities in respect to obtaining private contributions.

As an alternative to this, a further fifth category could be added to the definition of nonprivate foundation in section 509(a) of the House bill. We believe that the exclusion could be framed to require an advanced study organization to meet several definitions of eligibility.

First, it must spend substantially all its income directly for the active conduct of scientific, scholarly or educational activities, and as you recall, such an expenditure criterion is already in other definitions of the code.

Second, it must maintain as a principal part of its operations a faculty, body of scholars or professional staff directly engaged in objective nonpartisan research or analysis, instruction or other scientific, scholarly or educational activities.

Third, it must furnish directly to the individual scholars programs of study or instruction or facilities for scientific, scholarly or educational purposes. The results of its research must be made freely available to the general public.

This requirement, of course, is very similar to that already in section 512(b)(9) of the code.

Fourth, its governing board must be independent, not controlled directly or indirectly by any one person, family, organization or closed group.

Fifth, its support from related organizations or persons and its receipts for services under contract may not exceed a specified fraction, say a quarter or a third of its total support.

Finally and summing up, it would be required to have characteristics in general like those of graduate schools of universities.

We believe, Mr. Chairman, that an appropriate definition for the proposed category would exclude effectively the nonoperating, nonexpending, narrowly supported, tightly controlled organizations at which the present legislation seems to be directed.

Mr. Chairman, we have already laid before the staff of your committee and discussed with them a possible draft of an amendment designed to effect and flesh out this definition. That is all, sir.

The CHAIRMAN. Thank you, gentlemen.

Now one thing I hope you would do is to look over this bill and let us know the parts of it that you support and think are right with regard to foundations. I know that most people want to talk about what they do not like, but I think that you do agree that there are some things about this bill that are correct, do you not?

Dr. KAYSEN. Mr. Chairman, I think we can all agree, without pretending to be tax experts, that there is a problem of abuse, that we are aware that many of these calling themselves foundations have been created and used to evade the tax laws. We think that is a necessary and desirable legislative task.

We have concentrated our efforts on those parts of the bill that concern our own problems, and if I may so, sir, I repeat again we believe we can state firmly that none of our institutions, none of the familiar institutions has engaged in the kind of abuse against which the bill is legitimately directed.

The CHAIRMAN. Right. When we propose to do something in the areas where there is abuse all the good guys who have not done anything wrong come in and say, "Why do you want to do this to us?" But I think you can understand that we have a responsibility to end abuses where they occur. Unfortunately, we do not know what everybody is doing in this area—we all agree on that. And the foundations agree they will pay the expenses of providing the information.

Let us take the Brookings Institution, aren't you already providing information to people who want to know anything about your activities anyway?

Mr. HARTLEY. Yes, sir.

The CHAIRMAN. That is my impression. Where is it, down the street?

Mr. HARTLEY. That is correct.

Senator BENNETT. Massachusetts Avenue.

Mr. HARTLEY. It is at 1775 Massachusetts Avenue, Mr. Chairman.

The CHAIRMAN. If you will let us know what the problems are we will see if we can do something about the areas where those problems exist.

Senator ANDERSON. Senator Talmadge?

Senator TALMADGE. Do most of of your contributions come direct or do they come from foundations?

Dr. KAYSEN. Sir, I think we should answer that individually. For the Institute for Advanced Study, most of our operating income comes from an endowment, from our own portfolio, about 75 to 80 percent. We have some small contributions. We have some Government grants and contracts.

Dr. HASKINS. Carnegie Institution is in the same situation. Almost all of the income comes from endowments, a little bit from Government grants. We do no contract work.

Mr. WILSON. The Center for Advanced Study is the youngest of these organizations. It was established 15 years ago. It was experimental, to see whether or not there was a way that scholars in the behavioral sciences—the social sciences, and some aspects of biology—could improve their understanding after they were already distinguished scholars, if they lived together and worked out their hypotheses in contrast to or in conflict with each other.

It became clear to the board of trustees of the organization 5 years ago that the center had made a major contribution and should be permanent. We now have a very modest endowment, and we are still required to raise the additional funds to survive permanently. The present provisions of the bill would have made it so difficult that we

might as a matter of fact not have been able to survive if the bill were written as it now is.

Senator TALMADGE. You did not answer my question. Does most of your money come from foundations or from contributors individually?

Mr. WILSON. Almost all of our money has come from foundations. We have an alumni in the sense that colleges and universities have, so there is not that other way to get our money.

Mr. HARTLEY. Senator, to answer your question for the Brookings Institution of our total income last year for our operating expenditures last year, about 29 percent was derived from investment income, about 30 percent from grants of private foundations, about 10 percent from Government grants and contracts, about 8 percent from conference fees, 7 percent from sales of publications and other miscellaneous institutional receipts, and about 16 percent from gifts from business firms and individuals.

Senator TALMADGE. Thank you.

Senator CURTIS. I would like to ask you, Mr. Hartley, would the sale of your publications be subject to tax under the House bill as unrelated business income?

Mr. HARTLEY. No, sir; because we sell no publications except those which report the findings of our own research, and our publications operation is run at a loss, Senator. In other words, the income from the publications does not cover the production and distribution costs.

Senator CURTIS. I am not trying to suggest a tax, but I think there is a potential danger in this field because many tax-exempt organizations by the very nature of their work sell certain literature as really a part of their work and it is not unrelated, but once we enter that field, we don't know where it would lead later on.

Mr. HARTLEY. Well, sir, I think the best that we could say, and we have been very careful to follow this policy, is that we produce no publications except those that are the direct results of studies that are conducted under our auspices. We do not publish manuscripts as a commercial publisher does.

Senator CURTIS. One more thing. I would like some information. I do not want to put in the record, you can send it to my office, I would like to know the names of Government officials or employees that the Brookings Institute has hired in the last year and from what departments they come.

Mr. HARTLEY. I will be glad to supply that to your office, Senator.

Senator FANNIN. You have mentioned attempts to influence legislation. Also there have been complaints about some of the foundations indirectly promoting candidates for public office. Now what is your position on working openly with individual Members of Congress, say probable presidential candidates, promoting and publicizing their particular fields of activity or political interest? I might say there has been open support of a particular Member's position on a particular subject, and even where the Member has been working with the foundation. I would say this is true on pollution of air and water, busing of students for integration and programs of that nature. Would you like to comment?

Mr. HARTLEY. Senator, so far as I am aware, any member of our staff who supplies information to a Member of the Senate or the House

of Representatives does so at the request of the Senator or the Representative. We had the unusual situation during a recent debate on a weapons system here in the Senate in which two Senators, one on one side of the question and one on the other, asked one of our staff members to supply them with information that would help their case. This particular staff member did, and we think that he helped them in a way that strengthened each of their viewpoints.

Senator FANNIN. Of course, I was not directing the question necessarily to you, but you seem to have felt that maybe the Brookings Institution has been involved in this endeavor, and I just feel that is very serious. I think complaints are to this effect: Here are organizations that are tax exempt and that they are entering into political activities.

Do you feel that any of these organizations or foundations should in any way enter into political activities?

Mr. HARTLEY. As foundations or organizations; no; sir.

Senator FANNIN. In any other way? In other words, if they are paying the salaries of people that are involved in political activities; is this equitable?

Mr. HARTLEY. Well, sir, so far as individuals are concerned, we cannot deprive an individual of his rights as a citizen, but on the other hand we do our very best to see that the individuals do not represent the institution as such in their activities.

Senator FANNIN. If an individual is employed by the Brookings Institution, for instance, and he decides that he is going to go out in this politcial arena, will you continue him on your payroll or would you continue financing his endeavors?

Mr. HARTLEY. In one case that happened during the campaign in 1968 he actually resigned from the staff.

Senator FANNIN. I cannot get into personalities. I do not know whether that was by request or whether it was of his own volition.

Mr. HARTLEY. We made it clear to him we thought it would be better if he resigned.

Senator FANNIN. I want it understood that I am not referring only to Brookings Institute. There are other foundations that are involved in political activities, and I am personally very concerned about it.

Thank you, Mr. Chairman.

Senator HANSEN. I have no questions.

Senator ANDERSON. Thank you very much for your presentation.

Senator BENNETT. I have one question, Mr. Chairman.

In this situation where employees of an institution such as Brookings are used or comply with requests from Members of Congress to furnish material which is used in public debate, do you think that the institution should make it perfectly clear that this information is furnished unofficially and cannot be used with the imprimatur of the institution and its prestige?

Mr. HARTLEY. Yes, sir; and we always try to make this clear. If you will recall when some members of our staff are invited to appear before congressional committees, they make it clear that they are speaking in their personal capacity and not as a representative of the Brookings Institution.

Senator BENNETT. When the material they furnish is used by the

politician and the institution is quoted or the prestige of the institution is claimed; do you disallow it?

Mr. HARTLEY. Well, Senator, we do our very best. Every publication that we issue states clearly that the publication itself is presented by the institution as a competent treatment of a subject worthy of public consideration. But to maintain the standards of academic freedom and scholarly work, we also state in the publication that it represents the views and the conclusions of the individual author and does not represent the views of the trustees and the officers of the institution.

Senator BENNETT. I will take you one step further. When the newspapers report that this particular point of view is supported by the Brookings Institution do you disavow it?

Mr. HARTLEY. Well, sir, we try to disavow it in the beginning when a publication is issued, but it is almost impossible to keep up with all the places where the Brookings Institution is quoted as saying such and such is true. The best we can try to do is to protect ourselves in the very beginnig, and we always try to make clear in every press release we issue announcing a publication that the material which is issued is the result of a study made by an indiivdual, and does not represent the view of the institution.

Senator BENNETT. Thank you.

Senator GORE. Mr. Chairman, I would like to observe that if the Brookings Institution finds out how to overtake rumors I would like to——

Senator BENNETT. I am not talking about rumors. I am talking about specific claims of support and backing.

Senator CURTIS. Mr. Chairman, this makes it necessary for me to ask two or three more questions.

Do you not regard an institution such as yours as a public one?

Mr. HARTLEY. Public in the sense of publicly supported?

Senator CURTIS. No, that any tax-exempt institution belongs to the public, the results of their work should be made public.

Mr. HARTLEY. And that is one of the things we always try to do, Senator. Every study we undertake, if we deem it to be a competent study, is published. This is one of the problems we have in doing work under contract or grant from the Government of the United States. We always reserve the right in all of our contracts with the Government to publish the report if the Government itself does not publish it. Because of our policy there are some fields of governmental activity in which we do not accept grants or contracts. We regard our audience, Senator, as the entire American public and the members of the executive and legislative branches of the Government, so in that sense we are a public institution.

Senator CURTIS. I think so. I think when some entity earns the status of tax exempt, they earn that by performing a service for society as a whole. That is why I take issue with the idea that the proper role of an institution such as yours is to disavow what your scholars write. I think you should take responsibility for it and make it available to everybody in return for the tax-exempt privilege. Your research should be of the type and of the quality that you would not have to disavow.

I think I am a pretty avid friend of tax-exempt institutions and I am thoroughly against this 7½-percent tax as well as many other features of the House bill, and I would like to ask you this. Do you permit your scholars to prepare material for politicians, that that same material is not published under your name and made available to the general public?

Mr. HARTLEY. Well, we try to be as helpful as we can, Senator, in answering requests that may come to us, and the material which is prepared for them I assume has to be based on studies that have been previously made and published. In this respect we try to be as fair to everybody as we can and to answer every request that we can.

Senator CURTIS. Let me put it this way. Do you make public every bit of research material that you furnish to any Government official or officer?

Mr. HARTLEY. To the best of my knowledge the material that is furnished is based on what we have already published, sir.

Senator CURTIS. That hardly answers my question.

Mr. HARTLEY. I am not quite clear.

Senator CURTIS. All right, I will put it more bluntly. Did your scholars do ghost writing for members of Congress in connection with the military authorization bill which is before the Senate?

Mr. HARTLEY. To the best of my knowledge, Senator, there were two requests that came in to an individual on the staff, one from a Senator who was in favor of the bill and one from a Senator who was against the bill. The staff member who was involved supplied information to both Senators, and to the best of my knowledge helped both of them, and they felt he was helpful to them.

This is what we were trying to do.

Senator CURTIS. I still contend that the price of tax-exemption is that you are a public institution, and that whatever is published should be available to the American public, and I think that might reach the problem that may exist, I do not know, but it appears to.

Dr. KAYSEN. Mr. Chairman, could Dr. Wilson say something to this point, and then I would like to say something to this point if I may?

Senator ANDERSON. Sure. Keep it short.

Mr. WILSON. Yes, sir. Mr. Chairman, Senator Fannin began this conversation and wanted to make clear that he was not asking the question only of Brookings.

Senator FANNIN. Yes.

Mr. WILSON. I thought therefore we ought to extend this conversation from the Brookings Institution into the discussion of what all post-doctoral higher educational institutions felt were their obligations. That is the reason for my wanting to intervene.

It is our judgment that the processes of scholarship presently require continuing education beyond the Ph. D. The scholars who participate do as a matter of fact continue to be the kinds of scholars they would have been in universities. There has never been a time when a university has not some time or another been embarrassed by statements of its scholars, but this is as a matter of fact universally a problem of free inquiry.

I think that it is quite clear that none of these institutions of which we are speaking today engages in what would be clearly partisan

research, and if you were talking about trying to achieve a particular political end, each of these institutions would say that is not their role, nor the appropriate objective of the scholars as they engage in research.

Senator FANNIN. I think you will agree that this has been violated though in many instances.

Mr. WILSON. I think, Senator Fannin, that there may have been violations. I am not sure of what you speak. I think I could say confidently I know of no violations that have taken place under the auspicies of the institutions that we were trying to describe to you this morning.

Senator FANNIN. Understand I agree with the statement made on page 5 about this research. Certainly it is wholly commendable. I am not making a blanket condemnation, but I am concerned over some of the abuses.

Mr. WILSON. We are, too. But we think we are best protected in our legitimate exercise if the abuses are corrected, and we think the correction can only be properly made if there is a careful focus on the failures rather than a sweeping change which would bring into question the support of what we consider to be increasingly important research institutions to continue the work beyond what had been available under structures of universities that went only to the doctor's degree.

Senator FANNIN. I certainly want to make it clear that I was not making a blanket condemnation of foundations in any respect, because I have great admiration for the work that is being done, and I agree with what is stated in the testimony in most respects, but I am vitally concerned again on the exceptions.

Dr. KAYSEN. I would just like to add to this, Mr. Chairman, if I may, that the position of our institutions in these matters is just the same as the position of the universities and colleges. The faculty of those institutions, like the faculty and staff of ours, operate under conditions of academic freedom. This means that it is very difficult for the institutions to take responsibility for what they say.

I think what we must do, what we try to do, we are not always successful, is to take responsibility for a man's professional competence and intellectual integrity when we put him on the staff or when we invite him to come as a visitor. That is the judgment we do make.

But in our society, neither in the universities and colleges nor in the advanced study institutions, do we get the right to censor a man's activities, and, if he wishes to take the extreme case that Senator Curtis posed, if he wishes to spend his evenings ghostwriting speeches for members of one or another body in the legislature, we cannot really say anything about that.

We could, I think, if it got to a certain point say, "You are not doing your academic job, you are not doing what you came here to do. You are doing something else. That is not appropriate."

Senator CURTIS. May I interrupt there?

Dr. KAYSEN. Yes, sir.

Senator CURTIS. I did not suggest censorship. I suggested that if it is a public institution, the research be made public, and I think that would dry up the abuse.

Dr. KAYSEN. We agree with that, sir, and we believe we have an obligation to make the research public. This obligation is fulfilled by the individual scholars, most of whom work and live to publish their work. That is the way they carry on their job. But I must return to the fact—I think it is a fact—that Dr. X or Professor Y will answer an inquiry, "What do you think about so and so, you are an expert on the subject, what do you think about it?"

Now, I think it would be going a little far, and I do not understand you to say, Senator Curtis, that if Dr. X is on the staff of Brookings or on the staff of one or another institution, we have an obligation to see that he publishes the answer to the question that Congressman Y or Senator S is asking him. We do have an obligation to see that the work which we are paying him to do, the time he has spent, results in some publishable work. That is the obligation we feel and I believe we fulfill, sir.

Senator ANDERSON. Thank you. I have been a Senator longer than 20 years. I think the Brookings Institution and others have done fine work. Thank you very much.

(The joint statement of the Advanced Study and Research Institutes, and individual statements of Carl Kaysen, O. Meredith Wilson, Kermit Gordon, and Caryl P. Haskins follow:)

Joint statement presented on behalf of Advanced-Study and Research Institutions, presented by Carl Kaysen, Director, The Institute for Advanced Study, Princeton, New Jersey, O. Meredith Wilson, Director, Center for Advanced Study in the Behavioral Sciences, Inc., Stanford, California, Kermit Gordon, President, The Brookings Institution, Washington, D.C., and Caryl P. Haskins, President, Carnegie Institution of Washington.

SUMMARY

1. Advanced-study and research institutions are an integral part of America's system of higher education, and they are similar in many respects to colleges and universities. The differences, which are dictated primarily by the requirements of advanced study, do not justify any different treatment of these institutions for Federal tax purposes.

2. These institutions have never been regarded as "foundations" at all, and they have never engaged in the abuses at which the Bill is primarily directed. The Bill, however, in its broad definition of "private foundation" fails to recognize the basic differences between these institutions and other organizations covered by Code section 501(c)(3). Hence the Bill should be amended to make clear that these institutions are outside the definition of private foundation.

3. Unless the definition of private foundation is clarified, these institutions may be subject to financial burdens and operating restrictions that will severely reduce their resources and hamper their active conduct of scientific and educational activities.

4. The proposed tax should be eliminated or reduced and changed to a supervisory fee.

5. To ensure that these institutions will receive the outside support they will need to continue their activities, the Bill should be amended to make clear they are eligible to receive qualifying distributions from private foundations.

6. To ensure that these institutions, whch are "operating" in every sense of the word, will qualify as "operating foundations" under section 4942(j)(3), that term should be defined by reference to an organization's activities or use of funds rather than by reference to the composition of its assets or support.

7. The "expenditure responsibility" rules in the Bill should be relaxed to preserve these institutions' independence.

8. The Bill's rules pertaining to activities that "influence legislation" should be clarified.

9. The Bill's rules against furnishing "facilities" to foundation managers should be clarified.

STATEMENT

I. Advanced-study institutions in the American system of higher education

This statement explains the position of centers of advanced study and research, and other academic institutions not organizationally connected with universities and colleges, in relation to the legislation before the Committee. It was prepared by Mr. Kermit Gordon, President of The Brookings Institution of Washington, D.C.; Dr. Caryl P. Haskins, President of the Carnegie Institution of Washington; Dr. Carl Kaysen, Director of the Institute for Advanced Study, Princeton, New Jersey; and Dr. O. Meredith Wilson, Director of the Center for Advanced Study in the Behavioral Sciences at Palo Alto, California; with the assistance of counsel. The document sets forth a position not only for these four institutions but for a number of others which are listed in the first appendix of this statement. In addition to these institutions on whose behalf this document is filed, there are still others with a similar range of functions which are similarly situated in respect to the legislation before the Committee. All these institutions are an integral part of the American system of higher education. The language of the House Bill before the Committee would give the status of educational institutions only to those organizations meeting the criteria set forth in Section 201(a)(1)(B)(ii). These criteria would appear to exclude some of the organizations represented and leave others in serious doubt as to their status. This definition does not correspond to the facts of the system of higher education of which our institutions form a part, and accordingly the definition should be so changed as to reflect these facts.

The document has four parts: first, an introduction on the nature of the American system of higher education, then a description of the role of advanced training and research organizations in the system, followed by an explanation of the difficulties created for such institutions by the proposed legislation, and finally, recommendations as to how the legislation could be changed so as to avoid these problems without either raising a host of new ones or altering the broader policy of the law.

The system of higher education in the United States is marked by a high degree of pluralism and extraordinary diversity. What are usually classified as institutions of higher education are the 2500 separately organized non-profit degree-granting institutions which provide post high school education other specialized vocational training. These range in size and character from small private junior colleges to great state universities. They include as well as public institutions, and among the former church-related as well as secular ones. Most of the institutions enroll a small number of students, but the 350 largest ones account for nearly two-thirds of all the enrollment. The system as a whole performs at least six distinct functions. The first group of four functions of the system comprises the provision of education and training, of several types: (a) general or liberal education; (b) preprofessional training; (c) professional educational (d) postgraduate training for science and scholarship. The fifth function includes the conduct of scientific and scholarly research; the sixth, which is sometimes described as public service as distinct from education and research, includes the transmission of specialized knowledge to the non-academic public, and its direct application to a wide variety of public problems. Frequently this process of application is organized through contract relations between agencies of government and private business firms and educational institutions or their subdivisions. Sometimes it is done as a regular activity of special divisions of educational institutions organized for that purpose. The smaller institutions in this diverse system typcally specialize in one or another function, and the most numerous smaller institutions are the two- and four-year colleges providing liberal and general education. At the other end of the scale the great universities, public and private, usually cover the whole spectrum of activities described above.

Scientific and scholarly research and postgraduate education are intimately related. It is impossible to carry on the effective training of scientists and scholars at the higher levels except in institutions which are actively carrying on research and scholarship, since an indispensable element of such training is apprenticeship in the actual tasks of research and scholarship. It is frequently, although not always, the case that those institutions which are engaged in research are also involved in the transmission of specialized knowledge to the general public, and its application to specific problems.

Most of the research and a high proportion of the advanced training is concentrated in a relatively small number of universities. Fewer than 50 account for more than two-thirds of all doctoral degrees and perhaps two to three dozen would be considered as the most important centers of both excellent training and first rate research in most fields. In these institutions the distinction between research and education is very difficult to draw, and the two activities are intermingled.

Traditionally, the criterion of the granting of degrees has been taken as the mark that distinguishes an educational from a purely research institution. Given the intermingling of research and higher educational functions, this distinction become artificial, since candidates for the Doctor of Philosophy degree and other higher degrees are typically engaged in research programs as part of their training. In the last several decades more and more holders of the highest degree continue their education and training in postdoctoral programs. This practice began in mathematics and the natural sciences; it is now increasingly frequent in the social sciences and humanities. These postdoctoral programs reduce further the meaning of the distinction between education and research.

The institutions here represented perform these research and higher training functions or assist in their performance in a variety of ways. Typically, they cover only a part of the range of scientific and scholarly activities which are also to be found in the universities. They are special purpose enterprises which have grown up to meet particular needs in this diverse system. That these institutions are organizationally separate from universities, and the specific range of functions which they perform, are both products of their own history and circumstances.

Our educational system is in a sense like our economic system, one of free enterprise, and there is no master plan which allocates roles and functions. At the time each of these enterprises originated, the particular function which it performed was not being well performed elsewhere in the system; frequently the need for it was hardly recognized, and the new institution succeeded by demonstrating that it could serve a new and necessary purpose. It is more an accident of terminology than an essential feature of the processes of higher education and research that we associate the same functions with higher education when they are performed within the organizational boundaries of a large diversified multipurpose institution such as the great university, and think of them as serving a different purpose when they are performed by independent institutions. A more appropriate view would see all these functions and all the institutions which perform them as parts of our system of higher education.

It might be said that the institutions of the kind under discussion are so small a part of the system as to warrant no special concern. Aside from the element of inequity that such a view would involve, it fails to take account of the tremendous leverage which the higher levels of advanced training and research have on the character of the system as a whole. It is the training and research programs of a relatively small number of institutions—amongst which those here represented are prominent—that have played a major part in both the change in the quality and international standing of American science and learning in the last generation, and the equally remarkable internal change in the character of American higher education in the same period. Before World War II we were for the most part still under the intellectual tutelage of the universities of Britain and continental Europe in major fields of science and learning. In most fields first-rate graduate training and research of international quality were to be found in only a handful of institutions, hardly even a dozen at most.

Now the United States is a world leader in many fields of science and scholarship, and the inferior of no nation in any. The number of universities with excellent programs of graduate training and significant programs of research has grown rapidly, and such institutions are to be found in every region of the country. In this great process of change the contribution of every first-rate institution has been significant. And no Committee of the Congress needs to be instructed today on the significance of research and advanced training to the nation.

The institutions here represented all began as pioneers embodying the vision of some man or group of men, acquired a staff and organization relevant to their purposes, and created an intellectual tradition. An intellectual tradition, intangible as it is, is an imprtant part of what makes for the success of any research or scholarly enterprise. It cannot be easily duplicated or transferred to another organization, and the cost of destroying or damaging the enterprises which

embody it are great, even though they may not be readily visible. Excellence is vital to the enterprise of research and scholarship. It still comes in small and few enough packages so that the country cannot afford to lose any one.

II. Description of advanced-training and research institutions

This portion of our statement is presented by O. Meredith Wilson, the full-time Director of the Center for Advanced Study in the Behavioral Sciences, Inc.

The Center is an educational institution located in Stanford, California, on land leased from Stanford University. It has now been operating for about fifteen years. It is widely recognized as a leader in the important area of post-doctoral education.

What I plan to say this morning is not, however, merely to represent the views of the Center. I feel that I am speaking generally on behalf of the American system of higher education at the advanced levels, and on behalf of the American system of scholarship, research and learning at the advanced levels. Post-doctoral education and scholarship must be encouraged, supported and improved. Our educational structure must be sound and healthy at the top—just as it must also be sound and healthy at the bottom.

The advanced-study institutions are involved in a variety of ways in scientific and scholarly research, advanced training, and the dissemination of the results of research to the academic and general public. None of them is engaged in partisan political activity. They have come into existence to meet a variety of needs which are important in the world of education and research and which are not easily met by university organizations within the traditional framework. Although these enterprises are independent, not-for-profit corporations, their activities are closely interconnected with the activities of the universities and colleges of the United States. Both sets of institutions have worked together in a way which provides an effective division of labor among them.

Your Committee, I am sure, has an understanding of the vital role the tax laws play in stimulating the successful efforts in the field of education and scholarship which are so essential to our progress and our national welfare. Fortunately for the country, we have a long tradition that our laws shall be hospitable—not hostile—to true educational institutions and institutions engaged in scholarly pursuits. It is of the utmost importance that this tradition be maintained, whatever reforms may now be desirable in particular provisions of the tax laws.

The activities of organizations such as the Center, and The Institute for Advanced Study, and The Brookings Institution, and Carnegie Institution of Washington, are illustrative of some of the finest achievements of advanced education and advanced scholarship.

The Institute for Advanced Study, for example, is probably familiar to you as Einstein's professional home in America, and as the place where Von Neumann did his great work on the electronic computer. The Carnegie Institution of Washington has produced a number of research results of great practical importance to the nation. These include the origination of hybrid corn (which has recently become so critical a factor in the lives of people in the underdeveloped nations) first developed in 1011 at Carnegie Institution's Department of Genetics; discoveries such as silicates for new forms of optic glass, refractories and high-strength cements; early work on radar and initiation of the proximity fuse; and the exciting astronomical discoveries that have come from the Mount Wilson and Palomar observatories, which are supported and managed by Carnegie Institution jointly with the California Institute of Technology.

The Brookings Institution is so well known to you who serve in Washington for its many scholarly contributions to the science of government, economics and public affairs that it is not necessary to take your limited time this morning to dwell on the details. At our Center, each year we have in attendance, on a one-year basis, a group of about fifty eminent post-doctoral scholars in the behavioral sciences who have been carefully selected and invited to come as fellows. I have set fourth some of the tangible results of our program in the separate written statement submitted to you on the Center's behalf. I refer you to that written statement rather than repeat the specifics here.

These four organizaions together—and indeed others in the country which are somewhat like them—cover a wide range in advanced education and advanced research. They operate in the natural sciences, in the social sciences, in the humanities. They are a distinct part of the system of higher education—just as

much so as colleges and universities except at a somewhat higher level. They have facilities of their own. They and the scholars who attend them have numerous ties with universities and colleges and other institutions of learning and programs of research. They have professional staffs of exceptionally high caliber. They do not always have the same kind of faculty or formal curriculum which you will find at colleges and universities at lower levels, because programs for post-doctoral work and advanced training and education must be carried on in ways which meet the special needs of such a body of scholars.

It should be emphasized that the advanced study institutions have not participated in the foundation abuses at which the Tax Reform Bill is directed. So far as we are aware, no example of any such abuse has been cited in the testimony. They have not been accumulating substantial amounts of income. They have not been electioneering or lobbying. They have not been engaging in practices of self-dealing or control of businesses. And they have not developed habits of making discriminatory grants. Thus in all these respects too they deserve to be given the same tax treatment which you plan to assure for colleges and universities.

A large factor in the success and the stability of these advanced study institutions is their independent boards of trustees. In general, their trustees are public spirited citizens of prominence and achievement, who bring a variety of talents and experience to the shaping of the policies of the institutions.

Another large factor is the ability of the organizations to obtain substantial support from grant-giving foundations or from philanthropically-minded individuals interested in supporting not only tested programs but also innovative programs which appear worth while. It is essential that such sources of support should not dry up as a result of undue restrictions imposed by any new tax legislation. It is also important that such organizations not be penalized because far-sighted individuals or foundations may have furnished them sufficient support to enable them to achieve some assurance of continuity.

The advanced study institutions are an indispensable part of the American educational system. They have shown a remarkable ability to meet changing conditions and to respond to new demands in a rapidly changing world.

During the fifteen years since the Center was founded, a great deal of innovation has occurred in the thinking and the practice with respect to post-doctoral education and other advanced research and training in the United States. Innovative efforts will continue to be required in the future. It is our hope that in considering this legislation your Committee will recognize—as we do—how necessary and urgent it is that the avenues of support for these institutions and programs be kept open.

III. Problems created by the proposed legislation

This portion of our statement is presented by Kermit Gordon, President of The Brookings Institution.

The advanced-study and research institutions described above would be seriously affected if the provisions of H.R. 13270 respecting private foundations were enacted in their present form.

A. The definitions

The problem begins in section 509 with the Bill's broad-sweeping approach in defining the term "private foundation." Instead of attempting to describe, in a positive manner, the major characteristics of the organizations to be classed as "private foundations," the Bill approaches the definitional problem by indirection. It states only that certain tax-exempt organizations are *not* to be treated as private foundations. Consequently, unless an organization is covered by one of the four exclusions in section 509, it is automatically treated as a private foundation whether or not it has the characteristics that would be described in a positive approach to the definition.

This definition-by-exclusion approach requires, obviously, that the terms of the exclusions bear the full burden of holding the Bill's coverage within proper limits. We submit that the four exclusions in section 509 plainly fall short of carrying that burden because they fail clearly to exclude from the Bill's coverage many institutions, such as those we have described, which are completely unlike the organizations at which the Bill's controls are primarily directed.[1]

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[1] Advanced-study institutions, or at least many of them, do not fit the exclusions in section 509 because they are not, technically, colleges or universities and because their sources of support are such that they do not qualify under the mechanical tests for publicly- and broadly-supported organizations.

Further, although each of these institutions is in every sense actively and directly "operating" in educational or scientific fields, many of them are not, because they have large endowments or only a few major sources of support, included in the Bill's definition of "operating foundation." [2]

In short, the Bill in its present form sweeps into the definition of "private foundation," and out of the definition of "operating foundation," many of America's advanced-study and research institutions—independent operating institutions which have never been regarded as "foundations" at all and which certainly have never engaged in the abuses at which the Bill is directed.

Because of the nature of these institutions' activities, and their need for funds to carry on these activities, the proposed legislation would have serious consequences for them if they were treated as private foundations and subjected to the burdens and restrictions set forth in the Bill.

B. The tax

The first problem, of course, would be the financial burden imposed by the proposed 7½% on net investment income. As explained above, these institutions are a part of the system of higher education. They share many of the attributes of colleges and universities; the differences—small size, flexibility or absence of a formal curriculum or degrees, and increased emphasis on independent research—are dictated primarily by the requirements of advanced study.[3] One practical respect in which these institutions are, unfortunately, similar to colleges and universities is in their pressing need, with rising costs, to increase their financial resources merely to continue their present activities. Beyond this, these institutions constantly need increased financial resources to keep pace with rising levels of education and to meet the growing need for their services.

Advanced-study institutions are not in the business of selling goods or services for profit, and of course they are not in a position to increase their resources by attracting equity investments or by borrowing. They must, instead, depend for their support primarily upon their existing resources and upon the future generosity of other persons.

It must first be noted that, under the Bill's terms, other persons—the general public and foundations—will in the future be less inclined or less able to be generous in their contributions to private foundations. This will result from the Bill's proposed changes in the tax consequences of charitable contributions of appreciated property to private non-operating foundation, and from the Bill's proposed restrictions, discussed below, on the ability of private foundations to make grants to these institutions out of income. Futhermore, the grant-making private foundations themselves will be subject to the 7½% tax on net investment income and will consequently have less money available for grants. Under these circumstances, any amount paid out in taxes, no matter how small, would be difficult or impossible for these advanced-study institutions to recoup from other sources. The tax would therefore cause a corresponding reduction in available funds, and a corresponding cutback in these institutions' educational and scientific activities.

For example, if the Brookings Institution had been subject to the 7½% tax for its fiscal year ended June 30, 1969, its tax liability would have been approximately $200,000. Brookings has several education and research projects with a budget of less than $50,000 per year. If the tax had been in effect, Brookings would have had to discontinue four or more of these programs, or to cut back on other programs. In terms of individual students, an existing program of study for, say, 100 mathematicians, economists or physicists could, if the tax were in effect, accommodate only 92 or 93. This loss in advanced-study opportunity for seven or eight individuals could be made up, partially, only if the government were to use the tax revenues, less the government's expenses, to subsidize their study.

The proposed tax on investment income, in summary, would aggravate an already difficult financial situation and would have immediate, continuing and permanent effects, both direct and indirect, on these institutions' ability to maintain their existing programs and facilities.

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[2] Inexplicably, the term "operating foundation" is defined in section 4942(j)(3) by reference to the composition of an organization's assets or support rather than by reference to its activities or use of funds.

[3] For example, the very nature of advanced-study—study which extends the frontiers of knowledge—often precludes the possibility of maintaining the type of "regular curriculum" that involves instruction by others in predetermined subjects.

C. Restrictions on sources of support

The financial hardship imposed by the tax would be severely compounded by a separate provision of the Bill that would have serious financial implications for these institutions even if the tax were eliminated entirely. That is the Bill's provision that would, in effect, prohibit private foundations from making grants to private non-operating foundations except out of corpus.

In the past many advanced-study institutions have received substantial support from the heavily-endowed grant-making foundations. In the future, however, unless the proposed Bill is modified (or except to the extent that private foundations are willing to make out of corpus) these institutions, if they are viewed as private non-operating foundations, will have to look elsewhere for the support necessary to replace both the loss of contributions from private foundations and the loss of revenue resulting from the 7½% tax on net investment income. Unfortunately, in view of the Bill's proposed changes in the treatment of charitable contributions, particularly to private non-operating foundations, the replacement sources of support are almost certain to be inadequate.

D. Expenditure responsibility rules

There is another serious aspect, from the standpoint of these institutions, to the problem of receiving grants from private foundations. That is the problem created by the new "expenditure responsibility" rules in section 4945, and it arises whether or not the recipient institution is an operating foundation and whether or not the grant is made from corpus or income.

If and to the extent that private foundations make grants to these advanced-study institutions, the expenditure responsibility rules in the Bill will require the granting foundation to exercise substantial control over the recipients' use of funds. This, obviously, would impair the traditional independence and academic freedom enjoyed by advanced-study institutions (and seems, incidentally, to run counter to other provisions of the Bill, such as the operating foundation definition, which favor organizations that are relatively free of control by another party).

Institutions such as Brookings have on occasion refused grants where the grant-making foundation proposed to involve itself with the work financed with its funds. Ironically, the proposed legislation would put these advanced-study institutions in a position where they would find it both more necessary and more difficult than ever before to obtain support from grant-making foundations and yet, if they were to succeed, they would do so at the cost of impairing their independence.

E. Other major problems

Other parts of the proposed legislation create other problems of major concern to advanced-study institutions.

First, we are concerned by a broad and ambiguous restriction in section 4945(b)(1) against activities that constitute an "attempt to influence legislation." We agree that these institutions should no engage to any extent in direct lobbying or "grass roots" campaign with respect to pending legislation (other than appearances or communications respecting legislation that directly affects the institutions themselves.[4] The Bill in its present form, however, is very imprecise and will, we believe, be seriously inhibiting to many of these institutions.

For example, the Brookings Institution publishes scholarly analyses of public issues and public policies. These studies seek to inform and assist the American public and the executive and legislative branches of government by clarfying economic, governmental, and international issues and by exploring policy alternatives. These studies sometimes contain recommendations of the authors on matters that may, sooner or later, become the subject of legislation. We believe the Bill should be clarified to provide assurance that studies of this kind would clearly qualify as "non-partisan analysis and research" even where the authors' conclusions happen to touch on matters in disagreement between the political parties.

Further, these institutions' faculties and staffs include many of America's leading scholars and experts in certain fields, and our government is accustomed to seeking their views on pending legislation. Again it is unclear, under the Bill, that this useful exchange would be permitted to continue.

We suggest, accordingly, that the language of the Bill in section 4945(b)(1) and (c) be modified to make clear that the only prohibited activities are "grass

[4] *Cf.*, Treas. Reg. § 1.162-20(b)(2).

roots" campaigns and direct lobbying with the Congress with respect to specific pending legislation.

Second, advanced-study institutions, by their nature, have "facilities," such as offices, laboratories and libraries, which are used by their own officers and trustees—persons who are defined in the Bill as "disqualified persons." The present language of the Bill in section 4941(d)(1) may be interpreted as prohibiting these institutions from allowing these individuals to use these facilities in the future. This obviously unintended result should be corrected. In other respects, also, the Bill's prohibition against furnishing facilities to disqualified persons appears to be too broad. For example, under the Bill in its present form the Carnegie Institution of Washington apparently could not permit a top-level government astronomer to use the Mount Wilson and Palomar observatories.

Finally, if these institutions were treated as private foundations they would, because of the severe penalties that may be imposed in foundation management, be severely hampered in their ability to attract capable trustees and managers. This will result from the Bill's broad-sweeping prohibition of many activities in areas that are not clearly defined. An example we have already mentioned is the ambiguous prohibition against activities that influence legislation. Although taxes and penalties would be imposed on a foundation manager only if he acts "knowingly," in many cases it will be impossible in advance to know whether a particular activity violates the law. There is a risk, perhaps, that knowledge of an ambiguity in the law—knowledge of the possibility of a violation—constitutes the only knowledge necessary for the imposition of a tax and penalty on foundation management.

The result of these uncertainties, in any event, may be that many persons will resign their positions, and these institutions in the future will be unable to attract capable replacements. Those trustees and managers who do continue to serve may become reluctant, because of the Bill's ambiguities, to undertake worthwhile activities. In short, these severe sanctions in the Bill, coupled with the uncertainty as to exactly which acts may result in sanctions, may lead in the long run to one of the most unfortunate consequences of all.

IV. Recommendations

This portion of our statement is presented by Caryl P. Haskins, President of the Carnegie Institution of Washington.

We believe that education and research at the highest level, extending beyond the graduate schools of American universities, are absolutely indispensable to the future progress of the Nation. Independent advanced study therefore merits not only the active support of our government but also a freedom of operation equal to that granted schools, colleges and universities. Such support and freedom will be severely hampered if advanced-study institutions are classified as private foundations or if they are further classified as non-operating foundations.

Consider, for example, the Carnegie Institution of Washington: it "operates" and is an "educational organization" in every usual sense of the words, very much like the Smithsonian Institution. All its endeavors and every spare dollar of income—and sometimes capital taken from endowment—are devoted to operating its research facilities and enabling its eminent staff members (its faculty) and its fellows (its students) to pursue research which probes and often penetrates the outermost boundaries of human knowledge. The great telescopes and program of research in astronomy in California, operated jointly with the California Institute of Technology are a representative example of its activities. These are resources and activities—physical in part but primarily human—which we believe this country cannot afford to dissipate. Taxing their income by 7½ percent would inevitably erode their substance most seriously.

The Carnegie Institution has been operating since 1902 in response to its founder's extraordinary vision of the need for an advanced research and educational organization in the 20th century. Others were later established in response to new demands and new visions. The door should be kept open for additional advanced research and study organizations.

What are our proposals?

First, we urge that Congress clarify the status of advanced-study institutions by specifically adopting a category that would accommodate them clearly outside the category of "private foundation." The best way to do this, we believe, would be by revising the category of "educational organization" in, or adding a separate category to section 170(b)(1)(B), at pages 109–112 of the Bill. This would

assure that these institutions are to be excluded from the definition of private foundations. It also would make clear that we are so-called "30-percent" organizations. This would place us in the same category as universities which we regard as entirely comparable in intent and effect.

As an alternative, a fifth exclusion could be added to the defintion of "private foundation" in section 509(a), at pages 15-16 of the Bill. The new exclusion could be framed so that an advanced-study organization would have to meet several definitive tests:

First, it would have to spend substantially all of its income directly for the active conduct of scientific, scholarly, or educational activities. Such an expenditure test is already in other definitions in the Code (section 170(g)(2)) and in the Bill (section 4942(j)(3)(B), at pages 33-34.)

Second, it would be required to maintain as a principal part of its operations faculty, body of scholars or professional staff engaged directly in objective, nonpartisan research or analysis, instruction or other scientific, scholarly, or educational activities.

Third, it would have to furnish directly to individual scholars programs of study or instruction or facilities for scientific, scholarly, or educational purposes. The results of its research would have to be freely available to the general public. a requirement similar to that in section 512(b)(9) of the Code.

Fourth, its governing board would have to be independent, that is, not controlled directly or indirectly by any one person, family, organization or closed group.

Fifth, its support from related organizations or persons and its receipts for services under contract could not exceed a specified fraction—say, one-quarter or one-third—of its total support.

Finally, it would in general have to have characteristics in common with those of graduate schools of universities.

We believe that the definitional language for the suggested category could be framed so as to exclude the non-operating non-expending, narrowly-supported, tightly-controlled organizations at which the new legislation appears to be aimed.

If we cannot be placed clearly outside the definition of private foundations, we urge that the definition of "operating foundation" in section 4942(j)(3), at pages 33-34 of the Bill, be clarified so that there will be no doubt that we can qualify. In the case of the Carnegie Institution, for example, the very circumstances it has treasured and which it can primarily credit for the quality of its research and educational programs—its endowment, its independence from government support and its concentration on operations rather than fund raising, grant-seeking and grant-making—paradoxically trap it unless the definition of "operating foundation" is amended. If we are to be private foundations under the Bill, we will not, unless we are treated as "operating foundations," have the flexibility needed for our programs, and we will not attract the support from the granting foundations that we will need to offset the loss we would suffer from "private foundation" status. This is true of many, if not all, of the advanced-study organizations for which we are testifying.

Another amendment we urge, on behalf of those of our group who may not be able to qualify for "operating foundation" status, is to expand the definition "qualifying distributions" in section 4942(g)(1) at page 30. Under the definition as now written, as we understand it, an advanced research and educational organization that is treated as "non-operating" could not be supported by a non-operating grant-making foundation except by grants out of corpus. While many such foundations expend principal, it seem clear that they cannot take care of all "non-operating" beneficiaries. We recommend an amendment that would include as a "qualifying distribution" a grant or gift which the donee organization expends within a year for the exempt purpose for which it was given. The test would be modeled on the test proposed for section 170(e)(3) at page 124.

We have already mentioned the need for clarification of section 4945(b)(1) and (c) with respect to lobbying activities.

We would hope that section 4942(g)(1)(A) at page 30, lines 6-7, would be clarified so as to make clear that expenses of a foundation in the nature of administrative and ordinary and necessary business expenses will be treated as "qualifying distributions." At the same time, it should be made clear that the inclusive phrase in section 4945(b)(5) at page 44, lines 23-24, making "taxable expenditure" include an amount paid or incurred for a purpose other than a

section 501(c)(3) purpose, will not be used to penalize foundations for expenditures made in good faith.

Finally, we urge, both as donors and as donees, that the "expenditure responsibility" required by section 4945(f), at page 47, to be exercised by a grantmaker over a grant recipient be rephrased so that the test can be met by "best efforts" or "reasonable diligence." As donees, we are particularly concerned that these rules might lead to impairment of our operations and loss of the operational autonomy and flexibility that advanced study requires.

There are other troublesome aspects to the Bill. We have in mind, for example, the possibility that the directors of our departments who appear to be within the term "foundation manager" might be required to give up the use of laboratory or other "facilities" that our institutions have always made available in accordance with their policy of encouraging continued research by those of their staff members who have assumed administrative responsibilities. But it is impossible to cover all of the technical problems in a limited compass, and they are less serious than those from which we have specifically requested relief.

Appendix to Joint Statement Submitted on Behalf of Advanced-Study and Research Institutions

Organizations subscribing to the views set forth in the Joint Statement presented on behalf of Advanced-Study Institutions:

American Academy of Arts and Sciences,
Boston, Mass.
American Council of Learned Societies,
New York, N.Y.
The Brookings Institution,
Washington, D.C.
Carnegie Endowment for International Peace,
New York, N.Y.
Carnegie Institution of Washington,
Washington, D.C.
Center for Advanced Study in the Behavioral Sciences, Inc.,
Stanford, Calif.
Institute for Advanced Study,
Princeton, N.J.
National Bureau of Economic Research,
New York, N.Y.
Social Science Research Council,
New York, N.Y.
Wistar Institute of Anatomy and Biology,
Philadelphia, Penna.
Marine Biological Laboratory,
Woods Hole, Mass.

The Tax Reform Act of 1969 (H.R. 13270)

(Memorandum by Advanced-Study Group on proposed amendment to exclude from the definition of "private foundation" an additional category called "advanced-study or research institution")

In America's system of higher education, the highest level of education is provided, to a significant extent, by a number of independent advanced-study and research institutions. Examples are The Brookings Institution, Carnegie Institution of Washington, Center for Advanced Study in the Behavioral Sciences, and The Institute for Advanced Study. These institutions, which have never been regarded as "foundations," are engaged directly and actively in educational and scientific activities and are similar in many respects to colleges and universities; the differences—flexibility or absence of a formal curriculum or degrees, and increased emphasis on independent research—are dictated primarily by the requirements of advanced study and do not justify any different treatment of these institutions by the Bill.

The Bill, however, in its definition of "private foundation" (at pages 15–17 of H.R. 13270) fails clearly to treat these institutions like colleges and universities and to exclude them from the coverage of the provisions applicable to private foundations.[1] Consequently, unless the definition is clarified by amendment, these institutions may be subject to financial burdens, restrictions on their sources of support, and operating restrictions that will severely reduce their resources and impair their ability to continue their educational and scientific programs. (A full description of these problems is set forth in material submitted to the Committee on Finance by the Advanced-Study Group under date of September 10, 1969.)

Attached to this memorandum is a proposed amendment that would ensure that these institutions will be excluded from the definition of private foundation and be free to continue their present operations. The amendment is narrowly drafted so as to exclude from its coverage the types of organizations at which the new legislation appears to be aimed.

A technical explanation of the amendment's provisions is also attached.

[91st Cong., 1st sess., H.R. 13270]

Amendment intended to be proposed by Mr. ——— to H.R. 13270, an Act to reform the income tax laws, viz:

1. On page 16, on line 21 strike out the word "and" and on line 23 strike out the period and insert: "; and

"(5) an advanced-study or research institution."

2. On page 44, on line 19 strike out the word "or" and at the end of the line insert: ", or (5)".

3. On page 57, after line 2 insert the following (and redesignate subsections (d) through (k) of section 101 as subsections (e) through (l)):

"(d) Definition of Advanced-Study or Research Institution.—Section 7701(a) (relating to definitions) is amended by adding at the end thereof the following new paragraph:

"(35) Advanced-Study or Research Institution.—The term "advanced-study or research institution" means an organization, including a learned society, which is described in section 501(c)(3) and which—

"'(A) expends substantially all of its income directly for the active conduct of scientific scholarly, or educational activities;

"'(B) maintains as the major part of its operations a faculty or one or more bodies of scholars or scientists (a significant number of the members of which hold advanced degrees) engaged directly, under conditions of academic freedom, in instruction or scholarly or scientific studies or research (exclusive of instruction, studies, or research for the primary purpose of commercial or industrial application);

"'(C) makes available (or permits and encourages the scholars associated with it to make available) to the general public the results of its studies or research or furnishes directly to a significant number of individuals, selected objectively, programs of study or instruction or facilities for scientific, scholarly, or educational purposes;

"'(D) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) who are not foundation managers; and

"'(E) normally receives not more than one-third of its support in each taxable year from any combination of—

"'(i) gifts, grants, or contributions from one or more disqualified persons (as defined in section 4946) other than organizations described in section 170(b)(1)(B) and private foundations not described in section 4946(a)(1)(H), or

"'(ii) gross receipts (exclusive of tuition or enrollment fees) from performance of services under contract.'"

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[1] The problem arises because of the Bill's definition-by-exclusion approach in defining the term "private foundation." The definition states that any organization described in section 501(c)(3) is a "private foundation" unless it is covered by one of the four exclusions in new section 509. Many advanced-study institutions may not clearly fit these exclusions because they are not, technically, colleges or universities and because their sources of support do not permit them to qualify under the mechanical tests for publicly- and broadly-supported organizations.

TECHNICAL EXPLANATION OF AMENDMENT

The Amendment would add to new section 509(a) of the Internal Revenue Code, at pages 15-17 of H.R. 13270, a new paragraph (5) which would exclude from the definition of "private foundation" any organization which is an "advanced-study or research institution." The term "advanced-study or research institution" would be defined in a new paragraph (35) added by the Amendment to section 7701(a) (relating to definitions). The Amendment also makes a technical change on page 44 of the Bill to make clear that these institutions will be treated like other excluded organizations for purposes of the expenditure responsibility rules.

The definition of "advanced-study or research institution" would apply to section 501(c)(3) organizations which satisfy each of five tests set forth in the Amendment in subparagraphs (A) through (E). The five tests are designed to serve two related purposes: first, to be descriptive of the principal characteristics of these institutions; and second, to exclude from the new definition, and thereby leave subject to the Bill's provisions, organizations which are not part of the system of higher education. Excluded from the new definition, for example, would be organizations which direct their efforts to research primarily for commercial or industrial application, and organizations which do not operate under conditions of academic freedom.

Paragraph (A) of the new definition requires that the institution be engaged, both actively and directly, in educational, scholarly or scientific activities; it further requires that the organization expend substantially all of its income in conducting such activities. This test is already used in the Code in section 170(g)(2)(B) (relating to the unlimited charitable contribution deduction) and in the Bill in new Code section 4942(j)(3) (relating to operating foundations). An organization would not qualify under this test if, for example, a substantial portion of its income were expended to finance such activities carried on under the auspices of one or more other organizations.

The test in paragraph (B) reflects the major distinguishing characteristics of these institutions. The organization must operate primarily through a group of individuals (a faculty or one or more bodies of scholars or scientists) who are themselves engaged directly in instruction or scholarly or scientific studies or research. As an indication of higher-education status, a significant number of these individuals must hold advanced degrees, and their activities must meet both a procedure test and a purpose test. As to procedure, the activities must be conducted under conditions of academic freedom, which means freedom of the teacher or scholar to express the truth as he sees it without interference by any other authority or fear of loss of position. As to purpose, the activities must be pursued primarily to enhance the knowledge or capabilities of the individuals involved or of the public at large. Activities carried on for the primary purpose of commercial or industrial application are not indicative of an institution of higher education and will not qualify in meeting the test in paragraph (B).

Paragraph (C) adds a test that ensures that the organization and its works will be exposed to or involved with the general public to a significant extent. The test requires that the organization make available (by publication or otherwise) to the general public the results of its studies or research. However, since these organizations often do not themselves publish the results of their scholars' work, this test will be satisfied if the organization permits and encourages its scholars to make available the results of their work. (This test is intended to codify the current practices generally followed already by institutions of higher education such as colleges and universities; an organization would not fail to meet this test, for example, merely because its works are of direct interest only to a limited segment of the general public or because it or the scholar involved does not make available the results of efforts that are deemed unsuccessful.) Alternatively or in addition, an organization would satisfy the test in paragraph (C) if it offers programs of study or instruction or facilities directly to a significant number of individuals for scientific, scholarly or educational purposes. The meaning of "significant" will vary depending on the field of study, the nature of the program and other factors such as available financial resources. The individuals in question must, in any event, be selected on an objective basis. Examples of "facilities" within the meaning of paragraph (C) are libraries or laboratories.

Paragraphs (D) and (E) are designed to ensure that the organization will be independent and not be controlled or influenced in its operations by a par-

ticular person, family, organization or group. In paragraph (D) the test is put in terms of direct or indirect control of the institution by disqualified persons other than foundation managers. (Foundation managers are excluded from the control restrictions in paragraph (D) even if they are also substantial contributors as defined in section 4946(a)(2); this exclusion is necessary because many officers and trustees of these institutions are substantial contributors (that is, contributors of over $5,000 in any one calendar year) and is appropriate in view of the specific limitations in paragraph (E) on the amount of support that may be received from disqualified persons including foundation managers.) This test is already used in the Bill in new section 509(a)(3)(C) (page 16, lines 17-19 of H.R. 13270). The prohibited control for this purpose would include informal understandings or arrangements as well as formal voting control.

The test in paragraph (E) is designed to minimize the opportunity for control or influence stemming from financial support of the institution. Under this test, not more than one-third of an institution's support could be received from certain sources. These sources include disqualified persons who are individuals, business corporations, related foundations (as defined in section 4946(a)(1)(H) and others. For example, an institution would not qualify under this test if it normally receives as much as one-third of its support from a private foundation which received substantially all of its contributions from the same individual who made (directly or indirectly) substantially all of the contributions to the institution in question. Further, to avoid outside parties' influence over the institution's activities and any impairment of its academic freedom, the support restrictions also apply to gross receipts from the performance of services under contract. Thus, under the test in paragraph (E), at least two-thirds of an institution's support must be derived from sources such as receipts from carrying on exempt activities (such as tuition fees and sales of publications), endowment income, contributions from "30-percent" organizations including the government, contributions from the general public (in amounts such that the contributors would not be disqualified persons), and contributions from unrelated private foundations.

Separate Written Statements Submitted for the Record by the Brookings Institution; Carnegie Institution of Washington; Center for Advanced Study in the Behavioral Sciences, Inc.; the Institute for Advanced Study

Statement of Kermit Gordon, President of the Brookings Institution

Summary

The provisions of H.R. 13270 would seriously affect the programs and activities of the Brookings Institution, which is not a foundation, but an independent, nonpartisan, nonprofit organization, akin to a university, engaged in advanced study and education.

To treat the Institution as a foundation under the provisions of the bill would be to place it in a category in which it does not belong. A group of institutions engaged in advanced study and research, of which Brookings is one, is submitting a suggestion for an amendment to the bill that would exclude these organizations from the provisions of the bill.

If the proposed exclusion is denied, the bill if enacted would have extremely adverse effects on the future operations of the Brookings Institution.

If Brookings had been subject in recent years to the proposed 7½ percent tax on net investment income, its annual tax liability would have averaged around $200,000, which is nearly as much as we would have had to pay were we subject to the regular corporate income tax. The tax would be doubly burdensome on Brookings; it would curtail both the available income on the Brookings endowment and the ability of the foundations to make grants to Brookings.

We are apprehensive about the effects of the provision which would penalize efforts to influence legislation, other than through making available the results of nonpartisan analysis and research. Although it would appear on the surface that Brookings is well protected by the exemption for nonpartisan analysis and research—since this phrase constitutes an accurate description of our program—there are ambiguities and uncertainties beneath the surface which would cause serious injury to staff morale and impair our sources of financial support.

Though one section of the bill is designed to minimize the degree of control which a grant-making foundation can exercise over an operating foundation, the "expenditure responsibility" requirement imposed on foundations works in the opposite direction; it virtually requires a cautious and conscientious grant-making foundation to involve itself intimately in the affairs of the operating foundation. It will be difficult to maintain the independence of the Brookings Institution if foundations are required to assume "expenditure responsibility" with respect to their grants to us.

STATEMENT

I am Kermit Gordon, President of the Brookings Institution, a nonprofit research and educational organization chartered under the laws of the District of Columbia. I appreciate the courtesy of the Committee in allowing me to present this statement concerning the problems raised by H.R. 13270 for the Brookings Institution.

Though most people in Washington, and many elsewhere in the country, are familiar in a general way with the role of Brookings, I have found that few people are familiar with the Institution's origins, broad purposes, and range of activities. Before turning to a discussion of the possible impact of the proposed legislation on Brookings, I would like to describe the Institution and its objectives.

We believe that in its conception and structure, the Brookings Institution is unique. Other organizations share some of its research interests or perform some similar educational services, but no other private institution combines its broad range of policy interests with its fundamental commitment to make social science research useful to leaders throughout our society.

The Institution is now 53 year old. Its origins date back to the first of its predecessor organizations—the Institute for Governmental Research—which was established in Washington in 1916. Its founders were a distinguished group of businessmen and educators who saw the need for an independent organization that would apply the analytic tools of scholarship to the study of public problems. Though it is commonplace today that systematic study by highly trained scholars can be valuable in the solution of public problems, the conception which led to the creation of the Institute was a pioneering notion in 1916.

In the early days of the Institute for Government Research, the work of the organization was focused on the improvement of organization and management in the federal government. The development of a budgeting system for the federal government was largely the work of the Institute. Its studies led directly to the enactment of the Budget and Accounting Act of 1921, which established the executive budget, created the Bureau of the Budget, and established the Office of the Comptroller General. It is widely regarded as one of the landmark events in the improvement of the organization and management of the federal government.

In addition to its pioneering work on budgeting, the Institute's studies made notable contributions to the improvement of federal personnel administration, the development of a civil service retirement system, and other advances in government administration.

Among the founders of the Institute was Robert S. Brookings, a prosperous St. Louis businessman, who retired at the age of 46 shortly before the turn of the century in order to devote his wealth and the rest of his life to public service. As a result of his experience as a trustee of the Institute, and his wartime service in 1917-18 with the War Industries Board, he became convinced of the need for basic economic data and analysis in intelligent decision-making in government. He found that other leaders in business, education and government shared his views, and he took the lead in organizing another institute, designed to do for economic policy what the Institute for Government Research was doing for government administration.

The Institute of Economics—the second antecedent organization of the Brookings Institution—was thus established on Mr. Brookings' initiative in 1922. The work of the Institute influenced the readjustment of international debt policies through its studies of reparations and war debts in the 1920's. It later conducted important research in the fields of trade barriers, agricultural policy, income distribution, social security, and other labor and welfare problems.

The third antecedent organization was the Robert Brookings Graduate School of Economics and Government, established in 1924. The School, which was

founded and initially financed by Mr. Brookings, was avowedly experimental in nature, and it soon attracted wide attention for its pioneering emphasis on training for the public service. Its program focused on the opportunities afforded its students for ready access to the source materials of public policy research and personal contact and discussion with Washington officials. During its existence, the School awarded doctor of philosophy degrees to 74 persons, many of whom have since had distinguished careers in public service, research, and education.

The three antecedent organizations were merged in 1928 into the Brookings Institution. The goals of the Institution have not changed in any significant way since 1928. We remain an independent organization devoted to nonpartisan research, education, and publication in the fields of economics, government, and foreign policy. Our primary function—the analysis of public problems and public policy—is carried out through three research programs: Economic Studies, Governmental Studies, and Foreign Policy Studies. Our staff of social science analysts numbers 145, of whom 82 are members of the resident staff, and 63 are nonresident associates, most of whom are also faculty members of colleges and universities throughout the country.

Over the years we have developed a number of policies to guide our research activities. First, the studies we publish present the opinions and conclusions of the author, not of the Institution. In determining whether to publish a study, the Institution reaches a judgment as to whether it is a competent treatment of a subject worthy of public consideration, but it does not seek to influence the author's conclusions. Second, the Institution will not undertake contract research for private clients. Third, in conducting research financed by government grants or contracts, it will not accept classified projects, and it insists on the unqualified right to publish its findings.

The largest of our research programs is in the field of economic studies. Projects currently under way emphasize problems of economic growth and stability, monetary and fiscal policies, international economics, industrial organization, social economics, and labor economics. The program also includes cooperative research with major universities in public finance, econometrics, regulation of economic activity, and the role of transportation in economic development. Of particular interest to this Committee will be the program of Studies in Government Finance, which is now reaching completion after the publication of some 30 books dealing with the major issues of tax and expenditure policy. This is probably the most comprehensive effort to analyze current problems of public finance ever undertaken in the United States, and it is particularly timely in view of the current high interest in tax reform and intergovernmental fiscal relations.

The Governmental Studies Program is somewhat smaller, but growing in scope. Its current studies deal with problems of the legislative process; public policy, especially in the fields of civil rights, poverty, and urban problems; courts and the administration of justice; and political parties and public management.

The Foreign Policy Studies Program is studying U.S. foreign policy issues which changes in the international environment will bring increasingly to the fore, and whose resolution will require new perceptions and policies. The program deals with three major areas: the U.S. politico-military role, economic development and interdependence, and problems of political development. In this field of research, we are employing the study group technique—an arrangement under which the research staff meets regularly with a study group, which includes members of Congress, officials of the executive branch, and academic specialists, for discussion and debate of the analytical papers prepared by the staff.

In addition to its research activities, the Institution conducts a large and ambitious mid-career educational program. This activity—our Advanced Study Program—provides opportunities for leaders in government, business, labor, and the professions to develop a deeper understanding of government operation and public policy issues. Conferences, seminars, briefings, and reading programs are conducted to broaden the horizons of the participants and to study specific policy problems. Government officials, business executives, union leaders, scholars, journalists and other public figures participate as lecturers and discussion leaders. Since this program was launched a decade ago, more than 9,000 participants have benefited from these activities.

In the words of my predecessor, Robert D. Calkins, Brookings stands as "a plot of non-political territory where scholars, responsible officials in public life, and leaders in private life may meet for consideration of problems in the national interest." We provide these opportunities not only through our Advanced

Study Program, but through a wide range of other actvities which bring persons with common interests to Brookings. Each year we award about a dozen research fellowships to advanced graduate students at universities throughout the country to help them develop the necessary skills for evaluating specific programs of the We also bring to Washington each year up to 10 young postdoctoral economists to help them develop the necessary skills for evaluating specific programs of the federal government. High level civil servants are given leave by their agencies for periods up to a year to come to Brookings to conduct depth studies of problems of importance to their agencies. We provide office facilities and other services for mature scholars from American and foreign universities who are doing research on problems that are related to the organization, operation or polices of the U.S. government. In the last year, we have welcomed to Brookings 70 people in these various categories.

In carrying out this range of activities, I believe that we have kept faith with the charter of the Institution, which states that the business and objects of the Brookings Institution are: "To promote, carry on, conduct, and foster scientific research, education, training and publication in the broad fields of economics, government administration, and the political and social sciences generally, involving the study, determination, interpretation and publication of economic, political and social facts and principles relating to questions of local, national or international significance; to promote and carry out these objects, purposes and principles without regard to and independently of the special interests of any group in the body politic either political, social or economic."

The Institution is governed by a distinguished Board of Trustees, whose present chairman is Douglass Dillon, former Secretary of the Treasury. From the very beginning, the trustees of Brookings and its antecedent organizations have been drawn from all regions of the nation and have constituted a cross-section of our national leadership. Many have been prominent leaders in business and the professions, and 19 have been presidents of colleges and universities. They have also made important contributions to the public service, either before or after serving as Brookings trustees. Two were presidents of the United States; three were Supreme Court justices; three were Secretaries of State; ten others were also Cabinet officers; and a number have been ambassadors and members of the Senate and the House of Representatives.

The trustees under the by-laws have the responsibility "to elect the President, to satisfy themselves with reference to the character, intellectual competency, and scientific integrity of the staff; to approve the fields of investigation and the major specific studies to which the available funds are allocated; and to review periodically the administration and the program of the Institution."

The by-laws go on to state: "The expressed policy of the Trustees with reference to the scientific work of the Institution is as follows: It is the function of the Trustees to make possible the conduct of scientific research, and publication, under the most favorable conditions, and to safeguard the independence of the research staff in the pursuit of their studies and in the publication of the results of such studies. It is not a part of their function to determine, control, or influence the conduct of particular investigations or the conclusions reached."

After many years of effort, the Institution is now receiving enough financial support to enable it to plan its future program with some confidence. In our earlier years, there were numerous financial crises during which the very survival of the Institution was in jeopardy. Staff members who shared the faith and vision of the founders at times agreed to forego their salaries to keep the Institution alive. We owe a great deal to the sacrifices of those who went before us.

I do not mean to suggest that we no longer have budgetary concerns: in fact, we shall operate at a deficit this year if we are not able to raise additional funds in the next nine months. But we have been able steadily to expand and diversify our sources of support.

In our last fiscal year, total operating expenditures of the Institution came to $5.2 million. Of our total income, 20 percent was derived from investment income, 30 percent from grants of private foundations, 10 percent from government grants and contracts, 8 percent from conference fees, 7 percent from sales of publications and other institutional receipts, and 16 percent from gifts from business firms and individuals.

We have today a large and highly qualified staff; our finances have risen substantially; and we are able to sustain a greater diversity of activities than ever before. I believe it will not be immodest to say that the Institution today

realizes its founders' dreams more fully than at any time in the half century of our existence.

Let me turn now to the problems which H.R. 13270 would raise for the Brookings Institution.

(1) It is not completely clear into which category the Brookings Institution would fall under the bill as now written. Though under the mechanical test of Section 509, Brookings would seem to approach the categories of publicly- and broadly-supported organizations which escape the restraints imposed by the bill, it would probably fail to meet these mechanical tests by a small margin. Our problem is that the "disqualified person" restriction in the formula in Section 509(a)(2) for defining broadly-supported organizations is fixed, regardless of the size of the recipient organization, by reference to any contribution over $5,000, and therefore discriminates against relatively large organizations; a $5,000 contribution is a large contribution to an organization with a $50,000 budget but it not a large contribution to an organization with a $5 million budget. We request that the Committee substitute a percentage limitation in place of his fixed dollar limitation.

If Brookings cannot qualify for exclusion from the private foundation category under the formula in Section 509(a)(2), it is not even wholly clear that Brookings would qualify as an operating foundation under the mechanical test imposed by Section 4942(j)(3). In that event, we would be a private non-operating foundation.

We have never regarded ourselves as a "private foundation", nor are we so regarded by the public. We are a research and educational organization and we conduct under our auspicies and through our staff nonpartisan research and educational activities for the benefit of the American public.

While Brookings is far from being a foundation, it is clearly a part of the system of higher education. We are much more akin to a university than to a foundation. We engage in all three of the principal functions of American universities—research, teaching, and public service. Members of our staff enjoy academic freedom. Most of our senior fellows and research associates hold the Ph. D. degree. Our staff members teach not only in our own mid-career educational programs, but also at other institutions. They teach regularly at universities in the Washington area, give lectures and seminars at universities throughout the country, and take leaves of absence from Brookings to teach at universities for a term or semester. Members of university faculties work at Brookings in large numbers—as Guest Scholars, as Economic Policy Fellows, as Research Fellows. More than 50 members of university faculties in all parts of the country are nonresident members of the Brookings staff. The studies we publish are used as textbooks at universities throughout the country.

To treat Brookings as a foundation under the provisions of this bill would, in our judgment, be inconsistent and inequitable. A group of institutions engaged in advanced study and research, of which Brookings is one, is submitting a suggestion for an amendment to the bill which would exclude these organizations from coverage. I respectfully request that the Committee give sympathetic consideration to our case.

(2) In the event that our plea for exclusion is denied, we shall probably be categorized under the terms of the bill as an "operating foundation", although this is by no means certain. But whether or not we were so categorized, we would in any case be subject to the 7½ percent tax on net investment income, as would the private foundations on which we depend for suport.

I find it very difficult to identify a valid tax policy which would support the proposed tax on net investment income. I am familiar with the argument that the services provided by the federal government benefit nonprofit organizations just as they benefit profit-making business corporations, and that the former group should be required to bear some of the cost just as taxable corporations do through the corporate income tax.

However, this argument seems to me defective in two ways. First, regardless of benefits received, business corporations pay no income tax unless they have a positive net income. (Treasury statistics show that *most* corporations have no taxable net income and hence pay no corporate income tax.) Grant-making foundations should not—and under the terms of H.R. 13270 they may not—earn a positive income; that is, their disbursement to qualified recipients must equal or exceed their net investment income. Hence if they are to be treated analogously to private business firms, they should in all equity be treated like corporations which earn no net income.

If the Brookings Institution had been subject to the 7½ percent tax over the last four years, its annual tax liability would have averaged about $200,000. This is nearly as much as we would have had to pay were we subject to the regular corporate income tax. Although the corporate income tax rate is of course much higher, we would then have been entitled to the 85 percent dividends received credit and the deduction of operating and administrative expenses. Far from being a "modest" or "token" tax, the 7½ percent tax on net investment income would thus impose on Brookings a burden nearly as heavy as the corporate income tax.

Second, a primary justification of the corporate income tax rests on the proposition that in the absence of such a tax, the owners of the corporation would escape taxation under the individual income tax on that portion of their equity in the earnings of the corporations which was not distributed to stockholders. But this rationale clearly has no applicability to foundations and other nonprofit organizations, for these entities have no stockholders who possess an equity interest. Moreover, the requirement that foundations distribute all of their income would in any case prevent foundations from reducing federal receipts from the individual income tax by accumulating income.

The 7½ percent tax would be doubly burdensome on nonprofit research organizations like Brookings, for it would curtail both the income on the Brookings endowment which would be available to finance our program, and the ability of the foundations to make grants to Brookings.

As an alternative to the 7½ percent tax, I hope that the Committee will give consideration to a filing fee sufficient in the aggregate to finance fully the costs of an operating unit in the Internal Revenue Service which would enforce the tax laws applicable to foundations. A fee based on this principle would seem to me wholly equitable.

(3) We have deep apprehensions about the possible effects of Section 4945(c), which in effect prohibits efforts to influence legislation through attempts to affect the opinion of the general public or through private communication with any member or employee of a legislative body, other than through making available the results of nonpartisan analysis and research. Although it would appear on the surface that Brookings is well protected by the exemption for nonpartisan analysis and research—since this phrase constitutes and accurate description of our program—there are ambiguities and uncertainties beneath the surface which could cause serious injury to the morale of our staff and could impair our sources of financial support.

The primary purpose of our studies is to clarify public problems and explore policy alternatives. These studies sometimes contain recommendations of the authors on matters that may, sooner or later, become the subject of legislation. We believe the bill should be clarified to provide assurance that studies of this kind would clearly qualify as "nonpartisan analysis and research" even where the authors' conclusions happen to touch on matters in disagreement between the political parties.

There are other ambiguities. Are we to assume that any activity by a Brookings staff member is assumed to be an act of the Brookings Institution? Is a staff member proscribed from writting a letter to the editor of a newspaper urging the passage or defeat of a particular piece of legislation? A university faculty member is of course perfectly free to do so; is such a person to understand that if he joins the Brookings staff he must surrender these rights of citizenship?

It is a common occurence for a member of Congress or a congressional staff member to write or telephone a specialist on the Brookings staff to ask for information or analysis relating to proposed legislation. Is the Brookings staff member now required to decline to answer such questions?

Remembering that grant-making foundations would, under the bill, bear "expenditure responsibility" for the use of their funds by Brookings, it is predictable that some of them at least will be frightened off by the ambiguities and uncertainties inherent in Section 4945(c). If they are to be jointly responsible for actions by the Brookings staff which may subseqently be deemed improper under these ambiguous provisions, some of them will simply avoid the risk by declining to make the grant. These consequences would seriously impair the effectiveness of Brookings; yet so far as I am aware in the years I have been associated with the Institution, no congressman or senator has ever charged Brookings with seeking improperly to influence legislation.

(4) Because we are so heavily dependent on foundations grants, we are deeply concerned by another consequence of the requirement in Section 4945(f) that the

grant-making foundation exercise "expenditure responsibility" with respect to our use of the foundation's funds.

This requirement reveals a confusion and inconsistency of purpose in the proposed legislation. The terms of the definition of "operating foundation" are designed to minimize the degree of control which a grant-making foundation can exercise over an operating foundation. The expenditure resonsibility requirement operates in precisely the opposite direction; it virtually requires a cautious and conscientious grant-making foundation to involve itself intimately in the affairs of the operating foundation. We have on occasion declined to accept grants from foundations—and from the government—on terms which manifested a desire to monitor and influence our work; we have our own standards of integrity, and we think they may be breached if we allow any other organization—even the organization which is putting up the money—to enterfere in our work. Now the "expenditure responsibility" requirement will virtually force them to. It will be difficult to maintain the independence of the Brookings Institution if foundations are required to assume expenditure responsibility with respect to their grants to us.

All of these problems would be solved if the bill recognized us for what we are: an independent, nonpartisan institution, akin to a university, engaged in advanced study and education. I hope that the Committee will accept this view, and amend the bill as we have requested.

STATEMENT OF CARYL P. HASKINS, PRESIDENT, CARNEGIE INSTITUTION OF WASHINGTON

This statement, presented on behalf of Carnegie Institution of Washington, is filed as a supplement to testimony on behalf of the group of advanced study and research organizations of which the Institution is a member.

Carnegie Institution of Washington was founded by Andrew Carnegie in 1902 and incorporated by Act of Congress approved April 28, 1904 (Public Law 260, 58th Congress). Under the Act, a copy of which is attached, its purposes are to "encourage, in the broadest and most liberal manner, investigation, research, and discovery, and the application of knowledge to the improvement of mankind; and in particular . . . to conduct, endow, and assist investigation . . . and to cooperate with governments, universities, colleges, [and] technical schools. . . ." Throughout its life, the Institution has performed educational functions along with fundamental research in accordance with Mr. Carnegie's original Deed of Trust which provided that the Institution should "afford instruction of an advanced character to students properly qualified to profit thereby." The Institution has always been governed by a Board of Trustees independent of its founder. They have always been drawn from the most distinguished Americans of their time. Past Trustees have included Alexander Agassiz, General Omar N. Bradley, Robert Woods Bliss, Frederic A. Delano, Simon Flexner, James Forrestal, Herbert Hoover, Ernest O Lawrence, Charles A .Lindbergh, Henry Cabot Lodge, General John J. Pershing, Elihu Root, William Howard Taft, and others.

The current Board includes: Eric Ashby, Amory H. Bradford, Vannevar Bush, Michael Ference, Jr., Carl J. Gilbert, William T. Golden, Crawford H. Greenewalt, Caryl P. Haskins, Alfred L. Loomis, Robert A. Lovett, William McC. Martin, Jr., Keith S. McHugh, Henry S. Morgan, William I. Myers, Garrison Norton, Robert M. Pennoyer, Richard S. Perkins, William M. Roth, William W. Rubey, Frank Stanton, Charles P. Taft, Charles H. Townes, Juan T. Trippe, and James N. White.

In pursuit of its program, the Institution operates six facilities: a photosynthesis and experimental ecology laboratory on the campus of Stanford University in California; an embryology laboratory on the campus of Johns Hopkins University in Baltimore; two laboratories in Washington, D.C. specializing in geophysics, biophysics, and astrophysics; a genetics laboratory in Cold Spring Harbor, New York; and (jointly with California Institute of Technology) the world-famous Mount Wilson and Palomar astronomical observatories in California. The work and functions of the Institution parallel in many respects the work and functions of the Smithsonian Institution.

All of our departments cöoperate in the programs of a university or universities. One of the best known associations is that with the California Institute of Technology. The Institution and the Institute jointly manage the Mount Wilson

and Palomar Observatories, which offer the leading astronomical observing facilities in the world and for many years have been the world center for advanced training of astronomers. The Institution also has a photosynthesis and plant ecology laboratory on the campus of Stanford University, and an internationally leading laboratory of embryology on the campus of Johns Hopkins University, both important centers of graduate and postdoctoral training.

In order to devote its full energies to its research and educational activities, the Institution has never solicited support from the general public. It relies primarily on the income of its endowment most of which derives from gifts made by Mr. Carnegie in 1902 and 1910, before income tax laws came into effect. It accepts a limited number of grants from government agencies, principally from the National Science Foundation and NASA.

The professional staff at the six departments is composed of about 70 senior scientists, who conduct research of the most advanced kind. Although each department is of relatively small size, all enjoy worldwide recognition and esteem. Many of our scientists serve on university faculties, and the facilities are generally available to university faculty members. More than 100 visiting scientists, American and foreign, shared our laboratories and observatories last year.

Candidates for the Doctor of Philosophy degree at universities carry on their research in our laboratories under the supervision of Staff Members of the Institution, and the laboratories are accredited for this purpose. Sixty students worked at the Institution during 1968–1969. Even more important, about 55 younger scientists who have received their degrees work each year on postgraduate research as the colleagues of older and more experienced investigators in its laboratories and observatories. A striking illustration of the close relations between Fellows and Staff Members occurs at the Institution's Mount Wilson Observatory where approximately half of the observing nights on the telescopes are allocated to students and Fellows.

In some fields, as in embryology and astronomy, the Institution has provided a major world source of advanced investigators who go on to teaching or research posts from these fellowships. About 440 men and women have held fellowships at the Institution since 1952. Of these more than half now have professorships or other academic positions, and are considered leaders in their profession. Eighty have gone on to responsible positions in fundamental research, and 28 to industrial and other applied research.

During the fiscal years 1967–68 and 1968–69, about $4.8 million per year was spent for operations, 88 percent from endowment fund sources, for support of the staff, Fellows and students. We have reported publicly on our work in a report distributed throughout the world every year since 1902.

The Institution, I am proud to say, operates with a high degree of economy. Government salaries have long been our standard, and we never have exceeded them. Our ratio of technical assistants to Ph. D.'s in our laboratories is 1 to 1.9 and the ratio of *all* supporting staff, including even buildings and grounds, to Ph. D.'s is only 1.2 to 1. These ratios again are low. At the same time we make decisions on important new initiatives quickly—usually within a day or two.

For 67 years the Institution has contributed actively to the intellectual life of the country, particularly in the natural sciences. Many of the exciting astronomical discoveries that have totally changed man's concepts of the universe have come from Mount Wilson and Palomar, supported and managed by the Institution and the California Institute of Technology.

The Institution's program has always been devoted primarily to scientific fundamental research and highly specialized scientific instruction, but a number of its research results have been of great practical importance to the nation. Methods of hybridizing corn, which have meant billions of dollars to American farmers and industry, were first developed in our Department of Genetics in 1911. Other such discoveries include silicates for optical glass, refractories and high strength cements; and research on the ionosphere that led to long distance radio transmission. Our scientists have made valued contributions to the national defense, in their early work on radar, in the invention of the proximity fuse, in devices for night detection of aircraft, and in design of the atomic submarine. Its research has assisted medicine, as in improved methods of penicillin production, and in embryological investigations.

During the Second World War the Institution also was the source of many of the ablest scientists in the Office of Scientific Research and Development

(OSRD), of which the Director was Dr. Vannevar Bush, President of the Institution.

These contributions are continuing. Our Department of Terrestrial Magnetism has just reported the invention of an extraordinarily sensitive new instrument for measuring strain within the earth. It is so sensitive that it measures displacements one-thousandth the distance within an atom. We believe that we may have in this instrument a means of developing predictions of major earthquakes.

The Institution's research has always been self-generated. It has never accepted and does not now accept sponsored research, whether from a government agency or from a private corporation. However, the Institution has always been quick to expend its funds to meet national needs. For example, early pathfinding research on the proximity fuse and on the atomic bomb were initiated by its personnel and supported by it.

In sum, the Carnegie Institution is an operating organization engaged in fundamental research that also makes important contributions to advanced education and scientific training. Some of its operations are integrated with university facilities. Many of its staff serve on university faculties, and its facilities are generally available to university faculty members. A number of graduate students do their theses in its laboratories under supervision of its staff; and a substantial number of young scientists with advanced degrees are each year resident in the laboratories and receive the most advanced training available in their fields. There is little difference between the operations of the Institution and those of the research institutes or graduate departments of many universities.

Unfortunately, however, the proposals in H.R. 13270, as we read them, may be construed to place the Institution in a category different from that of the universities and thus have a crippling effect upon its operations.

The tax proposals which would severely and adversely affect the operation of the Institution's research facilities and educational program are the provisions that would (1) reduce by 7½ per cent the investment income on which the Institution depends; (2) disqualify it as a recipient of support from grant-making foundations; (3) exclude it from the category of 30 per cent organizations for purposes of charitable contribution deductions by individuals; and (4) make it virtually ineligible as a donee of appreciated securities.

These provisions would apply to the Institution because, under the proposed definitions, it may not fall, as it should, in the category of "educational organization" except from the category of "private foundation" and would probably be treated under the proposed law (notwithstanding the fact that it is in every sense an operating research and educational institution) as a "non-operating private foundation." This is true for the following reasons: (1) The value of the Institution's endowment, the income from which is essential to its operations and is wholly expended therefor, is considerably more than the value of its laboratory buildings, equipment, and other physical assets. (2) The Institution does not receive a substantial part of support either from the government or the general public.

The most serious damage to the Institution's program caused by the proposed legislation would be (1) reduction of its total program caused by payment of federal taxes coupled with (2) doubt as to its eligibility to receive fully deductible contributions from individuals or grants from other foundations. These provisions would force curtailment or even abandonment of parts of a program that has prepared many national leaders of research and teaching, past and present, in astronomy, embryology, plant biology, geophysics, and genetics. They could very well force abandonment of a major new astronomical observatory, of the Palomar class, which we have just begun in South America.

We respectfully urge that provision be made so that the Carnegie Institution and similar organizations will be specifically retained in the exempt category of "public" and "operating" institution. This result can best be accomplished by defining an "educational organization" exempt from classification as a private foundation to include not only schools, colleges, and universities, but also an "organization primarily engaged in fundamental research (or an organization of the kind described in Section 512(b)(9)) that operates laboratories and other facilities for such research, and provides related instruction to individuals who are candidates for degrees at colleges or universities and postdoctoral training to individuals who are not candidates for degrees."

If such provision is made, as I most earnestly hope it will be, the Institution will be enabled to continue its 67-year old program; to make important basic research contributions, to prepare university teachers, and to give foreign scientists as opportunity to understand us by working with us.

Articles of Incorporation

[*Public No. 260. An Act to incorporate the Carnegie Institution of Washington*]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the persons following, being persons who are now trustees of the Carnegie Institution, namely, Alexander Agassiz, John S. Billings, John L. Cadwalader, Cleveland H. Dodge, William N. Frew, Lyman J. Gage, Daniel C. Gilman, John Hay, Henry L. Higginson, William Wirt Howe, Charles L. Hutchinson, Samuel P. Langley, William Lindsay, Seth Low, Wayne MacVeagh, Darius O. Mills, S. Weir Mitchell, William W. Morrow, Ethan A. Hitchcock, Elihu Root, John C. Spooner, Andrew D. White, Charles D. Walcott, Carroll D. Wright, their associates and successors, duly chosen, are hereby incorporated and declared to be a body corporated by the name of the Carnegie Institution of Washington and by that name shall be known and have perpetual succession, with the powers, limitations, and restrictions herein contained.

Sec. 2. That the objects of the corporation shall be to encourage, in the broadest and most liberal manner, investigation, research, and discovery, and the application of knowledge to the improvement of mankind; and in particular—

(*a*) To conduct, endow, and assist investigation in any department of science, literature, or art, and to this end to cooperate with governments, universities, colleges, technical schools, learned societies, and individuals.

(*b*) To appoint committees of experts to direct special lines of research.

(*c*) To publish and distribute documents.

(*d*) To conduct lectures, hold meetings, and acquire and maintain a library.

(*e*) To purchase such property, real or personal, and construct such building or buildings as may be necessary to carry on the work of the corporation.

(*f*) In general, to do and perform all things necessary to promote the objects of the institution, with full power, however, to the trustees hereinafter appointed and their successors from time to time to modify the conditions and regulations under which the work shall be carried on, so as to secure the application of the funds in the manner best adapted to the conditions of the time, provided that the objects of the corporation shall be all times be among the foregoing or kindred thereto.

Sec. 3. That the direction and management of the affairs of the corporation and the control and disposal of its property and funds shall be vested in a board of trustees, twenty-two in number, to be composed of the following individuals: Alexander Agassiz, John S. Billings, John L. Cadwalader, Cleveland H. Dodge, William N. Frew, Lyman J. Gage, Daniel C. Gilman, John Hay, Henry L. Higginson, William Wirt Howe, Charles L. Hutchinson, *Samuel P. Langley*, William Lindsay, Seth Low, Wayne MacVeagh, Darius O. Mills, S. Weir Mitchell, William W. Morrow, *Ethan A. Hitchcock*, Elihu Root, John C. Spooner, Andrew D. White, Charles D. Walcott, Carroll D. Wright, who shall constitute the first board of trustees. The board of trustees shall have power from time to time to increase its membership to not more than twenty-seven members. Vacancies occasioned by death, resignation, or otherwise shall be filled by the remaining trustees in such manner as the by-laws shall prescribe; and the persons so elected shall thereupon become trustees and also members of the said corporation. The principal place of business of the said corporation shall be the city of Washington, in the District of Columbia.

Sec. 4. That such board of trustees shall be entitled to take, hold, and administer the securities, funds, and property so transferred by said Andrew Carnegie to the trustees of the Carnegie Institution and such other funds or property as may at any time be given, devised, or bequeathed to them, or to such corporation, for the purposes of the trust; and with full power from time to time to adopt a common seal, to appoint such officers, members of the board of trustees or otherwise, and such employees as may be deemed necessary in carrying on the business of the corporation, at such salaries or with such remuneration as they may deem proper; and with full power to adopt by-laws from time to time and such rules or regulations as may be necessary to secure the safe and convenient transaction of the business of the corporation; and with full power and discretion to deal with and expend the income of the corporation in such manner as in their judgment will best promote the objects herein set forth and in general to have and use all powers and authority necessary to promote such objects and carry out the purposes of the donor. The said trustees shall have further power from time to time to hold as investments the securities hereinabove referred to so transferred

by Andrew Carnegie, and any property which has been or may be transferred to them or such corporation by Andrew Carnegie or by any other person, persons, or corporation, and to invest any sums or amounts from time to time in such securities and such form and manner as are permitted to trustees or to charitable or literary corporations for investment, according to the laws of the States of New York, Pennsylvania, or Massachusetts, or in such securities as are authorized for investment by the said deed of trust so executed by Andrew Carnegie, or by any deed of gift or last will and testament to be hereafter made or executed.

Sec. 5. That the said corportion may take and hold any additional donations, grants, devises, or bequests which may be made in further support of the purposes of the said corporation, and may include in the expenses thereof the personal expenses which the trustees may incur in attending meetings or otherwise in carrying out the business of the trust, but the services of the trustees as such shall be gratuitous.

Sec. 6. That as soon as may be possible after the passage of this Act a meeting of the trustees hereinbefore named shall be called by Daniel C. Gilman, John S. Billings, Charles D. Walcott, S. Weir Mitchell, John Hay, Elihu Root, and Carroll D. Wright, or any four of them, at the city of Washington, in the District of Columbia, by notice served in person or by mail addressed to each trustee at his place of residence; and the said trustees, or a majority thereof, being assembled, shall organize and proceed to adopt by-laws, to elect officers and appoint committees, and generally to organize the said corporation; and said trustees herein named, on behalf of the corporation hereby incorporated, shall thereupon receive, take over, and enter into possession, custody, and management of all property, real or personal, of the corporation heretofore known as the Carnegie Institution, incorporated, as hereinbefore set forth under "An Act to establish a Code of Law for the District of Columbia, January fourth, nineteen hundred and two," and to all its rights, contracts, claims and property of any kind or nature; and the several officers of such corporation, or any other person having charge of any of the securities, funds, real or personal, books, or property thereof, shall, on demand, deliver the same to the said trustees appointed by this Act or to the persons appointed by them to receive the same; and the trustees of the existing corporation and the trustees herein named shall and may take such other steps as shall be necessary to carry out the purposes of this Act.

Sec. 7. That the rights of the creditors of the said existing corporation known as the Carnegie Institution shall not in any manner be impaired by the passage of this Act, or the transfer of the property hereinbefore mentioned, nor shall any liability or obligation for the payment of any sums due or to become due, or any claim or demand, in any manner or for any cause existing against the said existing corporation, be released or impaired; but such corporation hereby incorporated is declared to succeed to the obligations and liabilities and to be held liable to pay and discharge all of the debts, liabilities, and contracts of the said corporation so existing to the same effect as if such new corporation had itself incurred the obligation or lability to pay such debt or damages, and no such action or proceeding before any court or tribunal shall be deemed to have abated or been discontinued be reason of the passage of this Act.

Sec. 8. That Congress may from time to time alter, repeal, or modify this Act of incorporation, but no contract or individual right made or acquired shall thereby be divested or impaired.

Sec. 9. That this Act shall take effect immediately.

Approved, April 28, 1904.

CENTER FOR ADVANCED STUDY IN THE BEHAVIORAL SCIENCES,
Stanford, Calif., September 5, 1969.

HON. RUSSELL B. LONG,
Chairman, Finance Committee,
The Senate, Washington, D.C.

DEAR SENATOR LONG: I am writing in my capacity as Director of the Center for Advanced Study in the Behavioral Sciences, a postdoctoral educational institution providing for the further development and advancement of scholars who have completed their formal university training and who have distinguished themselves by their work in the field of behavioral sciences. I write because of our concern about certain potentially adverse effects which H.R. 13270, the tax reform bill which your Committee is now reviewing, might have upon an organization such as ours.

Some of the points in this letter will be touched upon in the testimony which I and representatives of certain other organizations expect to present before your Committee on Wednesday, September 10, 1969. I think it may be helpful to your Committee also to have this fuller statement of the Center's views.

Our concern lies not in certain restrictions which the bill seeks to impose on "private foundations," such as restrictions on self-dealing, excessive business holdings, and investments which jeopardize the organization's purposes. Instead. I am concerned about provisions in the bill which might be interpreted so as to jeopardize the support for, and hence the ability of, the Center to carry out its mission, a mission which I believe is clearly in the best interest of scholarship and education in this country.

From a review of the bill passed by the House of Representatives and the report of the House Ways and Means Committee, I believe that the Center, as a postdoctoral educational organization, should not be classified under Section 509 as a "private foundation." Moreover, even if the Center were so classified, it is the kind of an institution which, according to the House Committee report (p. 41), should be eligible, as an "operating foundation," to receive qualifying distributions from other foundations.

I am troubled, however, by some of the rigid standards and inflexible criteria in the bill which might permit, contrary to what I believe to be the Congressional intent, a different classification, thereby damaging the ability of the Center to raise the support it vitally needs if it is to carry out its purposes.

More specifically, my concern is that if the House bill were enacted in substantially its present form, it might be possible for enforcing authorities to conclude that the Center is not an educational organization exempted from the "private foundation" category by Section 509(a)(1) and further that the Center, because its sources and levels of support vary from year to year, has not met the rigid fiscal criteria needed to qualify as an "operating foundation." The end result of such classifications would be that other foundations could not make "qualifying distributions" to the Center, which count toward satisfaction of the foundation's obligation to distribute income. Accordingly, the foundations probably would be reluctant to make grants to organizations like ours. For an educational institution like the Center, which from its inception has been dependent on support from private foundations (and recently on government grants and fellowships as well), such a result could endanger not only our future growth, but also our very existence.

Such an impediment to obtaining further support would be particularly damaging to relatively young, innovating organizations like the Center. The Center has been, in the 15 years of its existence, a leader in the field of postdoctoral education. It began with an idea for an experiment in higher education—now an established aspect of higher education. As is often the case, such experiments initially depend on foundation support—and that has certainly been the history of the Center. Now that its concept has been proven, the Trustees of the Center have decided that it would be in the best long-term interests of education in this country to seek to endow the life of the Center, rather than to rely on tentative annual funding. This effort to achieve stability and permanence could be thwarted, unjustifiably in my view, by the impediments which the House bill might place on potential sources of support.

With your indulgence, I would like to review the activities of the Center in hopes that the substantive purposes and operating procedures of organizations like ours, rather than the rigid standards and inflexible criteria found in H.R. 13270, would be utilized more fully to determine the impact of any tax reform legislation which may be enacted. I would also urge that the Committee review, in light of the description which follows, the scope to be given the term "educational organizations" (in Section 170(b)(1)(B)(ii)), which are excluded from the category of "private foundations" by Section 509(a)(1). I urge this review primarily because there have been substantial advances in educational theory and practice since that definition was first adopted in 1954, particularly at the postdoctoral level of education which was in its infancy at that time.

The Board of Trustees of the Center for Advanced Study in the Behavioral Sciences holds in its trust and is responsible for the operation of an educational institution which was established to provide for the further development and maturity of distinguished scholars who had already completed all the formal work provided by our universities and who, by their additions to knowledge, were regarded as among the best students of the Behavioral Science world. The Center,

one of the few institutions in this country offering formal in-residence postdoctoral education, combines for scholars in the social sciences, psychology, philosophy, the humanities and biology, opportunities to increase their competency, broaden their perspectives, and to expand man's knowledge of human behavior.

Some of the special characteristics of the Center as a postdoctoral educational institution are:

The gathering in one place of leading scholars in varying disciplines fundamental to behavioral sciences.

The opportunity for interdisciplinary exchange and study in seminars, working groups and joint explorations, with each scholar drawing new knowledge and understanding from other disciplines.

The freedom for scholars alone or with others to explore a given field or subject in depth.

The chance for a scholar to engage in research, writing or self-examination, to reassess his goals and priorities, to test his hypotheses, to engage in original scholarship with new insights provided by scholars in other disciplines.

The opportunity to receive formal instruction in highly specialized areas.

Like other educational institutions with very high standards, the Center exercises extreme care in the selection of the Fellows who comprise its student body. The process involves two basic stages: determination of a candidate's eligibility, and selection of each year's roster of Fellows.

Eligibility: Judgments concerning all candidates nominated for Fellowships are based upon information provided by the candidate's references, confidential panels of leading scholars in the candidate's field and, at times, interviews with some of the Center's Trustees. Because of the importance attached to this process, selections, which are made solely by the Trustees after long periods of review, are based upon the following criteria: (1) *interest* in developing more adequate knowledge of human behavior, (2) *intellectual competence*, (3) *knowledge* of significant work in his discipline, and (4) *promise* as a productive scholar.

Selection of each year's roster: The determination of each year's roster is normally completed 1 year in advance, based upon the candidate's preferences and upon other criteria designed to insure an appropriate distribution among disciplines, institutions, nationalities and age levels. Since each scholar is an essential part of the environment for the others, great care is exercised in the selection process to insure the creation of an exciting and stimulating intellectual environment.

I am attaching a table showing the distribution of Fellowships by field of study, and by country or state of origin. The evaluation of the period of study at the Center by the Fellows themselves is very high. In the interest of brevity, I have not included a list of the Fellows or their reports on their year at the Center, but they are available should you or your staff desire to review them.

The products of the Center, also characteristic of leading educational institutions, include: the enhanced quality and competence of the scholars; new or more sharply defined goals and perspectives; impressive additions to the literature and to man's knowledge in the behavior sciences.

Much of the value of the Center is to be found in the changed perspective and the increased vitality of the scholars themselves, but it may help to appreciate the value of the Center if your Committee were to have available some concrete evidence of the product of the research which takes place here at the Center. I am, therefore, attaching a list of books which have been attributed by their authors to the influence of the Center and to the period of time which they spent here as Fellows. These 18 pages of bibliography do not include any of the articles, published in professional journals here and abroad, which would number in the thousands.*

While there may have been little understanding of the concept of postdoctoral education and the Center 15 years ago, the concept is clearly established today and the status of the Center as a postdoctoral educational institution is well recognized. It is regarded as such by most colleges and universities and has been referred to as such by Presidential Committees and Federal agencies. The

*The list referred to was made a part of the official files of the committee.

Center is, in fact, supported as an organization providing opportunities for postdoctoral education and research, both directly and indirectly, by the Office of Education, the National Science Foundation and the National Institutes of Mental Health. This support includes both grants made directly to the Center and scholarships provided to the Fellows.

As early as 1960, the President's Science Advisory Committee referred to postdoctoral education as a "new and growing form of higher education." The following quotation from Dr. Ernest R. Hilgard, Chairman of the Behavioral and Social Science Survey Committee, which was created in 1968 to advise the National Research Council and the Social Science Research Council on the support needed for the behavioral sciences, may help to appraise postdoctoral education generally, as well as the stature of the Center.

Postdoctoral training is coming to be expected in the physical and biological sciences as a matter of course, and only more slowly so in psychology and the social sciences. In some parts of Europe and Asia there is a special kind of degree or diploma issued on the basis of advanced scholarship, after formal graduate-school training is completed. We may be coming to that in this country. The many "specialty-boards" in medicine are being duplicated now in psychology; this is a straw in the wind. Apart from formalities, there is no doubt that the Center *is* a postdoctoral educational institution, contributing to the understanding of advanced scholars, and through them modifying the course of training in our universities.

As might be expected, however, postdoctoral education for distinguished scholars differs significantly in form and content from formal education at lower levels of attainment. It is here that the scope to be given the term "educational organization" contained in H.R. 13270 may come into question. For example, that definition (Section 170(b)(1)(B)(ii)) calls for a "regular faculty and curriculum."

The Center has a regular faculty but one whose characteristics differ substantially from an undergraduate faculty. The Center has a few paid staff members providing formal instruction in specialized areas (mathematics, computer science, languages), but the bulk of the faculty is, in keeping with advanced concepts of postdoctoral education, drawn from the ranks of the noted scholars in residence at the Center. In seminars, working groups and joint explorations, one scholar—by definition a teacher as well—will teach his colleagues. At other times, he will be a student of his colleagues. Thus, the very nature of postdoctoral education requires a departure from the particular concept of a regular faculty employed at lower educational levels.

Similarly, in keeping with modern concepts of advanced education, the Center's curriculum differs in character from that found at the undergraduate level. While the Center offers formal instruction in certain specialized areas and draws on the curriculum of leading colleges and universities located nearby, a major part of the Center's educational program does not involve a curriculum similar to that found at lower levels. Instead, the scholars themselves—interacting, studying in seminars, working groups, joint explorations, or alone—chart in substantial part, the course of their educational enrichment and exploration. This widely accepted concept of a regular curriculum in postdoctoral education might be though by some to be inconsistent with the meaning of the phrase "regular curriculum" as it was adopted in 1954 with reference to education at lower levels of attainment.

We believe that the Center for Advanced Study in the Behavioral Sciences is in fact, an educational institution. We believe that the provisions of H.R. 13270 might work a hardship on our program and might make it impossible for us to continue. We believe that the loss of the Center for Advanced Study as a resource for postdoctoral work in the behavioral sciences would be a serious loss to scholarship in the United States and to the understanding of human behavior among the scholars of the world at large.

We would hope that in light of the significance of this matter to the future course of education, it could receive the consideration of your Committee. We would recommend that the Committee consider, should it decide to report favorably on legislation similar to H.R. 13270, either confirming in the Committee's report that organizations like the Center fall within the scope of the term "educational organizations" in Section 170(b)(1)(B)(ii) or amending that definition of an "educational organization" so as to make it expressly clear that

it includes organizations such as ours which normally maintain a regular program for the postdoctoral education of scholars.

We would be pleased, of course, to assist the Committee or its staff should any further information or materials be needed.

Very truly yours,

O. MEREDITH WILSON,
Director.

[Enclosures]

CENTER FOR ADVANCED STUDY IN THE BEHAVIORAL SCIENCES

O. Meredith Wilson, Director.—Born in Mexico, September 21, 1909; Ph.D. in History at the University of California, 1943; Associate Dean of the College, University of Chicago, 1946–47; Professor of History and Dean, University of Utah, 1947–52; Secretary, Fund for the Advancement of Education, 1952–54; President, University of Oregon, 1954–60; President, University of Minnesota, 1960–67.

BOARD OF TRUSTEES

Logan Wilson, Chairman.—President, American Council on Education; born Huntsville, Texas, March 6, 1907; Ph.D. in sociology at Harvard University, 1939; Professor and Head of Sociology Department, Tulane University, 1941–43; Dean of Newcomb College of Tulane, 1944–51; Academic Vice President of the Consolidated Universities of North Carolina, 1951–53; Chancellor, University of Texas, 1953–61; author of *The Academic Man, Sociological Analysis.*

William G. Bowen.—Provost and Professor of Economics and Public Affairs, Princeton University; born Cincinnati, Ohio, October 8, 1933; A. B. Denison University, 1955; Ph.D. in Economics, Princeton University, 1958; author of *The Wage-Price Issue; Performing Arts: The Economic Dilemma; The Economics of Labor Force Participation;* and other studies in the fields of education and labor economics.

Donald C. Cook.—President, American Electric Power Service Corp.; born Escanaba, Michigan, April 14, 1909; J. D., George Washington University, 1939; Special Counsel U.S. House of Representatives Committee on Naval Affairs, 1943–45; Executive Assistant to U.S. Attorney General, 1945–46; Director, Office of Alien Property, 1946–47; Commissioner of the U.S. Securities and Exchange Commission, 1949–53.

Caryl P. Haskins.—President, Carnegie Institution of Washington; born Schenectady, N.Y., August 12, 1908; Ph.D. in biology at Harvard University, 1935; President and Research Director of Haskins Laboratories, 1935–55; member, President's Scientific Advisory Committee; author of *The Amazon, Of Ants and Men*, etc.

Edwin E. Huddleson, Jr.—Partner, Cooley, Crowley, Gaither, Godward, Castro and Huddleson; born Oakland, California, January 28, 1914; LL.B., Harvard Law School; trustee of the RAND Corporation, the Mitre Corporation, System Development Corporation, Aerospace Corporation.

Robert K. Merton.—Department of Sociology, Columbia University; born Philadelphia, Pennsylvania, July 5, 1910; Ph.D. in sociology at Harvard University, 1936; author of *Social Theory and Social Structure, Mass Persuasion*, and other studies in social theory, mass communications and the sociology of professions.

Robert R. Sears.—Professor of Psychology and Dean of the School of Humanities and Sciences, Stanford University; born Palo Alto, California, August 31, 1908; Ph.D. in psychology at Yale University, 1932; Director of Child Welfare Station at the University of Iowa, 1942–49; Director of the Laboratory of Human Development at Harvard University, 1949–53; Chairman, Department of Psychology, Stanford University, 1953–61; author of studies on child development and on personality.

Frank Stanton.—President of Columbia Broadcasting System; born Muskegon, Michigan, March 20, 1908; Ph.D. in psychology at Ohio State University, 1935; author of studies in communication and audience responses to mass media.

Ralph W. Tyler.—Director Emeritus of the Center for Advanced Study in the Behavioral Sciences; born Chicago, Illinois, April 22, 1902; A.B., Doane College, 1921; A.M., University of Nebraska, 1923; Ph.D., University of Chicago, 1927; Chairman Department of Education and University Examiner, University of Chicago, 1938–53 and Dean of Division of Social Sciences, 1948–53; Director, Center for Advanced Study in the Behavioral Sciences, Stanford, California, 1953–67.

CENTER FOR ADVANCED STUDY IN THE BEHAVIORAL SCIENCES—DISTRIBUTION OF FELLOWSHIPS, BY FIELDS, 1954-55 THROUGH 1968-69

	Number	Percent		Number	Percent
Anthropology	81	12	Miscellaneous	7	1
Biology	18	3	Philosophy	34	5
Economics	53	8	Political science	73	11
Education	20	3	Psychiatry	29	4
History	58	8	Psychology	127	19
Humanities	26	4	Sociology	81	12
Law	25	4			
Linguistics	26	4	Total	672	100
Mathematics-statistics	14	2			

CENTER FOR ADVANCED STUDY IN THE BEHAVIORAL SCIENCES, DISTRIBUTION OF FELLOWS BY STATE AND COUNTRY, 1954-55 TO 1968-69

Country	Number of institutions	Number of fellows	Country	Number of institutions	Number of fellows
United States:			United States—Continued		
Arizona	1	1	Washington, D.C.	5	10
California	14	105	Wisconsin	2	14
Colorado	1	1			
Connecticut	3	39	Subtotal	100	562
Georgia	1	1			
Illinois	4	69	Austria	1	1
Indiana	2	7	France	4	5
Iowa	3	6	Germany	5	5
Kansas	3	3	India	4	4
Louisiana	1	2	Indonesia	1	1
Maine	1	1	Israel	1	4
Maryland	2	6	Italy	2	2
Massachusetts	6	76	Japan	4	4
Michigan	4	42	Mexico	1	1
Minnesota	1	10	Netherlands	4	6
Missouri	2	6	Norway	4	5
Nebraska	1	1	Poland	3	4
New Hampshire	1	4	Portugal	1	1
New Jersey	3	18	Romania	1	1
New York	15	75	South Africa	1	1
North Carolina	2	11	Sweden	2	4
Ohio	2	4	United Kingdom:		
Oklahoma	1	1	Australia	4	4
Oregon	4	9	Canada	5	7
Pennsylvania	7	22	England	11	46
Rhode Island	1	1	Scotland	3	3
Tennessee	2	2	Yugoslavia	1	1
Texas	2	7			
Vermont	1	1	Subtotal	63	110
Virginia	1	3			
Washington	1	4	Grand total	163	672

BEHAVIORAL AND SOCIAL SCIENCES SURVEY COMMITTEE,
Washington, D.C., August 18, 1969.

Dr. O. MEREDITH WILSON,
Director, Center for Advanced Study in the Behavioral Sciences
Stanford, Calif.

DEAR DR. WILSON: Because of my services as a consultant to the Behavioral Sciences Division of the Ford Foundation in the days when the Center was under discussion, and because of my residence in Stanford ever since the opening, I have been in an unusually good position to watch its development and to assess how well it has served the purposes for which it was established. I had one year there myself—in 1956–1957—so that I saw it from the inside as well.

As this letter indicates, I have currently been involved in a study of the status of the behavioral and social sciences on a national basis, under the joint auspices of the National Academy of Sciences and the Social Science Research Council. This gives me some added perspective from which to view the work of the Center, for the fields we have chosen to explore (anthropology, economics, geography, history, linquistics, political science, psychiatry, psychology, sociology, and aspects

of mathematics-statistics-computation) have all been within the range of fellow-selection by the Center.

I can present one "statistic" to show how influential the Center has become in creating a body of behavioral and social scientists concerned with the broader aspects of their disciplines in their relation to each other. We set out to find the best representatives that we could of each of the specialties named above, by consulting the officers of the national professional associations, representatives in the National Research Council, Division of Behavioral Science, and in the Social Science Research Council. In this way we appointed a group of chairmen and co-chairmen for the separate panels, and had them nominate members for their committees to be as widely representative as possible of the range of their disciplines, chiefly of energetic and productive men at the height of their careers rather than the established senior citizens.

The result was that we came up with 76 members of our committees and panels responsible for the reports soon to appear. The "statistic" to which I refer is that a recent check shows that 33 of these 76, or 43 percent, had been Fellows at the Center for Advanced Study in the Behavioral Sciences. There was no deliberate effort to select Fellows; in the effort to achieve diversity it was quite possible that Fellows might have been sidestepped. In any case, I find this a fitting testimony as to what the Center has done in selecting promising men, and in motivating then to accept appointment in serving their professions and society at large through nonremunerated activity such as that of our survey.

If there is one theme central to the report that we are preparing from our survey, it is that the behavioral and social sciences are now at the stage that their data and methods can be made increasingly pertinent to the social crises of our day. This who have participated widely in the interdisciplinary discussions at the Center have been prepared to see the limitations that are imposed by an exclusive preoccupation with disciplinary specialization, and they have been helpful in working out suggestions for new forms of organization that will permit work to go on at a high scientific level while at the same time meeting new standards of potential relevance.

If there is any criticism I would have of the Center it is that with but 50 Fellows per year it cannot possibly meet the needs of the very rapidly growing fields that it serves. It has been so successful, in my mind, that it ought to be duplicated elsewhere. I have been pleased to learn, for example, of a grant of $400,000 from the National Science Foundation to establish a facility for advanced study in social science at the Institute for Advanced Study at Princeton. The readiness for such a new facility is a tribute to the influence of your Center in the past.

Postdoctoral training is coming to be expected in the physical and biological sciences as a matter of course, and only more slowly so in psychology and the social sciences. In some parts of Europe and Asia there is a special kind of degree or diploma issued on the basis of advanced scholarship, after formal graduate-school training is completed. We may be coming to that in this country. The many "specialty-boards" in medicine are being duplicated now in psychology; this is a straw in the wind. Apart from formalities, there is no doubt that the Center *is* a postdoctoral educational institution, contributing to the understanding of advanced scholars, and through them modifying the course of training in our universities.

Sincerely yours,

ERNEST R. HILGARD,
Chairman, Behavioral and Social Sciences Survey Committee.

STATEMENT OF CARL KAYSEN, DIRECTOR OF INSTITUTE FOR ADVANCED STUDY

The Institute for Advanced Study is devoted to the encouragement, support and patronage of learning—of science, in the old, broad, undifferentiated sense of the word. The Institute partakes of the character both of a university and of a research institute; but it also differs in significant ways from both. It is unlike a university, for instance, in its small size—its academic membership at any one time numbers only about one hundred fifty. It is unlike a university in that it has no scheduled courses of instruction and no commitment that all or most branches of learning be represented in its Faculty and members. It is unlike a research institute in that its purposes are broader, that it supports many separate

fields of study, that it maintains no laboratories; and above all in that it welcomes temporary members, whose intellectual development and growth are one of its principal purposes. The Institute, in short, is devoted to learning, in the double sense of the continued education of the individual, and of the intellectual enterprise on which he is embarked.

The Institute was founded in 1930 by gift of Louis Bamberger and his sister, Mrs. Felix Fuld. The further financial basis for its development and growth was provided by a substantial legacy from the founders. Mr. Bamberger and Mrs. Fuld were greatly influenced in their conception of what the Institute should be by the ideas of Abraham Flexner, its first Director. Flexner, who had earlier led the reform of medical education in the United States, was then at the Rockefeller Institute (now Rockefeller University) which he had helped to create. He was concerned that American universities at the time did not provide adequately for the pursuit of science and learning at the highest levels. Americans who wanted to be trained in that pursuit had to go to Europe for training, and most of the leading figures in science and scholarship were to be found abroad in Germany, France, and England. It was Flexner's purpose to bring the possibility of leadership in many of these fields to this country; and the gifts of Mr. Bamberger and Mrs. Fuld gave effect to it. I think the record of the Institute will show that their hopes were realized and, having been Director only a short time, I think I can say that in all modesty.

At present the academic work of the Institute is carried on in three schools: a School of Mathematics, a School of Natural Sciences, and a School of Historical Studies. The members of the School of Mathematics are for the most part pure mathematicians, and the members of the School of Natural Sciences theoretical physicists, astrophysicists, and astronomers; but there have been members in both these Schools who have worked in other sciences—chemistry, biology, and psychology, for example. The School of Historical Studies is broader still in scope, and includes in principle all learning for which the use of the historical method is a chief instrument. Here, too, our work tends to reflect the interests of the Faculty: Greek archaeology and epigraphy, Greek philosophy and philology, Roman history, palaeography, medieval history and the history of art, modern history, the history of mathematics and the sciences. Here again there have been members, working alone or in concert, in disciplines not represented on the Faculty.

In these three Schools together, the Institute has twenty-three professors (not counting the Director) who constitute its present Faculty: 9 in mathematics, 5 in physics, and 9 in historical studies.

For the three year period beginning with the academic year 1968–69, the Institute is broadening its range by the addition of a small experimental program in the social sciences. This will involve bringing together for each of the three years six to eight scholars who are using the methods and perspectives of the social sciences in the study of history, especially the study of social change. The visitors under this program will be drawn from a variety of disciplines, including history, sociology, anthropology, economics, political science and psychology. The program aims at providing the stimulation of discussion of common perspectives by scholars working on a variety of problems, not an integrated team or project approach. This program is being financed by a grant from the Carnegie Corporation and the Russell Sage Foundation.

A principal function of the Institute is to provide for members who come here for short periods, for a term or a year or, in the Schools of Mathematics and Natural Sciences, occasionally for two years. There are currently some hundred twenty such members in residence. Admission to membership is by vote of the Faculty concerned. Perhaps a half or two-thirds of our members are invited by us because we know or learn of their work, and believe that a time here would be fruitful for them, for their work, and for that of other members; other members are selected from the many applicants who write to us outlining the state of their researches and their reasons for desiring to come. Inevitably there is a real competition for memberships, since both the physical limitation of the institution, and the desire to preserve a community small enough to be a true community, limit the number of members admissable.

Of the visiting members more than half are young men and women within a few years of their doctorate. The work they do at the Institute contains a high element of postdoctoral training as opposed to research. In Mathematics and Natural Sciences postdoctoral training is widely recognized as a regular part

of the process of preparation for those who are entering the academic and research profession. The work of the balance of the members, who are for the most part already well established academically, can correspondingly be viewed as having a larger element of research and a smaller one of training although of course any scholar is engaged in the process of learning throughout his whole life.

The work product of the Institute is therefore of two kinds: the research that is produced by its permanent faculty and the visiting members, and the training that the visiting members receive. In both respects the work of the Institute, though small in volume, is of significant importance because of its quality, and because its visitors come to it from, and return to, the leading institutions of higher education and research in this country and indeed, to a great extent, in the rest of the world as well.

Some flavor of its past activities can be conveyed by mentioning the names of a few of its professors and the subjects in which they have been active. In mathematics. Marston Morse and Hassler Whitney, recognized as among the leading American mathematicians, are both professors in the Institute. Amongst Europeans who have come to this country and become a permanent part of its mathematical community, many have been at the Institute, including notably, Herman Weyl at an earlier period and André Weil and Atle Selberg today. The late John von Neuann was professor of mathematics at the Institute, and he was distinguished not only for his important papers in a great many different branches of mathematics but also for his fundamental contribution to the invention of the electronic computing machine, his work on long range weather forecasting, and his important services to the national defense. The 1968 Report of the National Academy of Sciences on the Mathematical Sciences describes the Institute as "a world center of mathematical research."

In physics, of course, the name of Albert Einstein, who was professor here from the foundation of the Institute, springs first to mind. C. N. Yang and T. D. Lee were working at the Institute when they did the work for which they received the Nobel Prize. In the '50s, the Institute shared with Niels Bohr's Institute of Theoretical Physics in Copenhagen the position of the world's leading center of theoretical nuclear physics. Today the Institute counts among its faculty members in physics Professors Freeman Dyson, the recipient of this year's Max Planck Medal and one of the world's leading mathematical physicists, and Marshall Rosenbluth, America's leading contributor to the understanding of plasmas. Rosenbluth was the recipient of the Einstein Award in 1967.

In the historical fields, amongst many distinguished men, one can mention the late Erwin Panofsky, this generation's most erudite and influential historian of art, and Homer Thompson whose work as the supervisor of excavations in the Athenian Agora for a generation has been a major factor in increasing our knowledge and understanding of classical Greece.

The Institute relies primarily on its own resources for the financing of its operation and in the last academic year more than three-quarters of its receipts came from the return on its own investments (including realized capital gains), somewhat less than 20% from grants and contracts from govenment agencies, and 5% from grants from private foundations and other private organizations. Thus, if we are not an educational institution under the proposed new law, we become a private foundation, and we would not qualify as an operating foundation.

The language which defines an educational institution for the purposes of the Act, Section 201(a) (1) (B) (ii), speaks of an organization "which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at a place where its educational activities are regularly carried on." While we can clearly meet the tests of having a regular faculty and a regularly enrolled body of students in attendance at the Institute, I am less ready to assert that we can clearly meet the requirement of maintaining a regular curriculum, since the essence of our enterprise is the guided self-education of the members, even the youngest of whom have already had considerable academic training, along lines based on their past activities and present interests.

The status of "private foundation" under the proposed statute would present the Institute with two serious problems. First, of course, would be the direct impact of the proposed tax. Had the provisions of the House Bill been applied to us in our last fiscal year, ending June 30, 1969, we would have had to pay

nearly $250,000 in taxes. This is a large sum, and equals a quarter of what we spent on grants and stipends for visitors in that year. It is clear that taxation at such a rate would force a significant curtailment of our activity. Second, and even more important, would be the effect on our relations with the major grant-making foundations. Since the Bill would create doubt as to whether we were in fact an educational institution, these foundations would be properly hesitant in making grants to us since such grants might not be "qualifying distributions" under the Bill. As a consequence, our ability to initiate new programs or to continue and expand the one we have just initiated would be severely handicapped if not completely ended. The new program in the social sciences about which I spoke above was initiated on an experimental basis with grants from the Carnegie Corporation and the Russell Sage Foundation. The first step toward putting it on a long-run basis has been a grant from the Ford Foundation, conditional on a somewhat greater matching effort from other private sources. This example is not untypical in that grants from the larger private foundations have played a significant role in making possible new ventures in enterprises such as the Institute as well as in the univeristies and colleges. The combined effect of both these restrictions—the diminution in the availability of our own resources to support our programs, and the inhibition of foundation support—would be to curtail our existing program seriously, and impair our capacity for growth even more seriously.

The experience of nearly 40 years has shown that the idea of the Institute has been a useful and beneficial one and that the Institute fills an important place in the whole stream of American higher education. In the fields in which we have been most active in the past—mathematics, theoretical physics, and astrophysics, classical archaeology, classical and medieval history, the history of art are the most important—the Institute has played an important role in the development of the ideas and research interests of a significant proportion of the best men in the faculties of American universities. It has further had an important function as an international meeting place in which Americans and Europeans exchanged ideas and kept abreast of each other's work in these same fields. It is my hope that in the future it can play the same critical role in developing areas in the social sciences. The Institute has been an innovator, one of the first institutions in this country to recognize the importance of postdoctoral training to the career of the young scientist and scholar. It has had many followers in its history, and independent institutions such as the Center for Advanced Study in the Behavioral Sciences, or the Centers for Advanced Study that are part of a University such as those at the University of Illinois, the University of Virginia, the Institute of Historical Research at the University of Wisconsin, Dumbarton Oaks here in Washington which is in effect the Institute of Byzantine Studies of Harvard University, as well as others here and abroad have followed its model.

Functionally the Institute is an integral part of the system of higher education in the United States. Its basic mission is a combination of advanced training and research. Its faculty are academic personnel, all of whom have taught and done research in major universities both in the United States and abroad before coming to the Institute. Further, from time to time, many of them serve as visiting professors in these same institutions. Visiting members of the Institute come from the universities and return to them, typically to their faculties. One chief aim of their stay here is to enhance their capacities for continuing research and advanced training at the universities. Both the faculty and the visiting members are all active contributors to the scientific and scholarly literatures of their respective disciplines. There is no logical basis for distinguishing between the same functions in a part or subdivision of a university, and in an independent non-profit institution, and recognizing one but not the other as part of the system of higher education.

In the light of this, I submit that it is squarely within the policy purpose of the Bill before the Committee so to modify its language that the Institute, as well as other specialized institutions of research and advanced training operating in a similar way, is clearly given the same exempt status that other institutions which are also part of the system of higher education enjoy.

Senator ANDERSON. The next witness is the Honorable Brooks Hays, Chairman of the Southern Committee on Political Ethics.

STATEMENT OF HON. BROOKS HAYS, CHAIRMAN OF THE SOUTHERN COMMITTEE ON POLITICAL ETHICS

Mr. HAYS. Mr. Chairman, having been a Member of Congress for 16 years, and having served as acting chairman of the Cox committee to study foundations, I am aware of the pressure of time, and I will try to be very brief.

I was inspired to request this time largely because I thought it might be helpful to share with the committee the results of that study, which was in a different context in 1953. I will simply highlight some of the things that came to the members of the committee as a result of the study which was prompted by Congressman Eugene Cox of Georgia. Upon his death I succeeded to the chairmanship.

Incidentally, I wanted to make available to your staff the full findings, because it was a rather comprehensive statement. The interesting thing to me, Mr. Chairman, was that Congressman Cox changed his mind about foundations. He went into the study with a negative attitude, believing that something was wrong with the foundation system, even going as far as to express the suspicion that it was against the interest and the traditions of the United States.

I watched his evolving conclusions, and was quite impressed with the conviction he expressed at the end, that the foundation system is thoroughly American, and is important in our free enterprise system.

Foundations are what I call creatures of freedom and are of great service in buttressing the humanitarian things that Government in modern times has to do.

The statement of John D. Rockefeller, Jr., impressed our committee. He said "it is harder to give away a dollar intelligently than to make it honestly."

The Congress of the United States and all who preside over this Government need all the help that they can get in the great business of relieving distress, and that is what it is all about.

I serve as a member of two college boards. I am on the Board of George Washington University, and for a longer period I have been on the George Peabody Board, the college for teachers at Nashville. This college grew out of one of the early foundation movements.

George Peabody, a great philanthropist, was drawn in great compassion toward the plight of the South following the Civil War, and he asked experts to make a thorough study of where he could best use his money. So while the modern foundation is a flowering of this impulse to help needy people, and to aid in the great causes of education and health and welfare, we found that it even goes back to Rome and to Greece, and the committee is probably familiar with the Charitable Use Statute of 1611 in England, when it was found that even the church, with all of its wealth and it was from a third to a half of all the wealth of the land was not able to do the work that needed to be done to meet human distress.

I am appearing as chairman of the Southern Committee on Political Ethics, and I would like to say that I have no interest from the standpoint of exemptions for us. We are not eligible because we decided that it might unduly limit our activity. My appearance is not in the interest of any tax exemption for us.

But we are students of the problems of politics, and we just happen to be a group of southerners, I hope in time that it will spread out. Pursuing the idea of helping to improve the moral and ethical tone of our political system, we encountered good work being done by tax exempt organizations, the Southern Regional Council, for example.

I would hope that the committee would approach the problem of limiting the activities of foundations with great caution, and that your best craftsmanship would be used in this area because while I agree thoroughly with what is obviously the general feeling of the Congress that foundation money should never be used to help an individual candidate nor to help one party or another, I think that to say that foundations must not do anything that affects legislation would unduly restrict the activities of some very fine and useful organizations.

Our group is composed of newspapermen like Harding Carter and Hugh Patterson, former Members of Congress, Frank Smith, Carl Elliot, and Hugo Sims, and public men like Camille Gravell of Louisiana. It is bipartisan. We have leaders of the black community, Vernon Jordan of Atlanta, Clarence Mitchel of Baltimore and others.

So, Mr. Chairman, I simply hope that the committee might take a look at the summary of my views which I have hastily sketched here, and such portions of the Cox Committee report that the staff calls to your attention.

Americans are a compassionate people and I know that those who preside over the affairs of this Nation are not going to let human suffering go unattended. But if we do not have this help from private resources with the great ingenuity and inventiveness and vision that private organizations can supply, we will have a trend toward stateism in the field that ought not to be entirely preempted by either the church, which is left unfettered of course in its eleemosynary work, or the State, resulting from the pressures on the State to do the things that some are saying the foundations should not do.

Thank you very much, Mr. Chairman, for letting me make this statement.

Senator CURTIS. Mr. Chairman, I would like to ask a question. First I want to welcome our former colleague. At least three of us have had the privilege of serving with you in the House, and I want to thank you for coming here and speaking up in behalf of what I regard as a group of organizations that are very vital to our way of life.

Would you subscribe to this general approach, that we first provide for complete reporting followed by very thorough auditing by the IRS, and find out what the facts are before we embark on any major legislation, except in those fields where an abuse is clearly defined and there are available answers?

Mr. HAYS. I most certainly would, Senator. I think that this would be a great step, and I think you are going to find what we might call the old, the mature, the legitimate foundations are all in agreement on this. I have not studied the matter of disclosures, but the Cox committee recommended that legislation be enacted to require that all grants be publicized. You have the problem of defining the legislative function, drawing the line so that administrative functions are not impaired, and things that must be done by the IRS are left to them, because much of it I think is already provided for. The IRS should be fully equipped to hold the foundations to an accounting.

Nevertheless, if If understand your question, I am in thorough agreement with it, because this is a public trust. The foundations are engaged in the great business of administering trusts, and what they do, since they enjoy these privileges, should be disclosed.

Senator ANDERSON. Thank you very much.

(Mr. Hays' prepared statement follows:)

STATEMENT OF BROOKS HAYS, CHAIRMAN SOUTHERN COMMITTEE ON POLITICAL ETHICS

SUMMARY

Mr. Hays appears as Chairman of the Southern Committee on Political Ethics, and as former Acting Chairman of the House Select Committee to Investigate Foundations in 1952.

From his personal experiences with foundation programs over two decades, Mr. Hays has very favorable impressions of them. He feels they have been, and are, of particular importance to the uplifting of the Southern States. He notes that the Southern Committee on Political Ethics has no self-interest in this matter, since it is not tax-exempt and receives no foundation support.

He points out that when the House Select Committee to Investigate Foundations was established in 1952, the activities of a few foundations had caused apprehension and concern. In its investigation the Committee found:

In general, foundations were not diverting their resources from their basic purposes and were not working against the interests or traditions of the United States.

The larger and older foundations were rendering great service to the country.

The larger foundations favored public accounting and disclosure, some smaller ones opposed it.

The Select Committee recommended full disclosure of all grants.

STATEMENT

Mr. Chairman, and members of this distinguished Committee, my name is Brooks Hays. I appear before the Committee today in my capacity as Chairman of the Southern Committee on Political Ethics, and also as former Member of Congress, where for 16 years I represented the Fifth Congressional District of Arkansas. In that capacity, I served, in 1952, as Acting Chairman of the House Select Committee to Investigate Foundations, assuming that position upon the death of the Chairman, the Honorable E. E. Cox of Georgia.

The Select Committee's investigation of the foundations sparked an interest in their activities which I have maintained through the years. During my career, I have had the honor, in addition to my service as a Member of Congress, to serve as Special Assistant to Presidents Kennedy and Johnson, as a member of the board of directors of the Tennessee Valley Authority, as an Assistant Secretary of State, and as a member of the faculties of Rutgers University and the University of Massachusetts.

At present, I am a member of the governing boards at George Peabody College and George Washington University. I am also Executive Director of the National Conference on Citizenship, which was chartered by Congress in 1953. I am a director of the Southern Regional Council, and Director of the Ecumenical Council of Wake Forest University.

I have sketched this background, Mr. Chairman, to indicate the variety of experiences which have helped shape my convictions regarding the great value of private foundations to our total American society. In almost every activity in which I have engaged over the past two decades I have come in contact with foundation programs. My cumulative impression of those programs is an extremely favorable one.

The advancement of the South, in all areas of activity, has, of course, been of special interest to me. In 1967, I joined with a small group of Southerners, a list of whom is attached, to found the Southern Committee on Political Ethics

(SCOPE). Our purpose is to do whatever we can to help elevate the tone of political activity and to dignify the profession of public service in our region.

My fellow members of SCOPE asked me to appear before this Committee to oppose the imposition of unreasonable restrictions on foundation activities. In doing so, we have no self-interest. SCOPE is not a tax-exempt organization, and cannot receive foundation support.

However, we note that many organizations which are working effectively for the uplifting of the South do receive foundation help. An example is the Southern Regional Council and its Voter Registration Project. There are many others. Many of these, as I understand it, could not have been established under the provisions of the bill passed by the House.

I hope the Committee will consider very carefully the provisions of the Bill which would prohibit the use of foundation funds in any manner which might influence legislation.

While certainly no substantial portion of the funds or activities of foundations and their grantees should be used to influence legislation, a complete prohibition seems to be unreasonable. A great many things, in one way or another, eventually influence legislation, often in very constructive ways. As the language in the bill is now drawn, I fear that the result would be a very inhibiting influence on foundation officials in making grants in areas of public concern.

I mentioned, Mr. Chairman, that I had the honor of serving as the ranking member and later as Acting Chairman of the Select Committee to Investigate Foundations during the 82nd Congress in 1952. At that time, as now, the activities of a few foundations has caused some apprehension and concern.

The Committee was given a mandate by the House to determine "if the foundations were using their resources for purposes other than those for which they were established for purposes not in the interest or tradition of the United States."

In general, the Committee found that these organizations were not diverting their resources and were not working against the interest or tradition of the United States.

The Committee did find that a negligible number of foundations—a few of the smaller ones—had permitted subversive influences to penetrate their organizations. Such cases were duly reported to the appropriate agencies of the government.

The older and larger foundations—such as Rockefeller, Ford and Carnegie—were determined to have rendered a great service in the fields of health and education and in expanding the frontiers of knowledge.

We found that the larger foundations favored public accounting and public accountability. Some of the smaller ones opposed this, largely on the grounds that it would inhibit some contributions. Our Committee recommended that all such information should be filed with the Internal Revenue Service, and that full disclosure should be made of all grants.

On the question of tax evasion by use of the foundation device, the Committee found some abuses and recommended further study. The Internal Revenue Service was at that time giving attention to such abuses.

Mr. Chairman, the highly-competent general counsel for the Select Committee, Mr. Harold M. Keele of Chicago, was entitled to much of the credit for the excellence of the study. His views and experience might perhaps be of value in the present situation.

I have with me a copy of the Select Committee's report. I don't wish to burden the record unless the Chairman feels it would be valuable, but I will be happy to make a copy available to the Committee and the staff.

In closing, Mr. Chairman, I would like to echo the sentiments of John D. Rockefeller, Jr., who once observed that it is more difficult to give a dollar away intelligently than to make it honestly.

I feel, based on my experiences, that the responsible foundations are trying to operate their philanthropies in an intelligent and constructive manner.

I believe the American foundations are creatures of freedom, and are making great contributions toward the strengthening of our society.

Senator ANDERSON. Next is Dr. Elvis Stahr. We are glad to see you here.

STATEMENT OF DR. ELVIS STAHR, PRESIDENT, AUDUBON SOCIETY

Dr. STAHR. Mr. Chairman, members of the committee, I have submitted a written statement which for the sake of brevity I shall touch upon only in part. However, I would appreciate it if the full statement could be incorporated in the record.

Senator ANDERSON. Without objection that will be done.

Dr. STAHR. I am Elvis Stahr, president of the National Audubon Society. I am speaking today for the Audubon Society, and also for the National Conservancy, the National Wildlife Federation, Trout Unlimited and the Wilderness Society. Also Mr. Chairman I have a letter from the Izaak Walton League of America which I would like to have appended to my statement with your permission.

Senator ANDERSON. Without objection that will be done.

(The letter follows:)

THE IZAAK WALTON LEAGUE OF AMERICA,
Glenview, Ill., October 2, 1969.

Hon. ELVIS J. STAHR,
National Audubon Society,
New York, N.Y.

DEAR MR. STAHR: The Izaak Walton League is pleased that you will have the privilege of appearing in person before the Senate Finance Committee in connection with the tax reform bill. As you know, the League was required to submit its statement for the record by September 9, which gave us practically no time at all to study the myriad of complex legal details of the proposed legislation. Consequently, the League statement was confined to the basic thrust of the bill as it pertains to relationships between citizen conservation societies concerned with human environmental issues and charitable foundations and others which provide some of the operating funds of such societies.

We find it unfair, unjust and against the broad public interest that such citizen societies should be prevented from any activity, supported by charitable funds, which directly, indirectly or ultimately might have some influence on legislation to protect and preserve environmental values; whereas any business with a dollar interest in an activity which threatens such environmental values is free to take any and all steps to influence legislation and charge it off to business expense for tax purposes. This would be intolerable and can hardly represent the intent of Congress, which has clearly demonstrated its concern with environmental values.

We urged also that the sections of the bill dealing with foundations and other such charitable organizations be deleted from the bill and be taken up in depth and detail in public hearings at which all view points can be adequately expressed.

Your statement in behalf of the National Audubon Society has been studied. The League is happy to be associated with it.

Sincerely,

J. W. PENFOLD,
Conservation Director.

Dr. STAHR. These conservation groups together with ours comprise over a half million members and our organizations are dependent entirely upon voluntary public support. We receive no Government grants, and I am not here to plead the cause for private foundations. Rather, I am here solely to speak for the field of conservation.

When man landed on the moon he found not a living thing for the moon has no water, no air, indeed none of the elements that life depends upon. Back here on earth today Lake Erie is dead, the largest river on the east coast, the Hudson, is in its death throes. It is little more than an open sewer as it flows past the biggest city in the country.

The very air we breathe contains rising amounts of pollutants, and a declining proportion of oxygen. The parade of examples of serious

pollution and degradation of our national environment is far too long to embark upon further here.

Our concern is to try to see to it that this death march is halted, and that this earth of ours does not become another moon, barren and lifeless, or a place unfit for a full and healthful life for man.

The cause of conservation, I submit, cannot and should not be abandoned on the door step of Government. It is the vital concern of all people. We see it as our role to inform mankind about the natural world he inhabits, and about his relations to it and about its importance to him.

As I have said, we are not here to speak for private foundations. Indeed we believe foundations in general have been derelict for they have been slow to recognize the very grave problems of conservation. In the past few years, however, we have been successful in generating increasing financial support from foundations. I say financial support for that is in truth the only really effective support they can give. The foundations are not experts in conservation and they usually don't pretend to be.

Their most effective role in conservation is to give financial support to organizations which are experts in the field.

Yet the struggle to preserve our planet as a place where decent life can exist is to be won as it must be won, our efforts will have to be expanding and steadily increased over the long pull. It is therefore essential that we have an ever increasing amount of support from every source available including foundations. Any thing that will in any way endanger the increasing and continuing perpetual support of conservation we must view as potentially fatal.

We believe that the proposed tax law which you are considering presents just such a danger, probably inadvertently. Our concern is not alone with the details of specific provisions but also with the overall impact, in that the bill seems to add up almost to a general policy to put a damper on future contributions, both from foundations and from private citizens, to organizations such as ours.

As it stands, it may not hurt foundations as such nearly as much as it will hurt conservation.

I have referred in my written statement to sections in H.R. 13270 that appear the most dangerous to us. I would like to talk about two of them very briefly now.

The first is the divestiture provisions of section 4943. As I have said, we see the war for conservation as never ending. It will require perpetual support. To the extent that 4943 will discourage additions to existing foundations and the creation of new ones, we will have lost an important source of increasing perpetual support.

I have recently been made aware of an amendment of Senator Miller's which appears to represent the type of balanced and equitable approach that I am suggesting.

Second, the penalty provisions of section 4943 are extremely, even though indirectly, dangerous to us. Our most effective weapon in conservation is an informed public, and we must attempt to educate and thereby affect the opinion of the general public to support both the Government's and our own efforts, for without that support little can be done by anyone.

We believe that a grant to us by a foundation will not be prohibited by 4945, but we are not the ones to decide if such a grant shall be made. That decision must be made by the foundation managers, and they may very well be advised by their counsel that it is possible that such a grant may be subject to the sanctions of 4945. You see, because of the severe penalties of 4945, foundation managers will have to live in the world of possibilities. If they decide to play it ultra safe, they won't suffer. We will.

If we are to be realistic in expecting future foundation support, it must be made clear that grants to bona fide conservation organizations will not be subject to the penalties of 4945.

There are other provisions of H.R. 13270 which will diminish the ability and/or the incentive of private donors to support us, and my written statement mentions them. They need balanced consideration, taking more fully into account—than in our view does the House bill—the values to our society of the work done by nonprofit groups such as ours.

At a time when the cause of conservation is just beginning to receive the very essential supports of foundations, and of growing numbers of concerned private citizens, it is our earnest hope that whatever changes may come in the tax law will not have the effect of diminishing that support, for if they do, we are the ones that will suffer and when I say we, I speak in fact of all mankind.

In short, Mr. Chairman and members of the committee, we plead with you to take a most careful look at this bill from the point of view of beneficiaries such as we all are for the kind of tax incentives that encourage support of the conservation effort.

If I may borrow a phrase from Mr. Hays who just testified, we hope you will use our best craftsmanship to achieve a fair and equitable and constructive result.

Thank you.

Senator ANDERSON. Are there questions? I wouldn't want you to be here without somebody saying that you were a fine man, you served with distinction in the administration some years ago and we are glad to have you before us.

Dr. STAHR. Thank you very much, sir.

Senator CURTIS. Mr. Chairman, I would like to comment upon the case made against the divestiture provision. I agree with you very much.

With a new foundation it is very likely that it will be created by the donor out of something that he has; isn't that correct?

Dr. STAHR. Yes, sir.

Senator CURTIS. It is easier for him to give a portion of his business than to give anything else.

Dr. STAHR. That is often true.

Senator CURTIS. And this divestiture serves no purpose whatever. It will not bring in one dime of revenue, and there is no evidence before the committee that that particular class of foundations are guilty of any more laxity than anybody else. That is the reason that I strongly favor a period of gathering some information before we try to find the answers. Thank you.

(Dr. Stahr's prepared statement follows:)

STATEMENT OF THE HONORABLE ELVIS J. STAHR, PRESIDENT, NATIONAL AUDUBON SOCIETY

Mr. Chairman and Members of the Committee: I am Elvis J. Stahr, President of the National Audubon Society, one of this country's largest direct-membership conservation organizations. Today I am speaking for the Audubon Society and am associated with several other conservation organizations—Izaak Walton League of America, National Conservancy, National Wildlife Federation, Trout Unlimited and Wilderness Society. Each of these organizations concurs with the fundamental principles enunciated in this statement but not necessarily with the exact wording. Obviously, the other organizations are not responsible for any answers I give to questions you might ask.

These organizations have a combined membership of over 500,000. As our membership has grown through the years, so have our concerns with the environment in which we live.

Someone who starts out watching a bird soon realizes that when that bird can no longer find a tree to nest in, or a swamp in which to search for food, the bird cannot survive. Our birdwatcher soon finds that this applies to every other member of the animal kingdom, including man—each species needs its own special food and shelter, yet all are inter-related. So our members wind up worrying about a lot more things than birds and wildlife. That's what has happened to us and it is reflected for example in the Audubon's official statement of objectives:

> To promote the conservation of wildlife and the natural environment.
>
> To educate man regarding his relationship with, and his place within, the natural environment as an ecological system.

In pursuing these objectives through the years we have established many private sanctuaries and parks in several different parts of the country, to help preserve habitat as well as wildlife. We have helped inform the public about the battles to save our publicly-owned wild areas—to name just a few, the redwoods, the Grand Canyon, the Everglades, the Great Swamp.

We have pioneered in teaching concepts of conservation to both adults and children—with summer study camps primarily for teachers and youth workers, with long-standing programs of producing teaching material on natural history and conservation at all grade levels, with fine nature centers which we have helped local people plan and establish all over the country.

The purposes of our organizations, then, are two—action and education. This can encompass anything from taking kids out of the city ghetto on a walk through a centuries-old hemlock forest, to working to save one of our precious unique wildernesses. It includes battling a world-wide pollutant that we feel is such a critical threat to all of us. I refer, of course, to our current campaign against "hard" pesticides—those insect-killers that farsighted scientsists warned us long ago would turn on us and destroy the life around that we cherish and, indeed, cannot live without.

The key phrase in this brief discussion of conservation and the environment is that last one—"cannot live without."

People are just beginning to realize fully what we are doing to our environment—how closely all living things are tied together in a web of mutual support—and how wantonly we have been tearing that web apart. We have wrested precious minerals from the land and left behind acres of stripped soil, mountains of slag and tailings. We have felled the trees and left the land behind open to erosion and flooding, then taken the wood, made it into pulp, and dumped the wastes into our rivers—along with our sewage, garbage and chemicals. We have called our wetlands useless and have proceeded to *make* them just that by filling them up with our bounty of tin cans, old stoves, refrigerators, furniture and junked cars. Our affluent society, with its cars, air conditioning and central heating, has given our urban areas such polluted air that it is a health hazard just to stand on a street corner in places like New York and Los Angeles and breathe.

The message we conservationists try to get across is that man cannot live without trees, clean water, clean air, unpolluted wetlands and shorelines, and productive natural life cycles of both plants and animals; that man must learn to use nature's resources and to return them to her in a way in which she can use them to *renew* life, not destroy it.

We have no selfish motives, no profit motives—we have only the public interest to serve, including the interests of our posterity in a decent environment on this planet.

We know now why life wasn't found on the moon. It simply lacks the air, water and other basic ingredients of the processes which make life possible here on Earth. It is ironic indeed that these very ingredients are being seriously degraded, polluted and in some cases even destroyed here on earth.

Now we are gettiing down to the reason I am here. This tax reform bill, as passed by the House, would be a serious setback to the conservation movement. It would have no *direct* effect on any of our organizations, because we are not "private foundations." But indirectly, it would curtail the activities of non-profit conservation organizations that depend upon philanthropy and Foundation grants for part of their budgets.

It would endanger our sources of funds just at a time when groups like ours so urgently need to step up our efforts to make the public aware of the facts and the dangers in connection with what is happening to the environment and to develop alternative solutions for problems in their own communities, states and areas.

As members of this committee, you are aware of how vital it is to have an informed public, and how important a role private organizations can and do play in educating all of us on many important matters. There need to be means of informing interested citizens other than through government sources.

This is not to say that government agencies have not done fine work in some areas. But in other areas they have failed—to get an idea of what they have failed to do, may I suggest you read the recent report of the citizens' panel of the President's new Council on Environmental Quality. So we feel strongly that these private organizations must be strengthened.

You will appreciate my concern, then, that practically out of the blue we are confronted with new—and surely unintentioned—roadblocks to that strengthening. In general, we are in agreement with Assistant Secretary Cohen's statement that, "The Federal Government thus has a vital interest in insuring that their assets [private foundations] are properly applied. The provisions of the House bill dealing with private foundations will tend to insure that their property is devoted solely to charitable purposes. Private foundations will thus become an [sic] even more useful as a flexible source of support for achievement of new levels of thought and action, relieving the burdens of government." In this respect, we approve many of the purposes of the bill. However, we fear that the House in its enthusiasm to insure devotion of the property of foundations to charitable purposes may have created a law which in some instances will produce the opposite result.

The problems related to private foundations not our sole concern, but as objective beneficiaries of grants and gifts from private foundations as well as from the general public we would like to discuss proposed Code sections 84 and 277, 506, 4942, 4943, and 4945:

SECTIONS 84 AND 277

The combined effect of the limitation on tax preferences and allocations of deductions may critically penalize conservation organizations since substantial gifts of real estate and other property for such purposes would no longer be attractive to donors. We concur with the Administration's suggested removal of charitable gifts from the area of limit on tax preferences and allocation of deductions:

". . . it appears that the inclusion [in the Bill] of gifts of appreciated property to charity as a tax reference item will reduce the benefit of the contribution, and thus, unduly restrict public support of worthwhile educational and other public charitable institutions."

SECTION 506

In providing new laws concerning charitable organizations, the House created section 506 (7½% tax on investment income) primarily so that taxpayers, in general, would not have to pay the increased governmental supervisory costs. We also believe private foundations should pay such administrative costs. However, 7½% is too high to be a true license fee. We recommend the adoption of the Administration proposal of a 2% rate, and consider it important that the money be suitably earmarked for administration and supervising.

SECTION 4942

As beneficiaries we believe that a minimum distribution requirement is sound. We are in complete agreement with the House's philosophy that when donors receive immediate and sometimes substantial tax benefits from contributions, charitable organizations should receive current benefits.

While our group approves the principle of a statutory income equivalent, it is not prepared to comment on the appropriate percentage, nor on the many technical problems that undoubtedly exist in this difficult section, except for the definition of "operating foundation" in section 4942(j) (3) (B) (ii). This provision attempts to prohibit private foundations from creating other private foundations in order to circumvent the income equivalent. As drafted, it may discourage the creation of new small charitable organizations.

The limitation of receiving funds from the public or at least five exempt organizations none of which contributes more than 25 percent, in effect declares any such organization captive instead of looking to its actual operation. While such a principle may be valid for large organizations, *i.e.*, the larger the entity the easier to measure worthiness by its contact with the public at large, it may be incorrect regarding the establishment and operation of smaller entities. Many worthy organizations would not have been created if this section were applicable since each was originally created by one man, then primarily sustained by the grants of one foundation, and ultimately adopted by the public. These and other entities like them are the future supporters of conservation. If they are automatically defined as non-operating, they will experience difficulty in obtaining grants.

We recognize the technical difficulties inherent in revising this section to accomplish valid purposes without doing away with the type of organization just mentioned, but believe they can be solved.

SECTION 4943

As beneficiaries we oppose this section. We have benefited greatly from grants by private foundations in the past and hope to in the future.

As stated earlier, we are "objective beneficiaries." If the Senate adopts the House's concept of an income equivalent and proper self-dealing provisions, we see no reason for a divestiture law. The evils of control that have been referred to relate primarily to these two areas. Perhaps there should be some additional safeguards: a requirement of public holding within a reasonable period, for example, would place corporations much of whose stock is held by a private foundation under the scrutiny of the Securities and Exchange Commission. Perhaps percentage of ownership should, within a reasonable period, be cut to less than 50%.

As a group, we do not believe it is our place to make specific recommendations along these lines. What is important is that divestiture provisions, if any, should not be so harsh that present donors will be discouraged from adding to foundations, and potential donors will be discouraged from creating them. Foundations are normally created with mixed motives: a desire to protect control of a corporation rather than see it subject to raids or swallowed in an acquisition can quite properly be coupled with a desire to benefit charity. We believe the House limitation of 20% to be both unnecessary and harmful, and hope the final law will either remove the divestiture provision completely or at least substantially liberalize it.

Reiterating the group's position against section 4943, the ends of charity are met where there can be no self-dealing and private foundations must dispense their income annually, regardless of corporate control. In fact, charity has benefited greatly and will continue to do so when men of philanthropic spirit are encouraged to create private foundations with the assets of a business.

SECTION 4945

We note that section 4945 imposes a 100% tax on every "taxable expenditure" of a private foundation plus a tax of 50% on any foundation manager who agrees to the making of such expenditure, and that the term "taxable expenditure" not only includes any amount paid or incurred by a private foundation to carry on "propaganda" or otherwise to attempt to influence legislation, but also is additionally defined to include "any attempt to influence legislation through and attempt to affect the opinion of the general public or any segment thereof"

as well as any private communication with any member or employee of any legislative body or any other person who may participate in the formulation of the legislation.

The precise scope and meaning of these proscriptions are far from clear. Private foundations might well conclude that under the bill they could no longer safely make grants to any exempt organization active in the conservation area of our National life which directly or indirectly engages—to any degree—in any of the activities described above, because it might be deemed that the grantee's activities "tainted", so to speak, the grants by the private foundations and made them "taxable expenditures." Should this occur, it would have a serious adverse impact on a variety of organizations which traditionally, some for more than half a century, have been engaged in conservation work in this country.

The problem, we think, is simple and ominous: the bill imposes such inordinately heavy penalties for tansgression of its provisions, not only on an offending foundation itself, but also on its managers (which by definition include trustees as well as executive officers) as to mean as a practical matter that it is unlikely that foundations will risk making grants to any conservation group since those groups conceivably might—indeed, they sometimes must under their charters—endeavor to influence public opinion to stop the littering, polluting and general degrading of our natural environment, on which every human depends. Public problems of these kinds sooner or later may engage the interest of legislative bodies, from city councils to the Congress, and thus may in instances be said to involve legislation.

We would therefore stress to the Committee that the provisions of the bill regarding foundation grants to non-profit organizations such as ours should be, in any event, much more precisely and clearly defined in order that both private foundations and their grantees might know with certainty what they can and what they cannot properly do, in order that the work of conservation groups, such as ours, which is almost universally approved and applauded, be not significantly impaired.

We earnestly hope, and respectfully ask that you give these provisions of the tax reform bill separate and thorough study on their own merits and demerits.

I would like to mention an additional matter of importance to our group aside from the matters previously covered. If the Committee should decide to recommend an amendment to bill section 201(a)(1)(B) extending the 30% classification to any additional specific type of organizations, it is respectfully requested that there be included "an organization whose principal purpose is to promote the conservation of either wildlife or natural resources."

In conclusion, the conservation societies for which I am speaking today concur with the objective of removing existing evils from the foundation field, but believe that parts of the bill have a punitive rather than remedial effect. We can perseive that an unintended result of parts of the bill will almost surely be the drying up of a most important and proper source of funds upon which religious, educational, conservation and other proper charitable activities must depend in order to do their vital work.

Senator ANDERSON. The next witness is Howard J. Privett, the James Irvine Foundation.

Senator BENNETT. Mr. Chairman, since we have two witnesses from the James Irvine Foundation, maybe we should hear both of them together. That is your decision.

Senator ANDERSON. Will you proceed.

STATEMENT OF HOWARD J. PRIVETT, THE JAMES IRVINE FOUNDATION; ACCOMPANIED BY JOHN T. SAPIENZA, COVINGTON & BURLING, WASHINGTON, D.C.; AND JOHN S. FLUOR, DIRECTOR, JAMES IRVINE FOUNDATION

Mr. PRIVETT. We very much appreciate the opportunity presented to us to present the views of the James Irvine Foundation of the bill that is before you, the members of this very distinguished committee.

My name is Howard J. Privett a member of the law firm of McCutchen, Black, Virleger & Shea of Los Angeles, Calif.

I have served as counsel for the James Irvine Foundation for more than 10 years. On my left sits Mr. John S. Fluor, one of the 11 members of the board of directors of the James Irvine Foundation. On my right sits Mr. John T. Sapienza of the firm of Covington & Burling, the Washington counsel for the foundation.

In the time allotted to us this morning, we should like to address ourselves and to focus your attention for a moment on the effect of two provisions of this bill on the small community oriented foundations like the James Irvine Foundation. The sections I refer to are the provisions for limiting the stock ownership of private foundations and the provisions that relate to a minimum investment return from their investment assets.

Let me say first, that Mrs. Joan Irvine Smith is not a member or director of the James Irvine Foundation nor has she ever been connected with the foundation. She is a granddaughter of James Irvine, the donor of the James Irvine Foundation, and a stockholder in the Irvine Co.

Mr. Irvine was a very successful California businessman. The asset which he had, which he personally characterized as his life's work, was a large landholding which was operated by him as a ranch in Orange County, Calif. It consists of approximately 18 percent of the land area of that county today. In 1937 Mr. Irvine, who had always expressed his philanthropic concern for his neighbors and assisted them during his lifetime, made an irrevocable decision or rather a decision that became irrevocable on his death. He committed 51 percent of the stock of the Irvine Co., which is the incorporated name of the ranch to which I have referred, to the James Irvine Foundation. He did this by establishing a charitable trust under the laws of the State of California and committing to this trust this 51 percent stock ownership during his lifetime. The balance of the stock, or 49 percent, he gave to the various members of his family. Therefore, the Irvine Company is owned 51 percent or majority by the charitable foundation, and the minority of 49 percent is owned by the members of his family.

We think that a close examination of the records that are available, and these are not complete, will disclose that there are literally thousands of foundations in the country, including some of the great ones about which you have heard, and from whom you have heard in the proceedings before this committee, names like the Kellogg Foundation, that have been started by the gift of a substantial business interest to the foundation. So this is not an atypical situation we have with the James Irvine Foundation. We submit that it is typical.

The gift that Mr. Irvine made, when it became irrevocable in 1947 on his death, 10 years after the establishment of the foundation, had a value for estate and inheritance tax purposes of $5.6 million.

Now if this gift had not been for charitable use and expressedly and explicitly limited to charitable use, it would have been subject to an estate inheritance tax of 77 percent, or approximately $4.3 million.

The estate tax benefit, and the only tax benefit conferred by virtue of this gift, was that $4.3 million. Mr. Irvine gained no tax benefits during his lifetime by reason of this gift. The Irvine Co., during Mr.

Irvine's lifetime and at all times since that date, down to the present, has paid the full measure of tax that any other corporation pays. Mr. Irvine gained no tax deduction during his lifetime. On the $4.3 million tax that was not paid on Mr. Irvine's death, what have been the benefits that have been conferred? On this gift income to date has been earned which has been distributed to the private colleges and universities, hospitals, and youth organizations in the communities served by this foundation of $10.3 million. That is to say almost double the amount of the tax benefit conferred or of the loss of tax revenue to the U.S. Treasury has been returned directly to the small community which Mr. Irvine desired to benefit at the time he made this gift.

We, therefore, with this background and with this framework, and we claim no special status for the James Irvine Foundation, indeed we think it is very clear from the Treasury Department report and the express pronouncements of the Treasury following its study, we think it is clear from the hearings before the House Ways and Means Committee that the results obtained for charity by virtue of Mr. Irvine's gift are commonplace in the foundation field.

It is in this framework that we ask the members of the committee to consider first the effects of 20-percent stock ownership limitation. First, it is probably a bad thing for foundations that this has come to be known as the 20-percent stock ownership limitation. It is not that at all. As applied to the small foundations that I am talking about now, it is a 100-percent divestiture requirement. As long as a donor gives part of his business to the members of his family who are the natural objects of his bounty, and he gives the balance of it to a foundation, the foundation must divest itself of all its interest, for as long as much as 20 percent of the stock owned is owned by members of the donor's family, the foundation is not permitted to own any stock.

Accordingly as applied to the Irvine Foundation, we would be required to divest 100 percent of our stock in the Irvine Co.

Now it has already been observed that a very substantial portion of the capital available in the country today that can be transferred and devoted for public use and for our concern for the betterment of American life is in business enterprises owned by men of vision and concern like Mr. Irvine. We submit that there have been no facts established by either the Treasury Department or in the hearings thus far held which would warrant the adoption of a so drastic and far reaching rule as the compulsory divestiture that has been proposed in the House bill.

We respectfully draw the attention of the members of the committee to the lack of the existence of any evidence whatsoever that there is a correlation between the amount of stock that a charitable organization owns and the opportunity for or the incidence of any of the abuses about which there has been testimony.

Now of course there are abuses in the foundation field as there are abuses in all the other areas of American life as we know it. We respectfully urge the members of the committee to reject the sweeping divestiture proposal, and to proceed with measures designed specifically to deal directly with the areas of abuses where they have occurred.

We think that the self-dealing provisions of the present bill contains provisions which may be helpful in this respect. The directors of the

James Irvine Foundation have adopted and publicly stated the policy that they operate this trust in the public interest, and that any rules that the members of the committee might think appropriate to prevent abuses by rules with respect to self-dealing we think would be appropriate.

We think further that the provisions for reporting and publication of all of the facts regarding foundations will be helpful. We further submit that the entire foundation field has been hurt by the very severe lack of enforcement and audit of existing laws and regulations, and we think it very likely that many of the witnesses who are here today would not be here today and we would not be taking up the time of this committee, if the laws that are already on the books and have been on the books for some years had been actively enforced. If a fee by foundations is necessary to bring about this auditing which will take the field of private philanthropy out of the disrepute which has come upon it, then we think that also would be appropriate.

If notwithstanding what we think or the very strong reasons for rejecting this divestiture proposal in its broad sweeping application which we cannot see how it will in any respect operate to cure the abuses about which there has been testimony, is to be adopted, then we respectfully urge the members of the committee to give the most serious consideration to whether that rule should be given a retroactive ex post facto application to irrevocable trust established by the donors who are long since dead.

We respectfully submit that men like Mr. Irvine at the time they committed their property and made irrevocable decisions with respect to it, which were lawful and valid at the time they were made, had a right to expect from the Government that it would not change the law in the future so as to undo the dispositions which they made of their property and the basis for the decisions which they made which were valid and lawful at the them when they were made and have been lawfully carried out since that date.

Finally on this particular rule, if a divestiture rule is to be applied retroactively, no segment of the foundation community will be more seriously effected or harder hit than the small community oriented foundations whose only or principal asset consists of ownership of stock in a closely held corporation.

The provisions of the House bill in this respect are grossly inadequate. They would allow the James Irvine Foundation a total of only 5 years to dispose of an asset that is worth somewhere in excess of $100 million in a corporation where there has never been any established market. In fact there have only been 2 minute sales of this stock within the last 20 years, and one of those from a brother to a sister consisting of one share and a sale of a few shares at an estate sale.

The Ford Foundation, I believe, started in 1953 to divest itself of its interest or a portion of its interest in the Ford Motor Co. Moving as rapidly as it could with safety for the value of its assets and for protection of the interest of the other stockholders, it has taken down to the present, and it still owns somewhere in the neighborhood of 27 percent of the Ford Motor Co. equity, so in a period of 13 or 14 years. moving as rapidly as they could, it has taken them that length of time, and we respectfully submit that the 5 years it is allowed by the present

bill to foundations such as ourselves is not nearly adequate for that purpose and that the inevitable result will be that this trust will lose very substantially the value of its capital, which should remain in perpetuity for the benefit of the charities Mr. Irvine intended to benefit.

I call your attention also that the House bill has a 2-year interim provision, which requires disposition of 10 percent of your excess holdings within 2 years, unless you can make a case for hardship. That particular provision, it is interesting to note, applies to existing organizations, but it does not apply to foundations created in the future. They have a full 5 year period without an interim provision. We think this is an unfair application and recommend that both the 5 year interim period and the 2-year period be eliminated from the bill.

The United States Supreme Court in deciding what was a reasonable divestiture period for the DuPont Co. which was found to have violated the antitrust laws in acquiring General Motors stock, for the protection of the interests of the corporation whose stock was held, for the protection of the value of the interest of the stockholders of DuPont, for the protection of the interests of the other stockholders of the General Motors Corp. the court allowed a 10-year period. We don't feel that interests that were lawful when acquired and have been lawfully operated ought to be less liberally treated. We respectfully submit to the members of the committee that the absolute minimum period that is required to protect the interests of the charities that are now irrevocable who hold their assets in closely held corporations is 10 years. We submit further that we see no reason for great liberality not being allowed in this respect.

Mr. Chairman, the other provision I would like to make mention of briefly is the minimum investment return provision. The directors of the James Irvine Foundation have always followed the policy of paying out on a current basis all of the income which they receive.

We have no objection to the provisions in the bill which require that foundations make that kind of a payout.

However, we believe the minimum investment return proposal is unrealistic as it would apply to foundations such as the James Irvine Foundation.

In the first place, taking an asset such as the Irvine Co., which lies just south of the urban growth in Los Angeles County, the value of the real properties in that county since 1960 have accelerated very rapidly, and the growth in the value of these real properties because of the growth in population density has very greatly exceeded the capacity of these properties to earn income, and necessarily of course the increase in the value of such properties will run years ahead of the actual income that will be produced from those properties as they are developed for residential, commercial, industrial purposes as they can be.

Accordingly we suggest for the consideration of the committee that an income equivalent provision tied to a concept as illusory as fair market value when applied to an interest in a closely held corporation will not necessarily protect the interests which are to be protected and may work severe hardships on the organizations which hold those investments.

We call the attention of the committee to the fact that we are not talking about investments that directors or trustees of foundations

have gone out and selected in the marketplace. We are talking about the investment that they have by virtue of a gift from their donor, and gifts made with directors by the trustor to the trustees of the trust as to the manner in which those should be administered.

In summary, we respectfully submit that the minimum investment return provision should be tried to the tax benefit that has been conferred, not to the market value of the asset.

Secondly, that it should not apply to those trusts which are irrevocable, and which are prevented by the terms of their governing instruments from making distributions out of their corpus.

The James Irvine Foundation trust does not permit the trustees in the James Irvine Foundation to distribute out of the corpus of the trust. Accordingly we could not comply with the minimum investment return provision unless our income was actually equal to 5 percent. That would be taken care of, of course, by the requirement that we distribute all of our income.

Secondly, we submit that this minimum investment return provision should not apply to assets which trustees are directed by their governing instruments to retain.

If a trustee has no power to change the corpus of his trust or the investment in which the trust is endowed, then it would serve no purpose for the Congress to apply a provision which would over a period of years erode the value of the corpus.

With these points, Mr. Chairman, I conclude my formal statement.

(The James Irvine Foundation's prepared statement and a supplemental statement follows:)

Statement of the James Irvine Foundation Regarding Provisions of Section 101 of H.R. 13270

The James Irvine Foundation, a California corporation, is the owner, as trustee, of 459 shares of stock of The Irvine Company, which is 54.55 percent of its issued and outstanding stock. This interest was acquired by *inter vivos* gift from James Irvine in 1937 under the terms of an Indenture of Trust in which Mr. Irvine directed the Foundation to hold and administer the stock under the trust "as a unit without division or segregation thereof" and to devote the income therefrom exclusively to charitable uses and purposes in the State of California. The Indenture further provides, *inter alia:*

"Trustor hereby makes the following directions with respect to the management of the shares of stock of The Irvine Company and the property thereof, which consists for the most part of a land holding situated in Orange County, California: that inasmuch as the development and operation of said property has constituted the life work of the Trustor, it is the purpose of said Trustor, by the creation of this trust and by vesting in the Trustee through its holding of said stock of The Irvine Company, the exercise of a controlling voice in the operation of its properties, to perpetuate the operation thereof and thus insure an adequate foundation for the charitable purposes herein provided."

The Irvine Company is a closely held business corporation. The ownership of its stock, other than that held by the Foundation, is divided between 12 parties, most of whom are related by blood or marriage to the Foundation's donor. The stock is not traded and has no established market. Except for transactions in which the Company purchased and retired shares of its own stock, there have been only two sales in the past 20 years; one in 1964 in which a minority shareholder sold his sister one share at a price of $115,000 and one in 1960 in which the estate of a deceased shareholder sold 15 shares at a public auction for a price of $108,333 per share to raise money for taxes. The Company's purchases were: 50 shares at a price of $100,000 per share in 1962 and 13½ shares at a price of $250,000 per share in 1968.

Under the laws applicable to The Irvine Company, the Foundation's stock ownership entitles it (a) to elect four of the seven members of the Company's Board of Directors, (b) to vote the stock on all matters of Company business requiring shareholder approval and (c) to receive 54.55 percent of all corporate distributions. The cash dividend paid by the Company during its fiscal year ended April 30, 1969 was $2,850 per share, or a total of $1,308,150 on the 459 shares owned by the Foundation. This represents an increase of more than 500 percent in the annual dividend rate of $500 per share paid by the Company in 1948, the year the Foundation's rights in the stock vested.

Through a partial liquidation in 1962, The Irvine Company distributed several parcels of real property to its shareholders in redemption of a portion of their stock. The Foundation's pro rata share interest in the properties had a value of $6,211,263.

There have been no business transactions between the Foundation and The Irvine Company. More specifically, the Foundation has neither loaned or borrowed money nor sold or purchased property from the Company.

The Foundation is managed by an 11-member Board of Directors. One of the Directors is a granddaughter of Mr. Irvine. The remaining 10 Directors are in no way related to Mr. Irvine or his family. In the administration of its trust, the Foundation is regulated and supervised by the California Attorney General under the provisions of the Uniform Supervision of Trustees For Charitable Purposes Act (California Government Code, Secs. 12580–12595).

Mr. Irvine gained no tax advantage and realized no deduction or other tax benefit during his lifetime by reason of his gift of a majority of The Irvine Company stock to the Foundation in trust for charitable purposes. On Mr. Irvine's death in 1947, the trust became irrevocable under California law and a tax benefit was realized in that the stock (which was then valued at $11,000 per share or $5,610,000) was exempt from the estate and inheritance taxes which would have been payable if the *inter vivos* gift had not been limited to charitable uses.

The Foundation's ownership of a majority stock interest in The Irvine Company has at no time in the past, and does not today, provide a tax benefit or advantage of any kind to the Company. All of its operations were fully taxable before Mr. Irvine's charitable gift in trust, and they remained so after the gift was made. Today, as during Mr. Irvine's lifetime, The Irvine Company pays the full measure of taxes that any other corporation is obligated to pay. The only income tax benefit that has resulted from the fact Mr. Irvine's gift of stock was for charitable uses is that the Foundation is not obligated to pay taxes on the dividends that it receives. The dividends, of course, are the trust income which the Foundation distributes to charity on a current basis.

TAXES ON EXCESS BUSINESS HOLDINGS

(Section 101(b) of H.R. 13270 and New Section 4943 of the Code)

This section places precise limits on the amount of voting stock of a business corporation that may be owned by a foundation. The maximum limit is 20%. The specific limit applicable to each foundation is determined by subtracting from the 20% maximum the percentage of voting stock owned by all disqualified persons, including the foundation's donor and all other substantial contributors and their families and lineal descendants. An exception is provided where an independent third-party has control of the business corporation and the foundation and all disqualified persons combined own less than 35% of the voting stock. In that case, the maximum limit on the amount of voting stock of a business corporation that may be owned by a foundation is 35% reduced by the aggregate percentage of the voting stock owned by all disqualified persons. Under the terms of a *de minimis* rule included in the section, foundations are permitted to own as much as 2% of a business corporation's voting stock even though the combined ownership of disqualified persons is equal to or exceeds the applicable maximum limit.

All stock held by a foundation in excess of its permitted limit must be disposed of within specified time periods. The sanctions imposed for failure to comply with the divestiture requirements is an initial tax of 5% of the value of the excess stock holdings and an additional tax equal to 200% of the value of such excess stock holdings if they have not been disposed of by the close of a designated correction period.

It may be somewhat difficult to assess the full extent of the near and long term damage to the cause of private philanthropy that would result from a change in the policy of our tax law as drastic and as bludgeon-like in its application as that proposed by this section of the House bill. But there can be doubt that the damage would be great and would have far reaching consequences. It would reverse the incentive that has been provided by our tax laws over the past half century for the dedication of private wealth to the benefit of the public. Moreover, it would compel long established public trusts that have been administered explicitly in the public interest to divorce themselves from the stock interests with which they were endowed and which have provided the resources for their important and growing contributions to the public welfare.

The effects of such a policy change would fall most heavily on the small community-oriented foundations capitalized by a substantial ownership interest in a local business and on donors whose accumulated wealth consists of ownership of a business enterprise. In this area, a compulsory divestiture rule would constitute a deterrent of such proportion that it would virtually eliminate the making of gifts of substantial interests in the donor's business for the perpetual use of charity, whereas such gifts are now commonplace and were the source of beginning for many of the great foundations operating in the country today. Since the personal wealth of the group of persons who own businesses represents a significant portion of the private capital in the United States, there can be little doubt that the adoption of such a rule would be followed by a substantial diminution in the number and financial capacity of foundations to serve the ever-growing local needs that are now being met through private philanthropy. The magnitude of the potential loss can be, perhaps, best demonstrated by a brief look at The James Irvine Foundation.

Its founder, Mr. James Irvine, owned a large ranch in Orange County, California, which he incorporated under the name "The Irvine Company". Mr. Irvine devoted himself fully to this enterprise and personally characterized it as his life's work. Forty-nine percent of the stock of the company was given by Mr. Irvine to members of his family. With the remaining 51 percent or majority of the stock he established a charitable trust for the benefit of the people of California with particular emphasis on the needs of the people of the county in which the ranch was located. The James Irvine Foundation was organized to administer this trust as its trustee.

On Mr. Irvine's death in 1947 his trust became irrevocable under California law. On that date the total value of the majority stock interest with which Mr. Irvine endowed the trust was $5,610,000. To date the income received from this 5.6 million dollar gift has enabled the trust to make direct grants of more than 10 million dollars to the universities, colleges, hospitals, youth organizations and similar charities within the community it was established to benefit. During the same period of time the value of this gift, which will continue to serve the public in perpetuity, has increased dramatically.

The contribution to the public welfare from Mr. Irvine's gift of a majority stock interest in his business is not a unique or isolated occurrence. Indeed, the record of the hearings before the House Ways and Means Committee, establishes that such results are quite commonly obtained from gifts of substantial business interests for charitable uses.

The proposal to enact a law applicable to such gifts as harsh and undiscriminating as across-the-board compulsory divestiture is unwarranted and should be rejected unless there is clear evidence (1) that the gifts produce some substantial evil which cannot be reasonably corrected by more refined regulations and (2) that the evil resulting from the gifts will have demonstrably more serious consequences than those produced by the remedy. Clearly, no such condition can be found in the operations of private foundations. The study made by the Treasury Department at the request of this Committee and of the Committee on Ways and Means disclosed that "the preponderant number of private foundations perform their functions without tax abuse"; that "most private foundations act responsibly and contribute significantly to the improvement of our society"; and that "upon the whole, the record of foundation disbursements is one of solid accomplishment". (Treasury Report on Private Foundations, February 2, 1965, pp. 2, 13 and 14.)

In the area of foundation involvement in business, the Treasury has reported "several kinds of undesirable results" from the operations of a minority of foundations. They are said to be (a) competitive advantages; (b) varied forms

of self-dealing; (c) deferral benefits to charity; and (d) distraction of the attention of foundation managers from charitable activities. The Treasury concedes (Report, p. 36) that these results are not a necessary consequence of foundation ownership of business interests and no facts have been presented, either in the Treasury study or the hearings of the House Committee, which would support a conclusion that they do occur in the operations of any meaningful proportion of the foundations that own in excess of 20% of a business corporation. This is true, we submit, because the situations and practices that give rise to such results are not related to and cannot be rationally correlated with the amount of a foundation's stock interest in a business corporation.

The appropriate remedy for the "undesirable results" of foundation involvement in business suggested by the Treasury study may be found in more active enforcement of existing law or in the adoption of new provisions tailored specifically to deal directly with the conduct and practices that cause such results. They cannot be corrected as effectively and should not be corrected by a wholesale compulsory divestiture rule, whose impact would extend well beyond the limits of the problem and would itself give rise to "undesirable results" of an economic and social nature more serious than those it seeeks to eliminate.

It has been suggested by some qualified commentators, and we think correctly so, that the only substantial basis for the Treasury proposal of a broad stock ownership limitation is administrative convenience and that the only benefit that would be realized by adoption of the rule would be some easing of the burden of administering the tax law. (See, *e.g.*, Robert E. Gother, *Analysis and Criticism of The Treasury Proposal To Limit Stock Ownership By Private Foundations*, 13 UCLA Law Review 1017 (1966), a copy of which is annexed hereto for the convenience of the members of the Committee.) We acknowledge that the burden of enforcing a law is a proper legislative concern and that there would be administrative difficulties and additional costs involved in enforcing regulations directed at specific abuses. However, the assumption of these burdens is more than justified by the greater effectiveness such rules would have in the curbing of abuses in the problem areas and by the preservation of the substantial benefits to the people that now obtain because businessmen are free to contribute interests in their businesses in unlimited amount to perpetual charitable uses.

We, therefore, respectfully urge the members of the Committee to proceed with measures designed to curb specific abuses and to reject a broad, sweeping compulsory divestiture rule which would defeat the intentions of donors of existing public trusts and operate as a powerful deterrent to the making of substantial gifts of corporate stock to charity in the future.

If the Committee nevertheless concludes that the divestiture proposal should be adopted, we request that new section 4943 be modified in the following respects to mitigate the harsh and unjust effects it would have on existing organizations.

1. An exception to the divestiture requirements should be made for foundations and trusts in existence on May 26, 1969, with respect to all business interests acquired by gift or bequest before that date. The House bill has already provided an exception for two such organizations: the W. K. Kellogg Foundation which has as its sole asset 50.34% of the voting stock of the Kellogg Company; and the Benwood Foundation which owns about 70% of the stock of the Coca-Cola Bottling Co. (Thomas) of Chattanooga. The good reasons that commend the making of these exceptions, also apply to The James Irvine Foundation and the overwhelming majority of other foundations. In this connection, Representative James B. Utt (Republican of California), a member of the Committee on Ways and Means, made the following pertinent observation in proceedings recorded in the Congressional Record for August 6, 1969:

"We have given certain foundations complete immunity.

"It was considered that control of a corporation by a foundation was an evil thing. It was even evil if it were to be controlled by a consort consisting of the founder and members of the founder's family to the second and third generations. Later, the committee decided that if the people of the foundation were 'good' people and qualified under a technical amendment, total control of a corporation was to be OK. That took care of the Kelloggs of Battle Creek. I am certain that there are many family foundations just as virtuous as the Kellogg Foundation, but they do not receive preferential treatment. To name but a few, I would refer you to the Hormel Foundation, the Waterman Foundation and the Kaiser Foundation. Why this discrimination?"

Congress has, on numerous occasions, applied the equitable principle that new tax provisions should not apply to transactions irrevocably entered into in good faith at a time when there was no tax or penalty on such transactions. See, *e.g.*, IRC Sec. 2038 (excluding from estate tax revocable transfers made on or before June 22, 1936), IRC Sec. 2041 (excluding from estate tax unexercised general powers of appointment created on or before October 21, 1942), IRC Sec. 2107 (excluding from estate tax estates of expatriates losing U.S. citizenship prior to March 8, 1965), Sec. 601 of H.R. 13270 (excluding existing tax-exempt securities), and Sec. 703 of H.R. 13270 (excluding from the proposed repeal of the investment credit property acquired prior to April 19, 1969 and property constructed, reconstructed, erected or acquired pursuant to a contract which was, on April 18, 1969, and at all times thereafter, binding on the taxpayer). These, and many other like provisions enacted by Congress, recognize the basic unfairness of applying penalties or prohibitions to transactions completed in good faith at a time when no penalty or prohibition existed.

2. If the modification suggested above is not adopted, an exception to the divestiture requirements should be made with respect to business interests which foundations and trusts are directed to retain by the terms of governing instruments which were irrevocable on May 26, 1969. The Treasury recognized the need for this exception in its Report on Private Foundations, saying (p. 37):

"An exception to the general disposition requirement would seem advisable for existing foundations whose governing instruments, as presently drawn, compel them to hold specified business interests, if relevant local law prevents suitable revision of the controlling document."

However, the House bill does no more than provide a moratorium on the application of the divestiture requirements "during the pendency of any judicial proceeding by the private foundation which is necessary to reform its governing instrument to allow disposition of such holdings." No provision is made for the possibility that the petition for such reform may not be granted, as has occurred in the past. (See, *e.g.*, *Cocke* v. *Duke University*, 260 N.C.I., 131 S.E. 2d 909 (1963).) Moreover, where donors have conveyed business interests to foundations with direction that they be retained at a time when it was lawful under Federal tax law as well as State law for such interests to be retained in unlimited amount, no reason exists for requiring what is in effect an *ex post facto* application of the divestiture rule.

3. Provision should be made for an *unrestricted ten-year transition period* for the disposition of stock holdings in excess of the prohibited amount, with authority vested in the Secretary of the Treasury to extend the period in cases of hardship. Ten years is the minimum period within which it can be reasonably expected that foundations can dispose of major interests in closely held corporations without serious and unwarranted loss in the value of their capital and possible loss to other owners of the same equity.

The experience of the Ford Foundation in disposing of its Ford Motor Company stock provides a relevant example of the time required to dispose of major business interests. Beginning in 1956, it undertook a massive program to divest itself of this stock as rapidly as practicable "within the limits of prudence" and a trustee's "fiduciary responsibility to preserve the value of the asset." After 13 years, it has only succeeded in reducing its holdings from 88.4 percent of the total stock outstanding to 27.4 percent.

It may also be helpful to consider the time required for disposition of major business interests to comply with judicial orders requiring divestiture under the antitrust laws. In *United States* v. *du Pont & Co.*, 366 U.S. 316 (1961), the Supreme Court allowed the defendant a period of ten years for disposition of its General Motors stock. Similarly, in *United States* v. *United Fruit Co.*, 1958 CCH Trade Cases Sec. 68,941, United Fruit was permitted eight years and four months after the date of the decree to dispose of its International Railways of Central America stock. In both of these cases the business interests to be sold were in publicly held corporations whose stock had an established market. Even longer periods would have been necessary to comply with the divestiture orders had the corporations involved been closely held with no existing market for their stock.

The courts in ordering divestiture for violations of the antitrust laws have fixed transition periods of sufficient length not only to protect the value of the stock to be sold and the equity of other investors, but to permit an orderly transfer of control with minimum disruption of the business relationships and management of the enterprise whose stock is to be sold. Those considerations

should be of even greater concern in fixing the transition period for divestiture of business interests lawfully acquired and operated for the welfare of the people.

The transition period allowed by the House bill for foundations to dispose of their present holdings in excess of the permitted limits is clearly inadequate. As applied to The James Irvine Foundation, it allows a maximum of five years and possibly only two years* after May 26, 1969, for sale of all the Foundation's 54.55% stock interest in The Irvine Company.

The ten-year period which the House bill is commonly thought to allow is not available to this Foundation and no doubt the same is true of many others. Under the terms of the bill, ten years is allowed for divestiture only if, at the close of the five-year period beginning on May 26, 1969, the foundation and all disqualified persons including the donor's family and descendants, own less than 50% of the stock. Because almost all of The Irvine Company's stock not owned by the Foundation is owned by decendants of its donor, the Foundation cannot meet that condition until it has sold all but 4.55% of its interest.

In practical effect, therefore, the bill allows this Foundation no more than five years to accomplish a divestiture of a controlling stock interest of exceedingly great value which it has held for more than 32 years. The probability is great that this time limit would impose forced sale conditions and the loses that inevitably result from sales under such conditions since there is no established market for Irvine Company stock and only two sales, other than repurchases by the Company, have occurred in the past 20 years; a sale of one share in 1964 by a minority shareholder to his sister and a sale of 15 shares by the estate of a deceased shareholder.

TAXES ON FAILURE TO DISTRIBUTE INCOME

(Section 101(b) of H.R. 13270 and new section 4942 of the Code)

This section of the bill would require foundations to distribute all of their income by the end of the year following the year in which it is earned or, if greater, an amount equal to a "minimum investment return" of 5% on the "aggregate fair market" value of all of their investment assets. The minimum investment return is to be adjusted prospectively from time to time to the extent necessary to retain a comparable relationship between the return rate and money and investment yields. The fair market value of investment assets is to be fixed by the Secretary on a monthly basis for securities having an established market and as frequently as he may deem appropriate for other assets. The sanction imposed for failure to make the required distributions is a tax of 15% on the undistributed amount with an additional tax of 100% on such amounts as remain undistributed at the close of a specified correction period.

We agree that charitable foundations should be required to pay out all of their current income for charitable purposes. The James Irvine Foundation has from the beginning distributed all of its income on a current basis. The only delay in distribution occurred during pendency of the suit brought by Mrs. Joan Irvine Smith to rescind the charitable trust and require transfer of the trust principal and income to her and other heirs of James Irvine. Upon termination of this suit the accumulated income of the trust was distributed to charitable beneficiaries.

The effect of the minimum investment return provision in the House bill would be to reduce the capital of charitable organizations each year in the amount by which their annual net income is less than 5% of the current value of their investment assets. As applied to foundations which have a broad base of diversified investments that can be readily marketed and that the managers have the power to sell, the resulting impairments of capital may not be significant. However, as applied to the numerous foundations and trusts that do not have such a favorable investment asset position, the necessary result would be a serious and continued impairment of their capital with consequent loss of their capacity to carry out the charitable purposes for which they were established.

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*The James Irvine Indenture of Trust directs the Foundation to hold The Irvine Company stock "as a unit without division or segregation thereof" which may not permit sale of the stock in units over a period of years. If that should prove to be the case, the two-year period in which the bill requires sale of 10% of excess holdings would have the effect of requiring the sale of all this Foundation's stock in two years which would be most unjust and seriously threaten it with a substantial loss of capital.

Consider, for example, the application of the minimum investment return requirements to:

(1) trusts established by instruments which are irrevocable under State law and which either direct the trustee to retain the existing trust investments or provide that the trustee cannot change the form of the investment assets;

(2) trusts whose only or only substantial asset, at present, is stock in a closely held corporation for which there is no established market and which cannot be readily sold except at distress prices far below its fair market value; and

(3) trusts established by instruments which are irrevocable under State law that do not permit distributions out of the trust capital.

While the stated purpose of the minimum investment return requirement is to prevent avoidance of current benefits to charity "by investments in growth stock or non-productive land" (Report, p. 25), the provision is not limited in its application to investments voluntarily made or retained. By its terms, it applies to all investment assets without regard to the legal or practical power of foundation managers or trustees to change the form of their investments or to otherwise obtain a return on their assets which is equal to 5% of their theoretic current fair market value. Moreover, the tax sanctions for failure to make the required minimum investment return distributions are imposed without regard to the legal power of foundation managers or trustees to distribute trust capital to make up the deficiencies in their income.

To avoid the unwarranted and unjust applications of the minimum investment return rule mentioned above, we respectfully urge the Committee to amend the provisions of new section 4942 to accomplish changes in its terms in each of the following respects:

1. Existing irrevocable trusts established by instruments which do not permit distributions out of capital should be exempt from the operation of the minimum investment return provision since it would not be possible for them to meet its requirements. The Treasury Department has priviously suggested that an exemption for such organizations should be made. (See, Treasury Department Tax Reform Studies and Proposals, February 5, 1969, p. 301.)

2. The value of investment assets held under existing irrevocable trust instruments which do not permit the trustee to change the form of the investment asset should be excluded from the operation of the minimum investment return provision. No objective of the tax laws or any other useful purpose would be served by compelling a foundation administering such a trust to deplete its other, perhaps very limited, capital to satisfy the minimum investment return requirement with respect to investments which it has no power to change.

3. The value of securities in closely held corporations and other investment assets held on May 26, 1969, which do not produce income equal to the minimum investment return rate should be excluded from the operation of the rule for a period of not less than ten (10) years. This would provide foundation managers and trustees with a reasonable period of time in which to make an orderly disposition of such assets and to realize their fair market value. The two-year moratorium on the application of the minimum investment return to existing organizations included in the House bill is grossly inadequate for this purpose.

4. The value of property acquired after May 26, 1969, by means other than purchase (*i.e.*, by gift, bequest, corporate liquidations, dividends in kind, etc.) which is unproductive when received, should be excluded from the operation of the minimum investment return rule for some reasonable period of time within which it can be sold. The need for this exclusion would be acute if unproductive property of high value in relation to other foundation assets was received and could not be sold for a period of years.

5. If a minimum investment return distribution is to be required, the 5% rate should in all fairness be based on the tax benefits conferred (estate or income tax saving on the bequest or gift to charity plus income tax saving on realized capital gains). It should not be applied to the unrealized appreciation in value of the assets of foundations since no tax benefit has been realized by any one or will be realized until the assets are sold.

CONCLUSION

On behalf of the Directors of the James Irvine Foundation, I should like to express our appreciation for the opportunity to present our views on the provisions of H.R. 13270. They and I hope that these views will be helpful to your Committee in its deliberations. We strongly urge that this Committee avoid provisions which will unfairly and oppressively affect this and other private foundations and diminish their ability to carry on the philanthropic work which has substantially benefited the communities in which they operate.

Respectfully submitted,

By HOWARD J. PRIVETT, *Counsel.*

ANALYSIS AND CRITICISM OF THE TREASURY PROPOSAL TO LIMIT STOCK OWNERSHIP BY PRIVATE FOUNDATIONS

(By Ronald E. Gother*)

The issue squarely presented by the Treasury Department's proposed[1] amendment prohibiting all tax exempt private foundations from owning more than twenty percent of the stock of any corporation, is the extent to which convenience of administration should be taken into account in the formation of tax legislation. Although the Treasury Department merely mentions administrative convenience as one of the reasons for its proposal, when the other reasons advanced by the Department are analyzed closely, it is apparent that administrative convenience is the sole justification. In the course of studying the Treasury proposal, I will analyze each of the reasons given for its support by the Treasury Department, the history of similar proposals made in the past, the enforcement problems which it raises, and the various alternatives which have been suggested. Although additional safeguards may be necessary to prevent an abuse of the tax exemption privilege, the proposal to limit the amount of stock of any one corporation which may be owned by a private foundation is unwarranted, unnecessary, and goes beyond the scope of merely preventing abuses. If adopted it may seriously curtail charitable gifts.

The proposal of the Treasury Department as set forth in its most recent *Report on Private Foundations* is deceptively simple. The recommendation is that a private foundation should be prohibited from owning more than twenty percent of the voting power or equity of a corporation, or of the capital of a partnership and other incorporated business.[2] Present foundations with holdings which exceed this maximum limitation would be granted a prescribed period (unspecified) within which to reduce their holdings below the maximum limit. Foundations which do not comply with this requirement would lose their tax-exempt status.

I. HISTORY OF PROPOSAL

The proposal to limit the amount of stock or other business interests which a foundation can hold and still be deemed to be operating solely for charitable purposes is not new, but has been proposed several times in the past. In 1950, Congress conducted an extensive investigation of the tax-exempt privilege. The House version of the proposed legislation would have disallowed a charitable deduction for income, gift and estate taxes for corporate stock donated to a foundation if the donor and his family controlled the foundation and owned more than fifty percent of the voting stock of the corporation or more than fifty per cent of the entire outstanding stock of all classes.[3] It was at this legislative session that extensive provisions were adopted with regard to the taxation of unrelated business income,[4] certain types of prohibited transactions,[5] and the unreasonable accumulation of income.[6] The proposal to set a maximum limitation on the amount of stock which a foundation could hold was, however, rejected by the Senate

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*Member of the California Bar.

[1] STAFF OF SENATE COMM. ON FINANCE, 89TH CONG., TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS) Comm. Print (1965)) [hereinafter cited as TREASURY REPORT].

[2] Throughout the Article for the sake of convenience the author refers to the proposal as one limiting the ownership of stock although the proposal is larger in scope and encompasses partnership interests and other unincorporated business interests.

[3] H.R. REP. NO. 2319, 81st Cong., 2d Sess. (1950), 1950-2 CUM. BULL. 380, 414.

[4] INT. REV. CODE OF 1954, § 512.

[5] INT. REV. CODE OF 1954, § 503(c).

[6] INT. REV. CODE OF 1954, § 504.

and it was the Senate version which finally passed. The *Senate Report* summed up the reasons for rejecting the House proposal in the following manner:

> The House Report expressed the view that denial of deduction in such cases would simply be a recognition of the fact that where such control exists no complete gift for which a deduction should be granted has been made. In the opinion of your Committee this overlooks the fact that the donor or his family must use the property set aside in the foundation or trust for charitable, etc., purposes rather than for personal purposes.
>
> The view was also expressed that as the result of allowing these deductions there was an avoidance of income, estate and gift tax deductions. Outweighing this in the view of your Committee is the fact that if these deductions are not allowed still larger funds would be lost to private charities.[7]

In 1955 a committee headed by Representative B. Carroll Reece conducted hearings to determine whether provisions were necessary to implement the 1950 legislation. In its report[8] the committee did not come to any conclusion with respect to the ownership of stock by a foundation. It did, however, "suggest" to the House Ways and Means Committee that it consider denying a tax exemption if a foundation invested more than five or ten percent of its capital in the securities of any one corporation provided it also held substantial other assets so that it would not violate the five or ten per cent limitation. The Reece Committee, however, did not recommend that the donor be denied his income, gift or estate tax deduction for the gift. The Committee suggested a two- to five-year period within which existing foundation with holdings exceeding the limitation could conform without losing the tax exemption. The Committee proposals did not result in any legislation.

Earlier in 1965 Congressman Wright Patman issued the third installment of his report as Chairman of the Sub-Committee on Small Business. In this now famous "*Patman Report*"[9] he proposed that a three per cent maximum limit on such business interests be imposed.

From this it can be seen that the proposal of the Treasury Department is not a new or original thought although its seems to have steered a middle ground between prior proposals.

II. TREASURY DEPARTMENT REASONS PURPORTEDLY JUSTIFYING ITS PROPOSAL

Basically, the Treasury Department sets forth three reasons, other than administrative convenience, to which it only briefly alludes, which purportedly justify the proposals to limit the amount of stock a foundation can own. The three reasons are that (1) the ownership of a significant amount of a corporation's stock by private foundations puts regular business enterprises at a competitive disadvantage, (2) the opportunities and temptations for self-dealing proliferate, and (3) private foundation management spends more time concentrating on the commercial activities of the company whose stock it owns than it does on the charitable activities. Each reason will be analyzed separately.

A. *Competitive advantages*

The Treasury Department sets forth three ways in which a corporation acquires some sort of competitive advantage when its stock is owned in part by a tax exempt foundation. In analyzing these competitive advantages it is essential to keep in mind the fact that even though twenty per cent or more of the stock of a corporation is owned by a private foundation, such corporation pays the same corporate income tax as any other profit-making corporation engaged in business. The fact that the stock of such a corporation is owned by a charitable organization does not mean that the corporation secures any particular tax advantage.

1. Capitalization of Business with Before-Tax Income

As an example of this competitive advantage the Treasury Department cites the situation of a corporation which desires to allocate $1,000,000 of its gross earnings to the establishment of a new business to be carried on by a subsidiary. If the subsidiary were to be a fully taxable corporation, the parent would only be able to contribute to it approximately $500,000 out of the $1,000,000 of its

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[7] S. REP. NO. 2375, 81st Cong., 2d Sess. (1950), 1950-2 CUM. BULL. 483, 511.

[8] H.R. REP. NO. 2681, 83d Cong., 2d Sess. 217 (1954).

[9] CHAIRMAN'S REPORT TO THE HOUSE SELECT COMMITTEE ON SMALL BUSINESS, 88TH CONG., 2D SESS., TAX-EXEMPT FOUNDATIONS AND CHARITABLE TRUSTS: THEIR IMPACT ON OUR ECONOMY, THIRD INSTALLMENT 133 (Comm. Print. 1964).

gross earnings because it would first incur federal income taxes. However, if in lieu of creating a taxable subsidiary, the corporation created a charitable foundation to operate the same business, it could deduct its capital contribution and thereby donate the full $1,000,000 to the establishment of this new business operation. Whatever advantage a profit-making corporation would gain by forming a foundation to carry on a portion of its business would only be temporary. Thus, when a charitable foundation is organized, the amount of property donated to the foundation, $1,000,000 in the example, is permanently set aside for charity. Neither the income nor the capital contributed to the foundation can be returned to the corporation. Whatever possibilities there are for self-dealing in this type of situation, including favorable loans to the donor corporation, which seem to be a major concern of the Treasury Department, would be eliminated by the proposal to prohibit all transactions between the donor and the foundation.[10] Because the profit-making corporation can only take a charitable deduction for five per cent of its taxable income, it is apparent that any competitive advantage in a situation of this sort is of limited use. It would be necessary for the profit-making corporation to have taxable income of $20,000,000 in order to capitalize a foundation with $1,000,000 of before-tax income.

2. Lack of Demand for Dividend Income

A second competitive advantage envisioned by the Treasury Department is that a private foundation is less likely to demand that the corporation whose stock it owns declare dividends. For this reason, the corporation could retain more income to expand its business or modernize its facilities, giving such corporation a competitive advantage over other corporations whose shareholders may demand dividend income. However, a great number of profit making corporations in business today do not pay dividends even though they have shareholders who are not tax exempt entities. Such shareholders believe it is in their best interest to allow the company to reinvest the profits. Thus, there is no connection between the dividend payment policies of a corporation and the tax status of its shareholders. Moreover, in many situations the foundation, in the long run, may receive a greater benefit by allowing the corporation to reinvest its income, thereby increasing the value of the stock rather than siphoning out its income as dividends.

3. Acquisition of Business

The *Treasury Report* cites *Commissioner v. Clay B. Brown*[11] as an example of how a foundation can compete unfairly in the acquisition of a business. In *Clay Brown* the tax exempt foundation acquired an operating business, liquidated it, and then leased its assets to a newly formed operating company for a term of years. The rent, which the foundation received tax free, was used to discharge the purchase obligation. At the same time the rent was tax deductible to the operating corporation.[12] The Treasury Department argues that in this type of situation the foundation is able to pay more for the business than a non-tax exempt purchaser, thereby acquiring a competitive advantage.[13]

The Treasury Department also sees a competitive advantage in the potential ability of a foundation to lease business assets[14] to an operating subsidiary,

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[10] Section A of the *Treasury Report* deals explicitly and comprehensively with the self-dealing situation. In effect, it recommends rules patterned after the total prohibitions against transactions with related parties proposed by the 1950 House Bill. Such proposals would prevent private foundations from dealing with any substantial contributor, any officer, director, or trustee of the foundation, or any party related to them, except to pay a reasonable compensation for necessary services and to make incidental purchases of supplies.

[11] 380 U.S. 563 (1965). In this case the U.S. Supreme Court held that the seller of the business was able to report the installment payments he received as part of the purchase price as capital gains notwithstanding the fact that the payments were made out of the future income from the business.

[12] Shortly after the *Brown* decision the Internal Revenue Service issued T.I.R. 768 (1965), in which it indicated that in the future it will continue to challenge the deductibility of the rental payments made by the operating corporation. The Service in some prior cases has successfully established that the rental deduction is limited to a reasonable rental. Royal Farms Dairy Co., 40 T.C. 172 (1963); Estate of Goldenberg, 23 CCH TAX CT. REP. 810 (1963). See also Warren Brekke, 40 T.C. 789 (1963). However, the Service has also lost cases involving the same issue. Anderson Dary, 39 T.C. 1027 (1963); Isis Windows, 22 CCH TAX CT. REP. 837 (1963); Oscar C. Stahl, 22 CCH TAX CT. REP. 996 (1963).

[13] One student writer has suggested that, in fact, the charity can bargain for a lower price because its tax exemption allows it to return the purchase price to the seller faster. See Note, 18 U.C.L.A. L. REV. 167 (1965).

[14] If debt were incurred in acquiring the asset, the income from its subsequent lease would be unrelated business income and taxable to the foundation under INT. REV. CODE OF 1954, § 512.

siphoning off most or all of the subsidiaries' earnings by rental payments which are deductible by the subsidiary but are not taxable to the parent foundation. Apparently the competitive advantage is that the foundation can accumulate such tax-free rental income for future business operations.

Initially, it should be realized that only a relatively few foundations misuse their tax exemption privilege this way, in such situations. In only one case has the Commissioner been able to prove that an excessive price was paid for the business, and that case obviously involved a sham transaction.[15] Moreover, the Treasury Department has taken the position that *Clay Brown* will not apply if an excessive price is paid.[16] Although it is not clear that the courts will concur with this position, at least a potential remedy of more limited scope currently exists.

In addition, both of these alleged competitive advantages could be cured by means less drastic than prohibiting a foundation from owning more than twenty per cent of a corporation's stock. For example, competitive advantages could be eliminated by expanding the unrelated business income provisions of the code.[17]

B. Self-dealing

The Treasury Department states that the prohibited transactions section of the new proposals [18] should eliminate all types of self-dealing. However, it asserts that self-dealing occurs more frequently when a foundation owns a large block of a corporation's stock. Consequently if a foundation could not own a large block of stock the enforcement of the prohibited transactions section would be easier. This is the only time that the Treasury Department admits that the ease of administering this law is a reason for its proposal. However, if the prohibited transactions section is strengthened, any remaining self-dealing problems should be reduced to a level where they could be adequately handled on a case-by-case basic. At this point it would seem that the matter could be left to the states. Most states have developed sufficient limitations and safeguards to prevent a diversion of funds by transactions between the trustee and the foundation.[19] Even though in the past the states may not have been too active in policing private foundations, the move is in that direction,[20] and several states, including California,[21] have extensive regulatory provisions.

C. Lack of attention to charitable activities

The *Treasury Report* points out that when a foundation becomes involved in business activities the charitable pursuits, which constitute the real reason for its existence, may be subordinated to the demands of the commercial enterprise. More time may be spent on the operation of a business than on the charitable activities. However, there does not seem to be any correlation between the proposal to limit the amount of stock which a foundation may own, and this particular problem. Directors of the foundation need not be active in the management of the corporation. In a great many situations the foundation operates as an independent organization.

It does not follow that directors will spend less time than necessary to carry out the foundation's charitable activities if they are also engaged in the corporate business. As a practical matter either the corporation or the foundation, or both, will have other salaried personnel to manage the day-to-day operations. Quite often the private foundation is a passive entity merely distributing its income periodically to the support of other active charitable institutions. In this event, little time is required of directors in order to carry out the foundation's charitable purposes.

Even if the foundation were to own only a varied portfolio of common stocks, it does not necessarily follow that the directors will have more time to spend on

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[15] See Kolkey v. Commissioner, 254 F.2d 51 (7th Cir. 1958).

[16] See T.I.R. No. 768, CCH 1965 STAND. FED. TAX REP. ¶ 6739.

[17] See Note, 13 U.C.L.A. L. Rev. 167, 173 (1965).

[18] For a summary of the new proposals with regard to prohibited transactions, see note 10 *supra*.

[19] See 2 SCOTT, TRUSTS § 170–170.25 (2d 1956).

[20] Fremont-Smith, *Government Supervision and Accountability of Foundations*, in INSTITUTE ON FEDERAL TAXATION, NEW YORK UNIVERSITY, SIXTH BIENNIAL CONFERENCE ON CHARITABLE FOUNDATIONS 69 (1963). See generally Fremont-Smith, *Duties and Powers of Charitable Fiduciaries: The Law of Trusts and the Correction of Abuses*, 13 U.C.L.A. L. REV. 1041 (1966).

[21] CAL. GOV'T CODE §§ 12580–95. See generally Howland, *The History of the Supervision of Charitable Trusts and Corporations in California*, 13 U.C.L.A. L. REV. 1029 (1966).

the active pursuit of charitable activities. Such directors will, of course, be otherwise engaged in their own individual occupations. They may be officers and key employees of other active business corporations completely independent from the private foundation. The amount of time which they will have to devote to the foundation will depend on their other active business interests.

D. Administrative convenience

To summarize the foregoing, at least the first two reasons given by the Service to justify its proposal, that is, to eliminate purported competitive advantages and all types of self-dealing, would be adequately dealt with either by the prohibited transactions provision proposed by the Treasury or by expanding the unrelated business income provisions of the Code. The Service has found in the past that the prohibited transactions and unrelated business income sections of the Code are the most difficult to administer for the reason that the issues are complex and violations are sometimes hard to detect. Limiting the amount of stock which a foundation could own may reduce the administrative burden somewhat by eliminating, in some instances, the circumstances under which these sections come into play. It should, however, be acknowledged by the Service and clearly understood that this ease of administration is the primary reason for its proposal. The third reason for the proposal, that is, lack of attention to charitable activities, seems to be more of an afterthought on the part of the Service and a make-weight argument. It can be seriously questioned whether tax legislation of any sort should, or can, affect the amount of time which the directors of a foundation are to spend on its charitable activities.

III. ENFORCEMENT PROBLEMS

As a sanction for violating its proposal the Treasury Department would withdraw the foundation's tax exempt status. A second sanction might also be imposed by the state which supervises the foundation's activities. Such a remedy would compel the foundation to divest itself of stock so that it would not lose its tax exemption privilege.

A. Withdrawal of exemption

If the tax exempt status of a foundation were to be withdrawn, its income would be subject to tax, presumably at the regular corporate rates. This would affect the charitable activities of the foundation in two ways. First, it would have less income available for charity because a portion would be paid to the federal government. Second, the charity could not solicit additional contributions from others for it would no longer qualify as an organization to which deductible contributions may be made for federal income tax purposes. Even if this were only a temporary matter, the charities could suffer irreparable damage.

B. Divestiture

Divestiture could also work to the disadvantage of a charity. It would be apparent to any purchaser that this would be a forced sale which would in all probability bring a reduced price. This would be particularly true if the divestiture were required within a specific time rather than within a "reasonable time" or some other flexible alternative.

Unless the corporation whose stock is owned by the foundation has a public market (in which event the alleged abuses and advantages previously discussed are not likely), there may not be any market at all for the stock. It is possible that a foundation could wind up in a situation in which it could not sell the stock.[22] One large foundation has not been able to sell its minority interest in a large brewing company because the potential purchasers would not buy unless the majority joined in the sale and the majority was unwilling to do so.[23]

Forced divestiture completely ignores the possibility that such stock interest may be an excellent investment which returns to the foundation substantially more in income and other benefits than could be acquired by other investments. The responses to the Treasury proposals contained numerous examples of this

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[22] The *Treasury Report* does contain the suggestion that the Secretary of the Treasury be given the power to extend the time limit "in appropriate cases." TREASURY REPORT 37.

[23] HOUSE COMM. ON WAYS AND MEANS, 89TH CONG., 1ST SESS., WRITTEN STATEMENTS BY INTERESTED INDIVIDUALS AND ORGANIZATIONS ON TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS, VOL. I 158-59 (Comm. Print 1965) [hereinafter cited as STATEMENTS].

fact. Yale Professor John G. Simon summarized this quite well in a letter he submitted in response to Treasury proposals wherein he pointed out that of the 534 foundations surveyed in the Patman Report, the 112 which held ten percent or more of the stock of a corporation received dividends over a 10-year period equal to forty-two percent of the market value of their corporate holdings. This was substantially in excess of a twenty-nine percent average return experienced by the entire 534 foundations.[24]

A forced divestiture could, in some instances, work significant hardships on the donor. For example, the donor who in the past made a gift of a thirty per cent interest in the stock of his closely held corporation would be forced to accept outside third parties as stockholders in his business unless he or his family bought the stock back from the foundation.

Divestiture could also follow an irregular pattern because the matter would have to be left to the states. Some states would in all probability take no action whatsoever to compel a divestiture. In fact, without legislation many states may not even authorize such action at this time. As a result, if the Treasury proposal were adopted it can be expected that new foundations, and perhaps some of the existing foundations, would attempt to find friendly jurisdictions within which to do business so as to avoid this harsh penalty.

IV. ALTERNATIVES WHICH HAVE BEEN SUGGESTED

Numerous comments and suggestions were made in response to the Treasury proposals. Most of the comments were from those who had a personal interest and who would be adversely affected. As a result, each entity proposed either an exception to the proposal, so that they could continue to operate, or an alternative. The following are some of the alternatives which have been suggested:

A. Limit the charitable deduction for stock donated to a private foundation to cost and not market value of the stock represents an interest in a corporation controlled by the donor.

B. Do not legislate at all in this area but rather leave it to state law to limit the investments of a private foundation as New York (which prohibits a corporation from making a contribution to any foundation which owns ten per cent or more of the corporation's voting stock)[25] and Ontario (which prohibits a charitable institution from owning more than a fifteen per cent interest in a business)[26] have done.

C. If a foundation owns stock in excess of the maximum limitation, tax the dividends from such stock as unrelated business income.

D. Allow a foundation to prove that whatever stock interest it has in a corporation, even if it exceeds a twenty per cent interest, does not give it control of the corporation.

E. Insert a grandfather clause specifically exempting all existing foundations.

F. Provide an exemption for stock which is listed on the national stock exchanges.

G. Impose the twenty per cent maximum limitation only for stock acquired by purchase and not by gift or bequest.

H. Do not apply the twenty per cent rule if the grantor or related parties are no longer in control of the corporation.

I. Allow a foundation to hold the stock even though it is in excess of the maximum limitation as long as it produces a reasonable rate of return.

V. GENERAL COMMENTS AND CONCLUSIONS

The one glaring deficiency of the Treasury proposal is the fact that no evidence has been brought out to indicate the extent to which charitable giving will be restricted if the proposal were adopted. Certainly a significant portion of the charitable giving which occurs in the United States is prompted by the tax benefits accruing to a donor. The persons who would be most directly affected by the restrictions are those who have accumulated wealth mainly in the form of stock in closely held corporations. They have little else except such stock which they can use to make gifts to charity. The personal wealth of this group of persons

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[24] *Id.* at 458. *But see* Troyer, *The Treasury Department Report on Private Foundations: An Examination of Some Criticisms*, 13 U.C.L.A. L. REV. 965 (1966).

[25] N.Y. GEN. CORP. LAW § 34.

[26] ONTARIO STAT. ch. 13, § 2 (1959).

represents a significant portion of the private capital in the United States. Any proposal which affects the ability of such persons to make tax deductible charitable gifts must of necessity reduce the total amount of all private charitable activities.

If the Treasury proposal to limit the amount of stock which a foundation can own has any merit whatever, it must be the ease of administration of the tax law with respect to private foundations, achieved by establishing a maximum limitation. Although no one would dispute the fact that the facility of administering any law, and particularly the tax law, is a proper and desirable goal, it must in each instance be balanced and weighed against the effect it will have on the over-all objective of the law. The objective of the tax law with respect to tax exempt organizations is to promote the dedication of private capital to the public good. From the small sampling of statistical evidence which is presently available it can be demonstrated that even if this particular Treasury proposal reduced charitable giving only by a small percentage, the public loss would be significant. Of the many foundations which own more than twenty percent of a corporation's stock, there are three in particular whose charitable activities have promoted the public good in significant ways over the years. These artivities would be severely affected by the proposal. One is Duke Endowment which owns fifty-seven percent of the outstanding stock of Duke Power Co. In the course of its operations it has already allocated $220,000,000 (more than double its initial grant) for its charitable purposes.[27] Lilly Endowment, Inc., the owner of forty-five percent of the Class A voting stock of Eli Lilly & Company, has made grants for various charitable purposes totalling $53,000,000,[28] while the W. K. Kellogg Foundation, owner of fifty-one percent of the Kellogg Company voting stock, has made grants of $67,000,000.[29] Other large foundations which hold more than twenty per cent of a corporation's stock include the Kresge Foundation (owner of thirty-four percent of the S. S. Kresge Company voting stock), John A. Hartford Foundation (owner of thirty-four percent of the Great Atlantic & Pacific Tea Company, Inc. voting stock), Samuel H. Kress Foundation (owner of forty-two percent of the S. H. Kress & Company voting stock), Werner-Gren Foundation for Anthropological Research (owner of twenty-four percent of Electrolux Corporation voting stock), the Pew Memorial Trust (owner of twenty-one percent of Sun Oil Company voting stock), and The Danforth Foundation (owner of twenty-three percent of the Ralston-Purina Company voting stock). No doubt there are many others,

These large and prominent charitable foundations have and will continue to make important contributions to the public welfare. Unless curtailed by a revision of the tax law it can be expected that significant additional private wealth will be dedicated to the benefit of the public. It is submitted that, on balance, the administrative convenience factor is of secondary importance.

OCTOBER 3, 1969.

SUPPLEMENT TO STATEMENT OF THE JAMES IRVINE FOUNDATION

The Directors of The James Irvine Foundation do not believe that the time of the Committee on Finance of the United States Senate should be used to review the legal squabbles of a dissident minority shareholder with the management of a private corporation; nor do they believe that the merits or demerits of such controversies are in any way relevant or material to the determination of a national tax policy applicable to private foundations. However, for purposes of the record it is necessary for us to advise the Committee of the falsity of the charges made in the statement submitted by Joan Irvine Smith.

We regret that Mrs. Smith as a minority shareholder of the Irvine Company has taken the position that she has with respect to her grandfather's gift of a majority of the Irvine Company stock to the Foundation in trust for charitable uses. The other three grandchildren of Mr. Irvine and the other members of the Irvine family who also have a stock interest in the Company have not joined Mrs. Smith in either her attacks on the Company or her attempts to invalidate Mr. Irvine's trust. To the contrary they have contributed in a constructive way

[27] II STATEMENTS 500.
[28] I STATEMENTS 284.
[29] I STATEMENTS 357.

to the growth and development of the Company and to the fulfillment of Mr. Irvine's charitable objectives.

The allegations in Mrs. Smith's statement to your Committee that the Foundation has engaged in unlawful conduct and self-dealing are wholly untrue. Mrs. Smith's assertion of these spurious charges can be understood only in the perspective of the events of the past ten years.

During that period Mrs. Smith has been engaged in an all-out effort to discredit and disrupt the management of the Irvine Company in order to gain the control over its affairs that was denied to her by Mr. Irvine's gift of stock to the Foundation. In this endeavor Mrs. Smith has resorted to a variety of techniques and devices. She has maintained a steady stream of baseless litigation in which she has never succeeded in substantiating the allegations made in her complaints or in obtaining a judgment in her favor. Mrs. Smith has also retained a press agent to publicize unfounded charges and false accusations against every chief executive officer of the Irvine Company and all but one of the men who have been elected to its Board of Directors since 1959. In addition, Mrs. Smith has made extensive use of private investigators and has surreptitiously recorded conversations of officers and directors of the Company and meetings of directors by concealing recording devices on her person and in the living room of her home.

The California Attorney General in his capacity as the supervisor of the administration of private foundations has made investigations of various of Mrs. Smith's charges and has found them to be without merit. Moreover, the Attorney General under the Uniform Supervision of Charitable Trusts Act has periodically reviewed the operations of the Foundation and has found no instance of unlawful conduct or self-dealing.

In the most-recently concluded of Mrs. Smith's law suits, she attempted to invalidate the charitable trust established by Mr. Irvine and to recover for herself and other heirs the Irvine Company stock held by the Foundation under the terms of the trust. The claim and accusations made by Mrs. Smith in her pleadings and testimony in that case included a large number of the charges contained in her statement to your Committee. The United States District Court in entering its judgment in favor of the Foundation and against Mrs. Smtih found expressly that "none of the contentions of the plaintiff [Mrs. Smith] are well founded." 277 Fed. Supp. 774, at 802 (1967). The judgment was affirmed by the Court of Appeals for the Ninth Circuit (402 F.2d 772 (1968)) and Mrs. Smith's petition for writ of certiorari was denied by the United States Supreme Court on April 28, 1969 (394 U.S. 1000, No. 1167).

With respect to the decision in that case Mrs. Smith's attorney, Lyndol L. Young, in a memorandum to the minority stockholders of the Irvine Company dated June 11, 1969, stated *inter alia*:

"Three years ago Mrs. Smith instituted a determined fight to free The Irvine Company from the control of the Foundation by taking action in the United States District Court and before the United States Treasury Department, the Internal Revenue Service and the Congress. The battle was waged simultaneously on all of these fronts. Her objective was and is to compel the Foundation to get out of The Irvine Company. The Federal court action, if successful, would have recovered the 459 shares of Irvine stock now held by the Foundation for the Irvine heirs or the Irvine estate. This case should have been won, but it was lost because, as everybody now knows, the courts have been polluted with the money influence of the private tax-exempt foundations.

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"There never was a greater miscarriage of justice than the decisions of the courts in this litigation.

"However, the record that was made in the federal courts in Mrs. Smith's case against the Foundation laid the framework and is largely responsible for the action that is about to be taken by the Congress, which will accomplish the forced demise of The James Irvine Foundation as the majority and controlling stockholder of The Irvine Company."

We believe it is clear from the foregoing that Mrs. Smith's charges against the Foundation are without substance in fact or in law and that her submittals to your Committee and to the Committee on Ways and Means are calculated not to serve the public interest but to benefit her private interests at the expense of the charitable beneficiaries of Mr. Irvine's trust.

Respectfully submitted,

HOWARD J. PRIVETT,
Counsel.

Senator BYRD. Mr. Chairman, may I ask a couple of clarifying questions?

Mr. Privett, do I understand you correctly that the value of the trust when it was established was roughly $5 million?

Mr. PRIVETT. $5.6 million.

Senator BYRD. $5.6 million, and you have distributed $10.3 million?

Mr. PRIVETT. Yes, sir.

Senator BYRD. Over what period of time?

Mr. PRIVETT. Since 1947. That is when the trust became irrevocable.

Senator BYRD. The assets of the trust are $100 million, you say?

Mr. PRIVETT. Senator, we have no specific basis for determining what the value of this stock interest is. The last sale of the stock was a redemption by the company in November of last year of a small number of shares held by another shareholder, and the redemption price was $250,000 per share. If that is the value our asset would be approximately $124 million.

Senator BYRD. What is the trust income?

Mr. PRIVETT. It was $1.3 million in dividends last year.

Senator BYRD. That is total income, $1.3 million?

Mr. PRIVETT. Yes, sir. You are talking about now the dividend income that was received by the foundation in respect of its stockholders.

Senator BYRD. Thank you.

Thank you, Mr. Chairman.

Senator ANDERSON. $125 million earnings; you can buy Government bonds and get 5 percent, which would give you an income of over $6 million; can you not?

Mr. PRIVETT. That is correct, Senator. This is the point that I think that we have not been able to make clear. It is very easy to take the value which I said this stock sold for in a redemption last November and to immediately apply a factor to that, but the reason for this increase in value and the reason for that value, Senator, is because of the massive appreciation that has occurred in the value of this large landholding.

Now there are only about 5,000 acres of this 84,000-odd acre landholding that have been developed. A master plan was developed in 1964 as this urbanization took place. It was approved by the Orange County Planning Commission and the company is moving ahead as rapidly as the market will absorb the development that it is making in the residential, commercial and industrial field, but until we get these developments on the ground, and the real estate is returning income, then the income from this asset is not going to approximate the growth that there has been in the value of the underlying assets.

Senator GORE. Mr. Chairman, with my limited knowledge of this foundation, it is an example particularly adverse to the genuine public interest. It is an example of the dead ruling the living, of the investment of 84,000 acres, a large percentage of a whole county, in perpetuity, contrary to the feelings of ancient civilizations as well as our own.

Senator Byrd has called attention to the small dividends received by the trust. True, the dividends remain in the company, and the control of the company by the trust, by the foundation, is used for that purpose. This is likewise typical, as the distinguished gentleman says, of many foundations.

The committee has a great challenge here to look after the public interest interpreted by a democratic society and not by a particular board of directors or by the bequest of some man who has long since gone to his reward.

Thank you.

Senator FANNIN. Mr. Chairman, I think timing is vital in the disposal of property or in the development of property. I know in my State of Arizona and certainly in New Mexico that if all of the land were placed on the market at one time, the value of it would drop appreciably. So I think that we must look at this broadly. I would just like to ask the question that I think is important.

Does the ownership of the stock as now held provide a tax benefit or privilege to the Irvine Co.?

Mr. PRIVETT. Senator, the Irvine Co. enjoys no tax benefit of any kind whatsoever by reason of the fact that the foundation owns this particular stock interest in the company. I should also like to say, Senator, that the foundation exercises its franchise in voting this 51 percent stock interest to elect men to the board of directors of the company.

This board of directors has followed the policy of paying out a very high proportion of the operating income of the company in dividends, much higher than competing companies or other companies that are not owned in any proportion by private foundations.

I have set forth in the written statement which we filed some of the details of the dividend distribution that there has been, but roughly in excess of 80 percent of the operating income of the company is paid out in dividends, and we respectfully suggest that the operation of this substantially agricultural enterprise as a ranch, which has had this phenomenal growth in value, and which is going to inure this value in perpetuity to the benefit of charity has occurred without any abuse on the part of the foundation. Rather it seems that because the rapid acceleration has occurred, and because it does take time to get to developments on the ground that are going to produce the income, that there is a feeling that the foundation has not functioned, moved ahead as aggressively with its projects as it should.

I submit that a careful examination as the California attorney general has given to the affairs of the Foundation would disclose the facts to be that the land area of Orange County that is controlled by the Irvine Co. is being developed as rapidly as the market will absorb the land, and short of going out and wholesaling the land off for speculative purposes, the development could not progress faster than it is progressing under the excellent land management team that manages the Irvine Co.

Senator GORE. What is wrong with speculation and enterprise on the part of American citizens? Why should they be denied the opportunity to develop as individuals view the opportunity?

Mr. PRIVETT. I am not complaining about what other individuals——

Senator GORE. You seem to be condemning this.

Mr. PRIVETT. I am not condemning that, Senator.

Senator GORE. Pardon me?

Mr. PRIVETT. I am saying that from the standpoint of the trustees of the foundation——

Senator GORE. That is a different proposition from our standpoint.

Mr. PRIVETT. Their objective is to take the asset which Mr. Irvine gave them, and to develop this asset so that it has the greatest benefit for the people of California that he wanted to benefit, and the manner——

Senator GORE. The people of California may not agree with the view of the board of directors.

Mr. PRIVETT. Well, the uniform supervision of charitable trust acts has been law in California since 1955. We have now and have always had a very active attorney general in carrying out that obligation, and the deputy attorney general attends meetings of the board of our foundation, and if they have any feeling that the manner in which the Irvine Ranch is being developed and whether the judgment of our trustees that the orderly development of this property under a master land use plan, within the center of it a 1,000-acre campus of the University of California which arose from a gift of 1,000 acres of land to that university for the development, and around that university will be a city of more than 100,000, and it will be developed with sufficient green belts, with schools, parks churches, and provisions for the kind of an environment——

Senator GORE. Who is going to determine the manner of development?

Mr. PRIVETT. That is being determined by the board of directors of the Irvine Co., which consists of three members that are on the foundation board, who are elected by the foundation, and the president of the company, and three members of the minority stockholder group.

Senator GORE. Then you propose in perpetuity to manhandle the people of an entire city?

Mr. PRIVETT. We do not propose to manhandle anyone, Senator. All I can say in that respect is that our purpose is to carry out the public trust which we have, and to do so in a way that is a fitting and proper way.

Senator GORE. Thank you.

Mr. PRIVETT. We think we have done that and we think the California attorney general agrees with us.

Senator ANDERSON. Do you think that the founder of this trust would be happy seeing his family squabbling?

Mr. PRIVETT. I am sorry, Senator, I did not get the question.

Senator ANDERSON. I will skip it.

Further questions?

Will Mrs. Smith come forward.

Mr. PRIVETT. Is it your desire that we remain at the table, Senator, to answer such questions as you might have?

Senator ANDERSON. Go ahead, Mrs. Smith.

Senator BENNETT. I made the proposition. I will set the captives free.

Mr. PRIVETT. No; we are very pleased, thank you, sir.

Senator BYRD. Mr. Chairman, could I make a comment at this point?

Senator ANDERSON. Yes, sir; you may.

Senator BYRD. I think the committee will agree that it is not very often that the committee has such an attractive witness as the one we will have in a few minutes. And I might say that not only is she a

woman of charm but she is a splendid businesswoman, energetic, and determined. She I understand is a minority among a majority on a board of directors, and whether she is right and the majority is wrong I don't pretend to say. But she is a fine Virginian and I am very pleased to have Mrs. Smith, to welcome her here to this committee and to have my colleagues come to know her as Joan Irvine Smith of Middleburg, Va.

STATEMENT OF MRS. JOAN IRVINE SMITH, THE JAMES ERVINE FOUNDATION, ACCOMPANIED BY LYNDOL L. YOUNG, ATTORNEY FOR MRS. SMITH

Mrs. Smith. I should like to begin my statement by saying that my great-grandfather James Irvine acquired the Irvine Ranch in 1864, more than 100 years ago. My grandfather, James Irvine, Jr., inherited the property from his father and incorporated his holdings as the Irvine Co., under the laws of the State of West Virginia in 1894.

Today the principal assets of the Irvine Co., are 88,000 acres of urban land in Orange County, Calif., which is adjacent to the metropolitan area of Los Angeles. This holding constitutes 20 percent of the entire area of Orange County, and is worth in excess of $1 billion.

As the largest individual stockholder in the Irvine Co., I hold 180 shares of that stock which constitutes 22 percent of the total stock outstanding. The James Irvine Foundation holds as trustee 459 shares or approximately 55 percent of the total stock outstanding.

The foundation stock interest of course represents absolute control of the corporation. It should be extremely obvious that as a substantial stockholder in the Irvine Co., I am seriously affected by the mismanagement policies of that corporation under the absolute domination and control of the James Irvine Foundation.

Mr. Surrey's statement before this committee cited the following abuses committed by foundations which bill H.R. 13270 will correct. They are self-dealing, failure to make adequate current distribution, ownership of business, utilization of the foundation by the donor as an instrument to facilitate the control of business, and speculative investment of assets.

The James Irvine Foundation is guilty of all these abuses and more. This foundation is by far the rottenest apple in the foundation barrel. In view of the time allotted to me to make my oral statement, I will have time to cover only a few of the most recent abuses practiced by the James Irvine Foundation.

However, I have filed a much more detailed written statement with the committee, which covers those incidents that I will not have an opportunity to go into at this time.

Now it should be pointed out that there has been and always will be as long as the James Irvine Foundation controls the Irvine Co., an interlocking directorship relationship between the foundation and the corporation.

There are seven directors of the Irvine Co., and five of them are elected by the foundation and serve as its agents, representatives and puppets of that foundation.

I am the only stockholder in the Irvine Co., who is also a director of the corporation. Mr. McLaren, the president of the foundation, is also the chairman of the board of directors of the Irvine Co. He is the dictator of the corporation. He has repeatedly told me that I am an outside director because I am not a part of the Irvine Co. management, and therefore, that the only functions which I am entitled to perform as a director is to approve all of the acts of the foundation-controlled management of the corporation.

Whatever may be the qualifications of Mr. Privett as the attorney for the foundation, he is certainly no authority on what constitutes good management for a private enterprise corporation such as the Irvine Co. Neither does Mr. McLaren posses the qualifications that are so necessary to the successful management of a private enterprise corporation.

Now the background of Mr. McLaren is solely that of a certified public accountant. Incidentally, Mr. McLaren's firm up until a short time ago did the auditing for the Irvine Co., in addition to the other hats that he also wore.

It was this gentleman who represented my grandfather as his tax accountant and tax adviser, and in this capacity he inveigled himself into my grandfather's confidence and convinced him that the Irvine Ranch would have to be sold in its entirety in order to pay the estate and California inheritance taxes which would be levied against his estate.

It was solely upon this representation of Mr. McLaren that my grandfather entered into the trust agreement under which the foundation became the tax-exempt owner in trust of the controlling stock interest in the Irvine Co.

Now this representation by Mr. McLaren was untrue, as the assets that were in my grandfather's testamentary estate in addition, his Irvine stock holdings were liquid and adequate to have paid these taxes, if my grandfather had not transferred this Irvine stock to the foundation as trustee, but had left this stock to his estate for the benefit of his heirs.

It is not necessary that the members of this committee consider only my statements with reference to the mismanagement policy of the Irvine Co. under the control of the James Irvine Foundation. Let us look at the record and the statements of impartial witnesses concerning the incredibly low dividend policy of the Irvine Co., since the absolute control of this company passed to the foundation upon the death of my uncle, Myford Irvine in 1959.

In that year the estate of Myford Irvine sold 15 shares of Irvine stock for $100,000 per share, and in November 1968 the Irvine Co., purchased 13½ shares of its own stock from a dissatisfied stockholder for $250,000 per share. At no time during the last 10 years were the dividends of the Irvine Co. more than 1 percent of the value of the stock of that company when it was either $100,000 per share or $250,000 per share.

When Mr. McLaren and Mr. Privett appeared before the Committee on Ways and Means of the House of Representatives on Februrary 21, 1969, Mr. Mills, the chairman of the committee, examined both Mr. McLaren and Mr. Privett concerning this penurious dividend policy of the Irvine Co., under the control of the foundation.

Mr. Mills asked Mr. McLaren what he considered the corpus of the foundation to be worth, and Mr. Privett answered for Mr. McLaren by stating that based upon the sale of 13½ shares of Irvine stock in November 1968, the corpus of the foundation consisting of 459 shares of Irvine Co., stock would be approximately $123 million.

Mr. Mills then wanted to know what the annual income of the foundation was based upon its stock holdings in the Irvine Co., and Mr. Privett replied, "Approximately $1¼ million."

Now Mr. Mills asked Mr. McLaren whether or not he as chairman of the board of directors of the Irvine Co. was satisfied that the company is properly managed, and Mr. McLaren stated that he was completely satisfied.

Mr. Mills then asked Mr. McLaren, Why is it that the Irvine Co. is only producing a return per year on those shares of Irvine stock that are held by the foundation of 1 percent or less when that return is related to the value of the corpus of the foundation;"—to wit, its Irvine stock based on $250,000 per share?

Mr. McLaren had no answer to this question. Mr. Mills also told Mr. McLaren and Mr. Privett that he would not accept as a true value for the purposes of determining the relationship of income to value the transaction involving the sale of only 13½ shares of stock of the Irvine Co. at $250,000 per share, and commented that the value of the foundation's Irvine stock would be far greater if put on the market than that of 13½ shares sold by minority interests.

Mr. Mills then stated to Mr. McLaren that if the Irvine Co. under the management of the foundation cannot make more money than that on its Irvine Co. stock, to wit, less than 1 percent on the value of $123 million as stated by Mr. Privett, whether this is a good thing for the foundation to continue to have this much of its total corpus tied up in the stock of Irvine Co., and Mr. Mills further stated that he thought Mr. McLaren would welcome the Treasury's suggestion that the Congress force the foundation to diversify its investment to some greater extent, to where it would get a better rate of return on its investment than it was getting out of its stock in the Irvine Co.

Now, during Mr. Dillon's appearance before this committee on September 25, I believe Senator Curtis asked him how the Government would receive any tax benefits from the divestiture provision of the House bill as recommended by the Treasury. Here is the answer to this application to the James Irvine Foundation.

I have just called your attention to the 1-percent dividend record of the Irvine Co. as managed by the James Irvine Foundation, which has only produced for the taxpaying stockholders of that company approximately $1,250,000 per year.

When this foundation is forced to divest itself of its controlling stock interest in the Irvine Co., it will sell its Irvine stock to new stockholders who will be taxpayers. New private enterprise corporate management will replace the inefficient, incompetent, self-dealing and fraudulent foundation controlled management.

Under new competent management, dividends of at least 5 percent could be paid to the stockholders, which will amount to in excess of $12 million per year. The Government will of course receive taxes on this amount rather than on approximately $1 million per year, which is at present being received by the individual taxpaying stockholders.

In addition, the Irvine Co. will pay far more substantial corporate taxes with new private enterprise management who will accelerate rather than retard the proper development of the Irvine Ranch properties.

Through this divestiture, the foundation will receive on its own evaluation $123 million for its stock. Invested at the rate of 5 percent the return per year on this amount will be in excess of $6 million instead of the present $1.3 million per year, which will certainly redound to the substantial advantage of the charitable beneficiaries.

Now Orange County, Calif., where the Irvine Ranch is located is growing at the rate of 210 persons per day, and at present its population is 1,400,000 people. Over the last 12 months 26,000 homes have been constructed in the county. Now although the Irvine Co. owns 20 percent of the most readily residential developable land in that county, they have, because of inefficient, incompetent management, constructed only approximately 1,000 homes in the last 12 months. This of course is less than 4 percent of the total home construction in that area.

According to Mr. John McIntire, of the nationally known land planning and civil engineering firm of McIntire & Quiros, the Irvine Co. should under proper management construct at least 10,000 dwelling units per year, and should do that for the next 10 years which would be 100,000 homes constructed by 1980.

To further illustrate the mismanagement practiced by the Irvine Co. under the control of the James Irvine Foundation, they have this very year frozen 50,000 acres of prime residential real estate now ready for development, in a so-called but fictitious agricultural preserve. This will mean that 50,000 acres of prime Irvine Co. land will be frozen out of development for the next 10 years or more.

I call your attention to the statement that Mr. Mills made to Mr. McLaren regarding this agricultural preserve, to wit, "I do not know what hat you wear at this meeting,"—meaning the hat of the president of the foundation or the hat of the chairman of the board of directors of the Irvine Co.—"but in either case how do you justify entering into this agreement"—meaning the agricultural preserve—"to forestall the increased value of property that you as a director or a trustee are obliged to preserve and maintain as a part of the corpus of the foundation? Was this a good thing on your part as the chairman of the board of the Irvine Co. to allow this restriction to occur on 49,253 acres of land in a part of the Irvine Co. which is 53 to 54 percent owned by the foundation? Is that good foundation practice?"

Mr. McLaren stated that he believed it was because through the establishment of the agricultural preserve the Irvine Co. expected to save, which it has not done so far, $1,500,000 per year on real estate taxes in Orange County.

Now, concerning this explanation by Mr. McLaren, Mr. Mills stated, "But as the taxes go up, the fact that you have saved that much in taxes also means that you also have avoided through this device the normal increase in value of that property."

Mr. Mills then wanted to know whether or not Mr. McLaren and Mr. Privett had explored with the courts in California to see whether this agricultural agreement could be set aside, or whether it is in the best interests of anyone, and Privett answered that they had not, and

that I have filed a suit in the Federal court in Los Angeles asking the court to set aside the agreement and that he as the attorney for the foundation was going to file an answer to this lawsuit on March 3, 1969.

Mr. Mills then stated, "You are just filing an answer? I thought you were going before somebody to ask that the restriction"—meaning the agricultural preserve—"be removed. You are not going to do that?"

Mr. Privett replied, "Definitely not, Chairman Mills."

Mr. Mills then asked, "Why don't you want it removed if you are going to diversify your assets or your investments? This is a situation where a foundation is operating, dominating, and controlling a business enterprise, one of the things which I do not think a foundation ought to engage in. The issue is whether a foundation should be permitted to own and dominate a business operation such as the Irvine Co., to place encumbrances upon its properties perhaps to such an extent as to minimize values, and whether it is in the public interest for a foundation to remain in this condition, that is the issue before the committee.

"We do have this recommendation that the situation ought not to be permitted to go on in perpetuity."

Mr. Mills then stated, "When you put on your hat as chairman of the board of directors of the Irvine Co. and put this amount of land into the agricultural activities for 10 years, there is not anybody who would question that you have materially reduced your possibility of income. I am not a real estate man, but when you tell me you cannot sell land in that community and get more for it than you can raising agricultural products, you have lost me. Now you have tied yourselves out of it."

Mr. Schneebeli, a Republican member of the Committee on Ways and Means wanted to know why the board of supervisors of Orange County entered into the agricultural agreement which reduced the county's tax income by $1,500,000 per year, and when Mr. McLaren stated that he could not speak for the county officials, Mr. Schneebeli stated, "Well, does it make much sense?"

Mr. Utt, the second ranking Republican member of the committee and in whose congressional district the Irvine Ranch is located and who is intimately acquainted with the mismanagement policies of the Irvine Co. under the control of the foundation expressed his opinion concerning the establishment of the agricultural preserves as follows:

"I agree so completely with your statement"—referring to my statement—"on that preserve or whatever you call it to relieve the Irvine Co. of $1.5 million taxes to the county. I cannot understand the board of supervisors doing it because I have a great many close associates owning land within that conclave of the Irvine Co., some 1,000 or 2,000 or 3,000 and they have been dealing with them on a water system and they are not going to be interested in that because they cannot develop it, because you can stop development of the Irvine Co. because of the establishment of this agricultural preserve."

I replied to Mr. Utt's statement as follows:

"To me it is absolutely appalling because this land"—meaning the agricultural preserve—"lies directly beside Tustin, and know what the growth in Tustin is. You know all of the growth comes up to the Irvine Co. land in that area and it stopped and it does not go any far-

ther and there are these people that you speak of that have 3,000, 4,000 acres that lie there in one piece. San Joaquin Fruit Co. I believe owns some property there in that area and they have attempted to develop this land. They cannot get sewers, they cannot get anything."

Now, Mr. McLaren paid no attention whatsoever to the criticism by Mr. Mills and other members of the Committee on Ways and Means concerning the mismanagement policies of the foundation through its control of the Irvine Co. Upon his return to California, Mr. McLaren continued to engage the Irvine Co. in the same practices and policies for which he had been challenged by Mr. Mills.

On June 16, a regular meeting of the Irvine Co. board of directors was held, and at this meeting the Irvine Co. 1969 restricted stock property plan was approved. Under this plan certain foundation-elected key executives of the Irvine Co. which include Mr. McLaren are to receive a bonus in kind for their services, but the exact nature of this bonus is not described. It could be a distribution of the stock of the Irvine Co. or one of its subsidiaries, or a piece of the assets of the Irvine Co. such as a shopping center or an apartment complex.

Now, these so-called key executives would be selected at the sole and unfettered discertion of the compensation committee which is appointed of course by the foundation-controlled board of directors.

This is just one more of many such schemes the foundation, trustees and their controlled Irvine Co. management have attempt to put over on the minority stockholders.

Again as in the past I have been compelled to file legal action to prevent the dissipation of Irvine Co. assets.

As you will be able to see from my written statement, I have for the past 12 years been in a continuous battle with the James Irvine Foundation trustees and their Irvine Co. management to keep them from getting their fingers literally in the company till.

This foundation reform legislation is long, long overdue gentlemen.

Thank you.

Senator ANDERSON. Do you want your full statement to be put in the record?

Mrs. SMITH. Certainly.

Senator ANDERSON. That will be done.

(Mrs. Smith's prepared and supplemental statements follow:)

STATEMENT OF JOAN IRVINE SMITH WITH REFERENCE TO THE JAMES IRVINE FOUNDATION

SUMMARY

The James Irvine Foundation, as trustee, holds 459 shares of the stock of the Irvine Company, a West Virginia corporation, which represents approximately 53% and the control of the Board of Directors and the management of this One Billion Dollar corporation. The principal asset of The Irving Company consists of land holdings in Orange County, California, amounting to 84,000 acres which are located in the metropolitan Los Angeles area. This holding constitutes 20% of the total area of Orange County, California. In 1960, the population of Orange County was approximately 700,000 persons. Today, it is approximately 1,500,000 persons. In 1960, the population of Orange County represented 4.4% of the total population in California. Today, it is 7%. During the year 1968, the County's growth averaged 6,388 persons per month, or 210 per day. The Irvine Company has an outstanding capital stock issue of 841½ shares and The James Irvine Foundation holds, as trustees, 459 shares or 53.7% of the total stock of this Company. I am the largest individual stockholder of the Irvine Company with

my stockholding of 180 shares which constitutes approximately 21% of the total issued stock. The remaining shares are principally owned by members of the Irvine family.

N. Loyall McLaren is President of The James Irvine Foundation and Chairman of the Board of Directors of The Irvine Company and 5 of the 7 Directors of this corporation are designated and elected by Mr. McLaren, as the President of The James Irvine Foundation. As Chairman, Mr. McLaren rules the Board of Directors and the management of The Irvine Company, which is personally selected by him, with the ruthless tactics and strong-arm methods of a dictator. During the reign of Mr. McLaren over The Irvine Company since 1959, no consideration whatever has been given to the 45% stock rights and interests of the Irvine family stockholders. During this same period, the policies and practices of Mr. McLaren with reference to the management of The Irvine Company have only produced dividends to the stockholders of less than 1% based on the market value of their stock. As recently as November, 1968, The Irvine Company itself purchased from a stockholder, 13½ shares of its own stock for $250,000.00 per share and based on this transaction, the total dividends of approximately $2,300.00 per share paid by The Irvine Company for the year 1968 constitute a dividend return of less than 1%. During the last 5 years the net income of The Irvine Company, including land condemnations and sales was approximately between $8,000,000.00 and $10,000,000.00, and under proper management, dividends based upon this sum of at least $6,000.00 per share should have been declared and paid to the stockholders.

Under the following titles in my attached statement, there are set forth many of the self-dealing practices and abuses of The James Irvine Foundation in connection with its absolute and arbitrary control of the Board of Directors and the management of The Irvine Company, a private enterprise corporation, whose business is wholly unrelated to the charitable activities of the Foundation.

The illegal hellis transactions with the Irvine Company.

The death of Myford Irvine.

The Stevens Development Company deal.

The Upper Bay Development Company deal.

The University of California at Irvine.

The Long deal.

Attempt to bring my attorney to directors meeting.

The hostile attitude of N. Loyall McLaren.

The Irvine Ranch Agricultural Preserve Foundation deal.

The so-called "1969 RESTRICTED STOCK AND PROPERTY PLAN" proposed by the foundation for certain foundation controlled key executives of the Irvine Company.

The Irvine Company policy established by the foundation does not justify its tax exemption as a charitable organization.

I strongly recommend to the Committee on Finance, United States Senate, that the provisions which are contained in H.R. 13270 that is now under consideration by your committee with reference to the divestment by private foundations of stock held in corporations whose business is unrelated to the charitable activities of foundations; the income tax of 7½% based on value of the investment assets of foundations and the 5% annual income distribution applicable to all foundations, be approved by your committee, but with the following revisions, to wit: that the divestment period commence with the year 1970 on a basis of at least 20% instead of the 10% provided in H.R. 13270 at the end of 1971 and that there be an annual 20% divestment provision during each of the remaining 4 years so that at the end of the 5-year period, as now provided in H.R. 13270, The James Irvine Foundation will have been required to divest itself of all stock that it holds in the Irvine Company. Also, that the 7½% income tax be made applicable to the year 1969 in order that this new tax will be paid on April 15, 1970 and that the 5% income distribution provision be made applicable to the year 1969 instead of 1970.

STATEMENT

My name is Joan Irvine Smith. I live with my husband, Morton W. Smith and our children on our farm in Middleburg, Virginia.

My great grandfather, James Irvine, immigrated from Ireland to the United States in 1846. He was then 19 years of age. Upon his arrival in New York City, he went to work in a paper mill but soon thereafter left New York for the

California goldfields, where he worked as both a miner and a merchant. He later moved to San Francisco where he engaged in the mercantile business. In 1865 James Irvine, with two partners acquired 3 ranches in what was then Los Angeles County and which originally were Spanish land grants. These ranches were known as the Rancho San Joaquin, Rancho Lomas de Santiago and a portion of Rancho Santiago de Santa Ana and covered approximately 115,000 acres.

In 1876, James Irvine acquired his partners' interest and thereafter the above-named 3 ranches were known as The Irvine Ranch. James Irvine died in 1886 and The Irvine Ranch was left to his son, my grandfather, James Irvine, Jr., in trust until he was 25 years of age whereupon the ownership of The Irvine Ranch vested absolutely in him.

In 1894, James Irvine, Jr. incorporated The Irvine Company under the laws of West Virginia with a capital of $100,000.00 divided into 1,000 shares of the par value of $100.00 per share.

In 1921, my father, James Irvine II, received from his father 200 shares of the stock of The Irvine Company. This stock holding was placed in trust under an agreement between James Irvine II and his father who was also the trustee. This trust agreement provided that if James Irvine II predeceased his father without issue, the 200 shares of Irvine stock reverted to his father, but if James Irvine II predeceased his father with surviving issue, the trust agreement provided that if such issue survived James Irvine, Jr., the 200 shares of Irvine stock would be distributed to such issue and the trust thereupon would be terminated.

My father died in 1935 and was survived by myself and my mother. I was two years old. On August 24, 1947, my grandfather died and thereupon I became the owner of 200 shares of the stock of The Irvine Company.

After my father died in 1935, certain problems arose with reference to Federal Estate Taxes and California Inheritance Taxes which involved the 200 shares of the stock of The Irvine Company which my father had received in trust from his father in 1921. At this time, N. Loyall McLaren, who was a certified public accountant and tax adviser for my grandfather was employed to handle the Federal Estate Taxes and the California Inheritance Taxes that were involved in the estate of my father. In connection with the settlement of these tax problems, Mr. McLaren became closely associated with my grandfather and during the period between 1935 and 1937, Mr. McLaren had inveigled himself into the confidence of my grandfather to the extent that he succeeded in having my grandfather sign an Indenture of Trust and to allegedly assign to a California corporation, as trustee, to wit, The James Irvine Foundation, 510 shares of the stock of The Irvine Company which amounted to 51% of the total issued and outstanding stock of this company. Under this Indenture of Trust, the title to the 510 shares of Irvine stock was not to vest in The James Irvine Foundation, as trustee, until after the death of my grandfather. During the period from 1937 to 1947 when my grandfather died, he received all of the dividends and there was no change whatever in the ownership and the control and the management of The Irvine Company by my grandfather. The James Irvine Foundation, as trustee, during this period of 10 years had no connection whatever with the business or corporate affairs of The Irvine Company or with the 510 shares of Irvine stock.

After the death of my grandfather, on August 24, 1947, the James Irvine Foundation, as trustee, illegally received the delivery of the 510 shares of Irvine stock from the executors of the estate of my grandfather who were also directors and trustees of the James Irvine Foundation. At the time of the death of my grandfather, the certificates of stock representing the 510 shares all stood in the name of my grandfather. After the delivery of these certificates in November, 1947 for 510 shares of Irvine stock to the Foundation, as trustee, following the death of my grandfather, a stock certificate was for the first time issued in the name of the James Irvine Foundation.

When my grandfather died, I became the owner of the 200 shares of Irvine stock but I was only 14 years of age and a minor. A certificate for the shares was therefore issued in the name of my mother, Athalie R. Clarke, as guardian of my estate. In 1952, when I was 19 years of age, I was married and under the laws of California, I thereupon had reached by majority and was entitled to have the 200 shares of Irvine stock transferred from the name of my mother as said guardian to my own name. I then placed 100 shares of Irvine stock in a trust for my mother. Upon her death, this 100 shares reverts to me.

In 1957, I became a Member of the Board of Directors of the Irvine Company and thereupon I was in an official position to become acquanited with the affairs

of The Irvine Company and what I discovered disclosed to me that there were many irregularities and illegal, self-dealing and unjust enrichment transactions that were connected with the management of the company under the control and domination of The James Irvine Foundation.

The 180 shares (formerly 200) of the stock now owned by me in The Irvine Company represents 21.1% of its total capital stock. The 459 shares (formerly 510) of Irvine stock now owned by The James Irvine Foundation amounts to 53.7% of the total capital stock of the corporation. The total issued capital stock of The Irvine Company at this time amounts to 841½ shares. Approximately 202½ shares of Irvine stock are owned by other members of the Irvine family. On November 6, 1968, The Irvine Company purchased 13½ shares of its own stock which were then owned by the Macco Realty Company. The price paid by The Irvine Company for this stock was $250,000.00 per share and based upon this valuation, my 180 shares of Irvine stock has an established market value of $45,000,000.00.

The illegal Hellis transactions with the Irvine Co.

The first discovery that I made concerning the self-dealing and mismanagement practices of The James Irvine Foundation was shortly after I became a Director in 1957, and involved the illegal dealings of one W. B. Hellis that were connected with The Irvine Company. Mr. Hellis was a Director and Vice President of the Irvine Company and since 1950 he also had held the dual and conflict of interest position of Director, Member and Trustee of The James Irvine Foundation.

In August of 1947, Mr. Hellis and a friend of his, whose name is W. S. Tubach, had gone with my grandfather to a cattle ranch owned by The Irvine Company in Montana, and I learned that while on this trip my grandfather had met his death by alleged accidental means while fishing in a stream that was located on the cattle ranch. As I heard the story, there had been a very violent argument between my grandfather and Mr. Hellis during lunch on August 24, 1947, and right after the argument my grandfather and Hellis and Tubach supposedly went fishing and each man took a location on the stream and they were to meet afterwards. Well, my grandfather never came back. I don't recall if it was Hellis or Tubach who found my grandfather supposedly, but he was in the water and he was dead.

I then discovered that at a meeting of the Board of Directors of The Irvine Company which was held on October 16, 1947, as disclosed by the minutes of this meeting, which meeting was attended by Directors Hellis, Dinsmore, Scarborough and Plum, absent, Myford Irvine. Hellis stated to the Board of Directors that on this trip to Montana, my grandfather had orally agreed to loan him and his wife and Tubach, from funds of The Irvine Company, the sum of $190,000.00. There was no writing signed by my grandfather or any other corroboration to support the statement of Hellis concerning this alleged agreement. To my astonishment, I further discovered from reading the minutes of this meeting that the Board of Directors for the first time in the entire existence of The Irvine Company authorized the making of a loan of company funds to anybody, let alone a Director and Vice President of the Company and a total stranger to the company such as Tubach.

The minutes of this meeting further disclose that N. Loyall McLaren and A. J. McFadden who were present at the meeting as Directors, Members and Trustees of the James Irvin Foundation and as nominee Directors to the Board of Directors of The Irvine Company upon an amendment to the By-Laws of said company increasing the number of Directors from five to seven, sat in and participated in this meeting as directors for the Foundation and gave their approval to the making of this loan in the sum of $190,000.00. As above pointed out, Hellis was made a Director and Trustee of the Foundation in 1950.

I further discovered that through an investigation made by my attorneys that Hellis and his friend Tubach had been buying properties together with the Irvine Company under the control of the Foundation that were located in Imperial Valley as tenants in common with the company. It also further developed that there were other unjust enrichment transactions involving the purchase of lands and where Hellis and Tubach each owned a ½ undivided interest with the Irvine Company owning the other ½ interest and financing the deal. The various transactions in Imperial Valley amounted to approximately $11,000,000.00. Subsequently,

I requested the Foundation controlled Board of Directors of the Irvine Company to take action against Hellis and Tubach with reference to these illegal transactions where founds of the Irvine Company had been used to unjustly enrich both Hellis and Tubach, but they refused to take action. My mother and I thereupon instituted legal action against Mr. and Mrs. Hellis and Mr. and Mrs. Tubach consisting of a proceeding to perpetuate testimony and as a result thereof Mr. Hellis resigned as a Director and Vice President of the Irvine Company and also a Director, Member and Trustee of The James Irvine Foundation and there was a voluntary partition made of the properties which stood in the names of Hellis and Tubach as to an undivided ½ interest and in the name of the Irvine Company as to the remaining ½ interest.

The death of Myford Irvine

My uncle, Myford Irvine, who succeeded my grandfather as President of the Irvine Company was found dead in the basement of his home on January 11, 1959, from gun shot wounds. An autopsy disclosed that he was shot in the stomach twice from a 16 gauge shotgun and once in the head by a .22 revolver. It appeared that my uncle was confronted with financial obligations which had caused him considerable worry. He had endeavored to either sell or borrow money on his stock in the Irvine Company which consisted of 150 shares, but was unable to do so. His death was officially attributed to suicide.

The Stevens Development Co. deal

Immediately following the death of my uncle, A. J. McFadden, who had never been a Director or Officer of the Irvine Company during the lifetime of my grandfather and who was made a Director of the company in 1947 by The James Irvine Foundation was elected President of the Company and N. Loyall McLaren was elected Vice President and acting President. Mr. McFadden was elected as only an interim President until a permanent President had been elected. Mr. McLaren took over the task of interviewing candidates for the office of President and one of the men that he interviewed was Roger Stevens, a real estate man with offices in New York City. Mr. Stevens came to the Irvine Ranch but instead of talking about becoming the President of the Irvine Company, Mr. McLaren stated that Mr. Stevens had made a proposal to develop the properties owned by the Irvine Company, and under the Stevens proposal, the Company was to put $12,000,000.00 worth of land into a new corporation to be called the Stevens Development Company. It was apparent this was a pre-arranged self-dealing transaction between McLaren and Stevens. Mr. Stevens was to contribute $5,000,000.00 to the capital of this new corporation which would make a total capitalization of $17,000,000.00.

The stockholders of the Irvine Company were to have an opportunity to purchase a part of Mr. Stevens' commitment for stock in the sum of $5,000,000.00 and also employees of the Company which would have included the Foundation Directors, Mr. McFadden and Mr. McLaren, would also have enjoyed the right to purchase some of Mr. Stevens' stock. Furthermore, under the Stevens proposal, he or the new Stevens Development Company would have the right of first refusal on all of the company acreage, which would have been the same as giving the Stevens Development Company an option on the entire property that was owned by The Irvine Company in Orange County. The Stevens proposal was made to the Board of Directors immediately after Mr. McLaren had become a Member of the Board and Vice President of The Irvine Company. I believe it was at the April meeting in 1959 that Mr. McLaren made the Stevens proposal to the Directors, and he further stated that he had hired the New York law firm of Cravath, Swain & Moore to represent The Irvine Company and to evaluate the Stevens proposal.

The Stevens proposal covered approximately sixteen pages and Mr. McLaren handed copies to each member of the Board of Directors and stated that he was very much in favor of it. I looked over a copy of the proposal and it was very long and very detailed, but one of the things I could certainly see from it was that the Irvine family minority stockholders would be totally out as far as making any capital gains on the sale of any of the Orange County properties because of the way that the Stevens proposal had tied up the entire Irvine Ranch property.

I asked Mr. McLaren about that, and he said, "Well, you can spin off the stuff in Montana and in Imperial Valley," and so I said, "Well, that is not where the appreciation has been, it has been in Orange County." Mr. McLaren replied, "Well, that's where we've got the stockholders where the hair is short, you are not going to get any capital gains here".

Later there was a luncheon held at the Irvine Coast Country Club for the Board of Regents of the University of California, who were considering the location of the Univeristy of California at Irvine on part of the property of the Irvine Ranch. Mr. McLaren was present and, after the luncheon I told Mr. McLaren that I was not going to go along with his deal, and he told me that I was, that I was going to do exactly as I was told to do and we got into quite an argument outside of the Club. Later that afternoon, Mr. McLaren called me at my home and asked me if he could come down and he came down with Roger Stevens and an attorney from Cravath, Swain & Moore and I believe another gentleman who was an attorney from the same law firm or an associate of Mr. Stevens. The meeting lasted about a half an hour and Mr. McLaren tried to convince me to go along with the Stevens proposal. I had previously obtained legal opinions from three law firms in Los Angeles, which were in writing and I had them with me at the meeting and all three opinions stated that the Stevens proposal for the Irvine family minority stockholders was a very bad thing and should not be gone into and just was certainly not a good business deal as far as the Irvine family stockholders were concerned. I told Mr. McLaren that if he pushed the Stevens deal that I would sue for liquidation and Mr. McLaren turned to Mr. Halloran from the Cravath law firm and said, "Tell her the laws in the State of California when the Foundation owns 51% of the Company, that she can't sue for liquidation," and I said, "You had better tell Halloran that this is not a California corporation, it is West Virginia, and in West Virginia you only need 20% and I have got the 20%".

Thereupon the whole tenor of the conversation changed and Mr. McLaren got very sugary and sweet and said how he had always taken care of my affairs, represented me on the Board of Directors, looked after my mother's and my interest and that I shouldn't spend all of my money going to these attorneys, that I didn't need to, that all they were going to do was cost me money for legal fees, and so on, and so forth, and Mr. Halloran said, "Well, I couldn't give her better advice than to seek legal counsel whenever she feels it's necessary". They then started talking about setting up separate corporations with the Company properties in Orange County and spinning them off, and so forth and there was a discussion about that, and then the meeting was over, and they all left. The next day at the Board of Directors meeting, Mr. McLaren again tried to push his self-dealing Stevens deal through and I had the three legal opinions which I read into the record, that it was a bad deal, and I informed them that I would start to sue for liquidation if they tried to push it, and Mr. McLaren then told Mr. McFadden to contact Stevens and tell him that the deal was off, and that was the end of the Stevens proposal at that time. I was very excited about the Stevens proposal because Mr. McLaren was supposed to be contacting Mr. Stevens to come in as President of The Irvine Company, and here he came in with an entirely different situation where he was going to strip the Irvine Company of its Orange County property and put it in this other corporation where Mr. McLaren would have an interest. This was the end of the Stevens deal and Mr. Stevens returned to New York.

The Upper Bay Development Co. deal

Following the Stevens proposal, Mr. McLaren brought another self-dealing proposal to the attention of the Board of Directors of The Irvine Company which was known as the Upper Bay Development Company, and under this proposal by Mr. McLaren this Company was to be organized as a subsidiary corporation of The Irvine Company. The Irvine Company was going to take one-third of the stock, and the Irvine family minority stockholders were going to be able to get a third of it so Mr. McLaren at the Directors meeting stated that this was a very highly speculative business venture and he felt that the Foundation would give up its one-third stock interest. They would not take their third, and instead The Irvine Company employees would get that third and that instead of said employees having to buy the third of that stock in this subsidiary, which would hold about 170 odd acres of the land of The Irvine Company, that was worth approximately $50,000.00 an acre, that The Irvine Company would advance 90% of the money for the employees to go into the deal and that the employees would only have to put up 10%. Mr. McLaren and Mr. McFadden were both directors of The Irvine Company and the Foundation, Mr. McFadden was President of The Irvine Company and Mr. McLaren was Vice-President and Mr. McLaren was also President of the Foundation so both of them would have participated in the ownership of one-third of the stock of this subsidiary corporation as employees of

The Irvine Company and 90% of the purchase price of this stock would be advanced by The Irvine Company and they would only personally contribute 10% thereof.

I asked Mr. McLaren whether the Company was going to loan the Irvine family minority stockholders the money to purchase their stock and he said, No, that we would have to buy all or any part that we wanted with our own money. Later this proposal came before the Board of Directors and the Company Tax Counsel wrote a memorandum on how this subsidiary corporation was to be set up and how it was to be divided with the employees of The Irvine Company which included Mr. McLaren and Mr. McFadden as officers of the Company and Directors and Trustees of the Foundation who would get a piece of the stock which would be financed up to 90% with Company money. Through my efforts, this self-dealing transaction which would have unlawfully enriched McLaren and McFadden, was abandoned.

After Mr. McLaren became Chairman of the Board of Directors in 1960, he opposed many of my motions as a Director and as the only stockholder of The Irvine Company who was a Director with reference to many matters which were for the best interest of the Company and the Irvine family stockholders. One of these matters was the master plan for the development of the extensive land holdings of The Irvine Company. This plan was finally adopted but both Mr. McLaren and Mr. McFadden fought it and the other Foundation Directors also opposed it, but finally agreed to it.

The University of California at Irvine

When the Board of Regents of the University of California indicated that they were interested in locating a University on The Irvine Ranch providing The Irvine Company would make a gift of the property to the Board of Regents, Mr. McLaren wanted to sell the property to the Board of Regents. I was in favor of the Company making a gift of the property and I cited the University of California at Los Angeles as an example as to how The Irvine Company would be benefited by having the University located on its property like the City of Westwood which was developed adjacent to the University of California at Los Angeles was an example of what would happen if the Board of Regents established a similar University on the property of The Irvine Company. There was another group who owned considerable property that was going to give their property to the Board of Regents and the University would have been located on this other property if we had not made a gift of our property to the Board of Regents and if this had happened, we would not have the University of California at Irvine where it now exists, on the property of The Irvine Company at Irvine, Orange County, California.

The Long Deal

Another self-dealing transaction involving an officer of The Irvine Company and the Foundation controlled Board of Directors of the Company was the Long transaction. Mr. Long was a Vice President of The Irvine Company in charge of the Land Development Department. This transaction came before the Board of Directors with reference to a tract of company land of approximately 125 acres that was situated along what was known as the Upper Back Bay in Newport Beach, and on this particular property the Company began to put in the improvements, that is the public utililities and the streets so that it could be developed. I was then advised that the Company was going to have a man who had done other development work for the Company to the development on this particular property. Mr. Long, who was a Vice President of the Company, came before the Board of Directors and stated that he had a small minority interest in the Bay Crest Corporation which was one of the corporations that another individual by the name of Austin Sturdyvand was acting in the development of this property. The way it turned out was that there were two other people who also had an interest in this property, and they both came in with bids for the property. I think one bid was for $13,000 an acre and the other bid was for $12,500 an acre which was later raised to $13,000 an acre and the bid of Mr. Sturdyvand was $11,000 an acre. Mr. Long was involved in this trasaction with Mr. Sturdyvand. Mr. McFadden, who was the President of the Company and also a Director of both the Company and The James Irvine Foundation stated that he was going to handle the deal and that as President he would take care of the matter and that the best group would purchase the property. As it turned out, the other two bids for $13,000 an acre were discouraged by Mr. McFadden or his agent from being interested in the purchase.

One of said purchasers was told by a representative of The Irvine Company that this Company was an eleemosynary organization and wasn't interested in making money. When these two other bids dropped out, Mr. McFadden and Sturdyvand agreed to a purchase price of $13,000 an acre and then he kicked in for The Irvine Company additional acreage which had not been approved by the Board of Directors or brought to my attention as a Director and stockholder of the Company and also Mr. McFadden added another 12.73 acres which likewise had never been authorized by the Board of Directors or brought to my attention as a Director and stockholder and sold the same to Sturdyvand at $10,000 an acre. This property was appraised shortly thereafter in the neighborhood of $30,000 an acre.

Both Mr. McLaren and Robert H. Gerdes, who was also a Director of The Irvine Company, as well as a Director of the Foundation approved the transaction with Sturdyvand. At the Directors meeting which occurred after the deal was closed by Mr. McFadden, he stated that all of the extra acreage that was added to the original 125 acres which was approved by the Board of Directors with the exception of my "No" vote had been added to and sold to Sturdyvand. This transaction was a typical example of how The Irvine Company has been mismanaged under the control and domination of The James Irvine Foundation. Later, my mother, Mrs. Athalie R. Clarke, and myself, filed a derivative stockholders suit against the Foundation and its Directors and Mr. Long for damages that the company lost in the sale of the property to Sturdyvand at $13,000 an acre. The lower Court sustained a Demurrer to our Complaint without leave to amend. An appeal was taken to a higher Court and the judgment of the lower Court was reversed as to Long, McFadden and McLaren and my mother and I were given permission to file an Amended Complaint which we were unable to do because the appraiser who had appraised this property had died during the appeal and we therefore were unable to use his testimony and so the action was dismissed.

Before this suit was filed, I attended a meeting of the Board of Directors and there was a discussion with reference to the Long situation. I requested that Mr. Long be brought to the Directors meeting for the purpose of telling the Directors exactly what kind of an interest he held in the Bay Crest Corporation and Mr. McLaren spoke up and said that Mr. Long didn't have to tell anybody about anything and that he, Mr. McLaren, was satisfied with the deal and that it had gone through and been completed and that that was simply the end of it. I later discovered that Mr. Long had considerably more than a small minority interest in the Bay Crest Corporation and there was another corporation involved in this Sturdyvand transaction in which he was the total stockholder and there were two other corporations also involved which I understood that Mr. Long held at least a 50% interest therein.

Attempt to bring my attorney to directors meetings

Because of all of the improper and illegal transactions that were involved under the control and domination of The James Irvine Foundation, I requested the right to bring my attorney to the meetings of the Board of Directors of The Irvine Company. As I have already pointed out, I was the only stockholder in the Company that was also a Director and furthermore as the owner of the 200 (now 180) shares of stock of The Irvine Company, I was the owner of ap- approximately 21% of all of the assets of this corporation and was therefore vitally and substantially interested in how the affairs and business of The Irvine Company were managed. It was the general practice of Mr. McLaren, as Chairman of the Board of Directors to overrule all of the motions or resolutions that I proposed by telling me that I was out of order and when I would appeal his ruling, I of course was overruled because the Foundation Directors who were in the majority all voted to uphold the ruling of Mr. McLaren. The Foundation could not keep me off the Board of Directors because my 200 shares of stock under the cumulative voting law in California permitted me to elect myself as a Director and therefore the Foundation could not keep me from serving as a Director of The Irvine Company. My request to have my attorney present at the meetings of the Board of Directors was turned down. My attorneys thereupon filed a Petition with the Court for a Writ of Mandamus for the purpose of directing and ordering the Board of Directors of The Irvine Company to permit me to bring my attorney to the meetings of the Board. I was the only woman on the Board of Directors and the Foundation Directors

were attorneys and businessmen and Mr. McLaren was a certified public accountant and also the Foundation selected an attorney for The Irvine Company and he was also present at the meetings and of course his opinions supported the wishes of the Foundation Directors who controlled the meeting. The Court held that under the laws of West Virginia where The Irvine Company was incorporated that the Board of Directors was the exclusive authority as to who could attend the meetings of the Board and therefore this proceeding was dismissed.

The hostile attitude of N. Loyall McLaren

The attitude of Mr. McLaren as Chairman of the Board of Directors toward me as a Director and a substantial stockholder in The Irvine Company is perhaps best illustrated by a conversation that my mother and myself had with Mr. McLaren in San Francisco. On this occasion, Mr. McLaren referred to me as an outside Director and he referred to a book which he had written and in which he stated that unless you were a Director who was also a part of management which of course I was not, that you therefore were an outside Director and didn't have any say in what was going on in the company. You simply attended the Directors meetings to approve what management did, and not to direct management unless you were part of management and therefore he considered me to be an outside Director, even though I own 21% of The Irvine Company and neither Mr. McLaren or any other Director on the entire Board of Directors owned a single solitary share of stock therein. The control by The James Irvine Foundation directors that controlled The Irvine Company, from time to time created wholly owned subsidiary corporations and in connection with the organization of these companies, the Irvine family stockholders indicated that they would like to have a voice in the management thereof. One of these corporations was The Irvine Industrial Complex, a California corporation. However, the Irvine family stockholders were told by Mr. McLaren that the control of the Board of Directors of these subsidiary corporations would also be under the control of The James Irvine Foundation and that the Foundation did not intend that any other stockholder would have anything to say about the control of The Irvine Company or any of its subsidiary corporations.

On one occasion, when there was a discussion about the subsidiary corporation, Mr. Privett, who is the attorney for The James Irvine Foundation, was present. During the discussion, I brought up the fact that the Treasury Department had recommended to the Committee on Ways and Means of the House of Representatives that all private foundations, such as The James Irvine Foundation, should be prohibited from holding more than 20% of the stock of another corporation such as The Irvine Company and Mr. Privett stated that The James Irvine Foundation would give up the tax exemption rather than divest its stock in the Irvine Company because the prime interest of the Foundation was running The Irvine Company in perpetuity and forever.

The Irvine Ranch Agricultural Preserve Foundation deal

On January 29, 1969, the Board of Supervisors of Orange County, pursuant to an application filed by The Irvine Company, adopted a resolution by a vote of 3 supervisors and with 2 supervisors voting "No", which substantially provided that the application of The Irvine Company for the establishment of an agricultural preserve on the lands of The Irvine Company in Orange County and covering an area of approximately 49,253 acres was approved. Although I am a Director and the largest individual stockholder in The Irvine Company, I had not been notified of the filing of this application with the Board of Supervisors, otherwise I would have been present at the hearing and would have objected thereto. This resolution further provided in substance that on February 18, 1969, the Board of Supervisors would consider the execution of an agreement with The Irvine Company to establish the agricultural preserve pursuant to the California Conservation Act of 1965.

On February 11, 1969, the Board of Directors of The Irvine Company, by the vote of the Foundation controlled Directors, McLaren, Sullivan, Mason and Wheeler and with the fifth Foundation controlled Director, Newman being absent, adopted a resolution authorizing the President of The Irvine Company to enter into the Agricultural Preserve Agreement with the Board of Supervisors of Orange County. I voted against this resolution and so did Director N. Keith Gaede, husband of Linda Irvine Gaede who owns 45 shares of the stock of The Irvine Company. As above mentioned, I am the only Director who is also a stockholder.

On February 18, 1969, the date which had been set by the Board of Supervisors for the purpose of considering the execution of the Agricultural Preserve Agreement with The Irvine Company, my attorney, Lyndol L. Young, personally appeared and requested the Board of Supervisors to postpone the consideration of this agreement for a period of one week in order that I and my mother, who is also a stockholder in The Irvine Company, could appear before the Board of Supervisors and protest the execution of this agreement. Mr. Young advised the Board of Supervisiors that I and my mother were attending a hearing before the Committee on Ways and Means of the House of Representatives—United States Congress in Washington, D.C. and that I was scheduled to appear as a witness before this committee on February 19, 1969 and was therefore unable to be present at the meeting. The attorney for The Irvine Company was present at this meeting and he objected to the postponement requested by Mr. Young and thereupon the Board of Supervisors adopted a resolution approving the execution by the Chairman of the Board of Supervisors of this agreement.

The establishment of the fictitious agricultural preserve on 40,253 acres of land of The Irvine Company in Orange County out of a total holding of 84,000 acres during the 10-year period of the agreement prohibits The Irvine Company from selling or leasing any part of the lands contained therein free and clear from the incompliances, restrictions, limitations and liens imposed thereon under the terms of the agreement which are that no part of the agricultural preserve lands may be devoted to any uses other than agricultural. Only 10,000 acres involved in the agricultural preserve are actually devoted to agricultural purposes and the remaining 30,000 acres do not contain topography that is agriculturally oriented. This means that The Irvine Company, during this 10-year period, is prohibited from developing any part of this 40,253 acres of the company's valuable lands in Orange County for residential, industrial, commercial or business uses. Consequently, The Irvine Company and the minority stockholders, including myself, will be substantially damaged both as to dividends and the intrinsic value of our Irvine stock. The Agricultural Department of the Company now operates at a substantial loss.

Because of the mismanagement policies by the Foundation through its control of The Irvine Company in refusing to adequately develop the Company property in Orange County, a great number of home buyers who desire to locate in Orange County have had to go elsewhere in order to find a home and by reason thereof, many thousands of home sales have been lost to The Irvine Company. The major portion of the lands covered by the agricultral preserve are presently ready and marketable for residential, business, commercial and industrial development and under proper management, this land would be developed by the construction of 10,000 homes per year during the period of the next 10 years or a total of 100,000 new homes. Because of the establishment of the agricultural preserve on 40,253 acres of these lands, the buyers who would prefer to purchase homes on the Irvine Ranch will go elsewhere and in this event, The Irvine property that constitutes the agricultural preserve will remain vacant and economically unproductive and unsalable indefinitely and for many years in the future, and this will have a detrimental, restrictive influence on the orderly urban growth of the property of The Irvine Company in Orange County.

I have instituted a stockholders derivative action in the United States District Court in Los Angeles against The James Irvine Foundation and the Foundation controlled Directors of The Irvine Company and the members of the Board of Supervisors of Orange County for the purpose of having this Agricultural Preserve Agreement set aside and adjudicated as invalid.

The so-called "1969 restricted stock and property plan" proposed by the Foundation for certain foundation controlled key executives of The Irvine Co.

At the meeting of the Board of Directors of The Irvine Company on June 16, 1969, attended by myself and the other 6 members of the Board, John V. Newman, Director of both The Irvine Company and the Foundation and Chairman of the Compensation Committee of the Board of Directors of The Irvine Company, handed a 3-page document to each of the Directors, including myself, which document was entitled "The Irvine Company—1969 Restricted Stock and Property Plan." Director Newman read a prepared resolution to the effect that this plan be approved by the Board of Directors. During the discussion of the resolution, Foundation Director Sullivan, who is a member of the Compensation Committee, stated that under this plan, a piece of the assets of The Irvine Company and of its subsidiary corporations will be given to the key executive employees of

The Irvine Company who will be selected by the Compensation Committee in its sole discretion. Directors Mason and Wheeler who are respectively the President and Secretary of The Irvine Company, disqualified themselves from voting on the resolution as they were interested parties who will participate in the plan. I spoke against the plan as a give away to the Foundation agents and representatives who had served the interests of the Foundation and not the interests of the minority stockholders of The Irvine Company. Three Directors who were all members of the Compensation Committee voted "Yes" and I voted "No". Director and Chairman of the Board and also a Director of the Foundation, McLaren, said to me, "You are making a terrible record". I replied that "I was not", and thereupon Director McLaren stated that he voted "yes". His vote was necessary to adopt a resolution by a majority of the whole Board. McLaren was and is the salaried Chairman of the Board of Directors of The Irvine Company and he is by definition in the "Plan" a key executive employee. Like Directors Mason and Wheeler, he is an interested party who will participate in the plan.

For many years, McLaren and the Foundation's attorney, Mr. Privett, have voted the stock of The Irvine Company owned by the Foundation and McLaren exercises such control over the Foundation, that he votes the stock in his uncontrolled discretion and in effect, personally selects 5 of the 7 members of the Board of Directors of the Company.

The liklihood of mishandling and self-dealing under the "1969 Restricted Stock and Property Plan" is evidenced by the history of The Irvine Company under the control of the Foundation since 1959, which has required my constant guarding against the misappropriation of corporate assets, such as the illegal Hellis transaction mentioned by me where a Director of The Irvine Company was purchasing real estate in joint ownership with the Company and borrowing money from the Company while serving as a Director; also, the Stevens Development Plan Deal mentioned by me where an option to buy the entire Orange County property of The Irvine Company was to be conveyed to a corporation controlled by a Mr. Stevens, under a plan giving employees of The Irvine Company the right to purchase part of Mr. Stevens' stock. (Such employees included the Chairman of the Board, Mr. McLaren); and the Upper Bay Development Company Deal, also mentioned by me which involved an attempted transfer of 170 acres of land valued at approximately $50,000 per acre, to a subsidiary corporation in which the employees of the corporation were to be permitted to purchase ⅓ of the stock therein and The Irvine Company would loan the employees 90% of the money they would need to buy this ⅓ interest. Mr. McLaren would have participated in this self-dealing transaction if I had not interfered and frustrated its execution.

Then we have the recent Agricultural Preserve Deal, also mentioned by me, that is presently being litigated, and which involves the placement of approximately 50,000 acres of The Irvine Company land in Orange County in a fictitious "agricultural preserve", freezing this acreage from commercial development for 10 years, thereby depressing the present value of The Irvine Company's assets for purposes other than and contrary to those of the minority stockholders. I am convinced by these and other similar self-dealing proposals and practices of the Foundation and its President, McLaren and the other Foundation Directors who are also Directors of The Irvine Company, that this "1969 Restricted Stock and Property Plan" is designed as it is (without any guidelines or standards) for the specific purpose of distributing the assets of The Irvine Company in a manner which would work a fraud on myself and the other minority stockholders and would constitute a wasting of the assets of the Company.

Like the other self-dealing transactions proposed and attempted by McLaren during the past 10 years by virtue of his position as Chairman of the Board of Directors of the Company, I have been compelled to file another lawsuit in West Virginia where The Irvine Company was incorporated, in order to prevent this giveaway plan from being carried into effect. My attorneys filed a motion in this action for a preliminary injunction, and the West Virginia Court has ordered, with the agreement of the attorneys for The Irvine Company, that no further steps will be taken by the Board of Directors in connection with this plan pending the hearing of my motion for a preliminary injunction.

The Irvine Co. policy established by the foundation does not justify its tax exemption as a charitable organization

The dividend record of The Irvine Company under the domination and control of The James Irvine Foundation has been extremely low. In November, 1968, The Irvine Company purchased 13½ shares of its own stock from the Macco

Realty Company for the sum of $250,000.00 per share or a total sum of $3,375,000.00. Dividends paid by The Irving Company during the past 10 years are less than 1% of the asset value of the 459 shares of the stock of The Irvine Company that is held by the Foundation. This low rate of dividends is not attributable to the net earnings and profits of the Company which constitute the source of money that is available for the payment of dividends, which averages approximately $8,000,000.00 to $10,000,000.00 per annum including land condemnations and land sales. The James Irvine Foundation contends that it is a charitable organization and it has therefore obtained from the Internal Revenue Service a tax exemption on all income and capital gains received by it on its stock in The Irvine Company. It is the duty of The James Irvine Foundation, through its control of The Irvine Company, to produce maximum dividends on its Irvine stock and also to declare adequate dividends for the minority stockholders and not to accumulate dividend income for capital improvements or development which the Foundation controlled Board of Directors has done since 1959 when Myford Irvine died and the absolute control of the management of The Irvine Company was taken over by the Foundation.

The Tax Reform Act of 1969—H.R. 13270 provides that all tax exempt private foundations, including The James Irvine Foundation, commencing with the year 1970, will be required to pay an income tax of 7½% based on the value of the investment assets held by the Foundation. In my opinion, this income tax of 7½% should be made applicable to the year 1969 in order that the payment thereof will commence on April 15, 1969 instead of April 15, 1971. I also believe that the provision in H.R. 13270 that requires tax exempt foundations to distribute each year 5% of the value of the investment assets of the Foundation should be applicable to the year 1969 instead of the year 1970.

Supplemental Written Statement of Joan Irvine Smith Amplifying Her Testimony Before the Finance Committee, U.S. Senate, on October 7, 1969

(Re the incompetent and self-dealing management policies of the James Irvine Foundation through its 53 percent stock control of the Irvine Co.)

On February 21, 1969, N. Loyall McLaren, President of the James Irvine Foundation, and Howard J. Privett, attorney for Mr. McLaren, appeared before the Committee on Ways and Means and were examined by the Chairman, Mr. Mills, and other members of this Committee.

During the examination of Mr. McLaren, he referred practically all of his answers to the questions propounded to Mr. Privett. Mr. Mills asked Mr. McLaren the following question: "What do you consider the corpus of the Foundation to be worth?" Mr. Privett answered for Mr. McLaren as follows: "The last sale of Irvine Company stock, which was rather recently (November, 1968), was at $250,000 per share. If that value could be obtained, and that was a sale of only 13½ shares, then the corpus of this Foundation would be approximately $123,000,000."

Mr. Mills then asked the following question: "What is your annual income?" Mr. Privett replied: "Approximately 1¼ Million Dollars."

Mr. Mills inquired of Mr. McLaren as follows: "You are, Mr. McLaren, a member of the Board of Directors of the Company?"

"Mr. McLaren. I am.

"Mr. Mills. And you are acquainted with the operations of the Company?

"Mr. McLaren. Yes.

"Mr. Mills. Are you satisfied that the Company, itself, is properly managed?

"Mr. McLaren. Completely satisfied.

"Mr. Mills. And yet Mr. Privett has testified here that the income of the Foundation is about, on an annual basis, 1% of the value of the corpus, or less?

"Mr. McLaren. The income of the Irvine Company is now three times as much as it was a few years ago.

"Mr. Mills. That is not my question. Why is it that the Irvine Company is only producing a return per year on those shares of stock that the Foundation owns (459 shares, which is 53%) of 1% or less, when that return is related to the value of the corpus?"

[Mr. McLaren did not answer this question.]

"Mr. Mills. Now, Mr. Privett, you have given us a value of the corpus of the Foundation which is based upon the sale of a very few shares by a minority interest (18½ shares). I am not willing to accept that as a true value for purposes of determining the relationship of income to value. I think you would admit that maybe the value of the Foundation's less restricted portion would be far greater if put on the market than that of a few shares sold by a minority interest. Is that right? I think it would work that way in California. It would in Arkansas.

"Mr. Privett. I think there is certainly an increment of value added from the fact of majority control. And I would have to agree that if the minority interest was worth that much, and it was put on the market place between a willing buyer and seller, that if control was added with it, there would be an increment that was added to it.

"Mr. Mills. All right, let me ask you, Mr. McLaren, you are President of the Foundation and you are on the Board of Directors of the Company as Chairman of the Board. Is that right?

"Mr. McLaren. That is correct.

"Mr. Mills. I don't know which hat you wear at this meeting, but in either case how do you justify entering into this agreement to forestall the increased value of property that you as the Director or Trustee are obliged to preserve and maintain as a part of the corpus of the Foundation? Was this a good thing on your part as the Chairman of the Board of the Irvine Company to allow this restriction to occur on 46,000 acres, I believe somebody said, of land in a part of the Irvine Company which is 53 or 54% owned by the Foundation. Is that good Foundation practice?

"Mr. McLaren. I believe it is.

"Mr. Mills. Tell me why.

"Mr. McLaren. This matter has been under consideration for about two years. It has been studied intensely by officials of the Company and some members of the Board of Directors over that period. The final conclusion was that the effect of going into this agricultural preserve would be an immediate saving in taxes of somewhere around $1,500,000 a year."

[The Directors referred to by Mr. McLaren all hold the conflict of interest position as Directors and Trustees of The James Irvine Foundation. The two independent Directors on the Board are myself and Keith Gaede, husband of Linda Irvine Gaede, who, like myself, is a stockholder in the Irvine Company.]

"Mr. Mills. But as the taxes go up, the fact that you have saved that much in taxes also means that you have also avoided through this device the normal increase in value of that property."

Mr. Mills then asked Mr. McLaren the following question:

"Mr. McLaren, did you get the permission of the Attorney General's Office in California to enter into this agreement with the authorities of Orange County?

"Mr. McLaren. Certainly not.

"Mr. Mills. You did not?

"Mr. McLaren. Certainly not.

"Mr. Mills. If the Attorney General of California checks on your operations and decides that you have not acted in your capacity as President of the Foundation in permitting this encumbrance to be placed upon an asset of the Foundation, but that you have acted actually as Chairman of the Board of the Irvine Company, would you be in a difficult position to explain it?

"Mr. McLaren. I certainly wouldn't. As I mentioned before, after careful consideration extending over a long period, five of the Directors of the Company out of a total of seven decided that the entering into of such agreement was in the best interests of the Company."

[All five of the Directors referred to by Mr. McLaren held their office as agents and representatives of the Foundation and were elected as such Directors at the annual meeting of the stockholders through the stock held and voted by the Foundation.]

"Mr. Mills. I have been told that the States are developing control over foundations through the Attorneys General of the States. This is not true in California?

"Mr. McLaren. No.

"Mr. Mills. I don't know, if this Company [Irvine Company] can't make any money than that, whether it is a good thing to continue to have this much of your total corpus tied up in one operation, unless you are looking to some future time when the situation might change. I think you would welcome the Treasury

suggestion that we force you to diversify to some greater extent where you might get a greater return on your investment than you are getting out of this operation [the Irvine Company].

"But the very restriction that has been entered into with the Orange County authorities on the use of the property seems to me to be at least a borderline violation of the initial trust provision to which you have just referred, Mr. Privett.

"Mr. PRIVETT. I would just have to say, Mr. Chairman, I disagree——

"Mr. MILLS. Is it a chancery court that handles equity matters in California?

"Mr. PRIVETT. We call it just our Superior Court, but it is on the equity side.

"Mr. MILLS. Have you explored with the Court to see whether this agreement could be set aside, or whether it is in the best interests of anyone?

"Mr. PRIVETT. We have not. The previous witness, Mrs. Smith, filed a suit in the U.S. District Court last week asking that Court to review the question, and I think our answer to that complaint is due on the 3d of March.

"Mr. MILLS. I am not looking for a client or anything of that sort, but the previous witness, Mrs. Smith, may have been raising issues that really did not get to the crux of the thing. Aside from that, I just want to get this clear now. Mr. McLaren, you are the President of the Foundation. Suppose we pass legislation saying that a Foundation may not have in its portfolio of investment more than 20% of any single business operation. Would it then be your judgment that you would have to begin immediately the process of divesting enough Irvine Company stock to get you below the 20% level within the time limit prescribed by law—or what would you do? What would you recommend to the Foundation that you do? You are the principal officer of the Foundation.

"Mr. MCLAREN. I believe that under the trust indenture we would have to get court approval of any such action. I do not know how the California courts would feel.

"Mr. MILLS. I do not think that the courts in California would say that you didn't have to divest yourself when you are required by Federal law to do so. At any rate, if you didn't divest, you wlułd immediately lose your tax exemption under Federal Law. Would you welcome that; would you allow that to happen, or what would you do? Would you forego the Foundation's tax exemption rather than divest the stock?

"Mr MCLAREN. That would be a question that would have to be considered by our Board of Directors at the appropriate time. I can't speak for the Board.

"Mr. MILLS. I understand. I am trying to find out whether we should do this or not. The Treasury recommends that we require you to do that without imposing any hardship on you. Do you feel that in your dual capacity as President of the Foundation and as Chairman of the Board of the Irvine Company that you operate both organizations?

"Mr. MCLAREN. No. Personally, no. They are separate Boards of Directors.

"Mr. MILLS. I will tell you one thing. If I am the Chairman of the Board of a company, I am going to accept the responsibility of being the principal officer of that company unless I am just paid to front for somebody. I think that fact is pretty clearly demonstrated here. Mr. McLaren. What I am concerned about, though, is why the Attorney General hasn't looked into this interboard relationship between the Corporation and the Foundation.

"Mr. PRIVETT. I assure you, Mr. Mills, that the Attorney General has looked into that relationship.

"Mr. MILLS. That isn't a question of looking over somebody's shoulder. The question is one of judgment. This is a situation of whether a Foundation is operating, dominating, and controlling a business enterprise—one of the things which I don't think a Foundation ought to engage in. The issue is whether a Foundation should be permitted to own and dominate a business operation, such as the Irvine Company, to place encumbrances upon its properties perhaps to such an extent as to minimize values, and whether it is in the public interest for a Foundation to remain in this condition. That is the issue before the Committee. We do have this recommendation that this situation ought not to be permitted to go on in perpetuity. I think we have had many extraneous points go into this record. As a result of my questions, and I wouldn't say as a result of what either Mrs. Smith or you have said, but someone said that it is the purpose of the Irvine Company to try to get this restriction removed on this property. Is that right? What are you going to do on March 8?

"Mr. PRIVETT. On March 3, I will file an Answer to a lawsuit filed by Mrs. Smith against the Foundation and the Company, trying to prevent them from entering into the agricultural preserve.

"Mr. MILLS. You are just filing an Answer? I thought you were going before somebody to ask that the restriction be removed. You are not going to do that?

"Mr. PRIVETT. Definitely not, Chairman Mills.

"Mr. MILLS. Why wouldn't you want it removed if you are going to diversify your assets or your investments?"

Following the foregoing examination of Mr. McLaren and Mr. Privett by Mr. Mills, Mr. Schneebell, a member of the Committee on Ways and Means, interrogated Mr. McLaren as follows:

"Mr. SCHNEEBELI. Mr. McLaren, you made the statement that you are able to save a million and a half dollars a year in taxation by this Agreement [Agriculture Preserve Agreement].

"Mr. MCLAREN. Maximum.

"Mr. SCHNEEBELI. Why would the county officials be willing to sign an agreement to reduce their own county income by one and a half million dollars a year? I find public officials generally like to look good in a short term; and in a short term, the more income they have, the less they are concerned about raising more taxes, so why should they make an agreement to reduce their own income by this amount of money?

"Mr. MCLAREN. Obviously, I can't speak for the county officials.

"Mr. SCHNEEBELI. Well, does it make much sense?

"Mr. MCLAREN. Presumably one of the big factors they took under consideration was the desirability of preserving a large amount of agricultural land to balance the growth and development of the county. I think that was one of the principal factors.

"Mr. SCHNEEBELI. The message that we are getting from the people says that, 'You are making too many deals with the high-income people,' and it seems to me that this would be a glaring example of this whereby they are reducing their own income by this amount of money by an agreement. I don't understand why they are doing it. Well, with the large amount of income which your Company seems to have annually, I don't see where you are going to be forced into a position of a forced sale. I wouldn't think that that would occur to them insofar as it applies to your property. You say that the concern here is a matter of forced sale? Wherein would the Irvine Company be forced to sell land with its holdings? Is this a threat to your Company?

"Mr. MCLAREN. All of these negotiations were conducted by our professional staff under the direction of Mr. Mason, the President of the Company. [Mr. Mason was personally selected to represent the Foundation by Mr. McLaren.] So I am not in a position to give you details. I didn't participate except in the final reports that were received."

Mr. Corman, a member of the Committee on Ways and Means, inquired of Messrs. McLaren and Privett as follows:

"Mr. McLaren, I could see that the obligation of the Directors of the Foundation is to maximize the dollars available for charitable purposes.

"Mr. PRIVETT. That is correct.

"Mr. CORMAN. The obligation of the Directors of the Company is to maximize the income for the stockholders.

"Mr. PRIVETT. That is correct.

"Mr. MILLS. There is bound to be a conflict.

"Mr. CORMAN. That is why one of the very substantial minority stockholders has a complaint—Mrs. Smith.

"Mr. MILLS. Mr. Corman, I thought you were through. I was going to ask you to yield when you completed your statement. I want to point out that I don't see how in the world there could possibly be any time in the operation of these two entities—Irvine Company and the Foundation—when there wouldn't be a perpetual conflict. It looks to me that the Irvine Company is interested more in conservation than in making a profit and that the Irvine Foundation should be interested in its stock bringing in a maximum amount of income to the Foundation.

"Mr. MCCLAREN. May I just reply to that for a second?

"Mr. MILLS. Yes, sir.

"Mr. MCCLAREN. The primary obligation of the Foundation, as I see it, is to distribute the largest possible amount annually to deserving charities in California.

"Mr. Mills. It is also obliged to see to it that the stock of any company that it owns, that it manages, produces a maximum amount of return to the Foundation.

"Mr. McLaren. That is right. That is what we are trying to do.

"Mr. Mills. I don't know. When you put on your hat as Chairman of the Board of the Irvine Company and put this amount of land into agricultural activities for ten years there is not anybody who would question that you had materially reduced your possibility of income.

"Mr. Privett. I think, Mr. Chairman, about that, that there is a mistake of fact here that, if I could, I would like to attempt to clear up. This 50,000 acres that were put into agricultural preserve is only agricultural land now or unproductive land, and we have got, in addition to that, 24,000 acres of land that is in the same situation—not developed. Now the question is, if we can develop all of this land today, if it could be developed and absorbed in the market in one year, that would be our desire to do, because the Company is a profit-making company to make the highest return to the shareholders that it can. That is its obligation.

"Mr. Mills. You could sell it, couldn't you?

"Mr. Privett. Not without, according to the studies that I have made, a terrible loss to the Company.

"Mr. Mills. In this burgeoning community, with its rapid rate of growth? I am not a real estate man, but when you tell me you cannot sell land in that community and get more for it than you can raising agricultural products, you have lost me.

"Mr. Privett. I think if you are talking about whether we make more income next year if we put the 84,000 acres on the market——

"Mr. Mills. No, hold it because you can't tell what is going to happen six months from now. Maybe the population will be rising then at the rate of 420 a day instead of 210. Now you have yourselves tied out of it."

In connection with the establishment of the agricultural preserve, which covers 49,253 acres out of a total of 84,000 acres that constitutes the Irvine Ranch in Orange County, I employed the nationally-known Land Planning and Civil Engineering firm of McIntire & Quiros to make a survey for me of the following questions that are connected with the incompetent and fraudulent foundation-controlled business management policy of the Irvine Company in converting this large portion of the urban acreage in Orange County into an agricultural preserve for a period of ten years or longer, to wit:

(1) Is there a higher and better use for this urban acreage than to freeze the same for a period of ten years in an agricultural preserve?

(2) Will the preserve area as established act as a restriction on the normal urban growth patterns of Orange County?

(3) Is it in the best interests of the stockholders of the Irvine Company to continue this preserve for a period of years?

(4) Approximately how many home sales could have been obtained on the Irvine Ranch north and south of the Santa Ana Freeway during the past five years had this agricultural preserve property been opened to developers?

(5) If the Irvine Company adopted a policy to implement an unrestrained sales and promotional effort, how many homes could be marketed in the next ten years?

(6) In order to capture diverse elements of the urban market, would it be better to consider sales efforts on a broader front than that limited because of the preserve area?

The civil engineering firm of McIntire & Quiros is rated as one of the top firms in the United States that is connected with land development and planning and is perhaps the largest firm in the State of California that is identified with this field.

In their report, McIntire & Quiros have answered the foregoing questions as follows:

"To an engineer, it is obvious that only 9,000 to 10,000 acres of the entire preserve contains topography that could be truly agriculturally oriented within the exact meaning of the word. Our rough analysis indicates that of this 9,000 to 10,000 acres of agriculturally suitable land, approximately 2,000 acres are southerly of the Santa Ana Freeway, and approximately 7,000 acres lie northerly of the Santa Ana Freeway. Topographically, only this latter acreage might truly serve all the needs of an intense agricultural use."

[The 10,000 acres referred to constitute the only acreage that is contained in the 49,253 acre agricultural preserve that is actually devoted to agricultural purposes, such as the growing of oranges and the production of certain field crops. The

remaining 39,000 acres have never been and never will be, during the ten-year period of the agricultural preserve agreement, devoted to any agricultural uses whatever, and it is, therefore, obvious that the major portion of the agricultural preserve is fictitious, not only in name but also for the production of anything that is connected with agriculture.]

The report continues:

"In any case, with the diverse land development program available, this highly restricted preserve land use could be subject to critical examination when one considers its location in the heart of Orange County. In short, the most agriculturally suitable land was not set aside in the preserve. This would have been an impossibility, as 49,253 acres of this type land do not exist on the total Ranch.

"It is our considered opinion that there is a higher and better use for the majority of the land in the preserve area. The topographical restrictions on much of this land are so penal as to virtually prohibit any type of agriculture whatsoever. Notwithstanding the tax savings, if any, let us explore the results of this so-called tax shelter for ten years on land that not only cannot be farmed but will yield little or no revenue. This would obviate a property tax drain on more than approximately 50% of the entire ranch for a prolonged period of time.

"We do believe that the preserve area as planned does block normal growth patterns in many areas. To satisfy the potential demands of Orange County growth (if the Irvine Company is interested in enjoying its fair share of this tremendous market), sales efforts must be diversified and more builders brought into the picture on a broader front. The three most obvious areas not provided for in the Irvine Company planning are the Easterly encroachment of Tustin, the Northwest encroachment of Laguna, and the Southerly extension of the Irvine Campus environs.

"We are presently making inquiries into the number of residential homes constructed North and South of the Santa Ana Freeway between the Easterly boundary of the Ranch and the Westerly limits of San Juan Capistrano over the past several years. The single apparent reason for this phenomenon is and was the policy of the Irvine Company not to make land available to buyers in the Irvine Ranch. For this reason, many thousands of home sales were lost to the Irvine Company. All indicators predict that this growth will not only continue but will probably intensify during the 1970's. If the Irvine Company is ready to meet this challenge, it should capture the lion's share of the market. The geographical location is such as to preclude the majority of the buyers going elsewhere if a reasonable competitive merchandise is offered.

"This activity would in no way interfere with other development on the Northerly portion of the Ranch. In our opinion, the Irvine Ranch could absorb 100,000 single family dwellings by 1980. Assuming the 100,000 units would require more than 25,000 acres of land in addition to the provision for Industrial, Commercial, etc., and further assuming other companion-type development programs will have substantial acreage demands, it would appear that the agricultural preserve will act as a restrictive influence on the orderly urban growth of the Irvine Company lands in Orange County."

On October 22, 1968, at a regular meeting of the Board of Directors of the Irvine Company, the following resolution was adopted:

"*Resolved further*, That it shall be the policy of this corporation to declare as regular dividends substantially all of net income from operations that is not needed as investment capital, working capital, or adequate reserves to meet contingencies."

Following the adoption of this resolution, the management of the Irvine Company was directed to file a report concerning the allocation of funds received from the conversion of the residential properties of the Company which were held under leases into fee title ownership covering approximately 2,700 pieces of residential property. It was considered that should this program be developed, there would be more money available for investment and dividend purposes, and the report of management that was subsequently filed with the Board of Directors pointed out that the fee program would provide a larger cash flow in the earlier years from which larger dividends would be possible than under the leasehold program, and the report further stated as follows:

"Since it is also a recognized Purpose of the Irvine Company to increase the total earning asset, it will be necessary to invest a portion of the proceeds from the fee sales in projects such as office buildings, apartments, shopping centers and other conventional investment opportunities. At the same time, however, a portion of the proceeds should be used to increase dividends to the stockholders."

Notwithstanding the dividend policy as established by the resolution of the Board of Directors of the Irvine Company adopted on October 22, 1968, as well as the report of the management of the corporation hereinabove mentioned concerning the allocation of funds received from the sale of the residential properties of the Company through their conversion from leasehold to fee title, the Board of Directors on September 9, 1969 adopted a resolution that repudiated the October 22, 1968 resolution, as follows:

"Whereas, The Irvine Company has converted its new single family residential developments to a fee or lease with option to buy; and

"Whereas, there are in existence approximately 2,284 residential leases on completed projects which have not been granted the lease with an option to buy; and

"Whereas, the income from these residential leases forms a re-occurring income to the corporation of approximately $1,900,000; and

"Whereas, it is the policy of this Corporation to invest on its own lands and increase the earning assets of the corporation through a development program in the fields of commercial, industrial and multi-family residential developments; and

"Whereas, this Corporation, after careful consideration, recognizing the problems involved with single family residential leasehold, wishes to offer to the lessees within existing completed developments the opportunity to purchase the leased lot or obtain a new lease with option to purchase; and

"Whereas, the funds so derived from the exercise of this option are desired to be reinvested as earning assets of this corporation's diversified development program;

"Now, therefore, be it resolved, that this corporation offer each of its single family residential lot lessees the opportunity to either buy the leased lot or obtain a new lease with an option to purchase in the manner set forth in the report presented to the March 5, 1968 meeting of its Board entitled 'Corporate Policy—Single Family Residential Development—Program for Implementation From Leasehold to Fee'; and

"Resolved, further, That, notwithstanding the policy adopted by this Board at its meeting of October 22, 1968, with respect to the allocation of net income dividends, it shall be the policy of this Corporation to retain after-tax funds derived from sales and the exercise of the options to buy in existing residential developments not heretofore authorized for conversion to the sale or lease-option program for equity funding of this Corporation's commercial, industrial and multi-family developments, and that in determining net income for purposes of allocation to dividends under the general Corporate Policy referred to above, such after-tax funds shall be first deducted from net income."

It is obvious that under this resolution, the resolution adopted on October 22, 1968 is repudiated and nullified insofar as the allocation to dividends of any part of the funds received from the sale of the residential properties of the Company which are now under leases. I understand that the foundation-controlled management of the Irvine Company expects to receive approximately the sum of $40,000,000 from the conversion of leaseholds to fee title and that no part of this fund will be used for the payment of dividends, although the entire net fund after taxes which constitutes profits received by the Corporation, and which are entirely available for dividend purposes, will be transferred to the capital assets of the Irvine Company and used for development purposes. I was unable to be present at the meeting of the Board of Directors on September 9, 1969, but I am advised that Director Keith Gaede voted "No" on this resolution.

At the hearing before the Committee on Ways and Means on February 21, 1969, as well as at the hearing this morning, On October 7, 1969, Mr. Privett referred to the development program of The Irvine Company for the year 1969 with the statement that under the Foundation management, The Irvine Company expected to complete approximately 1,200 homes on the Irvine lands in Orange County. I have been advised that the official records of Orange County show that during the year 1968 building permits for construction of homes in Orange County were issued for 13,988 single family residence and 10,333 multiple dwellings, or a total of 24,321 units. These figures, when compared to the 900 single family residences which Mr. Privett indicated covered the development of the Irvine Company in 1968, and the estimate of Mr. Privett for 1,200 single family residences in 1969, furnishes another answer to the reason why only 1% of the value of the stock of the Irvine Company, based upon $250,000 per share, is being disbursed as

current annual dividends to the stockholders of the Irvine Company. The number of total permits issued by Orange County in 1968 numbering 24,321, when compared to the 900 homes constructed by the Irvine Company in 1968, conclusively demonstrates the mismanagement policies of the Irvine Company under the control of the Foundation. In my written statement filed with the Finance Committee, I have indicated that the land holdings of the Irvine Company in Orange County constitute 20%, or one-fifth, of the total area of Orange County, and on this ratio the Irvine Company, based upon the 24,321 permits for the construction of single family residences and multiple dwellings issued in Orange County in 1968, is developing less than 5% of the total annual residential building requirements for all of Orange County.

Notwithstanding the criticism by Mr. Mills and other members of the Committee on Ways and Means concerning the mismanagement policies of the Foundation through its control of the Irvine Company, Mr. McLaren paid no attention thereto, and upon his return to California he continued to engage the Irvine Company in the same practices and policies for which he had been challenged by Mr. Mills. On June 16, 1969, a regular meeting of the Board of Directors of the Irvine Company was held and at this meeting a resolution was introduced by John V. Newman, who is both a Director of the Irvine Company and The James Irvine Foundation, and Chairman of the Compensation Committee of the Board of Directors of the Irvine Company. Prior to introducing this resolution, Mr. Newman presented a three-page document which was entitled "The Irvine Company—1969 Restricted Stock and Property Plan."

Under this Plan, certain key executives of the Irvine Company, which include Mr. McLaren, were to receive a bonus for their services, but the exact nature of the bonus was not described. It could have been a distribution of the stock of the Irvine Company or one of its subsidiaries, or a piece of the assets of the Irvine Company. The so-called key executives would be selected by the Compensation Committee in its sole discretion. I voted against the resolution and the Plan described therein. All of the Foundation Directors, including Mr. McLaren, voted for the resolution. In order to prevent the Irvine Company from acting under this resolution I was compelled to file legal action in the State of West Virginia where the Irvine Company was incorporated in 1894. A motion was made by my attorneys for a preliminary injunction, but the attorneys for the Irvine Company stipulated that the Company would not take any corporate action whatsoever with respect to the "1969 Restricted Stock and Property Plan", which was the subject of the lawsuit; and, upon the basis of this stipulation, the Court made an order to the effect that until plaintiff's motion for preliminary injunction is heard by the Court, the defendant, the Irvine Company, shall not take any further action in connection with the said 1969 Restricted Stock and Property Plan. I request permission, Mr. Chairman, to file a copy of this Complaint for the record.

On August 7, 1969, the House of Representatives, by a vote of 390 to 34, passed H.R. Bill No. 13270. Under the provisions of this Bill, which relate to tax-exempt foundations, The James Irvine Foundation will be required, when the Bill becomes law, to divest itself of its controlling stock interest in the Irvine Company. Both Mr. McLaren and Mr. Privett and the members of the Board of Directors of the Irvine Company and The James Irvine Foundation are familiar with the tax-exempt foundation provisions of this Bill. But again, like the 1969 Restricted Stock and Property Plan that was adopted at the Directors Meeting of June 16, 1969, the Foundation Directors and the Irvine Company paid no attention whatever to the effect that this Bill will have on the controlling interest of the Foundation in the Irvine Company. And at the meeting of the Board of Directors held on September 9, 1969, the Foundation Directors continued to pursue their same mismanagement policies with reference to the Irvine Company as though the Foundation would continue in control of the corporation in perpetuity. At this meeting, Mr. Mason, the Foundation's President, stated that a very serious financial condition confronted the Company. He stated that the consolidated statement of income for the three months period ending July 31, 1969, shows that the net income for the first quarter of 1969–1970 is approximately 22% below that budgeted. The consolidated statement of income budgeted and forecast for the year ending April 30, 1969, as of August 21, 1969, forecasts a net income for the year to be $5,741,500, which is $281,500 less than budgeted. Mr. Mason further stated:

"The current national economic picture, with money becoming increasingly tighter, and high interest, make forecasting for the balance of the year extremely

difficult. It is too early in the fiscal year to be able to accurately establish the net income for the entire year because of the major effect that both residential and industrial sales have on the total income of this corporation. While the forecast for the current fiscal year appears achievable at this time, management is deeply concerned about the prospects for the fiscal year 1970-1971. The current housing and industrial sales are based upon financed commitments made prior to the severity of the current situation, and management is concerned that, if the situation worsens, it will not be possible to begin new developments or housing developers to obtain financing for new houses which will be a part of the next fiscal year's income. Further, the Federal Government's policy of curtailing will probably have a serious effect on buying psychology, especially as it relates to single family housing, increasing construction costs and high-interest rates which are already discouraging and making it impossible for many home buyers to qualify for new homes."

Notwithstanding the unfavorable financial outlook for the Irvine Company in the immediate future, the management recommended, and the Foundation's Board of Directors approved, the expenditure by the Company of large sums of money that are connected with the construction of residential apartment houses and other units on the land of the Irvine Company in Orange County, California, and

(1) The creation within the Company of a Merchant Builder Department. Under this program, which was approved by the Foundation Board of Directors, the Company will enter a new field of home construction through personnel employed by the Company. Heretofore all construction of homes, apartment houses, office buildings and other structures on the land of the Irvine Company have been through independent or outside builders. This program involves the employment of additional personnel by the Company with salaries of $40,000 to $60,000 for key employees, and also contemplates the raising of additional and large sums of money for the purpose of entering into this new field of activity where neither the present personnel or management of the Company have had any previous experience.

Another inexcusable policy of the Irvine Company under the control of the Foundation is the arbitrary refusal of the Foundation Management to file an application for the Irvine Company with the Securities and Exchange Commission for the registration of the minority stockholders' shares of stock in the Irvine Company. In order for a minority stockholder to sell a single share of his or her stock, it is mandatory that the Irvine Company shall file its application and that the stock of the minority stockholder shall be registered with the Securities and Exchange Commission. Although my 180 shares of stock in the Irvine Company have the intrinsic value of approximately 100 Million Dollars, I am not able to sell one share thereof until this application has been filed and approved. Under these circumstances, the only person who is qualified to purchase a share of the Irvine Company from me or any other minority stockholder must qualify as a sophisticated buyer, which means that this buyer must sign a letter to the effect that any Irvine stock purchased from me will be for investment purposes only and will not be re-sold by him for a period of at least three years. Sophisticated buyers are very rare. Both myself and other minority stockholders have requested the Foundation Management of the Irvine Company to cooperate with us by filing such an application with the Securities and Exchange Commission, but this Management has repeatedly refused to do so.

H.R. Bill 13270, which was passed by the House of Representatives on August 7, 1969, was introduced by Honorable Wilbur D. Mills for himself, as Chairman of the Committee on Ways and Means (a Democrat), and by Honorable John W. Byrnes, Member of the Committee (Republican). Insofar as the provisions of this Bill relate to tax-exempt foundations, the members of the Committee, both Democratic and Republican, were practically unanimous in their support thereof. When the Bill reached the voting stage in the House, a few members of the Committee voted "No", but I understand this vote was not based upon their opposition to the tax-exempt foundation provisions of the Bill, but was related in the most part to the provisions thereof with reference to the changes in the rate of capital gains taxes and the lowering of the oil depletion benefit from 27½% to 20%. Honorable James B. Utt, Republican Congressman from the 35th District of California, which is the District in which the 84,000 acre Irvine Ranch is located, and who was born in Tustin, Orange County, California—that is a city which is located on a portion of the Irvine Ranch—and who is intimately

familiar with the mismanagement policies and abuses of The James Irvine Foundation in connection with its control and management of the Irvine Company since 1947, when James Irvine died and the control of the Company passed to the Foundation, is the second ranking Republican member of the Committee on Ways and Means; and during the hearings of the 1969 Tax Reform Bill before the Committee, Mr. Utt strongly advocated and favored the provisions of the Bill which are applicable to tax-exempt foundations and particularly the provisions thereof which relate to the mandatory divestment by all foundations of their controlling stock interests in separate businesses or corporations, whose business is unrelated to the charitable activities of a private, tax-exempt foundation, such as The James Irvine Foundation. Under the divestment provisions of H.R. 13270, The James Irvine Foundation is required to divest itself of all of its stock in the Irvine Company within a period of five years commencing with a 10% divestment in the year 1971.

The James Irvine Foundation will also be required to commence the divestment of its stock in the Irving Company through a sale or the transfer thereof to a charitable organization commencing in the year 1970 and each year thereafter in order to satisfy the annual 5% income distribution provisions of this Bill. The James Irvine Foundation, as Trustee of 459 shares of the stock of the Irvine Company, has an income on this stock through dividends amounting to approximately $1,000,000 per year. The value of these 459 shares of the Irvine stock will be determined annually by the appraisal of the United States Treasury Department; and, assuming that the first valuaton thereof will be approximately $200,000,000 the Foundation will be required to distribute 5% of this sum of money, or the sum of $10,000,000 during the year 1970, and at least the same amount, or more, during each succeeding year. The only source where this amount of money can be raised by the Foundation is through the sale of its Irvine stock or by a gift thereof to qualified charitable organizations. It is, therefore, obvious that The James Irvine Foundation will be required to surrender its stock control of the Irvine Company within the very near future.

The provisions applicable to tax-exempt foundations which are set forth in H.R. 13270 are the result of many years of intensive study by the Treasury Department, the staffs of the Committee on Ways and Means of the House of Representatives, and the Finance Committee of the United States Senate.

On February 2, 1965, Honorable Douglas Dillon, Secretary of the Treasury, wrote the following letter:

"Hon. HARRY F. BYRD,
"*Chairman, Committee on Finance,*
"*U.S. Senate,*
"*Washington, D.C.*

"Hon. WILBUR D. MILLS,
"*Chairman, Committee on Ways and Means,*
"*House of Representatives,*
"*Washington, D.C.*

"DEAR MR. CHAIRMEN: I am presenting herewith the Report of the Treasury Department on private foundations. This report responds to the requests by the Committee on Finance of the Senate and Committee on Ways and Means of the House of Representatives, that the Treasury Department examine the activities of private foundations for possible tax abuses and report its conclusions and recommendations to the Committees. The report contains the results of an intensive study made by the Department pursuant to such requests and contains proposals for correction by legislation of inadequacies of the law disclosed by the studies.

"Sincerely yours,

"DOUGLAS DILLON."

Among many abuses practiced by private foundations which are set forth in the 118-page report that was attached to the letter of Secretary Dillon, the most flagrant abuse involved the foundations' control of business and corporation enterprises that were not related to the charitable activities of the foundations. This report contains the following statement:

"Many private foundations have become deeply involved in the active conduct of business enterprises. Ordinarily, the involvement takes the form of ownership of a controlling interest in one or more corporations which operate businesses; occassionally, a foundation owns and operates a business directly. Interests

which do not constitute control may nonetheless be of sufficient magnitude to produce involvement in the affairs of the business.

"Serious difficulties result from foundation commitment to business endeavors. Regular business enterprises may suffer serious competitive disadvantage. Moreover, opportunities and temptations for subtle and varied forms of self-dealing—difficult to detect and impossible completely to proscribe—proliferate. Foundation management may be drawn from concern with charitable activities to time-consuming concentration on the affairs and problems of the commercial enterprise.

"For these reasons, the Report proposes the imposition of an absolute limit upon the participation of private foundations in active business, whether presently owned or subsequently acquired. This recommendation would prohibit a foundation from owning, either directly or through stockholdings, 20 percent or more of a business unrelated to the charitable activities of the foundation. Foundations would be granted a prescribed reasonable period, subject to extension, in which to reduce their present or subsequently acquired business interests below the specified maximum limit."

On August 26, 1965, appoximately six months after the Treasury Department Report was filed, to wit, on February 2, 1965, Chairman Wilbur D. Mills, Democrat of Arkansas, Committee on Ways and Means, and ranking minority member, John W. Byrnes, Republican of Wisconsin, issued a press release which requested that organizations or individuals who are interested in the "Treasury Department Report on Private Foundations" issued on February 2, 1965, submit written statements indicating their views on the Treasury Department proposals. Interested parties were requested to submit written statements by October 15, 1965. Over 100 written statements were filed by interested private foundations pursuant to this request and were printed in two volumes by the United States Government Printing Office and made available to the public and all interested parties. This Government pubication discloses that practically every large tax-exempt foundation in the United States, or its attorneys, filed their written statements which contain their views and objections with reference to the adoption of legislation based upon the Treasury Department Report dated February 2, 1965.

At the request of Chairman Mills and Member John W. Byrnes of the Committee on Ways and Means, the staff of the Joint Committee on Internal Revenue Taxation, immediately commenced a study and analysis of the statements that were submitted by all of the interested parties.

During the years 1965, 1966, 1967 and 1968, a great deal of time and study was devoted by Mr. Stanley S. Surrey, Assistant Secretary of the Treasury, to the preparation of legislation to be proposed to the Committee on Ways and Means and the Finance Committee with reference to the adoption of the recommendations contained in the Treasury Department Report of February 2, 1965.

H.R. 13270, which has been passed by the House of Representatives and is now before the Committee on Finance, United States Senate, with reference to the provisions contained in this Bill that relate to private tax-exempt foundations, has received the approval of Secretaries of the Treasury, Dillon, Fowler and Kennedy insofar as the divestment provisions of the Bill are concerned. Furthermore, the exempt foundation provisions of this Bill as passed by the House of Representatives have received the express approval of the Nixon Administration through the statements of Secretary Kennedy and Assistant Secretary Cohen, who appeared before the Committee on Finance, United States Senate, on December 4, 1969, with the exception of the 7½% income tax provision contained in the Bill, and which provision the Nixon Administration recommended be reduced from 7½ to 2%. All of the other provisions with reference to private tax-exempt foundations that are contained in H.R. 13270 have been approved by the Nixon Administration in their entirety.

I believe that the Members of the Finance Committee will be interested in the statements made by Congressman Utt during the appearance of myself and Messrs. McLaren and Privett before the Committee on Ways and Means on February 21, 1969. As I have already mentioned, Congressman Utt is undoubtedly the best-posted and most intimately acquainted person in the Congress concerning the activities of The James Irvine Foundation since the death of Myford Irvine in 1959, which have resulted in the mismanagement policies of the Irvine Company as heretofore detailed by me. Congressman Utt has continously since

1952 represented the Congressional District in California in which the Irvine Ranch is located and where the James Irvin Foundation exercises its control over the Irvine Company. I am, therefore, calling these statements of Mr. Utt to the attention of the Members of the Finance Committee, as follows:

"Mr. UTT. Mr. Chairman, I had a few questions that I wanted to ask Mrs. Smith to clarify some of the statements that have been made. You made some very serious charges against the self-dealing within the Irvine Co. and your supplemental statement adds a great deal more and I think it is certainly pertinent to this committee, on not dealing at arm's length, self-perpetuating, and I want to ask, was the statement made by the attorney for the Irvine Co. or the Irvine Foundation, either one, to the effect that they would give up their tax-free exemption rather than surrender control of the Irvine Co.?

"Mrs. SMITH. Yes, it was made at a stockholders meeting approximately, oh, it was about 2 years ago and there were a good many witnesses there. I mean there were many people there that heard it.

"Mr. UTT. Which indicates very definitely that its real purpose is not to be a charitable foundation.

"Mrs. SMITH. That is correct.

"Mr. UTT. It is really a foundation for perpetuation and control of a separate corporation nonrelated to the charitable purpose of the foundation.

"Mrs. SMITH. That's absolutely correct. Its whole purpose is to run this corporation.

"Mr. UTT. Now, have you examined, legally or otherwise, what would happen to that foundation in case they relinquished their tax free exemption which apparently doesn't mean very much to them? It could be done. Would it destroy the foundation? Would it revert to the original donor, or his heirs or would it continue on as a non-tax-free foundation?

"Mrs. SMITH. As I understand it, according to the way the indenture of trust is worded, I believe that they would be out of business completely because I think it would invalidate the indenture of trust.

"Mr. UTT. You made in your original statement a statement with reference to subsidiary companies.

"Mrs. SMITH. Yes.

"Mr. UTT. And then in your supplemental statement you explained what they were. One was the Irvine industrial complex.

"Mrs. SMITH. That's right.

"Mr. UTT. And how many acres did that involve?

"Mrs. SMITH. Three thousand.

"Mr. UTT. Three thousand?

"Mrs. SMITH. Yes. It originally was 2,700.

"Mr. UTT. Is that a corporation under the laws of California?

"Mrs. SMITH. That's right.

"Mr. UTT. So you have lost your West Virginia corporate law so far as that subsidiary is concerned?

"Mrs. SMITH. That's correct.

"Mr. UTT. This was formed by the Irvine Co.

"Mrs. SMITH. That's right.

"Mr. UTT. On the order and instructions of the Irvine Foundation?

"Mrs. SMITH. That's right.

"Mr. UTT. And how were the directors selected on that subsidiary corporation?

"Mrs. SMITH. They were appointed by the foundation. They were not voted on.

"Mr. UTT. And you personally have no stock in the subsidiary corporation?

"Mrs. SMITH. No, the Irvine Co. owns all the stock.

"Mr. UTT. So you could not under any circumstances by cumulative voting buy yourself onto the directorship of that subsidiary?

"Mrs. SMITH. Not only can I not buy into the directorship, I can't even look at the books. The foundation won't let me.

"Mr. UTT. That is gratuitous but it is all right. What I am leading to is, is there a second subsidiary corporation doing approximately the same thing?

"Mrs. SMITH. That's right.

"Mr. UTT. Let's follow that to the ultimate conclusion. Wouldn't it be possible to sequester every asset of the Irvine Co. into a series of subsidiary corporations in which you would be ruled out completely as a director of any of those companies?

"Mrs. SMITH. Absolutely.

"Mr. UTT. You would remain as a director of the shell.

"Mrs. SMITH. That is correct. This was the idea of the Stevens Development Co. that I spoke to and it would have also been true in the Upper Bay Development Co.

"Mr. UTT. O.K. Generally when you take a position do the Irvine heirs decide to go along with your position? The Irvine Co. bought in about 13 shares of stock just recently.

"Mrs. SMITH. That's correct.

"Mr. UTT. For $3.2 million.

"Mrs. SMITH. That's correct. It was $250,000 a share.

"Mr. UTT. They did not retire it.

"Mrs. SMITH. No, they did not.

"Mr. UTT. Did it find its way into the foundation, or where does it reside? How can it be treasury stock and still be voted?

"Mrs. SMITH. I would like to explain that to you. All of the individual stockholders want that stock retired. I called a special stockholders meeting a week ago last Monday for the purpose of retiring the stock. The foundation sent out a letter prior to this meeting advising the other stockholders not to vote to retire the stock because the following day they had a board of directors meeting coming up and at that board of directors meeting there was going to be a certain resolution passed which would involve the retirement of this stock so they considered the retirement on the Monday premature, so we all arrived at the stockholders meeting and all of the stock was represented.

"Now, the motion was made to retire the 13½ shares and when it was asked for discussion I asked the foundation attorney or Mr. McLaren, whoever was going to speak, to explain the reasons in this letter that they had spoken of exactly why they didn't want to retire the stock at that time.

"Being a director, I knew that the reason they didn't want to retire the stock was because they were planning a stock split and the stock split would have gone one of two ways. One was to have a California corporation merger of the West Virginia corporation. I think the split was to be 10,000 to 1.

"The other way was to go directly through the West Virginia corporation, again on a split of 10,000 to 1.

"However, the individual stockholders would have to sign an agreement that the new stock which they were acquiring was not for public sale. It was to be held by them as an investment. In other words, this was not a forerunner of public issue. It was strictly just to hold this stock in smaller amounts.

"So I asked Mr. Privett or Mr. McLaren to explain this to the stockholders. They refused. My attorney asked them to explain it to the stockholders. They stated this was the board of directors business. They would not have the stockholders knowing anything about it.

"Well, the meeting must have gone on for maybe an hour. These other stockholders became very agitated because this obviously affected them considerably, what was done with this stock, the Irvine family stockholders, so when it came to vote the family stockholders voted to retire that stock.

"The foundation voted against the retirement of the stock.

"Mr. UTT. All the family heirs voted to retire the stock.

"Mrs. SMITH. To retire.

"Mr. UTT. I am a little puzzled how a corporation can buy stock and not retire.

"Mrs. SMITH. Well, it can remain in the treasury and if they had passed the stock split that they were anticipating and these shares which would be expanded in number were in the treasury they would be sitting there available to take stock options on for the employees.

"Mr. UTT. One more question and I will wrap it up. Has Hugh Metzgar been a director of the corporation?

"Mrs. SMITH. He is a director of the foundation presently.

"Mr. UTT. And who writes all the compensation insurance for the Irvine Co.?

"Mrs. SMITH. At one time Mr. Metzgar did, but he no longer does.

"Mr. UTT. He divested himself from that?

"Mrs. SMITH. He has some other insurance. I can't tell you exactly what he does have but he has some insurance. But there is a great deal of it that he divested himself from.

"Mr. UTT. The Tom Cleverdon Co. still writes that insurance, does it not?

"Mrs. SMITH. What?

"Mr. UTT. Tom Cleverdon.

"Mrs. SMITH. Yes, Cleverdon & Co. was his company.
"Mr. UTT. And it still writes some insurance.
"Mrs. SMITH. It writes some insurance. I couldn't tell you exactly what. I haven't read the records.
"Mr. UTT. A trustee director writing insurance for the company.
"Mrs. SMITH. That's right. Oh, on that same point Mr. McLaren's firm of Haskins & Sells used to audit the books, too. He doesn't do that any more though. Well, he does on special auditing; yes.
"Mr. UTT. I agree so completely with your statement on that preserve or whatever you call it to relieve the Irvine Co. of a million and a half taxes to the county. I can't understand the board of supervisors doing it because I have a great many close associates owning land within that conclave of the Irvine Co., some 1,000 or 2,000 or 3,000 acres, and they have been dealing with them on the water system and they are not going to be interested in that because they can't develop it because you can stop development of the Irvine Co. for sale.
"Mrs. SMITH. To me it is absolutely appalling because this land lies directly beside Tustin, and you know what the growth in Tustin is. You know how all of the growth comes up to the Irvine Co. lands in that area and it stops and it doesn't go any farther and there are these people that you speak of that have 3,000, 4,000 acres that lie there in one piece.
"San Joaquin Fruit Co., I believe, had some property there in that area and they have attempted to develop this land. They can't get sewers. They can't get anything.
"Mr. UTT. I think that's all, Mr. Chairman."

Mr. PRIVETT. Mr. Chairman, could I request a very brief moment?

Senator ANDERSON. We do not want to have a debating society but go ahead for just a second.

Mr. PRIVETT. None of the charges of self-dealing to which Mrs. Smith has addressed herself, all of which have been the subject of one or more of the seven or eight lawsuits that she has filed during this period, have ever been substantiated by evidence. Mr. McLaren's firm does not serve as the auditor of the Irvine Co. They have not since 1952.

Mr. McLaren is not eligible under the 1969 restricted stock and property plan to which the witness has just testified. The agricultural preserve agreement a Federal district judge in Los Angeles just a few weeks ago dismissed Mrs. Smith's complaint with respect to this agricultural preserve. She has now filed a second amendment complaint which will be heard in due course.

I would like to simply say we do not feel—we obviously have a dissident stockholder—we do not feel that the battles that Mrs. Smith is waging as a dissident stockholder ought to affect the decision that is made on a national tax policy.

We also want to point out that none of the other members of the Irvine family have ever filed any lawsuits, and none of the members of the other Irvine family have joined Mrs. Smith in the attacks which she has made on the foundation. We draw your attention also to the fact that we are closely supervised by the California attorney general, and if the California attorney general agreed with Mrs. Smith's charges, and he has investigated them on several occasions and found them to be without merit then severe corrective action would be warranted.

We welcome the attention of the members of the committee to any legislation designed to prevent any of the specific abuses that Mrs. Smith has discussed, even though we resolutely say we are not guilty of these, and we have been exonerated from the charges that have been made in courts of law when we have been able to offer the evidence.

Senator ANDERSON. I cannot testify about Mrs. Smith's capability but I can say that I could do better than earning only 1 per cent on assets.

Senator GORE. Mr. Chairman, the principal point here is whether or not a so-called charitable foundation should be engaged in the operation and in the domination of a business undertaking. That is the question at issue, and I think the gentleman has made an excellent case against himself.

Senator ANDERSON. Are there questions?

Thank you very much.

Senator BYRD. Mr. Chairman, just two brief questions. Am I correct now? The 88,000 acres of land is owned by the company?

Mrs. SMITH. That is right.

Senator BYRD. And then the foundation owns 55 percent of the company?

Mrs. SMITH. Owns it as a trustee.

Senator BYRD. As a trustee?

Mrs. SMITH. Yes.

Mr. PRIVETT. Under an irrevocable charitable trust.

Senator BYRD. The land is owned by the company?

Mr. PRIVETT. That is correct, Senator.

Senator BYRD. Now other than the 55 per cent that it holds of the company under a trust agreement, what other assets does the foundation have?

Mr. PRIVETT. Those are the only assets that the foundation has except that in 1963 there was a partial liquidation of the company under which approximately $11 million worth of property was distributed in kind to the shareholders in redemption of 10 percent of the outstanding stock. The foundation therefore in addition to its Irvine Co. stock has a portfolio now of approximately $7 million of diversified stocks and bonds which arose from the partial liquidation of the company in 1963, but Mr. Irvine endowed this foundation with this 51 percent stock interest, and that was the only asset with which he endowed it in the trust.

Senator BYRD. One final question. Mrs. Smith is a director of the company but not of the foundation?

Mrs. SMITH. That is correct.

Mr. PRIVETT. That is correct. The foundation is managed by an 11-member board of directors which are independent businessmen with the exception of one of Mr. Irvine's granddaughters, Catherine Wheeler, who is a granddaughter like Mrs. Smith, and she serves on the Irvine Foundation Board.

Senator BYRD. But Mrs. Smith is a director of the company?

Mr. PRIVETT. That is correct.

Senator BYRD. Thank you.

Senator ANDERSON. Do you have a statement to make, Mr. Young?

Mr. YOUNG. Yes, Mr. Chairman. In connection with the statement, the oral testimony and also the written statement of Mrs. Smith, I would appreciate at this time the permission, Mr. Chairman, of yourself and the committee to file a copy of the complaint that Mrs. Smith referred to in connection with the vacating of the agricultural preserve, which she said is now pending in the Federal court.

Senator ANDERSON. Without objection that will be done at this point in the record.

(The document referred to was made a part of the official files of the committee.)

Mr. YOUNG. And also with reference to the key employees giveaway plan which was referred to, that action has been filed in West Virginia by a West Virginia law firm. The complaint is verified. There is an affidavit connected with it. It is verified, and with the permission, Mr. Chairman, of yourself and the committee, I would like very much to file a copy of that complaint and a copy of the affidavit that is attached thereto.

Senator ANDERSON. Is there any objection?

(No response.)

Senator ANDERSON. The Chair hears none.

Go ahead.

(The documents referred to were made a part of the official files of the committee.)

Mr. YOUNG. Mr. Chairman, that action has been set for trial, the one in West Virginia, on November 10 of this year.

Mr. Chairman, there is one other matter that I would like to bring to your attention, and that is the attempt which is set forth on page 12 and 13 of Mr. Privett's written statement where he implied that Mr. Utt of the Ways and Means Committee and in whose district the Irvine Co. and the Irvine Ranch is located is not in favor of the divestiture provisions of the bill that came over, the House bill and which is now under consideration by your committee.

This is flagrantly untrue, and I am authorized expressly by Mr. Utt to repudiate the statement which implies very definitely that Mr. Utt favored the exception in the bill of the Kellogg Foundation from the divestiture provisions of the bill, and that he made a speech on the floor of the House in which he referred to the discriminatory practices that the Committee on Ways and Means indulged in, in giving an exceptional consideration to the Kellogg Foundation and the Bendow Foundation.

He stated if you are going to give any exceptions how about some other foundations like the Hormel Foundation, the Waterman Foundation, and the Kaiser Foundation.

The basis, however, of the statement of Mr Utt was not to give any exceptions to any foundation, but to show that by giving the exceptions to the Kellogg Foundation and to the Bendow Foundation was opposed by him, and I am expressly authorized to state to this committee, Mr. Chairman, that Mr. Utt in committee, I mean in the executive session of the committee voted against making the Kellogg Co. and the Bendow Co. an exception to the divestiture provisions of this House bill that is now under consideration by this committee.

Mr. Utt is the Congressman from the district in which President Lincoln—I mean President Nixon has his home. I beg your pardon, Senator Gore, I did not mean that.

Senator GORE. I think there is one comparison, the only one I can think of: we have the highest interest rates now since Lincoln's time.

Mr. YOUNG. Well, that is true. That was a slip of the tongue. I do not know why I said President Lincoln.

Senator CURTIS. Mr. Chairman, I seriously—and I do not mean to enter into this family quarrel—I seriously question whether or not we should receive in our record here what took place in the executive session of the Ways and Means Committee, unless that committee releases it. It is executive, and should not be recorded here.

Furthermore, it is totally immaterial to the merits of the case.

Mr. YOUNG. Mr. Utt authorized me to make the statement which I did, Senator.

Senator ANDERSON. I request that we check carefully whether that can be done.

Mr. YOUNG. It was in the session that he made it a matter of record. I think it is in the record published by the committee.

Senator ANDERSON. It will be checked.

Are there additional questions?

Thank you very much.

Mr. YOUNG. Thank you.

Senator ANDERSON. Our next witness is Mr. Charles Stewart Mott.

Mr. Mott, they tell me you will be our oldest witness. As the oldest member of this committee I welcome you and am very much interested in what you have to say.

STATEMENT OF CHARLES STEWART MOTT, CHARLES STEWART MOTT FOUNDATION, ACCOMPANIED BY FRANK K. MANLEY, EXECUTIVE DIRECTOR

Mr. MOTT. My name is Charles Stewart Mott, of Flint, Mich., and I want to mention a few of the extraordinary accomplishments of the foundation bearing that name over the past 43 years and why I believe it should not be weakened by undue restrictions.

Our foundation is based on some simple ideas of helping people; through opportunities in education, health, and recreation. We do this by keeping Flint schools open 3,800 hours a year compared with the national average of 1,800 hours. We have more adults using the schools at night than children in the daytime.

This partnership between the Mott Foundation and the Board of Education has promoted taxpayers' use of their schools around the clock, around the year. It is known as the Community's Gold concept.

For the past 34 years we have examined the health status of all Flint school children and have established an out-patient clinic Children's Health Center to treat all indigent children. This has raised the percentage without medical defects from 13 percent to about 90 percent, and those without dental defects from 13 percent to about 50 percent.

We provide our program primarily for the people of Flint, but consider Flint also as a laboratory to demonstrate our program to others. Seventy thousand people have visited our community school workshops in Flint, and now 378 localities have 1,337 community schools in operation.

We make grants to nine university regional training centers in addition to training programs conducted by the seven universities of the State of Michigan to train community school leadership personnel.

These accomplishments suggest why we are concerned about anything that threatens our ability to carry out these programs.

Foundation services outnumbered governmental objectives in education, health and social services, which reinforce the concept of tax exemption for funds to be used.

If some foundations do a poor job, regulate them; but do not penalize foundations clearly operated for the public advantage. These foundations function as government's equivalent of industry's research and development departments. If using foundation income for acceptable purposes is good, then a 7½ percent tax on that income is not logical.

Proposed prohibition of all dealings between foundations and donors could create unreasonable problems. Proposed distribution of annual income of 5 percent of the fair market value of investment assets within 12 months could be unduly restrictive and detrimental.

It would preclude investment in growth businesses which require reinvestment of current earnings for greater future value and earnings.

The proposed ownership limitation seems to us to be the most unfair, unworkable and destructive of proposed changes. This would prevent reasonable latitude of investment management to produce maximum current and future income to carry forward our programs.

We agree that abuses should be corrected, but feel that proper ethical operations for the public good should not be penalized. Required divestiture could result in serious loss of income and consequently cutback of services.

We agree with the proposed limitation on use of assets and with requirements for disclosure and publicity on operations, and some other proposals, but consider that foundations should be encouraged rather than discouraged.

Possibly a voluntary association of foundations could establish what would be in effect accreditation standards of objectives, methods and practices.

We are private only in the source of funds. Our devotion and service are entirely to the public interest.

When Flint lacked college opportunities, we gave a campus and helped construct buildings, and as a result 9,500 young people who could not have afforded to live away from home are now getting a college education at a saving of about $16 million a year to their families.

Community schools open around the clock around the year and create informed participation in citizenship, democracy in action. President Eisenhower sent Gen. Edwin Clark and President Kennedy sent Bud Wilkinson to get us to start a physical fitness program. Both reported we already had the finest program in the United States, one that should be promoted everywhere.

I would like to invite you to visit Flint and see for yourselves what the Mott Foundation is doing, which would be the best way for you to understand why I ask you not to destroy or weaken these good works by restrictive or punitive legislation.

I think it was Jack Knight who said do not burn down the barn to kill a few rats. The cost of opening 1,337 community schools cost us $361,000, and a contribution by the community and others of $7,395,000. That is a ratio of our contributing one-twentieth of what others put in in order to carry on this program. It shows what they think of it.

If the market value of stocks given to foundations is disallowed, and cost of stock to the donor is substituted you would find the source of the gifts of this sort to dry up very fast. If you would not allow the dedicated giver to have anything to do with the income produced, you would find that the reason for making large gifts would be affected. In many cases the large gifts are given by a donor because he wants to accomplish a good result, and wants to be sure that it will be used to the best advantage.

Our 3-day workshops have been attended by over 12,000 people per year, over 70,000 during the past 6 years. Almost without exception everyone has said, "If we had not seen it we would not have believed it."

Our capital expenditures have been over $33 million in order to provide facilities for carrying on our programs and I give as reference the following names and groups who have seen it in operation:

Secretary of Transportation John Volpe; Secretary of Housing and Urban Development George Romney; General Edwin Clark; Congressman Donald Riegle; Bud Wilkinson, 70,000 people who have attended 3-day workshops in Flint; all seven Michigan universities; Chicago University; Arizona State University; Brigham Young University; Board of Education for Flint; 80,000 people of the city of Flint who have participated in after-hour classes and games in the afternoon and evening programs, and President Richard M. Nixon, who is quite familiar with the operation, and who on August 8 made a speech recommending all of the projects that we had in operation long before he was elected President.

I am proud of the good work done by the Foundation bearing my name for these past 40 years. I appreciate the opportunity to testify and can assure you that at 94 years of age my motivation is not selfish. It comes from my heart, and this is no time to diminish the resources of our country.

The CHAIRMAN. Thank you very much, Mr. Mott.

Are there any questions?

Senator BENNETT. Mr. Chairman, just for the record, Mr. Mott, can you give us an idea of the proportion or the percent of the income of the foundation that you disburse every year?

Mr. MOTT. We disburse or contract, commit ourselves to the entire income, which is about $16 million.

Senator BENNETT. Do you know offhand what percentage that is of the present value of the assets of the foundation? I ask that because this bill would require that a foundation distribute 5 percent of its assets. Do you have any idea what that would be in relation to the total value of the assets?

Mr. MOTT. No. I can only guess roughly. Income $16 million, and the assets something like $250 of $300 million. Whatever the percentage is.

Senator BENNETT. That would be about 5 percent. Thank you.

Senator CURTIS. Mr. Mott, where are your glasses?

Mr. MOTT. In my pocket.

Senator CURTIS. There was a conversation up here calling attention to the fact that you read that statement without your glasses.

Mr. MOTT. Yes, sir.

Senator CURTIS. Mr. Chairman, I think we ought to take note of the fact that Mr. Mott is accompanied in the room by a distinguished

former member of the Cabinet. I refer to Post Master General Arthur Summerfield of Michigan.

Mr. Mott, what has you foundation done regarding housing?

Mr. MOTT. On the housing thing I would like to turn that over to Mr. Manley here, who is right in touch with the whole thing.

Mr. MANLEY. Mr. Chairman, what we have tried to do in Flint through our community school concept program is to try to work on all the problems that we have in our community. As a consequence we have worked very closely with the urban renewal people as well as the highway department, and we have relocated through the highway department, and so on, about 9,000 families, and we have tried to have it through scattered housing.

We were the first city in the country to have an open housing law passed by an ordinance. We feel that we have done quite a bit in the private as well as the Federal development program in housing. Also, along with housing field, Mr. Mott has contributed $4.5 million for the Genesee County recreational area as well as another park given to the county for recreational purposes in the very dense part of our community.

There are many other things that we could go into; we are very alert to all the problems of any community.

Senator CURTIS. Mr. Manley, do you feel that a tax of 7½ percent, if placed upon this foundation's income, in reality will actually fall on the beneficiaries?

Mr. MANLEY. Yes, sir.

Senator CURTIS. Will this foundation be adversely affected by the divestiture provisions of the House bill?

Mr. MANLEY. Yes, sir.

Mr. MOTT. Is it felt that foundations should make gifts for housing?

Senator CURTIS. No, no. We knew of your work in that regard, and I merely wanted the record to so reflect.

Mr. MOTT. We simply spent certain amounts of money in promotion of ideas to get housing done.

Senator CURTIS. That leads to another question. Could you give an example, either Mr. Mott or Mr. Manley, of how the foundation has served as a laboratory for Federal legislation?

Mr. MOTT. We think that the establishment of community schools, opening the schools for 3,800 hours a year as against 1,800 is an example. We are pushing that, and it is increasing all over the country. We think that the Government should take cognizance of that and what we have recommended and put it into operation; they should do the same thing in the encouragement of that.

Also, the establishment of colleges in Flint so that the kids in Flint do not have to leave home to attend college; we have 9,500 kids attending college in Flint that could not go if they had to board away from home.

Senator CURTIS. That is all, Mr. Chairman.

Senator FANNIN. Mr. Mott, perhaps you could tell us about your youth retention laboratory.

Mr. MOTT. The what?

Senator FANNIN. The youth retention laboratory. I am just referring to how you retain your youth.

Mr. MOTT. I am so absolutely dedicated to what we are trying to do that somebody says—well, an old confrere of mine, when I complimented him on his 88th birthday, he said the only thing we can do now, Stewart—we cannot do much—is to talk about old times and things that happened.

I said you have got me entirely wrong. I was born today. I am looking only to the future, and I am going ahead 100 percent full steam.

Senator FANNIN. Mr. Mott, we have heard a great deal about foundation-controlled corporations. I would just like to ask you, speaking of your foundation, as to how you justify the foundation having a controlling interest in several corporations?

Mr. MOTT. Those corporations were investments that I have personally made because I felt there was growth and were profitable and a hedge against inflation, which very few people pay much attention to now, and from my point of view represented wonderful investment personally. The results from those over the years have proved that they were wonderful investments.

When people came along and said we want more money to spend in the foundation to do these various things, I did not have the cash. I did not want to sell the stock in these corporations, so I gave the stock to the foundation. There is no reason why we ought to penalize those foundations simply because of the whim of somebody.

Senator FANNIN. Well, wasn't your foundation largely built up by gifts which resulted in big tax savings to you? In other words, did you not receive tax savings?

Mr. MOTT. I complied with the law as it existed, so there certainly should be no criticism of my complying with the law. When I gave about a quarter of a billion dollars to the foundation, I did not receive any tax-exemption on that.

Senator FANNIN. In other words, you say that——

Mr. MOTT. I had already paid taxes in many cases of 90 percent of the income from those corporations.

Senator FANNIN. Thank you.

Senator HANSEN. Thank you, Mr. Chairman.

Mr. Mott, let me compliment you on your very stimulating testimony. I would like to ask you, sir, how can Congress control the abuses by some foundations without handicapping constructive ones?

Mr. MOTT. I think that you are hopping on a man who is trying to do the best he can under the rules and regulations, and then you ask me how to write a taxation bill.

Senator HANSEN. You are the only one who has not told us how.

Mr. MOTT. There are so many complications on these things. As Jack Knight says, do not burn down the barn in order to kill a few rats. It certainly seems to me that the Senate ought to be able to devise conditions in the tax bill that would protect good foundations and serve punishment on those that are not good.

Senator HANSEN. I have one further question if I could, Mr. Chairman.

How would it seriously handicap your foundation to require it to spend 5 percent of the total market value each year of the corpus of that foundation?

Mr. MOTT. That means that the Government would take away from the foundation 5 percent of a certain amount of money from the

beneficial operations of the foundation. Whatever they take away as tax the foundation could not spend for the beneficial things that we stand for.

Senator HANSEN. Thank you, Mr. Mott.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, gentlemen.

Thank you very much, Mr. Mott. We are very proud to have you with us today.

(Mr. Mott's prepared statement follows:)

STATEMENT OF CHARLES STEWART MOTT ON TAXATIONS OF FOUNDATIONS

SUMMARY

1. My name is Charles Stewart Mott, and I want to mention a few of the extraordinary accomplishments of the foundation bearing that name for the past 43 years, and why I believe it should not be weakened by undue restrictions.

2. Our Foundation is based on some simple ideas of helping people through opportunities in education, health, and recreation. We do this by keeping Flint schools open 3,800 hours a year, compared with the national average of 1,400 We have more adults using the schools at night than children in the daytime. Ths partnership between the Mott Foundation and Flint Board of Education has promoted taxpayers' use of their schools around the clock around the year, and is known as the Community School concept.

3. For the past 34 years, we have examined the health status of all Flint school children, and have established an outpatient-clinic children's health center to treat all indigent children—raising the percentage without medical defects from 13% to about 90%, and of those without dental defects from 13% to about 50%.

4. We provide our program primarily for the people of Flint, but consider Flint also a laboratory to demonstrate our program to others. 70,000 people have visited our community school workshops in Flint, and now 379 localities have 1337 community schools in operation.

5. We make grants to 9 university regional training centers— in addition to the training program conducted by the seven universities of the State of Michigan—to train community school leadership personnel.

6. These accomplishments suggest why we are concerned about anything that threatens our ability to carry on these programs.

7. Foundation services carry out avowed governmental objectives in education, health, and social services—which reinforces the concept of tax exemption for funds so used.

8. If some Foundations do a poor job, regulate them, but do not penalize Foundations clearly operated for the public advantage. The Foundation functions as government's equivalent of industry's research and development department.

9. If spending Foundation income for acceptable purposes is good, then a 7½% tax on that income is not logical.

10. Proposed prohibition of all dealings between Foundations and donors could create unreasonable problems.

11. Proposed distribution of annual income or five percent of the fair market value of investment assets within 12 months could be unduly restrictive and detrimental. It would preclude investment in growth business which require reinvestment of current earnings for greater future value and earnings.

12. The proposed stock ownership limitation seems to us the most unfair, unworkable, and destructive of proposed changes. This would prevent reasonable latitude of investment management to produce maximum current and future income to carry forward our programs. We agree that abuses should be corrected, but feel that proper, ethical operations for the public good should not be penalized. Required divestiture could result in serious loss of income and consequent cut-back of services.

13. We agree with proposed limitations on use of assets, and with requirements for disclosure and publicity on operations, and some other proposals, but consider that Foundations should be encouraged rather than discouraged. Pos-

sibly a voluntary asso ıon of Foundations could establish what would be, in effect, accreditation standards of objectives, methods, and practices.

14. We are "private" only in source of funds, our devotion and service are to the public interest.

15. When Flint lacked college opportunities, we gave a campus and helped construct buildings—as a result, 8,000 young people who could not afford to live away from home are getting a college education at a saving of about $16,000,000 a year to their families.

16. Community schools—open around the clock around the year—are creating informed participating citizenship, democracy in action.

17. President Eisenhower sent General Edwin Clark—and President Kennedy sent Bud Wilkinson—to get us to start a physical fitness program. Both reported we already had the finest program in the United States, one that should be promoted everywhere.

18. I would like to invite you to visit Flint and see for yourselves what the Mott Foundation is doing—which would be the best way for you to understand why I ask you not to destroy or weaken these good works by restrictive or punitive legislation.

STATEMENT

I want you to know that I appreciate the opportunity to offer some testimony on proposed changes in taxation of foundations. Particularly, I want to present some very specific facts about one foundation, its origin, purposes, accomplishments, and future potential if it is not weakned by undue restrictions and limitations.

My name is Charles Stewart Mott, and I want to tell you something about the foundation which bears my name, and which was established 43 years ago. First, I would like to note that I served in the New York State Naval Militia from 1894 to 1900—and that in 1898 I enlisted as a Gunner's Mate First Class in the United States Navy, and served on the *U.S.S. Yankee* during the Spanish-American War. I have also been of service to the military in the first and second World Wars. I moved from the New York area to Flint, Michigan, in 1907. I served as Mayor of Flint in 1912, 1913, and 1918, giving my salary as Mayor to the City Health Department and Red Cross. More than fifty years ago, I organized the Y.M.C.A. in Flint. I mention these things to establish the point that my patriotism and concern for service to the Nation and the community are not of recent origin, but have been a matter of public record since the last century. Exactly these motives brought me to establish the Charles Stewart Mott Foundation in 1926, under the laws of the State of Michigan, to carry on philanthropic, charitable, and educational work.

Establishment of the Foundation involved some basic assumptions:

First, that those of us who have benefited from society have an obligation to benefit society in return;

Second, that it is possible to benefit society by helping people improve the quality of their lives;

Third, that creation of opportunity for self-improvement helps best by developing self-reliant strength;

Fourth, that extensions of opportunities in education, recreation, and health are fundamental means of improving the quality of living; and

Fifth, that existing facilities, agencies and democratic methods can serve best in the development of such extended opportunities.

Those ideas may sound very simple indeed, and so they are. Upon them the Mott Foundation is built. We have been working with those ideas from the beginning, and our Foundation has been guided always by dedicated, unpaid trustees who have shared our concern for carrying out our responsibilities to society by creating opportunities for people to improve the quality of their lives. In the depression years, when everyone agreed that somebody else should do something about juvenile delinquency, we began implementation of these ideas in Flint, Michigan. Finding that Flint schools were open only about 1400 hours a year—the national average—and that young people had no constructive recreational opportunities in the evenings, we offered to help the Flint Board of Education make those school buildings the public had built available for use by that public in the afternoons and evenings when they had previously been locked. We did this by providing funds to the Board of Education to conduct supervised recreational and educational activities for young people and adults.

The response was enthusiastic—both from the Board and from the public. We also began grants for examination of the health status of school children, and means of correcting the physical and dental defects revealed by those examinations. From this experimental beginning in 1935, what is now known as the Community School Concept developed. The partnership between the Mott Foundation and the Flint Board of Education has grown over the years so that we now contribute some $4,000,000 annually to permit the Flint schools to operate a wide scope of programs—adult education, recreation, physical fitness, health, special education, and many others—for both adults and children. Flint schools are open 3,800 hours a year, now, and a similar multiplication of effectiveness of existing facilities has been applied in many areas. In the field of health, for example, we have built a $4,000,000 Children's Health Center—with operating expenses of $1,500,000 annually—to make certain that the physical and dental defects which will yield to correction are corrected for the children whose parents cannot afford such medical and dental attention. These are only a few of the several implementations of those basic ideas on which the Mott Foundation is built.

From the beginning of our Foundation activities, we have also had another simple idea. It is this: we felt a special obligation to, and interest in, the Flint community—made up of some 200,000 people in the city and another 200,000 in the surrounding county. We basically planned, therefore, to carry on our program of community improvement for the people of the Flint area first—while holding as equally important the concept that this demonstration, with Flint as a laboratory, should be made available to as much of the rest of the world as might wish to observe, learn, and apply the demonstrated ideas to their own communities.

In order to make this demonstration highly available to others, everywhere, we have, for the past 12 years, held a series of three-day Community School Workshops in Flint at which visitors from everywhere have been able to see the programs in action. More than 70,000 people have thus taken advantage of the opportunity to share in this Community School Workshop experience—and their almost universal comment has been that they could not have believed such a program could be carried out with such wide and intense community participation if they had not seen it for themselves. I can't begin to tell you all of the results and effects of this spreading of the community school idea—which is the essence of democracy in action—except to mention that at the latest count we have record of community education programs developed in 379 different localities involving 1337 different schools. Of these 1337 schools, we can document the fact that Mott Foundation funds served to help initiate the community program in 625 of the schools. The other 712 community schools, deriving their inspirations from the Flint demonstration, have applied the principles and techniques without financial assistance from the Mott Foundation. To meet the need for personnel trained in such community school techniques, we have worked with many educational institutions to develop training courses for Community School Directors—both in Flint and elsewhere.

The Mott Foundation has employed about $2,000,000 in grants to provide for leadership training to make possible the establishment of community schools throughout the 379 localities mentioned. We are working with nine University Regional Training Centers across the Nation, in addition to the training program conducted by the seven universities of the State of Michigan. So successful has been this approach to provision of demonstration community school programs, and leadership training, that the State of Michigan has just appropriated a million dollars to help stimulate and implement such programs throughout the State. I might mention, that of the 625 schools where some Mott Foundation funds have been utilized in initiating community school programs, our grants of only $361,796 have resulted in local community contributions exceeding $7,000,000 in this implementation of school-centered community development.

I have not mentioned Mott Foundation application of basic ideas at the college level, or our work with and through existing social agencies, or the contribution of a $6,500,000 Children's Hospital to the University of Michigan, or many other aspects of Mott Foundation activities. I have not mentioned our accomplishments in the field of physical fitness—which have received such generous comments from Presidential advisors in this sector. But perhaps I have told you enough to demonstrate that we believe very deeply in what we are doing—and that carrying out these programs is our purpose in living.

Since this is true, you can understand our concern about any governmental action which threatens the resources of the Mott Foundation in such a way that

they might be unable to carry forward this great work we have begun, and which is producing such rich returns in human values in the lives of many thousands of people.

I would like to explore with you one more simple idea—the idea of exemption from tax of money used for such purposes as those which our Foundation carries out. It seems to me that the concept of exemption is a simple one based upon the fact that money so exempted is being used to fulfill avowed governmental objectives in this democracy of ours. A government for the people, such as ours, accepts responsibilities to serve its people as far and as well as it can in education, health, and social services. If a potential taxpayer uses his funds to carry out such avowed governmental objectives—providing educational services, health services, and social services—he may achieve more effectiveness, more economy, and more flexibility than the nature of governmental operation could logically permit. The dollars he, through a foundation may spend to accomplish such admitted governmental objectives will obviously make it unnecessary for government to spend a larger number of dollars to accomplish what he has already done. Thus, the logic of tax exemption of funds used to fulfill obligations of a democratic government to its people would seem to be unassailable. We consider that the Mott Foundation devotes its funds exactly to the efficient fulfillment of such objectives.

If it is asserted that some foundations do a poor job, or are so manipulated as to serve private ends of their donors, or in some other fashion serve rather as a tax haven than an instrument of public—good then I reply that it should not be difficult to frame, enact, and enforce laws preventing such abuse while not penalizing those foundations which do operate clearly for the public advantage. If it is protested that foundations provide grants, even in such approved fields as education, recreation, health, and social services, to carry out programs which government would not undertake—then I would note that, within the bounds of common sense, this is a virtue rather than a sin. A foundation may venture risk money on an experimental program inappropriate for government—but it is by such experimental pilot programs that new and better ways of serving education, health, and social service are developed. The foundation can be government's equivalent of industry's research and development department. Indeed, as government recognizes to an increasingly great extent its obligation to serve the people of the nation in education, health, housing, employment training, and social service fields, the function of the so-called private foundation becomes more and more valuable as the trail-blazer, the pathfinder, the troubleshooter, to do those necessary things for the public good which government cannot or will not do. I could cite as a typical instance the development of fine techniques of humane relocation of families displaced by highway and Urban Renewal programs—as pioneered by an agency funded in part by the Mott Foundation. The methods developed by this agency were later incorporated into Federal laws and regulations to the advantage of the entire nation.

To bring the question of these proposed tax changes down to simplest terms, we—believing in all sincerity that the Mott Foundation is conducted for the public good, in the public interest—would protest any change which reduced the resources available to carry on our programs. At the same time, we are equally in favor of any change in law which would serve to prevent abuses of foundations by those who would attempt to use them for their own private advantage.

If devotion of the income of foundations to acceptable programs is *good*, it must be 100% good, not 92½% good. For this reason, I do not understand the logic of the proposed 7½% tax on the income of foundations.

With respect to the proposed limitations of dealings between a foundation and persons with certain specified relationships to that foundation, it would appear that the test should be one of fairness and honesty—not a complete prohibition. It is not difficult to imagine circumstances under which a foundation might need to borrow money or lease property; a total ban on dealings between foundations and donors might create undue cost or hardship to the foundation. The Mott Foundation has not relied on, and does not expect to rely on, such practices, but circumstances could exist where a foundation might have justifiable need of legitimate dealings with one or more of the donors contributing to it.

The proposed requirement of distribution of annual income or five per cent of the fair market value of investment assets within a year could lead to unreasonable applications under some circumstances.

At best it restricts the flexibility of the trustees of a foundation to apply their best discretion in the making of grants on the basis of the worthiness of the objectives—since in a given calendar year, insufficient projects of demonstrable merit might be proposed, while another year's approved requests might require more than that year's income. Again, it would seem that a test of general practice in expending earnings within a reasonable period for objectives of obvious merit would be a better yardstick than a calendar requirement would be.

There are two points of concern with this provision—first, the one just mentioned, an absolute requirement to spend income within the one-year period—and, second, the requirement that if an investment does not yield 5% for such expenditure as income, then a portion of the capital asset must be sold to provide the equivalent of such income for expenditure within the specified period. A balanced investment program will include growth stocks, also the development of a particular business may, in the very process of healthy growth, require retention of its earnings to expand facilities for a period of years resulting in greater income-producing resources in the long run. We have planned the Mott Foundation for a very long run indeed—to continue its good works throughout the foreseeable future—and have established our investment program accordingly. It seems to us that a reasonable and prudent latitude in investment management is both fair and necesary to permit establishing and conserving capital resources for future as well as present income for foundations.

Of all the proposed changes in the law regulating foundations, the stock ownership limitation seems to us the most unfair, unworkable, and destructive. Certainly, if a foundation has acquired a portion of the ownership of a business which is being operated in whole or in part for the benefit of a donor or his family, such practice should be stopped or punished. But if a donor in good faith contributes all or part of a business to a foundation to provide income to carry on its good works, it is not reasonable that this business should have to be sold at a sacrifice. The Mott Foundation has substantial holdings exceeding twenty per cent of the outstanding stock of several corporations, including complete ownership in some cases. Where a foundation owns 100 per cent of a business or corporation, there can scarcely be any question of manipulation of that business for the advantage of stockholders other than the foundation—so why should a foundation be required to divest itself of such complete ownership? If there are reputed to be temptations in ownership of a fraction of the stock of a company by a foundation, certainly 100 per cent ownership is the best assurance of removal of those temptations. In no instance are the officers of these corporations, who carry on the day-to-day activities of the business, substantial donors or management personnel of the foundation. Rather, the operation of these corporations is carried out by professional management personnel. We would note that such corporations are already paying over 50 per cent of earnings as corporate profits taxes. To force the foundation to dispose of securities or other business interests could seriously weaken the income situation, and thus reduce our ability to carry forward the long-term programs on which we are already embarked.

Believing, as we do, that the objectives and programs of the Mott Foundation are good, and in the public interest, we feel an obligation to enhance and conserve our investment position to produce the maximum income for carrying these programs on. In practice, we disburse our dividends within a year after they are received in accordance with the law, and we feel we should be able to make and preserve the best investments and business operations to keep the maximum resources available for our programs. Required divestiture could result in serious loss of income for the charitable purposes of the Foundation. We have been guilty of no abuses that would justify so stringent a requirement. Again, we come back to the principle: correct abuses, but do not penalize proper, ethical operations demonstrably conducted for the public good. It would seem that strict enforcement of present laws would be sufficient to prevent abuses, without imposing this drastic provision requiring divestiture.

Lest you believe I have come here to disagree with everything proposed in the legislation under consideration, I would note that we agree with proposed limitations on the use of assets, and with the requirements for disclosure and publicity on operations, and some other proposed regulations. Basically, we feel that the private foundation deserves to be encouraged rather than discouraged, promoted rather than hampered, considered a national asset rather than a reprehensible haven of sharp practice—in short, a very good citizen rather than the villain of the peace.

Perhaps foundations themselves, as a group, should set up a formal association of foundations to adopt voluntary standards of approved purposes, methods, and practices, to provide a mechanism for self-policing. To be an accredited member of such an association would be conditional upon conformity to universally accepted standards of approved objectives, methods, and practices. It seems to me that encouragement of development of such a framework for establishment and maintenance of standards would be a better approach than governmental restrictions which could prove detrimental to the public good.

Maybe what Iam trying to say to you as elected representatives of the people of the United States is this: please don't hamstring us, because it's *your* race we're running. We are a "private" foundation only in the source of our funds—in our programs we are as devoted to the public as government itself, and all our activities are completely in the public interest.

I would like to tell you about a lot more of our programs—how, by financing creation of two colleges we make it possible for the families of 8,000 young people to save $16,000,000 a year and give their sons and daughters college educations while living at home.

I would like to tell you more about community schools—buildings that belong to the taxpayers, and that the taxpayers actually use around the clock, around the year for every kind of wholesome and constructive activity—with 20,000 adults per semester turning out for adult education and recreation classes in Flint alone—and hundreds graduating from high school each year in middle age—more adults using the schools at night than children in the daytime—giving working democracy a true medium in which to function, the community school, now carrying its torch of Interest, Involvement, and Information throughout the Nation to create that informed participating citizenship we all want . . .

I would like to tell you what President Eisenhower's General Edwin Clark—and President Kennedy's Bud Wilkinson have to say about our physical fitness program, and its importance to this Nation . . .

Most of all, since I can't expect time to tell you about all these and a dozen other programs—and you wouldn't be able to believe their excellence without seeing them for yourselves—I would like to invite you to visit Flint, Michigan, and see our programs in action. Then you would not wonder that I appear before you to ask you not to destroy or weaken these good works by restrictive or punitive legislation.

The CHAIRMAN. The next witness will be Mr. Byron P. Hollet of the Lilly Endowment, Inc.

Senator BYRD. Mr. Chairman, would you recognize me for a brief moment?

The CHAIRMAN. Senator Byrd.

Senator BYRD. Mr. Chairman, I would like to submit for the record a statement in behalf of Colonial Williamsburg. It is a statement of Carlisle Humelsine, president of Colonial Williamsburg.

I would like to point out that in the past 40 years Colonial Williamsburg has spent nearly $100 million in Virginia in that great colonial area of our State.

I would want to point out to the committee, too, that this Colonial Williamsburg is managed by an 18-member independent board and is not subject to any individual or to any other foundation.

I submit now with your permission, Mr. Chairman and gentlemen of the committee, a statement in behalf of Colonial Williamsburg by Carlisle L. Humelsine, president of Colonial Williamsburg.

(The statement referred to by Senator Byrd follows:)

STATEMENT IN BEHALF OF COLONIAL WILLIAMSBURG

(By Carlisle Humelsine, President, Colonial Williamsburg)

The Tax Reform Bill of 1969 (H.R. 13270), as passed by the House of Representatives on August 7, 1969, poses, in its present form, a genuine threat to a number of historical preservation and educational institutions whose work in their

various field of endeavor has earned national and even world-wide respect and renown. One of these institutions, one that has become a national symbol of the American heritage and a source of deep satisfaction and inspiration to literally millions of Americans, is Colonial Williamsburg, Incorporated, the widely known preservation and educational undertaking at Williamsburg, Virginia.

For those who are not familiar with the restoration, its program, and the arrangements that have been made for its financial support and permanence, perhaps it should be said that the work was begun more than forty years ago by Mr. John D. Rockefeller, Jr., who saw, in the survival of the early eighteenth-century town plan and of nearly one hundred original eighteenth-century structures, a unique opportunity to preserve and restore for the edification of future generations of Americans the environment out of which developed the concepts that are so fundamental to our nation today.

The work has been an exceedingly careful one, marked by the highest degree of scholarly integrity and a notable absence of the kind of commercialism that too frequently has blighted our historic sites. The work has been a costly one, approaching one hundred millions of dollars. Today, the preserved area of Williamsburg, extending along the one-mile strip of Duke of Gloucester Street from the Christopher Wren Building of the College of William and Mary to the restored Capitol where Washington and Jefferson sat as burgesses, constitutes America's—and probably the world's—most extensive single undertaking in historical preservation. More than 300 rooms in the assemblage of public buildings, taverns, and historic residences, that are open daily to the public, are furnished with one of the world's finest and most representative study collections of seventeenth and eigtheenth-century furniture and furnishings. Colonial Williamsburg has become one of our leading educational institutions in the fields of historical preservation, eighteenth-century decorative arts, archaeology, and, perhaps most important of all, of the social, economic and political circumstances out of which this nation arose.

More than one million Americans and visitors from all over the world visit Williamsburg every year. Of this count, nearly 100,000 are students and school children, many of whose American history curriculum in their home schools has been specifically programmed for preparation for the Williamsburg visit and for better appreciation of its broad educational content. Many of these visitors, too, are distinguished persons, heads of state, whose first glimpse of the United States is Williamsburg, where, normally in a brief, overnight visit before calling on the President in Washington, they are given the opportunity to see first-hand an impressive manfiestation of our national heritage and fabric as a people.

Colonial Williamsburg, Incorporated, the organization responsible for the carrying on of the project, is managed by an entirely independent board of 18 distinguished Americans, representing all parts of the country and the various fields of interest to the restoration. The organization is subject neither to the control nor the influence of any single person or any other foundation. Its financial resources are its own, and are used exclusively for the purpose of continuing to serve the interests of the American public through its educational programs and historic preservation projects.

In the early years of the restoration, it became clear that the small town of Williamsburg was wholly incapable of providing accommodations that the growing number of visitors more and more urgently needed. In the depression years of the 1930's and the war years of the 1940's, Colonial Williamsburg was left to provide these facilities itself, if its great work was not to founder. Consequently, in the late 1930's the Inn and Lodge were built to provide essential hotel and dining accommodations to the public. Today, these facilities represent only a fraction of the many others privately owned and operated in the Williamsburg area. Indeed, the stimulus of Williamsburg has become a factor of cardinal importance not only in respect to the prosperous growth of the Williamsburg community, but in the economy of the Commonwealth of Virginia as a whole.

At Williamsburg, the availability to the public of convenient hotel and related accommodations has been essential from the very beginning. These facilities operated by Williamsburg Restoration, Incorporated, a wholly owned subsidiary of Colonial Williamsburg, have been designed, specifically, to meet the expanding educational goals of the project by providing a functional environment for seminars and conferences in the atmosphere of Williamsburg. Without these facilities, Colonial Williamsburg's effort to convey the relevancy of our eighteenth-century heritage in today's world would be enormously diminished in importance and impact. Materially related to its exempt purposes as these facilities may be,

however, Colonial Williamsburg has, since its beginning, operated these activities through a separately incorporated wholly taxable entity. No attempt has been made to shield income from these operations from normal corporate taxation—Federal, State, or local—and separate corporate structures have been maintained to provide a clear distinction between operations not subject to tax and taxable operations. The operations of both the tax-exempt parent and the taxable subsidiary are regularly examined and audited by the Internal Revenue Service.

The gross income of Colonial Williamsburg, after a reorganization of some of the business operations scheduled to take place on January 1, 1970, will be derived annually from the following sources in the following approximate amounts:

Admissions, sales of handcraft products, publications and films	$3, 750, 000
Rentals and other income from residences and other functionally related properties	2, 850, 000
Endowment funds (invested securities)	3, 400, 000
Total	10, 000, 000

The annual cost of normal operating programs at Williamsburg exceeds $8,725,000. A major portion of the income derived from endowed funds, therefore, is required to meet the difference between operating costs and operating income. Inflationary and other economic factors operating everywhere in the country in recent years have had the effect of continually widening this difference, and thereby making the endowment fund income more and more vital to the survival of Colonial Williamsburg. The balance of income from endowed funds has been programmed into many years in the future to permit the continuation of preservation and restoration necessary to the ultimate completion of the undertaking, and to the research and archaeological projects, production of educational films and publication of books and research materials, which are all so essentially related. Obviously, therefore, all income from every source is devoted directly to the exempt purposes of the organization.

The Tax Reform Bill of 1969, as presently worded, would impose upon Colonial Williamsburg a federal tax liability in the neighborhood of $1,000,000 per year. This would have the disastrous effect of forcing the organization into annually escalated deficits and could only lead to wholly unintended results. It would bring at once a halt to plans for completing the restoration and expanding current educational programs in response to public interest and attendance. Moreover, the organization would be forced to re-appraise its fundamental mission, with the view of cutting back existing operations to accommodate to a much-reduced financial capacity.

There is not the slightest question that the effect of such actions would be to diminish materially the significance of Colonial Williamsburg and to deprive future generations of much of its inspirational impact.

An understanding of the general purposes of the tax reform bill make it abundantly clear that no such effect was intended. In a number of instances, Colonial Williamsburg is particularly noted in the House Committee on Ways and Means explanatory report, with references to specific provisions provided in the bill to avoid irreparable harm to it and similar organizations. In at least two sections, however, the present language of the bill would expose such organizations, and Colonial Williamsburg in particular, to an inevitable erosion of their fundamental financial security. These proposals contradict the general intent of the greater portion of the bill and should not be left standing in their present form.

These inconsistencies lie in the present wording of those portions of the bill that would (a) define "gross investment income," as used in Section 506(b) (2) of the Internal Revenue Code of 1954, (b) add a new Section 509 to the Code, and (c) modify existing Section 512(b).

Fortunately, these provisions are capable of simple remedy, by adding legislative language consistent with the balance of the bill. At the appropriate time, I would like to ask the Committee's permission to submit suggested amendments.

These changes would have the effect of recognizing the fundamentally public nature of the financial support behind such organizations as Colonial Williamsburg. In the case of Colonial Williamsburg, income derived from admissions and from other services and facilities furnished to the public, either directly or through functionally related activities, far exceeds income derived from endowed funds. In other words, the activities of Colonial Williamsburg have historically met the purposes of the bill to insure responsiveness on the part of such organizations to the needs and interests of the public.

STATEMENT OF COLONIAL WILLIAMSBURG

The tax on investment income and the tax (at ordinary corporate rates) on income from functionally related business activities, as currently provided in the Tax Reform Bill of 1969 (H.R. 13270), will gravely jeopardize the educational and preservation programs of Colonial Williamsburg.

For the reasons set forth in the attached explanatory statement, consideration by the Senate Committee on Finance of the following three amendments to the House Bill is respectfully requested:

1. Amend proposed Section 506(b)(2) defining "gross investment income" to read as follows:

"(2) Gross Investment Income—For purposes of paragraph (1), the term 'gross investment income' means the gross amount of income from interest, dividends, rents, and royalties, but not including any such income to the extent included in computing the tax imposed by Section 511 *or any such income derived from a functionally related business as defined in Section 4943(d)(4).*" (New matter italic.)

2. Amend proposed Section 512(b)(15), imposing the unrelated business income tax on interests, annuities, rents and royalties received from controlled corporations, to read as follows:

"(15) Notwithstanding paragraph (1), (2), or (3), amounts of interests, annuities, royalties and rents derived from an organization of which the organization deriving such amounts has control (as defined in Section 368(c)), *other than such amounts derived from a functionally related business as defined in Section 4943(d)(4)*, shall be included as an item of gross income (whether or not the activity from which such amounts are derived represents a trade or business or is regularly carried on), and there shall be alowed all deductions directly connected with such amounts." (New matter in italic.)

3. Amend proposed Section 509(a)(2)(B) to read as follows:

"(B) normally receives not more than [one-third] *one-half* of its support in each taxable year from gross investment income (as defined in Section 506(b)(2);" (Eliminate matter in brackets; new matter italic.)

The following describes means of amending the several sections referred to above.

Page 5, amend line 19 as follows: Delete period and add, "or any such income derived from a functionally related business as defined in Section 4943(d)(4)."

Page 91, amend line 3 as follows: After second bracket, add words, "other than such amounts derived from a functionally related business as defined in Section 4943(d)(4),"

Page 16, amend line 4 as follows: Delete word *third*, substitute word *half*.

The CHAIRMAN. Mr. Hollet.

STATEMENT OF BYRON P. HOLLET, DIRECTOR, THE LILLY ENDOWMENT, INC.

Mr. HOLLET. Mr. Chairman and members of the committee, my name is Byron P. Hollet. I am a director of Lilly Endowment of Indianapolis, Inc., and I am appearing on behalf of that private foundation.

Lilly Endowment was established 32 years ago by three members of the Lilly family, two of whom are now deceased. Those founders made gifts to the endowment of substantial amounts of Eli Lilly & Co. which have been retained by the endowment.

Preceding witnesses have covered many aspects of the proposed legislation affecting private foundations. Lilly Endowment supports much of this legislation designed to correct abuses. We believe that funds which have been committed to charity through gifts to a foundation must be devoted exclusively to charitable needs.

We also endorse the concept that there must be a public benefit at least commensurate with the tax privileges accorded.

Since Lilly Endowment was founded, It has distributed to charity substantially its entire income, over $77 million, an amount which

is more than 2½ times the initial value of all of the gifts which have been made to the endowment.

We have been concerned over the provision of the House bill which would levy a tax of 7½ percent on the income of the private foundation. We are glad to see that the Treasury Department has recommended the substitution of a supervisory fee or a tax of 2 percent for that purpose, and we endorse that recommendation.

In the time remaining I should like to express, however, our deep concern over two specific provisions of the House bill, the minimum 5-percent pay-out rule and the 20-percent limitation on business holdings.

The bill would require, as you know, a foundation to distribute annually its entire net income and in any event not less than 5 percent of the current market value of its assets. We have always distributed substantially our entire net income and have no objection to such a requirement. But as to the 5-percent minimum pay-out provision, we have two objections.

First, we think the 5-percent requirement is too high, and second, we believe it would be unfair to apply that percentage to the current market value of the assets of a foundation each year.

With reference to our first objection, we believe that Congress should not expect nor require a foundation to earn a greater return from its investments that can be realized from a well-managed portfolio of equity securities, Attachments B and C to our written statement, which is already submitted, demonstrate that a 5-percent return can seldom if ever be realized.

Therefore, to meet the 5-percent requirement, a foundation must follow one of two courses of action.

(a) The foundation must invest its funds in fixed income securities, such as bonds and preferred stocks with a high yield but little or no growth potential or

(b) The Foundation must pay out a portion of its principal each year to meet the deficit between the income it receives and the 5 percent of the fair market value of its assets.

Neither of these alternatives advances the interests of charity. Indeed either in our judgment curtails such interests.

Let me illustrate my point by taking Lilly Endowment itself as an example. Had our endowment chosen to dispose of its gift of stock at the end of each year in which they were received and to invest the proceeds in government bonds, for example, the following would have been the results:

For the period from 1937 through 1968 our endowment would have received income of only $15 million instead of $81 million it actually received. For the year 1968 our endowment would have received only $1.2 million instead of $6.8 million it actually received and contributed.

Funds given to charity in the 32-year history of our endowment would have been reduced from $77 million to $15 million, or a reduction of about 80 percent. Yet curiously enough the program of investing in government bonds would likely have qualified under the 5-percent requirement, whereas the alternative which we followed would not, because of the increase in market values of foundation assets to which the 5 percent must be applied.

The second alternative to meet the 5 percent pay-out would be to distribute annually enough of the principal of the foundation's assets to make up the difference between the full income it receives and the 5 percent. This we submit can only result in a steady depletion of the assets of the foundation, and eventually lead to its extinction.

While we are aware that there may be some who believe that a life of a private foundation should be limited, we do not share this belief, and we do not think that this belief is shared by those connected with the hundreds of thousands of churches, schools, hospitals, and other benevolent institutions which could not continue to exist in this country without the existence of the private foundation, particularly whereas here under the proposed bill, the formation of new foundations is discouraged.

Our second objection to the 5 percent minimum pay-out provision arises because the percentage figure would be applied annually to the market value of the foundation's assets. We have observed that the market value of any particular security can and does fluctuate widely from year to year. Such fluctuations could substantially distort the minimum pay-out required of a foundation each year, and thereby seriously hamper the planning and orderly administration of its grants to charity.

To avoid this situation, we suggest that the minimum distribution requirement, whatever it may be, should be more broadly based and applied to an average of market values of a foundation's assets taken over a period of years, 10 years, for example, or for such period of time as the asset has been held if less than 10 years.

This change would go far to insure a more effective and orderly way for the foundation to carry out its programs.

Now, let me discuss in the brief time I have left our objections to that provision of the bill which would limit to 20 percent the holdings of the foundation in an incorporated business enterprise when combined with the holdings of disqualified persons under the bill.

First we think that the current provision in the House bill would certainly produce some results not in the best interests of the public welfare. It would force many existing foundations including Lilly Endowment to divest themselves of investments which have proved to be highly beneficial in the past, under circumstances which might seriously impair the Foundation's ability to realize the true value of such investments.

Further, such a limitation most certainly would discourage and impede further gifts to existing foundations, and the formation of new foundations.

We do not believe that control of a business enterprise by a foundation in and of itself is bad, and we suggest that there is no significant evidence to establish this as a fact. If property having substantial value and significant growth potential is contributed to a foundation and managed for the exclusive benefit of charity, it is difficult to understand why Congress would consider control of the property by the foundation its donor and members of his family as objectionable; particularly is this true where the term "disqualified persons" under the House bill apparently would include not only donors living or dead, their spouses living or dead, and all descendants no matter how remote

of those living and dead persons, but also through the application of most severe attribution rules found in the Internal Revenue Code the brothers and sisters of those living or dead donors and their descendants.

The application of the House bill's definition of disqualified persons would in the case of Lilly Endowment include the stockholdings of persons extending through five generations, many of whom have neither an active interest nor the slightest participation in the affairs of the Foundation or the Lilly Co.

The House proposal leaves little or no opportunity to establish or to enlarge a philanthropic foundation through gifts of stock to a family-controlled corporation.

Society has received great benefits from charity made possible through the medium of the family foundation. Our national policy we believe should seek to take every advantage of this opportunity, and to turn private wealth to the public good and to stimulate not discourage, the institution of the family charitable institution, thereby relieving the Federal Government and its taxpayers from the support now given by private foundations.

Mr. Chairman, members of the committee, I thank you on behalf of the Lilly Endowment for this opportunity to appear before you and to express our views.

The CHAIRMAN. Thank you very much, sir.

Senator BENNETT. Mr. Chairman, as you know, this is a day when we have a regular luncheon at 12:30.

The CHAIRMAN. Senator Anderson wants to hear Mr. Ross Malone before we quit for lunch. I suggest if you have to leave to attend your meeting, Senator, I will stay as long as we can and then we will come back.

Senator BENNETT. If you are only going to hear Mr. Malone before lunch I will be happy to stay here and then we can come back.

The CHAIRMAN. Thank you very much, sir.

Mr. HOLLET. Thank you.

(Mr. Hollet's prepared statement follows:)

STATEMENT OF BYRON P. HOLLET

My name is Byron P. Hollet.[1] I am a member of the board of directors of Lilly Endowment, Inc., of Indianapolis, Indiana. This private philanthropic foundation was incorporated June 25, 1937, as a nonprofit corporation under Indiana law.[2] I am appearing before this committee on behalf of Lilly Endowment to present the views of its board of directors on H.R. 13270, the "Tax Reform Act of 1969."

Lilly Endowment is in agreement with those provisions of the bill which are intended to correct abuses by some private foundations of their tax-exempt privileges. We endorse the fundamental position that funds which have been committed to charity and for which tax benefits have been granted, should, in fact, be devoted to charitable ends.

We feel, however, that certain provisions of H.R. 13270 go further than necessary and, in fact, would create what we believe to be unintentional hardships on Lilly Endowment and other similarly situated foundations whose assets are not in fixed-income-producing securities. I shall confine my discussion to these provisions and to what we believe are constructive suggestions for modifying or altering them.

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[1] For biographical sketch, see attachment A.

[2] For additional information on the Endowment, see the enclosed copy of its report for 1968.

DISTRIBUTION OF INCOME

Section 101(b) of the House bill (new section 4942 of the code) would require a foundation to distribute annually an amount equal to at least 5 percent of the market value of its assets.

Lilly Endowment distributes to tax-exempt organizations essentially its entire net income each year for the purposes of its stated objectives—the promotion and support of charitable, educational, or religious programs. Its income is derived for the most part from common stock of Eli Lilly and Company received as gifts, principally from three members of the Lilly family. These gifts were valued in the aggregate at approximately $29 million at the times they were received. Through 1968 the Endowment had distribtued in grants $77 million of a net income of $79 million. Commitments for future grants amounted to $6.3 million at December 31, 1968.

In analyzing the performance of Lilly Endowment over its thirty-two-year history, it should be noted that its annual distribution of income to charity now amounts to almost one-fourth of the aggregate value of its assets at the time they were acquired; further, that Lilly Endowment has, since its founding, disbursed almost 2.7 times as much money as it has received through donations.

During the twenty-year period 1946 to 1965, the Endowment received income from its assets equal to an average annual yield of about 3.5 percent on the year-end market value. Since 1966 market values have risen; and, although dividend rates have increased, the yield has averaged only approximately 1.5 percent of market value.

A fixed formula for distributing income based on the market value of the assets of a particular year would obviously have a decided impact on the investment alternatives available to Lilly Endowment and other foundations. If the 5-percent-minimum-investment-return requirement (and the proposed 7.5-percent tax on income) had been in effect from the date of Lilly Endowment's founding, the Endowment would have been forced to dispose of more than one-third of its principal assets. In turn, income available for distribution in 1968 would also have been reduced by more than one-third, from $6.8 million to $4.4 million—a reduction of $2.4 million. And further reduction of principal—with concurrent loss in income available for distribution—would probably continue year after year.

Under provisions of the House bill, the only way a foundation could hope to avoid depleting its principal would be through investment in fixed-income securities, such as bonds and preferred stocks, with a high yield but little or no growth potential. If, from the beginning, such an investment policy had been followed by Lilly Endowment and its assets had been converted to government bonds, the Endowment's initial investment value of $29 million would have held fairly steady, but the income available to charity would have been decreased from $79 million to $15 million, a reduction of more than 80 percent.

Had the Endowment chosen to dispose of its gifts of stock at the end of each year in which they were received and to invest the proceeds in one of five representative alternative investment programs, the differing results in income earned would have been as presented in the following table:

COMPARATIVE INCOME—FROM RETENTION OF DONATED STOCK HAVING A MARKET VALUE OF $29,000,000, AT DATES RECEIVED, COMPARED WITH INVESTMENT THEREOF IN 5 ALTERNATIVE, PROGRAMS

[In millions]

	1937–68	In 1968
Denoted stock	$81	$6.8
Moody's industrial stocks	72	5.4
Dow-Jones industrial stocks	68	4.8
Massachusetts Investors Trust [1]	61	4.3
State Street Invest~ent Corp [1]	45	3.4
Government bonds held to maturity	15	1.2

[1] Assumes capital gain distribut ..is accepted in additional shares.

Note: Computations made by Ernst & Ernst, certified public accountants.

A requirement that private foundations distribute their net income on a current basis seems entirely justified and reasonable. Lilly Endowment has followed such a practice since it was founded. A 5-percent-minimum-distribution requirement, however, would effectively prevent the investment by private foundations in common stocks, since income from such investments seldom reaches 5 percent when applied against current market values (see attachments B and C).

If society is to receive the long-term benefits to be derived from investments in stocks which participate in the growth of the general economy, it is apparent that a 5-percent-minimum-investment-return requirement would be too severe, particularly when administrative costs of operating the foundation must first be paid. On the other hand, a minimum-investment-return formula more in line with the return which can be reasonably expected over a period of time from a well-managed investment portfolio would provide concurrent benefits to society as well as providing the foundation with some desirable freedom of choice in selecting investment alternatives.

Because of widely fluctuating market values in any single year or over relatively short periods of time, provision also should be made for basing the minimum-investment-return requirement on an *average* of asset values over a period of years (ten years, for example), rather than on current market values.

In addition to the threat which the bill's requirement poses to a foundation's freedom to invest in common stocks, with their potential for a greater return to charity than can be achieved through government bonds or other fixed-income investments, attention should be directed to the effect which such a requirement would have on the establishment of new foundations. We believe prospective donors would be discouraged from contributing to foundations low-yielding stocks or stocks in family-owned companies.

Society has received great benefits from charity made possible through the medium of the family foundation. Our national policy should seek to take every advantage of this opportunity to turn private wealth to public good and to stimulate, not discourage, the institution of the family charitable foundation.

Alternative

We suggest for consideration the following alternative to the 5-percent-minimum-investment-return requirement:

a. The minimum-investment-return requirement should be based on an average of asset values over a period of years (ten years, for example) rather than on current market values, subject as they are to fluctuation, and

b. The required annual distribution as a percent of that average market value should not exceed the return that could be reasonably expected from a well-managed portfolio containing common stocks.

This alternative will ensure that society receives concurrent benefits from tax-exempt privileges and, at the same time, will permit a foundation to exercise investment discretion that will provide greater long-range benefits to society.

STOCK-OWNERSHIP LIMITATION

Section 101(b) of the House bill (new section 4943 of the code) would limit to 20 percent the holdings of a foundation in an incorporated business enterprise when combined with the holdings of "disqualified persons".

In April, 1969, the Treasury Department recommended that a foundation be permitted to own 20 percent of the voting stock of a corporation. Included in the recommendation was a provision that no divestiture of such stock would be required as long as the aggregate ownership by donors did not exceed an additional 15 percent. The Treasury proposal would have permitted reasonable ownership by foundations of a corporation's voting stock.

The House bill drastically changes this concept by providing that the maximum amount of stock in any corporation that can be held by a foundation is 20 percent *reduced* by the aggregate holdings of disqualified persons. This major change might force (depending upon final resolution of the definition of "disqualified persons") almost complete divestiture by Lilly Endowment of its holdings of stock in Eli Lilly and Company, a company which has paid continuous dividends since 1885 and which has attracted an increasing number of outside investors now totaling more than 15,000.

A major objective of the stock-ownership-limitation provision, as stated in the House report, is to prevent diversion of foundation management from concern with charitable activities.

Such an abuse of a foundation's tax-exempt privilege has not materialized in the thirty-two years that Lilly Endowment has been a large stockholder of the company. There has been no diversion of the full-time staff of the Endowment from concern with charitable activities, because the staff has no responsibility for the operation of the company. And, as the record shows, charity has been generously advanced.

This provision of the House bill could affect adversely many foundations, such as Lilly Endowment, which have not been guilty of any abuse of tax privileges. It certainly will discourage many contributions to existing foundations and the establishment of new foundations. A potential donor owning more than 20 percent of a corporation's stock could not make any significant gift of such stock to a private foundation with the expectation that the foundation would retain the investment. Thus, a potential donor, or his family, who wishes to contribute to or establish a foundation with shares of a closely held company, for which there is no immediate market, will be deterred by the realization that his charitable intention could be frustrated through forced divestment of the contributed property in a comparatively short period of time.

The House proposal, as currently written, leaves little or no opportunity for a family to establish a philanthropic foundation through gifts of stock in a family-controlled corporation. While recognizing that some limitation on stock ownership may be in the public interest, it would seem wise, as a matter of public policy, to encourage within less-stringent limitations the motivation for charitable giving.

Alternative

We suggest for consideration the following alternative:

> The voting stock of any one corporation held by a foundation should be limited to 20 percent and when combined with the holdings of disqualified persons should be limited to 35 percent. This, basically, is the recommendation made by the Treasury Department in its report to Congress in April, 1969.

with the expectation that the foundation would retain the investment. Thus, a potential donor, or his family, who wishes to contribute to or establish a foundation with shares of a closely held company, for which there is no imediate market, will be deterred by the realization that this charitable intention could be frustrated through forced divestment of the contributed property in a comparatively short period of time.

The House proposal, as currently written, leaves little or no opportunity for a family to establish a philanthropic foundation through gifts of stock in a family-controlled corporation. While recognizing that some limitation on stock ownership may be in the public interest, it would seem wise, as a matter of public policy, to encourage within less-stringent limitations the motivation for charitable giving.

Alternative

We suggest for consideration the following alternative:

> The voting stock of any one corporation held by a foundation should be limited to 20 percent and when combined with the holdings of disqualified persons should be limited to 35 percent. This, basically, is the recomendation made by the Treasury Department in its report to Congress in April, 1969. "Disqualified persons," for this purpose, should include only substantial donors who are living, their spouses and lineal descendants, and managers of the foundation (as defined in the bill).

The limitation suggested by the Treasury would be adequate to prevent abuses resulting from foundation control of business enterprises and would materially alleviate some of the hardships which would be incurred under the House limitation. At the same time, it would permit some investment alternatives that, as demonstrated in the past, would provide greater returns to society (see page 5).

Also, the above recommendation would define "disqualified persons" in such a way as to preclude the possibility, which we believe exists, of interpreting the definition to include the stockholdings of deceased donors and, thereby, those of many persons who have neither an active interest nor any active participation in the affairs of either the foundation or the corporation.

Special exemption.—The House bill would make an exception of an organization created by an inter vivos trust which was irrevocable on December 31, 1939, and which met certain other requirements. If this special exemption is retained in the bill, we suggest that it be enlarged to include incorporated foundations existing on that date which hold interests in corporations whose common stock is traded on public exchanges or in the over-the-counter market.

TAX ON INVESTMENT INCOME

Section 101(a) of the House bill (new section 506 of the code) would impose a tax equal to 7.5 percent of a foundation's net investment income.

The proposal to tax a private foundation's investment income at the rate of 7.5 percent per year will divert this income from charity.

Alternative

Lilly Endowment proposes the following alternative to the imposition of such a tax:

> A fee could be paid by foundations, on some equitable basis, as a means of providing the funds necessary to support governmental supervision of private foundations.

Charity, thus, would be deprived only of those funds necessary to provide such supervision.

CONCLUSION

A few foundations have, apparently, been guilty of abusing their tax-exempt privileges. Most foundations, however, have conducted their affairs with scrupulous concern for the public interest. Lilly Endowment supports legislation aimed at correcting specific abuses and does not oppose—within the ranges suggested here—a minimum-investment-return requirement, a stock-ownership limitation, or a fee to support governmental supervision.

BYRON P. HOLLET

Byron P. Hollett was born September 28, 1914, in Indianapolis, Indiana. He attended public schools and was graduated from Shortridge High School in 1932. In 1936 he received a Bachelor of Arts degree from Wabash College, where he majored in history and economics; and in 1939, a Bachelor of Laws degree from the Harvard University School of Law.

In World War II he spent four years in the United States Navy, serving in the South Pacific, and attained the rank of lieutenant.

Before and after his naval service, Mr. Hollet was associated in the practice of law with his father's firm, Hollet & Lafuze. Since 1951 he has been a partner in the Indianapolis law firm of Baker & Daniels.

In addition to being a member of the board of directors of Lilly Endowment, Inc., Mr. Hollett is a director of the American Fletcher National Bank and Trust Company and the United Fund of Greater Indianapolis. He is also a member of the board of governors of the James Whitcomb Riley Hospital for Children, a trustee of Wabash College, and Chancellor of the Episcopal Diocese of Indianapolis.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
August 7, 1969.

AVERAGE YIELDS AND PRICE-EARNINGS RATIOS

Following are average yields and price-earnings multiples for the industry groups that make up the Merrill Lynch stock price index. These industry averages are based on current dividend rates, estimated 1969 earnings, and closing prices of July 25. Comparable figures for the Dow-Jones Industrial Average are shown at the bottom of page 2.

[P/E=price/earnings]

Industry group	Yield (percent)	P/E ratio	Industry group	Yield (percent)	P/E ratio
540 stock composite	3.5	13.3	Machine tools	4.0	10.6
Aerospace mfg	4.2	10.7	Machinery—Heavy	4.7	10.1
Agricultural machinery	5.3	11.8	Meatpacking	2.9	12.5
Air conditioning	1.6	21.6	Metal fabricating	6.0	13.4
Airlines	2.5	17.2	Movie producers	2.8	23.5
Aluminum	3.3	10.8	Office equipment	1.1	29.0
Apparel manufacturing	2.7	13.6	Oilfield equipment	3.1	14.1
Appliances, housewares	3.2	13.5	Packaged foods	3.3	16.5
Auto equipment	4.6	11.1	Paint	4.7	13.0
Auto finance	5.4	10.5	Paper—Composite	3.5	12.5
Automobiles	4.2	9.4	Paper—Diversified producers	3.8	13.7
Banks:			Papermakers	3.5	14.4
New York City	4.3	10.8	Petroleum	3.4	12.6
Outside N.Y.C	3.7	10.6	Plumbing and heating	3.3	13.4
Beer	2.7	19.0	Printing and publishing	2.9	15.7
Beet sugar	5.7	9.5	Railroad car leasing companies	4.7	12.4
Biscuits	3.7	17.5	Railroads:		
Bread baking	4.0	10.0	Composite	5.1	9.3
Canning	2.7	15.7	Coal	6.6	9.5
Cement	4.1	13.3	Eastern	5.5	11.6
Chemicals	4.4	12.9	Southern	5.2	9.5
Cigarettes	5.6	10.1	Western	4.7	9.0
Coal	1.0	17.3	Recreation	2.1	14.8
Construction machinery	4.8	11.0	Roofing and wallboard	3.2	15.3
Consumer electronics	2.6	14.0	Rubber	3.9	10.7
Containers:			Shoe chains	3.0	13.0
Glass	2.0	13.9	Shoe manufacturing	3.8	11.1
Metal	2.3	13.4	Small loans	4.4	11.1
Paper	2.7	9.5	Snuff	5.2	10.1
Copper	5.6	7.0	Soap detergents, toiletries	2.4	18.4
Cosmetics	1.6	20.7	Soft drinks	2.2	24.5
Dairy products	3.7	14.3	Steel	4.9	8.2
Department stores	2.9	15.6	Textiles	5.4	11.0
Discount chains	1.1	13.4	Utilities:		
Drugs	2.1	23.5	Composite	5.2	12.4
Electrical equipment	2.7	16.7	Electric	5.1	13.1
Electronics	0.8	23.1	Gas distributors	6.0	11.7
Food chains	3.2	12.8	Holding companies	4.8	14.2
Gold	1.5	25.0	Integrated gas companies	6.1	11.0
Home furnishings	2.1	16.6	Natural gas pipelines	5.1	10.7
Industrial—Composite	3.2	13.9	Communications	4.7	14.1
Insurance—Fire and casualty	4.4	15.3	Variety chains	3.8	12.0
Insurance—Life	2.1	12.2	Vending	1.8	15.0
Lead and zinc	4.4	15.4			
Liquor	3.1	16.3	Dow-Jones industrials	4.2	12.9

Senator ANDERSON. I do want to welcome Mr. Ross Malone. He has been a very prominent attorney in New Mexico. He has been with the General Motors Corp. and has been involved in many other organizations, and we are glad you are here.

The CHAIRMAN. I do have to go to another meeting soon.

Go ahead, Mr. Malone.

STATEMENT OF ROSS L. MALONE, PRESIDENT; ACCOMPANIED BY GEOFFREY C. HAZARD, JR., EXECUTIVE DIRECTOR; AND H. CECIL KILPATRICK, TAX COUNSEL OF THE AMERICAN BAR FOUNDATION, CHICAGO, ILL.

Mr. MALONE. Thank you very much, Mr. Chairman, for giving me the opportunity to appear before lunch. I think I can conclude by 12:30.

I am president of the American Bar Foundation of Chicago, Ill., and I am accompanied today by Mr. Geoffrey C. Hazard, Jr., the executive director of that foundation, and Mr. H. Cecil Kilpatrick, of Washington, who is the tax counsel of the foundation.

The American Bar Foundation is a nonprofit research and educational organization sponsored by the American Bar Association which as you know is the national organization of lawyers of the United States.

The foundation devotes itself to the study of the operation of law in society, and studies seeking to improve the administration of justice.

The foundation is currently conducting some 40 research projects in these areas of improvement of administration of justice and the public administration of the law. They range from "Criminal Law Administration in the Large City" to "The Mentally Ill and the Law," and the "Canons of Professional Ethics" of the profession.

The foundation finds itself in a position which is a bit uncertain insofar as the provisions of H.R. 13270 are concerned. The principal support of the American Bar Foundation comes from some 40,000 lawyers of the United States, who are members of the American Bar Association, hence of the American Bar Endowment.

The American Bar Endowment is the third member of the American Bar Association family, which is composed of the association, the endowment and the foundation.

The association is the membership-in-action organization of the bar.

The endowment is a 501(c)(3) organization which solicits and receives bequests, memorial gifts and contributions from members of the bar and others for public purposes, and the principal beneficiary of the endowment is the American Bar Foundation of which I have the honor to be president.

The principal source of funds of the endowment is contributions from some 40,000 members of the American Bar Association which are carried out through the group insurance, group life insurance program, which is handled through the endowment.

The problem that we have insofar as the present bill is concerned is uncertainty first as to whether or not the 40,000 members who contribute through the endowment plus 1,500 fellows of the American Bar Foundation who contribute annually to our support, constitute the general public within the purview of the bill or whether because they are members of a single group they would not so qualify.

The second concern that we have results from the fact that our principal source of revenue is grants from the American Bar Endowment, grants which are made out of the money that these 40,000 lawyers contribute to the endowment. We are the primary beneficiary of the endowment, but are not certain whether or not grants so made would qualify as an "indirect" contribution from the 40,000 lawyers to the American Bar Foundation.

Those are the two problems that create uncertainty insofar as our status under the act is concerned.

We are entirely sympathetic to the objectives of eliminating abuses in the private foundation area, but we feel that the organization, the American Bar Foundation, is clearly intended to be in the class of public rather than private foundations within the general contemplation of the act, but that its status by virtue of this unique situation might be in doubt.

The funds that are expended by the foundation are spent in scholarly research. We do not support the enactment of legislation. We make

empiric studies of the operation of law in society, and undertake to draw conclusions from what we find, but we then make the product of our efforts available to the entire public for such use, implementation or assistance as it may be to them.

We have carefully examined ourselves insofar as the criticism of private foundations included in the House bill are concerned: the self-dealing, failing to distribute, holding interests in private business, financial speculation, debt finance property acquisitions, unrelated business, organizations for the benefit of their members; and we conclude that we clearly do not have any of those problems. But the work of the foundation would be handicapped if by virtue of the technicalities I have mentioned we should end up in the category of a private foundation.

We have submitted with my statement a proposal by our conusel as to changes which might be made which would eliminate the problem which I have mentioned.

I want to thank you very much for the opportunity to appear and to make this statement.

Senator ANDERSON. We are happy to have you here.

Senator BENNETT. Just one question.

Your testimony boils down to the fact that it is the relation of the foundation to the limited membership which creates your chief problem?

Mr. MALONE. Yes, sir; whether or not that membership constitutes the general public, and then whether the passage of that money through the endowment to us would qualify it as an indirect contribution. We hope it would be. We think it would be.

Senator BENNETT. You have those two problems?

Mr. MALONE. Yes, sir; and they are both covered in our technical memorandum.

Senator BENNETT. That is all, Mr. Chairman.

The CHAIRMAN. Thank you very much, sir.

Mr. MALONE. Thank you very much. Mr. Chairman, and thank you, Senator Anderson.

(Mr. Malone's prepared statement follows:)

STATEMENT OF ROSS L. MALONE, PRESIDENT AMERICAN BAR FOUNDATION

SUMMARY

1. The American Bar Foundation is a non-profit research and educational organization sponsored by the American Bar Association and devoted to study of the operation of law in society and to improvement of the administration of justice. It currently is conducting some 40 projects in various fields of the law.
2. As passed by the House of Representatives, H.R. 13270 can be interpreted as subjecting the American Bar Foundation to the restrictions, liabilities and tax consequences of a private foundation. We believe this result is at variance with the policy expressed in the Act and an unintended consequence of technical complexities in drafting.
3. These adverse consequences can be avoided by minor amendments, drafts of which are presented in the Technical Explanations appended to this statement and which we believe are consonant with the purposes of the Act.

STATEMENT

My name is Ross L. Malone. I am President of the American Bar Foundation, a non-profit legal research institute, incorporated under Illinois law in 1952. The Foundation's purpose is to improve the practical operation of the law and

the administration of justice through research and education. It has been ruled exempt under section 501(c)(3) of the Internal Revenue Code.

The American Bar Foundation was created to provide a means by which the organized legal profession of the United States could contribute to improvement of the law and administration of justice through research. It was created by the American Bar Association and maintains close colloboration with the bench, bar, agencies of government, and law schools throughout the country. Its financial support is provided chiefly by the American Bar Endowment, a charitable foundation comprised by the members of the American Bar Association and deriving most of its income from their contributions. The Foundation also receives support from the American Bar Association itself and from gifts, grants and contracts from business, agencies of government and foundations, including the Ford Foundation. In addition, the Foundation receives annual gifts from some 1,300 lawyers comprising the Fellows of the American Bar Foundation, a group of distinguished members of the bar from all parts of the country.

The Foundation's reports on its research are published and made available to the general public, concerned agencies of government—federal, state and local—and the legal profession. The guiding aim of its research program is to broaden understanding of how the law and the courts operate and to suggest improvements in the administration of justice. It does not lobby or attempt to influence legislative bodies.

The Foundation commenced active operation in 1954 and began major research in 1957 with a project on the administration of criminal justice that had been conceived by Justice Robert H. Jackson. Since that time, the size and scope of the Foundation's research program has steadily expanded. The Foundation studies include the following topics:

Administration of Criminal Justice:
- Criminal Law Administration in the Large City
- The Public Prosecutor's Office
- Representation of Indigent Accused Persons
- The Mentally Ill and the Criminal Law
- Criminal Justice in the Rural Community

Judicial Administration:
- The Workload of the United States Courts of Appeals
- Removal and Retirement of Disabled Judges
- Efficient Utilization of Jurors
- State Administrative Law
- Procedures in Federal Income Tax Controversies

Private Legal Transactions:
- Model Business Corporation Act Annotated
- Model Landlord-Tenant Code
- Model Debenture Indenture Provisions
- Title Examination in Real Estate Transfers

Public Law:
- Consumer Credit Legislation
- Mentally Ill and the Law
- Law of Man's Activities in Outer Space
- Marriage Conciliation Services in Domestic Relations Courts
- Children's Attitudes Toward Law and Authority

Jurisprudence:
- Fellowships in Legal History
- Sources of Our Liberties—Legal Documents in American History
- Weaver Constitutional Law Essay Prize

Legal Services and the Legal Profession:
- Legal Problems of the Poor
- Canons of Professional Ethics
- Legal Services for Middle Income Individuals
- Legal Education and Training

The American Bar Foundation is under the administration of a Board of Directors composed of lawyers and jurists from across the United States. The present Board of Directors consists of the following members: Ross L. Malone, New York, President; Lewis F. Powell, Jr., Richmond, Vice-President; Robert K. Bell, Ocean City, New Jersey, Secretary; Joseph H. Gordon, Tacoma, Treasurer; Honorable Dudley B. Bonsal, New York; Harold J. Gallagher, New York; Honorable Erwin N. Griswold, Washington, D.C.; W. Page Keeton, Dean, School

of Law, University of Texas; Phil C. Neal, Dean, School of Law, University of Chicago; Barnabas F. Sears, Chicago; Bernard G. Segal, Philadelphia; Whitney North Seymour, New York; William A. Sutherland, Washington, D.C.; Maynard J. Toll, Los Angeles; Karl C. Williams, Rockford, Illinois; Edward L. Wright, Little Rock.

In addition the Foundation has a Research Committee to guide policy in the development of its research program. The members of this committee at present include the following: Derek C. Bok, Dean, Law School, Harvard University, Roderick M. Hills, Los Angeles; Spencer L. Kimball, Dean, Law School, University of Wisconsin; Phil C. Neal, Dean, Law School, University of Chicago; William Reece Smith, Jr., Tampa; Oscar M. Ruebhausen, New York; Stanley L. Temko, Chairman, Washington, D.C.

The staff of the American Bar Foundation consists of approximately 30 professional and semi-professional members, mostly lawyers but also including social scientists in the disciplines of economics, political science, psychology and sociology. The Executive Director, Geoffrey C. Hazard, Jr., holds a joint appointment on the faculty of law at the University of Chicago. Several of the staff members have teaching appointments in departments of the University of Chicago and in other institutions of higher education in Chicago. In addition to its professional research staff, the Foundation maintains and operates a library consisting of a working collection of legal materials, selected periodicals in law and related social sciences, and an extensive collection of materials relating to the history, organization and activities of the legal profession.

The Foundation publishes an Annual Report each year; a copy of the most recent (1967–68) is attached. At intervals it issues a catalog of its publications; a copy of its most recent catalog is attached. The Foundation's accounts are audited annually by the Certified Public Accounting firm of Peat, Marwick, Mitchell & Co. It files annual reports with the Treasury Department of the United States, the State of Illinois and the State of New York. Its books and accounts are audited from time to time by agencies of the United States Government to verify project charges and cost allocations in connection with projects funded in whole or in part by the government.

I attach a summary tabulation of the revenues and expenditures of the Foundation for the fiscal years ended June 30, 1965 to 1969, inclusive. As will be seen from Schedule 1 accompanying the summary, its primary source of funds has been contributions by the American Bar Endowment, an organization also ruled exempt under section 501(c)(3). The members of the Endowment are the members of the American Bar Association, now numbering over 135,000 lawyers, of whom over 40,000 make annual contributions to the Endowment. The members meet annually and elect the Board of Governors of the Endowment.

It seems clear that none of the criticisms levelled at private foundations by the Ways and Means Committee report on H.R. 13270 apply to the organization or operation of the Foundation. These criticisms relate to:

(a) Self-dealing between a foundation and substantial contributors;
(b) Failure to distribute income for charitable purposes;
(c) Holding interests in private business;
(d) Financial speculation;
(e) Debt-financed property acquisitions;
(f) Engaging in unrelated business;
(g) Organizations set up primarily for the benefit of their members.

The American Bar Foundation shares its building, the American Bar Center, at 1155 East 60th Street in Chicago, with the American Bar Association and the American Bar Endowment. It uses its entire income for research, except reserves for development and contingencies which total about six months' income. (See financial summary, attached.) It owns no interest in private businesses except publicly traded securities held as investments producing on the average less than 5% of its annual gross income, and has no other assets except its headquarters building.

The Foundation is therefore greatly concerned by advice that the complex provisions of H.R. 13270 could result in the Foundation's being treated as a "private foundation." I attach as an appendix to this statement a technical explanation of the provisions of the bill which lead our advisers to this conclusion. This explanation concludes with recommendations of possible amendments which would accomplish the objectives of the legislation, as we understand them, without impinging on the Foundation's research and educational activities in a manner which we believe the Congress does not intend.

May I thank you for this opportunity to appear on behalf of the American Bar Foundation. We earnestly hope that the Committee will adopt modifications in H.R. 13270 which will assure continuation of the Foundation's program of research in the operation of the law and the administration of justice.

Appendix to Statement by Ross L. Malone, President, American Bar Foundation, Concerning H.R. 13270

TECHNICAL EXPLANATION OF EFFECT OF H.R. 13270 ON THE AMERICAN BAR FOUNDATION

Under H.R. 13270, the Tax Reform Act of 1969, as passed by the House, it will be possible to argue that the American Bar Foundation is a "private foundation." Should it be so classified the Bar Foundation would become subject to the policing restrictions which are enacted in various sections of H.R. 13270. The burdens include the restriction on making grants to individuals for conducting research projects, the cost of maintaining legal compliance with the Act's complex requirements, taxation of investment income, and the added difficulty in persuading other foundations to make research grants to the Bar Foundation.

This interpretation, with the consequent restrictions, could be avoided by amendment of the Act as passed by the House that is fully compatible with the Act's purposes. Such amendment could take either of two forms, which are specifically suggested on pages 5 and 7 herein.

Under the Act, all present 501(c)(3) organizations are classified as "private foundations" *unless* they fall into the Act's stated exceptions. These exceptions are:

1. That class of organizations which will qualify for the 30% charitable contribution limitation under the Act,
2. Organizations which meet the statutory test established to implement the concept of broadly supported organizations,
3. Organizations which exist to perform the functions, etc., of the above two classes of organizations or which are operated, supervised, or controlled by one of these types of organizations and which are not controlled by "disqualified persons" as defined in the Act, and
4. Organizations operating exclusively for testing for public safety purposes.

The American Bar Foundation might be deemed to fall outside these exceptions.

First, to qualify as an organization to which the 30% charitable contribution limitation would apply and thus to be excluded from the definition of private foundation, an organization such as the American Bar Foundation would have to receive a substantial part of its support from a governmental unit or from direct or indirect contributions from the general public. The Foundation is supported principally by contributions from the American Bar Endowment, a charitable corporation which in turn receives its chief support through contributions of 40,000 members of the legal profession. While the American Bar Foundation *indirectly* receives a substantial part of its support from a great number of people, namely, the members of the American Bar Endowment, the specialized interest of these people in the law and in its advancement might be such that they could be said not to constitute a sector of the "general" public. Since the term "general public" is found in section 170 of the Internal Revenue Code as it now exists, it is possible to look to the Treasury Regulations to assist in the definition of the term. The Regulations at section 1.170-2(b)(5)(iii)(c)(3) indicate that in determining whether an organization receives its support from a "representative number of persons" and thus is publicly supported "consideration must be given to the type of organization and whether or not the organization limits its activities to a special field which can be expected to appeal to a limited number of persons." The implication is that a group which has a specialized interest area (such as a group which includes only lawyers) might not be "a representative number of persons."

Thus, if it were held that the American Bar Endowment did not receive a substantial part of its support from the general public, the American Bar Foundation could not be excluded from "private foundation" status under the first provision.

Second, to determine if an organization falls within the concept of a broadly publicly supported organization, a review of the sources or the organization's support is required. The review of the organization's income must follow a series of mechanical tests set forth in the proposed statute. The organization will fall outside the definition of a "private foundation" if it (1) normally receives more than one-third of its support by way of gifts, grants, contributions, or membership fees from persons other than "disqualified persons," or (2) normally receives more than one-third of its support by way of gifts, grants or contributions from an organization to which the 30% charitable contributions limitation applies. (Further, the organization must not receive more than one-third of its support from gross investment income.) The proposed law defines a "disqualified person," among other things, as anyone who is a "substantial contributor," *inter alia*, one giving $5,000 or more in any one year. The American Bar Endowment provides the American Bar Foundation with sums in excess of $5,000 per year, and these sums have constituted between 40% and 70% of the Foundation's annual report. Therefore, even though the support of the American Bar Foundation is provided *indirectly* by a great many individuals in the form of their gifts to the American Bar Endowment, which in turn passes these amounts on to the American Bar Foundation, the contributions come to the American Bar Foundation *directly* from the American Bar Endowment, and they exceed $5,000 in each year. This would seem to result in the conclusion that this portion of the support of the Foundation comes from a disqualified person which may not be an organization to which contributions can be deducted based on the 30% limitation. If this were true the Foundation would not qualify for the second exception.

The American Bar Foundation might not meet the third exception to the definition either. This is because arguably the organization is not operated by or in connection with the American Bar Endowment.

The fourth exception is not applicable by definition.

RECOMMENDED AMENDMENTS TO H.R. 13270

Two possible alternative amendments to H.R. 13270 would eliminate the possibility of the above-described result:

1. The definition of an organization to which charitable contributions are deductible under the 30% limitation might be changed to include this type of organization; or

2. The defined term "substantial contributor" might be altered to exclude an organization which has a substantial number of members.

Organizations to which contributions are deductible based on the 30% limitations are described in proposed section 170(b) (1) (B) of the Internal Revenue Code (section 201(a) of H.R. 13270).

Subparagraph (vi) of that section, found at pages 111 and 112 of the Act as passed by the House, reads:

"(vi) an organization referred to in subsection (c)(2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a govermental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public, shall be allowed to the extent that the aggregate of such contributions does not exceed 30 percent of the taxpayer's contribution base."

It is respectfully requested that this language be amended to read:

"(vi) an organization referred to in subsection (c)(2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public *or from an organization having a substantial number of members*, shall be allowed to the extent that the aggregate of such contributions does not exceed 30 percent of the taxpayer's contribution base." (Emphasis indicates new material.)

This amendment would put the American Bar Foundation in the class of organizations to which contributions are deductible based on the 30% limitation.

The organization would then be excluded from "private foundation" status. It is submitted that the amendment would not have any other significant effect on this provision of the statute.

The alternative amendment would exclude the American Bar Endowment from the definition of a "substantial contributor," and thereby from the definition of a "disqualified person." The definition of a "substantial contributor" is found in proposed section 507(b)(2) of the Internal Revenue Code (section 101(a) of the Act at page 8 of the bill as passed by the House), and it reads as follows:

"(2) SUBSTANTIAL CONTRIBUTOR.—For purposes of paragraph (1), the term 'substantial contributor' means—

"(A) any person who (by himself or with his spouse) contributed more than $5,000 to the private foundation in any one calendar year (or bequeathed more than $5,000 to the private foundation), and

"(B) any person who (by himself or with his spouse) contributed or bequeathed the greatest amount to the foundation in any one calendar year.

In the case of a trust, such term also includes the creator of such a trust."

It is respectfully requested that this language be amended to read:

"(2) SUBSTANTIAL CONTRIBUTOR.—For purposes of paragraph (1), the term 'substantial contributor' means—

"(A) any person who (by himself or with his spouse) contributed more than $5,000 to the private foundation in any one calendar year (or bequeathed more than $5,000 to the private foundation), and

"(B) any person who (by himself or with his spouse) contributed or bequeathed the greatest amount to the foundation in any one calendar year.

In the case of a trust, such term also includes the creator of such trust, *but in the case of a foundation, such term shall not include a foundation which is not itself a private foundation.*" (Emphasis indicates new material.)

Given the present support of the American Bar Foundation which is received from the American Bar Endowment (which is a membership organization and not a private foundation) this amendment would exclude the American Bar Foundation from "private foundation" status. It is submitted that the amendment would not have any other significant effect on the statute.

AMERICAN BAR FOUNDATION—SUMMARY OF REVENUES AND EXPENDITURES, FISCAL YEARS ENDED JUNE 30 1965 TO 1969

	Fiscal year ended June 30						
	1965	1966	1967	1968	1969	5-year average	Percent of total
REVENUES FOR ALL FUNDS							
Contributions, gifts, and grants (schedule 1)	$585,934	$655,946	$613,408	$716,404	$1,080,792	$730,497	83.83
Space occupancy	63,768	65,089	74,269	73,009	74,275	70,072	8.04
Investments	25,182	34,025	51,685	50,297	37,229	39,684	4.56
Publications and royalties	19,209	29,235	14,133	33,952	17,882	22,882	2.63
Beneficiary proceeds	5,000	5,844	5,833	8,968	11,122	7,353	.84
Memorial and other	1,059	111	1,290	343	1,626	886	.10
Total revenues	700,152	790,250	760,618	882,973	1,222,876	871,374	100.00
EXPENDITURES BY PURPOSE							
General fund:							
Projected development	7,751	54,181	50,085	73,828	140,688	65,307	7.04
Cromwell Library	90,746	100,132	89,372	88,784	105,195	94,846	10.22
General and administration	197,954	89,003	125,984	207,292	131,092	150,265	16.19
Special funds:							
Research projects	334,772	392,729	408,843	618,115	858,671	522,626	56.32
Trust funds	1,339	3,004	3,602	2,688	483	2,223	.24
Building fund (depreciation)	76,437	76,037	75,602	78,340	78,340	76,951	8.30
Future development fund	0	0	2,311	954	75,103	15,674	1.69
Total expenditures	708,999	715,086	755,799	1,070,001	1,389,572	927,892	100.00
Excess revenues (expenditures)	(8,847)	75,164	4,819	(187,028)	(166,696)	(56,518)	

AMERICAN BAR FOUNDATION—SUMMARY OF CONTRIBUTIONS, GIFTS AND GRANTS, FISCAL YEARS ENDED JUNE 30, 1965 TO 1969

	1965	1966	1967	1968	1969	5-year average	Percent of total contributions
American Bar Endowment	$170,292	$257,600	$232,900	$349,600	$715,000	$345,078	47.24
American Bar Association	109,795	102,708	100,000	100,000	0	82,501	11.29
Fellows of the American Bar Foundation	101,500	103,000	87,551	86,050	92,300	94,080	12.88
The Ford Foundation	115,000	100,000	55,980	90,363	191,992	110,667	15.15
Office of Economic Opportunity	0	26,458	111,958	54,617	53,857	49,378	6.76
National Institute for Mental Health	45,591	15,179	15,019	15,018	0	18,161	2.48
Federal Highway Administration	0	0	0	6,970	16,643	4,723	.65
National Aeronautics and Space Administration	10,000	50,000	10,000	0	10,000	16,000	2.19
United Fruit Co	4,733	0	0	0	0	947	.13
Various law firms and contributors [1]	29,023	1,000	0	0	1,000	6,205	.85
Value of book contributed to Cromwell Library by publishers [1]	0	0	0	13,786	0	2,757	.38
Total	585,934	655,945	613,408	716,404	1,080,792	730,497	100.00

[1] No substantial contributors included in this receipt category.

AMERICAN BAR FOUNDATION—SUMMARY OF EXPENDITURES BY LINE ITEMS, FISCAL YEARS ENDED JUNE 30, 1967 AND 1968

	1967	1968	Average	Percent to total
Personnel [1]	$454,413	$594,065	$524,239	57.43
Fringe benefits and taxes	37,543	46,416	41,980	4.60
Travel	47,537	71,154	59,345	6.50
Publications	53,810	92,316	73,063	8.00
Other printing and duplicating	10,962	28,791	19,878	2.18
Communications	25,139	39,871	32,505	3.56
Equipment and furnishings	13,432	18,900	16,166	1.77
Books, subscriptions, microfilming	22,323	21,962	22,142	2.43
Building fund—depreciation	75,601	78,340	76,970	8.43
Outside professional services	0	57,746	28,873	3.16
Sundries	15,039	20,440	17,739	1.94
Total	755,799	1,070,001	912,900	100.00

[1] This figure includes salaries for approximately 50 professional, nonprofessional, and clerical employees, as well as some individual grants for research. See the annual report.

Note: Comparable figures are unavailable for 1965, 1966, and 1969. However, it is believed that the percentages shown above would not vary much if figures for those years were included.

The CHAIRMAN. We will be back at 2 o'clock.

(Whereupon, at 12:30 p.m. the committee recessed, to reconvene at 2 p.m. on the same day.)

AFTERNOON SESSION

Senator ANDERSON. Mr. Gordon.

STATEMENT OF LINCOLN GORDON, PRESIDENT, JOHNS HOPKINS UNIVERSITY, IN BEHALF OF THE ASSOCIATION OF AMERICAN UNIVERSITIES

Mr. GORDON. Mr. Chairman, my name is Lincoln Gordon, president of the Johns Hopkins University in Baltimore, and I am appearing this afternoon on behalf of the Association of American Universities.

I have prepared a written statement on those aspects of the proposed

Tax Reform Act of 1969 which are of special importance to our group of universities and would appreciate the inclusion of the full text in the record of these hearings.

Senator ANDERSON. Without objection that will be done.

Mr. GORDON. The Association of American Universities brings together the 20 State and 22 private universities in this country, which are leaders in post-graduate and professional education, basic and applied research, and undergraduate instruction of high quality.

We account for more than 60 percent of the Ph. D. degrees granted each year, the great majority of medical students, and the best known schools of law, business, engineering, education, and other professional training programs.

There are many complaints in the air nowadays about the structure and performance of American universities. Some of those complaints are well justified. But taken as a whole, the American university system has enormous strength and vitality which is the envy of educators throughout the world. Neither student disturbances nor legitimate complaints about details of internal organization or curriculum ought to distract us from the basic fact that an increasingly technological society will need a constantly greater flow of highly-trained manpower in all fields and the organized application of trained intelligence to the solution of complex national problems.

At the same time, the public rightly expects us to push steadily forward to the goal of full equality in the educational opportunity.

So for the foreseeable future the load upon the Nation's universities will increase. We must look to larger numbers of students and steadily improved training programs for scientists, physicians, engineers, teachers, and administrators. We can expect a growing engagement by the universities in problems of urban reconstruction, environmental pollution, delivery of health care, international relations, and economic development at home and abroad. There is no prospect of a lull in this set of massive challenges to the system of higher education.

To meet these challenges requires massive financial resources. We face the dual pressures of increasing student enrollments which are about 7 million today for all higher education and expected to reach 10 million within a decade, coupled with rising costs per student, especially for graduate and professional training.

The Carnegie Commission for Higher Education forecasts an increase in total institutional expenditures for higher education from $17 billion 2 years ago to $41 billion per year by the academic year 1976–77.

To meet those needs, additional funds will be required from all three major sources, State and local governments, Federal, and private.

With State and local budgets under severe strain, and in face of the Federal financial problems which this committee knows so well, the need for expanded private support for higher education is greater than ever.

Last year private giving to higher education amounted to about $1½ billion. Of this total, the 42 universities in the Association of American Universities received over $500 million, almost 30 percent of that figure going to the State universities in the group.

There could not be a worse time to reverse our long-standing national

policy of providing strong incentives for private philanthropy through the operation of a tax system.

The bill before you as passed by the House would sharply curtail private support for higher education, directly through reduced incentives for individual charitable gifts, and indirectly through the proposed tax on foundation income.

The Association of American Universities supports the basic purposes of tax reform, that is the achievement of greater equity and the removal of unwarranted special tax favors and loopholes. Certain of the proposed reforms, and some of these are specified in my written statement, ought to be adopted even though there may be as a byproduct some reduction of incentives to charitable giving.

We strongly oppose, however, those provisions of the House bill which would reduce incentives to make gifts in the form of appreciated property, especially their inclusion in the calculations of limits on tax preferences and allocation of deductions. Gifts of appreciated securities in recent years have constituted more than half of the total of individual gifts to universities, and comprise a vital element in the flow of private support for our institutions.

We are fully in accord with the reasoned position presented to this committee by the American Council on Education on these points, as well as on the need to avoid retroactivity in provisions on charitable remainders.

I want to put a special stress this afternoon on the consequences to higher education of the proposed foundation tax. In 1967–68 foundation grants for higher education totaled $321 million of which $234 million went to the member institutions of our association.

Foundation support has been a cardinal element in the strengthening of the American university system, stimulating innovation and opening up new areas of inquiry in teaching.

The proposed 7½ percent tax on foundation investment income would seriously and adversely affect foundation support for higher education. Since foundations would under the terms of the bill be required to spend all of their current income, the incidence of that tax would in fact fall not on the foundations as such but on the institutions dependent upon foundation support, institutions such as universities, whose own tax exemption is rightly continued by the bill because of their service to the public interest.

We recognize that the existing law contains loopholes which have permitted certain dubious financial practices especially by smaller foundations, but such abuses should be directly attacked by legislative restrictions and a proper system of auditing to which a general tax on foundation income in no way contributes.

We strongly urge, therefore, that the committee replace the foundation income tax by a supervisory fee sufficient to cover the costs of proper foundation audit and control, an amount which would surely be very much less than the estimated $100 million per year involved in the 7½-percent tax.

We suggest that the Secretary of the Treasury be empowered to levy a fee approximating the cost of a foundation supervision unit within the Internal Revenue Service, and to determine an equitable formula for distributing this cost among individual foundations.

We are also deeply concerned by the provision in the House bill defining as a taxable foundation expenditure, and I quote the language, "Any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof," then there is a saving clause, "other than through making available the results of nonpartisan analysis or research."

The saving clause is obviously intended to permit institutions like ours to carry on objective academic research and analysis, even if our work influences public opinion, but the wording is so ambiguous and the penalties on foundation managers are so harsh that we fear a serious inhibition on foundation grants in many fields where university participation in public affairs is highly desirable.

We therefore suggest that the committee substitute wording which will prevent foundation grants from being used to finance partisan activities and lobbying, but which will permit support of nonpartisan activities carried on by educational, scientific, and charitable institutions.

In conclusion, Mr. Chairman, let me emphasize that higher education faces a grave financial crisis for which no ready or easy solutions are in sight. Recent Federal appropriations for higher education have not increased in proportion to costs, and some have been reduced. State and municipal budgets are under extreme strain.

In the face of rising enrollments, rising costs, and rising public demands on the resources of universities, amendment of the Federal tax law to curtain private giving would convert this already grave situation into an acutely critical one.

We ask that the committee recognize the seriousness of these issues, and adopt the proposals outlined above, so as to maintain incentives to direct private giving and permit the private foundations to continue the volume and character of their indispensable support to higher education.

I will be happy to respond to questions or to assist the committee further in any way that may be desired.

Senator ANDERSON. Thank you.

(Mr. Gordon's prepared statement follows:)

STATEMENT OF LINCOLN GORDON, PRESIDENT, THE JOHNS HOPKINS UNIVERSITY ON BEHALF OF THE ASSOCIATION OF AMERICAN UNIVERSITIES

SUMMARY

A. Recommendations

1. Propose that a fee be levied on private foundations adequate to cover the cost of unit in the Bureau of Internal Revenue whose function is to insure that the foundations operate within the law.

This fee to substitute for the 7.5 percent tax on investment income, but set annually by the Secretary of the Treasury pursuant to an equitable formula producing funds adequate to cover the costs of administering the supervisory unit.

The fee not to be any fixed percent of investment income, but set annually by the Secretary of the Treasury pursuant to an equitable formula producing funds adequate to cover the costs of administering the supervisory unit.

2. Propose that private foundations be prohibited from financing partisan political activity or lobbying, but be permitted to finance activities, carried on under the auspices of non-partisan educational charitable or scientific organizations, in the area of public service and public affairs.

3. With respect to tax treatment of charitable deductions, the primary recommendations of the Association of American Universities is deletion of the provision which would include appreciation on gifts to colleges and universities in the Limit on Tax Preferences and the Allocation of Deductions. More than half of all private giving of individuals to universities is accounted for by gifts of appreciated property. Public as well as private institutions rely on these gifts.

Other changes are also important such as the elimination of retroactivity on any changed treatment of charitable remainders.

The AAU strongly supports all of the amendments to the House bill proposed on behalf of all higher education by the American Council on Education.

B. Background

1. Private giving is an integral unique and indispensable characteristic of American higher education.

Integral because both public and private institutions depend on private giving.

Unique because no other nation in the world benefits from the advantages of multiple independent sources of income for higher education.

Indispensable because without private gifts the diversity, innovative capacity and ability to adapt that characterize American higher education would be lost. Without private giving, an unhealthy degree of dependence on government support would be inevitable.

2. Both private and public institutions depend heavily on private giving. Of the total of $1.5 billion given to all of higher education in 1967–68, $592 million was given to private and $220 million to State universities.

The 42 members (22 private and 20 public) of the Association of American Universities rely on private giving to an exceptional degree. They receive almost half of all private gifts to higher education.

3. Enactment of the tax bill as passed by the House would result in a sharp decrease in private giving to universities in the immediate future.

4. Over the next decade, the number of students in higher education will increase from about 7 to about 10 million—almost 50 percent. Costs per student will continue to rise despite maximum efforts to increase efficiency.

To avoid an unacceptable decline in quality, total national expenditures on higher education will have to increase over the coming decade from about $18 to about $40 billion each year.

If private giving is to continue to play its proper role, the current $1.5 level will have to rise to well over $3 billion per year.

5. There has been no time in our history when reduced incentives to private giving would seriously impair the capacity of universities to serve the Nation.

STATEMENT

Mr. Chairman and Members of the Committee: I appreciate the opportunity to express the point of view of the members of the Association of American Universities on some aspects of the proposed Tax Reform Act of 1969 that are of special importance to them. While the views and proposals that appear below are those of the Association, the words in which they are expressed are mine.

This Association, whose members are listed on an attached page, is composed of 22 private and 20 public universities characterized by strong and diverse programs of graduate and professional education, and by undergraduate instruction of high quality. They granted 14,000 doctoral degrees in 1967–68, 62 percent of the national total. Graduate study is the most expensive form of higher education and is because of the more extensive personal contact between students and professors likely to increase in cost most rapidly in the future. They enroll in total almost 200,000 students. They receive more than $1.0 billion per year from the Federal government for the support of academic science—about half of the national total. Their endowments have a current market value of about $5.8 billion—more than half of the national total. (But even this very large sum produces less than 10 percent of the annual operating income of the AAU members. For all private universities total endowment income in only 7 percent of the annual operating revenues, and for all public universities .6%.)[1] They are

[1] Financial Statistics of Institutions of Higher Education. Current Funds Revenues and Expenditures, 1965–66. National Center for Educational Statistics.

engaged in expensive large scale innovation and experimentation, as is the case with use of computers. They maintain large and expensive libraries and archives which are simultaneously the working tools of scholars in all fields, the places where the history of our nation and of mankind is recorded, and the indispensable source of information for students. They are deeply involved in the objective study of every major problem faced by our society.

The high cost of performing these critically important functions generates special financial problems for this group of universities. Every one of them is engaged in a desparate effort to secure resources to meet expenses as all costs rise and as new tasks are thrust upon them.

1. TASKS OF UNIVERSITIES

Looking ahead to the tasks that the nation will expect all universities to perform, it is clear that the load upon them will steadily increase. American universities will continue to educate a large proportion of the college undergraduates, and prepare a high proportion of them for advanced professional work. Their professional schools will supply most of the nation's need for engineers in an increasingly technological economy. They will supply the Nation's scientists, physicians, and college and university teachers. They will continue to pioneer on the frontiers of knowledge in all fields. They will be urgently pressed by the Federal, State and local governments to turn their resources increasingly to the diagnosis and solution of social and economic problems. They will properly and inevitably become more and more deeply engaged in seeking solutions to the problems of the cities, of minority groups, of transportation, housing, delivery of health care, environmental pollution, international peace and economic development. Indeed, none of our deepest national problems can be solved without the human resources and knowledge made available by higher education. No matter what changes may occur in the governance of universities, their internal structure, their curricula or other characteristics, they will be called upon to perform all of these tasks for society.

Performance of all these functions will become increasingly costly for the indefinite future. The increase in the numbers of students is paralleled by an inexorably rising cost per student. Added to these will be the rising costs of participation in community affairs which the universities should not and can not shirk. The Carnegie Commission on Higher Education has reduced these factors to dollar estimates. Its forecasts indicate that total institutional expenditures for higher education will increase from $17.2 billion in 1967–68 to $41 billion in 1976–77.[2] The expenditures of major universities will rise even more rapidly, and may well triple over the coming decade. These are staggering cost increases, but failure to meet them would mean an unacceptable deterioration in the quality of higher education in this country.

2. IMPORTANCE OF DIVERSITY

Many of the educational needs of the Nation can not be best met, or met at all, by large universities. Community colleges perform a unique and important function. The smaller liberal arts colleges stress important values and best serve the needs of thousands of young people. State institutions and private institutions each have their unique qualities to contribute to the National needs. This diversity of emphasis, the different mix of purposes, experimentation in different ways of adjusting to the needs of many kinds of student and to widely varying community needs constitute a central strength of our system of higher education. If we are to retain this rich diversity, the high and rising financial needs of all of these types of institutions must be met.

3. NEED FOR FUNDS FROM ALL SOURCES

The financial burden of this entire system is so heavy that steadily rising support will be needed from the federal government, from state governments, from local governments and from all private sources—individual, foundation and corporate. There is no need to explain to this Committee why both the federal government and the states are finding difficulty in providing adequately for higher education. The prospects for the short term are not encouraging. Over the long

[2] Carnegie Commission on Higher Education. Quality and Equality: New Levels of Federal Responsibility for Higher Education. December 1968, p. 8.

run, funds from both sources must grow as the economy expands and as needs grow. However, the most likely prospect is for a lag between the emergence of urgent needs and the elevation of levels of governmental support. The need for private giving will become progressively more acute.

4. SIGNIFICANCE OF PRIVATE SUPPORT

Sound public policy calls for a strong effort to expand private support for higher education both now and for the indefinite future. There are two major reasons why private giving is essential.

First, the institutions need the money. The $1.5 billion now supplied by private giving is an indispensable part of the total budget for higher education. It means survival for many institutions, and elevation of standards above mediocrity for others. It provides resources for innovation, experimentation and high levels of excellence for most universities.

The special dependence of the 42 members of the Association of American Universities on private giving is indicated by the fact that they received $560 million in gifts in 1968—43 percent of the total given to 881 institutions.[3] Of the $560 million, $172 million was received from private foundations—55 percent of all foundation funds given to all institutions of higher education in that year.

The private universities, which receive relatively smaller portions of their income (and particularly small parts of their continuing operating revenue for general purposes) from government, are most heavily dependent upon private giving. Most of them would be in desperate circumstances if private giving were seriously impaired. Nevertheless, it should be specifically noted that public as well as private institutions depend upon private giving. Among the members of the AAU, almost 30 percent of all voluntary giving, and of foundation support, is to the public members. In absolute terms the public members of the AAU received $156 million in voluntary gifts, of which $66 million was from private foundations.

The second reason why private giving is essential to the health of higher education relates to the terms and conditions under which the money is made available. Most government support—Federal and State—is given for specific purposes defined in advance for the colleges and universities. These funds are indispensable, but a high degree of earmarking of most government funds for specific uses is inevitable.

Private gifts provide universities with resources that help them to determine their own character and their own priorities. Private gifts are the major source of funds needed to adapt the curriculum to new needs, to explore new forms of university governance, to help with community problems, and to meet unexpected financial emergencies. This source of revenue is particularly important as the volume of government support grows, as it will and should.

As our national expenditures on higher education rise, private giving will have to rise if this source of funds is not to decline in relative significance. The current level of $1.5 billion in private giving will have to exceed $3 billion by the end of the coming decade if its relative role is to be sustained.

In the face of needs for increased private giving to meet part of the rising costs of higher education and in face of the obvious desirability of sustaining diversity in sources of support, the outlook for increases in private giving is clouded by several basic trends.[4] First, the proportion of adjusted gross income of all taxpayers devoted to all forms of charitable giving has actually been declining in recent years and may decline still further. Second, private foundations, after a burst of giving to universities, are not sustaining the earlier rates of growth in giving. Third, competition from other worthy objects of charitable giving—such as urban projects and the performing arts—will probably increase. Fourth, universities have passed through a period of intensified effort to secure increased charitable giving, and further increases will be more difficult.

5. REDUCED INCENTIVES TO PRIVATE GIVING IN THE HOUSE BILL

This is the worst of all possible times to reverse our long standing national policy of providing strong incentives for private philanthropy through the opera-

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[3] Voluntary Support of Higher Education, 1967–68. Council for Financial Aid to Education.

[4] These have been identified and analyzed in detail in William Bowen's book, *The Economics of the Major Private Universities*. Carnegie Commission on Higher Education, 1968. This analysis relates to the major State as well as private universities.

tion of the tax system. The bill as passed by the House will tend to curtail sharply the volume of gifts and grants from private sources to higher education—directly through reducing incentives to individuals to make charitable gifts and indirectly through the proposed tax on foundation income. Accordingly, we urge that the Senate redress the balance by a thorough review of the provisions of the legislation in this light. We urge that it modify or remove provisions of the House bill which most seriously threaten to restrict private giving, and which can be changed without generating inequities, substantially impairing tax revenue, or defeating the main objectives of tax reform.

6. SUPPORT FOR NEEDED TAX REFORMS

We recognize that the desirability of encouraging charitable gifts must be considered in the context of the entire tax system. We are fully in accord with the need for and desirability of tax reform. We agree with the imperative need for greater equity in the distribution of the tax burden, for removing a large list of special tax favors, and for closing loopholes which have permitted many taxpayers to avoid their just share of the tax burden. The case for major reforms is compelling, and I wish to make clear that this testimony is in no way directed against the major thrust of tax reform legislation.

Recognition of the need for tax reform leads us to support a number of proposed changes because they are equitable and sound, even though one consequence of adopting them will be, as a by-product, some reduction of incentives to charitable giving. We agree that taxpayers should not be allowed, in the words of the House report (p. 58), to make "a charitable contribution deduction for a gift of a remainder interest in trust to a charity which is substantially in excess of the amount the charity may ultimately receive." However, in our opinion any abuses that have developed can easily be remedied without destroying the well understood and effective systems that are now operating, and we associate ourselves with the proposals made by the American Council on Education to accomplish this end. We also believe that removal of the unlimited charitable deduction is sound, even though this will adversely affect giving to some institutions of higher education. As another example, we believe that the proposed changed in tax treatment of "bargain sales" is sound in principle. Many of the proposals need perfecting, as, for example, in the important matter of avoiding retroactivity which would create confusion and inequity. We assume that such technical matters can and will be worked out.

7. REDUCED INCENTIVES TO MAKE GIFTS IN THE FORM OF APPRECIATED PROPERTY

We stress, in concert with the position of the American Council on Education, that the central deficiency of the House bill is a set of changes that will reduce incentives to make gifts in the form of appreciated property. In this connection, the importance of gifts of appreciated securities in relation to total private giving to large and small colleges and universities throughout the nation is not generally recognized. In recent years, appreciated securities have constituted over half of the total of gifts. Appended is a table showing the percentages for a number of representative institutions.

Simply stated our two major recommendations on the treatment of gifts of appreciated property are:

(a) For purposes of the limit on tax preferences (Sec. 301), which we consider in principle a sound change in the tax law, the value of appreciation of property should not be counted as a preference item when appreciated property is given as a charitable gift. The reason for this proposal is that charitable gifts, in contrast with every other tax preference item, do not generate income for the taxpayer (as in the case of tax free interest and capital gains) or tax benefits arising out of profit-seeking activities (as in the case of accelerated depreciation and farm losses).

(b) In connection with the new provision for allocation of deductions between taxable and tax free income (Sec. 302), which we also consider sound in principle, charitable gifts should not be considered a personal itemized deduction subject to allocation. All of the other items subject to allocation are involuntary

expenses to the taxpayer—interest payments, tax payments, theft and casualty losses, medical expenses, etc. Charitable gifts do not logically fall in this category, because they are discretionary. The taxpayer freely chooses to make a gift or not to make it. They are hence not "expenses" in the sense that the other items are expenses, and a change in tax treatment may therefore adversely affect the decision to make the gift.

The Executive Branch has recommended these two exclusions, which we strongly endorse. These exclusions are the major way through which private giving to universities can be sustained without weakening the general reforms, without producing large losses of revenue, and without introducing inequities among taxpayers. Failure to amend the House bill in this respect will have extremely serious consequences for the entire volume of private giving for higher education, and the repercussions on some private institutions would be crippling.

Other witnesses have emphasized the significance of the two proposals above, and have dealt with other important proposals for changes in the House bill, particularly those provisions which would seriously affect deferred giving. We wish to associate ourselves with the testimony on behalf of all higher education by the American Council on Education.

8. THE ROLE OF PRIVATE FOUNDATIONS AND THE PROPOSED TAX ON FOUNDATION INCOME

Simply in terms of revenue dollars, the foundations are an important source of income for higher education. Their grants to all institutions of higher education totalled $311 million in 1967–68. Of this, $173 million went to the private and $61 million to the public members of the AAU. These funds are a substantial contribution to the revenue of the institutions.

The qualitative contribution of private foundations to universities has been to stimulate innovation, to permit exploration of new areas of inquiry and teaching, to point the way for governmental and other support, to finance new forms of academic organization, and to provide physical resources for new undertakings. This tremendous positive contribution has continued throughout this century, and the nation, as well as universities, is better as a consequence of the role played by foundations.

Our system of medical education was completely revamped in the first two decades of this century through foundation support, and another wave of reform in medical education is now being propelled in substantial part by foundation assistance. Foundations have been one of the catalysts in bringing about innovation in universities. New fields of knowledge have been initially explored with their help. For example, they have taken the lead in stimulating research on the linked questions of population growth and food production. Worldwide beneficial effects, most particularly in stimulating the "green revolution" and widespread programs of family planning, have resulted. Foundation grants in the arts and humanities have helped to redress a serious imbalance generated by concentration of governmental support in the physical and biological sciences. The pioneering efforts which they financed have stimulated governmental and international activities. Finally, foundation gifts have had a strong multiplier effect by stimulating other private gifts, particularly for capital construction.

Turning now to the proposed 7.5 percent tax on the investment income of private foundations, we believe that it should be replaced by the concept of a supervisory fee based on actual costs of supervision.

The report of the Committee on Ways and Means of the House of Representatives did not spell out the reasons for the imposition of this new tax, which represents a startling departure from the well-established policy of exempting the income of private foundations from taxation. The report said merely that: "Your Committee believes that since the benefits of government are available to all, the costs should be borne, at least to some extent, by all of those able to pay. Your committee believes that this is as true for private foundations as it is for taxpayers generally." (p. 19) This sentence is the only reference to the basic justification for imposing the tax, and it does not establish a convincing case on several counts.

First, the tax would in fact fall not on the foundations but on institutions whose vitality depends in large measure on philanthropic gifts. The House bill

recognizes the position of these institutions by properly continuing their traditional tax exemption. Yet the full incidence of the proposed foundation tax would fall upon the universities, colleges, schools, churches and other tax exempt beneficiaries of foundations. A reduction of $100 million per year, the estimated yield of the tax, would be a very serious matter for many of these tax exempt organizations.

In this connection, the needs of these organizations are so pressing and the functions which they perform are so vital to society that government would be under strong pressure to replace a large part of the income that would be lost to them by reason of the proposed foundation tax.

Second, the tax is misdirected. The existing law does indeed contain loopholes which have made dubious financial practices possible, and some smaller foundations have apparently taken advantage of these. However, imposition of a general tax on the investment income of foundations would not be an appropriate or effective response. A reduction in the income of all foundations through a general tax would in no way contribute to the removal of any abuses which may exist. The direct and effective way to deal with abuses is to specify what is legal and illegal and to enforce the law.

Third, the bill does not in fact require that all private non-profit organizations pay taxes. The investment income of foundations whose disbursements are solely for educational, charitable, research, and religious purposes would be taxed, but the income of other organizations such as groups of trade and business associations and labor groups would not be taxed. The proposed tax is therefore discriminatory, and paradoxical in that organizations whose avowed and proper reason for existence is to advance the interests of their members are not taxed while those whose function is solely to help others are taxed.

However, we recognize that abuses have existed, and we believe that foundations can properly be required to carry the cost of governmental activities specifically devoted to enforcing whatever limitations on foundation activities may be enacted. We suggest that an annual supervisory fee be collected from foundations to cover these costs. Both the House report and the Executive Branch testimony before this Committee suggest such a solution. Thus the House Ways and Means Committee report stated that: "It is clear that vigorous and extensive administration is needed in order to provide appropriate assurances that private foundations will promptly and properly use their funds for charitable purposes. This tax, then, may be viewed as being in part a user fee." (p. 19) Secretary Kennedy suggested a "supervisory tax" of 2 percent on the investment income of foundations to finance such an operation in the Bureau of Internal Revenue.

We urge modifications in the proposals for change made by the Executive Branch. The first is to define the charge as a fee rather than a tax. We consider the distinction between a fee and a tax to be not only important in principle but as having important practical consequences. A fee is to finance a specific service, and is not a contribution to the general revenues. Second, the amount of the fee should be commensurate with the cost of the service financed by the fee. In contrast, a tax is essentially open ended with no objective criterion for setting its amount.

The fee would have these advantages:

(a) The purpose of the fee would be unambiguous. The illogical and harmful effects of the concept of a tax would be eliminated.

(b) The amount of the fee to be paid by each foundation could be set in an equitable manner and the total amount collected could be related directly to the cost of administering a Bureau of Internal Revenue unit charged specifically with responsibility for ensuring foundations do not abuse the privileges given to them by law.

(c) The amount collected from foundations in fees would surely be very less than the estimated 100 million dollars per year that would be produced by the proposed tax. The adverse effect upon beneficiaries of foundation grants would be markedly reduced.

(d) Foundations would by paying a fee completely finance those activities of government generated specifically by their operations. We suggest that the amount of the fee not be written into law, because the cost of the supervisory unit is not known, and it will change. Adjustment of the fee to cover the cost of the unit would require amendment of the tax law. We suggest

that the Secretary of the Treasury be empowered to levy a fee approximating the cost of the supervisory unit, and to determine an equitable means of setting the fee to be paid by each foundation.

9. RESTRICTIONS ON THE SCOPE OF FOUNDATION ACTIVITIES

We wish to call to the attention of the Committee our concern over the provision which would define as a taxable foundation expenditure "any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof . . . other than through making available the results of non-partisan analysis or research." Our concern is sharpened by the further provision which imposes a personal tax on foundation managers equal to 50 percent of the amount of the taxable expenditure.

The savings clause relating to non-partisan analysis or research is obviously intended to permit grantees of foundations to carry on objective academic research and analysis even if their work influences public opinion. However, the meaning of the prohibition itself is so vague and ambiguous, and the penalties on individual foundation managers are so harsh that foundations would be inhibited from making grants in many fields where the participation of academic people in public affairs is urged and expected, but where effects on public opinion are inevitable. Moreover, the saving clause is inadequate because many productive and non-partisan activities of faculty members do not consist literally of "making available the results of non-partisan analysis or research." They lead seminars composed of non-partisan groups of citizens and advise technical groups—for example, non-partisan advisory and study commissions to local, state and national bodies on such matters as environmental pollution, transportation, model legislation on various topics, science policy, agricultural policy, trade policy, community organization, interstate compacts relating to water use and joint administration of facilities. A legitimate and desirable function of these activities is to illuminate public issues and thereby influence public opinion and legislation. Other witnesses will no doubt elaborate upon the difficulties which this proposed provision of law would generate. This testimony concentrates upon the manner in which the clause would deprive the public of the help of competent and sometimes uniquely qualified scholars and experts from the university world on matters of the highest importance.

We recognize the problem generated by foundation financed activities which may have partisan political repercussions. However, we believe that the wording of the proposed amendment of the law goes so far beyond what is required as to threaten legitimate and desirable activities in the public interest. Our suggestion is that the Committee adopt wording which will prevent foundation grants from being used to finance partisan activities and lobbying, but which will permit foundation grants to support non-partisan activities carried on by educational, scientific, and charitable institutions. This approach would appear to forbid the kind of activity which is clearly objectionable. It would allow the kind of productive work cited above.

10. CONCLUSION

Higher education faces grave current financial problems, and the outlook for the future is not bright. Recent federal appropriations for higher education have not been increased in proportion to costs and some have even been reduced. State and municipal budgets are under acute strain. In the face of rising enrollments, costs, and public demands on the resources of universities, amendment of the federal tax law to curtail private giving would convert an already serious situation into an acutely critical one.

We ask that the Senate Committee on Finance recognize the seriousness of these issues and adopt the proposals outlined above in order to maintain incentives to private giving to higher education and to permit private foundations to continue the volume and nature of their indispensable support to higher education.

On behalf of the Association of American Universities, I wish to express appreciation for this opportunity to testify on matters of first importance to higher education. We stand ready to assist the Committee further in any way you desire.

Appendix A

Gifts of securities as a percent of all gifts of individuals to selected colleges and universities in recent years

	Percent
California:	
University of Southern California	51
Mills College	55
Connecticut:	
University of Hartford	49
New Haven College	34
Yale University	69
Illinois:	
University of Chicago	75
Northwestern University	85
Maryland:	
The Johns Hopkins University	56
Massachusetts:	
Boston College	39
M.I.T.	70
Wentworth Institute	92
Harvard University	68
Pennsylvania:	
Haverford College	71
Lehigh University	46
University of Pennsylvania	53

Association of American Universities

Membership List

Brown University, Providence, Rhode Island.
California Institute of Technology, Pasadena, California.
University of California, Berkeley, California.
Catholic University of America, Washington, D.C.
University of Chicago, Chicago, Illinois.
Clark University, Worcester, Massachusetts.
University of Colorado, Boulder, Colorado.
Columbia University, New York, New York.
Cornell University, Ithaca, New York.
Duke University, Durham, North Carolina.
Harvard University, Cambridge, Massachusetts.
University of Illinois, Urbana, Illinois.
Indiana University, Bloomington, Indiana.
Iowa State University, Ames, Iowa.
University of Iowa, Iowa City, Iowa.
The Johns Hopkins University, Baltimore, Maryland.
University of Kansas, Lawrence, Kansas.
Massachusetts Institute of Technology, Cambridge, Massachusetts.
Michigan State University, East Lansing, Michigan.
University of Michigan, Ann Arbor, Michigan.
University of Minnesota, Minneapolis, Minnesota.
University of Missouri, Columbia, Missouri.

(Note.—There are 42 university members in the United States and 2 Canadian members, McGill University and the University of Toronto.)

University of Nebraska, Lincoln, Nebraska.
New York University, New York, New York.
University of North Carolina, Chapel Hill, North Carolina.
Northwestern University, Evanston, Illinois.
Ohio State University, Columbus, Ohio.
Pennsylvania State University, University Park, Pennsylvania.
University of Pennsylvania, Philadelphia, Pennsylvania.
Princeton University, Princeton, New Jersey.
Purdue University, Lafayette, Indiana.

University of Rochester, Rochester, New York.
Stanford University, Stanford, California.
Syracuse University, Syracuse, New York.
University of Texas, Austin, Texas.
Tulane University, New Orleans, Louisiana.
Vanderbilt University, Nashville, Tennessee.
University of Virginia, Charlottesville, Virginia.
University of Washington, Seattle, Washington.
Washington University, St. Louis, Missouri.
University of Wisconsin, Madison, Wisconsin.
Yale University, New Haven, Connecticut.

Senator ANDERSON. Mr. Simon.

STATEMENT OF JOHN G. SIMON, PROFESSOR OF LAW, YALE LAW SCHOOL

Mr. SIMON. Mr. Chairman, my name is John G. Simon. I am a professor of law at Yale Law School. Although my testimony today grows out of my academic studies of tax policy relating to foundations, for the record I should like to state that I also serve as the president of a foundation, the Taconic Foundation, which is not likely to be affected by the provisions I wish to discuss here today.

Many Members of Congress are concerned by the power of private foundations in the United States. Yet I take the liberty of stating that the tax reform bill as passed by the House would aggravate rather than solve the only potentially troublesome aspect of foundation power.

Let me say first that the power questions one usually hears about are not in my view the really troublesome ones. For example, the foundation's power to control resources should not trouble us. The trust department of one New York bank manages almost as many assets as are held by almost all American foundations, and the 1965 Treasury Report found that the foundations' share of total corporate invested wealth in this country had not increased over the prior 15 years, as compared for example to a great increase in the shares held by pension funds.

Moreover, the data submitted yesterday by Mr. Pifer shows that over the last decade the foundation's share of total national wealth has slightly declined.

With respect to another kind of power, power over decisionmaking processes in the larger society, foundation grants are so tiny in relation to Government expenditures, far less than 1 percent, that the foundations cannot impose their ideas on the Nation.

Foundations can only point out alternative approaches, new options which other institutions are free to accept or reject. Some innovations offered by the foundations such as preschool education for poverty children have been embraced by public institutions. Other ideas have been rejected and have ultimately dropped from sight.

In the last analysis, the people have decided in this world of private charitable enterprise just as the people decide in the world of private commercial enterprise.

I should add that on the whole foundations contribute to a diffusion of power in society by placing in nongovernmental hands the allocation of a fraction of resources that would otherwise be taxed and allocated by the Central Government. But in the world of philanthropy

as in the world of commerce, placing decentralized power in nongovernmental hands can become dangerous when there are two few hands. This is the problem which the tax reform bill aggravates. Let me explain.

Altough there are roughly 20,000 private foundations in the country, less than 300 of them have assets exceeding $10 million. In other words, less than 300 have an annual giving capacity of more than approximately $500,000. So it is largely to these 300 foundations that charitable organizations must turn to gain substantial foundation financing for new programs and new ideas.

Moreover, to obtain support in any one area of the country or in any one field of work, for example air pollution, crime control, mental health, one can turn only to a handful of these foundations, for most foundations must specialize to some extent, and in the course of time even the small group of foundations dealing with a particular problem or operating in a particular part of the country will be reduced in size by dissolution or reducing in effectiveness by the onslaught of tired blood.

Accordingly if charities seeking financing are to keep their options open, if they are to have alternative sources of support for experimentation and expansion, new foundations must enter the field from time to time to replace the foundations which have died out or which have become tired out.

In other words, a reasonable birth rate among the larger foundations must be sustained. Here as in the commercial market place it is wise public policy to promote or at least not discourage new entry into the field.

Now, what does the foundation birth rate depend on? Among foundations in the over $10 million class, as my full written statement shows, birth rate depends on the receipt by foundations of property which has appreciated in the donor's hands, and/or property which represents some share of the donor's coorporate control holding. The overwhelming majority of the larger foundations are launched with contributions of property falling into these two categories.

The tax reform bill would heavily discourage the founding of new foundations by discouraging both types of gift, the gift of appreciated property to a foundation, and the gift of corporate controlled stock to a foundation.

First section 201(c) of the bill permits almost all charitable organizations to receive deductions contributions of appreciated property other than tangible personal property without the donor being subject to tax on the long-term capital gain.

The big exception is the private nonoperating foundation. When it receives such property, the donor is taxed, unless the foundation is a conduit organization which redistributes the entire gift within 1 year.

This discrimination against nonoperating foundations will heavily discourage gifts of appreciated property to the larger foundations, in addition to having some overall negative impact on charitable giving.

The House report does not seek to explain this discriminatory provision. It justifies other changes in the appreciated property rules but not this one. The only justification for such a rule must be the

belief that it is good to divert gifts away from foundations, even at the cost of some decrease in overall charitable giving.

If this is a good result, it must be because of the power questions I have discussed today, or because of the certain quantitative or qualitative arguments covered in my full statement. I respectfully refer the committee to that statement at page 301 of the committee print.

That statement rebuts any notion that gifts to foundations produce a direct charitable benefit which is either too little or too late, and it suggests also that before the Congress condemns the foundations, either on the ground of quality or on the ground of quantity, it should have the benefit of the forthcoming report of the Peterson commission on foundations and private philanthropy, or some other dispassionate and considered appraisal of the overall record of the foundations.

Now the second provision of the House bill which affects foundation birth rate is proposed code section 4943 which would in effect prevent a foundation from receiving a gift of corporate controlled stock unless the combined voting interests of the foundation and the donor is brought below 20 percent within 5 years. I am not referring to the bill's limitations on a foundation's purchase of business control but only to the restrictions on gifts of business interests.

This restriction on such gifts will make it very difficult or unattractive for a man whose nest egg consists of corporate controlled stock to endow a foundation with that nest egg. It may be difficult because the stock is not readily marketable or it may be unattractive because it will force a sale to strangers or merger with larger competitors or conglomerate owners.

Accordingly this provision like the appreciated property provision will discourage the creation of new foundations, and may also have a negative effect on overall charitable giving.

Now what justification can there be for this provision? The Ways and Means Committee report attributes three evils to foundation ownership of controlled stock. Again time limits require me respectfully to refer the committee to my full statement, where I believe I have demonstrated that one of these three grievances, the alleged diversion of the energies of foundation managers, does not stand up under analysis or in the light of actual foundation experience, and my written statements also explains how two other asserted problems, the inadequacy of income yield and the unfair competitive advantage are satisfactorily cured by the income distribution and self-dealing provisions of this same bill, the tax reform bill, supplemented if necessary by certain fairly simple amendments outlined on pages 8 and 9 of my full statement reprinted at pages 312 and 313 of the committee print.

In other words, the abuses, and they do exist, are correctable without prohibiting a foundation from holding the control stock donated to it. If the committee nevertheless wishes to limit this practice, I suggest that it should at least allow a much longer period for divestiture than the 5 years allowed in this bill.

A long period will mitigate the discouraging impact of this provision on potential foundation donors.

I also commend to the committee the technical amendments that Mr. Mitchell Rogovin advocates in his testimony, which will facilitate the redemption of excess business holdings.

To sum up, because the appreciated property and stock ownership rules I have discussed would substantially reduce the birth rate among larger foundations, which is precisely where in the interests of limiting foundation power a reasonable birth rate is most needed, I respectfully make two suggestions:

First, that this committee refrain from approving an appreciated property rule which discriminates against private operating foundations, and second, that this committee refrain from adopting the stock ownership prohibition, or at least I minimize the deterrent impact of such a prohibition by substantially extending the deadline for divestiture beyond the 5-year period set forth in the House bill.

As these two provisions now stand in the House bill, they are likely to inflict serious damage on our system of private charitable enterprise, for that system as the president of Yale University has recently stated rests on the great importance of giving each new idea a chance to find a sympathetic sponsor by offering it more than one doorbell to ring. Innovation is the essence of progress, independence and variety are the essence of a free society.

Both seem to make it absolutely essential that an idea, a person, an institution not be dependent upon the ability to persuade or to please any single source of support.

I thank you very much.

Senator BENNETT. No questions. This is a very interesting new note in our testimony, and I am very glad to have it.

Mr. SIMON. Thank you, sir.

The CHAIRMAN. Thank you very much for a good statement.

(Mr. Simon's prepared statement and a letter to the chairman from Mr. Simon, regarding the cooperative assistance fund, follows:)

STATEMENT OF JOHN G. SIMON, PROFESSOR OF LAW, YALE UNIVERSITY

SUMMARY

Introduction

Certain provisions of H.R. 13270 are likely to have the unanticipated effect of aggravating rather than solving the questions of "foundation power" which are of concern to many members of Congress.

1. The Birth Rate Problem

a. By permitting decentralization of decision-making, foundations make a major contribution to the democratic process. Yet decentralization into non-governmental hands becomes dangerous if there are too few hands.

b. Over time, many of the 300 existing foundations in the over-$10-million class will be dissolved, leaving only a few of these foundations operating in any one field of activity (e.g., mental health, pollution) or in any one geographical region. This shrinkage will narrow the options available to organizations seeking substantial foundation funds for new ideas and new approaches, unless a reasonable foundation birth-rate is maintained in the over-$10-million category. New entry is desirable here in "private charitable enterprise," as it is in private commercial enterprise, in order to diffuse power.

c. The birth rate of the larger foundations largely depends on contributions to foundations of property which is (a) appreciated and/or (b) represents some part of a donor's corporate control stock.

d. Contributions of both types of property to foundations would be heavily discouraged by H.R. 13270, as outlined in parts 2 and 3, below.

2. The Impact of the Appreciated Property Provision

a. Section 201(c) of H.R. 13270 permits all charitable organizations *except private non-operating foundations* to receive deductible contributions of appreciated property (other than tangible personal property) without the donor being subject to tax on the long-term capital gain.

b. This discrimination against foundations will heavily discourage gifts of appreciated property to foundations, in addition to having some overall negative impact on charitable giving.

3. The Impact of the Stock Ownership Provision

a. Section 101(b) (new code section 4943) of H.R. 13270 would prevent a foundation from receiving a gift of corporate control stock unless the combined voting interest of the foundation and the donor is brought below 20% within five years.

b. This provision will make it very difficult or unattractive for a man whose nest egg consists of corporate control stock to endow a foundation with that nest egg.

c. Accordingly, this provision, like the appreciated property provision, will discourage the creation of new foundations and may also have a negative effect on overall charitable giving.

d. Of the three specific evils attributed to foundation control of business enterprises in the House Ways and Means Committee report, one does not appear to present a significant problem, and the other two can be cured by application of other provisions of H.R. 13270 and existing law, supplemented if necessary by certain fairly simple amendments.

e. Accordingly, if the stock ownership prohibition—and the appreciated property provision as well—are to be justified, it must be on the ground that there is some positive advantage in diverting charitable giving away from foundations to non-foundation charities.

4. The Arguments in Favor of Diversion

In this section various possible arguments in favor of diverting charitable gifts away from foundations—(a) quantitative arguments, (b) qualitative arguments, and (c) arguments relating to "power" and "non-accountability"—are briefly analyzed and are found to lack logical or empirical support. The suggestion is also made that some of these issues can best be analyzed in the light of the forthcoming findings of the Peterson Commission.

STATEMENT

There is an important relationship between the question of "foundation power," which concerns many members of Congress, and two provisions of H.R. 13270 which prevent private foundations from (a) receiving gifts of appreciated property without the imposition of a tax on the donor and (b) owning corporate control stock. The relationship, however, is not what some of the proponents of these provisions may suppose. For, as I hope to make clear in this statement, these restrictions are calculated to aggravate, rather than solve, any problems which "foundation power" may present.

The Birth Rate Problem

The private charitable foundation represents a uniquely American contribution to the democratic process. Foundations permit us to decentralize and place in private hands the decisions over the allocation of a fraction of the resources that would otherwise be taxed and allocated by the central government. In this way the foundations serve as a counterpart to our free enterprise system, implementing what Judge Learned Hand called the national presupposition that "right conclusions are more likely to be gathered out of a multitude of tongues than through any kind of authoritative selection. To many, this is, and always will be, folly; but we have staked upon it our all."

5. Conclusion

Because the case for diverting charitable giving away from foundations has not been made, and in view of the strong public policy reasons for maintaining a reasonable birth-rate among the larger foundations, it is respectfully suggested that the Committee

(a) refrain from approving an appreciated property rule which discriminates against foundations, and

(b) refrain from adopting the stock ownership prohibition, or at least minimize the deterrent impact of such a prohibition by substantially extending the deadline for divestiture beyond the five-year period set forth in H.R. 13270.

But in the world of philanthropy, as in the world of commerce, placing decentralized power into private hands becomes dangerous when there are too few hands. Although there are roughly 20,000 private foundations in this country, less than 300 of them have assets in excess of $10 million; in other words, less than 300 have an annual giving capacity of more than approximately $500,000. It is largely to these 300 foundations that individuals and organizations must turn to gain substantial foundation financing for new programs and approaches. Moreover, to obtain support in any one field of work (for example air pollution, crime control, mental health), or in any one area of this country, an organization can turn to only a handful of these foundations, for in order to husband their resources, most foundations must specialize to some extent. In the course of time, even the small group of foundations dealing with a particular problem—or operating in a particular geographical region—will be reduced in size by dissolution, or reduced in effectiveness by the onslaught of tired blood. Accordingly, if persons or charities seeking financing are to keep their options open, if they are to have alternative sources of support for experimentation and expansion, the birth rate in the foundation world must be sustained. Here, as in the commercial market place, a decreasing rate of new entry into the field would, over time, leave the remaining foundations with an undesirable degree of power to determine the rate and form of change in the philanthropic part of the private sector.

What determines the birth-rate of foundations in this over-$10-million class? We must look at the kinds of assets with which such foundations are brought into being. We find two types of assets, often overlapping: (a) In his study of "The Investment Policies of Foundations," Professor Ralph L. Nelson reports that "[t]he large endowed foundation receives its initial endowment commonly in the form of assets that the donor has held for a long time"—presumably appreciated assets.[1] (b) Professor Nelson also finds that most of the post-1940 growth in foundation assets has stemmed from contributions of what he calls "donor-related" assets, i.e., common stock in a "company . . . in which the donor was active and through which he had built his fortune." Thus, the 1965 Treasury Report on private foundations tells us that out of 175 foundations which had more than $10 million in assets in 1962, 78—or 45 percent—owned 10 percent or more of a stock of a business corporation. And 45 of the 175 foundations—26 percent of them—owned 20 percent or more of the stock of a business corporation. In a large number of the cases falling between 10 percent and 20 percent, the figure would be over 20 percent if one included the shares owned by the donor and his family. And many of the foundations which do not now wield corporate control or share control with the donor found themselves in such a posture in the years of their infancy.

It follows that a sustained birth rate among foundations in the over-$10-million category depends on the ability of foundations to receive property which (a) has appreciated and/or (b) represents some portion of a donor's corporate control holdings.

Unfortunately, the provisions of H.R. 13270 would heavily discourage donors from contributing *either* type of property to foundations and would therefore seriously impair the birth-rate of the larger foundations.

The Impact of the Appreciated Property Provision

Section 201(c) of H.R. 13270 (amending code section 170(e) and adding new code section 83) carefully discriminates against foundations with respect to the receipt of appreciated property. Section 201(c) permits most charitable donors to continue to give appreciated property (except for tangible personal property) to charity without paying a tax on the long-term capital gain.[2] But donations to private non-operating foundations, alone among all charitable organizations, are denied this treatment: unless the foundation redistributes the entire contribution within a year (which would prevent the foundation from becoming endowed

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[1] Professor Michael Taussig reports that contributions of appreciated property accounted for 39.5% of the value of all charitable gifts made in 1962 by taxpayers with more than $1 million in income—the category in which one would find the creators of foundations in the over-$10-million class. Taussig, "Economic Aspects of the Personal Income Tax Treatment of Charitable Contributons," National Tax Journal, vol. 20, March 1967.

[2] The non-taxability of this gain is, however, circumscribed by section 301 of the bill, imposing a limit on tax preferences, coupled with the allocation of deductions provisions of section 302. But these limitations apply to all charitable gifts of property, whether received by foundations or non-foundations.

or engaging in long-term programs), the gift to the foundation constitutes a taxable event, requiring payment of the capital gains tax on the appreciation.

Obviously, a potential donor will be heavily discouraged from contributing appreciated property to a foundation if the tax treatment of such a gift is dramatically less favorable than the treatment of a gift of the same asset to other charities. In the face of this discriminatory rule, some potential donors, whose main charitable objective is to create a foundation, may simply decline to give the property away at all—in which case neither the Treasury nor philanthropy will receive the appreciated property or any tax on it, except at some remote date and in uncertain amounts. In the case of other donors, the result may be to shift the benefaction to a non-foundation charity, although possibly in a reduced amount reflecting the frustration of the donor's original intentions. Charity as a whole will probably suffer reduced receipts as a result of section 201(c). But for present purposes the more important point is that section 201(c) will very substantially reduce the birth-rate in the world of the larger foundations—which is precisely where, in the interests of diffusing "foundation power," a reasonable birth rate in most needed.

The Impact of the Stock Ownership Provision

Section 101(b) of H.R. 13270, setting forth new code section 4943, would in effect prevent a foundation in the future from receiving a gift of all or any part of a donor's corporate control stock unless the combined voting interest of the foundation and the donor is brought below 20% within five years of the gift. In its impact on the creation of new foundations, this provision is less damaging than the proposals set forth in the 1965 Treasury Report, which would have deferred the donor's deduction until the control situation was terminated. Yet new section 4943 will still make it very difficult or very unattractive for many or most men whose nest egg is a controlling interest in a business enterprise to endow a foundation with that nest egg. A sale by the foundation and/or the donor within five years may not be feasible—or may not be perceived as feasible by the potential donor—either because the stock is not marketable or because the donor may not be able to accept the prospect of a forced sale to strangers or a compulsory merger.[3]

Here, as in the appreciated property situation, the result may be no gift to charity at all, or the donor may simply give the stock to a non-foundation charity which informally promises not to sell it. The resulting impact on the birth rate of foundations in the over-$10-million class will be understood by recalling that almost one-half of all foundations in this category hold what appears to be corporate control stock.

The House Ways and Means Committee explains that section 4943 combats three evils inherent in foundation control of business enterprises. One evil is the "diversion" of the foundations managers' attention to business affairs, "away from their charitable duties." Logically, this point is difficult to understand. A small foundation, without a staff, will be run by members of the family who would, in any event, be spending some of their time on business, some of their time on philanthropy. It is difficult to see why the amount of time devoted to philanthropy would be any less, merely because the family's philanthropic interest (the foundation) happens to be linked to the family's business activity (the controlled corporation). On the other hand, the foundation large enough to have a substantial professional staff will have employees who are spending full time on philanthropy and lay trustees who would not be devoting full time to foundation affairs in any event. Moreover, the diversified portfolio of a *non*-corporate-controlling foundation may require just as much financial attention as the single predominant investment of a corporate-controlling foundation.

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[3] Assuming that the donor does wish to maintain family control over the business without bringing in outsiders, the question of whether the Treasury proposals will deter him from contributing control stock to the foundation will in large part depend on the foundation's chances of achieving the required divestiture without selling to strangers. This possibility, in turn, will be a function of several factors: the extent to which the Treasury will or can interpret the accumulated earnings tax provisions to permit the family corporation to redeem the tainted stock in the foundation's hands (a rather doubtful prospect under current law); the proportionate size of the interest to be redeemed; and the cash position and cash needs of the enterprise that is supposed to be doing the redeeming. In the case of many substantial family corporations—the kind which would form the basis for endowing a foundation in the more than $10-million-dollar asset class—these factors will not indicate favorable odds for redemption, and thus the donor will seek some way of maintaining family hegemony over the enterprise, other than through a foundation.

Finally, logic aside, the roster of corporate-controlling larger foundations contains many names of distinguished foundations (e.g., Danforth, Lilly, Hartford, Irwin-Sweeney-Miller) which go about their charitable work without being "diverted" by the nature of their business holdings.

A second evil is said to lie in the fact that the donors of control stock "in some cases are relatively unconcerned about producing income to be used by the foundation for charitable purposes." This phenomenon, where it is found, can be corrected by a combination of the minimum payout requirements of section 101(b) of the bill (new code section 4942), coupled with vigorous enforcement of the existing tax on accumulated corporate earnings. To give further assurance of productivity, the new law could prohibit or penalize a foundation's retention of corporate-controlled stock unless the annual return on *that stock*, measured alone, equalled the minimum percentage which, under the payout provision of H.R. 13270, the foundation was required to distribute each year.

The third asserted evil is that, although the controlled company is fully taxed, foundation control gives the company an unfair business advantage in relation to competitors which are not owned by tax-exempt entities. Any such advantage would be substantially reduced if, through the techniques suggested above, foundations were placed under pressure to exact an adequate dividend pay-out from their controlled companies. Moreover, section 101(b) of the bill (new code section 4941) would prevent a foundation from making any loan, on preferential terms or otherwise, to any corporation 35% owned by the donor's family. In the interest of preventing unfair competitive advantage, this provision could be expanded to prohibit a foundation from providing debt or equity financing to a controlled business except (a) through the purchase of its securities from unrelated third parties on a national exchange, or (b) with the approval of the I.R.S. or the state equity court having equity jurisdiction.[4]

Accordingly, a stock-ownership prohibition is not needed to deal with the evils which the House Ways and Means Committee attribute to foundation corporate control. Yet some will find such a prohibition appealing precisely because—to the extent that it does not reduce charitable giving altogether—it will divert gifts from foundations to other charities.[5] This diversion is the same feature that presumably makes the appreciated property provision, discriminating against foundations, attractive to the House Ways and Means Committee. We must look, therefore, at the arguments in favor of a major diversion of charitable contributions away from foundations.

The Argument in Favor of Diversion

1. One argument is *quantative*. It contends that a dollar donated to a private foundation produces a direct charitable benefit "too little and too late" in comparison to a dollar donated to an operating charitable organization.

a. The "too little" argument presupposes that foundation endowments generate an inadequate yield compared to other charitable endowments. Yet the only comparative data I have seen do not support this premise: the average ordinary income (excluding capital gains) received by 59 large colleges and universities in 1962, as a percentage of assets at market value, was extremely close to the comparable percentage yield for the same year for foundations surveyed in the 1965 Treasury Report (3.87% for the colleges, 3.7% for the foundations). Moreover in the same year (1962), foundations paid out 6.5% of the market value of their assets in charitable grants, or almost twice the ordinary income received. The annual distribution requirement found in H.R. 13270—applicable to private foundations but not to other charities—should

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[4] Indeed, most of the problems presented by foundation corporate control are the very types of problems which state equity courts are experienced in handling and for which they have precise enforcement tools, as I have discussed in detail in vol. 1, House Committee on Ways & Means, "Written Statements . . . on Treasury Department Report," 89th Cong. 1st Sess. (1965), pp. 458–462. To do the job well, state courts and state Attorney General need some help from the Federal Government, which I have outlined in the 1965 paper cited above. In the interests of efficient policing and of honoring the principles of federalism in government regulations there is much to be said for the possibility of a state approach to this question.

[5] Note that if corporate control stock is donated to a school or church which informally agrees to hold it and vote it the donor's way, this arrangement is not prohibited by H.R. 13270, and yet the same evils can be found as in the foundation situation—except that there will be no self-dealing or payout rules to assist the I.R.S., for churches and schools are not covered by these rules under existing law or H.R. 13270, and they do not even have to file an annual information return!

assure the continuation of this favorable pay-out performance on the part of the foundations.

b. The "too late" argument presupposes that gifts to foundations typically become part of endowments, emerging only slowly as income grants to operating charities, whereas a gift to a non-foundation charity is immediately deployed for active charitable operations. Yet many gifts to non-foundation charities—especially major gifts of appreciated property—become part of the endowment funds of the college, church, hospital or other recipient organization, either because the donor so prescribes or because of the policies of the recipient charity. A dollar of endowment income given away by a foundation produces a direct public benefit just about as quickly as a dollar of endowment income spent by an operating charity. It is true that a good part of the appreciated assets donated to non-foundation charities are used for current operations rather than endowment, but that is also true for some portion of foundation assets; unfortunately I know of no comparative data on this point. In any event, even if there were data to support the "too late" argument, the dimensions of the problem must be considered in true perspective: in 1962 (the latest year for which I have figures), $450 million were deducted on individual income tax returns for gifts to foundations, as compared to $7.5 billion deducted on individual income tax returns for all charitable contributions—a figure which probably understates the total charitable gifts made by all itemizing and non-itemizing taxpayers.

2. Another argument for diversion is *qualitative*. Many critics are opposed to some of the ideas and approaches foundations have supported; others simply do not believe the foundations have accomplished very much. On these issues, I respectfully suggest that this Committee could benefit from the forthcoming findings of the Peterson Commission or some other dispassionate appraisal of the overall record of the foundation. A cursory examination of the testimony the House Ways and Means Committee received last February about foundation achievements in the health field alone—resulting in the saving of many millions of lives from such diseases as polio, yellow fever, hookworm and nutritional disorders—should, in my view, cause this Committee to pause before it concludes that foundations are charity's least effective branch and therefore deserve to be the object of tax discrimination.

3. Finally, there are arguments as to the "*power*" and "*non-accountability*" of foundations. Once more I take the liberty of suggesting that the Committee await the conclusions of the Peterson Commission on these points, offering at this time only the following brief comments:

a. With respect to overall power to control resources, the S.E.C. reports that as of June 1968 foundations held less than a third as much common and preferred stock as the private non-insured pension funds, and the trust department of one New York bank manages almost as many assets as are held by all American foundations. Moreover, the 1965 Treasury Report on Private Foundations noted that during the period 1950–1963, when the percentage of total corporate invested capital held by the pension funds increased more than seven times, the foundations' percentages did not increase at all.

b. With respect to foundation power over grant recipients, I have already suggested that this is a danger only if the foundation "birth rate" is suppressed so as to foreclose the range of options open to those recipients.

c. With respect to power over the decision-making processes in the larger society, I would submit that because their grant-making powers are quite limited—annual foundation grants account for approximately 10% of total charitable giving and amount to less than one percent of Federal government spending—the foundations cannot impose new ideas or approaches on the nation: they can only point out alternative possibilities in the arts and sciences, or in health, education and welfare, which other institutions are free to accept or reject. Some innovations demonstrated by the foundations—such as multi-stage rockets or pre-school education for poverty children—have been embraced by public institutions. Other innovations have been rejected and have dropped from sight. In the last analysis, the public-at-large decides.

d. The point I have just made also relates to the question of "non-accountability." There is, of course, no lack of accountability with respect to compliance with statutory and fiduciary standards; on these law enforcement issues, foundation managers must account to the appropriate federal and state government agencies, whose power would be increased in important ways by H.R. 13270. Accountability for the wisdom of grant-making decisions is another matter.

If foundation trustees had to seek approval from a large stockholder-like constituency, the foundations would lose some of their special capacity for flexibility and risk-taking. In a larger sense, however, there *is* a form of accountability: in the long run, as noted above, any foundation must win the approval of the general public for its ideas and experiments if it wishes to see them prevail.

Conclusion

Because the arguments in favor of diverting charitable gifts away from foundations appear to lack logical or empirical support, and because there are strong public policy reasons for maintaining a reasonable birth-rate among the larger foundations, I respectfully suggest that this Committee

a. refrain from approving an appreciated property rule which discriminates against foundations (section 201(c)), and

b. refrain from adopting the stock ownership prohibition (new code section 4943), or at least minimize the deterrent impact of such a prohibition by substantially extending the deadline for divestiture beyond the five-year period set forth in H.R. 13270.

As these two provisions now stand in H.R. 13270, they are likely to inflict serious damage on our system of "private charitable enterprise," for that system, as the President of Yale University has stated,

"Rests . . . on the great importance of giving each new idea a chance to find a sympathetic sponsor by offering it more than one doorbell to ring. Innovation is the essence of progress. Independence and variety are the essence of a free society. Both seem to make it absolutely essential that an idea, a person, an institution not be dependent on the ability to persuade or to please any single source of support."

NOTE.—Although this statement grows out of my academic studies of tax policy relating to philanthropy, for the purposes of full disclosure I should mention that I also serve as the President of the Taconic Foundation, an organization which owns no corporate control stock (alone or in combination with any donor) and which is not likely to receive any such stock or any substantial gifts of appreciated assets in the years to come, and therefore is not likely to be affected by the proposed legislation under discussion in this statement.—J. G. S.

COOPERATIVE ASSISTANCE FUND,
New York, N.Y., September 30, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I am writing this letter respectfully to request that the Committee on Finance, in its forthcoming report on H.R. 13270 (the Tax Reform Bill of 1969), explicitly resolve certain questions about the status under the bill of a new charitable organization, the Cooperative Assistance Fund.

The Fund was created in May, 1968 by a number of foundations to combat poverty, prejudice and community deterioration by assisting members of poverty and minority groups to improve their economic condition and also to have access to improved and integrated housing. The Fund will, among its other activities, make investments which have a substantial potential for upgrading the economic and housing opportunities available to such poverty and minority groups. Investment funds will be made available to groups or persons who are not able to obtain the required financing from conventional sources, in cases where the Fund has determined that such an investment will further the charitable objectives of the Fund.

The Fund will receive two types of contributions from the foundations and other charitable organizations which support its work: (a) "grant contributions," i.e., outright gifts which may be used by the Fund either for its investment program or for its other charitable activities, and (b) "investment contributions," i.e., funds which are made available to the Fund for its investment program and which the "investment contributor" may subsequently withdraw in an amount increased or decreased to reflect investment gains or losses. Seven foundations and one national church have decided to participate in the Fund as "grant contributors" or "investment contributors"; other foundations and churches are

contemplating participation. One officer from each of these contributing organizations will serve as a Trustee of the Fund along with other Trustees.

The Internal Revenue Service has determined that the Fund is exempt under Section 501(c)(3), in a letter dated January 2, 1969. The letter recites the fact that the Fund, as one of its charitable activities, will make investments of the type described above. (A copy of the determination letter, together with copies of the Fund's charter and by-laws, are enclosed.)*

The Fund will be able to receive support from the various private foundations which wish to finance it only if it is clear to all concerned that "grant contributions" and "investment contributions" made to the Fund by such foundations constitute "qualifying distributions' under the distribution-of-income requirements of new Code Section 4942. It is our understanding that this conclusion is correct for the following reasons, based on the language of subsection (g)(1) of Section 4942:

(a) Such a "grant contribution" or "investment contribution" to the Fund would constitute an "amount paid out to accomplish one or more purposes described in section 170(c)(2)(B)", and an "investment contribution" to the Fund could also be characterized as an "amount paid out to acquire an asset used (or held for use) directly in carrying out one or more of the purposes described in section 170(c)(2)(B)."

(b) Such a contribtuion would *not* be made to "an organization controlled (directly or indirectly) by one or more disqualified persons (as defined in section 4946) with respect to the foundation" (the foundation making the contribution). As noted above, an officer of each contributing foundation—a "disqualified person" as to that foundation—serves on the Fund's Board of Trustees, but does not "control" the Fund by so serving.

(c) Such a contribution would *not* be made to a "private foundation which is not an operating foundation (as defined in subsection (j)(3))." The Fund, if it is a private foundation, will be an *operating* foundation as defined in new Code subsection 4942(j)(3), since "substantially all" of its income will be spent to carry out the investment program or other charitable activities of the Fund, and "substantially more than half" of its assets will be represented by investments made by the Fund to expand economic and housing opportunities for poverty and minority groups in furtherance of the Fund's charitable purposes. Such investments are assets "devoted directly" to the "activities constituting the purpose or function" of the Fund, within the meaning of subsection 4942(j)(3).

If our understanding, as expressed above, agrees with the Committee's understanding, we should be grateful for a clarifying statement to that effect in the portion of the Committee's report dealing with Section 4942. I take the liberty of suggesting that it might read as follows:

"The Committee understands that foundations interested in investing funds in a manner which will promote charitable objectives, such as increasing economic and housing opportunities for members of poverty and minority groups, have adopted the device of forming a separately incorporated fund, qualifying under section 501(c)(3), for the purpose of engaging in such investing, along with other charitable activities, on a coordinated and efficient basis. In the case of one such organization which has been brought to the Committee's attention, the Cooperative Assistance Fund, all or many of the sponsoring foundations have a representative on the board of trustees of the fund, and contributions by the sponsoring foundations to the fund are made either as outright grants, or as 'investment contributions', the income or principal of which may be returnable to the sponsoring foundation under certain conditions. Since the investments of such a fund made in furtherance of its charitable objectives are assets 'devoted directly' to 'activities constituting the purpose of function for which it is organized and operated', such a fund will ordinarily constitute an operating foundation, and grants or 'investment contributions' to such a fund will ordinarily constitute qualifying distributions for purposes of section 4942."

The Committee's consideration of this request is greatly appreciated.

Respectfully yours,

JOHN G. SIMON,
Trustee of Cooperative Assistance Fund.

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*The charter and by-laws are made a part of the official files of the Committee.

INTERNAL REVENUE SERVICE,
Washington, D.C., Jan. 2, 1969.

COOPERATIVE ASSISTANCE FUND,
New York, N.Y.

GENTLEMEN: We have considered your application for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code.

The information submitted shows that you were created by several foundations exempt under section 501(c)(3) to pursue some of their common purposes and programs. Organizations exempt under section 501(c)(3) may become members by making an investment contribution of at least $1,000,000 or an amount equal to 2% of your investment assets, but not less than $100,000, or by making a grant or grants in aggregate amount of not less than $100,000. Organizations making investment contributions may, after 3 years, withdraw their investment plus any proportionate increase in the assets or less any proportionate decrease in the assets.

You were formed for the purpose of combating poverty, prejudice and community deterioration, by assisting members of poverty and minority groups to improve themselves economically, and to have access to improved and integrated housing. You will make investments which present substantial potential for an economic upgrading of the poverty and minority groups involved, through the providing of employment opportunities or otherwise, extending beyond the mere rendering of assistance to the individuals in the enterprise.

You will conduct or support (1) job-training projects in urban and rural poverty areas; (2) educational programs designed to enable members of minority groups to enter fields of entrepreneurship, management, and advantageous employment not generally entered by such persons; (3) promotion of open-occupancy, nondiscriminatory housing; and (4) assistance to low and lower-middle income families in obtaining improved housing.

If conventional sources are unable or unwilling to supply required capital, you will make investments in (1) business enterprises located in urban ghetto areas, or located outside of such areas but owned or operated by or employing significant numbers of minority or poverty groups from urban areas; (2) housing ventures for low-income or lower-middle income groups; (3) housing ventures not limited to low-income or lower-middle income groups but having integration as a major goal; (4) poverty area cooperative farming organizations and other poverty area cooperative organizations in need of credit; (5) other enterprises of an employment-creating nature located in rural poverty areas.

You also expect to make loans or equity-type financial assistance available to individual members of poverty and minority groups who are in need of such assistance in order to start or improve their own businesses or acquire existing ones, and who are unable to obtain required financing from conventional sources. Furthermore you have indicated that in no event will you invest in a large, financially strong, corporate enterprise.

Where it is in furtherance of your objectives, you will invest in or otherwise support other exempt organizations conducting rehabilitation and training programs, churches running community development programs, small business investment companies, local development corporations or development banks formed specifically for the purpose of assisting poverty and minority group individuals, and organizations established to provide credit for poverty area rural cooperative organizations.

In selecting recipients for financial assistance, you will, where possible, work with and rely on recommendations and referrals from, other organizations engaged in rehabilitation and other training programs in which the individuals to be aided have participated. In determining the potential of a particular assistance program for economic upgrading of a poverty area or the minority group, you will consult with organizations conducting research on economic opportunities for poverty and minority groups, and with churches and other section 501(c)(3) or governmental organizations operating antipoverty and anti-discrimination programs.

You do not expect to have material control over the operation of the businesses you aid, but will endeavor to prevent by contract a disposal of any businesses aided by you in a manner which would frustrate your purposes.

On the basis of your purposes and proposed method of operation, as briefly described above, it is our conclusion that you are exempt from Federal income tax under section 501(c)(3).

In this ruling we are not determining whether any of your present or proposed activities is an unrelated trade or business as defined in section 513 of the Code.

Though you have also considered the possibility of making investments in certain businesses to induce them to relocate in ghetto areas to provide necessary goods and services for residents you have advised us that you do not have any immediate plans to engage in this activity. Therefore, until such time as you can submit more information concerning this activity we will not rule on whether it falls within the intendment of section 501(c)(3) of the Code and the Regulations thereunder.

This ruling is based on evidence that your funds are dedicated to the purposes set out in section 501(c)(3). To assure your continued exemption, you should maintain records to show that funds are expended only for those purposes. In cases where the recipient organization is not exempt under section 501(c)(3), detailed records should be kept to show the name and address of each recipient; the amount distributed to each; the purpose for which the distribution was made; the manner in which the recipient was selected and the relationship, if any, between the recipient and members, officers or trustees of your organization. You should also keep adequate records regarding the shareholders, officers and employees of the recipient organization to establish that the purposes for which you were granted exemption are being accomplished. With respect to distributions to intermediary organizations i.e., small business investment corporations and community development banks, adequate records should be maintained to establish that the disbursements by such organization are fulfilling your exempt purposes.

You are not required to file a Form 1120 income tax return, but if you are subject to tax on unrelated business income under section 511 of the Code, you must file Form 990-T. You are not liable for Federal unemployment taxes. You are liable for social security taxes only if you have filed waiver of exemption certificates as provided in the Federal Insurance Contributions Act. (Your District Director, will be glad to tell you more about the latter point.)

You are required to file the annual information return, Form 990-A, on or before the 15th day of the fifth month after the close of your annual accounting period which ends on December 31.

Donors may deduct contributions to you, as provided by section 170 of the Code. Bequests, legacies, devises, transfers, or gifts to you or for your use are deductible for Federal estate and gift tax purposes under sections 2055, 2106, and 2522 of the Code.

If you change your purposes, character, or method of operation, please let your District Director know, so that he may consider the effect on your exempt status. Also, please keep him informed of any changes in your name or address.

We are informing your District Director of this ruling.

Thank you for your cooperation.

Sincerely,

LAWRENCE B. JEROME,
Chief, Exempt Organizations Branch.

The CHAIRMAN. Mr. Raymond B. Ondov, member of the Hormel Foundation.

I see you have a very interesting volume published here.

STATEMENT OF RAYMOND B. ONDOV, MEMBER, THE HORMEL FOUNDATION

Mr. ONDOV. Mr. Chairman and members of the committee, I should like to have my full statement printed for the record. May I suggest with regard to the volume which you have in front of you that it be incorporated by reference to the Library of Congress catalog card No. 6628962.

The CHAIRMAN. I hope I can find time to read it. This is a very interesting book. This is about the work of your foundation I am sure.

Mr. ONDOV. It is, and about the work of the company that the foundation controls, Mr. Chairman.

The CHAIRMAN. Yes.

Mr. ONDOV. It is a complete history of the first 75 years of the Hormel Co.

I am Raymond B. Ondov, Mr. Chairman, a member of the controlling body of the Hormel Foundation. I am also a resident of the city of Austin, Minn.

This statement is made by the Hormel Foundation in its own behalf.

The foundation is a philanthropic organization incorporated under the laws of the State of Minnesota in 1941 for religious, charitable, scientific, literary, and educational purposes. The foundation is concerned only with section 4943 of the Tax Reform Act.

This diverstiture provision would require the foundation to surrender control of the George A. Hormel & Co.

The foundation presently owns approximately 10 percent of the voting stock of the Hormel Co., but in addition it is the trustee of various Hormel family trusts, which own approximately 47 percent of the voting stock.

The income is paid to various Hormel family members for their lifetime and upon their death the foundation becomes the absolute beneficiary.

Some trusts require that approximately 10 percent of the stock is to be distributed to certain members of the Hormel family upon the death of Mrs. J. C. Hormel, who is now 73 years of age.

Upon the death of the family members, the foundation will then own absolutely 47.817 percent of the stock. The income which is paid to the family members at the present time is fully taxable, and there is no tax avoidance involved.

George A. Hormel & Co. is a member of the meat packing industry and its history is set out in the volume previously referred to entitled "In Quest of Quality."

The company's stock has been listed or traded on 2 major public stock exchanges since sometime prior to 1930. There are 2,380,248 shares of stock outstanding which are owned by over 2,800 stockholders throughout the Nation.

The Foundation has not engaged in any self-dealing. It makes no loans to the company, and there are no competitive advantages which accrue to the benefit of the Hormel Co. because of the ownership by the Foundation.

The Foundation distributes its income on a current basis, and substantially all of its income is distributed for sustaining the programs of the Hormel Institute which is a unit of the graduate school of the University of Minnesota.

The Hormel Foundation was created in the year 1941. The Hormel Institute as a graduate school of the university was created in 1942. The full controlling interests of the Hormel Co.'s stock was given irrevocably to the Hormel Foundation in 1954 upon the death of Mr. Jay C. Hormel.

The Institute, the Hormel Institute receives its financial support not only from the Hormel Foundation but from many other Federal and State agencies. The Foundation has disbursed over $600,000 in excess of the income that it has received to support its charitable endeavors.

During its lifetime it has disbursed over $4.5 million to various educational purposes and to charities. This Foundation makes no gifts

or contributions to individuals. It always makes its contributions to other tax-exempt organizations and of course specifically the University of Minnesota.

The founders of the Foundation and of the Hormel Company never served on the Foundation board. The Foundation has never engaged in any speculative trading activities. It has not and does not lend money to anyone. It has no unproductive assets except a very small tract of ground upon which the Hormel Institute is located. It has never attempted to influence legislation nor the results of a public election.

It never engages in financial transactions unrelated to its charitable purposes. It submits all its required reports to the Federal and state authorities including the State of Minnesota and its financial statements are audited.

The Foundation obviously was created primarily for charitable and educational purposes, and I have already alluded to those. The secondary purpose of the Hormel Foundation was to preserve the status, welfare and independence of the people of the city of Austin, Minnesota.

The city of Austin, Minnesota is populated by 28,000 people. It is in a county of 48,000. The area is agricultural. It is a one-industry city, which is completely dependent upon the existence of the Hormel Company in its present location.

The general executive offices of the company and its largest and oldest meat packing plant are located in Austin. The company employs over 5,000 people out of its Austin facilities. The standard of living is high and the home ownership is extremely high because of the economic stability provided by the company's location.

In order to protect this community in which the company was conceived and nurtured and developed, the Hormels vested controlling interest of the company in the Foundation. The Foundation board is composed of 7 members. The articles require that all of these 7 members must have their chief financial interests in the vicinity of Austin, Minn.

It is also required that a majority of them be residents and freeholders of Mower County, Minn., and Mower County is the county seat in which Austin is located.

The bylaws of the Foundation require it to maintain the management in the company and the control which is interested in the purposes of the Foundation and the welfare of the community.

In order to accomplish this, the Foundation is instructed to invest in Hormel Co. stock when money and shares are available.

The present act will completely destroy these purposes.

The founders have been dead for many years. The establishment of control became irrevocable in 1946 when George A. Hormel and his wife died, and in 1954 conclusively when Jay C. Hormel, their son, died.

There is no method available presently to preserve the honorable intentions of Mr. Hormel, his wife and his son. The founders of the company greatly feared a takeover by industry giants, and the resultant calamity to the Foundation and to this community. They established by honorable means a solution for the preservation of their fine ideals.

The present Act provides the avenue of destruction and opens the doors to leave the community destitute. In recent years many members of the meat industry have been taken over and acquired by alien interests. The Hormel Company possesses all of the desired factors making it vulnerable to a take-over.

When such an event occurs we believe that the company's general offices which are located in Austin would be removed from Austin, Minn., and that the plant facilities would be substantially reduced or completely eliminated.

Such a risk is too enormous to take. The impact of such probable actions simply should not have to be faced. There would be public and private chaos caused by the tragic uprooting of families from this location.

This calamity can be avoided without disturbing the purposes and effectiveness of the act. We believe the stockholding limitation could be removed in its entirety. Then enact the remaining restrictive measures which would fully accomplish the objectives of the Congress.

It must be remembered that divestiture provisions will produce no revenue. We agree the abuses should be stopped and we agree with Chairman Long that if flagrant abuses occur you should tax the eyeballs off them, but it is equally obvious that you intend then to tax the eyeballs off the guilty only and not off the innocent. Why then should you order divestiture by the innocent? Mr. Chairman, and members of the committee, do not tar us with someone else's sticky brush.

No case has been made to prove that control by a foundation is evil per se. Some argument is advanced that it will be easier to administer foundation law if control is eliminated. The House bill provides revenue for administration, the enlargement of reporting and disclosure rules, the elimination of self-dealing and current income distribution. We fail to see what is gained by divestiture.

The bill in its present form convicts and sentences us along with other meritorious foundations without any trial whatsoever much less even a fair trial, and without any evidence that we are guilty of any violation of any law either moral or legal.

We are even denied any presumption of innocence by its provisions.

Senator Dirksen told me that tax reform should be designed to establish greater equity in the tax laws. I submit to you that equitable principles have never condoned punitive measures against the innocent.

I note in the record an amendment to this tax bill which has been proposed by Senator Miller. This is amendment No. 222, which was presented on October 3, 1969. This amendment will relieve our problem created by the House-passed bill. We believe the amendment, coupled with the other provisions of the House bill, which I have referred to previously, will accomplish the intent and purpose of Congress to eliminate abuses in the tax-exempt foundation area. We support that amendment.

On the other hand, if Senator Miller's amendment fails to meet with your approval, we respectfully request a grandfather clause or exception which would permit our foundation and other meritorious foundations to retain its holdings. The Act presently contains two such exceptions on page 83 of the bill in paragraphs (A) and (B), and it thus recognizes our suggested philosophy.

We respectfully request a similar exception which can be easily drafted for the Hormel Foundation.

We support these exceptions in the House bill, because it is one of the ways by which the House does recognize the benefit of foundations to our society, and that there are foundations worthy of fair and equitable treatment.

I believe it is also an admission by the House that control is not evil per se.

We would respectfully request one further modification in paragraph 5(B) on page 84 of the bill, which would permit a family member to serve not on the foundation board but on the controlled company's board of directors.

Thank you, Mr. Chairman.

Senator ANDERSON. I have been interested in the Hormel Foundation for a long time. At one time some 40 years ago, Mr. Hormel, Sr., went on a trip around the world, and the younger Hormel was placed in charge of it. He came to us and told us that from the profits he went around the world again.

(Mr. Ondov's prepared statement follows:)

STATEMENT OF RAYMOND B. ONDOV ON BEHALF OF THE HORMEL FOUNDATION

SUMMARY

1. This statement is made by The Hormal Foundation in its own behalf. The Foundation is a philanthropic organization incorporated under the Laws of the State of Minnesota in December, 1941, for religious, charitable, scientific, literary or educational purposes.

2. The Foundation is concerned only with Section 4943 of H.R. 13270, pages 34 and following. This divestiture provision will require the Foundation to surrender control of the Geo. A. Hormel & Company.

3. The Foundation owns approximately 10 per cent of the voting stock of the Hormel Company, but in addition it is the trustee of various Hormel family trusts which own approximately 47 per cent of the voting stock. Some trusts require that approximately 10 per cent of the stock is to be distributed to certain members of the Hormal family. Upon the death of the family members, the Foundation will own absolutely 47.817 per cent of the stock.

4. Geo. A. Hormel & Company is a member of the meat packing industry. The company's stock has been listed or traded on two major stock exchanges since prior to 1930. There are 2,380,248 shares outstanding which are owned by over 2800 stockholders.

5. The Foundation has not engaged in self-dealing.

6. The Foundation distributes its income on a current basis. Substantially all of its income is distributed for sustaining The Hormel Institute which is a unit of the graduate school of the University of Minnesota. This Institute receives financial support from other federal and state agencies as well as private entities.

The Foundation has disbursed over $600,000.00 more than the income it has received in support of its charitable endeavors.

The Foundation makes no gifts or contributions to individuals.

7. The founders of the Foundation and of the Hormel Company never served on the Foundation board. James C. Hormel, grandson of Geo. A. Hormel and son of Jay C. Hormel, is the only family member to serve on the Hormel Company board of directors and the Foundation board. He resigned August 11, 1969, in order to preserve and protect the Foundation and the City of Austin, Minnesota.

8. The Foundation has never engaged in speculative trading activities.

9. In the first few years of existence the Foundation borrowed small sums on a short term basis to meet its commitments. However, it has been approximately twenty years since the last borrowing was paid. The Foundation has not and does not lend money to anyone.

10. The Foundation has no unproductive assets except a small tract upon which The Hormel Institute is located and another two acres of negligible value.

11. The Foundation has never attempted to influence legislation or a public election.

12. The Foundation never engages in financial transactions unrelated to its charitable purposes.

13. The Foundation submits all required reports to federal and state authorities and its financial statements are audited.

14. The Foundation was created primarily for charitable and educational purposes. It has performed in outstanding fashion with integrity and honor.

15. The City of Austin, Minnesota, is populated by 28,000 people, in a county of 48,000. The area is agricultural. It is a one-industry city completely dependent for its existence upon the Hormal Company. The general executive offices of the company and its largest and oldest meat packing plant are located here. The company employs over 5000 people in its Austin facilities. The standard of living is high and home ownership is extremely high because of the economic stability provided by the company.

In order to protect the community in which the company was conceived, nurtured and developed by the Hormels, the founders vested controlling stock interest in the Foundation.

The Foundation board is composed of seven members, all of whom must have their chief financial interests in the vicinity of Austin, Minnesota, and a majority of whom must be residents and freeholders of Mower County, Minnesota. (Austin is the county seat of Mower County.) The by-laws of the Foundation require it to maintain management in the company and a control which is interested in the purposes of the Foundation and the welfare of the community. In order to accomplish this, the Foundation is instructed to invest in Hormel Company stock when money and shares are available.

The present Act will completely destroy these purposes.

The founders of the company greatly feared a take over by industry giants and the resultant calamity to Foundation and the community. They established by honorable means a solution for the preservation of their fine ideals. The present act provides the avenue of destruction and opens the doors to leave a community destitute.

In recent years many members of the meat industry have been taken over and acquired by alien interests. The Hormel Company possesses all of the desired factors making it vulnerable to a take over. When such event occurs we believe the company's general offices would be removed and the plant facilities substantially reduced or completely eliminated. Who can afford to take such enormous risk? The impact of such probable actions are enormous. There would be public and private chaos caused by the tragic uprooting of families from this location.

The calamity can be avoided without disturbing the purpose and effectiveness of the Act. We believe the stockholding limitation could be removed in its entirety, enact the remaining measures and accomplish the objective.

An alternative would be to provide a "Grandfather Clause" or exception which would permit the Foundation to retain its holdings. The Act presently contains two exceptions on page 83, in paragraphs (A) and (B), and it thus recognizes the suggested philosophy. We respectfully request a similar exception for the Hormel Foundation.

We also respectfully request a modification in paragraph 5 (B), page 84, which would permit a family member to serve on the controlled company's board of directors.

It is our understanding that this Tax Reform Act is designed to establish greater equity in the tax laws; however, the divestiture provisions create a new gross inequity in our case. Equitable principles have never condoned punitive measures against the innocent.

We like not the role of prophets of doom. We prefer to be citizens of a small community with visions of hope and faith in its future.

STATEMENT

1. This statement is made by The Hormel Foundation in its own behalf. The Foundation is a philanthropic organization incorporated under the laws of the State of Minnesota in December, 1941, for religious, charitable, scientific, literary or educational purposes.

2. *Principal area of concern.*—The principal concern of the Foundation relates to Section 4943 of H.R. 13270 found at pages 34 and following thereof. This section permits a private foundation together with disqualified persons (as defined in Section 4946 on page 47 thereof) to hold a maximum of twenty per cent of the voting stock in an incorporated business. These provisions will force the Foundation to divest itself of a substantial amount of the common stock of Geo. A. Hormel & Company the effect of which will destroy the objects and purposes of the Foundation. Paragraph 6 herein sets forth the detail with regard to this area of concern.

3. *Principal source of income.*—The Foundation's principal source of income is received in the form of dividends from its principal asset, namely, 239,258 shares of the common stock of Geo. A. Hormel & Company. This stockholding represents 10.052 per cent of the total outstanding common stock of Geo. A. Hormel & Company. (Geo. A. Hormel & Company shall herein be referred to as Hormel Company.)

4. *Details of ownership, vested remainder interests and voting rights.*—In addition to said shares which are owned outright by the Foundation, it is the trustee of various trusts containing 1,119,016 shares of common stock of the Hormel Company which represents an additional 47.012 per cent of the total outstanding common stock of the Hormel Company. Details relative to these trust holdings is found in *Appendix A* attached. The Foundation as trustee votes these shares at Hormel Company stockholders' meetings. The life beneficiaries of these various trusts are family members of Jay C. Hormel as explained in Exhibit A. The life income paid these beneficiaries is fully taxable as in any private trust and no income tax avoidance occurs. Upon the death of the family members the Foundation will own absolutely and clear of any restriction 47.817 per cent of the outstanding common stock of the Hormel Company.

Geo. A. Hormel & Company has a total outstanding common stock of 2,380,248 shares. There is no other stock or debentures issued by the Hormel Company. Of this total stock 1,021,974 shares are publicly held and less than 2 per cent is held by directors, officers, and their families. Geo. A. Hormel & Company stock has been listed or traded on the Mid-West and American Stock Exchanges (or their predecessors) continuously since prior to 1930. This company was incorporated under the laws of the State of Delaware in 1928. As of a current date the company had 2880 stockholders.

5. *Relative to other provisions of H.R. 13270.*—The Foundation expresses no concern relative to other provisions of H.R. 13270 mentioned hereafter because:

5. (A) The Foundation has never engaged in any self-dealing practices. (Section 4941, page 17.) The only possible exception might be with regard to the personal home of Jay C. Hormel. The Will of Jay C. Hormel, a substantial contributor to the Hormel Foundation, deceased on August 30, 1954, gave all of his real estate in Mower County, Minnesota, to the Hormel Foundation, including his homestead, subject to the right of his wife and each of his three sons to buy or lease the premises. One of the sons exercised the right to buy a part of the land, including the homestead, paying part cash and the balance on a note secured by a first mortgage. The note and mortgage were paid in full on August 20, 1958. Under the right in the Will, the son leased another part of the land, and then re-leased it to the Hormel Foundation for its continued use by and under agreement with the University of Minnesota.

5. (B)(1) The Foundation has not failed to distribute its income and it consistently distributes its income on a very current basis. (Section 4942, page 25.) The donee or recipient of the most substantial moneys of the Foundation is the University of Minnesota. In less than one year after the incorporation of the Foundation, a formal Agreement was executed between the University of Minnesota and the Foundation for the establishment of The Hormel Institute as a unit of The Graduate School of the University of Minnesota. A copy of this Agreement is attached hereto as *Appendix B*. The purpose of The Hormel Institute is to promote education and research and this purpose has always been productively followed. The Institute has achieved such an outstanding reputation that today many federal, state and private entities contribute to its programs of education and research. Its current budget exceeds one million dollars a year. In 1967 the Foundation committed itself to provide a minimum of one million dollars to the University of Minnesota for the programs of The Hormel Institute. At the present time the unpaid portion of this committment is $800,000.00.

5. (B) (2) From the date of its incorporation until November 30, 1968, the total income of the Foundation is equal to $4,055,803.32. For this same period administrative expenses have totalled $43,465.66. During this same period the Foundation has disbursed the total of $4,633,510.77 to promote the educational and scientific projects of The Hormel Institute and in contributions to other tax exempt charitable, educational, religious and scientific organizations. Consequently, it can be seen that these Foundation disbursements have far exceeded its total income and that its administrative expenses are negligible. It should be noted here that the total remuneration to each of the controlling members of the Foundation has never exceeded the amount of $25.00 per meeting and generally has not exceeded the sum of $300.00 per year. The Foundation never makes a gift or contribution to any individual nor to any entity which is not tax exempt. For instance, the Foundation has made and is making contributions to the National Merit Scholarship Program and is committed to make contributions to this program over the next four years estimated at $70,725.00. Examples of other recipients of contributions are shown on *Appendix C* attached hereto. Additional information relative to The Hormel Institute is contained in *Appendix D* attached hereto.

5. (C) (1) At no time did Geo. A. Hormel who founded Geo. A. Hormel & Company nor any member of his family ever serve on the board of The Hormel Foundation. At no time did his son Jay C. Hormel nor any member of his family ever serve on the board of The Hormel Foundation, except his son James C. Hormel who became a member of the board on August 15, 1966 and resigned on August 11, 1969, for the reasons hereinafter set forth.

5. (C) (2) Since the death of Jay C. Hormel on August 30, 1954, no member of the families of either Geo. A. Hormel or Jay C. Hormel have served as an officer or director of Geo. A. Hormel & Company except James C. Hormel who became a member of the board of directors on February 15, 1960, and resigned on August 11, 1969, for the reasons hereinafter set forth.

5. (D) (1) The Foundation has never made investments which would jeopardize its charitable purposes nor in any way engage in speculative trading activities. (Section 4944, page 42) All cash received by the Foundation has been invested in government securities or in nominal purchases of common stock of Geo. A. Hormel & Company. The Foundation has never sold any of the Hormel Company stock. The Foundation has received shares of stock of other companies which it has retained in its portfolio.

5. (D) (2) The Foundation has never borrowed money from anyone nor has it ever loaned any money to anyone, except in the minor instances shown in *Appendix H*.

5. (D) (3) The Foundation has no unproductive assets except the small tract of real estate upon which The Hormel Institute is located and another tract of real estate of approximately two acres which has a negligible value.

5. (E) The Foundation has never expended any money for those items classified as "taxable expenditures" in Section 4945, page 43. It has never attempted to influence legislation or to influence the outcome of any public election. It has never made a grant to an individual for any purpose.

5. (F) The Foundation has never engaged in any financial transactions unrelated to its charitable purposes nor has it ever had any unrelated business income.

5. (G) The Foundation has always made all required reports to federal and state agencies. It maintains meticulous records of all of its activities and its financial statements have been audited by Ernst & Ernst.

6. *Details of Principal Area of Concern.*—

6. (A) The Hormel Foundation is managed by seven members whose names and titles are found in *Appendix E*. As previously stated, no Hormel has ever been involved in the management of the Foundation except James C. Hormel. *Appendix E* also contains the names of the board of directors of Geo. A. Hormel & Company.

6. (B) The assets of the Foundation are shown in *Appendix F*. The Foundation is a relatively small one. Substantially all of the Foundation's assets were given to it by three people, namely, Geo. A. Hormel, founder of Geo. A. Hormel & Company; his wife, Lillian B. Hormel; and their son, Jay C. Hormel. The details of the Foundation's ownership of stock and its ultimate ownership of Hormel Company stock have previously been recited.

6.(C) It is apparent that the primary purpose for establishing The Hormel Foundation was philanthropic. Geo. A. Hormel and Jay C. Hormel were very remarkable men. Both were imbued with a spirit of loyalty and dedication to reinvest in the betterment and welfare of their employees, the community of Austin, Minnesota, and our society in general.

Because of the philosophies of Geo. A. Hormel and Jay C. Hormel, the company has been a leader in establishing generous programs for the welfare of its employees including the guaranteed annual wage, production pay, profit sharing and the like.

The establishment of the Foundation and The Hormel Institute were additional evidences of the Hormels' generosity and desire to help and improve the less fortunate and our society.

6.(D). The Foundation's record proves that it has truly fulfilled the role which Congress intended when tax exemption was granted. The Foundation's management does not neglect their charitable duties. On the contrary, the Foundation's record establishes the imaginative and productive talent and energy contributed to its programs. Furthermore, there is not and cannot be any suggestion made that the corporate business is run in such a way that it unfairly competes with other businesses whose owners must pay taxes on the income they realize. It is not guilty of any of the abuses which have recently received notoriety. In spite of this good record, the divestiture provisions of the tax reform bill will cause great and severe hardship to the Foundation's objectives.

6.(E) Submitted with this statement is a recently published book entitled "In Quest of Quality" authored by Richard Dougherty. This book is an excellent history of Hormel's first 75 years. A brief scanning of the index and the book's pages will reveal more about the people of the Hormel Company, the City of Austin and the phenomenal growth of the Hormel Company than anything this statement could establish. This is the company upon which the stability of the Foundation has been and is based. This is the outstanding company upon which the Foundation relies to meet its commitments and to accomplish its charitable and educational objectives. If the Foundation is forced to divest itself of the substantial stockholdings in this company, it must then reinvest the assets which it owns and those which it holds as trustee. This involves unnecessary risk, speculation and expense. Neither the Foundation nor the trust beneficiaries should be forced to face these unknown elements.

6.(F)(1) A secondary, yet extremely important purpose of the Foundation is to hold and return the controlling stock interest in the Hormel Company for the benefit of those communities in which the company has established plants or processing facilities. This is particularly true of Austin, Minnesota. Geo. A. Hormel and Jay C. Hormel and members of their respective families had and have an intense loyalty to this community.

It is here they lived, their families were born and raised and its is here they are buried. It is here that Geo. A. Hormel & Company was conceived, born, nurtured and developed.

6.(F)(2) Austin, Minnesota, is a county seat community of 28,000 people, situated in a county of 48,000 people in the Southeastern part of the State. It is ten miles from the Iowa border and one hundred miles from Minneapolis-St. Paul. The surrounding area is agricultural. Rochester is fifty miles to the Northeast. Austin and Rochester are the two largest cities lying South of the Twin Cities. Austin is classified as a one-industry city because its entire economy is dependent on the Hormel Company. The general executive offices and the company's largest and oldest meat packing plant are located here. The company employs over 5,000 people in Austin. The standard of living is high and home ownership extremely high because of the economic stability of the company.

6.(F)(3) The Hormels felt a tremendous obligation to protect and preserve this community which they had fostered and which was solely dependent for its continued existence on the company they had created. The Hormel Foundation was an available and convenient entity for this purpose and they thus placed this honorable and awesome responsibility upon the Foundation's management. To accomplish this great purpose, the Hormels developed a plan whereby the Foundation would presently hold and ultimately own a controlling stock in the company. The method used has been previously set forth. Evidence of this objective is found in the Articles of Incorporation and By-Laws of the Foundation. Article III states:

"The membership of this corporation shall be composed of not less than five nor more than fifteen members, one-third of whom shall be competent business men,

one of whom must be an experienced attorney-at-law, all of whom shall be persons whose chief financial interests shall be within the City of Austin and vicinity, of Mower County, Minnesota, and a majority must be residents and freeholders of said county . . ."

Section VII of the By-Laws states:

"As the income of the Hormel Foundation consists almost wholly of dividends on shares of stock of Hormel Inc., a Minnesota corporation, and Geo. A. Hormel & Co., a Deleware corporation, the ability of the Hormel Foundation to carry on the purposes for which it was organized depends upon maintaining for those corporations a management and control which is sound and which is interested in the purposes of this Foundation and the welfare of this community. In order to maintain such control, investments of The Hormel Foundation on its own behalf, or as trustee, should be in shares of stock of the above Companies whenever additional shares are available, and otherwise should be in liquid investments so that the Foundation may be in a position to purchase such additional shares whenever they may become available."

Certainly there should be nothing but praise and commendation for the high principles of such a plan and purpose. There was not, nor is any evil in using the Foundation as the means to fulfill this objective. If the Hormels had any suspicion that Congress would one day attempt to nullify and destroy this means, they would have prescribed another method. Jay C. Hormel died on August 30, 1954, and this plan became irrevocable. Geo. A. Hormel and his wife died in 1946. If Congress forces divestiture upon the Foundation, there is no way to preserve the intentions of the Hormels to protect this community.

6.(F)(4) The Hormels had a great fear that a giant in industry would swallow their well-run, profitable company which would result in disaster to this community. In this day of conglomerate takeover, this is no idle fear. In recent years the meat packing industry has been the target of numerous takeovers. Wilson & Company was acquired by Ling-Temco-Vought. John Morrell & Co. was acquired by A M K. Cudahy is controlled by U. S. Smelting. Hygrade has been acquired. International Packers was acquired by Deltec International, Bryan Bros. by Consolidated Foods and Nat. Buring by Holiday Inns. Armour & Co. had substantial interests acquired by General Host and Greyhound. Swift & Co. and others have been approached for similar purposes. The Hormel Company has not been overlooked. For some years last past and periodically to date the company has been investigated by acquisition minded corporations or groups. However, because the Foundation holds voting control of the company no further action is taken. The Hormel Company would be particularly vulnerable to takeover. In the May–June 1969 issue of Harvard Business Review, page 93, appears an article entitled "Is Your Company a Takeover Target". The article contains formula indicator for self evaluation. The factors included are liquidity, debt position, price/earnings ratio and earnings stability. It says, "Emperical evidence suggests that there is cause for management concern when a company's total score approaches 50, or when any two factors score above the danger line." When we use the formula and table provided, the Hormel Company's score is 78, or well above the 50 mark, and in addition, three factors score above the danger line. (See computation in *Appendix G.*)

Furthermore, the Hormel Company is more profitable than other companies in the industry. For example, the ratio between its pre-tax earnings and its assets for 1968 is 17.55 per cent as compared with the following:

	Percent
Iowa Beef Packers	16.42
Wilson & Co	12.21
Armour	8.37
Swift	3.64
Cudahy	11.82

The Hormel Company's balance sheet indicates that it could develop additional debt leverage.

A small percentage of stock is owned by officers and directors and their families.

The liquidity of the company is well known. Fortune magazine listed it as one of a group of cash-rich companies. At year-end 1968 the company had $25 million in cash and government securities out of total assets of $108 million. A takeover of the Hormel Company by alien interests is inevitable. With new management

also comes changes in scope and purpose together with the tragic loss of long-standing identity and fulfillment of long and well established purposes and ideals.

6.(F)(5) The Foundation has great fear of such a disaster, its implications and consequences. This fear is not for itself, but rather to this fine community and area. A takeover would undoubtedly result in the removal of the company's general offices from Austin, Minnesota, together with either a substantial reduction of operations in the Austin plant or a complete elimination of this plant location. The impact of such potential actions are enormous. The entire economy of this community and much of this area of Minnesota is dependent on the operations of the company here. There would be public and private chaos caused by the tragic uprooting of families from this location. Small communities across the nation search diligently for methods of gaining new jobs to stabilize their economic structure. Austin has an outstanding history of stability. However, the proposed unnecessary action of the Tax Reform Bill will frustrate and destroy the secure sanctity of thousands of homes and the obliteration of purposeful ideals.

6.(F)(6) The Foundation believes that this calamity can be avoided without jeopardizing either the substance or effect of the Tax Reform provisions. It appears that the committee could eliminate the stockholding limitation entirely, enact the other measures which are in the bill and accomplish the desired objective.

On the other hand, by the simple expedient of a "Grandfather Clause" the chaotic results can be avoided. H.R. 13270, page 83, contains such a clause in paragraphs (A) and (B). Therefore, we see that the House of Representatives has approved and recognized the merit and philosophy of such a clause in two specific situations. However, neither of these exceptions will protect our Foundation or community. The Foundation respectfully requests a third exception be added which would not require The Hormel Foundation to divest itself of Geo. A. Hormel & Company stock.

6.(F)(7) In the Tax Reform Bill, under the title *Subchapter F–Exempt Organizations*, page 84, paragraph 5(B) is a provision prohibiting a family member from serving on a Foundation board or the board of directors of a controlled corporation. James C. Hormel, grandson of Geo. A. Hormel and son of Jay C. Hormel has been serving on the Foundation board and the board of directors of the Hormel Company. Upon becoming advised of said restriction, Mr. Hormel submitted his resignation from both boards on August 11, 1969, effective immediately. Mr. Hormel had gained the respect of the members of both boards for his integrity and able contributions. With profound regret his resignations were accepted. He resigned his positions in the same spirit and with the same loyalty which motivated his grandfather and father to establish the Foundation, namely, that the charitable purposes of the Foundation pre-empt personal prestige and desires, and that nothing should jeopardize the welfare or economy of our small community which Hormels are responsible for creating, developing and sustaining. We respectfully request a change in this section which would permit a family member to serve on the controlled corporation's board.

7. *Judgment should be based on performance.*—

7.(A) We submit that the record of the Foundation is free of all of the evils which are sought to be eliminated by the Tax Reform Bill, and this fine record will continue without any danger of such evils even though the Foundation continues to hold controlling interest in the Hormel Company.

Furthermore, the fact that some members of the Board of Directors of the Hormel Company also serve on the Foundation board has not in any way had an adverse effect on the income available to the Foundation from dividends. The dividend record establishes this. Another safeguard is the fact that there are over 2800 other stockholders of the Hormel Company, all of whom are the normal investors seeking adequate returns on their investments.

7. (B) There are no tax avoidance schemes involved nor is there any loss of public tax revenues by reason of the Foundation's control.

7. (C) The impressive and productive use of the Foundation's income proves that its primary purposes have not been restricted or limited by reason of the control of a commercial enterprise.

Finally, there is no competitive advantage possessed or used by the Foundation or the Hormel Company over other industries or businesses.

8. *Conclusion.*—The matters submitted herein established that the divestiture provision of the Tax Reform Bill should not be enacted into law; on the other hand if the provision is retained, then appropriate exceptions should be enacted

which would not require The Hormel Foundation to divest itself of its controlling stock interest in the Hormel Company and also permit a Hormel Family member to serve on the Hormel Company board of directors.

It is our understanding that the Tax Reform Act of 1969 is designed to establish greater equity in the tax laws. Equitable principles have never condoned punitive measures against the innocent. The gross inequity heaped upon The Hormel Foundation can be remedied without disturbing this Act's effectiveness and purpose. We respectfully request relief from the extreme hardships imposed by the Act in order to preserve our community and the home of Hormel.

APPENDIX A

THE HORMEL FOUNDATION

(A) The Foundation, as trustee of a charitable trust created under the Last Will and Testament of Geo. A. Hormel who died on June 5, 1946, holds 23,646 shares or .993 per cent of the total outstanding common stock. All moneys received are used for charitable and educational purposes.

(B) The Foundation, as trustee of Jay C. Hormel Trust No. 1 (which is an inter vivos trust created by Jay C. Hormel on July 16, 1934), and as trustee of Jay C. Hormel Trusts Nos. 101, 102, 103, 201, 202, 203, 301, 302 and 303 (which are inter vivos trusts created by Jay C. Hormel on December 26, 1950) holds 810,138 shares or 34.036 per cent of the total outstanding common stock. Jay C. Hormel died on August 30, 1954. The income from these trusts is payable to the wife and descendants of Jay C. Hormel for life and such income is fully taxable when received by the beneficiaries as in the case of any other private trusts. There is absolutely no tax avoidance. Upon the death of said wife and descendants all of said stock becomes the absolute property of The Hormel Foundation.

(C) The Foundation, as trustee of Geo. A. Hormel Trusts Nos. 3, 4, 5, and 6 (which are inter vivos trusts created by Geo. A. Hormel on October 20, 1934) holds 18,480 shares, and as trustee of a trust created under the Last Will and Testament of Jay C. Hormel, holds 22,846 shares, or a total of 41,326 shares or 1.736 per cent of the total outstanding common stock. The income from these Geo. A. Hormel trusts is payable to the wife and sons of Jay C. Hormel for life; the income from this Jay C. Hormel trust is payable to a sister-in-law of Jay C. Hormel for her life; the income is fully taxable when received by the beneficiaries as in the case of any other private trusts. There is absolutely no tax avoidance. Upon the death of said beneficiaries, all of said stock becomes the absolute property of the Hormel Foundation.

(D) Upon the deaths of the above-mentioned life income beneficiaries the Foundation will own absolutely 1,090,722 shares or 45.924 per cent of the total outstanding stock of the Hormel Company, plus it will hold as trustee of the charitable trust referred to in paragraph (A) above 23,646 shares or .993 per cent of the total outstanding stock for a combined total of 1,114,368 shares or 46.817 per cent of the total outstanding stock.

(E) The Foundation as trustee of Geo. A. Hormel Trusts Nos. 13 and 14, which are inter vivos trusts created on December 23, 1943, and Lillian B. Hormel Trusts Nos. 1 and 2 which are inter vivos trusts created on February 19, 1946, and the trust created under the Last Will and Testament of Lillian B. Hormel dated February 19, 1946, holds 243,906 shares or 10.247 per cent of the total outstanding common stock of the Hormel Company. The life beneficiary of these trusts is Germaine D. Hormel, widow of Jay C. Hormel. Upon her death the total stock will be distributed to the descendants of Jay C. Hormel. These trusts are fully taxable. The Foundation will receive no ownership in these shares.

APPENDIX B

MEMORANDUM OF AGREEMENT BETWEEN THE HORMEL FOUNDATION AND UNIVERSITY OF MINNESOTA ESTABLISHING THE HORMEL INSTITUTE, AUSTIN, MINN., AS A UNIT OF THE GRADUATE SCHOOL, UNIVERSITY OF MINNESOTA

Memorandum of Agreement between The Hormel Foundation, a corporation organized under the laws of the State of Minnesota, for religious, charitable, scientific, literary, and educational purposes, with its principal office in Mower

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County, Minnesota, hereinafter called the Foundation, and Regents of the University of Minnesota, a *constitutional* educational corporation of the State of Minnesota having its principal office of business at Minneapolis, Hennepin County, Minnesota, hereinafter called the University.

Whereas, the Foundation now possesses certain income-producing securities and expects from time to time to receive additional income-bearing securities and real and personal property, particularly the home property of Jay C. Hormel, including his residence and adjacent buildings and certain land now devoted to forestry and agricultural purposes, the income from which securities and the use of part of which real property is now, and when acquired will become wholly available for educational research, and charitable purposes, and

Whereas, the Foundation, in pursuing the purposes for which it was organized, desires that under the auspices of the University, it shall devote a portion of such income and real property to the promotion of education and research in plant, animal and poultry production and utilization, including the relation of animal products to disease and the treatment of disease, animal and poultry diseases, food technology, nutrition, tree culture, and wood technology, and principles and techniques of management in relation thereto, and such other subjects as may be mutually agreed upon, and

Whereas the University organized for education and research is likewise interested in the promotion of research and education in the above mentioned fields,

Now, therefore, this agreement made this *30th* day of *November*, 1942,

Witnesseth:

1. The University agrees to establish the Hormel Institute of the University of Minnesota as a unit of the Graduate School of the University (hereinafter called the Institute).

2. The University agrees to utilize said Institute to promote education and research in plant and animal production and utilization, including the relation of animal products to disease and the treatment of disease, animal and poultry diseases, food technology, nutrition, tree culture, and wood technology, and principles and techniques of management in relation thereto, and such other subjects as may be mutually agreed upon.

3. The University agrees that the Institute shall be under the general supervision of a board of five members recommended by the President of the University and approved by the Regents, to be nominated as follows: one from the Hormel Foundation upon nomination by that Foundation; one from the Mayo Foundation upon nomination by the Director of that Foundation; and three from the University upon nomination by the Dean of the Graduate School, at least one of which shall be from the Department of Agriculture; and that the Institute shall be under the immediate supervision of an executive director to be recommended by the Institute Board and approved by the President of the University and the Regents.

4. Amended as follows:

The Foundation agrees to make available to the Institute for the duration of this contract the woodland and other grounds, buildings and facilities on the property of Jay C. Hormel now or hereafter designated for the purposes of this Agreement, together with rights of ingress and egress.

The Foundation agrees to improve the Austin laboratory facilities so far as available funds therefor may permit through the acquisition and ownership of heavy expensive or fixed equipment and to provide on a reimbursable basis certain supplies for research projects carried on in the Austin laboratories.

The University agrees at the close of each Institute project conducted in the Austin laboratories to give the Foundation the first opportunity to purchase on an appraisal basis equipment and supplies purchased from Institute funds, and further agrees to return equipment or surplus supplies not purchased by the Foundation to the University campus.

In witness whereof the Foundation and the University have caused this Amendment to Agreement to be signed and sealed this 27th day of May, 1944.

5. The Foundation agrees to advise the University on or before April 1 of each year of the amount of funds which shall be available for the purposes of the Institute for the ensuing fiscal year from July 1 to June 30 and to turn over such funds to the University on or before July 1 or at such other times as may mutually be agreed upon.

6. It is mutually agreed and understood that the Regents may accept gifts,

grants, and donations from other sources in support of the purposes of the Institute.

7. It is mutually agreed and understood that the University reserves the right to publish the results of investigations of the Institute, such publication, however, shall give proper credit to the Foundation for the cooperative character of the investigations.

8. It is mutually agreed and understood that the main research and educational activities of the Institute shall be in Mower County, Minnesota, but that research and education may be carried on in Olmstead County, Minnesota and on the campuses of the University of Minnesota and elsewhere in the State of Minnesota if it shall appear desirable in the judgment of the Hormel Institute Board to do so.

9. It is mutually agreed and understood that, unless otherwise agreed to at the time the funds are made available, any patents, discoveries and inventions resulting from research financed by funds either from the Foundation or from other sources shall be the property of the University and held by it as trustee to promote education and research. The University is obligated to grant non-exclusive licenses *to utilize such patents, discoveries and inventions* upon equal terms to qualified American manufacturers unless *it is the judgment of the University that the public interest in the development and use of the patent is better served by some other form of license.* It is empowered to grant free licenses to the United States or any municipal subdivisions thereof. For the duration of this agreement, any income from such licenses shall be used to expand and extend the usefulness of the Institute.

10. It is mutually agreed and understood that the foundation at its option may with the consent of the University, transfer to the University any or all of its assets, real or personal, which are needed, used, or constitute a source of funds for the support of the Institute.

11. It is mutually agreed and understood that either party to this agreement may terminate this agreement on any July 1 provided the party desiring termination notifies the other party by registered mail on or before January 1 of that year.

In witness whereof the Foundation and the University have caused this agreement to be signed and sealed this 30th day of November, 1942.

The Hormel Foundation:

By S. D. CATHERWOOD,
Chairman.
By M. F. DUGAN,
Secretary-Treasurer.
C. D. BIGELOW.
HELEN MORRIS.

Regents of the University of Minnesota:

By W. C. COFFEY,
President.
By W. T. MIDDLEBROOK,
Secretary.
MARIE MOUSSEAU.
N. GERTRUDE KOLL.

THE HORMEL INSTITUTE: UNIT OF THE GRADUATE SCHOOL, UNIVERSITY OF MINNESOTA

Chairman, Bryce L. Crawford, Jr., Dean, the Graduate School, University of Minnesota, Minneapolis, Minnesota.

Member, Sherwood O. Berg, Dean, Institute of Agriculture, University of Minnesota, St. Paul, Minnesota.

Member, Dr. David E. Donald, Assoc. Professor, Physiology, Mayo Graduate School of Medicine, Rochester, Minnesota.

Member, Dr. LaVell Henderson, Head, Dept. of Biochemistry, College of Biological Sciences, University of Minnesota, St. Paul, Minnesota.

Member, Raymond B. Ondov, Attorney at Law, Member of the Hormel Foundation, Austin, Minnesota.

Executive Director, Dr. W. O. Lundberg, Professor of Biochemisty, the Hormel Institute, Austin, Minnesota.

Appendix C

Examples of Recipients of Contributions

The University of Minnesota.
National Merit Scholarship Fund.
Girl Scouts of America.
Boy Scouts of America.
Young Men's Christian Association.
Salvation Army (Building Fund).
Minnesota Sheriffs' Boy's Ranch.
Minnesota Private College Fund.
Iowa College Foundation.
Dakota Wesleyan University.
Midland Lutheran College.
United Negro College Fund.
National Scholarship Service and Fund for Negro College Students
Principles of Freedom.
Mayo Foundation.
Howard University.
City of Austin Library.
Village of Brownsdale-Community Building.
Minnesota Society For Crippled Children and Adults, Inc.
Boys Club of Minneapolis.
Minnesota Historical Society.

Appendix D

The Hormel Institute, University of Minnesota, Austin, Minn.

The purpose of The Hormel Institute is to promote research and education in various fields of biological science. It was established, in 1942, as a unit of the Graduate School of the University of Minnesota, by an agreement made between The Hormel Foundation[1] and the Board of Regents of the University.

The activities of The Hormel Institute are supervised by a Board of Directors.[2] The executive director, Dr. Walter O. Lundberg, professor of biochemistry, is responsible to this Board in administering the Institute's research activities and internal business operations. The assistant director is Dr. H. Schlenk, professor of biochemistry.

Presently, the Institute staff numbers 92; 23 members hold academic rank and the remainder hold civil service rank in the University. The Institute's research programs are conducted in several organizationally-independent sections. Each section is under the leadership of an academic staff member. Current research efforts are concerned almost entirely with lipids, and many research projects are carried on by two or more sections in collaboration.

The Institute shares only to a minor extent in the funds designated by the State of Minnesota for use by the University and, therefore, must obtain almost all of its support from outside sources. Its annual budget is somewhat in excess of $1,000,000. In addition to the support provided by The Hormel Foundation other agencies that recently have supported or are currently supporting research programs of The Hormel Institute are:

Abbott Laboratories.
American Heart Association.
Life Insurance Medical Research Fund.
Minnesota Heart Association.
National Council to Combat Blindness, Inc.
National Dairy Council.
Oscar Mayer Foundation.

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[1] Present members of The Hormel Foundation Board are: R. F. Gray, Chairman; J. G. Huntting, Vice-Chairman; Geo. W. Ryan, Secretary-Treasurer; M. B. Thompson; Raymond B. Ondov, and Robert F. Lichty.

[2] Present members of The Hormel Institute Board are: Bryce L. Crawford, Jr., Dean of the Graduate School, U. of M., Chairman; Sherwood O. Berg, Dean of the Institute of Agriculture, U. of M.; J. G. Huntting, Board of Members, The Hormel Foundation; LaVell Henderson, Department of Biochemistry, St. Paul, U. of M.; David E. Donald, The Mayo Graduate School of Medicine, Rochester.

Special Dairy Industry Board.
U.S. Army Quartermaster Food & Container Institute.
U.S. Department of Agriculture, Eastern Regional Division.
U.S. Department of Interior, Fish & Wildlife Service.
U.S. Public Health Service, National Institutes of Health: Division of Environmental Health Sciences, National Cancer Institute, National Heart Institute, National Institute of Allergy and Infectious Disease, National Institute of Arthritis and Metabolic Diseases.

The Institute does not have a formal graduate program leading to advanced degrees. However, graduate students of the University of Minnesota, as well as from foreign universities, have done and are doing their thesis work at the Institute. Such arrangements are facilitated by the fact that Institute section leaders hold appointments with departments of the University, including the Department of Biochemistry, College of Biological Sciences, St. Paul; the Department of Biochemistry and Department of Microbiology, College of Medical Sciences, and the Department of Animal Science, Institute of Agriculture. Teaching responsibilities of staff members of the Institute within the University's regular curricula are limited. The principal educational function of the Institute involves post doctoral research fellows and visiting scientists. The former gain experience in planning and in working on research projects under the guidance of the Institute's section leaders. Visiting scientists, from the United States and, more often, from foreign countries, come to the Hormel Institute for periods varying from several days to several years. Their purpose in working in these laboratories is to acquaint themselves with specific techniques employed here, and to acquire training for work which they will later perform in their own laboratories.

As a result of these training programs, collaboration frequently develops between the Institute and other departments of the University of Minnesota, as well as with research groups in other sections of the United States and in foreign countries. The Institute gains from this broad exchange of research ideas and experience. Regular seminars with guest speakers are held at the Institute and serve the same purpose.

SUMMARY OF RESEARCH INTERESTS

Dr. W. O. Lundberg: Institute director. Participates in several programs, with particular interest at present in interconversion of polyunsaturated fatty acids, blood coagulation, atherosclerosis, and other chemical and biochemical aspects of lipid science.

Dr. H. Schlenk: Analysis, preparation and chemical reactions of unsaturated fatty acids; preparation of polyenoic radioactive fatty acids. Gas-liquid and other type chromatography; methods for structure identification. Fish, plants, microorganisms and rats are sources and substrates in studies of: odd-numbered polyenoic fatty acids and their metabolism; phenolic fatty acids (anacardic acids) and their effect on microorganisms; wax esters, their biosynthesis and metabolism.

Cycloamyloses (Schardinger cyclodextrins): their chemical reactions, association and complex formation with other molecules, including enzymes.

Dr. R. T. Holman: Physical properties and physical methods of analysis of lipids. Separation methods for fatty acids by various types of chromatography, applied also to glycerides and other lipid components.

Development of near-infrared spectrophotometry; study of other optical methods, including ultraviolet absorption and optical activity. Mass spectrometry of lipids, especially derivatives of fatty acids and glycerides. Gas chromatography-mass spectrometry combination analysis; pyrolysis as a means of determining structure.

Programs on metabolism of polyunsaturated fatty acids and requirements for essential fatty acids, carried out mainly with rats, but oriented also to medical aspects of humans.

Studies of enzymatic conversions of polyunsaturated acids, specificity of enzymes for polyunsaturated acid structures, chain elongation and dehydrogenation of fatty acids.

Dr. J. R. Chipault: Deterioration of lipids, autoxidative deterioration in foods and in living tissues; autoxidation of complex lipids (phospholipids, lipoproteins); secondary reactions of oxidized lipids with other tissue components, particularly proteins, amino acids and other compounds with amino groups.

Effects of radiations on lipids; influence of lipids on the action of radiations on important components of tissues (enzymes, vitamins).

Nature of fecal lipids and their origin; intestinal lipids of normal and germ-free animals.

Infrared spectroscopy of lipids.

Dr. O. S. Privett: Methods for analysis of lipid classes and molecular species within the classes, particularly triglycerides and phospholipids. Preparation and isolation of polyunsaturated fatty acids, with emphasis on improvement of techniques for distillation, crystallization and chromatography. Ozonization of lipids and study of fatty acid ozonides as organic intermediates.

Metabolism of *trans* acids and their influence on tissue lipid composition. Studies on metabolism of plant lipids, particularly the changes of lipids with maturation of seeds.

Dr. H. K. Mangold: Chemical synthesis of unusual lipids; physical and chemical characterization of lipids isolated from plant, animal and human tissues. Relation between structure and function of individual lipid compounds; molecular pathology.

Dr. E. G. Hill: Nutrition studies, using miniature pigs and chicks. Lipid metabolism in connection with atherosclerosis. Experimental production of atherosclerosis in miniature pigs; metabolism of bile salts and cholesterol in pigs and chicks. Effects of methionine on lipid metabolism. Polyunsaturated fatty acids in blood and tissue lipids. Provides Germ-Free and Specific Pathogen-Free baby pigs for research work for the Institute staff and other Departments of the University.

Dr. H. M. Jenkin: Studies on biochemical, biological and immunological properties of various purified microorganisms including psittacosis-trachoma agents, leptospira, arboviruses and rickettsiae, cultivated in embryonated eggs or tissue cultures. Comparative studies of lipid components present in normal and infected host cells and in different strains of the same group of microorganisms, for further investigation of lipid metabolism and its relation to infectious diseases.

Development of cell culture systems in defined medium for radioisotopic metabolism studies of normal and infected cells. Essentiality of a variety of fatty acids and their positional isomers on growth of microorganisms and their hosts. Applications of thin-layer, column and gas chromatography, light and electron microscopy, radioisotopic tracers and serology are utilized in these studies.

Dr. H. H. O. Schmid: Development and use of methods for the isolation and analysis of lipids; thermoanalytical technique. Detection, isolation and structure determination of minor lipid constituents, especially in relation to plasmalogen metabolism. Biosynthesis and metabolism of complex lipids in heart muscle.

Dr. W. J. Baumann: Chemical synthesis of lipids; chemistry and biochemistry of alkoxylipids and naturally-occurring diol lipids; chemistry of glycolipids; structure of unusual lipid constituents. Novel separation techniques and spectroscopic methods of lipid characterization and analysis. Biophysics of complex lipids.

Dr. E. M. Stearns: Studies on the biosynthesis in interconversions of fatty acids and complex lipids in higher plants, principally by use of isotopically-labeled precursors and intermediates. Isolation and purification of enzyme systems for lipid transformation from germinating and maturing seeds of higher plants.

OTHER ACTIVITIES AT THE INSTITUTE

Development of a miniature pig for research purposes: Dr. W. E. Rempel (with the collaboration of Dr. Almut Dettmers), Department of Animal Science, University of Minnesota; Development of a miniature pig for use as an experimental animal for medical and nutritional research. Study of effectiveness of selection for small size in two separate lines of pigs under identical conditions. Estimation of genetic parameters, such as: Heritability of body weight, genetic correlations among weights at different ages and litter size, efficiency of feed consumption and its correlation with growth rate, prediction of progress and limits of selection. Conduct crosses of pigs from the above two lines to study heterosis. Obtain fundamental information on genetics in swine, particularly mode of inheritance of body size.

Hormel Institute Lipids Preparation Laboratory

Dr. O. S. Brivett and J. D. Nadenicek: Highly purified fatty acids and their derivatives are prepared which are not generally available from commercial producers. Presently, more than 150 compounds are on the distribution list of

"The Hormel Institute Lipids Preparation Laboratory" and requests for these materials are received from all parts of the world. Mixtures of pure compounds are prepared for use as analytical standards as well as general research purposes. Research is being carried out toward further expansion of this project, particularly in the preparation of lipid classes and polyunsaturated fatty acids in ultra-high purity for quantitative gas-liquid and thin-layer chromatography. The project is a non-profit public service to research institutions.

Production of educational movies for laboratories involved in lipid research. Two films on microanalylitical techniques for lipids have been distributed widely; a third film is in preparation on techniques for the determination of the structure of unsaturated fatty acids via ozonolysis methods.

HISTORICAL DEVELOPMENT OF THE INSTITUTE

1942—Hormel Institute established (November 30).

1943—Work began on Minneapolis Campus.

1944—Hormel Institute laboratory opened in Austin; 6 employees in first year (share a building with horses and cows).

1949—Dedication of laboratory building; about 25 employees (last large animal displaced from laboratory building). Completion of the new swine barn.

1953—Additional laboratory opened (chickens displaced).

1960—Dedication of another laboratory building, at a different site; 52 employees.

1964—Support received from National Insitutes of Health in form or a Program-Project Grant.

1965—Construction of mass spectrometry laboratory.

1968—Expansion and renovation of the microbiology section. Staff of the Institute consists of 12 permanent academic appointees, 67 civil service people, 11 research fellows and 2 graduate students, 12 part-time employees (mostly students). Some 13 countries are represented on the staff personnel at The Hormel Institute.

APPENDIX E

MEMBERS OF THE HORMEL FOUNDATION, NOVEMBER 30, 1968

Robert F. Gray, Chairman of the Board, Geo. A. Hormel & Co., Austin, Minnesota.

J. G. Huntting, President, Huntting Elevator Co., Austin, Minnesota.

Geo. W. Ryan, Vice President, Geo. A. Hormel & Co., Austin, Minnesota.

James C. Hormel,[1] Attorney at Law, Director, Geo. A. Hormel & Co., New York, New York.

Richard D. Arney,[1] Executive Vice President, Geo. A. Hormel & Co., Austin, Minnesota.

M. B. Thompson, President, Geo. A. Hormel & Co., Austin, Minnesota.

Raymond B. Ondov, Attorney at Law, Austin, Minnesota.

Robert F. Lichty,[2] President, First National Bank, Austin, Minnesota.

GEO. A. HORMEL & CO., BOARD OF DIRECTORS, NOVEMBER 30, 1968

Richard D. Arney,[1] Executive Vice President, Geo. A. Hormel & Co., Austin, Minnesota.

Harold Butler, Vice President, Geo. A. Hormel & Co., Austin, Minnesota.

Bruce Corey, Vice President, Geo. A. Hormel & Co., Austin, Minnesota.

Robert F. Gray, Chairman of the Board, Geo. A. Hormel & Co., Austin, Minnesota.

I. J. Holton, Executive Vice President and Secretary, Geo. A. Hormel & Co., Austin, Minnesota.

James C. Hormel,[1] Attorney at Law, New York, New York.

O. L. Marquesen, Plant Manager, Geo. A. Hormel & Co., Fort Dodge, Iowa.

Gordon Murray, Chairman of the Board, First National Bank, Minneapolis, Minnesota.

George W. Ryan, Vice President, Geo. A. Hormel & Co., Austin, Minnesota.

M. B. Thompson, President, Geo. A. Hormel & Co., Austin, Minnesota.

Sherwood O. Berg,[3] Dean, Institute of Agriculture, University of Minnesota, Minneapolis, Minnesota.

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[1] Resigned subsequent to November 30, 1968.

[2] Became a member of The Hormel Foundation on May 20, 1969.

[3] Became a member of the Board of Directors on June 23, 1969.

APPENDIX F

THE HORMEL FOUNDATION

Assets as of November 30, 1968

Cash	$35, 793. 79
Certificates of Deposit	21, 775. 00
U.S. Government Securities	321, 194. 38
Geo. A. Hormel & Co. common stock	11, 424, 569. 50
Other stock holdings	971, 280. 00
Inventory and miscellaneous	6, 115. 14
Land, buildings, improvements and equipment used by the University of Minnesota-depreciated value	101, 464. 67
Total value	12, 882, 202. 48

APPENDIX G

GEO. A. HORMEL & CO., VULNERABILITY TO TAKEOVER

HARVARD BUSINESS REVIEW, MAY–JUNE 1969

The entitled article appeared in the Harvard Business Review to provide an objective measurement to vulnerability to take-over. Page 94 states that "Empirical evidence suggests that there is cause for management concern when a company's total score approaches 50, or when any two factors score above the danger line." Hormel's score, using the table on Page 95, is 78, well in excess of 50, and three factors score above the danger line.

Our computations are as follows:

LIQUIDITY—PERCENTAGE OF WORKING CAPITAL TO TOTAL ASSETS

	Amount	Percent
Working capital	$40, 497, 197	37.0
Total assets	108, 484, 480	

DEBT POSITION—LONG-TERM DEBT AS A PERCENTAGE OF NET WORTH

Long-term debt	$3, 006, 000	4.0
Net worth	70, 220, 170	

PRICE/EARNINGS RATIO—ANNUAL EARNINGS PER SHARE DIVIDED TO PER-SHARE MARKET PRICE

Price	$36.00	9.4
1968 earnings per share	3.84	

EARNINGS STABILITY, PERCENTAGE GROWTH IN EARNINGS, PAST 3 YEARS[1]

	1965	1966	1967	1968
Earnings (in thousands)	$4,351	$3,511	$8,658	$9,134

Summary	Ratio	Score	Danger zone
Liquidity	37 percent	18	Yes.
Debt	4 percent	25	Yes.
Price/earnings ratio	9.4 to 1	35	Yes.
Earnings	Double	0	No.
Total points		78	Yes.

[1] Since our earnings have more than doubled, we would have a score of zero on the table on p. 95.

Appendix H

The Hormel Foundation

In the early years of the Foundation it was making substantial expenditures which exceeded its income. In order to meet its commitments for charity and education, it borrowed nominal amounts of money for short periods of time, all of which were repaid within a few months of the borrowing.

The following loans were made from Geo. A. Hormel & Company:

Date of borrowing	Amount	Paid
July 21, 1944	$500	Aug. 15, 1944
July 31, 1944	1,500	Do.
Oct. 30, 1944	1,000	Nov. 16, 1944
Jan. 4, 1945	1,000	Feb. 15, 1945
Jan. 27, 1945	500	Do.
Jan. 31, 1945	1,500	Do.
Mar. 26, 1945	1,000	May 16, 1945
Apr. 2, 1945	2,500	Do.
Apr. 20, 1945	1,000	Do.
June 29, 1945	1,500	Aug. 18, 1945
July 14, 1945	2,000	Do.
The following borrowings were made from Hormel, Inc.:		
Apr. 1, 1949	10,000	Aug. 15, 1949
Jan. 6, 1944	600	Feb. 15, 1944

Note: The foundation has never borrowed any money except as shown above.

Appendix I

The Hormel Foundation

This appendix contains general information relative to Geo. A. Hormel & Company dividend rates, stock dividends and stock splits, etc.

Dividend Rates

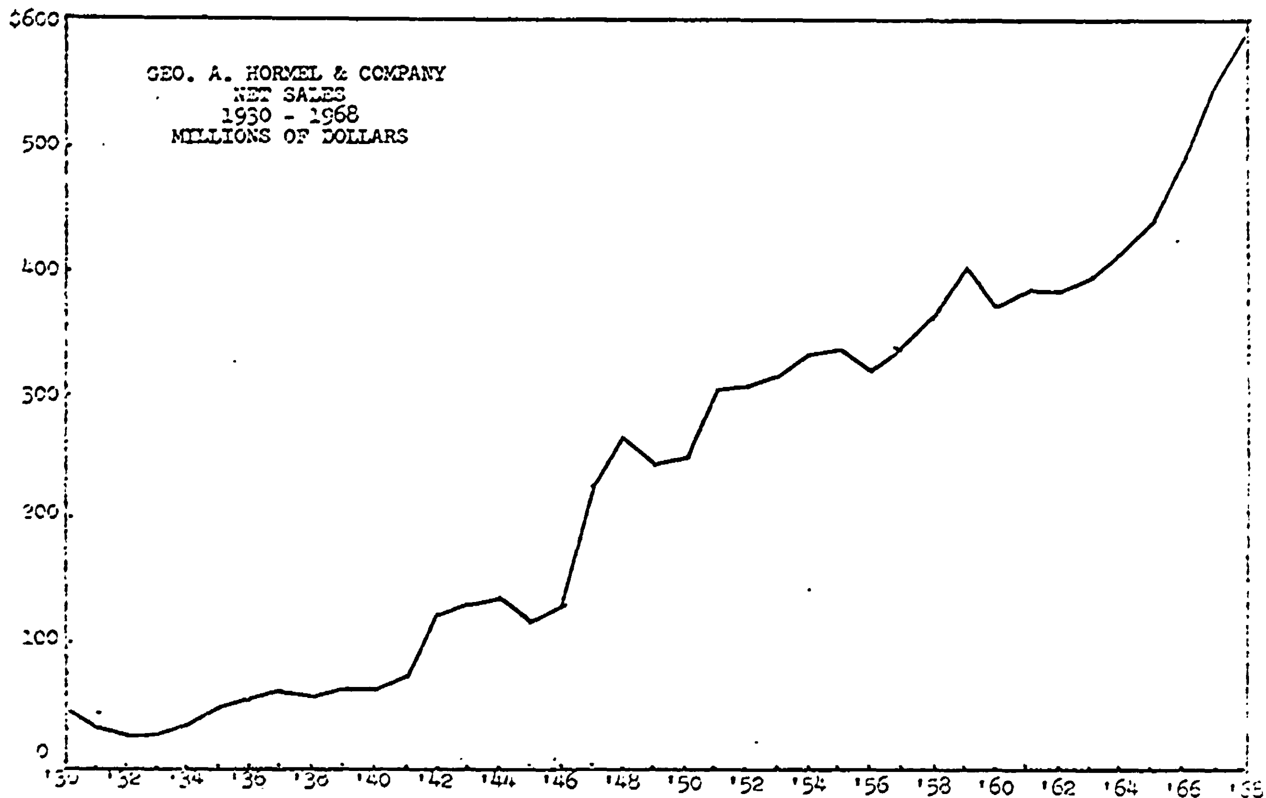
February 1928, 37½¢.
November 1929, 50¢.
February 1932, 25¢.
February 1938, 37½¢.
February 1940, 50¢.
November 1947, 62½¢.
February 1960, 35¢.
December 1964, extra, 20¢.
May 1967, 40¢.
May 1967, extra, 50¢.
February 1968, 45¢.
May 1968, 22½¢.
November 1968, 30¢.

Stock Dividends and Stock Splits

January 27, 1949, stock reclassified and 10% added.
January 25, 1957, stock dividend—10%.
January 29, 1960, stock split—2 for 1.
February 23, 1968, stock split—2 for 1.

The value of the 239,258 shares of the stock of Geo. A. Hormel & Company at the time of its receipt by the Foundation was $1,700,279.99. The value of the same stock as of November 30, 1968, had increased to $11,424,569.50, representing a total percentage increase of approximately 600%.

The Hormel Foundation
Appendix J



Appendix J.

Senator BENNETT. I have no questions except to ask when do these people leave to go around the world?

Senator ANDERSON. Thank you very much.

Mr. Hackler is our next witness.

We shall be glad to hear from you now, sir.

STATEMENT OF EUGENE T. HACKLER, VICE PRESIDENT, AMERICAN ASSOCIATION OF HOMES FOR THE AGING, AND TREASURER, EVANGELICAL LUTHERAN GOOD SAMARITAN SOCIETY; ACCOMPANIED BY THOMAS M. JENKINS, IMMEDIATE PAST PRESIDENT OF THE AMERICAN ASSOCIATION OF HOMES FOR THE AGING; AND JOHN RALSTON, TAX COUNSEL

Mr. HACKLER. I have with me the past president of the association, Tom Jenkins, and John Ralston, tax counsel from my office.

Mr. Chairman and members of the committee, I am Eugene Hackler. I live in Kansas. I am representing today, however, the American Association of Homes for the Aging, the national nonprofit Association of Voluntary Denominational and Governmental Homes for the Aging and Nursing Homes with their executive offices in New York.

We represent in that association about a half million residents. The other organization I am appearing for as treasurer is the Lutheran Good Samaritan Society of Sioux Falls, S. Dak., a corporation of Lutherans operating 10,000 beds in 18 States made up of about 130 nursing homes for the aging, three hospitals and a home for delinquent boys.

The society is an old institution having been organized in 1922. Now what I will speak about deals primarily with the small community exempt-type organization.

These associations believe that the tax reform that closes loopholes and removes tax shelters needs reforming, but a distinction needs to be made between tax reform, closing loopholes and operating charitable giving. We do not oppose in the area of private foundations and charitable organizations the provisions regarding the taxation of debt finance businesses or as they are commonly called the Claybourne provisions of the regulations.

We are not opposed to unrelated operating business income tax nor tax on income for advertisement in trade journals.

Genuine charitable giving, however, should not be lumped together with foundation abuses. Charitable exemption is made for the unselfish benefit of others, and should be we believe more clearly defined.

We would suggest these improvements in the Tax Reform Act of 1969. Nonprofit nursing homes and homes for the aging should be specifically exempted as hospitals are in the House bill. We think these institutions should be put in this same category as hospitals. That would be a specific exemption under the provisions of 170(b) (1) (b), as hospitals appear to be in the House bill.

These subacute institutions, namely nursing homes and homes for the aging appear to us to be one of the major resources for the relief of the high medical costs we now find in hospitals. Nursing homes where medical care is needed can provide very similar services to the

aging people of this country at from one-half to two-thirds less dollars than hospitals.

If we are to reconstruct the health delivery system in this country, we should encourage these type institutions. We need more institutions like these than we now have.

We further think that there should not be an appreciation in the value of the gifts of donors to these nursing homes and homes for aging. This exemption was granted to the hospitals in the House bill, so it would seem to us that anyone wanting to give charitable health dollars away for tax reasons would certainly favor hospitals over nursing homes or homes for the aging.

For the reasons just stated, these subacute kinds of institutions certainly need encouraging. Let me cite an example.

In the report of the executive director of the Lutheran Good Samaritan Society in August of 1969 he said that 12 new locations for homes were developed by the society, wherein all the land was given, and an additional $854,000 was contributed. This permitted the society to build nursing homes in 12 locations that would not otherwise have been built.

With this kind of contribution, funds then could be borrowed to build these new homes. In addition $135,000 in gifts were made for adding six expansion units in institutions already established, a total of nearly $990,000 was given to the society in the 12 months preceding August 1969 plus land permitting the building of 1,485 new nursing home beds.

These expansions would not have been possible in most instances without these gifts. Certainly the land would not have been so easily available in these 12 locations, had they not been able to give land at its current market value, and take a deduction for that value, even though they paid less for it when they bought it.

We are concerned also on the tax on undistributed investment income. We think this is beginning to destroy the idea of tax exemption for the operating charity and is a bad precedent of the tax exemption preserves and strengthens the idea of people volunteering to do something unselfishly for others that have special needs, and is a good balance for the private sector as opposed to the growth and dictates of government in the areas.

Once the idea is lost that tax exemption is not legitimate, and any kind of tax is imposed upon charitable income, whether it be a supervision fee of 2 percent or a 7½-percent tax, there will it seems to me be a progression of tax impositions that will eventually remove the tax exemption idea entirely.

Now tax exemption or tax benefit by giving to charity has been a part of English and American law since about 1536.

It might be interesting to note also that when this tax is imposed in the States that have conformity income tax statutes that there will be very likely a similar tax in the States as well as on the Federal tax return. In many States tax exemption for al valorem taxes is based upon a requirement that there be a Federal tax exemption. In addition, in the practical trying of these cases, very few judges grant exemptions to State ad valorem tax requests unless there is a Federal exemption. So this is a serious problem to the nursing homes in more ways than just a tax that is imposed by this statute.

If there must be a tax now on investment income as an alternative, there must be further provision and clarification of what may be set aside without being taxable for such things as life service contracts where we agree to take care of people for life, for reserves for improving services, for progressive and realistic upgrading of professional standards, for replacement costs, for the expansion of facilities, and for working capital reserves.

In the further area of the valuation of land and the distribution of investment assets when there is no 5 percent income produced, or the divestment provisions, we think you have developed in the House bill a very difficult administrative problem in permitting the Treasurer to evaluate the investment assets frequently as may be appropriate.

This is not so difficult when you are talking about assets on a major stock exchange, but it is difficult when you talk about land evaluations in the Midwest, where farms or where often closely held corporate stock is in the portfolio, or other assets that are sometimes owned. Evaluation and judgment on the value of a particular piece of real estate can vary greatly, as anyone who has practiced condemnation law knows, by the presentation of the low and high value experts under oath in the same case.

I would think that there should be a limitation of evaluation by the Treasury, perhaps not oftener than every 5 years or an acceptance of the assessed valuation of real estate by the local assessment officer, whether he be county treasurer or county assessor.

I want to speak next about small organizations within an operating exempt corporation. It seems to me that we should have reporting from the principal corporation under the 990(a) report most of us are now using. Most of these institutions, however, have small auxiliary units like ladies' aid auxiliaries, organizations of young people as Candy Stripers, other missionary groups such as the Gray Ladies who it seems would be required to report if they raised any charitable money. Our homes and institutions should not be spending a good deal of the charitable dollars for accounting and legal services to justify these reports. This would be pulling charitable dollars from their intended purposes, and where they are already badly in short supply.

The next area that concerns our association is the political activities of operating charities. We think it needs to be clarified.

Our institutions it would seem to us should not be restricted in their fight to interpret to legislators or to others their patients' or their constituents' needs or to advocate any cause for the elderly or the ill. It would be my suggestions that there be a specific enumeration of nonpermissible activities, and it seems to me that after these hearings you might have a very comprehensive list that should be included or could be included in the act.

I think, of course, that there should be included a specific prohibition against helping a specific candidate, being involved in partisan political activity, or granting funds for voter registration or other political activities in a single candidate area which are now causing grave concern to some people.

But we in our institutions need flexibility to improve patient standards for the ill and aging, for ad valorem tax problems in States throughout the country, for defining of licensure requirements of

administrators, where nearly all of the standards are developed in political arenas.

In summary, we believe that the excellent intent of the Tax Reform Act of 1969 for the reduction of tax inequities are desirable, but they should be obtained without including provisions harmful to volunteerism and philanthropy in this proposal. Gifts to charities are life loans for human needs and are quite different and should be treated differently from tax shelter problems.

It might be well to repeat that society can best be served by encouraging gifts to charities and not by eliminating them. We need to appeal to people to render the best they have for mankind. Some of this is exemplified by charitable gifts. In fact, the best justification for Government relieving religious, educational and charitable activities from taxes is that Government wishes to encourage these activities as representing the highest and noblest achievements of mankind.

Thank you very much for listening to me, and as a final statement may I say that both of these associations stand ready to assist the committee at any time where our experience and consultation would be helpful or desirable.

Thank you, gentlemen.

(Mr. Hackler's prepared statement follows:)

STATEMENT OF EUGENE T. HACKLER REPRESENTING THE AMERICAN ASSOCIATION OF HOMES FOR THE AGING, NEW YORK, N.Y., EVANGELICAL LUTHERAN GOOD SAMARITAN SOCIETY, SIOUX FALLS, S. DAK.

SUMMARY

1. Long term care institutions and homes for the aging should be specifically exempt—170(b)(1)(B).
2. Long term care institutions and homes for the aging should be exempt on any appreciation in value of gifts of donors.
3. We are opposed to any tax on undistributed investment income.
4. Political activities should permit interpretation to legislators of the needs of the ill and elderly or for advocating a cause for the elderly.
5. In the distribution of investment assets, the evaluation of *real estate* as frequently as "may be appropriate" needs thought and care.
6. Disclosure from auxiliaries, ladies aids or other small organizations should be eliminated.

We stand ready to assist this committee at any time where our experience and consultation would seem helpful.

STATEMENT

I am Eugene T. Hackler, an attorney of Olathe, Kansas. I appear today on behalf of the American Association of Homes for the Aging, of which I am a vice-president, and for the Ev. Lutheran Good Samaritan Society, of which I am Treasurer.

The American Association of Homes for the Aging is a national membership organization of non-profit, voluntary and governmental homes for the aging across the country, including all denominational groups. Our homes care for about one-half million people. The Association was founded in 1961 with a grant from the Ford Foundation. AAHA has been concerned with solving problems of common concern to its 1,000 member homes as well as to those dedicated to serving the institutional needs of our nation's elderly. My particular concern has been with problems relating to tax exemption.

The Evangelical Lutheran Good Samaritan Society is a non-profit, religious corporation with headquarters in Sioux Falls, South Dakota. The Society operates 130 institutions in 18 states, primarily nursing homes but several hos-

pitals, a home for delinquent boys, providing in all over 10,000 beds. The Society was organized in 1922.

Although this testimony is technically offered on behalf of these two organizations, I am, in reality, speaking not only for the one-half million people we care for in our homes but for most of the elderly people in the country who are confronted with the burdens of illness, aging and often money.

The Tax Reform Act of 1969 is, in my judgment, long overdue. The organizations which I represent do agree with much of the Bill. We are not opposed to—

1. The elimination of the exemption in areas of debt financed business, which we often refer to as the Clay-Brown provision, and
2. The exemption on unrelated business income, and
3. We think that interest, rents and royalties from controlled corporations and income from advertising and trade journals may be taxable.

We think the Bill can be improved in the following areas:

I. LONG TERM CARE INSTITUTIONS AND HOMES FOR THE AGING SHOULD BE SPECIFICALLY EXEMPT

The long term care institutions and homes for the aging should be specifically exempted by their inclusion as a 170(b)(1)(B) type exempt organization, the same as hospitals are to be exempted.

II. GIFTS OF APPRECIATED PROPERTY

Our members think that *long term care institutions and homes for the aging* should be exempt on any appreciation in value of gifts of donors to *long term care institutions and homes for the aging.* The present value of property that has increased in price since purchase should be deducted in full when given to our institutions with no payment of capital gains tax and without taxing the increase in value. This kind of giving is a major source of charitable contributions and if exemptions are given to some institutions and not others, it will channel the money in that direction to the detriment to our long term care institutions and homes for the aging, unless we are included in the exemption. In 1938 a House bill to tax gain on gifts of appreciated property was rejected by the Senate Finance Committee which eliminated this provision because "The Committee believes that charitable gifts generally are to be encouraged."

III. TAXING LONG TERM CARE INSTITUTIONS AND HOMES FOR THE AGING

We believe that the 7½% tax on undistributed investment income, or even 2% as suggested by Secretary Kennedy, should be eliminated for long term care institutions and homes for the aging. If we tax at all in this area, we will be setting a precedent for increased taxation as experience indicates that once we start taxing in an area, it is apt to be increased. If there must be a tax for administration purposes, it should not be applied against reserves for continuation of services (life care contract obligations) and reserves for improved services, expansion, replacement and working capital.

IV. POLITICAL ACTIVITIES

The political activities prohibition section of the Bill should be further clarified, as we believe that long term care institutions and homes for aging should not be restricted in their right to interpret to legislators their constituents' needs or to advocate a cause for the elderly. We should be permitted to work with legislators or voters on such matters as licensure of administrators, state and local ad valorem tax exemption, as well as standards of care for the ill and aging. Perhaps this is the intent of the Bill but it would seem to me to need clarification. Supporting a specific candidate or contributing funds to a political campaign should be prohibited. Charitable assets are not properly used for these purposes but they should be used to improve the conditions of our ill and aging.

V. DISTRIBUTION OF INVESTMENT ASSETS

We are also concerned about that portion of the Bill which provides that to avoid tax, private foundations must distribute income currently but not less than 5% of investment assets. The Bill imposes graduated sanctions in the event of failure to distribute. The specific concern (if private foundations are to be

taxed) is that assets will be evaluated as frequently "as may be appropriate" with the exception that the assets that can be easily evaluated are to be evaluated on a monthly basis. Evaluation of non-charitable assets will present a specific administration problem when you deal with the appraisal of real estate. In the Mid-west it is not unusual for charitable institutions to own farms or other real estate which might, on occasion, not produce a minimum pay-out of 5%. In these cases the Treasury Department and the taxpayer may have a real dispute as to the value of the investment. Appraising or judging the value of real estate can be most difficult. Though it needs to be done, a provision should be made limiting this appraisal so that taxpayers will not be burdened with the cost of preparing and spending money each year for expert evaluations of real estate. Having worked considerably in the field of condemnation, the evaluation of real estate can vary considerably between witnesses and recognized experts in the field. Although the courts can settle this matter, it is a difficult burden to place upon the taxpayer both time-wise and in the use of charitable dollars defending its evaluation. A judgment factor such as this needs considerable thought and care.

VI. DISCLOSURE

The Bill proposes to extend present disclosure requirements to all tax-exempt organizations with penalties for non-filing. Our concern is not disclosure by our present 990A form but clarification should be made so that every institution having auxiliaries, ladies aids or other similar small organizations should not have to report. This would take some charities additional dollars in administration.

Reasons and arguments

We believe that the excellent intent of the Tax Reform Act of 1969 for reduction of tax inequities can be obtained without including provisions harmful to volunteerism and philanthropy in their proposals. Charitable contribution should not be lumped with oil depletion, real estate depreciation and the like. Charitable gifts are not a "loophole". They are for the benefit of others, not the taxpayer. Charitable contributions should be treated quite differently from tax shelters. Gifts to charities are lifelines for human needs.

Both of the organizations I represent today are made up of homes that are "operating" charities, rather than "grant-making" type charities. These institutions are serving the ill and the aged and provide most of their funds from the residents they serve, with wide support from churches and interested citizens. Although most of them are church-related corporations, they would have difficulty in being identified as "a church" as provided in 170(b)(1)(B). If tax exemption for gifts to these institutions is eliminated, either because the institutions are no longer exempt or because the donors can give money with greater benefits to the taxpayer when making gifts to hospitals, then two major problems of this nation will increase—

(1) *Increased medical cost for the aging.* For those elderly people needing medical services, we find that the cost in homes for the aging and long term care institutions ranges from approximately one-third to one-half of the cost of hospitals. The nation already is concerned about the high cost of medical care for the aging. We presently need more institutions to care for the aged population.

In the work of the Ev. Lutheran Good Samaritan Society we find that most of our contributions come for the development of a new institution, in the form of donated land and money. The Tax Reform Act, if not amended, would seriously jeopardize the establishment of new institutions for us. During the last year we received nearly one million dollars, in that corporation alone, in cash contributions and approximately one-quarter million dollars in gifts of land for the development of new institutions. We can also learn to resolve the high cost of medical care problems in caring for the aging in sub-acute care institutions for use in the care of our economically deprived people in sub-acute care institutions. Sub-acute care institutions and neighborhood clinical settings can reduce high costs because sophisticated equipment is not needed. This appears to be one of the goals of the comprehensive health care planning package passed by Congress about a year ago and now getting underway in our major cities across the country. We must learn to better use the health dollar in the United States.

2. *Higher cost to the elderly.* If payment of taxes on investment income or the erosion of our tax exemption develops, then the costs to our residents will increase. This will be the natural result if our institutions are to survive. This

will be placing an unusually heavy burden upon our aging population. This will also increase the cost of government as the care of about 54% of the people in long term care institutions and homes for aging is now being paid for by private foundations.

In conclusion, I think we should ask ourselves if society can best be served by encouraging gifts to charities or eliminating them. Isn't it time we appealed to the best in mankind? The best justification for government in relieving religious, educational and charitable activities from taxes is that government wishes to encourage these activities as representing the highest and noblest achievements of mankind.

Respectfully submitted,

EUGENE T. HACKLER.

Mr. JENKINS. Mr. Chairman, may I take a moment?

Senator GORE. Yes; indeed.

Mr. JENKINS. I am Thomas M. Jenkins appearing with Mr. Hackler. My comments will be very brief.

I am the past president of the American Association of Homes for the Aging, and my concerns here today relate to this area of long-term care facilities for the aging.

I know that this committee is aware that something in the neighborhood of 80 percent of all the facilities built in the long-term care field in the United States in the last 20 years has been under the auspices of these nonprofit organizations, mostly church oriented by the major church organizations in the United States.

In the San Francisco Bay area alone I am aware of something in the neighborhood of $70 million in construction costs alone which have been contributed to this field of the aging, the care of the aging in the past 10 years, and when that is multiplied by the other facilities throughout the country, this means literally hundreds of millions of dollars of nontax moneys which have been contributed to this care of the aging field.

It is my real concern that the Tax Reform Act as presently structured will be the death-knell of these facilities. It will severely restrict the existing ones, and it is my feeling it will simply prohibit the building of new ones.

I would comment then only on two particulars. One relates to the area of the definition of private foundations. At least as I read the act, most of the facilities that we represent throughout the United States could be classified as a private foundation.

If they have received endowments over a period of time, which they are now relying upon to take care of people in the lower economic strata, they will have only one choice, and that is to cease giving aid to the very people who need that aid. This can happen in many of the facilities that I am personally aware of, even in such facilities as those sponsored by the Catholic charities, the Little Sisters of the Poor, who would normally be classified by all of those on all congressional committees as the one entitled to charitable exemption. Yet as the act is presently structured, I think they would fall within the provisions of private foundations and be subject to all the restrictions of the act.

Secondly, I think that there is a problem mentioned by Mr. Hackler on this whole area of property taxation within the 50 States. Many jurisdictions, and California is one of them, requires that you have a 501(c)(3) exemption in order to qualify for property tax exemption within that State.

Under the definitions of private foundations which are now contained in the bill, that exemption would be lost. They would lose their property tax exemption, and we conservatively estimate that in California alone each resident of a home for the aging, and there are many thousands, would be required to pay $30 per month per resident in taxes to the State of California. This again could have but one result, that is that the facilities would be unable to care for the very people that they were built for, for the very people who are the objective of these charitable institutions.

We are firmly convinced that this is not the intent of the Congress, and that this is not what was meant by the House when it passed the Tax Reform Act.

We seriously urge that that be amended, and particularly then that homes for the aging receive as a needed service the classification of exempt organizations as is done for hospitals.

One final comment. The restrictions on "political activity" which is contained in the House bill, the American Association has appeared before this committee, has appeared before many other committees of the Congress as well as before many houses of legislative bodies in the various States.

Thousands of hours of time worth literally millions of dollars have been spent by well-motivated people to assist the Congress, the legislative bodies of the various States, and various State and Federal agencies in developing guidelines, in preparing rules and regulations that relate to the care of the aging. This has been particularly true since medicare.

It is our feeling that as presently structured, the House bill would prohibit this kind of volunteer activity and contribution which is sorely needed by those in the legislative field. And so in summary, Mr. Chairman, we strongly urge that there be more serious consideration given of these two areas, in order to preserve that which many years ago, as long as 1835, de Tocqueville when he traveled throughout the United States said was a characteristic unique of the American Government, and that is this participation by the voluntary segment of our society in caring for its fellow man.

Thank you.

Senator GORE. The next witness is Mr. Mitchell Rogovin.

STATEMENT OF MITCHELL ROGOVIN, THE LOUIS AND HENRIETTA BLAUSTEIN FOUNDATIONS, INC.

Mr. ROGOVIN. Mr. Chairman and members of the committee, my name is Mitchell Rogovin. I am a partner in the law firm of Arnold & Porter. As a matter of background I perhaps should say that I was formerly Assistant Attorney General in charge of the Tax Division of the Department of Justice and Chief Counsel of the Internal Revenue Service. While I helped to formulate some of the positions in H.R. 13270, I do not believe there is any conflict in my representation of the Louis and Henrietta Blaustein Foundation.

I would like to limit my testimony to some modest suggestions that are geared to making the stock ownership provisions more workable.

As you know, section 4943 of the bill limits to 20 percent the combined ownership of a corporation's voting stock held by a foundation

and those who, under very broad rules of attribution, are referred to as "disqualified persons."

To the extent that the foundation is deemed to own more than 20 percent of the voting stock, this excess business holding must be disposed of within 10 years. The Treasury and the House seem to believe that a foundation that holds more than 20 percent of the voting stock will become preoccupied with "the business of business" rather than that of philanthropy.

Much is to be said for prohibiting foundations from engaging in the business of its equity developments, but there are two basic shortcomings in the bill that have effects on philanthropy far beyond those presumably intended or socially desirable.

The rules dealing with attribution are excessively broad. The 20 percent limitation on stock ownership, when coupled with the attribution rules, tends to substitute arithmetic for reason. For example, a foundation will be deemed to be in control of a corporation in which it has no vote where it holds nonvoting common and family members hold the voting stock. The family members would find themselves in an impossible situation. Not only must they dispose of 20 percent according to the tests of the statute, but they must dispose of all of the nonvoting common because it will be deemed to put the foundation in control of the business.

Under these circumstances, the foundation simply is not involved in the corporation's business, and there is no viable support for a presumption that it is. Where nonvoting stock is in a foundation the bill would require the distribution, as I say, of all of the stock that it holds. The alternative would be to dispose of relatives, and I think that is against public policy. Hence, we are in this impossible situation when nonvoting is held.

We know that the control of a corporation can take place with as little as 10 percent of the voting stock. Yet these artificial rules of attribution make having no voting stock a greater sin than having as much as 2 times that needed to control a large industrial corporation. We would, therefore, accordingly recommend that the House bill be modified to eliminate the rules of attribution in determining whether more than 20 percent of a business is owned by a foundation.

At this point I would like to underscore the fact that in other provisions such as the self-dealing provisions in the bill, it might well be desirable to have extremely broad rules of attribution prohibiting the sales between the foundation and a broad list of related or deemed-to-be-related persons. However, in determining whether control exists, if control is the focal point, it would seem that attribution rules merely substitute, as I say, arithmetic for reason.

At the very minimum we would say that the rules of attribution should not apply to a private foundation which itself owns no voting stock in the corporation.

An equally troublesome feature of the bill is its failure to provide a realistic method for a foundation to dispose of excess business holdings. A foundation with excess business holdings of a listed stock can divest itself by sale with no difficulty at all. The bill allows the foundation 10 years to accomplish this. Presumably the foundation will use the cash it has received from the sale of the stock to reinvest in diversified securities.

But foundations with excess business holdings in a closely held business will find no public market. The problem is compounded where the securities are of a nonvoting common variety, and it is this latter situation which I would like to bring to the committee's attention. The only realistic course for a foundation under these circumstances is to seek to have the issuing company redeem the stock.

The bill does not prohibit or forbid redemption. Indeed the House bill recognizes that closely held stock may have to be redeemed by the issuing company. To facilitate this event, the House bill relaxes the provisions against self-dealing to allow for a foundation to have its stock redeemed by the issuing company for fair market value.

Nonetheless, redemption is not feasible because the Internal Revenue Service may well make the argument that the redemption route either results in a constructive dividend to the donor, or that the redemption reflects an unreasonable accumulation of earnings on the part of the company.

In this connection, the Service has sometimes taken the position that where a corporation redeems shares from a foundation which received them as a gift, that redemption amounts to a taxable dividend to the original donor. How far the courts will go in asserting a constructive dividend is another matter, but the prospect of the assertion of a dividend is a chilling one, and it certainly does not allow for the easy disposition of excess business holdings by a foundation.

As to the redeeming corporation, the possibility of the assertion of a penalty tax on reasonable accumulations of income under section 531 also exists.

There are a number of policy reasons why one would favor a redemption mechanism without developing any type of tax consequence to the donor or to the redeeming company.

Closely held and family businesses generally have been protected from the tax consequences which would bring about their economic demise. For example, Congress recognizes that the heavy burden of death taxes could force a family business to liquidate, to merge, or to go public under extreme duress. Accordingly Congress provided for the stock redemption——

Senator GORE. Mr. Chairman, why should this not be done in many cases? What is the virtue of perpetuating one family distributing a particular piece of wealth?

Mr. ROGOVIN. What we are saying, Senator Gore, is that if this is what is wanted by the Congress, that is fine. If the foundation is to dispose of the stock, that being the rule of Congress, we will accept it. What we are saying is that we do not have an adequate system for the sale of these valuable assets unless we sell it back to the issuing company, and that for 50 years these were perfectly legitimate assets for a foundation to hold. Now Congress is considering changing the rules of the game. We are not quarreling with the question of whether the policy is wise or not. We are simply saying give us a transitional rule.

Senator GORE. All right, now what are your suggestions?

Mr. ROGOVIN. What I am suggesting here is a provision that would say that section 531 would not apply to an accumulation used to redeem excess business holdings. Once there is a determination that a founda-

tion has more than a permitted amount, then that excess amount could be redeemed by the issuing company without the assertion by the Internal Revenue Service of a penalty tax for unreasonable accumulations, and also without the assertion by the Internal Revenue Service of a constructive dividend to donors who were given this property perhaps many years before.

Senator GORE. Thank you. That is a helpful suggestion.

Mr. ROGOVIN. I believe, if I may conclude, for over 50 years the very holdings that the House would prohibit were perfectly legitimate holdings on the part of foundations. Here, however, we see that the holding today of the same securities would bring about a 200 percent penalty. Goodness, the Federal tax on adulterated butter is 10 cents a pound, on marijuana it is $1 an ounce, and on opium it is $300 a pound. But hold these securities that you could have held for 50 years under the House bill, and there would be a 200 percent penalty. Well, that seems to be severe.

What we are saying is that if the rules are to be changed, that there are adequate ways to allow for no tax consequence because of this change of policy on the part of the Congress.

I have nothing further.

If there are any questions I would be happy to try to answer them.

Senator GORE. Thank you for your clear testimony, Mr. Rogovin.

Senator ANDERSON. Thank you very much.

(Mitchell Rogovin's prepared statement follows:)

STATEMENT OF MITCHELL ROGOVIN, IN BEHALF OF THE LOUIS & HENRIETTA BLAUSTEIN FOUNDATION, INC.

SUMMARY

I. *Five troublesome provisions of H.R. 13270*

A. Viewed by a private foundation holding primarily non-voting stock in a closely held family business.

II. *Stock ownership limitation*

A. Attribution rules are too broad.

1. Causes private foundation with no voting stock to dispose of all its non-voting securities because of stock owned by family members.

2. Rules of attribution should not apply in determining whether a private foundation has excess business holdings.

3. Alternatively, non-voting stock should not be equated with control and no attribution should be allowed where no voting stock is held by foundation.

B. Where involuntary divestiture of excess business holdings is required, bill should affirmatively preclude adverse tax consequences on the disposition of closely held stock.

1. No market generally available for closely held securities—other than issuing corporation.

2. Redemption by issuing company of excess business holdings should not trigger:

a. Dividend consequences to the donor, or

b. Assertion of the penalty tax for unreasonable accumulations by the redeeming corporation.

3. Same result should apply where a foundation has to dispose of closely held securities because it did not obtain a 5 percent yield on its investment assets. (§ 4942).

4. Bill should permit retroactive adjustments in the redemption price so as to be able to comply with the "fair market value" requirements of § 4941(d)(1)(F).

5. An exception to § 4943(c)(4)(B) and (C) should be recognized where there is a binding agreement to redeem excess business holdings of a foundation over a period not to exceed 10 years.

6. An exception to § 4943(c)(5) should be permitted to as to allow codicils executed after July 28, 1969, that are unrelated to bequests to private foundations.

III. *Charitable contributions of appreciated property*

A. Develops elitist group of charities to which contribution of appreciated property is proper.

1. Creates second class of philanthropy as to which no such tax loophole will be brooked.

B. Illogical and discriminatory distinction.

1. Will shift contributions away from private charities.

2. Would, for the first time, tax unrealized appreciation.

IV. *Tax on investment income*

A. Tax intended to require private foundations to "make a small contribution . . . toward the cost of government."

1. Tax on private foundations and not on other philanthropy.

2. Tax-free status the hallmark of philanthropy. Precedent will cause state and local authorities to similarly tax investment income.

B. Better solution: require *all* exempt oragnizations to pay a small "user charge" measured by their capital.

1. Earmark such funds for audit program.

V. *Distribution of income*

A. 5% minimum distribution requirement unrealistic.

1. Places unwarranted burden on foundation manager.

2. Causes him to "churn" investments to seek 5 percent yield.

B. Foundations should be required to distribute earnings currently.

1. Failure to do so should be treated as failure to dedicate assets to charity.

C. Alternatively, yield minimum should be lowered to 3 percent.

VI. *Clay-Brown provision*

A. Provision sound and long overdue.

B. As drafted, however, unintended inequities might result.

1. *Example*—Where foundation borrows money in order to make a contribution in furtherance of charitable purpose and pledges recently acquired donated property as collateral for loan.

2. Language of sections 514(b) and 514(c) (1)(C) could be interpreted to cover above example.

3. While such an arrangement does not appear to be within policy of bill, ambiguity could be resolved by appropriate language in Committee Report.

STATEMENT

Mr. Chairman and Members of the Committee, my name is Mitchell Rogovin. I am a partner in the law firm of Arnold & Porter, of Washington, D.C. As way of background and disclosure, I was formerly Assistant Attorney General of the United States in charge of the Tax Division and before that, Chief Counsel for the Internal Revenue Service. Although in my former government positions I helped formulate some of the positions taken in H.R. 13270, I do not believe there is any conflict in my representation of the Louis and Henrietta Blaustein Foundation, Inc.

I

Introduction

Philanthropy, with its traces beginning at the dawn of time, is currently going through what has become a recurring process, a reappraisal by the society which it serves. Such reappraisals are as old as philanthropy itself and have occurred many times, in numerous areas. Over that span of time, charitable activities have been shaped, have been fostered and have been limited by the wisdom, the fears and the prejudices of the ages in which the reappraisals occurred.

One might say that when organized society first recognized that the poor had rights and the rich had duties, philanthropy was born. All cultures and civilizations provide examples demonstrating their sense of charitable obligation.[1]

[1] See, Andrews, *Philanthropic Giving*, Russell Sage Foundation, p. 30; 5 Encyclopedia Britiannica (1955 Ed.) *Charity*, p. 250.

The development of the law of charity thus mirrors the social, religious and economic philosophies which have held sway throughout the various periods of our history. In modern times the granting or withholding of tax privileges has become a favorite tool of society in shaping the development of charitable activities and an important means through which society imposes its will on philanthropy. The result has been that the tax treatment of charitable activities at any given period of time is, in itself, a mirror of the social, religious and economic philosophies of the time.

The unanswered question is what legacy will the 91st Congress leave for generations unborn. The result of the philanthropy of the 19th Century is all about us. The colleges, libraries, concert halls and research institutes stand tall as the product of private philanthropy of years gone by. Much of the testimony Foundations' Coordinated Testimony Group bears ample witness to what philanthropy has done in the past.[2]

Some specific concerns

The need for specific legislation to curb the overreach and abuse of some foundation managers has, over the past decade, been demonstrated. The House Bill, however, is an all too broad answer to the specific problems surfaced by the Treasury Report[3] or Congressman Patman's hearings on private foundations.[4] Indeed, at a point in time when it would seem that the Congress should be seeking to encourage foundation managers—the private sector—to work toward the eradication of the formidable problems facing our nation, the Bill challenges the continued existence of private foundations. It is not a good example of "creative or new federalism."

Since the Blaustein Foundation is, in comparison to some of the foundations represented at these hearings, relatively small and like many private foundations, it holds primarily nonvoting stock in a closely-held family enterprise, our comments on certain of the foundation provisions of H.R. 13270 reflect that point of view. It is, therefore, in this context, that we focus upon:

A. *Stock Ownership Limitation* (section 101(b) of the Bill and section 4943 of the Code).

B. *Charitable Contributions of Appreciated Property* (sections 201 (c) and (d) of the Bill and section 170 of the Code).

C. *Tax on Investment Income* (section 101(a) of the Bill and section 506 of the Code).

D. *Distribution of Income* (section 101(b) of the Bill and section 4942 of the Code).

E. *The Clay-Brown Provision* (section 121 of the Bill and sections 512 and 514 of the Code).

II.

A. *Stock ownership limitation*

This provision of the Bill limits to 20 percent the combined ownership of a corporation's voting and nonvoting stock held by a private foundation and those who, under broad rules of stock ownership attribution, are referred to as "disqualified persons." To the extent that a foundation and disqualified persons own stock in excess of the 20 percent limitation, the foundation must dispose of its stock within a 10-year period. This provision will, singlehandedly, cause the liquidation of countless private foundations and, coupled with the limitation on gifts of appreciated property to private foundations, will make it impossible for many men of wealth to contribute to philanthropy the most valuable asset they have—shares of the businesses built up by themselves, their family or a small group of entrepeneurs.

The general philosophy behind such legislation is the assumption that a foundation owning (together with so-called disqualified persons) more than 20 percent

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[2] See Statements of Miller and Wells, *The Role of Foundations in American Life*, September 9, 1969.

[3] Treasury Department Report on Private Foundations, Committee on Ways and Means, 89th Cong., 2d Sess. (1965).

[4] Tax-Exempt Foundations and Charitable Trusts: Their Impact on Our Economy. Chairman's Report to the House Select Committee on Small Business, 87th Cong., 2d Sess. (Comm. Print 1962); 2d Installment Subcommittee Chairman's Report to Subcommittee No. 1, House Select Committee on Small Business, 88th Cong., 1st Sess. (Comm. Print 1963); 3d Installment, *id.*, 88th Cong., 2d Sess. (Comm. Print 1964); 4th Installment, *id.*, 89th Cong., 2d Sess. (Comm. Print 1966); 5th Installment, *id.*, 90th Cong., 2d Sess. (Comm. Print 1967); 6th Installment, *id.*, 90th Cong., 2d Sess. (Comm. Print 1968); 7th Installment, *id.*, 91st Cong., 1st Sess. (Comm. Print 1969).

of a corporation's voting stock, will become preoccupied with the business of business rather than its charitable purpose.

While there is much to be said in favor of prohibiting foundation trustees and managers from engaging in the business of its equity investments, the House Bill would unnecessarily destroy a substantial source of philanthropic support to curb some possible abuses which may arise from control. Two basic shortcomings cause the Bill to have effects upon philanthropy far beyond these presumably intended or socially desirable. The first, the rules dealing with attribution, are excessively broad in some instances and totally unnecessary in others. For example, under these rules, a foundation can be deemed to be in control of a corporation in which it has no vote and, therefore, no control. The second reflects the absence of a realistic method in which a foundation can divest itself of shares of closely-held stock to meet the House Bill's limitation on stock ownership and still make available to charity the most cash possible. Closely-held stock generally has no market and cannot be sold for its real worth. The only method of obtaining real worth for charitable purposes is through the redemption of such stock by the issuing corporation.

Attribution rule

The 20 percent limitation of combined stock ownership is an arbitrary rule which substitutes arithmetic for reason.[5] It has the sole advantage of being a clear-cut rule. But even this advantage becomes fuzzy when the rules of attribution—the deeming of stock owned by others to be owned by the Foundation—are applied. The basic presumption is that when a foundation has more than 20 percent of a corporation's voting stock, its managers will become involved in business to the detriment of philanthropy. This, however, becomes strained to the breaking point when, for example, a foundation with nothing but the nonvoting stock of a corporation finds itself charged with all the voting stock owned by:

"A substantial contributor (anyone who has contributed more than $5,000 in any one calendar year or more than any other contributor in any one calendar year), a foundation manager, an individual who owns more than 20% of a corporation which is a substantial contributor, a holder of more than 20% of the beneficial interest of a trust or unincorporated enterprise which is a substantial contributor, a member of the family (under the personal holding company and collapsible corporation attribution rules) of any such person, or a corporation, partnership, trust, or estate as to which all such persons own in the aggregate more than 35%."[6]

To equate nonvoting stock with voting common stock is like assuming that holders of Series E Savings Bonds can vote on federal legislation. The presumption of business involvement is nonsense when novoting stock is held by a foundation. The attribution rules, while properly broad when dealing with matters such as self-dealing, have no relevance in the context of the provisions of the House Bill dealing with control by a foundation of a business enterprise.

In a situation where a foundation holds nonvoting stock in a family business and the voting stock is held by family members, the foundation must (because of the application of the rules of attribution) dispose of all its nonvoting stock. It is totally illogical to reach such a result in the name of keeping foundations out of business. The proposed bill would allow a foundation to own up to 20 percent of the voting stock in a business. In many instances, 10 percent of the voting stock is enough to exercise control. Thus, business involvement is sanctioned to that extent. Yet, where a foundation has no control—no voting stock—it will be deemed to be involved in business through the fiction of attribution.

Accordingly, the bill should be modified so as to eliminate the rules of attribution in determining whether 20 percent of a business is owned by a private foundation. At the very minimum, the rules of attribution should not apply to a private foundation which itself owns no voting stock.

[5] ". . . anodynes for the pains of thinking" as Judge Learned Hand put it. *Sansome v. Commissioner*, 60 F.2d 931, 933 (2d Cir. 1932), *cert. den.*, 287 U.S. 677 (1932).

[6] H. Rpt. No. 91–413 (Part 1), p. 21, 91st Cong., 1st Sess. (1969). These rules of attribution include and expand upon the rules set out in § 341(d) and § 544(a), I.R.C. 1954. They are proposed to be applied in mechanical fashion to the problems of self-dealing and excess business holdings, irrespective of the vast difference between these two problems.

Redemption

A second and equally troublesome feature of the House Bill is its failure effectively to provide a realistic mechanism for: (1) private foundations to comply with a forced divestiture of stock in a closely-held company; and (2) for public charities to obtain cash for closely-held stock in a manner which will most benefit charitable purposes.

Many public charities and private foundations hold stock in closely-held companies. Indeed, for over 50 years such stock has been considered by the Treasury as perfectly legitimate holdings for foundations. Under the House Bill, private foundations required to divest themselves of closely-held stock can meet this requirement by sale, by gift to a public charity, or by redemption. Realistically, however, redemption of the stock by the issuing company is the only method for the charity to obtain a market and a fair value. The transfer by the private foundation of closely-held securities to a public charity, without the capacity of sale by the recipient, is a paltry gift unless the public charity can otherwise convert it into expendable cash.

Many persons of wealth whose property is concentrated in closely-held corporations customarily leave substantial gifts to private and public charities under their wills. The House Bill will discourage future generous gifts of such stock to private foundations if the gift will make the foundation a 20% or more shareholder, unless there is some way for the foundation to divest itself of the shares. Likewise, when testamentary gifts are made to public charities, or if the public charities receive closely-held sotck from private foundations,[7] a method must be devised to allow the conversion of the stock into cash. Unless a redemption provision is provided, charity will get something substantially less than the true worth of the securities in both instances.

Why redemption is not currently feasible

The House Bill does not forbid redemptions from public charities or private foundations. In fact, the Committee Report recognizes that closely-held stock may be redeemed. To facilitate this end, the prohibition against self-dealing is relaxed in such cases where the stock is sold for fair market value by the foundation to a disqualified person which may be the corporation. Nonetheless, certain other possible interpretations of the Internal Revenue Code may make the redemption so dangerous to the donor and to the closely-held corporation that redemption is impossible.

The Internal Revenue Service has sometimes taken the position that where a corporation redeems shares which have been received by a foundation as gifts, the redemption amounts to a taxable dividend at high rates, to the original donors.[8] How far the courts will go along with the constructive dividend position is, perhaps, another matter, but the prospect of the assertion of dividend consequences is a chilling one. It should be made clear by amendment that a redemption of closely-held stock presently held by, or received as a testamentary bequest by a private foundation or owned or received by a public charity would not produce dividend consequences to the donors or to the decedent's estate.

So far as the redeeming corporation is concerned, the problem is the possible assertion of the penalty tax upon unreasonable accumulation of income under section 531 of the Internal Revenue Code.[9] For purposes of the penalty tax the Code presently allows a deduction for corporate charitable contributions in excess of the 5 percent of adjusted gross income normally allowed corporations as a

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[7] A method of divestiture approved by the Bill.

[8] *First National Industries, Inc.* v. *Commissioner*, 404 F.2d 1182 (6th Cir. 1968), *aff'g* 26 TCM 608 (1967) involved a parent corporation's donation of "equity" in a subsidiary's stock to a foundation. The subsidiary redeemed the stock from the foundation and the donor (parent corporation) was held taxable on the redemption proceeds. See also *Russell E. Phelon*, 25 TCM 1024 (1966). IRS contended for dividend treatment, but did *not* prevail in *Robert L. Fox*, 27 TCM 1001 (1968); *Jacobs* v. *United States*, 280 F. Supp. 437 (S.D. Ohio 1966); *aff'd* 390 F.2d 877 (C.A. 6th 1968); and *Winston* v. *Kelm*, 122 F. Supp. 649 (D. Minn. 1954). See also *Sheppard* v. *United States*, 361 F.2d 972 (Ct. Cls. 1966).

[9] See *Dickman Lumber Company* v. *United States*, 65-1 USTC 9133 (W.D. Wash. 1964), *aff'd* 355 F.2d 670 (C.A. 9th 1966); *Youngs Rubber Corp.*, 21 TCM 1593 (1962), *aff'd* 331 F.2d 12 (C.A. 2d 1964); *Kirlin Co.*, 23 TCM 1580 (1964), *aff'd* 361 F.2d 818 (C.A. 6th 1966), where the retention of earnings and profits to provide funds for the redemption of a deceased shareholder's stock (under section 303) so as to enable the estate to pay death taxes was found not to be an accumulation for the reasonable needs of the business. See also Washington, *Can Earnings Still be Accumulated to Finance Section 303 Redemptions?*, 44 Taxes 48 (Jan. 1966), and Herwitz, *Stock Redemptions and the Accumulated Earnings Tax*, 74 Har. L. Rev. 866 (1961).

deductible charitable contribution. An additional deduction should be allowed for the indirect charitable contribution made through a redemption of closely-held shares.

Policy considerations favoring redemption

Over the history of our modern income tax, closely-held and family businesses have been protected and sheltered from adverse tax effects which would cause the demise of the closely-held business as a part of our economic life. For example, Congress recognized that death taxes could easily force a closely-held business to liquidate, merge, or "go public" under extreme duress. Accordingly, it provided for stock redemption to pay death taxes without dividend consequences to the estate.[10]

Similar protection must be given to testamentary gifts of securities in closely-held companies, if forced mergers with their resulting concentration of power in larger units are to be avoided and if our pluralistc approach to philanthropy is to continue.

A private foundation required to divest a portion of its publicly traded securities has no problem. A private foundation or a public charity holding a security with no available market other than the issuing company will have difficulty realizing the full value of such assets.[11] Consistent with the desire for charity to obtain the full value of such assets, they should be encouraged to convert the closely-held stock into cash and thereafter be on parity with other private foundations or public charities which hold marketable securities. Thus, they will be in a better position to carry out their charitable purpose. The recommended additions in the bill are intended to facilitate the policy behind this provisions; to change the type of investments held by certain private foundations.

An alternative approach which recognizes that nonvoting stock in the hands of a private foundation is substantially different than voting stock should be considered. Since a foundation holding nothing but nonvoting stock in a family enterprise is harshly treated under the rules of constructive ownership, an exception should be added to the Bill to provide that where a foundation holds exclusively nonvoting stock amounting to less than 25 percent of the total equity of the corporation, the provision of section 4943 of the Bill will not apply.[12]

Other problems re divestiture of excess business holdings

Section 101(k) provides that section 4941 (the provision that imposes sanctions on self-dealing) shall not apply to sales by a foundation to a "disqualified person" if the sale is necessary in order for the foundation to dispose of its excess business holdings and if the foundation receives an amount equal to the fair market value of the stock.

How would this provision be applied in situations where the Internal Revenue Service or a court subsequently determines that the fair market value of the redeemed stock was higher than the redemption price originally agreed upon by the foundation and the corporation? The difficulty in valuing closely-held stock is well recognized. The Internal Revenue Service has often asserted a higher value for closely-held stock than the value reported by taxpayers on their federal estate and gift tax returns; and courts have often determined a still different value. If a foundation, in compliance with the excess business holding provisions, has its closely-held shares redeemed by an issuing corporation which is a "disqualified person," and if it is finally determined by the Service or a court that the redemption price was less than "fair market value," would a retroactive adjustment in the redemption price be permitted so that the founda-

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[10] Section 303 provides capital gains treatment for a stock redemption needed to pay death taxes and section 6166 provides for installment payment of estate taxes on estates composed largely of "an interest in a closely held business" defined *inter alia*, as consisting of 20 percent or more in value of the voting stock of a corporation. Treas. Regs. § 20.161–1(b) provides that the sale of interests in a family business to unrelated persons is a hardship justifying delayed tax collection. Simon, Hearings Before the Committee on Ways and Means on Tax Reform, 1969, N. 14 at 796.

[11] A similar problem in obtaining full value exists when, under the distribution of income provision of section 101(b) of the Bill (new section 4942), a private foundation fails to obtain a 5 percent yield on its investment assets. At that point, if its only assets are shares in closely-held corporations, some device is necessary to allow the issuing corporation to redeem the securities without adverse tax consequences to the redeeming corporation, its shareholders, the donor or the foundation. To fail to do so would only compound the foundation's inability to get a full value return on its assets.

[12] Section 4943(c)(2)(C) of the proposed Bill provides a *de minimus* rule under which foundations may retain not more than 2 percent of the *voting stock* notwithstanding the 20 percent limitation.

tion would have the opportunity to keep the transaction within the scope of section 101(k). By the retroactive adjustment, the redeeming corporation would pay to the foundation the difference between the original redemption price and the finally determined "fair market value."

If retroactive adjustments are not specifically provided for, the section 101(k) exception will be unworkable. Foundation managers and the redeeming corporations will be obliged to risk the imposition of the section 4941 sanctions because "fair market value" may subsequently be determined to be higher than the redemption price. Under section 4941(a), a tax of 5 percent of the amount involved in the self-dealing transaction will be imposed on the redeeming corporation and, if the redemption is not "undone" during the "correction period," a tax of 200 percent will be imposed under section 4941(b). A tax of 2½ percent will be imposed on the foundation manager who knowingly participates in the transaction, (section 4941(a)) and an additional tax of 50 percent will be imposed if he refuses to agree to a "correction" (section 4941(b)). Section 101(k) certainly was not intended to be so limited in application.

Accordingly, the House Bill should, therefore, make clear that a retroactive adjustment in the redemption price will comply with the "fair market value" requirement of section 101(k).

A second provision in the House Bill that will discourage redemptions is the reduced grace period that will result whenever the redeeming corporation is a "disqualified person." Section 4943(c)(4)(B) provides that the ten-year grace period for disposing of excess holdings is cut off after two years unless the foundation has disposed of at least one-tenth of its excess holdings to a person other than a "disqualified person." Section 4943(c)(4)(C) provides that by the end of the first five years, the foundation must have disposed of at least one-third of its excess holdings and (together with all disqualified persons) it must not hold as much as 50 percent of the stock of the corporation. Where family members (disqualified persons) own all of the voting stock of the business enterprise, the present rules of constructive ownership will attribute all of their stock to the private foundation even though the foundation only holds nonvoting stock. Under such circumstances, the foundation could not meet the interim requirements of either section 4943(c)(4)(B) or (C) unless it disposes of *all* of its holdings within two years. If it fails to do so, it must suffer the sanctions of section 4943 (a 5 percent tax and a 200 percent tax). This is unrealistic, unfair and possibly unconstitutional. In many cases, the redeeming corporation will not be able, within a two-year period, or five-year period, to redeem all the stock of the foundation (and perhaps all the stock of similarly situated foundations). Thus, even if redemption may be the only way for obtaining the real value of the stock, the redemption method will often be impossible because of the unrealistic time table set up in the statute.

The purpose for requiring partial divestiture over two, five and finally the tenth year is apparently to insure that a foundation does not wait until the tenth year and then claim hardship. It would seem that this problem would be adequately solved if the issuing corporation entered into a binding agreement with the foundation to redeem the excess business holdings over a ten-year period.[13] This would demonstrate the foundation's intention to divest and would allow the redeeming corporation to develop an appropriate plan for the redemption.

Accordingly, the House Bill should provide that the provisions of section 4943 (c)(4)(B) and (C) shall not apply where a binding agreement is entered into to redeem the excess business holdings over a period not to exceed ten years.

The effect of a codicil on pre-July 29, 1969, will

The "grandfather clause" in section 4943(c)(5) creates an inequitable result in its present form. A ten-year period is given for the disposition of excess business holdings when the assets come to a private foundation at some time in the future if there was a bequest in a will executed before July 29, 1969. If the will is dated after July 28, 1969, the foundation has only five years within which to dispose of excess holdings so received (section 4943(c)(6)).

Under state law, a codicil is generally considered to have the effect of making

[13] Thus, the foundation could offer its stock for redemption, sell it to third parties (if available) or give it to public charities during the 10-year period. In any event, it would dispose of all of its excess holdings within the 10-year period.

the will speak as of the date of the codicil.[14] This being the case, a taxpayer who in a will executed prior to July 29, 1969 has provided for a testamentary bequest to a private foundation is placed on the horns of a dilemma if he wishes, for non-tax reasons, to execute a codicil. If, for example, a taxpayer has after-born grandchildren and wishes to provide for them by codicil, he will cause the private foundation to lose the benefit of section 4943(c)(5). It would not seem that the intention of Congress was to create such a dilemma.

Accordingly, section 4943(c)(5) should be amended to provide that a codicil not related to a bequest to any private foundation should not be considered as changing the date of the original will.

Summary of legislative solutions

1. *Attribution*—The attribution rules should be amended so as not to be applicable to section 101(b) of the House Bill. If the attribution rules are retained with respect to section 101(b), at a very minimum, they should not apply to a private foundation which itself owns no voting stock.

2. *Redemption*—Affirmative legislation should be added to the House Bill to permit:

(a) Private foundations to offer to the issuing corporation for redemption over a ten-year period any stock in a closely-held corporation which is an excess business holding as of the effective date of the act or becomes an excess business holding because of a subsequent testamentary bequest, with no adverse tax effects to the foundation, the redeeming corporation, its stockholders, or the donor.[15]

(b) Public charities to offer at any time closely-held stock to the issuing corporation for redemption without adverse tax effects upon the redeeming corporation, its stockholders, or the donor.[15]

(c) Retroactive adjustments in the redemption price so as to comply with the "fair market value" requirement of section 4941(d)(1)(F).

(d) An exception to section 4943(c)(4)(B) and (C) where there is a binding agreement to redeem the excess business holdings of a private foundation over a period not to exceed ten years.

(e) An exception to section 4943(c)(5) to allow for codicils unrelated to bequests to any private foundation to be executed after July 29, 1969.

B. *Charitable contributions of appreciated property*

Predicated upon the stated desire "to remove *some* of the present tax advantages of gifts of appreciated property over gifts of cash," [16] this provision of the House Bill drives a further wedge between charitable institutions. It develops an elitist group of charities to which Congressionally recognized undesirable tax advantages will be permitted and a second class of charity where no such advantage will be brooked. It presumes to distinguish between worthy and less worthy charity.

As to the first class of charity, the donor may continue to deduct the fair market value of contributed property. Where, however, the donee is a private foundation, the House Bill requires the donor to elect as the measure of his contribution of property (1) his cost or other basis in the property, or (2) the fair market value of the property, but he must include in his tax base the untaxed appreciation with respect to the property involved.[17]

This provision of the House Bill draws a line totally lacking in rationality. Under this provision, for example, a gift of appreciated property to a local P.T.A. would be entitled to a deduction measured by the fair market value while a similar gift to the Brookings Institute would, because it is a private foundation, be limited to the donor's cost or subject him to tax upon the appreciation. Such a Congressional judgment as to favored and disfavored charity could hardly be based upon objective evidence. Indeed, it smacks of crass discrimination for it is no argument to condem the gift of appreciated property and then merely select out the impact of the bill an illogical slice of charitable institutions.

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[14] Atkinson, *Handbook of the Law of Wills* (2d Ed.), West Publishing Co. (1953), p. 468. While this result, says Atkinson, should only be reached where it is in accordance with the testator's probable intention, the case law is is far from clear.

[15] See Appendix A for illustrative draft language.

[16] H. Rept. No. 91-413 (Part I), p. 54, 91st Cong., 1st Sess. (1969).

[17] A tax on unrealized appreciation would be a sharp departure from the philosophy of our federal taxation scheme.

Appreciation as a measure of deductibility

Historically, the Treasury has accepted the proposition that there is no realization of income when appreciated property is donated.[18]

Since the beginning of World War II, the appreciation factor has played an increasingly large part in the stimulation of charitable giving. To that large segment of the population who wish to be generous and only have appreciated property to make large donations, if this provision remains in the bill, they realistically have no choice but to ignore the needs of private foundations and give to those charities to which the contribution will be afforded greater credit "for tax purposes." To assume the contrary is to ignore a basic fact of life in mid-twentieth century America.

Thus, the real impact of this provision is to shift donations away from the work of private foundations in certain instances and to shut off the flow completely in other instances. Such an effect is all the more troublesome when it is recognized that the work of philanthropy in the nation is as beset by inflation as is the private economy. Just at the point in our history when the demands on private philanthropy are at their high point, the Congress is considering legislation which would shut off the flow of funds to private foundations. It is illogical.

Accordingly, this provision should be struck from the Bill.

C. *Tax on investment income*

The House Committee Report says that private foundations should "make a small contribution, a tax of 7½ percent of their investment income, toward the cost of government." It is, however, curious indeed that the contribution is required only of private foundations; numerically but a fraction of the total number of exempt organizations. It is even more curious when one assumes that the other provisions of this bill will cause only Congressionally desirable foundations to retain exemption. In fact, the tax is actually placed on the beneficiaries of charity; a tax not placed on other exempt organizations with extensive investment income. Nor is the 7.5 percent federal tax the only concern to philanthropy. It is quite conceivable—indeed, inevitable—that state and local tax authorities will add private philanthrophy to their tax rolls once the lead is taken by the federal government.

Since literally the dawn of history the tax-free status of philanthrophy has been the favorite tool of society in shaping the development of charitable activities. The Revenue Code has never drawn a distinction among charities; making some tax-free and some 92½% tax-free. Certain activities are simply better handled in society through private charity as opposed to the business sector of government; a pattern now threatened by the 91st Congress.

It would appear that a user charge[19] to defray the administrative expenses of examining exempt foundations and other organizations would be a better alternative to a tax on investment income. Such a fee, likened to that paid by national banks to the Comptroller of the Currency, could be based on the organization's net assets. These fees could then be earmarked for the Revenue Service's audit program to insure that an adequate audit program can be developed.

Accordingly, the provision for a tax on investment income should be struck from the Bill and a "user-charge" substituted.

D. *Distribution of income*

The House Bill requires a private foundation to distribute all its income currently, but not less than 5 percent of its investment assets.

The 5 percent minimum distribution requirement is totally unrealistic. It imposes an unwarranted burden on the foundation manager. Instead of concentrating on philanthropy, he must turn his energies to chasing the vagaries of the stock market in pursuit of the ever-elusive 5 percent return. Certainly no precedent can be found in trust law for requiring a trustee to produce income of a fixed percent.

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[18] In 1938, the House attacked this position. It, however, got no further than the Senate Finance Committee. See H. Rept. No. 1860, 75th Cong., 3d Sess. 19 (1938), Sen. Rept. No. 1567, 75th Cong., 3d Sess. 14 (1938).

[19] The fee could be based on capital assets, not investment income. Further, I would recommend such a fee be paid by all section 501(c) organizations under the theory that the IRS does (or should) examine the activities of all exempt organizations.

The House Bill requires the adoption of an inflexible foundation investment policy that unduly restricts the foundation manager in making investment judgments. The foundation manager will have to stress "yield" only and ignore highly regarded "growth" stocks needed to offset the effect of inflation on the foundation's future distributions. The foundation manager will have to adhere to this rigid investment policy even in those economic periods when it proves unwise and imprudent, because his only alternative is the gradual liquidation of the foundation's assets.

The mandatory distribution of 5 percent of a foundation's investment assets can produce serious difficulties of compliance in situations in which a foundation holds low-yield, closely-held stock for which there is no market. In addition to the obvious problem of valuing the closely-held stock for purposes of the 5 percent computation, the foundation will encounter problems in meeting the minimum distribution requirement. Sale of part of the stock is one alternative, but this alternative would not be meaningful if there is no market for the stock. Another alternative is redemption by the issuing corporation of sufficient shares to allow the foundation to meet the 5 percent distribution requirement. Redemption would not be feasible, however, because of the existence of two deterrents in the current tax laws discussed above. The Internal Revenue Service may take the position that some or all of the redemption proceeds are constructive dividends to the original donors; the Internal Revenue Service may also take the position that the use of corporate funds for the benefit of a charity has accumulated earnings penalty tax implications under section 531. Certainly prospective donors would be reluctant to contribute low-yield, closely-held securities to a foundation if the foundation may be compelled to redeem the stock and thereby create constructive dividend problems for the donor. Certainly issuing corporations would be reluctant to redeem any such stock if the redemption may create section 531 implications. Where sale or redemption of low-yielding, closely-held stock is not possible, the House Bill, in effect, requires foundations to distribute such stock to public or private operating foundations in order to comply with the 5 percent distribution requirement. It is questionable whether the public welfare is well served by such a rule that necessitates a continuous reduction of foundation assets.

Foundations should be encouraged to provide current benefits to charity. At the same time, foundation investment policy should not be unduly inhibited. Both of these objectives can be accomplished by a modification of the House Bill that would focus on the specific abuse involved in this area: that the current-benefits-to-charity principle is eroded when foundations hold non-income producing securities in corporations controlled by the foundation or by "disqualified persons" because those who "use a foundation's stockholdings to retain business control in some cases are relatively unconcerned about producing income to be used by the foundation for charitable purposes." [30]

To cure this abuse, the blanket 5 percent requirement would not be necessary. Current benefits can be assured for charity by requiring a foundation to distribute annually the aggregate of all its current net income, thus eliminating the vague standards relating to unreasonable accumulations of income under existing law. In the event that a foundation failed to invest its assets in income producing property, *i.e.*, it does not receive an annual income, it would seem that such a foundation has failed to dedicate its assets for exclusively exempt purposes and should be penalized. In the alternative, the mandatory yield requirement should be reduced to 3 percent.

Congress should seek to encourage responsible foundation managers to work toward the eradication of poverty, the rebuilding of our central cities, the lifting of our schools to a new level of quality and the accomplishment of the other formidable tasks that challenge society at the tail end of the 20th Century, not to chase after a glamour stock that yields the magical figure of 5 percent.

Accordingly, the 5 percent minimum yield provision should be deleted from the Bill in its entirety. Alternatively, if a minimum yield is believed necessary, it should be set at 3 percent of investment assets.

E. *The Clay-Brown provision*

The House Bill seeks to overcome the situation where a tax-exempt organization acquires a business by agreeing to pay the former owners a percentage of future profits until the purchase price is paid in full with no commitment for

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[30] H. Rpt. No. 91-418 (Part I), p. 27, 91st Cong., 1st Sess. (1969).

payment other than from the assets or income of the transferred business. The Bill reaches this result by imposing the unrelated business income tax on the income received by the exempt organization in proportion to the existing debt on the income producing property. The legislation is sound and long overdue.

However, as drafted, the House Bill could produce certain unintended inequities. Specifically, the language of sections 514(b) and 514(c)(1)(C) could be interpreted as covering a transaction in which a charitable foundation borrows money in order to make a contribution in furtherance of its charitable purposes and pledges recently-acquired *donated* property as collateral for the loan.

Background

Since the specific transaction with respect to which we are concerned has already been entered into, after favorable rulings by the Internal Revenue Service (as later herein indicated), the background and surrounding facts become quite relevant in pointing up the need for clarifying language in the Committee Report.

The Foundation entered into an agreement with a university wherein the Foundation agreed to grant $500,000 to the university for the construction of a building for its Center of American Studies. The total grant is to be paid over the construction period in quarterly installments sufficient to cover the university's current construction costs.

In order to help the Foundation meet this increased financial burden, one of its founders transferred shares of publicly-traded common stock to an irrevocable trust for the benefit of the Foundation. The trust is to remain in existence for a period of ten years and one day, or until $650,000[21] in income payments are received by the Foundation, whichever occurs later. Under the terms of the trust indenture, all of the income from the corpus of the trust belongs absolutely to the Foundation and is to be paid over to it in quarter-annual installments by the bank trustee. Upon the termination of the trust, the trust principal, as then constituted, will be returned to the grantor (or his estate, in the event of his prior death) as his absolute property.

While it is anticipated that the amount of income to be derived from the trust over its entire term will be more than adequate to fund the Foundation's grant, it will not be sufficient during the construction period to cover the Foundation's obligation under the agreement. In order to raise the funds necessary to meet the quarterly payments to the university, as they become due, the Foundation arranged to borrow a total of $500,000 from a bank. As security for the loan (or loans), the Foundation assigned its income rights under the trust agreement to the bank.

By virtue of the foregoing transaction, it will be possible for the Foundation, with the then current net worth of $257,000, to make available the entire $500,000 grant to the university to meet the expenses of the building's construction as they become due during the construction period, and the Foundation will have funds to pay off the loan.

The Foundation received favorable rulings from the Internal Revenue Service determining that (1) no part of the income of the trust would be taxed to its grantor, (2) the trust would be allowed a deduction under section 642(c) of the Internal Revenue Code of 1954 for all of the income paid to the Foundation, and (3) none of the described transactions would adversely affect the exempt status of the Foundation.

The Committee Report makes it clear that unrelated debt-financed income would be taxable as unrelated business income "if the income arises from property acquired or improved with borrowed funds and the production of the income is unrelated to the" purposes of the exempt organization. In the situation with which we are concerned, the property acquired, the income interest in the trust, was not acquired with borrowed funds, but was, in fact, donated. The arrangement would not, therefore, appear to be within the policy of the Bill.

Definitional problem

The Bill as drafted (proposed section 514(b)), however, defines "debt financed property" as "any property which is held to produce income and with respect to which there is an acquisition indebtedness (as defined in subsection (c)) at any time during the taxable year. . . ." Section 514(c)(1)(C) in turn defines "acquisition indebtedness" as:

"The indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such ac-

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[21] This figure includes the interest factor.

quisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement. . . ."

It would appear that, as drafted, this language may inadvertently apply to the type of transaction entered into by the Foundation. While the Foundation did not borrow funds for the purpose of acquiring or improving property, the indebtedness probably would not and could not have been incurred unless the Foundation were given the income interest in the trust which could be pledged with the lender-bank.

It is difficult to believe that such a result lies anywhere within the realm of the avowed legislative purpose—to extend the unrelated business income tax provided by section 514 of existing law to the *Clay-Brown* type of transaction and similar cases. Certainly, no public policy is served by reaching such a result in a situation in which a foundation is merely anticipating its income in the interests of a university.

Solution

It is suggested that Congress' intention not to extend this legislation to such ends can be made clearer than it has been by expanding the Committee Report[22] to read as follows:

"Under the bill, the unrelated debt-financed income is included in 'unrelated business income.' It would be subject to tax, however, only if the income arises from property acquired or improved with borrowed funds and the production of the income is unrelated to the educational, charitable, religious, or other purpose constituting the basis of the organization's tax exemption. Borrowing by the exempt organization for its own exempt purposes would be unaffected by the bill. *Thus, where a foundation pledges recently acquired property in order to borrow funds which it immediately uses for tax exempt purposes and neither the donor of the pledged property nor any other private individual receive any direct or indirect financial benefit either as a result of the transfer of the property or the borrowing by the organization, it will be assumed that the borrowing is for the organization's 'own exempt purposes'* . . ." (italicized portion added).

III

Conclusion

The federal tax laws have historically encouraged private philanthropy. It is entirely appropriate that the Congress re-examine the character of and the compliance with such laws. The process should, however, be a deliberate one—directed toward the real abuses but carefully guarding the existence and effectiveness of private philanthropy.

We have attempted to come up with constructive alternatives to provisions which are unwise or inadvertently discriminate against private foundations currently holding closely held stock in a family enterprise. The President has said that this Bill "will take a long step toward making taxation, if not popular, at least fair for all our citizens." We believe the goal of "fairness" is not reached, however, unless the Senate tempers the overreach of certain of the provisions.

As the Bill now stands, it will cause the liquidation within less than a decade of many private foundations. Limitations on holdings and future giving, along with the mandatory yield provisions, will rapidly eat into the corpus of countless private foundations and cause generous benefactors of philanthropy to think twice or not to give at all. While the House Bill does not overtly address itself to the elimination of private foundations from the American scene, the overall effect of the various provisions will bring such a result about. The Senate should openly debate this result for the work of private foundations will not be found wanting.

APPENDIX A

RE PROPOSED LEGISLATIVE AMENDMENTS REGARDING TAX PROBLEMS INVOLVED IN REDEMPTION OF EXCESS BUSINESS HOLDINGS

Section 4943 (c) Disposition of closely held stock by redemption

Notwithstanding any other provisions of this section, a private foundation may dispose of excess business holdings in a closely-held business enterprise owned

[22] H. Rpt. No. 91-413 (Part I), p. 46, 91st Cong., 1st Sess. (1969).

by a private foundation on the effective date of this section or received by such foundation by bequest thereafter, by redemption of such stock by the issuing corporation during a ten-year period beginning on the effective date of this section or beginning on the date the estate tax return for a testator has been filed. For purposes of this section, a closely-held business enterprise is defined as one in which five or fewer persons and one or more private foundations own, directly or indirectly, 85 percent or more of the outstanding stock of a corporation. For purposes of direct or indirect ownership, a person shall be considered as owning the stock owned directly or indirectly, by his brothers and sisters (of half or whole blood), their spouses, their lineal descendants, his spouse, his ancestors and his lineal descendants.

Section 302(f) Redemption of stock held by certain private foundations

Notwithstanding any other provisions of this section, distributions made in the redemption of stock held by a private foundation, as defined in section 509, or held by a public charity as defined in section 509, of a closely-held business enterprise, as defined in section 4943(e), shall not constitute the equivalent of a dividend to the private foundation, the public charity or to any other shareholders of the redeeming corporation.

The first sentence of 535(b) (2) as amended, shall read:

2. Charitable contributions. The deduction for charitable contributions, *and for amounts paid out to public charities or private foundations in redemptions of a closely-held business enterprise, as defined in section 4943(e)*, shall be allowed, but in computing such *deductions* the limitations in section 170(b) (1) (A) and (B) shall apply, and section 170(b) (2) and (5) shall not apply. (New matter italicized.)

Section 4941(d) (2) (F) is amended to read:

(F) Any transaction between a private foundation and a corporation which is a disqualified person (as defined in section 4946), pursuant to any liquidation, merger, redemption, recapitalization of other corporate adjustment or reorganization shall not be an act of self-dealing if all of the securities of the same class as that held by the foundation are subject to the same terms, *except for a redemption of stock of a closely held business enterprise as provided in section 4943(e), in which case redemptions need not be made or offered to other holders of shares of the same class*, and provided that such terms provide for receipt by the foundation of no less than fair market value. (New material italicized.)

Add a new subsection to section 303(a) to read as follows:

(3) the amount paid out in redemption of stock of closely held business enterprises, as provided in section 4943(e).

The dividend problem created by a redemption could also be handled by a provision, the reverse of section 1111 (the DuPont-General Motors Tax Relief provision regarding the antitrust divestiture order). It could provide:

"Notwithstanding sections 301, 302, 303, 312 and 316, the gross income of no person shall include the proceeds of a redemption of stock by a private foundation, or by a public charity, as defined in section 509, in compliance with section 4943(e)."

Senator GORE. I believe that concludes our witness list that was scheduled for hearing today. We will insert at this point in the record a letter the committee has received from Mr. Jacob Blaustein.

We are now in recess until 9:30 tomorrow morning.

Thank you very much.

(The letter with attachments follow:)

BALTIMORE, MD., *September 3, 1969.*

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Old Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: You have doubtless heard from many, like myself, who are concerned with certain portions of H.R. 13270 dealing with private foundations. I hope you will consider my comments when the Senate Finance Committee examines the House Bill.

Although the enclosed memoranda are limited to just three aspects of the House Bill (i.e., Stock Ownership Limitation, Charitable Contributions of Appre-

ciated Property, Clay-Brown Provision), I wish to register a strong general protest regarding an all too broad bill which was apparently spawned out of haste and an over-reaction to certain specific abuses of a few private foundations.

The need for legislation to curb these specific abuses goes without saying. The need is just as clear now as it was four years ago when the Treasury Report on private foundations was issued or for that matter, seven years ago when Congressman Patman's first report on foundation abuses was issued. In the same vein, the extraordinary service private foundations have rendered our society needs no repeating. It is in this context that I conclude the House Bill is unwise in its totality, and legislation should be tailored to eliminate specific abuses. The Congressional task would seem to be, in the words of Gilbert and Sullivan, "to make the punishment fit the crime." Having said that, let me briefly enumerate three specific objections to which separate memoranda have been prepared and are attached.

1. Stock Ownership Limitation

If Congress decides that after 50 years certain investments are no longer appropriate holdings for private foundations, fair play demands that transition rules be provided so that private foundations can dispose of these prohibited holdings without adverse tax consequences.

The limitation on stock ownership is a confused concept. Nonetheless, it can be made workable and the assumed goals of Congress can be reached if modest amendments are made along the lines of the attached material.

2. Charitable Contributions of Appreciated Property

The House Bill—out of charitable organizations to which contributions of appreciated property are deductible at fair market value—excludes private foundations and makes second class citizens of this group of charities. The limitations clearly reflect a misshapened intention to dry up gifts to this worthy class of philanthropy. It should be noted that the term "private foundations" covers much more than family foundations. It includes large foundations such as the Brookings Institute and all others which are not generally supported by the public. If private foundations had, as a class, sinned, then punishment might be due them. But there is no evidence of such a taint. There have been abuses among a small number of private foundations which should be stopped, but there is no evidence of widespread abuses. Consequently, a broadside attack against private foundations as a class is clearly out of order and, if not revised, will do great damage. (Memorandum attached.)

3. Clay-Brown Provision

This provision is sound and long-overdue. However, as drafted, it could produce certain unintended inequities so as adversely to affect a foundation which borrows money in order to make a contribution in furtherance of its charitable purpose and pledges recently-acquired donated property as collateral for the loan. (Memorandum attached.)

In addition to these three items separately covered in the attached material, I wish to bring two other provisions of the House Bill to your attention:

1. Tax on Investment Income

The House Committee Report says that private foundations should "make a small contribution, a tax of 7½ percent of their investment income, toward the cost of government." It is, however, curious indeed that the contribution is required only of private foundations; numerically but a fraction of the total number of exempt organizations. In fact, the tax is actually placed on the beneficiaries of charity; a tax not placed on other exempt organizations with extensive investment income.

Since literally the dawn of history the tax-free status of philanthropy has been the favorite tool of society in shaping the development of charitable activities. Certain activities are simply better handled in society through private charity as opposed to the business sector of government; a pattern now threatened by the 91st Congress.

It would appear that some sort of a user charge to defray the administrative expenses of examining exempt foundations and other organizations would be a better alternative to a tax on investment income. Such a fee, likened to that paid by national banks to the Comptroller of the Currency, could be based on the organization's net assets. These fees could then be ear-marked for the Revenue Service's audit program.

2. Distribution of Income

In particular, the "income equivalent" provision requiring a minimum 5 percent yield is totally unrealistic. Foundation managers, instead of concentrating on their task of philanthropy, will have to spend the majority of this time chasing the vagaries of the stock market to grasp the ever-elusive 5 percent return. This is an all too apparent fault in the House Bill.

Congress should seek to encourage responsible foundation managers to work toward eradication of poverty, the rebuilding of our central cities, the lifting of our schools to a new level of quality and the accomplishment of the other formidable tasks that challenge society at the tail end of the 20th Century, not to chase after a glamour stock that yields the magical figure of 5 percent.

Foundation managers are required to maintain a prudent investment portfolio which would, presumably, include a mixture of growth, as well as income type investments.[1] To peg an arbitrary figure as a minimum yield makes as much sense as if the SEC required mutual funds similarly to guarantee a 5 percent yield. The vitality of voluntary action ought not to be hobbled by the rigidity of stated annual yield.

In speaking in opposition to portions of this Bill, I do not mean to indicate that the concept of reform of tax abuse in the foundation area is not necessary or appropriate. The process should, however, be a deliberate one—not spurred by the emotion of the moment.

I know you will be good enough to do what you can to bring about the necessary relief from H. R. 13270—so essential to the preservation of private foundations and their charity and institution beneficiaries.

I would like to take the liberty of suggesting that if, after you have had an opportunity to consider this letter, you find any or all of the points to bear merit, you will call them to the attention of the Committee staff.

Sincerely,

JACOB BLAUSTEIN.

MEMORANDUM

SEPTEMBER 2, 1969.

Re: Stock Ownership Limitation (Section 101(b)—H. R. 13270 New Section 4943 of the Code).

INTRODUCTION

This provision of the bill limits to 20 percent the combined ownership of a corporation's voting and nonvoting stock held by a private foundation[2] and those who, under broad rules of stock ownership attribution, are referred to as "disqualified persons." To the extent that a foundation and disqualified persons own stock in excess of the 20 percent limitation, the foundation must dispose of its stock within a 10-year period. This provision will, single-handedly, cause the liquidation of countless private foundations and will make it impossible for many men of wealth to contribute to philanthropy the most valuable asset they have: shares of the businesses built up by themselves, their family or a small group.

The general philosophy behind such legislation is the assumption that a foundation owning together with so-called disqualified persons, more than 20 percent of a corporation's voting stock will become preoccupied with the business of business rather than its charitable purpose.

While there is much to be said in favor of prohibiting foundation trustees and managers from engaging in the business of its equity investments, the House Bill would unnecessarily destroy a substantial source of philanthropic support to curb some abuses which may arise from control. Two basic shortcomings cause the Bill to have effects upon philanthropy far beyond these presumably intended or socially desirable. The first, the rules dealing with attribution, are excessively broad in some instances and totally unnecessary in others. For example, under these rules, a foundation can be deemed to be in control of a corporation in which it has no vote and, therefore, no control. The second reflects the absence of a realistic method in which a foundation can divest itself of shares of closely held stock to meet the House Bill's limitation on stock ownership and still make

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[1] The example of gilt-edge securities are legion which fail to yield 5 percent of their market value.

[2] The House Bill's definition of a private foundation is broad enough to cover most of the foundations and other funded charitable organizations in the country.

available to charity the most cash possible. Closely held stock has no market and cannot be sold for its real worth. The only method of obtaining real worth for charitable purposes is through redemption.

ATTRIBUTION RULE

The 20 percent limitation of combined stock ownership is an arbitrary rule which substitutes arithmetic for reason. It has the sole advantage of being a clear cut rule. But even this advantage becomes fuzzy when the rules of attribution—the deeming of stock owned by others to be owned by the Foundation—are applied. The basic presumption is that when a foundation has more than 20 percent of a corporation's voting stock its managers will become involved in business to the detriment of philanthropy. This, however becomes strained to the breaking point when, for example, a foundation with nothing but the nonvoting stock of a corporation finds itself charged with all the voting stock owned by:

> "a substantial contributor (anyone who has contributed more than $5,000 in any one calendar year or more than any other contributor in any one calendar year), a foundation manager, an individual who owns more than 20% of a corporation which is a substantial contributor, a holder of more than 20% of the beneficial interest of a trust or unincorporated enterprise which is a substantial contributor, a member of the family (under the personal holding company and collapsible corporation attribution rules) of any such person, or a corporation, partnership, trust, or estate as to which all such persons own in the aggregate more than 35%." [1]

To equate nonvoting stock with voting common stock is like assuming that holders of Series E Savings Bonds can vote on federal legislation. The presumption of business involvement is nonsense when nonvoting stock is held by a foundation. The attribution rules, while properly broad when dealing with matters such as self-dealing, have no relevance in the context of the provisions of the House Bill dealing with control by a foundation.

REDEMPTION

A second and equally troublesome feature of the House Bill is its failure effectively to provide a mechanism for: (1) private foundations to comply with a forced divestiture of stock in a closely held company; and (2) for public charities to obtain cash for closely held stock in a manner which will most benefit charitable purposes.

Many public charities and private foundations presently hold stock in closely held companies. Indeed, for over 50 years such stock has been considered by the Treasury as perfectly legitimate holdings for foundations. Under The House Bill, private foundations required to divest themselves of closely held stock can meet this requirement by sale, by gift to a public charity, or by redemption. Realistically, however, redemption of the stock by the issuing company is the only method for the charity to obtain a market and a fair market value. The transfer by the private foundation of closely held securities to a public charity, without the capacity of sale by the recipient, is a paltry gift unless the public charity can otherwise convert it into expendable cash.

Many persons of wealth whose property is concentrated in closely held corporations customarily leave substantial gifts to private and public charities under their wills. The House Bill will discourage future generous gifts of such stock to private foundations if the gift will make the foundation a 20% or more shareholder, unless there is some way for the foundation to divest itself of the shares. Likewise, when testamentary gifts are made to public charities, or if the public charities receive closely held stock from private foundations, a method must be devised to allow the conversion of the stock into cash. Unless a redemption provision is provided, charity will get something substantially less than the true worth of the securities in both instances.

WHY REDEMPTION IS NOT CURRENTLY FEASIBLE

The House Bill does not forbid redemptions from public charities or private foundations. In fact, the Committee Report recognizes that closely held stock may be redeemed. To facilitate this end, the prohibition against self-dealing is relaxed in such cases where the stock is sold for fair market value by the

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[1] H. Rept. No. 91-413 (Part I), p. 21, 91st Cong., 1st Sess. (1969).

foundation to a disqualified person which may be the corporation. Nonetheless, certain other possible interpretations of the Internal Revenue Code may make the redemption so dangerous to the donor and to the closely held corporation that redemption is impossible.

The Internal Revenue Service has sometimes taken the position that where a corporation redeems shares which have been received by a foundation as gifts, the redemption amounts to a taxable dividend at high rates, to the original donors. How far the courts will go along with this position is, perhaps, another matter, but the prospect of the assertion of dividend consequences is a chilling one. It should be made clear that a redemption of closely held stock presently held by, or received as a testamentary bequest by a private foundation or owned or received by a public charity would not produce dividend consequences to the donors or to the decedent's estate.

So far as the redeeming corporation is concerned, the problem is the possible assertion of the penalty tax upon unreasonable accumulation of income under section 531 of the Internal Revenue Code. For purposes of the penalty tax the Code presently allows a deduction for corporate charitable contributions in excess of the 5 percent of adjusted gross income normally allowed corporations as a deductible charitable contribution. An additional deduction should be allowed for the indirect charitable contribution made through a redemption of closely held shares.

POLICY CONSIDERATIONS FAVORING REDEMPTION

Over the history of our modern income tax, closely held and family businesses have been protected and sheltered from adverse tax effects which would cause the demise of the closely held business as a part of our economic life. For example, Congress recognized that death taxes could easily force a closely held business to liquidate, merge, or "go public" under extreme duress. Accordingly, it provided for stock redemption to pay death taxes without dividend consequences to the estate.

Similar protection must be given to testamentary gifts of securities in closely held companies, if our pluralistic approach to philanthropy is to continue.

A private foundation required to divest a portion of its publicly traded securities has no problem. A private foundation or a public charity holding a security with no available market other than the issuing company will have difficulty realizing the full value of such assets. Consistent with the desire for charity to obtain the full value of such assets, they should be encouraged to convert the closely-held stock into cash and thereafter be on parity with other private foundations or public charities which hold marketable securities. Thus, they will be in a better position to carry out their charitable purpose.

LEGISLATIVE SOLUTIONS

1. *Attribution.*—The attribution rules should be amended so as not to be applicable to section 101(b) of the House Bill. If the attribution rules are retained with respect to section 101(b), at a very minimum, they should not apply to a private foundation which itself owns no voting stock.

2. *Redemption.*—Affirmative legislation should be added to the House Bill to permit:

(a) Private foundations to offer to the issuing corporation for redemption over a ten year period any stock in a closely-held corporation which is an excess business holding as of the effective date of the act or becomes an excess business holding because of a subsequent testamentary bequest, with no adverse tax effects to the foundation, the redeeming corporation, its stockholders, or the donor.

(b) Public charities to offer at any time closely held stock to the issuing corporation for redemption without adverse tax effects upon the redeeming corporation, its stockholders or the donor.

Attached is a draft bill intended to amend H.R. 13270 accordingly.

SUGGESTED REVISED TEXT OF BILL

§ 4943(e) DISPOSITION OF CLOSELY HELD STOCK BY REDEMPTION

Notwithstanding any other provisions of this section, a private foundation may dispose of excess business holdings in a closely held business enterprise owned by a private foundation on the effective date of this section or received by such

foundation by bequest thereafter, by redemption of such stock by the issuing corporation during a ten year period beginning on the effective date of this section or beginning on the date the estate tax return for a testator has been filed. For purposes of this section a closely held business enterprise is defined as one in which five or fewer persons and one or more private foundations own, directly or indirectly, 85 percent or more of the outstanding stock of a corporation. For purposes of direct or indirect ownership a person shall be considered as owning the stock owned directly or indirectly, by his brothers and sisters (of half or whole blood), their spouses, their lineal descendants, his spouse, his ancesters and his lineal descendants.

§ 302(f) REDEMPTION OF STOCK HELD BY CERTAIN PRIVATE FOUNDATIONS

Notwithstanding any other provisions of this section, distributions made in the redemption of stock held by a private foundation, as defined in section 509, or held by a public charity as defined in section 509, of a closely held business enterprise, as defined in section 4943(e), shall not constitute the equivalent of a dividend to the private foundation, the public charity or to any other shareholders of the redeeming corporation.

The first sentence of 535(b)(2) as amended, shall read:

2. CHARITABLE CONTRIBUTIONS. The deduction for charitable contributions, *and for amounts paid out to public charities or private foundations in redemptions of a closely held business enterprise, as defined in section 4943(e)*, shall be allowed, but in computing such *deductions* the limitations in section 170(b)(1) (A) and (B) shall apply, and section 170(b) (2) and (5) shall not apply. (New matter italicized.)

§ 4941(d)(2)(F) is amended to read:

(F) Any transaction between a private foundation and a corporation which is a disqualified person (as defined in section 4946), pursuant to any liquidation, merger, redemption, recapitalization or other corporate adjustment or reorganization, shall not be an act of self-dealing if all of the securities of the same class as that held by the foundation are subject to the same terms, *except for a redemption of stock of a closely held business enterprise as provided in section 4943(e), in which case redemptions need not be made or offered to other holders of shares of the same class*, and provided that such terms provide for receipt by the foundation of no less than fair market value. (Italicized material is new.)

Add a new subsection to section 303(a) to read as follows:

(3) the amount paid out in redemption of stock of closely held business enterprises, as provided in section 4943(e).

MEMORANDUM

AUGUST 30, 1969.

Re Charitable Contributions of Appreciated Property (sections 201(d) and (d) of the Bill, Sections 170 and 83 of the Code.)

INTRODUCTION

Predicated upon the stated desire "to remove *some* of the present tax advantages of gifts of appreciated property over gifts of cash," this provision of the House Bill drives a further wedge between charitable institutions. It develops an elitist group of charities to which Congressionally recognized undesirable tax advantages will be permitted and a second class of charity where no such advantage will be brooked.

As to the first class of charity, the donor may continue to deduct the fair market value of contributed property. Where, however, the donee is a private foundation, the House Bill requires the donor to elect as the measure of his contribution of property (1) his cost or other basis in the property, or (2) the fair market value of the property, but he must include in his tax base the untaxed appreciation with respect to the property involved.

This provision of the House Bill draws a line totally lacking in rationality. Under this provision, for example, a gift of appreciated property to a local P.T.A. would be entitled to a fair market value deduction while a similar gift to the the Brookings Institute would, because it is a private foundation, be limited to

the donor's cost or subject him to tax upon the appreciation. The judgment as to favored and disfavored charity could hardly be based upon objective evidence. Indeed, it smacks of crass discrimination for it is no argument to condemn the gift of appreciated property and then merely select out of the impact of the bill an illogical slice of charitable institutions.

APPRECIATION AS A MEASURE OF DEDUCTIBILITY

Historically, the Treasury has accepted the proposition that there is no realization of income when appreciated property is donated.[1]

Since the beginning of World War II, the appreciation factor has played an increasingly large part in the stimulation of charitable giving. To that large segment of the population who wish to be generous and only have appreciated property to donate, they realistically have no choice but to ignore the needs of private foundations and give to those charities to which the contribution will be afforded greater credit "for tax purposes." To assume the contrary is to ignore a basic fact of life in mid-twentieth century America.

Thus the real impact of this provision is to shift donations away from the work of private foundations in certain instances and to shut off the flow completely in other instances. Such an effect is all the more troublesome when it is recognized that the work of philanthropy in the nation is as beset by inflation as is the private economy. Just at the point in our history when the demands on private philanthropy are at their high point, the Congress is considering legislation which would shut off the flow of funds. It is illogical—and this provision should be struck from the Bill.

MEMORANDUM

AUGUST 27, 1969.

Re. The Clay-Brown Provision (Section 121, H.R. 13270 Sections 512 and 514 of the Code.)

INTRODUCTION

The House Bill seeks to overcome the situation where a tax exempt organization acquires a business by agreeing to pay the former owners a percentage of future profits until the purchase price is paid in full with no commitment for payment other than from the assets or income of the transferred business. The Bill reaches this result by imposing the unrelated business income tax on the income received by the exempt organization in proportion to the existing debt on the income producing property. The legislation is sound and long overdue.

However, as drafted, the House Bill could produce certain unintended inequities. Specifically, the language of sections 514(b) and 514(c) (1) (C) could be interpreted as covering a transaction in which a charitable foundation borrows money in order to make a contribution in furtherance of its charitable purposes and pledges recently-acquired *donated* property as collateral for the loan.

BACKGROUND

Since the specific transaction with respect to which we are concerned has already been entered into, after favorable rulings by the Internal Revenue Service (as later herein indicated), the background and surrounding facts become quite relevant.

The Foundation entered into an agreement with a university wherein the Foundation agreed to grant $500,000 to the university for the construction of a building for its Center of American Studies. The total grant is to be paid over the construction period in quarterly installments sufficient to cover the university's current construction costs.

In order to help the Foundation meet this increased financial burden, one of its founders transferred shares of publicly-traded common stock to an irrevocable trust for the benefit of the Foundation. The trust is to remain in existence for

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[1] In 1938, the House attacked this position. It, however, got no further than the Senate Finance Committee. See H. Rpt. No. 1860, 75th Cong., 3d Sess. 19 (1938), Sen. Rpt. No. 1567, 75th Cong., 3d Sess. 14 (1938).

a period of ten years and one day, or until $650,000[1] in income payments are received by the Foundation, whichever occurs later. Under the terms of the trust indenture, all of the income from the corpus of the trust belongs absolutely to the Foundation and is to be paid over to it in quarter-annual installments by the bank trustee. Upon the termination of the trust, the trust principal, as then constituted, will be returned to the lender (or his estate, in the event of his prior death) as his absolute property.

While it is anticipated that the amount of income to be derived from the trust over its entire term will be more than adequate to fund the Foundation's grant, it will not be sufficient during the construction period to cover the Foundation's obligation under the agreement. In order to raise the funds necessary to meet the quarterly payments to the university, as they become due, the Foundation arranged to borrow a total of $500,000 from a bank. As security for the loan (or loans), the Foundation assigned its income rights under the trust agreement to the bank.

By virtue of the foregoing transaction, it will be possible for the Foundation, with the then current net worth of $257,000, to make available the entire $500,000 grant to the university in such a manner and at such times as will permit the university to meet the expenses of the building's construction as they become due during the construction period, and the Foundation will have funds to pay off the loan.

The Foundation received favorable rulings from the Internal Revenue Service determining that (1) no part of the income of the trust would be taxed to its grantor, (2) the trust would be allowed a deduction under section 642(c) of the Internal Revenue Code of 1954 for all of the income paid to the Foundation, and (3) none of the described transactions would adversely affect the exempt status of the Foundation.

The Committee Report makes it clear that unrelated debt-financed income would be taxable as unrelated business income "if the income arises from property acquired or improved with borrowed funds and the production of the income is unrelated to the" purposes of the exempt organization. In the situation with which we are concerned, the property acquired, the income interest in the trust, was not acquired with borrowed funds, but was, in fact, donated. The arrangement would not, therefore, appear to be within the policy of the Bill.

DEFINITIONAL PROBLEM

The Bill as drafted (proposed section 514(b)), however, defines "debt financed property" as "any property which is held to produce income and with respect to which there is an acquisition indebtedness (as defined in subsection (c) at any time during the taxable year . . ." Section 514(c)(1)(C) in turn defines "acquisition indebtnedness" as:

"The indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement. . . ."

It appears to us that, as drafted, this language may inadvertently apply to the type of transaction entered into by the Foundation. While the Foundation did not borrow funds for the purpose of acquiring or improving property, the indebtedness probably would not and could not have been incurred unless the Foundation were given the income interest in the trust which could be pledged with the lender-bank.

We find it difficult to believe that such a result lies anywhere within the realm of the avowed legislative purpose—to extend the unrelated business income tax provided by section 514 of existing law to the *Clay-Brown* type of transaction and similar cases. Certainly, no public policy is served by reaching such a result in a situation in which a foundation is merely anticipating its income in the interests of a university.

SOLUTION

We suggest that Congress' intention not to extend this legislation to such ends can be made clearer that it has been by expanding the Committee Report to read as follows (at p. 46):

[1] This figure includes the interest factor.

"Under the bill, the unrelated debt-financed income is included in 'unrelated business income.' It would be subject to tax, however, only if the income arises from property acquired or improved with borrowed funds and the production of the income is unrelated to the educational, charitable, religious, or other purpose constituting the basis of the organization's tax exemption. Borrowing by the exempt organization for its own exempt purposes would be unaffected by the bill. *Where a foundation pledges recently acquired property in order to borrow funds which it immediately uses for tax exempt purposes and neither the donor of the pledged property nor any other private individual receive any direct or indirect financial benefit either as a result of the transfer of the property or the borrowing by the organization, it will be assumed that the borrowing is for the organization's 'own exempt purposes'* . . ." (underlined portion added.)

(Whereupon, at 3:10 p.m., the Senate Committee on Finance recessed, to reconvene at 9:30 a.m. Wednesday, October 8, 1969.)

TAX REFORM ACT OF 1969

WEDNESDAY, OCTOBER 8, 1969

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 9:30 a.m., in room 2221, New Senate Office Building, Senator Clinton P. Anderson, presiding.

Present: Senators Long (chairman), Anderson, Gore, Talmadge, Williams of Delaware, Bennett, Miller, Jordan of Idaho, Fannin, and Hansen.

Senator ANDERSON. The hearing will come to order. Is Senator Yarborough, Senator Percy, Congressman Blackburn, or Justice Goldberg here? No. Then I believe the distinguished Senator from North Carolina, the Honorable B. Everett Jordan would like to introduce our first witnesses. Senator?

STATEMENT OF HON. B. EVERETT JORDAN, A U.S. SENATOR FROM THE STATE OF NORTH CAROLINA

Senator JORDAN of North Carolina. Thank you Senator Anderson.

Mr. Chairman and members of the committee: I am here this morning to introduce to you Mr. Thomas Perkins, Chairman of the Board of the Duke Endowment; Mr. Marshall Pickens, chairman of the hospital and orphanage section of the Duke Endowment; and Mr. Richard Thigpen, attorney for the Duke Endowment.

I personally am very much interested in any tax bill that affects the Duke Endowment for the following reason: I am a member of the Board of Trustees of Duke University and I am chairman of the Board of Trustees of Alamance County Hospital in Burlington, N.C. Being in these two positions, I have intimate association with the members of the Duke Endowment and I am thoroughly familiar with the workings of the Endowment.

The entire distribution of the assets that come from the Duke Endowment goes to aid every single orphan both black and white in the States of North and South Carolina. Negro university Johnson C. Smith in Charlotte receives annually. Duke University in Durham, N.C. (the entire university and medical school) receives a large amount of aid from this Endowment and in fact could not remain in operation without this aid. Furman University at Greenville, S.C., receives annual aid from this Endowment.

Every hospital in North and South Carolina receives $1 per day for every charitable patient. Money is provided to help build rural Methodist churches in North and South Carolina. Some money is provided for retired Methodist preachers in North and South Carolina.

The above mentioned institutions and individuals are provided for in the endowment and the proceeds from the endowment cannot be used for any other purpose.

Anything that would change the tax status to curtail the amount of money that the Duke Endowment can contribute to the above agencies would come from the orphans school funds, the hospitals and churches, and retired ministers; so I hope very much that nothing will be done to change the status of the Duke Endowment.

Thank you, Mr. Chairman, for letting me appear before your committee this morning.

STATEMENT OF RICHARD E. THIGPEN, COUNSEL, THE DUKE ENDOWMENT; ACCOMPANIED BY THOMAS L. PERKINS, CHAIRMAN, BOARD OF TRUSTEES, AND MARSHALL PICKENS, VICE CHAIRMAN

Mr. PERKINS. Thank you Senator.

I am chairman of the board of trustees. We are very grateful for your giving us a chance of telling you how the House bill affects Duke Endowment and, more importantly, the people of North Carolina and South Carolina. Mr. Richard E. Thigpen, counsel for Duke Endowment.

Mr. THIGPEN. Mr. Chairman, this is an unexpected honor to lead off this morning but we are glad we are here and you are here so that we can proceed and not take up too much time. On my left here is Mr. Marshall I. Pickens, vice chairman of the Duke Endowment and Mr. Perkins.

I am Richard E. Thigpen, an attorney of Charlotte, N.C., tax counsel for the Duke Endowment.

We have heretofore filed our formal statement and we request that that be made a part of the record.

Senator ANDERSON. Without objection that will be done.

Mr. THIGPEN. Today I would like, Mr. Chairman, and gentlemen of the committee, to talk briefly about the Duke Endowment and three of the proposed sections in H.R. 13270 as they affect the Duke Endowment. Mr. Justice Holmes once said that a page of history is worth a book of logic, and when I read all that has been said about H.R. 13270, I would like to get down a few historic facts.

A page in the history of philanthropy will well show the success of Mr. James B. Duke's vision for the economic and industrial development of the Carolinas and also his great concern for the social welfare of the two States. He had a great interest in developing the water power resources of the Carolinas and just as the Carolinas have gone forward industrially he took a large portion of the revenues from the electrical development and turned those revenues into the social welfare and betterment of the people of the two Carolinas.

In 1924 he set up the Duke Endowment by an irrevocable indenture, which had as its principal asset a large block of the Duke Power Company stock. It was then worth about 40 millions of dollars, all of the assets of the Duke Endowment. At December 31, 1968, except for about a million dollars in cash the assets of the Duke Endowment were government bonds, corporate bonds, and shares of stock all productive investments, with a fair market value at that time in excess of 600 millions of dollars.

From the beginning of the Duke Endowment in 1924 through 1968, the Duke Endowment had gross income of $331 million of which nearly 63 percent came from the dividends on the stock of the Duke Power Co. Over these years, 285 millions of dollars have been distributed to or set aside for charity and religion and education in North Carolina and in South Carolina.

The actual payments to the beneficiaries over the entire period of the Duke Endowment amounted to 78 percent of the gross income, 83 percent of the net income, and 90 percent of the net distributable income.

Now, I have to use that latter phrase, net distributable income because under the terms of the indenture, Mr. Duke very wisely provided that we should set aside 20 percent of the income on the original corpus in order to increase the assets of the Duke Endowment, and we have accumulated 25 millions of dollars under that provision, which will be satisfied within a very few years now.

Since 1925 we have published reports of all the activities of the Duke Endowment, and in 1968 the annual report gives a full account of the stewardship of the trustees of the Duke Endowment administering to four universities, about 200 hospitals, all of the orphanages in North and South Carolina and the rural Methodist churches in North Carolina, and making provision to aid the superannuated ministers of that denomination.

All of the provisions for the taxation and regulation of private foundations will affect the Duke Endowment, but today we are concerned with section 506, tax on private foundation investment income, section 4942, taxes on failure to distribute income, and the section 4943, taxes on excess business holdings.

We are concerned because these taxes, if imposed, will reduce the amount of money that the Duke Endowment can disburse for health, education, and welfare in North and South Carolina.

Let's look for a moment at the section 560 tax which is 7½ percent under the House bill. This is a minimal tax on the net investment income but it is not a tax upon true net income, because only the expense of producing investment income and managing the investment property are allowed as deductions from gross investment income.

But even assuming that all expenses of operating the Duke Endowment are deductible, this tax would take at least 1½ million dollars each year out of the moneys that are available for the work of the Duke Endowment in the Carolinas. For instance, Duke University, and I happen to be a trustee of Duke University so I know something about the financial problems, Duke University would lose at least $684,000 by reason of this tax, the first year, and the 191 hospitals in North Carolina and South Carolina would be short about $596,000 by reason of this tax in 1 year.

The real distributable income of the Duke Endowment is the amount remaining after expenses and the mandatory accumulations. The 1968 net distributable income was $18,166,000 of which 99½ percent was paid to charity, religion, and education in North Carolina and South Carolina.

There remained only a balance of $98,700 and some dollars undistributed.

The thrust of these provisions should be such that if there is a flow-through to charity and there is no delayed benefit to charity the mini-

mal tax should not apply when such payments exceed 90 percent of net income.

We also think that section 504 and 681 of the Internal Revenue Code should not be repealed because those provisions put a testamentary trust and a living trust on the same basis with regard to accumulations under instruments that became effective prior to 1951.

Let's look for a moment at section 4942 which levies an excise tax of 15 percent upon the net investment income of the Duke Endowment after qualifying distributions.

The statute prescribes a minimum investment income of 5 percent and that is based on 5 percent of the fair market value of the assets at the beginning of the year. It might be better if that tax was levied upon the book value or the cost of the assets at the beginning of the year. But let's look at an example, for instance as it affects us.

The 1968 gross income of the Duke Endowment was $21,494,000 which was about 3½ percent return on $613 million which was the fair market value of the assets at December 31, 1967.

The statutory 5 percent required return would be in excess of $30 million. The difference between the minimum investment income of over $30 million and the distributable amount of $18 million is in excess of $12 million on which the tax would be at least $1,871,000 for 1972 and subsequent years, and that must come out of corpus and thereby reduce the assets upon which or from which income is produced for these health, education, and welfare projects in the Carolinas.

The excise tax under this section would be on unrealized income, and we would be reducing our productive assets continually when we are subjected to that tax.

Let's look at another section for a few moments, section 4943, which deals with divestiture. But section 4943 imposes an excise tax of 5 percent of the value of excess business holdings. The Duke Endowment and disqualified persons own nearly 74 percent of the stock of the Duke Power Co. The stock, this stock, paid the Duke Endowment $16,845,000 in dividends in 1968, at the rate of $1.30 per share, and that dividend has gradually increased carrying out Mr. Duke's desire to provide a steady source of revenue to take care of these social welfare projects.

These dividends were 78.85 percent of gross income in 1968.

Under the proposed statute the Duke Endowment would have excess business holdings of 12 million shares of stock in the Duke Power Co. Assuming a value of $30 per share on the basic date, the aggregate value of the stock would be $360 million and that would support a tax of $18 million, which again would come out of corpus, which again would reduce the assets that were held to produce income for the benefit of the various institutions set forth in the indenture.

It is true that the statute provides for disposition of such excess holdings over a period of 10 years, but sales of 54 percent of the stock, even within that period would depress the value of the stock to a great extent.

The Duke Power Co. is a regulated public utility. It is regulated by the Public Utilities Commissions of North and South Carolina by the Federal Power Commission, by the Atomic Energy Commission, and they have to go before the SEC on matters of financing stock issues and bond issues.

The Duke Power Co. stock for many years has been traded upon stock exchanges. And the indenture of the Duke Endownment requires the retention of the Duke Power Co. stock, and it also prohibits the invasion of principal.

Back in 1963 the trustees of the Duke Endowment sought to revise the investment provisions of the indenture so as to diversify. The Supreme Court of North Carolina said that could not be done. Their exception provisions of subsection (k)(4) which should be enlarged to include such foundations as the Duke Endowment. They should extend the 55 percent limitation to 75 percent with respect to stock ownership and the provision of (k)(5) should be reduced from at least 80 percent of income from such stock to at least 75 percent with respect to income from such stock.

There are other problems which we will encounter but they can be disposed of by further exceptions to 4943 until the governing instrument of the Duke Endowment could be revised.

Briefly, the estimated effect of these three provisions of this proposed bill would cost the Duke Endowment $21,300,000, a portion of out income, a portion out of corpus, but in any event the beneficiaries, white and black orphans homes, a Negro university, Duke, Davidson and Furman Universities, United Methodist Churches and hospitals in North and South Carolina will have a whole lot less money to use for their religious, charitable and educational programs.

If such taxes are imposed then we urge that the exceptions suggested in our formal statement filed for the Duke Endowment, be incorporated in the revised bill as it comes out of this committee.

I thank you, Mr. Chairman, and gentlemen for the opportunity of appearing before you today.

Mr. PERKINS. Could I add one thing, Mr. Chairman? The Duke Power Company is required to supply the power needs of certain portions of North Carolina and South Carolina. In order to do this we are continually building facilities. Our cash needs for the next five years are estimated at $1½ billion. Of this amount $370 million will have to be raised through the sale of equity securities. If the Duke Endowment is required to divest itself of some $400 million worth of securities at the same time Duke Power Company is seeking to sell almost an equal amount it would be very difficult for us to raise the sums of money that will permit us to properly carry out our duties. Thank you, sir.

Senator ANDERSON. Thank you very much for your appearance.

(Mr. Thigpen's prepared statement follows:)

STATEMENT ON BEHALF OF THE DUKE ENDOWMENT, PRESENTED BY RICHARD E. THIGPEN, THIGPEN & HINES, CHARLOTTE, N.C.

SUMMARY

I. For 45 years The Duke Endowment has distributed 78% of its gross income and 90% of its net distributable income to charity, religion and education in North Carolina and South Carolina. In 1968 these distributions were 83.65% of gross income and 99.5% of net distributable income. (pp. 1–3)

II. The section 506 tax of 7½% would cost the tax-exempt beneficiaries of The Duke Endowment at least $1½ million each year. If imposed, this tax should not apply to trusts like The Duke Endowment, governed by irrevocable trust agreements. (pp. 4–7)

III. If the tax of 15%, imposed by section 4942, had been assessed for 1968, The Duke Endowment would have paid $1,871,212 out of corpus. If imposed,

this tax should not apply to trusts governed by irrevocable trust agreements prohibiting the invasion of corpus and requiring the retention of productive investments. (pp. 8–9)

IV. The exclusion provided in subsection 4 of section 4943 should be enlarged to 75%, and section 4943 made inapplicable to a trust governed by an irrevocable instrument requiring the trustees to hold specified business interests. (pp. 10–11)

V. Conclusion—if section 101 of H.R. 13270 becomes law the payments to charity, religion and education in North Carolina and South Carolina will be reduced. (p. 12)

STATEMENT

H.R. 13270 and the committee report thereon have been studied to determine the effect the provisions on private foundations will have upon the operations of The Duke Endowment.

I. Background and operation

The Duke Endowment was created December 11, 1924, by James B. Duke, who placed $40 Million worth of property in trust. The trust agreement is irrevocable. Twenty percent of the net income is added to corpus, and the balance is distributed to specified tax-exempt beneficiaries. Since creation, The Duke Endowment has operated continuously under the terms of the trust indenture and, up through December 31, 1968, has made the following allocations and appropriations to the beneficiaries named in the governing instrument:

Income available for allocation and appropriation in accordance with the terms of the Trust Indenture	$285,182,859
Allocation and appropriation thereof:	
Duke University, Durham, North Carolina	$143,226,522
Davidson College, Davidson, North Carolina	10,456,795
Furman University, Greenville, South Carolina	10,533,665
Johnson C. Smith University, Charlotte, North Carolina	7,235,645
Hospitals in North and South Carolina	70,883,301
Orphanages in North and South Carolina	10,585,498
Methodist Churches in North Carolina:	
(a) Superannuated Preachers	2,358,693
(b) Building Rural Churches	5,233,998
(c) Operating Rural Churches	4,130,913
Funds set apart as endowment and held for the benefit of Duke, Davidson, Smith and Furman	19,261,228
Funds held for appropriation	1,276,601
	285,182,859

These allocations were made from gross income of $331,563,772, of which nearly 63% represents dividends on stock of Duke Power Company. The disbursements to the several beneficiaries totalled $258,564,162, which were about 78% of gross income, 83% of net income, and 90% of net distributable income.

The mandatory accumulations added to principal amounted to $25,698,113 at December 31, 1968. These accumulations produced more than $20 Million of income, which thereby increased distributions to beneficiaries.

The table below summarizes the allocations, appropriations and payments for calendar year 1968.

	Allocations (in thousands)	Payments (in thousands)
Duke University	$8,034.3	$7,771.7
Davidson College	728.0	716.8
Furman University	708.0	696.8
Johnson C. Smith University	585.1	412.8
Hospitals	6,542.9	6,770.0
Orphanages	742.0	721.2
Methodist churches in North Carolina:		
(a) Superannuated preachers	250.7	249.7
(b) Building rural churches	259.9	360.0
(c) Operating rural churches	341.2	368.9
	18,192.1	18,067.9

THE 1968 FINANCIAL STATEMENT

	Amount	Percent
Gross Income:		
Dividends	$19,474,771.60	90.17
Interest	2,026,791.57	9.38
Capital gains	96,267.05	.45
Total	21,597,830.22	100.00
Expenses were	1,615,394.17	7.48
Net income	19,982,436.05	
Mandatory accumulations	1,815,821.87	8.41
Net distributable income	18,166,614.18	
Payments to beneficiaries	18,067,869.49	83.65
Balance	98,744.69	.46

Payments to beneficiaries in 1968 were 83.65% of gross income, 90.0% of net income, and 99.5% of net distributable income.

II. Section 506. The 7½ tax

Assuming that on May 27, 1969, The Duke Endowment was, and is now, a private foundation as defined in section 509, it would be liable for the 7½% tax imposed by section 506 upon net investment income for 1970 and subsequent years.

It is estimated that the net investment income of The Duke Endowment, after all expenses for 1969, will be $21,223,000. A tax of 7½% would amount to $1,591,725. Applying the ratios of 1968 payments to this amount of tax would reduce distributions to beneficiaries as follows:

Duke University	$684,664.59
Davidson College	63,143.73
Furman University	61,392.83
Johnson C. Smith University	36,370.92
Hospitals	596,419.30
Orphanages	63,541.66
Methodist Church	86,191.91

The Indenture of The Duke Endowment limits the beneficiaries to those listed above, and the Indenture further requires that they be paid specified percentages of the net distributable income. All of these beneficiaries will remain tax-exempt under H.R. 13270. In effect, a tax on The Duke Endowment's net investment income becomes a tax on organizations which remain tax-exempt under the new bill.

The "minimal tax" proposed in section 506 will reduce by at least $1½ Million the distributions to charity, religion and education in the States of North and South Carolina. The Treasury proposals and earlier suggestions were directed toward current and adequate returns to charity, with a recognition of mandatory accumulations required "by the governing instrument of existing organizations," and as permitted under section 504(a) of the Internal Revenue Code.

The published annual reports of The Duke Endowment show the vast amount of services performed in meeting "the needs of mankind along physical, mental and spiritual lines" in carrying out the responsibilities of the trustees in accordance with the terms of the trust agreement. The 1968 report contains 36 pages of such work in North Carolina and South Carolina. Schedule 2a, attached to Form 990A for 1968, lists on 20 pages the amounts and purposes for the 1968 distributions of more than $18 Million to beneficiaries. The expenses incurred in the proper distribution of the income, like the administrative expenses of a corporation, may not be treated as having been "paid or incurred for the production or collection of gross investment income or for the management, conservation, or maintenance of property held for the production of such income."

Section 506(a) imposes "a tax equal to 7½ per cent" on the net investment income of every private foundation. Mr. Mills, Chairman of the Ways and Means Committee, compared this tax to the tax a corporation in the 50% bracket paid upon dividends from another corporation, both U.S. corporations (pp. H. 6987–88 Congressional Record, August 6, 1969). In the case of the corporation, dividends are included in gross income, from which all expenses are deducted, and a special

deduction for dividends received is allowed for 85% of the dividends received, restricted to 85% of taxable net income. But, section 506 proposes to tax the private foundation upon its gross income, less the "ordinary and necessary expenses paid or incurred in the production or collection of gross investment income or for the management, conservation, or maintenance of property held for the production of such income."

Mr. Duke wisely directed that "each trustee shall be paid at the end of each calendar year one equal fifteenth part of three per cent of the incomes, revenues and profits received . . . upon the trust properties and estate during such year . . . in full for all services as trustee hereunder. . . ." (Indenture, Article Second, p. 6). This rate of 3% is less than the rate of 5% allowed trustees in North Carolina. These commissions are proper costs of administration

Where, as in the operation of The Duke Endowment, there is a consistent and undelayed "flow through" to charity, the actual distributions to charity, religion and education should be deducted. At most—the "minimal tax" should apply only to the net income retained by the foundation, after accumulations (within the purview of section 504(a)), all expenses of the foundation and distributions to beneficiaries. Section 504(a) should not be repealed. The "minimal tax" is not for the purpose of raising revenue and has been characterized "as being in part a user fee."

If such a minimal tax is to be imposed, then a provision should be added excluding a trust, such as The Duke Endowment, from the application of the tax. The following provisions are suggested:

1. The tax imposed by section 506 shall not apply to a trust governed by an instrument (in effect and irrevocable on December 31, 1969) setting forth the portion of the net income distributable to designated tax-exempt beneficiaries in any year in which the payments to such beneficiaries of the trust exceed 90% of the net income for such year, which under the governing instument may be distributed.

2. The term "Private Foundation" as defined in section 509 does not include a trust or endowment fund required by terms of the governing instrument (in effect and irrevocable at December 31, 1969) to distribute specified percentages of its net income to specified beneficiaries each year and which is an exempt organization under section 501(c)(3) of the Internal Revenue Code, provided such distributable income is paid over to or set aside for such tax-exempt beneficiaries during or within 180 days after the close of such year.

The provisions (18) and (21) in subsection (j) relating to "technical, conforming, and clerical amendments" should be eliminated and necessary corrections made in order to continue sections 504 and 681 in the Internal Revenue Code (see pp. 66, 70, 71 of H.R. 13270).

III. Section 4942. Tax on undistributed income

In addition to the "minimal tax" of 7½% on net investment income, section 4942 of H.R. 13270 imposes an "initial tax" of 15% on undistributed income and an additoinal tax of 100% of such income "undistributed at the close of the correction period" (the time allowed for paying out amounts treated as undistributed income).

Under this new provisioin, the "Distributable Amount" is not the actual net income of a foundation, but rather whichever of the following amounts is higher:

(1) The minimum investment return, or
(2) The adjusted net income.

Minimum investment income is determined for 1970 by applying a 5% rate of return to the "aggregate fair market value of all assets."

If applicable to The Duke Endowment, the effect of the above provisions would be as follows, using 1968 experience as an example:

1. Gross income	$21,491,553.00
2. Paid Trustee Commissions & Expenses	1,487,364.00
3. Mandatory Accumulations	1,815,821.00
4. Available for Distribution	18,188,366.00
5. Minimum investment income $613,262,353 (FMV 12-31-67) @ 5%	30,663,117.00
6. 1968 Distributions	18,192,067.11

7. The undistributed income (under the proposed statute) is—

Item 5	30,663,117.00
Item 4	18,188,366.00
	12,474,751.00

8. Tax at 15% 1,871,212.00

The effective date for section 4942 in the case of organizatons organized before May 27, 1969, is deferred until taxable years beginning after December 31, 1971, and until it is possible to reform the governing instrument by amendment, judicial proceeding or otherwise to meet the requirements of section 508(g)(1)(A), "so that its income is distributed at such time and in such manner as not to subject the foundation to tax under section 4942."

The Duke Endowment distributes annually all of its distributable income. The application of section 4942 would require a distribution of corpus—which may not be done under the governing instrument. The "minimum investment income" is akin to the "income equivalent requirement" proposed in 1965. Then the Treasury Department stated that: "Provisions for existing organizations whose underlying instruments require an accumulation of current income or prohibit in invasion of corpus may be desirable." The indenture may be "reformed" by judicial proceedings—but a previous attempt at reformation failed *Cocke* v. *Duke University*, 260 N.C. 1, 131 S.E. 2d 909 (1963).

If section 4942, or any similar provision is enacted, there should be a further provision, making such section not applicable to foundations such as The Duke Endowment. The exception might read:

Section 4942 shall not apply to a trust governed by an instrument (in effect and irrevocable at December 31, 1969) directing the trustees to accumulate a specified portion of the income of the trust, prohibiting the trustee from invading the corpus of the trust, and requiring the trustee to retain investments that do not produce the minimum investment return.

IV. Section 4943. Tax on excess business holdings

Section 4943 imposes a tax of 5% of the value of excess business holdings in a business at the end of any calendar year and an additional tax of 200% of such excess value at the end of the correction period. Generally, this means the amount of voting stock held by a foundation and disqualified persons in excess of 20% of the voting stock of a corporation with a permissive holding of 35% of such stock where some third party has actual control of the corporation.

Section 4943 does not apply to an organization created by an inter vivos trust which was irrevocable on December 31, 1939, which, together with disqualified persons, owned not more than 55% of the stock of a corporation, the common stock of which was traded on a public stock exchange at all times after 1960 (see Sec. (4), p. 83, H.R. 13270). This exception applies only when (1) the foundation has received at least 80% of its net income in each of the years 1966, 1967, 1968, and 1969 from such stock, (2) neither the donor of such stock nor a member of his family is a foundation manager nor a director of the corporation, and (3) the foundation does not purchase nor acquire any of such stock after July 28, 1969 (see Sec. (5), pp. 84–85, H.R. 13270).

The Duke Endowment and disqualified persons hold 74% of the voting stock of Duke Power Company, a regulated utility corporation whose stock is listed and regularly traded on the New York Stock Exchange. The daughter of the donor is a trustee of The Duke Endowment. The indenture requires the retention of the Duke Power Company stock. Litigation in 1963 (*Cocke v. Duke University*, 260 N.C. 1, 131 S.E. 2d 909) sought to revise the investment provisions of the 1924 trust indenture, but without success.

In 1968, the Duke Endowment had net income of $18,188,366 and received $16,945,630 from Duke Power Company, which was 78.85% of the total income and 93% of net income. Other years in the 4-year period would be comparable.

Provisions are made in the proposed statute for the disposition of excess holdings, but such provisions do not adequately provide an exception for existing foundations whose governing instruments, as presently drawn, compel them to hold specified business interests. (Tax Reform Studies and Proposals, U.S. Treasury Department, 2–5–1969, part 3, p. 302.)

If section 4943 is adopted, then the excluding provisions of subsection (4) should be changed to cover such foundations and disqualified persons owning

"not more than 75 percent of the stock of a corporation, the common stock of which was traded on a public stock exchange" on July 28, 1969. The percentage change would leave problems created by the special rules of subsection (5), which could be avoided by a provision, such as the following:

The provision of section 4943 (relating to taxes on excess business holdings) shall not apply to a trust governed by an instrument (in effect and irrevocable on July 28, 1969) which compels the trustees to hold specified business interests, if local law prevents suitable revision of the governing instrument.

CONCLUSION

The Duke Power Company has aided the economic and industrial development of the Carolinas. The power company dividends have provided funds for distributions to—

Duke University—a Methodist school,
Davidson College—a Presbyterian school,
Furman University—a Baptist school,
Johnson C. Smith University "an institution of learning for colored people," sponsored by the Presbyterian Church,
Orphanages "for the benefit of white or colored orphans,"
Rural Methodist Churches in North Carolina,
Superannuated Methodist preachers, and
Hospitals—"whether for white or colored, and not operated for private gain." Mr. Duke saw the need for hospitals and directed $1 per free bed day for charity patients, and funds for building and equipping such hospitals.

For the past 45 years The Duke Endowment has sought to fulfill the vision of James B. Duke and minister to the "needs of mankind along physical, mental, and spiritual lines" without regard to race or religion in accordance with the provisions of an irrevocable trust agreement.

The benefits flowing annually to the above named tax-exempt organizations will be proportionately reduced if section 101 of H.R. 13270 becomes law.

Senator ANDERSON. Senator Yarborough.

STATEMENT OF HON. RALPH YARBOROUGH, A U.S. SENATOR FROM THE STATE OF TEXAS

Senator YARBOROUGH. Mr. Chairman, and members of this committee, I appreciate very much this opportunity to appear before the committee today and discuss briefly two important measures which concern tax reform.

Although I have not read the daily transcript of these hearings in its entirety, I have read many excerpts of the testimony presented to the committee, and I shall limit my remarks to points that have not been covered by testimony before.

First, I want to discuss a measure presently pending in the Senate, of which I have the privilege of being the cosponsor, together with the distinguished presiding Senator, Senator Anderson, Senator Mansfield, the majority leader. In all there are 16 cosponsors of this measure, S. 2277. I anticipate an effort to be made to substitute for this bill, which would impose an excess war profits tax, for the 10-percent surtax. This bill would raise $9½ to $10 billion per year, according to the estimates of the Treasury. The present surtax raises $9½ to $10 billion a year. That is why I voted against the extension of the surtax. I think it is an unjust tax. It falls heaviest on the middle income and the lower middle income taxpayers.

This excess war profits tax is nothing new. We have had this type of tax in three previous wars. In World War I, the excess profits tax raised 39⁹⁄₁₀ percent of the total revenues. In World War II, from 1941 to 1945, it raised $39⁹⁄₁₀ billion which was 30⁸⁄₁₀ percent of all the revenues raised in that war, a sum of $40 billion. We had it

from 1946 on, and, it raised $40.6 billion which was 23 percent, 23⁄10 percent, of all of the revenues raised by the Federal Government in that period.

In the Korean conflict, we again enacted an excess war profits tax and during that war, it raised over $7 billion, 3⁄10 percent of the total expenditures.

We have had four major foreign wars in the history of America—World War I, World War II, the Korean conflict, and the Vietnam war. Mr. Chairman, the Vietnam war has cost the American people more money than any war in our history except World War II. I think it is inexcusable that we in the Congress have not levied an excess war profits tax when we had very favorable experience with this type of tax in World War I, World War II, and in the Korean conflict, and instead have put a surtax right on the backs of the people from whom the greater portion of the Federal revenues are raised--individual taxpayers.

The corporate percentage of the total Federal revenue, is much smaller than it was six years ago. Without belaboring the point, I ask leave to print at the conclusion of my remarks in the record a copy of S. 2277, and a copy of the statement I made at the time this bill was introduced pointing out the monies raised and the profits in defense contracts.

Senator ANDERSON. Without objection it will be inserted.

Senator YARBOROUGH. And the second measure to which I would desire to call attention, Mr. Chairman, is my bill which has often been before the Congress, to raise the personal exemption. My bill would raise the personal exemption from $600 to $1,200. I have offered it for 12 years. I ran and was elected to the Senate on that platform, as many others have been, and I have offered it, not only as an original bill earlier this year, S. 1717, but also as an amendment to this pending tax bill.

I think the people of my State, are more interested in an increase in personal exemption than any other one thing in the tax structure of the United States. In support of my amendment, I ask leave to print my full statement in the record. In the interest of time of the Committee, I shall not go through my state item by item, but I think we proved the case irrefutably for an increase.

The $600 fixed in the 1947–48 law represented what was then thought to be enough to support a child in a family unit. This amounts to $50 a month. Since 1948, the cost of living has increased 52⁄10 percent.

Now, Mr. Chairman, and members of the committee, that is 52⁄10 of what a family was living on in 1948. Furthermore, since 1948 Americans have increased their standard of living in food, in clothing, and in housing. Considering the present economic conditions, it would take $1,200 now to accomplish the purpose of the $600 exemption of 21 years ago.

But if we just keep it on the cost of living increase, since 1948, and do not allow 1 penny of 1 percent for the increase in level of living of American families, it would still have to be increased to $914 a year. If we just matched the increase in cost of living we would have an exemption of $914. If the committee thinks the stringency of the budget is such that they can't grant an exemption that would bring it up to the level of living now, I hope the committee will consider at

least bringing this personal exemption to $900, which would roughly equal the cost of living increase per se if the family didn't increase its living standards, food, clothing, housing since 1948.

Senator GORE. Mr. Chairman, could I have my question now?

Senator ANDERSON. Senator Gore.

Senator GORE. Senator Yarborough, the Secretary of the Treasury says the Government cannot afford this, but I notice that he is very strongly in support of giving tax reduction to corporations that are enjoying the highest profits in history. He is very strong for reducing the top bracket on earned income from 70 to 50 percent. Apparently we can afford those things, but cannot afford to give tax relief where it is needed most, to the man with the most children to feed, clothe, and educate. Your amendment will be the first one that I will offer when we go into executive session tomorrow.

Senator YARBOROUGH. Thank you, Senator Gore. I know from hearing the Senator on the floor, the Senator has been a member of this committee a long time, and I have heard him ably debate the late Senator Bob Kerr, who was one of the ablest debaters in the Senate, and the able Senator from Tennessee always held his ground. I have heard him debate many fair provisions and I want to commend him.

There are other witnesses, and I would like to ask leave to have printed at the conclusion of my remarks S. 1717, and the amendment to this to increase this exemption, and the statement that I made on September 22 in support of this amendment with economic data.

I will not take the time on the economic data as I did with the war profits tax. There are many other items in this bill, Mr. Chairman, and members of the committee, on which I have made statements in the past, public and some in the Senate, but they have been covered by prior witnesses. Maybe these points had not been, I had not seen in the press that these two had been specifically covered, and that is why I add these two now and ask leave and appreciate the kindness of the committee and I would like to print the statements and supporting data in full without taking the further time of this committee as there are other Senators and many other witnesses waiting. Thank you very much for your courtesy. Are there any other questions?

I would like to say, Senator, I was as shocked as you were when the Secretary of Treasury came here and recommended that the corporate tax be lightened when the share of the total budget paid by the corporations has gone down in 6 years, and the vast profits they are making, we read on the financial pages every day for the past years, how their profits have gone up and up, and he came here and recommended that the share the corporations were to pay be reduced over the House bill, and that the individual taxpayer pay more, when the individual taxpayers share of the budget is going up, and all of us, like you, who are elected officials, who are out actually seeing the people know the pinch that is on the average American. I don't mean just the average American in the lowest income tax bracket, but also the middle-income taxpayer. The white, black, middle-income people are the ones bearing the tough brunt of this situation.

Thank you very much.

Senator ANDERSON. Thank you for coming.

(Hon. Ralph W. Yarborough's prepared statement, bills S. 2277, S. 1717, and attachments follow:)

Statement of Hon. Ralph W. Yarborough, a U.S. Senator From the State of Texas

SUMMARY

1. Advocates adoption of Excess War Profits tax in lieu of 10% income tax surcharge. Excess War Profits tax proposed is similar to the one used in World War I, World War II and the Korean conflict. Believes surcharge is regressive and fails to stop inflation. Excess War Profits tax would equitably adjust the tax burden during Vietnam War.

2. Advocates increase in personal exemption from $600 to $1,200. He believes this to be necessary in order to bring exemption in line with the rise in the cost of living and further believes it necessary in order to more equitably relieve the tax burden.

STATEMENT

Mr. Chairman, I appreciate this opportunity to appear before you and this distinguished Senate Finance Committee and express my views on H. R. 13270 and tax reform generally. The legislative issue that is foremost in the minds of the vast majority of the American people is tax reform. The average American taxpayer has reached the end of his patience with our present tax system which allows some wealthy individuals and big businesses to shift their fair share of our nation's tax burden to the overtaxed lower and middle-income groups. The average American taxpayer is demanding tax relief from his elected representatives in Congress, and he expects to get it.

H. R. 13270 constitutes a major attempt to achieve genuine tax reform and to close some of the loopholes that exist in our present tax system. It is too broad and comprehensive for me to try to discuss its various provisions; hundreds of other witnesses are doing that; I will take a few minutes here to mention vital matters that may not have been adequately covered.

H. R. 13270 does not contain the two tax items which I believe to be absolutely essential to any meaningful tax reform. I strongly urge the Committee to adopt as a part of its tax reform bill the following important measures: (1) an excess war profits tax in place of the 10 percent income tax surcharge, and (2) an increase in the personal exemption from $600 to $1200.

I. Excess war profits tax

The most unjust feature of our present tax system is the 10 percent income tax surcharge. The surcharge, more than any other facet of our tax laws, directly hurts the lower and middle-income taxpayers. It is particularly damaging to those people who must exist on a small fixed income, such as the poor and the aged. In short it is a regressive tax. I was very disappointed that the House included an extension of this unjust tax through June 30, 1970, in H. R. 13270.

Proponents of the 10 percent income tax surcharge have tried to justify it on the basis that it is necessary to fight inflation. No reasonable person would deny that positive governmental action is needed to curb the runway inflation which is ravaging our economy. The truth, however, is that the 10 percent income tax surcharge is not stopping inflation. On the contrary, since the enactment of the surcharge in 1968, the consumer price index and the wholesale price index have risen at the alarming rate of 6 percent. Clearly, as an anti-inflationary device, the surcharge has been a miserable failure.

One of the reasons that the surcharge has failed to stop inflation is that it is not directed at the real cause of inflation—the tremendous cost of the war in Vietnam. The ever increasing cost of this war is driving prices sky high. To effectively fight inflation we must start at the source of the problem. We aid the economy by letting more of this tax burden fall on the excess profits made by war contractors. This is why I strongly urge that the Committee strike the provisions of H. R. 13270 dealing with the income tax surcharge and substitute an excess war profits tax. Such a tax would provide the government with an effective means of financing the war without imposing the financial burden on the segments of our society who are furnishing the manpower to fight it.

The excess war profits tax is not a new concept. We had such a tax in World War I, World War II and the Korean Conflict. Our nation's experience with this type of tax has taught us that it is a fair and effective method of raising the additional revenue needed to meet the increased demands of a wartime economy.

During World War I, this tax raised a total of $6.9 billion dollars. In World War II, it raised $40.6 billion, and $7 billion in the Korean Conflict. It is esti-

mated that the excess war profits tax I propose would produce approximately $10 billion annually in revenue, which exceeds the revenue produced by the surcharge, and aside from the surcharge, far exceeds the revenue that some of the less desirable changes contained in the House bill would probably produce.

An excess war profits tax is a fair tax. As its name implies, it is levied on "excess" not "normal" corporate profits which are attributable to war. The rationale behind this type of tax is that profits which are above normal level are not justified as a reward for past efforts or necessary as an inducement for future productive efforts. However, even more fundamental is the fact that by fighting this war, we are asking special sacrifices from the lower and middle-income groups in America; therefore, it is only right that we require those who are profiting from the war to bear its expenses. Since the hostilities in Vietnam were stepped up, aftertax corporate profits have increased by 33 percent. The simple truth is that some war contractors are getting rich on this war.

An excess profits tax is a proven tax method. It is fair and just. This is why I am a co-sponsor of S. 2277, which would establish an excess war profits tax. The substitution of an excess war profits tax for the income tax surcharge would show the American people that Congress is truly seeking a way to more fairly distribute the onerous tax burden of this nation. I request that a copy of S. 2277, together with a copy of my remarks when it was introduced, be printed at the closing of my remarks in the Record of this hearing.

II. INCREASE IN THE PERSONAL EXEMPTION FROM $600 TO $1,200

No tax reform measure which is intended to bring relief to the lower and middle-income taxpayers will be meaningful unless it includes a significant increase in the personal exemption. For over twelve years, I have worked for an increase in the personal exemption by introducing bills in different Congresses, hoping for some relief. On March 27, 1969, I introduced S. 1717 which would increase the personal exemption from $600 to $1,200. Since the passage of the House tax bill, I have reintroduced my bill as an amendment to H.R. 13270, and ask that a copy of S. 1717 and my amendment to H.R. 13270 be printed in the Record at the conclusion of my remarks.

The present $600 exemption has its genesis in the Revenue Act of 1948. In the 21 years since its adoption the personal exemption has not been increased despite the fact that the cost of living has increased 52.3 percent (based on the level of consumer index since 1948). Under present economic conditions, the $600 would have to be raised to $904 merely to equal the purchasing power of the $600 exemption 21 years ago.

Our standard of living has changed substantially over this period of time, also. Life in the '60's is quite different from that in the '40's and it will be even more different in the '70's. The Bureau of Labor Statistics recently published a study which attempts to answer the question: How much does it cost to live for an urban family of four in the spring of 1967, for three standards of living? The resulting three budgets share the basic assumption that maintenance of health and social wellbeing the nurture of children, the participation in community activities are desirable and necessary social goals.

For the moderate budget, the U.S. urban average cost was $9,076 in spring of 1967. The cost for the lower budget was $5,915, and the higher budget amounted to $13,050. The personal exemptions for a family of four totaled $2,400 which doesn't even approach the total of the lower budget. Certainly exemptions totaling $4,800, which my amendment would provide, are far more equitable.

When the present personal exemption is applied to taxpayers with children in college, the need for an increase becomes even more apparent. The U.S. Office of Education estimates that the average charges for tuition, fees, and room and board for a full-time resident, undergraduate student in a public four-year university for the 1969–70 school year will total $1,288. For other public four-year institutions, the cost for the year is estimated to be $1,043. In private institutions the average charges for the year are estimated to total $2,777 for a university and $2,274 for other four-year colleges. A college education in today's world is not a luxury, but a necessity. Consequently, an increase in the personal exemption would greatly assist the parents who are struggling to help their children prepare for life in the 1970's.

Of course, today's family earns more than its counterpart in 1948. However, the greater part of these increased earnings is attributable to inflation. Inflation together with relentless increases in taxes at every level have made real prosperity for the average American family more elusive than ever.

The most frequently heard argument against increasing the personal exemption is that the government cannot afford the amount of revenue that would be lost. To obtain meaningful tax reform, however, we cannot be blinded by short term effects. Considerations of equity to individual taxpayers must be paramount. In the long run, these tax savings to individuals resulting from an increase in the personal exemption to $1,200 will come back to the government in the form of higher tax payments from other taxpayers. Personal exependitures represent over 60 percent of the gross national product. These additional funds in the hands of consumers will increase the incomes of grocery stores, appliance dealers, clothing manufacturers and others, which will result in a correspondingly larger tax base for the Federal government and increased revenue.

The personal exemption is intended to accomplish three basic purposes: (1) to exclude from taxation those individuals and families with the lowest income; (2) to provide all taxpayers with a deduction from otherwise taxable income for essential living expenses; and (3) to provide an additional allowance to those taxpayers with dependents and for those who are aged and blind. I submit that at the present unrealistic amount of $600, the personal exemption is not fulfilling any of these purposes.

We must remove the glaring inequity of the present personal exemption from our tax structure. The provisions of the tax reform proposal do not go far enough in enabling the low and middle-income taxpayer to achieve the standard of living to which he is entitled. An increase in the personal exemption to $1200, is in my opinion, the best way to accomplish this objective.

The two measures I have discussed today—increasing the personal exemption and institution of an excess war profits tax—are aimed at redistributing this country's tax burden in a fairer way. They are designed to help people, not special interests. The overtaxed majority of our people have no one else to protect their interest but Congress. We must not let them down.

SUMMARY

Mr. Chairman, on total balance, my proposals, if adopted, would result in a much more equitable tax program than that contained in H.R. 13270, and would produce more than sufficient revenue to offset the tax relief items I support.

The essential core of my total program is to replace the surcharge with the excess war profits tax and to bring the personal exemption into line with the realities of the cost of living. I urge the Committee to give full consideration to the matters I have discussed.

Mr. Chairman, I appreciate the opportunity to appear before the Finance Committee to express my views.

RALPH W. YARBOROUGH FLOOR STATEMENT, MAY 27, 1969, IN SUPPORT OF WAR PROFIT TAX, S. 2277

Mr. President, I am proud to co-sponsor Senator McGovern's bill to establish an Emergency Excess War Profits Tax.

When James Otis observed in 1764 that "taxation without representation is tyranny" he had in mind the taxation of those without the voting franchise. With the franchise as broad as it is in America, no one can argue that taxes have been extracted from the people without their opportunity to exercise their right to vote.

But a more subtle variation of those famous words has sprung from the complexities of modern society. It is unfortunate, but true, that the development and passage of legislation through the halls of Congress depends a great deal upon which of contesting groups can generate the most clamor and pressure. In this context, those with large and lucrative government contracts have certainly been well represented. But, who, I ask, represents the low and middle income taxpayers when it comes to placing or adjusting the tax burden?

From the way today's tax structure places the greatest load upon those people, it becomes obvious that they have been heard but little at the bar of Congress.

President Nixon says he wants to "lighten the burden on those who pay too much, and increase the burden on those who pay too little." The time to do that is now.

The way to begin the reform of our tax system—which the people now demand and which is long overdue—is by enacting a tax upon those who have reaped high profits off the war in Vietnam, hoping that this move will open the door to eventual repeal of the regressive surtax.

"Equity and fairness demand this. I have with me some tables from articles in the April 21, 1969, issue of *U.S. News and World Report* reflecting the exorbitant nature of the war contractors earning profits directly and indirectly flowing from the war."

"When the blood of American lives washes into the Mekong or the Song Ba or the Song Cai, each of us are solemnly reminded of the sacrifice so many have made for a cause which many question or do not understand. The dreadful conflict is far too distant for it to be much of a reality to most of America.

"But, it is a sad reality and one that costs money as well as lives. Historically, we have always sought—with fairness and reason—to impose an appropriate tax burden upon those war profiteer enterprises which acquire extraordinary profits during wartime. If this was the road to equity during World War I, World War II, and the Korean War, it is the road to equity now. I supported such an excess war profits tax in the 90th Congress. Unfortunately, it failed. It is long overdue. If we fail to pass it, we value the profits of the war contractor higher than the blood of the men fighting and dying in Vietnam."

Trends in defense contracts, 1960–69

[In billions]

Year	Amount
1960	$22.5
1961	24.3
1962	27.8
1963	28.1
1964	27.5
1965	26.6
1966	35.7
1967	41.8
1968	41.2
1969 (estimated)	42.3

"Armed forces' contracts for goods and services in the U.S. have nearly doubled in nine years. . . ."

Source: *U.S. News and World Report,* April 21, 1969, p. 61.

[S. 2277, 91st Cong., first sess.]

A BILL To impose an excess profits tax on the income of corporations during the present emergency

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Excess War Profits Tax Act of 1969".

Sec. 2. (a) Subtitle A of the Internal Revenue Code of 1954 (relating to income taxes) is amended by adding at the end thereof the following new chapter:

"Chapter 7.—Temporary Excess Profits Tax

"Sec. 1601. Imposition of tax.
"Sec. 1602. Definitions.
"Sec. 1603. Adjustments to income for years in emergency period.
"Sec. 1604. Adjusment to income for years in base period.
"Sec. 1605. Unused excess profits deduction adjustment.
"Sec. 1606. Excess profits deduction.

"SEC. 1601. IMPOSITION OF TAX.

"(a) GENERAL RULE.—In addition to the other taxes imposed by this subtitle, there is hereby imposed on the income of every corporation, for each taxable year ending or beginning in the emergency period, a tax equal to 37 percent of the excess profits taxable income for the taxable year.

"(b) TAXABLE YEARS PARTLY IN EMERGENCY PERIOD.—In the case of a taxable year which begins before the emergency period or ends after the emergency period, the tax imposed by subsection (a) shall be an amount equal to 37 percent of the excess profits taxable income for the taxable year multiplied by a fraction the numerator of which is the number of days in the taxable year within the emergency period and the denominator of which is the total number of days in the taxable year.

"SEC. 1602. DEFINITIONS.

"(a) EXCESS PROFITS TAXABLE INCOME.—For purposes of this chapter, the term 'excess profits taxable income' means taxable income (computed with the adjustments provided in section 1603 or 1604, but otherwise as computed for purposes of the tax imposed by chapter 1) reduced by the higher of—

"(1) $25,000, or

"(2) the sum of—

"(A) the excess profits deduction for the taxable year, and

"(B) the unused excess profits deduction adjustment for the taxable year.

"(b) EMERGENCY PERIOD.—For purposes of this chapter, the term 'emergency period' means the period beginning on January 1, 1969, and ending on December 31, 1970.

"(c) BASE PERIOD.—For purposes of this chapter, the term 'base period' means the period beginning on January 1, 1961, and ending on December 31, 1964.

"SEC. 1603. ADJUSTMENTS TO INCOME FOR YEARS IN EMERGENCY PERIOD.

"(a) GENERAL RULE.—For purposes of this chapter in determining the taxable income of a corporation for a taxable year ending or beginning in the emergency period, the following adjustments shall be made:

"(1) DIVIDENDS RECEIVED.—The deduction for dividends received shall apply, without limitation, to all dividends on stock of all corporations, except that no deduction for dividends received shall be allowed with respect to dividends (actual or constructive) on stock of foreign personal holding companies or dividends on stock which is not a capital asset.

"(2) DISALLOWANCE OF CERTAIN DEDUCTIONS.—The deductions provided in section 247 (relating to deduction for dividends paid on certain preferred stock) and section 922 (relating to special deduction for Western Hemisphere trade corporations) shall not be allowed.

"(3) GAINS AND LOSSES FROM SALES OF EXCHANGES OF CAPITAL ASSETS.—There shall be excluded gains and losses from sales or exchanges of capital assets.

"(4) INCOME FROM RETIREMENT OR DISCHARGE OF BONDS, ETC.—There shall be excluded, in the case of any taxpayer, income derived from the retirement or discharge by the taxpayer of any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than 6 months, including, in case the issuance was at a premium, the amount includable in income for such year solely because of such retirement or discharge.

"(5) DEDUCTIONS ON ACCOUNT OF RETIREMENT OR DISCHARGE OF BONDS, ETC.—If during the taxable year the taxpayer retires or discharges any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than 6 months, the following deductions for such taxable year shall not be allowed:

"(A) The deduction allowable under section 162 for expenses paid or incurred in connection with such retirement or discharge;

"(B) The deduction for losses allowable by reason of such retirement or discharge; and

"(C) In case the issuance was at a discount, the amount deductible for such year solely because of such retirement or discharge.

"(6) RECOVERIES OF BAD DEBTS.—There shall be excluded income attributable to the recovery of a bad debt if the deduction of such debt was allowable from gross income for any taxable year ending before January 1, 1969, or if such debt was properly charged to a reserve for bad debts during any such taxable year.

"(7) NONTAXABLE INCOME OF CERTAIN INDUSTRIES WITH DEPLETABLE RESOURCES.—In the case of a producer of minerals, a producer of logs or lumber from a timber block, a lessor of mineral property or a timber block, and a natural gas company, there shall be excluded income exempt from the provisions of this chapter under the regulations prescribed by the Secretary or his delegate under section 1606.

"(8) NET OPERATING LOSS DEDUCTION ADJUSTMENT.—The net operating loss deduction under section 172 shall be properly adjusted in accordance with regulations prescribed by the Secretary or his delegate.

"(9) TAXES PAID BY LESSEE.—If under a lease for a term of more than 20 years entered into prior to January 1, 1969, the lessee is obligated to pay any portion of the tax imposed by this subtitle upon the lessor with respect to the rentals derived by such lessor from such lessee, or is obligated to reimburse the lessor for any portion of the tax imposed by this subtitle upon the lessor with respect to the rentals derived by such lesser from such lessee, such paymen or reimbursement of the tax imposed by this subtitle shall be excluded by the lessor and a deduction therefor shall not be allowed to the lessee. For purposes of this paragraph, an agreement for lease of railroad properties entered into prior to January 1, 1969, shall be considered to be a lease including such term as the total number of years such agreement may, unless sooner terminated, be renewed or continued under the terms of the agreement, and any such renewal or continuance under such agreement shall be considered part of the lease entered into prior to January 1, 1969.

"(10) BAD DEBTS IN CASE OF BANKS.—In the case of a bank (as defined in section 581) using the reserve method of accounting for bad debts, there shall be allowed, in lieu of the amount allowable under the reserve method for bad debts, a deduction for debts which became worthless within the taxable year, in whole or in part, within the meaning of section 166.

"(11) BLOCKED FOREIGN INCOME.—There shall be excluded income derived from sources within any foreign country to the extent that such income would, but for monetary, exchange, or other restrictions imposed by such foreign country, have been includable in the gross income of the taxpayer for any taxable year which preceded its first taxable year under this chapter. In determining the taxable year for which income derived from foreign sources would have been includable (but for such restrictions) in cases where specific identification cannot be made, such determinations shall be made in accordance with regulations prescribed by the Secretary or his delegate. Where income derived from sources within any foreign country is includable (without regard to this sentence) in a taxable year succeeding the first taxable year under this chapter, and but for monetary, exchange, or other restrictions imposed by such foreign country would have been includable in the gross income of the taxpayer for its first taxable year under this chapter, such income, in case such first taxable year began before January 1, 1969, shall be considered (in the application of this paragraph) as having been includable in gross income of a taxable year which preceded such first taxable year in an amount equal to that portion of such income as the number of days prior to January 1, 1969, in such first taxable year bears to the total number of days in such first taxable year. Deductions properly chargeable and allocable to income excluded under this paragraph shall not be allowed.

(12) INTEREST.—The deduction for interest shall be reduced, with respect to interest on the indebtedness included in daily amounts of borrowed capital, in accordance with regulations prescribed by the Secretary or his delegate.

"(13) PAYMENTS FROM FOREIGN SOURCES FOR TECHNICAL ASSISTANCE, ETC.—In the case of a domestic corporation which renders to a related foreign corporation technical assistance, engineering services, scientific assistance, or similar services (such services or assistance being related to the production or improvement of products of the type manufactured by such domestic corporation), there shall be excluded the remuneration for such services or assistance if such remuneration constitutes income derived from sources without the United States. Any deductions in connection with or properly allocable to the rendering of such services or assistance shall not be allowed. For purposes of this paragraph, a foreign corporation shall be considered to be a 'related foreign corporation' if the domestic corporation at the time it renders such services or assistance owns 10 percent or more of the outstanding stock of such foreign corporation.

"SEC. 1604. ADJUSTMENTS TO INCOME FOR YEARS IN BASE PERIOD.

"For the purposes of this chapter, in determining the taxable income of a corporation for a taxable year ending or beginning in the base period, the following adjustments shall be made:

"(1) NET OPERATING LOSS DEDUCTION.—The net operating loss deduction provided by section 172 shall now be allowed.

"(2) GAINS AND LOSSES FROM SALES OR EXCHANGES OF CAPITAL ASSETS, ETC.—There shall be excluded gains and losses from sales or exchange of capital assets and gains and losses to which section 1231 is applicable.

"(3) INCOME FROM RETIREMENT OR DISCHARGE OF BONDS, ETC.—There shall be excluded, in the case of any taxpayer, income derived from the retirement or discharge by the taxpayer of any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than 6 months, including, in case the issuance was at a premium, the amount includable in income for such year solely because of such retirement or discharge.

"(4) DEDUCTIONS ON ACCOUNT OF RETIREMENT OR DISCHARGE OF BONDS, ETC.—If during the taxable year the taxpayer retires or discharges any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than 6 months, the following deductions for such taxable year shall not be allowed:

"(A) The deduction allowable under section 162 for expenses paid or incurred in connection with such retirement or discharge;

"(B) The deduction for losses allowable by reason of such retirement or discharge; and

"(C) In case the issuance was at a discount, the amount deductible for such year solely because of such retirement or discharge.

"(5) DIVIDENDS RECEIVED.—The deduction for dividends received shall apply, without limitation to all dividends on stock of all corporations, except that no deduction for dividends received shall be allowed with respect to dividends (actual or constructive) on stock of foreign personal holding companies or dividends on stock which is not a capital asset.

"(6) INSTALLMENT SALES.—In the case of a taxpayer which has made an election under the regulations prescribed by the Secretary or his delegate under section 1606, income from installment sales and from installment sales obligations shall be computed under the accrual method without treating any portion of such income as unrealized at the close of any period and as if the taxpayer had reported such income on such accrual method for all taxable periods.

"(7) LONG-TERM CONTRACTS.—In the case of a taxpayer which has made an election under the regulations prescribed by the Secretary or his delegate under section 1606, income from long-term contracts shall be computed under the percentage of completion method and if the taxpayer had reported such income on the percentage of completion method for all taxable periods.

"(8) JUDGMENTS, INTANGIBLE DRILLING AND DEVELOPMENT COSTS, CASUALTY LOSSES, AND OTHER ABNORMAL DEDUCTIONS.—If, for any taxable year beginning or ending within the base period, any class of deductions for the taxable year exceeded 115 percent of the average amount of deductions of such class for the 4 previous taxable years (not including deductions arising from the same extraordinary event which gave rise to the deduction for the taxable year), the deductions of such class shall, subject to the rules provided in paragraph (9), be disallowed in an amount equal to such excess. For the purposes of this paragraph, each of the following groups of deductions shall constitute a class of deductions:

"(A) Deductions attributable to claims, awards, judgments, and decrees against the taxpayer, and interest on the foregoing;

"(B) Deductions attributable to intangible drilling and development costs paid or incurred in or for the drilling of wells or the preparation of wells for the production of oil or gas, and for development costs in the case of mines; and

"(C) Deductions under section 165 for losses arising from fires, storms, shipwreck, or other casualty, or from theft, or arising from the demolition, abandonment, or loss of useful value of property, not compensated for by insurance or otherwise. The class of deductions under this subparagraph for any taxable year shall not include deductions which are excludible under paragraph (2) or which would be so excludible if such paragraph were applicable with respect to such taxable year.

The classification of deductions of any class not described in subparagraph (A), (B), or (C), shall be subject to regulations prescribed by the Secretary or his delegate.

"(9) RULES FOR APPLICATION OF PARAGRAPH (8).—For the purpose of paragraph (8)—

"(A) If the taxpayer was not in existence for four previous taxable years, then the average amount specified in such paragraph shall be determined for the previous taxable years it was in existence and the succeeding taxable years which begin before the beginning of the taxpayer's second taxable year under this chapter. If the number of such succeeding years is greater than the number necessary to obtain an aggregate of four taxable years, there shall be omitted so many of such succeeding years, beginning with the last, as are necessary to reduce the aggregate to four.

"(B) Deductions of any class for any taxable year shall not be disallowed under such paragraph unless the amount of deductions of such class to be disallowed for such year exceeds 5 percent of the average excess profits taxable income for the taxable years beginning or ending within the base period, computed without the disallowance of any class of deductions under such paragraph. Such average excess profits taxable income shall, for the purposes of this subparagraph, be computed by aggregating the excess profits taxable incomes of all such taxable years, dividing such aggregate by the total number of months in such years, and multiplying the quotient by 12. For the purposes of this subparagraph, the excess profits taxable income for any taxable year shall in no case be less than zero.

"(C) Deductions of any class shall not be disallowed under such paragraph unless the taxpayer establishes that the increase in such deductions—

"(i) is not a cause or a consequence of an increase in the gross income of the taxpayer in its base period or a decrease in the amount of some other deduction in its base period, which increase or decrease is substantial in relation to the amount of the increase in the deductions of such class, and

"(ii) is not a consequence of a change at any time in the type, manner of operation, size, or condition of the business engaged in by the taxpayer.

"(D) The amount of deductions of any class to be disallowed under such paragraph with respect to any taxable year shall not exceed the amount by which the deductions of such class for such taxable year exceed the deductions of such class for the taxable year for which the tax under this chapter is being computed.

"(10) TAXES PAID BY LESSEE.—If under a lease for a term of more than 20 years entered into prior to January 1, 1960, the lessee is obligated to pay any portion of the tax imposed by this subtitle upon the lessor with respect to the rentals derived by such lessor from such lessee, or is obligated to reimburse the lessor for any portion of the tax imposed by this subtitle upon the lessor with respect to the rentals derived by such lessor from such lessee, such payment or reimbursement of the tax imposed by this subtitle shall be excluded by the lessor and a deduction therefor shall not be allowed to the lessee. For the purposes of this paragraph, an agreement for lease of railroad properties entered into prior to January 1, 1960, shall be considered to be a lease including such terms as the total number of years such agreement may, unless sooner terminated, be renewed or continued under the terms of the agreement, and any such renewal or continuance under such agreement shall be considered part of the lease entered into prior to January 1, 1960.

"(11) BAD DEBTS IN CASE OF BANKS.—In the case of a bank (as defined in section 581) using the reserve method of accounting for bad debts, there shall be allowed, in lieu of the amount allowable under the reserve method for bad debts, a deduction for debts which became worthless within the taxable year, in whole or in part, within the meaning of section 166.

"(12) PAYMENTS FROM FOREIGN SOURCES FOR TECHNICAL ASSISTANCE, ETC.—In the case of a domestic corporation which rendered to a related foreign corporation technical assistance, engineering services, scientific assistance, or similar services (such services or assistance being related to the production or improvement of products of the type manufactured by such domestic corporation), there shall be excluded the remuneration for such services or assistance if such remuneration constituted income derived from sources

without the United States. Any deductions in connection with or properly allocable to the rendering of such services or assistance shall not be allowed. For purposes of this paragraph, a foreign corporation shall be considered to be a 'related foreign corporation' if the domestic corporation at the time it rendered such services or assistance owned 10 percent or more of the outstanding stock of such foreign corporation.

"(13) ADJUSTMENT FOR BASE PERIOD LOSSES FROM BRANCH OPERATIONS.—In the case of a taxpayer which during 2 or more taxable years beginning or ending within the base period operated a branch at a loss, the excess profits taxable income for each such taxable year (determined without regard to this paragraph) shall be increased by the amount of the excess of such loss above the loss, if any, incurred by such branch during the taxable year for which the tax under this chapter is being computed. For purposes of this paragraph, the term 'branch' means a unit or subdivision of the taxpayer's business which was operated in a separate place from its other business and differed substantially from its other business with respect to character of products or services. A unit or subdivision of the taxpayer's business shall not be considered to differ substantially from the taxpayer's other business unless it is of a type classifiable by the Standard Industrial Classification Manual in a different major industry group or in a different subgroup of the taxpayer's major industry group than that in which its other business is so classifiable. This paragraph shall not apply unless the sum of the net losses of such branch during the base period exceeded 15 percent of the aggregate excess profits taxable income of the taxpayer during the base period. For the purposes of this paragraph, the aggregate excess profits taxable income of the taxpayer during the base period shall be the sum of its excess profits taxable income for all years in the base period, increased by the sum of the net losses of such branch during the base period.

"(14) RULES FOR APPLICATION OF PARAGRAPH (13).—For the purposes of paragraph (13)—

"(A) A branch shall be deemed to have been operated at a loss during a taxable year if the portion of the deductions under section 162 for such year which is determined, under regulations prescribed by the Secretary or his delegate, to be the portion thereof properly allocable to the operation of such branch exceeds the portion of the gross income during the taxable year which is determined under such regulations to be the portion thereof properly allocable to the operation of such branch; and the amount of the loss shall be an amount equal to such excess.

"(B) If the portion of the gross income determined to be properly allocable to the operation of the branch is a minus quantity, the amount of such excess shall be the sum of the deductions under section 162 determined to be properly allocable to the operation of the branch plus an amount equal to such minus quantity.

"SEC. 1605. UNUSED EXCESS PROFITS DEDUCTION ADJUSTMENT.

"(a) COMPUTATION OF UNUSED EXCESS PROFITS DEDUCTION ADJUSTMENT.—The unused excess profits deduction adjustment for any taxable year shall be the aggregate of the unused excess profits deduction carryovers and unused excess profits deduction carryback to such taxable year.

"(b) DEFINITION OF UNUSED EXCESS PROFITS DEDUCTION.—For purposes of subsection (a), the term 'unused excess profits deduction' means the excess, if any, of the excess profits deduction for any taxable year over the excess profits taxable income for such taxable year, computed on the basis of the excess profits deduction applicable to such taxable year, and computed without the allowance of any deduction under section 172 (relating to net operating losses). The unused excess profits deduction for a taxable year of less than 12 months shall be an amount which is such part of the unused excess profits deduction determined under the preceding sentence as the number of days in the taxable year is of the number of days in the 12 months ending with the close of the taxable year. The unused excess profits deduction for a taxable year beginning before or ending after the emergency period shall be an amount which is such part of the unused excess profits deduction determined under the preceding provisions of this subsection as the number of days in such taxable year in the emergency period is of the total number of days in such taxable year. There shall be no unused excess profits deduction for any taxable year for which the taxpayer is exempt from taxation under this chapter.

"(c) Amount of Carryback and Carryover.—

"(1) Unused excess profits deduction carryback.—If for any taxable year the taxpayer has an unused excess profits deduction, such unused excess profits deduction shall be an unused excess profits deduction carryback to the preceding taxable year.

"(2) Unused excess profits deduction carryover.—If for any taxable year the taxpayer has an unused excess profits deduction, such unused excess profits deduction shall be an unused excess profits deduction carryover to each of the 5 succeeding taxable years, except that the carryover in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such unused excess profits deduction over the sum of the excess profits taxable incomes for each of the intervening taxable years computed—

"(A) by determining the unused excess profits deduction adjustment for each intervening taxable year without regard to such unused excess profits deduction or to any unused excess profits deduction for any succeeding year, and

"(B) without regard to section 1602(a)(1).

For purposes of the preceding sentence, the unused excess profits deduction for any taxable year beginning after January 1, 1969, shall first be reduced by the amount, if any, of the excess profits taxable income for the preceding taxable year computed—

"(C) by determining the unused excess profits deduction adjustment for such preceding taxable year without regard to such unused excess profits deduction, and

"(D) without regard to section 1602(a)(1).

If such preceding taxable year began prior to January 1, 1969, the reduction referred to in the preceding sentence shall be an amount which is such part of the reduction determined under the preceding sentence, or such part of the unused excess profits carryback to such preceding taxable year, whichever is the lesser, as the number of days in such taxable year after December 31, 1968, is of the total number of days in such preceding taxable year.

"(d) No Carryback to Taxable Years Ending Prior to January 1, 1969.—For purposes of this section, the term 'preceding taxable year' does not include any taxable year ending prior to January 1, 1969.

"(e) Unused Excess Profits Deduction of Year of Liquidation.— For any taxable year during which the taxpayer (1) completes the distribution of substantially all of its assets in liquidation, or (2) completes the conversion of substantially all of its assets into assets not held in good faith for the purposes of the business, then the unused excess profits deduction for such year shall be an amount which is such part of the unused excess profits deduction determined under the preceding provisions of this section as the number of days in the taxable year prior to the date of the completion (described in (1) or (2), whichever is earlier) is of the total number of days in the taxable year, and no part of the unused excess profits deduction for such year shall be an unused excess profits deduction carryover to any succeeding taxable year.

"SEC. 1606. EXCESS PROFITS DEDUCTION.

"(a) Computation Under Regulations.—The excess profits deduction for a taxable year shall be an amount computed under regulations prescribed by the Secretary or his delegate which (subject to the provisions of subsection (b)) shall provide—

"(1) a deduction based on average base period taxable income comparable to the excess profits credit provided for in section 435 of the Internal Revenue Code of 1939,

"(2) a deduction based invested capital comparable to the excess profits credit provided for in section 436 of the Internal Revenue Code of 1939, and

"(3) rules comparable to the provisions of sections 437 through 459 (other than subsections (a), (c), and (d) of section 459) and of parts II, III, and IV of subchapter D of chapter 1 of the Internal Revenue Code of 1939.

"(b) Exceptions and Modifications.—The regulations prescribed under subsection (a) shall—

"(1) use the base period defined in section 1602(c) (in lieu of the base period defined in section 435(b) of the Internal Revenue Code of 1939),

"(2) provide for computing the deduction described in subsection (a)(1) by taking into account 100 percent of the average base period taxable income (in lieu of the percentages provided in section 435(a) of the Internal Revenue Code of 1939), and

"(3) provide rules containing such modifications in or such additions to the rules set forth in the provisions of the Internal Revenue Code of 1939 referred to in subsection (a) as the Secretary or his delegate determines necessary to carry out the purposes of this chapter."

(b) The table of chapters for subtitle A of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following new item:

"Chapter 7.—Temporary excess profits tax."

SEC. 3. The amendments made by this Act shall apply to taxable years ending after December 31, 1968.

INTRODUCTION OF A BILL TO AMEND H.R. 13270 TO PROVIDE FOR AN INCREASE IN THE PERSONAL EXEMPTION FROM $600 TO $1,200

Mr. President, I introduce for appropriate reference a bill to amend H.R. 13270 which would provide for an increase in the personal exemption of Federal income tax from $600 to $1,200. I introduced this measure this year on March 27, 1969, as S. 1717. Since the introduction of S. 1717, the House has passed its tax bill, H.R. 13270; therefore, I feel it would be appropriate if my bill is incorporated as an amendment to H.R. 13270. This is not the first time I have introduced this proposal; I have introduced it on numerous times in the past twelve years that I have been in the Senate.

H.R. 13270 is a result of the outcry from the American people for reform of this country's system of taxation. No tax reform program will be complete unless it includes a significant increase in the personal exemption. The present personal exemption has its genesis in the Revenue Act of 1948. Since its adoption over 21 years ago, the personal exemption has not been increased despite the fact that the cost of living in America has risen by 52.3 percent since 1948. The personal exemption, more than any other provision in the Internal Revenue Code has the greatest impact on the lower and middle-income taxpayer. I was disappointed that neither the House nor the President included an increase in the personal exemption as a part of the tax reform program.

The personal exemption is intended to accomplish three basic purposes: (1) to exclude from taxation those individuals and families with the lowest incomes; (2) to provide all taxpayers with a deduction from otherwise taxable income for essential living expenses; and (3) to provide an additional allowance to those taxpayers with dependents and for those who are aged and blind. At the present unrealistic amount of $600, the personal exemption is not fulfilling any of these purposes.

According to the figures compiled by the Social Security Administration, a nonfarm family with a yearly income of $3,335 or less is living in poverty. This means that such a family does not have the income necessary for a minimum diet and must also go without many of the necessities of life. Despite the conditions, such a family would have to pay $46 dollars of income tax if they have an adjusted gross income of $3,335. This clearly demonstrates that the present personal exemption has failed to accomplish its purpose of exempting the poor from income taxation.

Not only is the present personal exemption not protecting the poor, it also is not providing the average taxpayer with a deduction for the cost of raising his family. During the years since 1948, the standard of living in America has risen greatly. According to the Bureau of Labor statistics, the cost of living for an urban family of four on the lowest budget possible would be $5,915. On a more moderate budget this amount required would be $9,076. The personal exemptions however, for a family this size would total only $2,400. This would not even begin to approach the amount needed by such a family to meet the cost of living under the lowest possible budget. Certainly in this respect the present personal exemption has failed to accomplish its purpose.

When the present personal exemption is applied to taxpayers with children in college, the need for an increase becomes ever more apparent. The U.S. Office of Education estimates that the average charges for tuition fees, and room and board for a full-time undergraduate student in a public four-year university for the 1969–70 school year will total $1,288. In a private four-year university the charges are estimated to be $2,777 and in private four-year college they are

$2,274. A college education in today's world is not a luxury but a necessity. Consequently an increase in the personal exemption would greatly assist the parents who are struggling to help their children prepare for life in the 1970's.

An increase in the personal exemption from $600 to $1,200 is a necessity if Congress is to fulfill its responsibilities to the vast majority of citizens who are carrying our Nation's tax burden. Such an increase will also show that overtaxed lower and middle-income taxpayers that Congress is truly concerned about their problems and not just those of big business. We must not let the 91st Congress be remembered in history as the Congress that turned its back on the needs of the average taxpayer.

[H.R. 13270, 91st Cong., first sess.]

Amendments intended to be proposed by Mr. YARBOROUGH to H.R. 13270, an Act to reform the income tax laws: On page 366, after line 19, insert the following new section:

"SEC. 805. PERSONAL EXEMPTIONS.

"(a) INCREASE TO $1,200.—The following provisions are amended by striking out '$600' wherever appearing therein and inserting in lieu thereof '$1,200':

"(1) Section 151 (relating to allowance of deductions for personal exemptions);

"(2) Section 642(b) (relating to allowance of deductions for estates);

"(3) Section 6012(a) (relating to persons required to make returns of income); and

"(4) Section 6013(b)(3)(A) (relating to assessment and collection in the case of certain returns of husband and wife).

"(b) CONFORMING AMENDMENTS.—The following provisions are amended by striking out '$1,200' wherever appearing therein and inserting in lieu thereof '$2,400':

"(1) Section 6012(a)(1) (relating to persons required to make returns of income); and

"(2) Section 6013(b)(3)(A) (relating to assessment and collection in the case of certain returns of husband and wife).

"(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1969."

On page 366, line 20, strike out "805" and insert "806".

On page 367, line 18, strike out "$600" and insert "$1,200".

[S. 1717, 91st Cong., first sess.]

A BILL To amend the Internal Revenue Code of 1954 to increase from $600 to $1,200 the personal income tax exemptions of a taxpayer (including the exemption for a spouse, the exemptions for a dependent, and the additional exemptions for old age and blindness)

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) the following provisions of the Internal Revenue Code of 1954 are amended by striking out "$600" wherever appearing therein and inserting in lieu thereof "$1,200":

(1) Section 151 (relating to allowance of deductions for personal exemptions):

(2) Section 642(b) (relating to allowance of deductions for estates);

(3) Section 6012(a) (relating to persons required to make returns of income); and

(4) Section 6013(b)(3)(A) (relating to assessment and collection in the case of certain returns of husband and wife).

(b) The following provisions of such Code are amended by striking out "$1,200" wherever appearing therein and inserting in lieu thereof "$2,400":

(1) Section 6012(a)(1) (relating to persons required to make returns of income); and

(2) Section 6013(b)(3)(A) (relating to assessment and collection in the case of certain returns of husband and wife).

SEC. 2. (a) Section 3(b) of the Internal Revenue Code of 1954 (relating to optional tax if adjusted gross income is less than $5,000, in the case of taxable years beginning after December 31, 1964) is amended—

(1) by inserting after "After December 31, 1964" in the heading and inserting in lieu thereof "In 1967, 1968, and 1969";

(2) by striking out "beginning after December 31, 1964," and inserting in lieu thereof "beginning on or after January 1, 1967, and before January 1, 1970,"; and

(3) by striking out "After December 31, 1964" each place it appears in the tables and inserting in lieu thereof "In 1967, 1968, and 1969".

(b) Section 3 of such Code is further amended by adding at the end thereof the following new subsection:

"(c) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1969.—In lieu of the tax imposed by section 1, there is hereby imposed for each taxable year beginning after December 31, 1969, on the taxable income of every individual whose adjusted gross income for such year is less than $5,000 and who has elected for such year to pay the tax imposed by this section, a tax determined under tables which shall be prescribed by the Secretary or his delegate. The tables prescribed under this subsection shall correspond in form to the tables in subsection (b) and shall provide for amounts of tax in the various adjusted gross income brackets approximately equal to the amounts which would be determined under section 1 if the taxable income were computed by taking either the 10-percent standard deduction or the minimum standard deduction."

(c) Section 4(a) of such Code (relating to number of exemptions) is amended by striking out "the tables in section 3" and inserting in lieu thereof "the tables in sections 3(a) and 3(b) and the tables prescribed under section 3(c)".

(d) Paragraphs (2) and (3) of section 4(c) of such Code (relating to husband or wife filing separate return) are amended to read as follows:

"(2) Except as otherwise provided in this subsection, in the case of a husband or wife filing a separate return the tax imposed by section 3 shall be—

"(A) for taxable years beginning in 1964, the lesser of the tax shown in table IV or table V of section 3(a),

"(B) for taxable years beginning in 1965, the lesser of the tax shown in table IV or table V of section 3(b), and

"(C) for taxable years beginning after December 31, 1969, the lesser of the taxes shown in the corresponding tables prescribed under section 3(c).

"(3) Neither table V of section 3(a) nor table V of section 3(b), nor the corresponding table prescribed under section 3(c), shall apply in the case of a husband of wife filing a separate return if the tax of the other spouse is determined with regard to the 10-percent standard deduction; except that an individual described in section 141(d)(2) may elect (under regulations prescribed by the Secretary or his delegate) to pay the tax shown in table V of section 3(a), table V of section 3(b), or the corresponding table prescribed under section 3(c) in lieu of the tax shown in table IV of section 3(a), table IV of section 3(b), or the corresponding table prescribed under section 3(c), as the casé may be. For purposes of this title, an election made under the preceding sentence shall be treated as an election made under section 141(d)(2)."

(e) Section 4(f)(4) of such Code (cross references) is amended by striking out "and table V in section 3(b)" and inserting in lieu thereof "table V in section 3(b), and the corresponding table prescribed under section 3(c)".

(f) The last sentence of section 6014(a) of such Code (relating to election by taxpayer) is amended by inserting after "nor table V in section 3(b)" the following: ", nor the corresponding table prescribed under section 3(c),".

SEC. 3. (a) Section 4302(b)(1) of the Internal Revenue Code of 1954 (relating to percentage method of withholding income tax at source) is amended by striking out the table and inserting in lieu thereof the following:

Percentage method withholding table

Payroll period:	*Amount of one withholding exemption*
Weekly	$27.00
Biweekly	55.80
Semimonthly	58.60
Monthly	116.00
Quarterly	350.00
Semiannual	700.00
Annual	1,400.00
Daily or miscellaneous (per day of such period)	3.80

(b) So much of paragraph (1) of section 3402(c) of such Code (relating to wage bracket withholding) as precedes the first table in such paragraph is amended to read as follows:

"(1)(A) At the election of the employer and with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee after December 31, 1969, a tax determined in accordance with tables prescribed by the Secretary or his delegate, which shall be in lieu of the tax required to be deducted and withheld under subsection (a). The tables prescribed under this subparagraph shall correspond in form to the wage bracket withholding tables in subparagraph (B) and shall provide for amounts of tax in the various wage brackets approximately equal to the amounts which would be determined if the deductions were made under subsection (a).

"(B) At the election of the employer with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee before January 1, 1970, a tax determined in accordance with the following tables, which shall be in lieu of the tax required to be deducted and withheld under subsection (a):".

(c) Section 3402(m)(1) (relating to withholding allowances based on itemized deductions) is amended by striking out "$700" and inserting in lieu thereof "$1,400".

SEC. 4. The amendments made by the first two sections of this Act shall apply only with respect to taxable years beginning after December 31, 1969. The amendments made by section 3 of this Act shall apply only with respect to remuneration paid on and after January 1, 1970.

Senator ANDERSON. We will now here from the Honorable Charles Percy.

STATEMENT OF HON. CHARLES H. PERCY, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator PERCY. Mr. Chairman, and members of the committee, I am appearing this morning as a result of my very deep concern about the provisions of the Tax Reform Act of 1969, H.R. 13270. I cannot possibly support the bill in the form that it came over to us from the House, because there are simply too many questions that are unanswered in my mind as to its effect upon the whole structure of our institutions in America today.

I would like to indicate that I have had some degree of personal involvement and firsthand knowledge on the issue of private philanthropy and foundations. I served as a director and subsequently as chairman of the board for 10 years of the Fund for Adult Education of the Ford Foundation. This institution, a wholly owned subsidiary of the Ford Foundation, served as to educational television what Carnegie served to the public library. We created the concept, initiated all the early studies, helped cities across the country apply for licenses, and poured millions of dollars into the initial capital equipment that started some 45 educational television stations. I think, with due deference to all of the trustees who served on that foundation, including Milton Eisenhower, that we wouldn't have had educational television in this country if it hadn't been for the early pioneering efforts and funding of this foundation.

I also established a foundation in the Bell & Howell Co. that I headed and for which I was chief executive officer. I can say that our corporate giving substantially increased as we began to better understand the social responsibility that a major corporation had in the country. And I also founded a small modest personal foundation. I am happy to say that this foundation in the years that Mrs. Percy and

I have operated it has had zero administrative expenses, zero expenses of any kind other than the public audit that is made of it each year by Arthur Anderson & Co., and it has given no grants to anything other than Treasury approved organizations.

So that with this degree of involvement I would like to comment on the social needs of the country, which are expanding at a rate which even our prosperous society is presently unable or unwilling to meet. We do have in the United States a higher GNP and higher per capita income than any other country and yet we have very deep serious problems. We have problems of hunger. Our own Select Committee on Hunger and Human Needs has revealed the extent of malnutrition in this country.

We have problems of slums, crime, illiteracy, pollution, disease, poverty, and joblessness.

And this is why I am here this morning. Some of the financial needs of large, vitally important social sectors of our society are being met today and have been met in the past through private giving. We know that our future needs cannot be met as we are now structured without large-scale future private giving. I have no idea, nor does anyone else, as to how large this giving may be for certain key sectors of charity. I know this, however, the need is extremely large. It is being financed heavily through private charitable giving which, of course, foundations are one form.

There have been charges made in recent years that foundations have engaged in questionable activities such as self-dealing, financing political campaigns, lobbying for legislation, unfair business competition, and tax avoidance. In actuality, however, there is little available evidence to support or disown such charges, or even give us an idea as to whether the problem is a serious one or relatively unimportant. The fact is, no thorough, unbiased, professional study has ever been made concerning the financing or the operations of foundations.

I have had an opportunity in recent days to review the early preliminary findings of the Commission on Foundation and Private Philanthropy under the able leadership of Mr. Peter G. Peterson, chairman and chief executive officer, Bell & Howell Co., and my own successor in that organization. This independent commission of private citizens has been established to conduct a thorough, objective study of foundations and private philanthropy. It is using non-tax-deductible contributions to finance this, and no contributions have come from any foundations.

I have attached to my testimony a list of the distinguished members of this commission who are now giving the first really serious overall study into the nature of charitable giving and philanthropy in the United States.

The study is designed to answer questions and to present us with information that we do not know at present, but which we must know if we are not to place in jeopardy the entire social fabric of our society.

How large are the assets of private foundations and how much future growth is expected? How large is their annual investment income now and projected over the next 10 years? What percentage of income is paid out annually? To what sources and for what purposes is income paid out? What is the degree and what are the types of abuses? To what extent do charitable organizations depend upon support from

private foundations? What have been the successes and failures of foundations? What will be the effects upon existing foundations and what will their policies be if the tax laws are changed as is contemplated in the Tax Reform Act of 1969? How will such act affect the formation of new foundations? How may the entire nature of our society be changed if we are strait jacketed into total reliance upon Federal philanthrophy? I can't possibly cast an intelligent vote on this bill until I know the answer to some of these problems and I know that is the purpose of these hearings.

I do not know the answer to these questions, and I most respectfully submit that no one else does. Certainly, the Treasury Department, although charged with the enforcement of foundations, is unable to supply us with answers. Yet, gentlemen, here we are seeking to tamper with and perhaps destroy a fundamental force operating within our society.

Let us remember that what we may be doing in enacting the Tax Reform Act in its present form is to place in jeopardy the YMCA, the Heart or Cancer Association, the Boys Clubs of America, and all other youth character building institutions, family planning clinics, universities, colleges, hospitals, and the host of other private organizations which are contributing so much to the fabric of our society.

I would estimate if we didn't have these institutions and we set about to try to organize them today it would take us 50 years to establish what today is the envy of the world, private philanthrophy and private giving and voluntarism in American society, and that is the heart of what we are now talking about, and the incentives we are talking about removing.

Although still in a preliminary form some of the data I have seen, which is early data from the Peterson Commission, and I studied it this week end, suggest that a drying up of foundation and private contributions would drive many vital charitable organizations to the wall.

Charitable organizations in the Chicago area, for example, are expending greater sums than ever in recent years. Yet, they are unable to keep abreast of the cry for help and a significant number are operating at a deficit. Without the substantial assistance of private foundations, serious doubt arises as to whether many could continue operation effectively. Only 63 percent of the Michael Reese Hospital budget, for example, is met through charges to the public. In the case of the Chicago YMCA, less than 40 percent is covered in this manner. The Chicago Heart Association charges no fees to the public. As we all know, few hospitals, colleges, or universities could continue to operate if they had to rely chiefly or solely upon current fees or charges. As a past or present trustee of the University of Chicago, Illinois Institute of Technology, California Institute of Technology, Boys Clubs of Chicago, and other great institutions, I can personally attest to this fact. According to the preliminary survey by the Peterson Commission, two-thirds of all Chicago charities believe they would face critical budget crisis if private giving was cut by 25 percent. I believe a survey of similar organizations in each of your own cities and States would reveal the same fact.

That is only my supposition, however, based upon a preliminary result of the Peterson Commission survey. The key question is, Are

we prepared to risk the drying up of private contributions to these valuable charitable, educational, medical, and other social organizations, and thereby place their very existence in jeopardy? Must we not know more about the role of these institutions, their needs, and the effects of the proposed legislation on private giving before going ahead?

If we do discourage private giving——

Senator ANDERSON. Senator Gore.

Senator GORE. Senator Percy, you are raising a great many interesting questions. I wonder if the thrust of your testimony is that we do nothing about foundations?

Senator PERCY. No; not at all. In fact, at the end of my testimony I raise certain specific types of abuse which I think must be corrected.

Senator GORE. We have a problem that looms in much greater magnitude than specific abuses. I think we have a social and political prolem of great and historic magnitude comparable to that which came to a head back in the middle of the 17th century when the Duke of Norfolk set out to prepare his last will and testament. He sought to insure for all time to come that his progeny would have his estate intact. This led to a historic decision in the common law of England which holds that, and still holds, that property must vest, that the hand of the dead cannot rule the living; and yet in our society we have found a way around this historic rule which became necessary in Roman culture, in the Greek culture, in the Hebrew culture and in English common law. A man of wealth and fortune and vanity and imperious will and other great characteristics can create a private foundation, and thus under existing law perpetuate his property and his progeny in the influence and use and direction of that property through a private foundation. Now this creates very grave and serious public problems and particularly so when the deceased are privileged under the tax laws to exercise such great power over the living. We must recognize that encouragement of charitable giving through the tax system has a remarkable effect. When a wealthy donor creates a foundation for charitable purposes, such charity being largely subject to his own definition and will, through his gift, he is in practical effect being allowed to prescribe the use of public funds that would otherwise be paid in taxes for his own prescription, his own ideas, for all time to come of what is good for the public, and this in contravention of changing conditions. So I don't think this problem can be dismissed by merely saying we are going to look at a few abuses. In fact the abuses are so many we don't even recognize them.

The number of foundations is unknown. So I appreciate your testimony but I can't agree with you that we can forget this after a temporary treatment of abuse.

Senator PERCY. I think your question is an appropriate one. In my testimony I will imply that I do advocate even a higher payout than the House bill, and I would place limitations on stock ownership control. But I would like to say that in my judgment, in my own personal experience with foundations in this country, the dead hand of the past has not been allowed to control current giving and philanthropy policy. Let me take just a few of them. Let's take the Rockefeller Foundation. John D. Rockefeller made his money in oil. He set it up in this tremendous foundation. I was in the hearing room when Dr.

George Harrar was here testifying. Each year I study very carefully the work of the Rockefeller Foundation. Let's just take one area, that of population control, where they have been so far ahead of Government that nothing would have been done in this country if we hadn't had private philanthropy. John D. Rockefeller III, not the dead hand of the past but a forward looking man who this week in Look magazine has one of the best articles on youth, and sex and drugs and marriage, is a forward looking man carrying out measures through the philanthropy of his heritage which Government only reluctantly and timidly finally came to recognize as one of the great problems we face today.

Now, we ourselves are providing Government funds for population control but if they had not had the foresight, and the ability to carry this on irrespective of Government wishes in this regard, we wouldn't have had the momentum that we now have. I would say another trustee of the Rockefeller Foundation, my own son-in-law, John D. IV, is hardly the dead hand of the past. Here is one of the most enlightened forward looking members of your political persuasion that I could name, and he is a trustee of the Rockefeller Foundation.

Now, has the dead hand of Henry Ford been allowed to exercise itself on American society?

Senator GORE. Yes.

Senator PERCY. Only in a sense that the Ford money contributed to the foundation has benefited society after his death.

Senator GORE. And take the Irvine Foundation we had yesterday.

Senator PERCY. Some foundations may be subject to criticism.

Senator GORE. Mr. Chairman, I don't wish to take the time of the committee to debate with my colleague this question of the Ford Foundation here, but there are a great many good things that can be cited as having been accomplished by private foundations. But for every good example I dare say we can cite 1,000 that have been motivated primarily by tax avoidance and continued control of family assets.

Senator PERCY. Senator Gore, may I ask you the question, is that a provable fact?

Senator GORE. I said I dare say.

Senator PERCY. For every good action there are 1,000 motivated by a desire other than to do good?

Senator GORE. I said I dare say it and I do dare say it and if I had the privilege of proving it I think I can prove it. I cannot prove it without the facts. The Government doesn't know how many foundations there are. Indeed there isn't an agency of Government that can come within 10,000 of estimating accurately the number of foundations.

Senator PERCY. Let me say, I think what you are asking is a perfectly pertinent question. I do not know of any one who has ever gone in and analyzed all the 990 forms for the year 1968 except the Peterson Commission. They have pulled every single 990 form that has been filed. They have now a team of professional interviewers going out to these foundations, going out to their officers, to the original givers to find out in confidence and anonymously what motivated them. But until such time as we have this body of facts put together, I do not see how we can possibly legislate and start to destroy these foundations

before we know what they are doing. If that is true then we need fundamental change.

My guess is the abuse is exactly the other way around. The abuse percentagewise to the total giving is modest and small as against the total $20 billion of assets that are now available under public trustees, subject to public censure for wrongdoing; and the wrongdoing, I think is a minuscule product of the total amount of annual contributions of $1,500 million a year.

Senator GORE. Mr. Chairman, I want to close with this brief statement. I agree with you, Senator Percy, that we need a thorough study. None has ever been made. Why the executive department has not made it, I don't know. Why the Congress has not made it, I do not know. It ought to be done, but I don't think we can sit still and do nothing while this dangerous development continues. It has gotten so bad that now almost every time a man becomes a millionaire he begins to look for a good lawyer to set up a foundation, a private foundation, to avoid taxes and vest the control of his property in his family, and this is antidemocratic. It threatens to bring about serious political, economic and social consequences. So it seems to me that the context of this bill is not to destroy private foundations, it is really the beginning of a regulation of private foundations. I will close.

Senator PERCY. So far as regulation is concerned, proper regulation, I concur. It is needed, it is necessary. The good foundations in this country, and there are many of them, want proper regulation, in fact they are even willing to pay for it.

If I——

Senator MILLER. Mr. Chairman, may I ask one question at this point? I would like to reconcile the two viewpoints that have been expressed. Would it be your opinion that as to the abuses that have been indicated, we can go ahead promptly and legislate as to those? But, with respect to the broad problem which Senator Gore raises, we need further analysis and research before we make a broad policy change.

Senator PERCY. Absolutely.

I think we know enough now about some abuses so that we can definitely regulate those. In fact, I understand as of last night this committee has scheduled Peter Peterson, Chairman of the new Commission on Philanthropy and Foundations, to appear before it on the 22d of this month, and I think you will have then the first and best chance to have as objective a view as possible, I would question him as to what he has found out with his team of interrogators as to the degree of abuse that does exist and what can be done to regulate it and I think in my own conversations with him this past weekend he is fully aware that there is some abuse, that it must be regulated in order to protect the good name of the large bulk of foundations in this country. They are anxious to see abuses stamped out.

Senator ANDERSON. We have a long list of witnesses today and I hope you can be as brief as you can.

Senator PERCY. Pardon me, Mr. Chairman.

Senator ANDERSON. We have a long list of witnesses today.

Senator GORE. I apologize for that, Mr. Chairman.

Senator ANDERSON. It is very interesting.

Senator PERCY. I will see what I can skip in the testimony, Mr. Chairman. To continue though if we do discourage private giving and if we do drive private organizations to the wall with what are we left? The answer is clear: Government philanthropy, Government education, Government medicine, Government culture, and Government control. Do any of us want this?

I am not arguing here for pure private enterprise. Federal financial assistance and Government leadership have contributed significantly in many areas of social need in recent years. This will and should continue. But, what is required is the preservation of a healthy and dynamic pluralism in our society—a pluralism that can assure us of the freedom to innovate, the ability to take risks, the freedom to stand up to public opinion. Private organizations form a unique and necessary part or that pluralism. Consider for a moment some of the innovative and forward strides taken by or under the funding of private foundations: educational television, family planning and population research, agricultural innovation, support of the arts, employment of the handicapped, and medical research in heart therapy are just a few of the areas that immediately come to mind.

In addition, it is all too infrequently recognized how society profits from contributions of volunteer service which dedicated individuals render each year in charitable work. All Chicago charitable organizations, for example, rely upon volunteer assistance; in three-quarters of the organizations surveyed, the number of volunteer workers exceeded that of paid staff.

I have here a chart which I would just like to show you revealing the results of surveys that have been taken within the past few months in Chicago by the Peterson Commission. Of the Chicago charitable organizations surveyed, 100 percent of them relied upon volunteer assistance. And I would say that this would be quite representative of the charitable organizations in the major cities and smaller communities in every single State represented by the members of the Senate here this morning.

Of organizations surveyed which rely more upon volunteer assistance than paid workers, 75 percent of them actually have more people coming into their facilities to do volunteer work than the paid staff. Voluntary assistance, valued at $3 an hour, was contributed in organizations up to 20 percent of their total budget in 60 percent of those organizations.

If we go down over here in the chart we would see that in one out of five of all the private charitable organizations in Chicago, one out of five of them have more hours put in valued at $3 an hour by volunteer workers than by paid staffs. So that in those organizations $1 of contribution or tax deductibility may mean $2 or more of effort put out. Many times you can get voluntary workers and many of them might include the wives of members of our committee, voluntary workers who are far more productive than paid workers.

The other chart I have is an interesting study of what is happening to costs in private charity. I have compared it with average production workers. Wages have gone up 23 percent in the period 1963 to 1968, and yet the type of help required by charitable organizations in each of our own cities has increased much more: hospital interns whose salaries have gone up 81 percent in this same period; nurses, 50 per-

cent; profesional workers in general, 48 percent; social workers, 39 percent; executive directors, 35 percent; librarians, 28 percent; and clerical, 26 percent.

In every case the need is critical. As we see the value of voluntary contributed labor, we must take into account what it would cost the taxpayer if the Government had to hire that same kind of work to plan the hospital beds, to take care of our libraries, to take care of our character building organizations. Where would Government get the money to meet this kind of salary increase?

There is need to maintain vigorous private philanthropy in our society. This can only result from the expanding contributions of private persons, including private foundations. It is essential, therefore, that we not enact drastic changes in the tax law affecting charitable organizations or private foundations until the Congress has the facts to assure legislation which is right and which is consistent with our national needs and goals.

Now, Senator Gore, if I can just take specifically one area where I am deeply concerned as to what we are really trying to do, I can't figure out for the life of me what the House has in mind in the 7½ percent tax on net income. What are we trying to do? This means that 7½ percent of all the money that foundations would be contributing to organizations for educational, medical, health, cultural and other vital social purposes will be funneled into the Federal Treasury and then back out again to meet social needs, less Government overhead charges, and plus Government control and regulations. What is the rationale for this tax?

Senator GORE. It sounds like a democratic procedure to me.

Senator PERCY. But this is not a profitmaking organization. This is income that is being used for the very purposes that we say we have a tremendous need to fulfill in the United States. Do we think we are putting enough money into meeting the needs of the hungry, meeting the needs of education, meeting the needs of the sick. Absolutely not, we are all asking for more appropriation authority but we don't have the money. Now we are going to take the money right out of the charitable organizations, tax it, put it back in the Federal Treasury, then, send it back out there, less all our overhead charges. Now if——

Senator GORE. May I add one other thing there?

Senator PERCY. Yes, sir.

Senator GORE. Or to put the relatives of the donor on the payroll.

Senator PERCY. Would you repeat that again?

Senator GORE. Well, you listed many things that are being done to the income of foundations.

Senator PERCY. Yes.

Senator GORE. Very worthy things. I just added one other—to put the relatives of the donor on the foundation's payroll.

Senator PERCY. Well——

Senator ANDERSON. Let's let Senator Percy finish.

Senator PERCY. I would only indicate that before I would want to put a tax on these foundations I would want to know where the income is going and what it is being spent for and whether we are not thwarting the whole purpose of what we are trying to accomplish. If this tax is to provide revenue in order to more properly regulate and properly audit foundations, with this I would agree, but I would estimate that

the cost of so doing would come closer to 1 percent than 7½. Let's find out what that cost actually would be. At 7½ I think the tax is basically senseless and is a punitive measure and so serves no social or justifiable purpose whatsoever.

In addition, proposals of deductions, charitable trusts, contributions of appreciated property, and other provisions may have the effect of diverting funds from not only foundations in particular but private giving in general and from charitable sources to other less worthy sources. If the Tax Reform Act is enacted in its present form, some additional funds will flow into the public treasury instead of directly through private sources to charities, hospitals, and schools where I estimate the value derived is at least double that of Federal expenditures in these same areas.

Before skipping over to the center of the next to the last page, I mention two specific areas in my prepared statement where I think we ought to look closely: informational activities, and those charities deriving their support from four or fewer tax exempt organizations. In urging the committee to withhold drastic changes in the tax laws as they relate to foundations and philanthropic organizations, I am in no way suggesting that Congress fail to step in to correct abuses that may exist in the administration of foundations. Abuses do exist. Preliminary results of the Peterson Commission study disclose this as well as some abuses not covered by the House bill. They have found even additional abuses that have not been uncovered yet, and Mr. Peterson, I feel quite sure, will be very candid in revealing those to the members of this committee. But let us find out what the extent and degree of these abuses are, including such studies that should be conducted by the Treasury Department, and then let us enact appropriate legislation.

Accordingly to the Peterson Commission study, many foundations are not adequately audited by the IRS or the States. They have been shocked to find the number of organizations unaudited and they can tell you statistically now how many are actually audited by the States under which they are chartered and how many have never been audited by Internal Revenue Service. If this does in fact exist, let us request the Treasury Department to audit foundations periodically and have them pay for the cost——rather than imposing an unsupportable 7½ percent tax. If foundations engage in self-dealing or in unfair competitive practices, let's put a stop to it and enact penalties to discourage such behavior. If loose recordkeeping occurs or if unsupportably high operating expenses exist, let's pass appropriate measures to curtail such activities. If excessively low payouts are found in some foundations, let's raise them to a high enough standard level to overcome "hoarding" instincts and poor investment policies that need correction.

I think the Peterson Commission will definitely show to you how low the income has been on the investment of many of the foundations and where I think many of the members of that commission feel we should require foundations to pay out a higher percentage of their income than they now do.

Finally, if some foundations are contributing their funds for improper purposes, such as partisan political activities, then let us reaffirm our intention to flatly prohibit and penalize such activities.

As indicated in the preliminary Peterson Commission study, only a small percentage of foundations appear to engage in such abusive

practices to any degree and these appear to be the smaller ones. But, let us find out what abuses really exist, and to what extent they actually exist. Being more fully informed, then let us proceed to legislate. Also their study suggests that a sizable segment of foundation grants go to public charity, whereas I believe many have assumed, due to widespread publicity, that a significant percent of total foundation grants go to various kinds of partisan political activities. Revelations so far show that a very small percentage goes into political activity of any kind.

It is my understanding that in a very few weeks the Peterson Commission study can be made available and I am delighted that this committee has seen fit to have Mr. Peterson come before it October 22. I would urge that your final recommendations take into account this valuable evidence and facts, which up to now have been in extraordinary short supply not only about foundations but of the effects of this bill on private philanthropy in general. It took a Frenchman, De Tocqueville, in 1832, to discover that the genius of the United States of America lay in the organization of its private volunteer activities. Let us not take any action now that will tend to destroy or at least weaken a system that is the envy of most every nation in the world.

Mr. Chairman, as I said, when I appeared to introduce a witness to the committee yesterday, I think these hearings are among the most important hearings now going on before Congress. They are shedding light on what is the genius of the American system. As a result of these hearings and as a result of our legislation we will have a better awareness of the value of philanthropy and charitable giving but we will also have a greater sense of responsibility as to what we must do to keep it in line with the public interest. Thank you very much.

Senator ANDERSON. Thank you very much, Senator.

(Senator Charles H. Percy's prepared statement follows:)

STATEMENT BY HON. CHARLES H. PERCY, A U.S. SENATOR FROM THE STATE OF ILLINOIS

SUMMARY

1. Social needs of the United States are expanding faster than our society is presently able or willing to meet them. A social gap has opened between our needs and our ability to fill those needs. Serious social problems persist: Hunger, slums, crime, illiteracy, pollution, disease, poverty, joblessness.
2. Financial needs of large social sectors of our society are being met today through *private giving*, primarily through foundations and charitable giving.
3. No thorough, unbiased, professional study has ever been made concerning the financing of the operations of foundations. An independent commission of private citizens is currently making such a study to answer the questions to which we do not currently have information. Are we prepared to risk the drying up of private contributions to many valuable charitable, educational, medical and other social organizations and place their very existence in jeopardy without knowing the role of these institutions, their needs, and the effects of the proposed legislation on private giving.
4. Without the answer, the tax reform bill is placing in jeopardy a fundamental private force operating within our society. A drying up of foundation contributions could drive many vital charitable organizations to the wall.
5. If private giving is dried up we will be left with government philanthropy, government education, government medicine, government culture and government control. Pluralism is essential to a healthy society.

6. The 7½% tax is basically a *punitive* measure unrelated to costs of supervising foundations. Other tax reform provisions would dry up private giving. The definition of "lobbying" and propaganda activities is too restrictive.

7. Abuses must be corrected. Abuses will be pinpointed and specific legislation can then be enacted. Foundations should be audited regularly and billed for that auditing. Self-dealing must be stopped. Let's raise pay-out rates. But only a few foundations engage in abusive practices.

8. Alexis De Tocqueville in 1832 said that the genius of the United States of America lay in the organization of its private volunteer activities. Let us not take any action now that will tend to destroy or at least weaken a system that is the envy of most every nation in the world.

STATEMENT

Mr. Chairman, I appear before the Finance Committee today to talk about private foundations, their role in America, and the potential effects of H.R. 13270, the Tax Reform Act of 1969, upon both. I am not here today to attack or to defend the foundations. Rather, I am here to focus attention on the social needs of our society in the coming decades and to sound a warning that we must not undermine the means, human or financial, to meet those needs.

Before proceeding, I wish to inform my colleagues on this Committee that I bring a certain degree of personal involvement and first-hand knowledge to this issue. I served as a director and subsequently Chairman of the Board of the Fund for Adult Education of the Ford Foundation for ten years. The Fund was to educational TV what Carnegie was to the free public library, for it established the concept and underwrote the initial costs of educational television in the United States. I established a foundation in the company which I served as their Executive Officer for many years and also established a modest family foundation whose contributions go 100% to Treasury Department approved public charities. No administrative or overhead expenses exist, except for the expense of public auditing.

Mr. Chairman and members of the Committee, the social needs of the country are expanding at a rate which even our prosperous society is presently unable or unwilling to meet. The United States may have a higher GNP and a higher per capita income than any other country; yet serious social problems persist: hunger, slums, crime, illiteracy, pollution, disease, poverty, joblessness.

Chairman Russell Long made clear the other day that the costs of Medicare alone will amount to over $125 billion in the next 25 years. Commissioner of Education Allen has called for a program which will cost $100 million to do away with illiteracy in the United States. My own Banking and Currency Committee projected housing needs of 26 million units during the next 10 years. Even limited efforts to curtail water and air pollution will amount to billions of dollars a year. The list is not complete. These are merely indicators of the magnitude of the total problem facing us and future generations. Equal or greater sums will be needed for medical care, mass transit systems, family planning programs, research, drug controls, museums, crime enforcement, and many more demands.

Our country today faces a critical gap in meeting the needs of our society. A social gap has opened between our needs and our ability to fill these needs, between our expectations and our willingness to meet the expectations. Even approximate figures do not exist to give us a reasonable idea of what it will cost to meet our needs by the year 1975, let alone the year 2000. However, what we do know conservatively indicates that hundreds of billions of dollars will be required to close this gap.

As members of the Finance Committee you are in a particularly fine vantage point to understand how difficult it is to raise the necessary revenue to meet the budgetary demands of even existing Federal programs. Even upon termination of the Vietnam War, it is questionable as to how many dollars will be freed for financing presently unfunded or underfunded programs. And, even if significant sums of money are freed from existing budgetary commitments upon termination of the war or through other means, what guarantees do we have that such funds will be devoted adequately to closing the social gap?

This brings me to the reason for my appearing before you this morning. Some of the financial needs of large, vitally important social sectors of our society are being met today through past and present *private giving*. We know that our future needs cannot be met as we are now structured without large-scale future private giving. I have no idea, nor does anyone else, as to how large this giving may be for certain key sectors of charity. I know this, however, the need is

extremely large, and it is being financed heavily through private charitable giving, of which, of course, foundations are a form.

The Tax Reform Act of 1969, now under consideration by this Committee, contains a number of provisions which alter significantly the treatment for tax purposes of contributions to private foundations and charitable institutions, and expenditures by such organizations. In addition, the Act places limitations on the administration of such organizations and their managers so as to seriously threaten their ability to conduct operations in the future in a worthwhile, viable, and efficient manner.

There have been charges made in recent years that foundations have engaged in questionable activities such as self-dealing, financing political campaigns, lobbying for legislation, unfair business competition, and tax avoidance. In actuality, however, there is little available evidence to support or disown such charges, or even give us an idea as to whether the problem is a serious one or relatively unimportant. The fact is, no thorough, unbiased, professional study has ever been made concerning the financing or the operations of foundations.

I have had an opportunity in recent days to review the early preliminary findings of the Commission on Foundation and Private Philanthropy under the able leadership of Mr. Peter G. Peterson, Chairman and Chief Executive Officer, Bell & Howell Company. This independent commission of private citizens has been established to conduct a thorough, objective study of foundations and private philanthropy. Attached to my statement is a list of members, staff, and consultants to the Commission. It may be readily seen those serving in this study represent a broad philosophical and professional point of view.

The study is designed to answer questions and to present us with information that we do not know at present, but which we *must* know if we are not to place in jeopardy the entire social fabric of our society.

How large are the assets of private foundations and how much future growth is expected? How large is their annual investment income now and projected over the next 10 years? What percentage of income is paid out annually? To what sources and for what purposes is income paid out? What is the degree and what are the types of abuses? To what extent do charitable organizations depend upon support from private foundations? What have been the successes and failures of foundations? What will be the effects upon existing foundations and what will their policies be if the tax laws are changed as is contemplated in the Tax Reform Act of 1969? How will such Act effect the formation of new foundations? How may the entire nature of our society be changed if we are strait jacketed into total reliance upon Federal philanthropy?

I do not know the answer to these questions, and I most respectfully submit that no one else does. Certainly, the Treasury Department, although charged with the enforcement of foundations, is unable to supply us with answers. Yet, gentlemen, here we are seeking to tamper with and perhaps destroy a fundamental force operating within our society.

Let us remember that what we may be doing in enacting the Tax Reform Act in its present form is to place in jeopardy the YMCA, the Heart or Cancer Association, the Boys Clubs of America, and all other youth character building institutions, Family Planning clinics, universities, colleges, hospitals, and the host of other private organizations which are contributing so much to the fabric of our society.

Although still in preliminary form, some of the data I have seen from the Peterson Commission study suggest that a drying up of foundation and private contributions could drive many vital charitable organizations to the wall.

Charitable organizations in the Chicago area, for example, are expending greater sums than ever in recent years. Yet, they are unable to keep abreast of the cry for help and a significant number are operating at a deficit. Without the substantial assistance of private foundations, serious doubt arises as to whether many could continue operating effectively. Only 63 percent of the Michael Reese Hospital budget, for example, is met through charges to the public. In the case of the Chicago Y.M.C.A., less than 40 percent is covered in this manner. The Chicago Heart Association charges no fees to the public. As we all know, few hospitals, colleges, or universities could continue to operate if they had to reply chiefly or solely upon current fees or charges. As a past or present trustee of the University of Chicago, Illinois Institute of Technology, California Institute of Technology, Boys Clubs of Chicago, and other great institutions, I can personally attest to this fact. According to the preliminary survey by the Peterson Commission, two-thirds of all Chicago charities believe they would face critical budget

crisis if private giving was cut by 25 percent. I believe a survey of similar organizations in each of your own cities and states would reveal the same fact.

That is only my supposition, however, based upon the preliminary results of the Peterson Commission survey. The key question is, are we prepared to risk the drying up of private contributions to these valuable charitable, educational, medical, and other social organizations, and thereby place their very existence in jeopardy? Must we not know more about the role of these institutions, their needs, and the effects of the proposed legislation on private giving before going ahead?

If we do discourage private giving and if we do drive private organizations to the wall, with what are we left? The answer is clear: government philanthropy, government education, government medicine, government culture, and government control. Do any of us want this?

I am not arguing here for pure private enterprise. Federal financial assistance and government leadership have contributed significantly in many areas of social need in recent years. This will and should continue. But, what is required is the preservation of a healthy and dynamic pluralism in our society—a pluralism that can assure us of the freedom to innovate, the ability to take risks, the freedom to stand up to public opinion. Private organizations form a unique and necessary part of that pluralism. Consider for a moment some of the innovative and forward strides taken by or under the funding of private foundations: educational television, family planning and population research, agricultural innovation, support of the arts, employment of the handicapped, and medical research in heart therapy are just a few of the areas that immediately come to mind.

In addition, it is all too infrequently recognized how society profits from contributions of volunteer service which dedicated individuals render each year in charitable work. All Chicago charitable organizations, for example, rely upon volunteer assistance; in three-quarters of the organizations surveyed, the number of volunteer workers exceeded that of paid staff. Consider the billions of dollars of additional benefit that this source brings to our society. That benefit could not be maintained even if government could afford to assume the financial burden. Voluntarism is intrinsic to a healthy society. Voluntarism has an infinite number of roots. Many of those roots can take hold if nurtured by the people through private institutions.

There is a need to maintain vigorous private philanthropy in our society. This can only result from the expanding contributions of private persons, including private foundations. It is essential, therefore, that we not enact drastic changes in the tax law effecting charitable organizations or private foundations until the Congress has the facts to assure legislation which is right and which is consistent with our national needs and goals.

In the case of foundations, particularly, the Act imposes a 7½ percent tax on net income. This means that 7½ percent of all money that foundations would be contributing to organizations for educational, medical, health, cultural, and other vital social purposes will be funneled into the Federal Treasury and then back out to fill social needs less government overhead charges and plus government control and regulation. Just what is the rationale for this tax? It is not to defray costs of Federal supervision of foundation activities. No detailed cost estimate has been made, to my knowledge of what such supervision would cost. From what I gather, however, it could well be less than 1%. Thus, the 7½ percent tax is, in my opinion, basically a senseless, punitive measure.

In addition, proposals of deductions, charitable trusts, contributions of appreciated property, and other provisions may definitely have the effect of diverting funds from not only foundations in particular but private giving in general and from charitable sources to other less worthy sources. If the Tax Reform Act is enacted in its present form, some additional funds will flow into the public treasury instead of directly through private sources to charities, hospitals, and schools where I estimate the value derived is at least double that of federal expenditures in these same areas. It is unlikely that the increased revenues will find their way to the same sources as the private funds. Assuming they did we have seen that their effect would be drastically reduced. These and similar issues must be resolved before we enact legislation.

In addition, I strongly urge this Committee to look critically at two other key provisions of the House bill.

One provision so restricts the informational activities of foundations that they would be unable to bring reliable research and current events to the attention of the Government or the public and would likely cut them off from financial support. The manner in which the proposed legislation defines so-called "lobbying" and "propaganda" activities means that such organizations as Brookings Institutions, the Conservation Foundation, and National Education Television would be unable to present to Congress or to the public reliable new insights into the economic, social, and political problems facing us today.

The other provision also relates to organizations such as National Education Television, American Educational Research Association, Social Science Research Council, and the American Association of Learned Societies, which because they receive substantially all their support from 4 or fewer exempt organizations, are in danger of losing their tax-exempt status under the proposed legislation. Personally knowing of the reliable work being performed by National Education Television and these other organizations, I would consider it most disturbing if a too narrow redefining of the law forced to the wall highly effective, public spirited, independently oriented, educationally informative, nonpartisan organizations.

In urging the Committee to withhold drastic changes in the tax laws as they relate to foundations and philanthropic organizantions, I am in no way suggesting that Congress fail to step in to correct abuses that may exist in the administration of foundations. Abuses do exist. Preliminary results of the Peterson Commission study disclose this as well as some abuses not covered by the House bill. But, let us find out what the extent and degree of these abuses are, including such studies that should be conducted by the Treasury Department, and then let us enact appropriate legislation.

According to the Peterson Commission study, many foundations are not adequately audited by the IRS or the States. If this does in fact exist, let us request the Treasury Department to audit foundations periodically and have them pay for the cost—rather than imposing a unsupportable 7½ percent tax. If foundations engage in self-dealing or in unfair competitive practices, let's put a stop to it and enact penalties to discourage such behavior. If loose recordkeeping occurs or if unsupportably high operating expenses exist, let's pass appropriate measures to curtail such activities. If excessively low pay outs are found in some foundations, let's raise them to a high enough standard level to overcome "hoarding" instincts and poor investment policies that need correction. Finally, if some foundations are contributing their funds for improper purposes, such as partisan political activities, then, let us reaffirm our intention to flatly prohibit and penalize such activities.

As indicated in the preliminary Peterson Commission study, only a small percentage of foundations appear to engage in such abusive practices to any degree and these appear to be the smaller ones. But, let us find out what abuses really exist, and to what extent they actually exist. Being more fully informed, then let us proceed to legislate. Also their study suggests that a sizeable segment of Foundation Grants go to public charity, whereas I believe many have assumed, due to wide spread publicity, that a significant percent of total foundation grants go to various kinds of social and perhaps political activities. It is my understanding that in a very few weeks the Peterson Commission study can be made available to this committee, and I would urge that your final recommendations take into account this valuable evidence and facts, which up to now have been in extraordinary short supply not only about foundations but of the effects of this bill on private philanthropy in general. It took a Frenchman De Tocqueville in 1832, to discover that the genius of the United States of America lay in the organization of its private volunteer activities. Let us not take any action now that will tend to destroy or at least weaken a system that is the envy of most every nation in the world.

The public announcement of the Commission was made in April 1969, and now includes the following members:

J. Paul Austin, President & Chief Executive Officer, the Coca-Cola Company, Atlanta, Georgia.

Prof. Daniel Bell, Dept. of Sociology, Columbia University, New York, N.Y. Chairman, Commission on Year 2000 of American Academy of Arts & Sciences.

Daniel Bryant, Chairman & Chief Executive Officer, Bekins Moving & Storage Co., Los Angeles, Cal., Past President, Los Angeles Chamber of Commerce, and Los Angeles Merchants & Manufacturers Association.
James Chambers, President, Times Herald Printing Co. Publisher, Dallas Times Herald, Dallas, Texas.
Sheldon S. Cohen, Cohen & Uretz, Washington, D.C., Commissioner of Internal Revenue, 1958–69.
Thomas B. Curtis, Vice President & General Counsel, Encyclopaedia Britannica, Chicago, Ill., member, U.S. House of Representatives, 1950–69; member Ways and Means Committee, Joint Economic Committee.
Paul Freund, The Carl M. Loeb University Professor, Harvard University, Cambridge, Mass., President, American Academy of Arts & Sciences, 1964–67.
Martin Friedman, Director, Walker Art Center, Minneapolis, Minnesota, Commissioner, Smithsonian Commission, National Collection of Fine Arts.
Mrs. Patricia Roberts Harris, Professor of Law, Howard University, Washington, D.C., U.S. Ambassador to Luxembourg, 1965–67.
Hon. A. Leon Higginbotham, Jr., Judge, U.S. District Court for Eastern District of Pennsylvania, Philadelphia, Pennsylvania.
Lane Kirkland, Executive Assistant to the President, AFL-CIO, Washington, D.C., President of Institute of Collective Bargaining & Group Relations.
Dr. Philip Lee, Chancellor, University of California, School of Medicine, San Francisco, California; former Assistant Secretary, Department of Health, Education, and Welfare.
Edward Levi, President, University of Chicago, Chicago, Illinois.
Dr. Franklin Long, Vice President for Research and Advanced Studies, Cornell University, Ithaca, New York.
A. S. Mike Monroney, Consultant, Washington, D.C., Member, U.S. House of Representatives 1938–50; U.S. Senator, Oklahoma, 1950–69.
Key staff members include:
Director, Everett L. Hollis, Partner, Chicago law firm of Mayer, Friedlich, Spiess, Tierney, Brown & Platt.
Walter J. Blum, Professor of Law, University of Chicago and noted tax expert.
Fritz Heimann, Associate Corporate Counsel, General Electric Company, New York.
Consultants to Staff (some):
Economists: Arnold Harberger, Milton Friedman, Joseph Pechman, George Stigler, Theodore Shultz, and Michael Taussig.
Staff: John Labovitz and William Wineberg.
Sociologists—Educators: Norman Bradburn, Terry Clark, Edward Shils, and Ralph Tyler.
Business—Tax: Charles Davis and James Lorie.

Senator Anderson. Congressman Blackburn?
Senator Talmadge. Mr. Chairman, it is a pleasure indeed for me to welcome my friend and colleague from Georgia in his appearance before the Finance Committee.

STATEMENT OF HON. BENJAMIN B. BLACKBURN, A REPRESENTATIVE IN CONGRESS FROM THE FOURTH CONGRESSIONAL DISTRICT OF GEORGIA

Mr. Blackburn. Thank you, Senator, I appreciate that kind welcome.
Mr. Chairman, I appreciate your affording me the opportunity to appear before your committee. Of course, I have submitted my principal statement for the record and I will try to shorten it in my verbal testimony and only hit the highlights.
We, of course, have been hearing a great deal of testimony this morning relative to abuses of tax-exempt organizations. The field in

which I wish to direct my attention is the use of tax-exempt funds for partisan political activities, and I would like to include in my discussion not only foundations but all tax-exempt organizations, whether they be for religious or labor activities.

Many of these organizations engage in political activities which, by reason of their tax privileges, are being subsidized by the Federal Treasury. My purpose in being here today is to call the Congress' attention to some examples of political activities which I personally and many others consider to be improper by groups enjoying special tax privileges and to suggest possible ways of preventing future abuses.

I would like to discuss those funds under section 501(c)(3) and section 501(c)(5).

The Internal Revenue Code provides that "no substantial part" of the activity of any such organization is to be used on propaganda or otherwise attempt to influence legislation. Many organizations avoid this language because there is some ambiguity in the definition of the term "substantial part". As an example of this misuse of privilege, I would like to direct the attention of the committee to a group which was recently formed to actively lobby against the Anti-Ballistic Missile proposal, the coalition on national priorities and military policy. This organization is supported primarily by contributions from religious organizations. Its headquarters are located in a building here in Washington. This group has lobbied against the proposed ABM system. A few days ago a representative from this group came to my office and presented my staff with further information concerning its opposition to the 1969 Military Authorization Bill. I am attaching as an exhibit a copy of the material that I received. The business——

Senator TALMADGE. Mr. Chairman, may I ask a question at this point?

Mr. BLACKBURN. Yes, sir.

Senator TALMADGE. Was that organization financed by a foundation?

Mr. BLACKBURN. It is financed by a number of religious organizations, which themselves, are classified under the same section of the Internal Revenue Code.

Senator TALMADGE. And the language of the House bill precludes their lobbying activity?

Mr. BLACKBURN. No, sir; it would not. The House bill, as I recall, and you understand I am not on the Ways and Means Committee so I am not as intimately familiar with it as I would like to be, would permit appearing before congressional committees but it would prevent propaganda, that is attempting to sway public opinion.

Senator TALMADGE. Your point is you don't think the Ways and Means Committee language goes far enough in preventing political activity and lobbying by tax exempt groups?

Mr. BLACKBURN. No, sir; I do not. I think that I draw a distinction between lobbying in the sense of making appearances before members of Congress in their offices or before congressional committees and presenting a view. I think that any group should have that right as a matter of the extension of free speech. But to use tax exempt dollars

to propagandize the American public is a radically different thing and I think this should be definitely prevented.

I would like further to invite the attention of the committee to the National Student Association. Gentlemen, if you want to see tax returns which reveals very little I would suggest that you look into the returns which have been filed by this group. I am attaching some copies to my testimony. In fact this group——

Senator TALMADGE. How is that group financed?

Mr. BLACKBURN. Primarily by foundation grants.

Senator TALMADGE. For what purpose, do you know?

Mr. BLACKBURN. Promoting educational activities among the students of the country. Of course, they have no reluctance in taking positions on partisan political matters. In fact, this National Student Association has recognized that its blatant political activity would cost it its tax exempt status so now they have set up a parallel organization known as the National Student Institute, which will be the tax exempt organization. It will solicit the funds as a tax exempt organization, and then we strongly suspect that the funds that are contributed to the National Student Institute will then be funneled ino the National Student Association to be used for political and——

Senator TALMADGE. Do you know which foundations are making those grants?

Mr. BLACKBURN. I think the Ford Foundation is one of their major contributors but I don't—I can get the information.

Senator TALMADGE. You could get it and supply it for the record. I presume?

Mr. BLACKBURN. Yes, sir; I will.

(Additional data supplied by Mr. Blackburn follows:)

1. OTHER EXAMPLES OF TAX-EXEMPT ORGANISATIONS ENGAGING IN POLITICAL ACTIVITIES

Numerous groups have been formed in recent years for different tax-exempt purposes. As I stated in my testimony, the Internal Revenue Service Code specifically prohibits these organizations, which are exempt under Section 501(c) (3), from devoting a substantial part of their income to support of legislation or propaganda. With regard to the latter, I would like to bring to your attention an organization entitled The Institute for American Democracy. On the surface, this group claims to oppose extremism on the right and on the left. However, after close examination, it becomes obvious that their only purpose is to oppose extremism on the right (they feel this is more of a threat to American society than extremism on the left). Attached is a copy of some general information which they distributed about themselves which gives the impression that they are completely non-partisan. However, when examining a copy of the only publication put out by them, "Home Front," we find that this is not true at all. This organisation has only one purpose and that is to attempt to eliminate all groups on the right with which it disagrees. I believe that this is a form of propaganadad as stated in the IRS Code.

Secondly, I am enclosing a copy of this group's tax return. By going over the return, you cannot possibly determine how the funds received by this group are spent. Again, I believe this points out the need for a better reporting method to be issued by the I.R.S.

Finally, I would like to bring to your attention a copy of a petition which was recently submitted to the Federal Communications Commission by Lt. Col. Floyd Oles. In this petition, Col. Oles documents activities by The Institute for American Democracy which is trying to censor the programming of radio stations. Apparently, programs with which the Institute does not approve should be banned under what the Institute refers to as its air purification plan. I think that the Committee should seriously investigate the activities of this organization when it is so blatantly trying to influence public opinion by preventing the dissemination of viewpoints with which it disagrees.

Another group which I would like to bring to your attention is the Louis M. Rabinowitz Foundation. This Foundation has been giving funds to certain people with extremely questionable backgrounds. When examining the returns from this group, we found that it had given funds to one Mario Savio, the head of the Berkeley Free Speech Movement; to Julian Mayfield and Floyd McKissick, two well-known extremist black leaders; to one Clinton Jenks who was convicted of advocating the violent overthrow of the U.S. Government (his conviction was reversed because his lawyers were not allowed to see F.B.I. reports); and to the Southern Students Organizing Committee whose avowed purpose is to become the S.D.S. of the South. For the information of the Committee, I am enclosing a copy of a publication distributed by the National Review which gives a complete history of the Rabinowitz Foundation as well as outlines various activities in which it has been engaged.

Third, I would like to go deeper into some of the activities of the Ford Foundation. As in my testimony, I stated that the Ford Foundation had given money for many questionable projects. First, there is the fact that the Ford Foundation was responsible for financing various school decentralization projects in New York City; this activity was clearly of a political nature and precipitated a strike by the New York teachers' union. The Ford Foundation has distributed over $630,000 to a group entitled the Mexican-American Youth Organization. This organization finances travel regularly to Cuba and distributes pro-Castro propaganda to Mexican-Americans in Texas. Furthermore, the President of this organization has advocated the killing of Americans in order for Mexican-Americans to take over property which they desire. Also large chunks of Ford Foundation money have gone to various black extremist groups.

2. THE FINANCING OF THE NATIONAL STUDENT ASSOCIATION

Besides receiving funds from general membership dues, the NSA has received funds from the Office of Economic Opportunity; also it is financed by grants from foundations, the leading one being the Ford Foundation. Other foundations which have contributed to N.S.A. are The Fund for the Republic, The Catherwood Foundation, The General Mills Foundation, The Asia Foundation, The Edward W. Hazen Foundation, The Edward John Noble Foundation and several other "foundations which eventually turned out to be CIA fronts." One other group which is supplying funds to the NSA is the Stern Family Fund. While I have not been able to investigate the activities of this group, I am enclosing a copy of their tax return, and I believe the Committee will again see the need to have further clarification of how tax-exempt funds are used.

3. A COPY OF THE TAX RETURN FROM THE NATIONAL EDUCATION ASSOCIATION IS ATTACHED HEREWITH

If I can be of any further service to your Committee in its investigation of tax-exempt organizations, please do not hesitate to call on me.

Page 1

FORM **990-A** U.S. Treasury Department Internal Revenue Service

Return of Organization Exempt From Income Tax

Section 501(c)(3) of the Code
For the calendar year 1967, or other taxable year beginning ...., 1967, and ending ...., 19......
PLEASE TYPE OR PRINT

1967

Name: Institute for American Democracy, Inc.
Employer Identification Number: 52-0822376
Number and street: 30 Broad Street
City or town, State, and ZIP code: New York, New York 10004

Enter the name and address used on your return for 1966 (if the same as above, write "Same"). If none filed, give reason.
Same

PART II Part II information required pursuant to section 6033(b) and other applicable sections of the Internal Revenue Code must be submitted in duplicate as part of your return. This part will be made available to the public.

Line	Item	Amount
1	Gross sales or receipts from business activities	17,003.82
2	Less: Cost of goods sold and/or of operations (attach schedule) Subscription Expense	17,967.46
3	Gross profit from business activities	(963.64)
4	Interest	353.41
5	Dividends	
6	Gross rents	
7	Gross royalties	
8	Gain (or loss) from sale of assets, excluding inventory items (See instruction 8)	
9	Other income (attach schedule—Do not include contributions, gifts, grants, etc. (See line 17))	
10	Total gross income (lines 3 to 9, inclusive)	(610.23)
11	Expenses of earning gross income from column 3, Schedule A	
	DISBURSEMENTS MADE WITHIN THE YEAR OUT OF CURRENT OR ACCUMULATED INCOME FOR PURPOSES FOR WHICH EXEMPT, AND ACCUMULATION OF INCOME	
12	Expenses of distributing current or accumulated income from column 4, Schedule A	
13	Contributions, gifts, grants, scholarships, etc. (See instruction 13)	
14	Accumulation of income within the year (line 10 less the sum of lines 11, 12, and 13)	
15	Aggregate accumulation of income at beginning of the year (............)	
16	Aggregate accumulation of income at end of the year (............)	
	RECEIPTS NOT REPORTED ELSEWHERE	
17	Contributions, gifts, grants, etc., received (See instruction 17)	105,718.55
18	Less: Expenses of raising and collecting amount on line 17, from column 5, Schedule A	
19	Net contributions, gifts, grants, etc., received	105,718.55
	DISBURSEMENTS MADE OUT OF PRINCIPAL FOR PURPOSES FOR WHICH EXEMPT	
20	Expenses of distributing principal from column 6, Schedule A	111,048.81
21	Contributions, gifts, grants, scholarships, etc.: (a) Paid out in prior years (............)	
	(b) Paid out within the year (See instruction 21)	

Schedule A.—Allocation of Expenses (See Instructions for Attachments Required)

1. Item	2. Total	3. Expenses of earning gross income	4. Expenses of distributing income	5. Expenses of raising and collecting principal	6. Expenses of distributing principal
(a) Compensation of officers, etc.	22,500.00				22,500.00
(b) Other salaries and wages	31,047.55				31,047.55
(c) Interest					
(d) Taxes Employment	2,609.37				2,609.37
(e) Rent	4,059.12				4,059.12
(f) Depreciation (and depletion) Sch. #2					
(g) Miscellaneous expenses (attach schedule)	50,832.77				50,832.77
(h) Totals	111,048.81	Enter on line 11	Enter on line 12	Enter on line 18	111,048.81 Enter on line 20

Washington, D. C.

	Beginning of Taxable Year		End of Taxable Year	
	(A) Amount	(B) Total	(C) Amount	(D) Total
ASSETS				
1 Cash		21,343.25		13,894.22
2 Accounts receivable (see instructions)				
(a) Less allowance for bad debts				
3 Notes receivable (see instructions)				
(a) Less allowance for bad debts				
4 Inventories				
5 Gov't obligations: (a) U.S. and instrumentalities				
(b) State, subdivisions thereof, etc.				
6 Investments in nongovernmental bonds, etc.				
7 Investments in corporate stocks (see instructions)				
8 Mortgage loans (number of loans ______)				
9 Other investments (attach schedule)				
10 Depreciable (and depletable) assets (attach schedule)	3,038.36		4,605.36	
(a) Less accumulated depreciation (and depletion)	162.47	2,875.89		4,605.36
11 Land				
12 Other assets (attach schedule) Prepaid Expenses		838.26		738.26
13 Total assets		25,057.40		19,237.84
LIABILITIES AND NET WORTH				
14 Accounts payable (see instructions)				
15 Contributions, gifts, grants, etc., payable				
16 (a) Bonds and notes payable (see instructions)				
(b) Mortgages payable				
17 Other liabilities (attach schedule) Employment Taxes		874.46		832.92
18 Capital stock: (a) Preferred stock				
(b) Common stock				
19 Membership certificates				
20 Paid-in or capital surplus				
21 Retained earnings—Appropriated (attach schedule)				
22 Retained earnings—Unappropriated:	24,182.94		18,404.92	
(a) Attributable to ordinary income		24,182.94		18,404.92
(b) Attributable to gains from sale of assets				
23 Less cost of treasury stock				
24 Total liabilities and net worth		25,057.40		19,237.84

1 Date of current exemption letter 7-27-44

2 Attach a detailed statement of your charitable, business, and all other activities. Schedule C

3 Have you attached the information Schedules
(a) Instruction I? ☐ Yes ☐ No
(b) Instruction J? ☐ Yes ☐ No

4 Have you filed a tax return on Form 990-T for this year? ☐ Yes ☐ No
If "Yes," where filed? 4-2-43

5 In what year was your organization formed?
In what State or country? New York

6 If successor to previously existing organization(s), give name(s) and address(es) of the predecessor organization(s) ....

7 If you have capital stock issued and outstanding, state with respect to each class of stock:
(a) The number of shares outstanding ....
(b) The number of shares held by individuals ..... N/A
(c) The number of shares held by organizations ....
(d) The number of shareholders at end of year ....
(e) Whether any dividends may be paid ☐ Yes ☐ No

8 If you ... Furniture & Equipment $1,567.00 ... thereof.

9 Have any changes not previously reported to the Internal Revenue Service been made in your articles of incorporation or bylaws or other instruments of similar import? ☐ Yes ☐ No
If "Yes," attach a copy of the amendments.

10 Have you had any sources of income or engaged in any activities not previously reported to the Internal Revenue Service? ☐ Yes ☐ No
If "Yes," attach detailed statement.

11 Did you hold any real property for rental purposes with respect to which there is an indebtedness incurred in acquiring the property or in making improvements thereto or which was acquired subject to a mortgage or similar lien? ☐ Yes ☐ No
If "Yes," attach detailed statement.

12 Have you during the year advocated or opposed (including the publishing or distributing of statements) any national, State, or local legislation? ☐ Yes ☐ No
If "Yes," attach a detailed description of such activities and copies of any such statements.

13 Have you during the year participated in, or intervened in (including the publishing or distributing of statements) any political campaign on behalf of or in opposition to any candidate for public office? ☐ Yes ☐ No
If "Yes," attach a detailed description of such activities and copies of any such statements.

14 After July 1, 1950, did: the creator of your organization; or a contributor to your organization; or a brother or sister (whole or half blood), spouse, ancestor, or lineal descendant of such creator or contributor; or a corporation owned (50 percent or more of voting stock or 50 percent or more of value of all stock) directly or indirectly by such creator or contributor—
(a) Borrow any part of your income or corpus? ☐ Yes ☐ No
(b) Receive any compensation for personal services from you? ☐ Yes ☐ No
(c) Have any part of your services or assets made available to him? ☐ Yes ☐ No
(d) Purchase any securities or other property from you? ☐ Yes ☐ No
(e) Sell any securities or other property to you? ☐ Yes ☐ No
(f) Receive any of your income or corpus in any other transaction? ☐ Yes ☐ No
If answer to any question is "Yes," attach detailed statement unless previously reported. If previously reported, give year(s).

15 Do you hold 5 percent or more of any class of stock in any corporation? ☐ Yes ☐ No
If "Yes," you must submit the information required by the instructions for Schedule B.

U.S. GOVERNMENT PRINTING OFFICE

Subscriptions	$12,901.50
Sale of Material	4,102.32
	$17,003.82

NAME: Institute for [illegible] Inc.

ADDRESS: 30 [illegible]

New York, New York 10004

Taxable Year Ended 12.31.62

Schedule A - Line 6		
Salaries	23,500	-
Project printing	5237	47
Office supplies	3345	42
Project material	3535	80
Telephone & telegraph	2787	30
Travel	2494	76
Postage	1986	33
Temporary help	1911	52
Taxes	1448	31
Professional services	906	70
Miscellaneous office expenses	1095	62
Meetings and conferences	868	44
Hospitalization	443	73
Dues	250	-
Research material	197	23
Workmen's compensation insurance	82	-
Life insurance	48	59
	50,432	77

Attachment to pages 1 & 5

Institute for American Democracy, Inc.

(Attachment to pages 2, 4, and 6 (item 2))

The Institute conducts studies concerning un-American and anti-democratic attitudes, programs and movements in the United States of America and arranges public meetings and distributes booklets, pamphlets and similar literature, all of a non-partisan, educational nature, designed to present pertinent facts for the education of the public.

In carrying out its purposes, IAD attempts to inculcate a sense of individual responsibility to the democratic principles of the Nation and to foster an educational relationship with churches and other associations having similar charitable and educational purposes.

NAME: INSTITUTE FOR AMERICAN DEMOCRACY, INC.

ADDRESS: [illegible] BROAD ST.

NEW YORK, NEW YORK 10004

Taxable Year Ended 12-31-67

INSTRUCTION I

OFFICERS

PRESIDENT	DR. FRANKLIN H. LITTELL (E)
VICE PRESIDENT	SAMUEL DALSIMER (E)
TREASURER	DR. EDWIN DAVIS (E)
SECRETARY	JACOB SHAYMAN (E)

DIRECTORS

MORRIS ABRAM
DR. BURTON [illegible] (E)
DR. JOHN CRONIN, S.S.
DR. EDWIN DAVIS (E)
SAMUEL DALSIMER (E)
DR. FRANKLIN H. LITTELL (E)
RICHARD W. [illegible] SR.
HOWARD SAMUEL
JACOB SHAYMAN (E)

EXECUTIVE DIRECTOR

		Time Devoted	Compensation
CHARLES BAKER	(E)	100%	37,500.00

NO OFFICER OR DIRECTOR RECEIVED ANY COMPENSATION DURING THE TAXABLE YEAR.

ATTACHMENT TO PAGES 2, 4, 6

INSTITUTE FOR AMERICAN DEMOCRACY, INC.,
Washington, D.C.

Memo to: NEA's PR&R Conference Delegates.
Subject: Putting YOU in IAD.
Date: January 16, 1967.

If you are one of those who do not like to see extremists hacking away at our basic democratic precepts, then IAD should interest you.

We want to cooperate with people who will rally to the defense of our democratic way of life.

We are looking for allies willing to stand up and be counted when extremists are trying to put themselves in the driver's seat.

We need the help of real patriots, the kind willing to expose the false merchandise behind the advertising slogans of the super-patriots. America always needs the support of truly dedicated citizens, the kind who can endure the taunts and ridicule often associated with the Radical Left, and the harassment and intimidation frequently ascribed to the Radical Right.

If you are devoted to the basic philosophy of our democracy and if you are concerned about extremist efforts to take over or rip apart our basic national and local decision-making processes, then you may have a deep interest in the aims and activities of IAD.

Here are some questions and answers to tell you what IAD is all about:

WHAT IS THE INSTITUTE FOR AMERICAN DEMOCRACY?

It is a non-partisan, non-profit educational organization permanently headquartered in Washington.

It is the one organziation entrusted with the task of coordinating the activities of associations and indivdiulas who wish to shed more light (for the extremists of the worst form of heat) on Radical Left and Right goals and methods.

WHO IS BEHIND THIS EFFORT?

IAD is a broadly based voluntary association of individuals, but the Sponsoring Committee includes spokesmen for many nationally significant religious, civic, labor and educational groups, as well as many prominent businessmen, public figures and researchers.

The Chairman of IAD is Dr. Franklin H. Littell, clergyman, researcher, President of Iowa Wesleyan College, a Phi Beta Kappa with an academic Ph.D., and a nationally-recognized expert on church history and totalitarianism.

WHAT NEEDS DOES IAD SUPPLY?

IAD is helping turn the spotlight on extremism and extremists at the national level.

IAD helps local groups get themselves formed.

IAD helps provide grass roots anti-extremists with materials, research guides and information on what Radical Left and Right groups are up to.

IAD gives the individual with the desire to help and the person under attack a place to turn.

IAD serves as a clearinghouse for books, pamphlets, radio and TV programs and know-how.

ANY CONNECTION WITH PREVIOUS ANTI-JOHN BIRCH EFFORTS?

This Institute is the spiritual heir to the insights and information gained through the 1962 Greenwich Conference and the 1964-65 National Committee for Civic Responsibility.

While we have drawn strength and inspiration from those who have gone before, and while many of the pioneers of this effort are again in the vanguard, in essence this represents a fresh start.

IS IAD CONCERNED WITH OPPOSING COMMUNISM?

We are deeply concerned with combatting domestic Communism and intend to do so in a responsible manner.

The super-patriots who hide their imagined self-interest in the camouflage of "anti-Communism" all too often help the Communists toward the goals of

discrediting the democratic form of government and those institutions and organizations making significant contributions to the national dialogue. Both extremes work to undermine our national self-confidence.

HOW CAN THE INDIVIDUAL HELP?

You can help by speaking out in support of the democratic form of government whenever it is under attack.

You can help by studying the aims and methods of extremists and telling others about them.

You can help by becoming an associate member of IAD. (We're working out the mechanics now.)

You can help by subscribing to IAD's forthcoming newsletter, *Homefront*.

You can help by encouraging community groups to come to grips with the problem of extremism and by participating in their activities.

HOW DO I MAKE CONTACT WITH IAD?

One way is to write to: Dr. Franklin H. Littell, % Institute for American Democracy, 1330 Massachusetts Avenue, N.W., Washington, D.C. 20005.

[From Information Service, Mar. 26, 1967]

NEW INSTITUTE TO COMBAT EXTREMISM

An "Institute for American Democracy" has been launched as "a non-partisan, non-profit institute serving as a clearinghouse for materials on extremism" of both the left and the right.

The first issue of the organization's bulletin, *Homefront*, is dated February 1967 (15 cents, IAD, 1330 Massachusetts Ave., N.W., Washington, D.C. 20005). It pictures and gives brief biographical sketches of the 63 prominent citizens who compose the sponsoring committee. Among them are Morris B. Abram, Senators Case, Moss and McGee, Roy Wilkins, Bishops Burt, Grant, Pope and Thomas, Drs. David Hunter and Martin Marty. The Committee chairman is Dr. Franklin H. Littell, president of Iowa Wesleyan College.

Some of the functions of the Institute are listed as follows:

"IAD helps lay the base for local efforts to combat extremism by calling national attention to extremist activities.

"IAD attempts to analyze extremist activity patterns and to make this information available to those who can use it.

"IAD is working with individuals and groups concerned with offsetting the poisonous Radical Right radio outpouring of unfounded charges and malicious innunendoes with a healthy antidote of facts.

"IAD serves as a clearinghouse of information on available materials like the Anti-Defamation League's series of 15-minute taped radio programs: ADL and National Education Television films on extremism and pamphlets produced by many groups including both Protestant and Catholic church organizations, ADL, and the American Jewish Committee, AFL–CIO, the National Education Association, National Congress of Parents and Teachers, and others.

"We're also in the process of producing a series of *Who Is—What Is* leaflets to identify the persons and groups most prominent in the struggle for the mind of America. These will be available at a small charge.

"We have ready access to the Group Research, Inc. reports and a half-dozen other active files on extremist organizations. And you would be amazed at the amount of information already flowing in from concerned Americans who want to share their knowledge of extremist activity.

"We are building a bibliography of available articles, books, responsible research papers and seminar ingredients—and already the demand for speakers outpaces the supply. Early drafts of this bibliography already are in use."

Associate membership is invited at $5.00 per year.

INSTITUTE FOR AMERICAN DEMOCRACY, INC.,
Washington, D.C., April 14, 1967.

To: Citizens Inquiring about Some Specific IAD Policies.
From: Charles R. Baker, Executive Director.
Subject: Where IAD Stands in the Political Spectrum.

Thank you for your thoughtful question.

A good many persons ask similar questions, so many, in fact, that we have prepared this memo to tell folks where we stand on these matters. Here are my personal answers to some frequently encountered queries:

Question—*Where does IAD fit in the political scale?*

Answer—In the middle. IAD does not take a position on issues, as such, or candidates, as such. We are concerned with extremist tactics which tend to shut off the free exchange of ideas so essential to democracy.

Look at the list of IAD's sponsors and you will find many top level Republicans, Democrats and Independents. You will find *bona fide representatives* of a broad range of viewpoints—liberals and conservatives. These distinguished Americans no doubt disagree on many specific issues, but they are in complete agreement on the need to protect the middle ground from extremist onslaughts.

IAD opposes with equal fervor the Tactics of the Communist Party and its front groups, and the John Birch Society and the various groups in the JBS orbit, as well as the even further-out Radical Right organizations like the Minutemen and the Klu Klux Klan.

Question—*Why oppose extremism of both the Far Right and the Far Left?*

Answer—At both extremes, the zealots attempt to stifle the free flow of ideas. Both think their ends justify means which cannot be acceptable to a democratic society. They slander their real or imaginary foes. They foment fears and hatreds and they repeat half-truths and falsehoods over and over again until they are believed.

The mental attitudes of the Far Left and Far Right are much the same. That is why former Communists periodically "defect" to the Far Right, and the Far Rightists, on occasion, switch to the opposite extreme.

Question—*What do you mean by "extremism"?*

Answer—The use of tactics which are clearly out-of-bounds in a democratic society that force attitudes and "facts" on more open-minded citizens.

Question—*Who is employing these tactics?*

Answer—On the Far Left you have the Communist Party, the Progressive Labor Party and several score so-called "front" groups. On the Far Right you have the John Birch Society, the Minutemen, [Liberty Lobby] the Billy James Hargis "Crusade", the Carl McIntire "Reformation Hour", Major Bundy's so-called ["Church League of America"] and more than a thousand lesser groups.

Question—*Why so much concern over the John Birch Society?*

Answer—Because the Birchers have by far the most activity of any extremist group. In both 1965 and 1966, their annual budget exceeded $5 million. The Birchers have a paid staff of about 250, their own magazines, their own publishing house, a stable of propagandists, their own corps of 50 touring professional speakers, their own radio programs—all the trappings of a modern day campaign organization.

The Birchers set the tone and the propaganda themes for the great bulk of the Radical Right activty. The Radical Right takes in and spends about $30 million annually.

The Communist Party and groups in the CP orbit have far fewer members, fewer publications, no radio programs and a relatively small paid field force.

This does not mean you can ignore them. *In the 1930s and 1940s* the Far Left posed by far the greater threat to democracy. Today the pendulum has swung the other way, but it can always swing back again.

Question—*What about student groups and the 'New Left'?*

Answer—There is substantial difference between "protest", no matter how ill-founded, and the effort to force views on others by a long campaign. Student "protest" during the transitory period of student life only rarely carries over to post graduate days. The differences between the self-styled, "ultra-conservative" Young Americans for Freedom and the "liberal" Students for a Democratic Society may be very slight. Such student groups can become dangerous when adult organizations try to manipulate them, however.

The so-called "New Left" varies in character from campus to campus. There does not appear to be a tightly-knit national organization.

A number of adult Radical Right organizations have been involved in YAF activity. The Communists have penetrated student grops on some campuses notably Berkeley.

Question—*Are extremists in the Civil Rights movement?*

Answer—Certainly. And on both sides. This does not mean that all who oppose Civil Rights measures are Birchers or Klansmen any more than it means those who favor more rapid change in Civil Rights are Communists.

Both extremes foment racial tensions. Both hope to divert these tensions to their private ends.

When Birch speaker Jim Clark, the ex-sheriff of Selma, Alabama falsely calls the Selma demonstrators "Communist", he actually gives the Communists undeserved prestige among some individuals and groups in sympathy with the objectives sought at Selma.

Last year, when Stokely Carmichael went to Selma to "turn out the Negro vote" against Clark, he probably helped Clark far more than his opponent, giving the viewpoint represented by Clark a status it, too, did not deserve.

Question—*What about disagreements over the U.S. position in Viet Nam?*

Answer—Many thoughtful Americans back our present position in Viet Nam. Others believe we should further escalate our war activities. Others believe we should seek peace more aggressively. All three are legitimate viewpoints. There are many arguments on both sides.

The Communists attempt to use the Peace movement to achieve their objectives, and accuse those who disagree of being "war mongers".

The Birchers attempt to use the escalation movement to achieve their ends, and charge those who disagree with being "traitors."

The newest Robert Welch position papers charge that Communists are now in control of the U.S. Government, and that the Eisenhower, Kennedy and Johnson Administrations conspired with the Communists against America, and that "bi-partisan treason (is) rampant everywhere". Welch asserts that Communists are controlling *our* war actions.

If Gus Hall of the Communist Party charged the chief-of-state with conspiring with foreign powers to "sacrifice American GIs" in order to achieve "Foreign ends," likely the FBI, House Un-American Activities Committee and Senate Internal Security Subcommittee would be in instant action.

Because the John Birch Society Chieftan is not under that kind of surveillance, IAD has had to expose this JBS activity as our patriotic duty.

Question—*Doesn't exposing the anti-communists help the Communists?*

Answer—Not in my view. The professional anti-communists, those persons President Eisenhower described as being "more patriotic than you and I or anybody else" have a financial stake in keeping the fear of Communism alive. To some of them "anti-communism" is a multi-million dollar business.

Their fund raising formula calls for them to first wrap themselves in the flag, hold high the cross, and thus protected try to frighten people out of their wits by crying "Communism". After that comes the pitch for funds.

Instead of telling people why Communist activity is dangerous, they are more likely to smear their fores with such spurious claims as, "He has three HUAC citations," which means the name came up in three places during HUAC testimony. (If you played the piano in a 1940 ward bond rally where a CP member spoke, you may have a HUAC citation.)

Among the goals of domestic communism are: 1) fomenting racial tensions, 2) undermining our faith in the U.S. government and the Office of the President, 3) making us distrust the democratic process, and 4) turning us against the mass media and other "outside" sources of attitudes like established religions and educational institutions.

These are also the goals of the John Birch Society and many in its orbit. Those who, in the name of anti-communism, oppose the United Nations, the National Council of Churches, Medicare, Civil Rights, Union Shop provisions, Social Security or the Graduated Income Tax are simply masquerading. They are trying to use our natural opposition to the Communist ideology to cover their opposition to the United Nations, National Council of Churches, etc.

What we have to fear is not a vague "conspiracy."

What must concern us are the specific tactics employed by extremists of both sides to discredit the democratic process.

Question—*How can I help protect the democratic process?*

Answer—By taking an active part in it. By stepping up to your responsibilities as a citizen even when doing so makes short range problems for you.

FORM **990-A** U.S. Treasury Department Internal Revenue Service

Return of Organization Exempt From Income Tax

Section 501(c)(3) of the Code

For the calendar year 1967, or other taxable year beginning .... 1967, and ending .... 19...

PLEASE TYPE OR PRINT

1967

Name: Stern Family Fund	Employer Identification Number: 72-0457334 [illegible]
Number and street: 521 Royal Street	
City or town, State and ZIP code: New Orleans, Louisiana 70130	

Enter the name and address used on your return for 1966 (if the same as above, write "Same"). If none filed, give reason.

Same

PART II Part II information required pursuant to section 6033(b) and other applicable sections of the Internal Revenue Code must be submitted in duplicate as part of your return. This part will be made available to the public.

Line	Item	Amount
1	Gross sales or receipts from business activities	
2	Less: Cost of goods sold and/or of operations (attach schedule)	
3	Gross profit from business activities	
4	Interest	28,[illegible]
5	Dividends	106,[illegible]2.55
6	Gross rents	
7	Gross royalties	
8	Gain (or loss) from sale of assets, excluding inventory items (See Instruction 8)	220,552.66
9	Other income (attach schedule—Do not include contributions, gifts, grants, etc. (See line 17))	[illegible].28
10	Total gross income (lines 3 to 9, inclusive)	[illegible]31.33
11	Expenses of earning gross income from column 3, Schedule A	46,455.46

DISBURSEMENTS MADE WITHIN THE YEAR OUT OF CURRENT OR ACCUMULATED INCOME FOR PURPOSES FOR WHICH EXEMPT, AND ACCUMULATION OF INCOME

Line	Item	Amount
12	Expenses of distributing current or accumulated income from column 4, Schedule A	1[illegible].73
13	Contributions, gifts, grants, scholarships, etc. (See Instruction 13)	567,[illegible]
14	Accumulation of income within the year (line 10 less the sum of lines 11, 12, and 13)	none
15	Aggregate accumulation of income at beginning of the year	(none)
16	Aggregate accumulation of income at end of the year	(none)

RECEIPTS NOT REPORTED ELSEWHERE

Line	Item	Amount
17	Contributions, gifts, grants, etc., received (See Instruction 17)	261,500.00
18	Less: Expenses of raising and collecting amount on line 17, from column 5, Schedule A	none
19	Net contributions, gifts, grants, etc., received	261,[illegible]

DISBURSEMENTS MADE OUT OF PRINCIPAL FOR PURPOSES FOR WHICH EXEMPT

Line	Item	Amount
20	Expenses of distributing principal from column 6, Schedule A	none
21	Contributions, gifts, grants, scholarships, etc.: (a) Paid out in prior years (7,636,638.00)	
	(b) Paid out within the year (See Instruction 21)	293,[illegible].59

Schedule A.—Allocation of Expenses (See Instructions for Attachments Required)

1. Item	2. Total	3. Expenses of earning gross income	4. Expenses of distributing income	5. Expenses of raising and collecting principal	6. Expenses of distributing principal
(a) Compensation of officers, etc.	31,563.62		31,563.62		
(b) Other salaries and wages	13,890.44		13,890.44		
(c) Interest					
(d) Taxes					
(e) Rent					
(f) Depreciation (and depletion)					
(g) Miscellaneous expenses (attach schedule)	137,600.13	46,455.46	91,144.67		
(h) Totals	183,054.19	[illegible] (Enter on line 11)	136,[illegible].73 (Enter on line 12)	(Enter on line 18)	(Enter on line 20)

Vice President

5/1/68

521 Royal Street, New Orleans, La. 70130

	Beginning of Taxable Year		End of Taxable Year	
	(A) Amount	(B) Total	(C) Amount	(D) Total
ASSETS				
1 Cash		262,004.69		271,023.52
2 Accounts receivable (see instructions)				
(a) Less allowance for bad debts				
3 Notes receivable (see instructions)	18,268.66		17,336.50	
(a) Less allowance for bad debts		18,268.66		17,336.50
4 ~~Inventories~~ Accr. interest on bonds pur.		34.38		101.25
5 Gov't obligations: (a) U.S. and instrumentalities	202,125.00		251,500.00	
(b) State, subdivisions thereof, etc.		202,125.00		251,500.00
6 Investments in nongovernmental bonds, etc.		454,331.25		446,536.23
7 Investments in corporate stocks (see instructions)		3,013,527.47		2,931,403.88
8 Mortgage loans (number of loans ______)				
9 Other investments (attach schedule)				
10 Depreciable (and depletable) assets (attach schedule)				
(a) Less accumulated depreciation (and depletion)				
11 Land				
12 Other assets (attach schedule)				
13 Total assets		3,950,291.45		3,917,926.60
LIABILITIES AND NET WORTH				
14 Accounts payable (see instructions)				
15 Contributions, gifts, grants, etc., payable				
16 (a) Bonds and notes payable (see instructions)				
(b) ~~Mortgages payable~~ Payroll taxes W/H		1,110.65		828.23
17 Other liabilities (attach schedule)				
18 Capital stock: (a) Preferred stock				
(b) Common stock				
19 Membership certificates				
20 Paid-in or capital surplus		3,949,180.80		3,917,098.15
21 Retained earnings—Appropriated (attach schedule)				
22 Retained earnings—Unappropriated:				
(a) Attributable to ordinary income				
(b) Attributable to gains from sale of assets				
23 Less cost of treasury stock		( )		( )
24 Total liabilities and net worth		3,950,291.45		3,917,926.60

1 Date of current exemption letter January 3, 1938

2 Attach a detailed statement of the nature of your charitable, business, and all other activities. Charitable & philanthropic.

3 Have you attached the information required by:
- (a) Instruction I? ☒ Yes ☐ No
- (b) Instruction J? ☒ Yes ☐ No

4 Have you filed a tax return on Form 990-T for this year? ☐ Yes ☒ No

If "Yes," where filed? ....

5 In what year was your organization formed? 1936

In what State or country? Louisiana

6 If successor to previously existing organization(s), give name(s) and address(es) of the predecessor organization(s) ....

7 If you have capital stock issued and outstanding, state with respect to each class of stock
- (a) The number of shares outstanding ....
- (b) The number of shares held by individuals ....
- (c) The number of shares held by organizations ....
- (d) The number of shareholders at end of year ....
- (e) Whether any dividends may be paid ☐ Yes ☐ No

8 If you acquired capital assets out of income, attach itemized list and amount thereof.

9 Have any changes not previously reported to the Internal Revenue Service been made in your articles of incorporation or bylaws or other instruments of similar import? ☒ Yes ☐ No

If "Yes," attach a copy of the amendments.

10 Have you had any sources of income or engaged in any activities not previously reported to the Internal Revenue Service? ☐ Yes ☒ No

If "Yes," attach detailed statement.

11 Did you hold any real property for rental purposes with respect to which there is an indebtedness incurred in acquiring the property or in making improvements thereon or which was acquired subject to a mortgage or similar lien? ☐ Yes ☒ No

If "Yes," attach detailed statement.

12 Have you during the year advocated or opposed (including the publishing or distributing of statements) any national, State, or local legislation? ☐ Yes ☒ No

If "Yes," attach a detailed description of such activities and copies of any such statements.

13 Have you during the year participated in, or intervened in (including the publishing or distributing of statements) any political campaign on behalf of or in opposition to any candidate for public office? ☐ Yes ☒ No

If "Yes," attach a detailed description of such activities and copies of any such statements.

14 After July 1, 1950, did the creator of your organization, [illegible] value of all stock) directly or indirectly [illegible]
- (a) Borrow any part of your income or corpus? ☐ Yes ☒ No
- (b) Receive any compensation for personal services from you? ☐ Yes ☒ No
- (c) Have any part of your services or assets made available to him? ☐ Yes ☒ No
- (d) Purchase any securities or other property from you? ☐ Yes ☒ No
- (e) Sell any securities or other property to you? ☐ Yes ☒ No
- (f) Receive any of your income or corpus in any other transaction? ☐ Yes ☒ No

If answer to any question is "Yes," attach detailed statement unless previously reported. If previously reported, give year(s).

15 Do you hold 5 percent or more of any class of stock in any corporation? ☐ Yes ☒ No

If "Yes," you must submit the information required by the instructions for Schedule B.

U.S. GOVERNMENT PRINTING OFFICE, 1967—O-[illegible]

STERN FAMILY FUND, NEW ORLEANS, LA.

Return of organization exempt from income tax—calendar year 1967

Distributions from Trusts f/b/o Stern Family Fund and Others, created u/a/d:

June 1, 1955	$180,000.00
December 21, 1956	90,720.00
December 16, 1958	64,800.00
Sale of books, "Recognition of Excellence"	75.28
Total	335,595.28

Contributions paid:

Adult Instruction Membership of Louisiana	$951.00
Boston Symphony Orchestra, Inc	750.00
Bureau of Governmental Research	1,500.00
Center for Urban Education	250.00
Children's Hospital, Washington, D.C	17,000.00
Citizen Exchange Corps, Inc	30,000.00
Citizens Committee on Children of New York City, Inc	3,000.00
Citizens' Housing Council of the Greater New Orleans Area	1,000.00
Congregation Temple Sinai	1,000.00
The Isaac Delgado Museum of Art	55.61
Dillard University	29,500.00
Foreign Policy Association	100.00
Foundation for a Better Louisiana	2,500.00
Daniel Chester French Foundation	50.00
Goldovsky Opera Institute, Inc	2,000.00
[Greater Cleveland Associated Foundation]	1,000.00
Hampshire College, The Trustees of	2,000.00
Harvard College, President and Fellows of	1,050.00
Historic New Orleans, Inc	2,000.00
Institute for Local Self Government	15,000.00
Institute for Policy Studies	4,414.85
International Visitors Center, Inc	55,000.00
Junior Achievement of Greater New Orleans, Inc	300.00
Junior Criminal Deputy Association	50.00
The Kingsley House and New Orleans Day Nursery Association	2,000.00
League for Industrial Democracy, Inc	1,000.00
Louisiana Civil Service League	100.00
Loyola University	15,500.00
Massachusetts Audubon Society	25.00
Metairie Park Country Day School	60,000.00
Metropolitan Applied Research Center, Inc	3,000.00
Metropolitan Crime Commission of New Orleans, Inc	1,250.00
NAACP Special Contribution Fund	30,000.00
The National Conference of Christian and Jews, Inc	200.00
National Federation of Settlements, Inc	19,967.14
National Merit Scholarship Corp	16,033.00

33-865 O—69—pt. 6——48

Contributions paid—Continued

National Municipal League		$25.00
National Social Welfare Assembly, Inc		20,000.00
The New Orleans Branch of the National Urban League, Inc		12,500.00
New Orleans Jewish Welfare Fund		41,000.00
(PACT) Plan of Action for Challenging Times		4,000.00
Play Schools Association, Inc		80.00
Pittsfield General Hospital		25.00
Planned Parenthood Federation of America, Inc		2,800.00
Pratt Institute		15,000.00
Public Affairs Research Council of Louisiana, Inc		2,500.00
St. Mary's Episcopal Church		1,000.00
Johnson C. Smith University, Inc		15,000.00
Social Development Corporation		90,000.00
Social Welfare Planning Council		3,500.00
Southern Regional Council, Inc		10,000.00
Henry Street Settlement		15,000.00
Syracuse University		2,500.00
Tulane University of Louisiana		8,650.90
Union for Democratic Action Educational Fund, Inc		1,000.00
United Fund for the Greater New Orleans Area		28,000.00
United Jewish Appeal		250,000.00
United Negro College Fund, Inc		10,000.00
United States Conference of Mayors		5,000.00
United States National Student Association		17,500.00
University of Michigan, The Regents of the		15,162.00
University of Notre Dame Du Lac Gillen Foundation		1,000.00
Urban America, Inc		37,000.00
Xavier University		5,000.00
Young Audiences, Inc		100.00
Total		932,889.50
Less refund or portion of contributions made to the following:		
In 1964 to Columbia university	$8,416.30	
In 1966 to Community Service Foundation	257.60	
In 1962 to City of New York	36,520.05	
In 1963 to Iowa State College of Agriculture and Mechanic Arts	106.37	
In 1961 & 1965 to United Neighborhood Houses of New York, Inc	26,248.70	
		71,549.02
Total		861,340.48
Contributions made out of current or accumlated income (line 1)		567,476.89
Contributions made out of principal (line 2)		293,863.59
Total		861,340.48

FORM 990-A
U.S. Treasury Department
Internal Revenue Service

Return of Organization Exempt From Income Tax

Section 501(c)(3) of the Code
For the year January 1-December 31, 1966, or other taxable year beginning ________ 1966, and ending ________ 19___
PLEASE TYPE OR PRINT

1966

Name	Employer Identification Number
[illegible] FAMILY FUND	72-[illegible]
Number and street: 521 Royal Street	
City or town, State, and ZIP code: N[illegible] Orleans, Louisiana 70130	

Enter the name and address used on your return for 1965 (if the same as above, write "Same"). If none filed, give reason.
Same

PART II Part II information required pursuant to section 6033(b) and other applicable sections of the Internal Revenue Code must be submitted in duplicate as part of your return. This part will be made available to the public.

Line	Item	Amount
1	Gross sales or receipts from business activities	
2	Less: Cost of goods sold and/or of operations (attach schedule)	
3	Gross profit from business activities	
4	Interest	2,114
5	Dividends	112,952
6	Rents	
7	Royalties	
8	Gain (or loss) from sale of assets, excluding inventory items (See Instruction 8)	1[illegible]7,[illegible]63
9	Other income (attach schedule—Do not include contributions, gifts, grants, etc. (See line 17))	[illegible]1,675
10	Total gross income (lines 3 to 9, inclusive)	67[illegible],5[illegible]
11	Expenses of earning gross income from column 3, Schedule A	50,077
	DISBURSEMENTS MADE WITHIN THE YEAR OUT OF CURRENT OR ACCUMULATED INCOME FOR PURPOSES FOR WHICH EXEMPT, AND ACCUMULATION OF INCOME	
12	Expenses of distributing current or accumulated income from column 4, Schedule A	13[illegible]
13	Contributions, gifts, grants, scholarships, etc. (See Instruction 13)	[illegible]
14	Accumulation of income within the year (line 10 less the sum of lines 11, 12, and 13)	[illegible]
15	Aggregate accumulation of income at beginning of the year (none)	
16	Aggregate accumulation of income at end of the year (none)	
	RECEIPTS NOT REPORTED ELSEWHERE	
17	Contributions, gifts, grants, etc., received (See Instruction 17)	[illegible]
18	Less: Expenses of raising and collecting amount on line 17, from column 5, Schedule A	none
19	Net contributions, gifts, grants, etc., received	5,[illegible]
	DISBURSEMENTS MADE OUT OF PRINCIPAL FOR PURPOSES FOR WHICH EXEMPT	
20	Expenses of distributing principal from column 6, Schedule A	none
21	Contributions, gifts, grants, scholarships, etc.: (a) Paid out in prior years (6,886,469)	
	(b) Paid out within the year (See Instruction 21)	748,16[illegible]

Schedule A.—Allocation of Expenses (See Instructions for Attachments Required)

1. Item	2. Total	3. Expenses of earning gross income	4. Expenses of distributing income	5. Expenses of raising and collecting principal	6. Expenses of distributing principal
(a) Compensation of officers, etc.	33,925		33,925		
(b) Other salaries and wages	13,423		13,423		
(c) Interest					
(d) Taxes					
(e) Rent					
(f) Depreciation (and depletion)					
(g) Miscellaneous expenses (attach schedule)	136,110	50,077	86,033		
(h) Totals	183,458	50,077	133,381		
		Enter on line 11	Enter on line 12	Enter on line 18	Enter on line 20

3/4/67

521 Royal Street, New Orleans, La. 70130

Form 990-A—1966 **Schedule B.—BALANCE SHEETS (See Instructions)** Page 6

	Beginning of Taxable Year (A) Amount	Beginning of Taxable Year (B) Total	End of Taxable Year (C) Amount	End of Taxable Year (D) Total
ASSETS				
1 Cash		424,086		262,005
2 Accounts receivable (see instructions)				
(a) Less allowance for bad debts				
3 Notes receivable (see instructions)	19,156		18,269	
(a) Less allowance for bad debts		19,156		18,269
4 Inventories		300		34
5 Gov't obligations: (a) U.S. and instrumentalities			202,125	
(b) State, subdivisions thereof, etc.		352,148		202,125
6 Investments in nongovernmental bonds, etc.		450,069		454,331
7 Investments in corporate stocks (see instructions)		3,447,111		3,013,527
8 Mortgage loans (number of loans ____)				
9 Other investments (attach schedule)				
10 Depreciable (and depletable) assets (attach schedule)				
(a) Less accumulated depreciation (and depletion)				
11 Land				
12 Other assets (attach schedule)				
13 Total assets		4,692,950		3,950,291
LIABILITIES AND NET WORTH				
14 Accounts payable (see instructions)				
15 Contributions, gifts, grants, etc., payable				
16 (a) Bonds and notes payable (see instructions)				
(b) Mortgages payable				
17 Other liabilities (attach schedule) Payroll taxes W/H		515		1,110
18 Capital stock: (a) Preferred stock				
(b) Common stock				
19 Membership certificates				
20 Paid-in or capital surplus		4,692,435		3,949,181
21 Retained earnings—Appropriated (attach schedule)				
22 Retained earnings—Unappropriated:				
(a) Attributable to ordinary income				
(b) Attributable to gains from sale of assets				
23 Less cost of treasury stock		( )		( )
24 Total liabilities and net worth		4,692,950		3,950,291

1 Date of current exemption letter January 3, 1938

2 Attach a detailed statement of the nature of your charitable, business, and all other activities. Charitable & philanthropic.

3 Have you attached the information required by:
(a) Instruction I? ☒ Yes ☐ No
(b) Instruction J? ☒ Yes ☐ No

4 Have you filed a tax return on Form 990-T for this year? ☐ Yes ☒ No
If "Yes," where filed?

5 In what year was your organization formed? 1936
In what State or country? Louisiana

6 If successor to previously existing organization(s), give name(s) and address(es) of the predecessor organization(s)

7 If you have capital stock issued and outstanding, state with respect to each class of stock:
(a) The number of shares outstanding
(b) The number of shares held by individuals
(c) The number of shares held by organizations
(d) The number of shareholders at end of year
(e) Whether any dividends may be paid ☐ Yes ☐ No

8 If you acquired capital assets out of income, attach itemized list and amount thereof.

9 Have any changes not previously reported to the Internal Revenue Service been made in your articles of incorporation or bylaws or other instruments of similar import? ☐ Yes ☒ No
If "Yes," attach a copy of the amendments.

10 Have you had any sources of income or engaged in any activities not previously reported to the Internal Revenue Service? ☐ Yes ☒ No
If "Yes," attach detailed statement.

11 Did you hold any real property for rental purposes with respect to which there is an indebtedness incurred in acquiring the property or in making improvements thereto or which was acquired subject to a mortgage or similar lien? ☐ Yes ☒ No
If "Yes," attach detailed statement.

12 Have you during the year advocated or opposed (including the publishing or distributing of statements) any national, State, or local legislation? ☐ Yes ☒ No
If "Yes," attach a detailed description of such activities and copies of any such statements.

13 Have you during the year participated in, or intervened in (including the publishing or distributing of statements) any political campaign on behalf of or in opposition to any candidate for public office? ☐ Yes ☒ No
If "Yes," attach a detailed description of such activities and copies of any such statements.

14 After July 1, 1950, did: the creator of your organization; or a contributor to your organization; or a brother or sister (whole or half blood), spouse, ancestor, or lineal descendent of such creator or contributor; or a corporation owned (50 percent or more of voting stock or 50 percent of more of value of all stock) directly or indirectly by such creator or contributor—
(a) Borrow any part of your income or corpus? ☐ Yes ☒ No
(b) Receive any compensation for personal services from you? ☐ Yes ☒ No
(c) Have any part of your services or assets made available to him? ☐ Yes ☒ No
(d) Purchase any securities or other property from you? ☐ Yes ☒ No
(e) Sell any securities or other property to you? ☐ Yes ☒ No
(f) Receive any of your income or corpus in any other transaction? ☐ Yes ☒ No
If answer to any question is "Yes," attach detailed statement unless previously reported. If previously reported, give year(s).

15 Do you hold 5 percent or more of any class of stock in any corporation? ☐ Yes ☒ No
If "Yes," you must submit the information required by the instructions for Schedule B.

c60—16—79357-1 GPO

Page 5

FORM 990-A
U.S. Treasury Department
Internal Revenue Service

Return of Organization Exempt From Income Tax

Section 501(c)(3) of the Code
For the calendar year 1967, or other taxable year beginning .... 1967, and ending .... 19......
PLEASE TYPE OR PRINT

1967

Name: LOUIS M. RABINOWITZ FOUNDATION, INC.
Employer Identification Number: 13-6163095
Number and street: 30 EAST 42ND STREET
City or town, State, and ZIP code: NEW YORK N.Y. 10017

Enter the name and address used on your return for 1966 (if the same as above, write "Same"). If none filed, give reason.
SAME

PART II Part II information required pursuant to section 6033(b) and other applicable sections of the Internal Revenue Code must be submitted in duplicate as part of your return. This part will be made available to the public.

Line	Item	Amount
1	Gross sales or receipts from business activities	
2	Less: Cost of goods sold and/or of operations (attach schedule)	
3	Gross profit from business activities	
4	Interest	34673
5	Dividends	
6	Gross rents	
7	Gross royalties	50
8	Gain (or loss) from sale of assets, excluding inventory items (See Instruction 8)	519
9	Other income (attach schedule—Do not include contributions, gifts, grants, etc. (See line 17))	
10	Total gross income (lines 3 to 9, inclusive)	[illegible]
11	Expenses of earning gross income from column 3, Schedule A	NONE

DISBURSEMENTS MADE WITHIN THE YEAR OUT OF CURRENT OR ACCUMULATED INCOME FOR PURPOSES FOR WHICH EXEMPT, AND ACCUMULATION OF INCOME

Line	Item		Amount
12	Expenses of distributing current or accumulated income from column 4, Schedule A		4372
13	Contributions, gifts, grants, scholarships, etc. (See Instruction 13)		97358
14	Accumulation of income within the year (line 10 less the sum of lines 11, 12, and 13)		([illegible])
15	Aggregate accumulation of income at beginning of the year	(587869)	
16	Aggregate accumulation of income at end of the year	(521380)	

RECEIPTS NOT REPORTED ELSEWHERE

Line	Item	Amount
17	Contributions, gifts, grants, etc., received (See Instruction 17)	2933
18	Less: Expenses of raising and collecting amount on line 17, from column 5, Schedule A	NONE
19	Net contributions, gifts, grants, etc., received	[illegible]

DISBURSEMENTS MADE OUT OF PRINCIPAL FOR PURPOSES FOR WHICH EXEMPT

Line	Item		Amount
20	Expenses of distributing principal from column 6, Schedule A		NONE
21	Contributions, gifts, grants, scholarships, etc.: (a) Paid out in prior years	(334555)	
	(b) Paid out within the year (See Instruction 21)		NONE

Schedule A.—Allocation of Expenses (See Instructions for Attachments Required)

1. Item	2. Total	3. Expenses of earning gross income	4. Expenses of distributing income	5. Expenses of raising and collecting principal	6. Expenses of distributing principal
(a) Compensation of officers, etc.					
(b) Other salaries and wages					
(c) Interest					
(d) Taxes					
(e) Rent					
(f) Depreciation (and depletion)					
(g) Miscellaneous expenses (attach schedule)	4372	NONE	4372	NONE	NONE
(h) Totals	4372	NONE	4372	NONE	NONE
		Enter on line 11	Enter on line 12	Enter on line 18	Enter on line 20

	Beginning of Taxable Year		End of Taxable Year	
	(A) Amount	(B) Total	(C) Amount	(D) Total
ASSETS				
1 Cash		3753		8521
2 Accounts receivable (see instructions)				
(a) Less allowance for bad debts				
3 Notes receivable (see instructions)				
(a) Less allowance for bad debts				
4 Inventories				
5 Gov't obligations: (a) U.S. and instrumentalities	789001		720676	
(b) State, subdivisions thereof, etc.		789001		720676
6 Investments in nongovernmental bonds, etc.		41497		41497
7 Investments in corporate stocks (see instructions)				
8 Mortgage loans (number of loans ________)				
9 Other investments (attach schedule)				
10 Depreciable (and depletable) assets (attach schedule)				
(a) Less accumulated depreciation (and depletion)				
11 Land				
12 Other assets (attach schedule)		362		363
13 Total assets		834613-		771057-
LIABILITIES AND NET WORTH				
14 Accounts payable (see instructions)				
15 Contributions, gifts, grants, etc., payable				
16 (a) Bonds and notes payable (see instructions)				
(b) Mortgages payable				
17 Other liabilities (attach schedule)				
18 Capital stock: (a) Preferred stock				
(b) Common stock				
19 Membership certificates				
20 Paid-in or capital surplus		246744		249677
21 Retained earnings—Appropriated (attach schedule)				
22 Retained earnings—Unappropriated:				
(a) Attributable to ordinary income				
(b) Attributable to gains from sale of assets	587869	587869	521380	521380
23 Less cost of treasury stock		( )		( )
24 Total liabilities and net worth		834613		771057

1 Date of current exemption letter NOV. 8 1944
2 Attach a detailed statement of the nature of your charitable, business, and all other activities. CHARITABLE
3 Have you attached the information required by:
(a) Instruction I? . . . ☒ Yes ☐ No
(b) Instruction J? . . . ☒ Yes ☐ No
4 Have you filed a tax return on Form 990-T for this year? ☐ Yes ☒ No
If "Yes," where filed? ....
5 In what year was your organization formed? 1944
In what State or country? DELAWARE
6 If successor to previously existing organization(s), give name(s) and address(es) of the predecessor organization(s) ....
7 If you have capital stock issued and outstanding, state with respect to each class of stock:
(a) The number of shares outstanding . . . .
(b) The number of shares held by individuals . . . .
(c) The number of shares held by organizations . . . .
(d) The number of shareholders at end of year . . . .
(e) Whether any dividends may be paid . . . ☐ Yes ☐ No
8 If you acquired capital assets out of income, attach itemized list and amount thereof.
9 Have any changes not previously reported to the Internal Revenue Service been made in your articles of incorporation or bylaws or other instruments of similar import? . . . ☐ Yes ☒ No
If "Yes," attach a copy of the amendments.
10 Have you engaged in any activities not previously reported to the Internal Revenue Service? . ☐ Yes ☒ No
If "Yes," attach detailed statement.
[illegible]

11 Did you hold any real property for rental purposes with respect to which there is an indebtedness incurred in acquiring the property or in making improvements thereto or which was acquired subject to a mortgage or similar lien? . . . ☐ Yes ☒ No
If "Yes," attach detailed statement.
12 Have you during the year advocated or opposed (including the publishing or distributing of statements) any national, State, or local legislation? ☐ Yes ☒ No
If "Yes," attach a detailed description of such activities and copies of any such statements.
13 Have you during the year participated in, or intervened in (including the publishing or distributing of statements) any political campaign on behalf of or in opposition to any candidate for public office? . ☐ Yes ☒ No
If "Yes," attach a detailed description of such activities and copies of any such statements.
14 After July 1, 1950, did: the creator of your organization; or a contributor to your organization; or a brother or sister (whole or half blood), spouse, ancestor, or lineal descendent of such creator or contributor, or a corporation owned (50 percent or more of voting stock or 50 percent or more of value of all stock) directly or indirectly by such creator or contributor—
(a) Borrow any part of your income or corpus? . . . ☐ Yes ☒ No
(b) Receive any compensation for personal services from you? . . . ☒ Yes ☐ No
(c) Have any part of your services or assets made available to him? . . . ☐ Yes ☒ No
(d) Purchase any securities or other property from you? . ☐ Yes ☒ No
(e) Sell any securities or other property to you? . . . ☐ Yes ☒ No
(f) Receive any of your income or corpus in any other transaction? . . . ☐ Yes ☒ No
If answer to any question is "Yes," attach detailed statement unless previously reported. If previously reported, give year(s).
15 Do you hold 5 percent or more of any class of stock in any corporation? ☐ Yes ☒ No
If "Yes," you must submit the information required by the instructions for Schedule B.

14-(b) REPORTED IN PRIOR

13-[illegible]

NAME Louis M. Rabinowitz Foundation, Inc.

ADDRESS 30 East 42nd Street
New York, N.Y. 10017

Taxable Year Ended 12-31-67

	12-31-	66	12-31-	67
Schedule B - Line 12 - Other Assets				
Undeposited Interest Coupon (L.I. Lighting, 3/1/76)	363		363	
Page 2 - Question 3 - Instruction I				
1) Officers				
Victor Rabinowitz - President	(b)			
Lucille Perlman - Vice-President	(b)			
Marcia Rabinowitz - Secretary-Treasurer	(e)			
The above are also directors.				
2) Victor Rabinowitz devoted approximately				
ten hours per week to his position.				
The other members devote partial time.				
3) None of the officers received any				
compensation.				

[illegible]

NAME Louis [illegible] Foundation, Inc

ADDRESS 30 East 42nd Street
New York, N.Y. 10017

Taxable Year Ended 12-31-67

Page 2 - Question 3 - Instruction J		
(a) Market value of investments in		
Governmental Bonds	712739	
Non-Governmental Bonds	133388	
(b) Other Assets	8884	
(c) Total of (a) and (b)	855011	
Schedule A-Item (3) - Column 4		
Expenses of Distributing Income		
Secretarial and Clerical Services	3297	
Dinner Meetings with Applicants for Grants	750	
Postage, Stationery & Mailing	162	
Fee for Statutory Representation in Delaware	50	
Sundry Office Expense	84	
TOTAL	4373	

1967 Recipients of grants from Louis M. Rabinowitz Foundation, Inc.

Recipient	Amount
James Aronson, New York, N.Y	$3,000
Richard J. Barnet, Washington, D.C	1,500
Brooklyn Heights Youth Center, Brooklyn, N.Y	500
Norman Birnbaum, New York, N.Y	1,625
Donald L. Barnett, Iowa City, Iowa	2,500
Cedric Belfrage, Cuernavaca, Mexico	3,000
Lillian Boehm Foundation, New York, N.Y	1,333
Judith Coburn, Washington, D.C	5,000
Bernard Conal, La Jolla, Calif	3,000
Clergy and Laymen Concerned About Vietnam, New York, N.Y	1,500
Columbia Survey of Human Rights Law, New York, N.Y	500
Frank Donner, New York, N.Y	500
Horace B. Davis, Jamaica Plain, Massachusetts	1,900
Foreign Policy Roundtable, Inc., St. Louis, Mo	3,600
Harvey Goldberg, Madison, Wis	5,000
Marvin E. Gettleman, New York, N.Y	1,800
Jill Hamburg, Hoboken, N.J	300
Hashomer Hatzair, Inc., New York, N.Y	500
Len Holt, Washington, D.C	2,000
Donald Jelinek, Selma, Alabama	5,000
Clinton Jencks, Denver, Colo	5,750
Ivan Kovacs, Bronx, New York	1,000
Jon Katz, New York, N.Y	1,500
Gaylord LeRoy, Philadelphia, Pa	2,000
Walter Lowenfels, New Jersey	1,500
Debbie Louis, Venice, Calif	2,380
Law Students Civil Right Research Council, New York, N.Y	2,000
Floyd McKissick, New York, N.Y	2,500
Julian Mayfield, New York, N.Y	3,000
Jack Minnis, New Orleans, La	1,500
New York Shakespeare Festival, New York, N.Y	200
Jack O'Dell, New York, N.Y	1,250
Norman Rudich, Middletown, Conn	2,520
Samuel Rohdie, Oxford, England	1,000
Morris Schappes, New York, N.Y	1,000
Daniel B. Schirmer, Cambridge, Mass	2,000
Mario Savio, Berkeley, Calif	1,500
Southern Student Organizing Committee, Kenbridge, Va	1,000
Leon G. Summitt, New York, N.Y	2,000
Socialist Scholars Conference, New York, N.Y	2,000
Thorne Sherwood, Jr., Hartford, Conn	1,000
Michael Tanzer, New York, N.Y	7,200
United Jewish Appeal, New York, N.Y	2,500
Regents of the University of California, L.A	2,000
University of Wisconsin, Madison, Wis	2,500
George Wiley, Washington, D.C	1,000
Norman Seiden—returned part of grant made in 1965	500
Total	97,358

SCHEDULE OF GAINS & LOSSES
From sales and exchanges of property

NAME Louis M. Rabinowitz Foundation, Inc 13-6183095

ADDRESS 30 East 42nd Street, New York, N.Y. 10017

Taxable Year Ended 12-31-67

NO. SHARES OR BONDS	1 PROPERTY DESCRIPTION	2 DATE ACQ.	2 DATE 1967 SOLD	3 GROSS SALES PRICE (Contract Price)	4 DEPRECN. ALLOWABLE	5 COST OR OTHER BASIS	6 EXPENSE OF SALE ETC.	7. GAIN (OR LOSS) LONG TERM	7. GAIN (OR LOSS) SHORT TERM
50M	U.S. Treasury Bonds 4% - 10/1/69	2-15-55	[illegible]	48941		48300		641	
20M	Federal Home Loan Bank 4 3/8% - 3/1/68	8-6-65	Mar-Apr	19903		20025		(122)	

TOTAL SHORT TERM GAIN (OR LOSS)

TOTAL LONG TERM GAIN (OR LOSS) 519

TOTAL NET CAPITAL GAIN (OR LOSS) $ 519

5832

1st Anniversary Issue
INSTITUTE FOR AMERICAN DEMOCRACY

We're Building A Bulwark Against Extremism

On November 18, 1966, Dr. Franklin H. Littell, president of Iowa Wesleyan, stepped briskly to the microphone at a well-attended press conference in Washington's Sheraton-Carlton Hotel. "I am here," he said, "because many of America's leading citizens share the concern over the rising tides of extremism in our land.

Dr. Littell (above) used the blackboard to show how the John Birch Society is the hub of the Radical Right establishment at the kickoff press conference. The resulting picture had a press run in the millions.

"Growing numbers of Americans now believe that we are facing a serious assault on the very processes of democracy. Many want the kind of factual information they must have to do something about it. As a people, we must focus the spotlight of truth on the tactics and methods of those who seek to achieve their ends by means doing violence to our whole democratic concept," Littell declared.

In response to these needs, distinguished Americans, representing a broad cross section of our nation, have decided to sponsor the Institute for American Democracy (IAD), he reported. Dr. Littell, a Ph.D., ordained Methodist minister and former Senior Protestant Advisor to the High Commissioner of Germany, made the announcement as chairman of IAD.

MOST MAJOR NEWSPAPERS and radio and TV newscasters carried the news of IAD's emergence in some depth. The *New York Times* included IAD's address. As a result, we were almost instantly swamped with offers of assistance and cries for help.

The Communists greeted news of IAD's existence with a snort (in the West Coast *People's World*) that we would be telling "Big Lies" about the Reds. At the other extreme, Robert Welch reported in the Birch Society's *Bulletin* that IAD would be helping the "Conspiracy."

And in the broad American middle there was (and is) a healthy interest over whether IAD could make an effective contribution to the political climate of our times.

"THERE IS GENERAL AGREEMENT ON THE NEED," Dr. Littell pointed out in a recent statement. "IAD's sponsors, 70 distinguished Americans from the fields of religion, public service, education, business, labor, people at or near cabinet level in four Administrations testify to the common concern," he asserted.

"The extremists attempt to force their perverse views on the rest of us," he said. "Making false charges against national groups on the JBS 'dial-a-smear' telephone networks; maligning established churches over the air; bearing false witness against citizens of good repute are all part of the effort to poison the wells of free discussion and each such attack must be our concern. IAD is helping America face this challenge."

1st Year Accomplishments

- *IAD Reports Help Thwart Birch Drives; Welch Still Fuming; Birchers Burn* .... *Pg. 3*
- *Professional Radio Radicals Charge IAD with Being No. 1 Air Purifier* .... *Pg. 7*
- *Grass Roots Response to IAD Appeal Shows Growing Awareness of Need* .... *Pg. 5*
- *We're Answer to These Ladies' Prayers* .... *Pg. 4*
- *Already IAD's "The Place" To Turn For Aroused Citizens Needing Facts* .... *Pg. 6*
- *Look Who's Lighting the Candles Now* .... *Pg. 6*

If the amount of woodpulp involved is a reliable yardstick, the Radical Right zealots view IAD as their biggest problem. The nearly 3,000 John Birch cells have been told what stinkers we are in five of the past seven monthly Birch *Bulletins*.

Fretful that we would answer back if a personal attack were made by radio, Hargis, McIntire, Burpo, McBirnie, Bundy, Cotten and many others have produced scurrilous publications attacking the integrity of IAD's sponsors.

Fred Schwarz, the "Laymen's League" and many others have cranked out letters used in mail campaigns directed at trustees, customers and the like trying to get sponsors to drop IAD. Hargis has even publicly called for a boycott of goods and services with which they are identified.

McIntire mentions IAD on the air almost daily. Clearly, we're No. 1 on the Radical Right's "Hit [illegible]" Parade.

STAND UP FOR DEMOCRACY
—
Become an IAD Associate Member

BEST AVAILABLE COPY

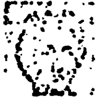
IAD's Sponsors

The following serve, *as individuals*, on IAD's Sponsoring Committee

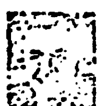
President, American Jewish Committee
Morris B. Abram

Exec. Editor, Catholic Star Herald
Msgr. Salvatore J. Adamo

Author Entertainer
Steve Allen

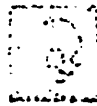

Past President, National Education Association
Dr. Irvamae Applegate

Former Assoc. Justice, U.S. Court of Appeals, D.C.
Judge Thurman Arnold, Esq.


Director, Center for the Study of Democratic Institutions
Harry S. Ashmore

President, Saint John's University
The Rev. Colman J. Barry, O.S.B.

Dep't. of Sociology, Columbia University
Prof. Daniel Bell


President, Union Theological Seminary
Dr. John C. Bennett

Why IAD?

As every Eric Hoffer reader knows, to a Bircher, nothing is more important than a "Birch-fact." That accounts for the extremist compulsion to discredit their foes, force acceptance of their views.

Driving home Birchtype "facts" takes the big share of the $30 million which Group Research, Inc., projections indicated the Far, Far Right takes in and spends annually.

The combined national budgets of the 100 or so significant Far Right groups exceed the combined national budgets of both major political parties.

Much of the money goes for a paid staff, including field organizers. The Birchers and their allies also produce more films, books, pamphlets, magazines and tapes than the two national parties. Just one unsigned Birch film, *Anarchy—U.S.A.*, is known to have 400 prints in circulation.

Given a clear field, the Birchers and their allies can "prove" that, "We are a republic *not* a democracy."

They'll help "resolve" our policy problems on Vietnam by convincing citizens the Administration has "a deliberate 'no win' policy."

They will show that "liberalism equals socialism equals communism" and, in the same breath, demand the end of mental health programs, Medicare, and the graduated income tax.

They will attempt to eliminate the appeals for social action in Protestant, Catholic and Jewish groups by trying to besmirch the reputations of these religious bodies.

Driving home these basic attitudes will be the hundreds of voices of the John Birch Society, Liberty Lobby, Americans for Constitutional Action, Hargis Christian Crusade, the McIntire complex, H. L. Hunt, et al.

Those harkening to these voices are campaigning now for county, city and especially school board spots. These are the groups which captured the GOP convention and gave it to Barry Goldwater four years ago. They are back again with more money, more knowhow, and a bigger professional force.

Their speakers now crisscross the nation. They fan the flames of white backlash, demand the expulsion of the UN, call for Earl Warren's impeachment, shout you can't trust Uncle Sam.

When the Birchtype speaker comes to town, somebody has to identify him for who he is and what he represents. When the "Birchfacts" are flying, somebody has to supply the cleansing truth. Somebody has to shine a light on extremist tactics, nationally and locally.

That's part of IAD's challenge. And we're helping people meet it every day. Who would do so, if not you? If not IAD? —C. R. Baker

Why IAD?

In the 1930's the Communist Party and fronts had more influence than the Radical Right. The pendulum can always swing their way again. Indeed, both extremes can grow at the expense of the middle.

The professional "anti-communists" are just that—professionals. They join the professional "anti-fascists" in the mutual assault on the middle ground. By giving the domestic communists attributes they do not possess, they steer the malcontents their way.

We must have responsible criticism of the Far, Far Left. The real foes of communism are the church, civic and labor groups who actually came to grips with this extremist threat while the Welches of the land were still peddling fudge.

Their viewpoint is represented here. For meaningful (as opposed to hysterical) opposition to communism, who is better equipped than IAD?

Why IAD?

For the economic extremists, the ends-justify-the-means philosophy usually just covers character assassination. For the racial extremists, it covers assassination—period.

All segments of our society must understand there is no great difference between Ku Klux Klansmen killing Jewish and Negro social workers in Mississippi and RAM "hero" Robert Williams openly calling for insurrection from his sanctuary in Communist China.

When Minutemen or Black Muslims set up gun caches and train their private militia, they both court the same explosive answer to what must be settled through communication. Democracy cannot function well enough at gunpoint.

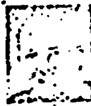
And this, too, poses a challenge to those seeking insights and information from IAD.

IAD's Sponsors

The following serve, *as individuals*, on IAD's Sponsoring Committee

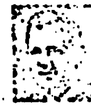
Former U.S. Attorney-General
Francis Biddle

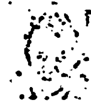
Former Member U.S. Delegation to U.N.
Jacob Blaustein

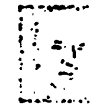

Bishop-Coad. of Ohio Protestant Episcopal Church
Rt. Rev. John H. Burt

Publisher, Delta, Miss. Democrat-Times
Prof. Hodding Carter

U.S. Senator, (New Jersey)
The Hon. Clifford P. Case


Exec. Sec'y., Gr. Portland Council of Churches
Dr. William B. Cate


Religious Editor, The New York Times
John Cogley


U.S. Catholic Conference
The Rev. John F. Cronin, S.S

Chairman, Exec. Comm., United Nations Assn. of USA
Oscar A. de Lima

John Birch Blues
Many Top Aides Quit Right-Wing Group, Say Funds, Members Decline
They Say Welch ...
Welch Optimistic on Future

The first time IAD did an in-depth analysis of a John Birch Society policy project, it not only helped blunt the Birch program, it caused turmoil within the Society which all signs indicate persist to the present day.

Tightening the screws on our anguish over Vietnam, Welch set out to convince citizens that, "We are sending our men to fight . . . in a war actually being controlled by Communists or Communist influences."

He charged that a "conspiracy" of "ILLUMINATI" (capitals his) is running affairs in both Moscow and Washington. He says American boys are being sacrificed as a part of a "deliberate 'no win' policy."

All this, and more, is contained in new Welch position papers called *The Truth in Time* and *The Truth about Vietnam*. In the March, 1967 JBS *Bulletin*, he called upon the 4,000 or so JBS cells to distribute the *Truth* papers and get signatures on a petition winding up with the implication that traitors are responsible for U. S. foreign policy. They were to make the latter "the most massive plea by petition ever directed at the American Congress."

The IAD analysis pointed out that neither the petition nor the position papers bore any indication that they were produced by the Birch Society. This was pointed out in a memo sent to Congress, a selected mailing list of 30,000 civic-minded individuals and to a number of Birchers.

The Northern Illinois Citizens For Democracy reproduced the IAD material in their newsletter when the petition surfaced in Evanston. Dixon Gayer of Fullerton, Calif., did the same in his influential publication, *The Dixon Line*.

In Bakersfield, Calif., this helped unmask a Birch group. Their Birch booth, set up to get signatures, was removed from a supermarket parking lot after citizen protests.

Stanley J. Bier, Rahway, N. J., realtor, got letters-to-the-editor published about it in areas where the Birchers are strong . . . In Chicago, the news media was advised in advance, and the petitions did not appear. And so it went around the nation.

When Welch told chapters to seek American Legion Post help in getting signatures, we told the Legion nationally, and apparently many posts got the word locally, and that did not come off, either.

The JBS Executive Committee inserted an unprecedented letter in the May *Bulletin* backing Welch on the petition, blistering IAD for being "disruptive."

Ex-Sheriff Jim Clark, ex-FBI informants Lola Belle Holmes and Julia Brown, and others crisscross the nation levelling the same old charges against Martin Luther King and the Civil Rights movement.

Books, films and TACT and Support Your Local Police front groups are all part of the Birch effort to fan the flames of racial tension. The package as put together by Barbara Hogan is IAD's brochure, "The Shake-Up America Campaign." Now in its second printing, "Shake-Up" has helped provide appropriate answers to Birch propagandists all over the nation.

In its first public year, IAD has provided requested information on at least 30 different Radical Right speakers—the antidote for poison spread at the grass roots.

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Samuel Dalsimer

Gen. Mgr., Emeritus Nat'l Rural Electric Coop. Assn.
Clyde T. Ellis

Former Fed. Security Agency Administrator
Oscar Ewing

Former U.S. Secretary of HEW
Marion B. Folsom

Exec. Dir., Coun. for Christian Social Action, United Church of Christ
Rev. Dr. Ray Gibbons

Deceased
President, Methodist Board of Christian Social Concerns
Bishop A. Raymond Grant

President, Unitarian-Universalist Assn.
Dr. Dana McLean Greeley

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Chairman of the Board, ... Co

President, ...
Ernest A. Hayes

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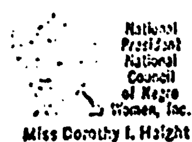
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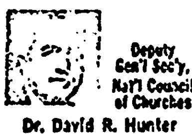
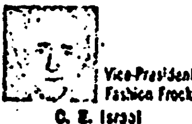
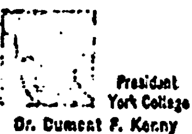
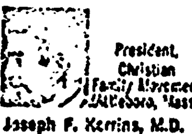
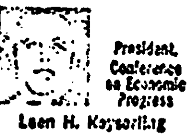
Miss Dorothy I. Height

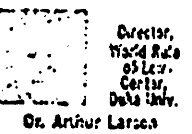

Deputy Gen'l Sec'y, Nat'l Council of Churches
Dr. David R. Hunter

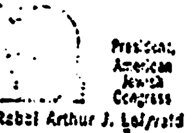

Vice-President, Fashion Frocks
C. E. Israel

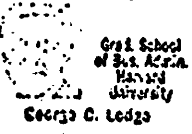

President York College
Dr. Dumont F. Kenny


President, Christian Family Movement (Attleboro, Mass.)
Joseph F. Kerrins, M.D.


President, Conference on Economic Progress
Leon H. Keyserling


Director, World Rule of Law Center, Duke Univ.
Dr. Arthur Larson


President, American Jewish Congress
Rabbi Arthur J. Lelyveld


Grad. School of Bus. Admin. Harvard University
George C. Lodge

They Stand Up for Democracy

"There's Something You Ought to Know"

Mabel Rupe

At 74, Mrs. Mabel E. Rupe of Tacoma, Wash., maintains the lifelong habit of working to better mankind. She was a Methodist medical missionary in India, sometimes in areas where there were no doctors. When she returned she married a rancher. When they didn't have children, they raised "borrowed ones." Both of them worked for Sen. Burton K. Wheeler when the communists took after him.

When Birch Council member Floyd Paxton's *Yakima Eagle* started "warning" against an impending "riot," Mrs. Rupe, a widow for many years, helped organize a street dance in the target area on target night. (Tacoma had no riot.) Every day she monitors the several hours of right wing radio programming beaming into the Tacoma area; sends IAD reports. As a direct result, both IAD and the local NAACP chapter have answered aired personal attacks. Residents report a noticeable improvement in the tone of the "call-in" radio programs she monitors.

Friends worry that this publicity will lead extremists to harm her physically. "And they may," she writes. "Just reread Brooks R. Walkers *The Christian Fright Peddlers* . . . However, I trust and am not afraid, and if it will do any good, go ahead." When we found a tape recorder for her, before accepting, she warned, "there is something you ought to know" . . . something about her angina pectoris sometimes interfering with the carrying on of her vital, self-appointed tasks.

An Unlisted Phone Kept Ringing

Betty Mason

A housewife and mother, she was publicly refuting Birchtype speakers and letters-to-the-editor long before she heard of IAD. The Masons live in Bakersfield, Calif., a Birch stronghold. She helped rebuff the JBS petition drive there. (See pg. 3.)

When Birch callers dominate the KGEE call-in programs, she and friend Mrs. Mary Paul search out the facts, phone them in. When Mrs. Paul secured an unlisted phone number to cut down on the number of harassing phone calls, the calls persisted until she exposed that, too, on the air.

When KGEE call-in moderator Howie Wines had ex-Sheriff Jim Clark as a guest, Mrs. Mason refuted his facts, using the "Clark Packet" secured from IAD. When Wines called that "garbage" and attacked the character of IAD, Mrs. Mason taped it, and IAD got free time to reply. When Mr. Wines attacked Mrs. Paul on the air, she informed the FCC, and KGEE got a letter of reprimand.

Mrs. Mason has become so familiar with IAD's Fairness Doctrine manual, that she lectured on the subject before the Kern County Council for Civic Unity this month. Meanwhile she is using IAD material to offset propaganda impact of *Anarchy-USA.* in the area; writes "Thank God for IAD."

When All Else Failed, She [illegible]

Eulah Eubank

When Robert Welch came to Richmond, Va., for a mid-October appearance, local Birchers were startled by the small size of the crowd. Usually he does better. Mrs. Eulah Eubank, widow of World War II veteran, got material from IAD to alert citizens to the current nature of Welch's typical remarks. Like the Birchers, she even got a letter in the Richmond paper. Looking for support, Mrs. Eubank was once spotted passing out HOMEFRONT on the streets just to make sure "somebody knows."

Mrs. Eubank, a University of Tennesse graduate, also has been attending *Anarchy-USA.* showings, speaking out at the end of the showing.

She Has a Cause, and a [illegible]

Gladys Sharon

A target for considerable verbal abuse in tiny Veneta, Ore., is Mrs. Gladys Sharon. She spends most of her time at home nursing a sick husband, but tangles with Birchers on as many as three call-in programs a day. She gets her facts straight, has good university contacts (although not a college grad); friends report her secret—her fight against the Radical Right is the only "luxury" she can afford.

IAD IS A MAGNET. Several thousand concerned citizens have searched it out. In our first public year, we have filled hundreds of requests for special information. They come from senators and school boys; heads of religious denominations and small town pastors; from university presidents and school teachers, from professional social workers, and aroused housewives. The IAD story must be told in terms of people. Here are five, chosen because they well illustrate that all you need to help defend democracy is courage and a place to turn for facts.

She Received a Minutemen 'Calling Card'

Lavelle Robertson

Real estate broker Lavelle Robertson subscribed to HOMEFRONT just as soon as news of IAD reached her home in Mesa, Ariz. She has been speaking against extremism since she was a government worker in the mid-1930's. She writes letters to editors; started tangling with "witch hunters" on call-in radio programs a decade ago. Recently, she received a "calling card:" a drawing of rifle sight cross hairs, warning "traitors beware;" signed "MINUTEMEN."

Mrs. Robertson told the FBI, sent IAD a copy of the card; said she thought a little publicity was her best insurance. She continues to put out information on touring Radical Right speakers, helping form local discussion groups, tapes and monitors what she views as "offensive radio;" keeps urging friends to "get HOMEFRONT."

Grass Roots Committees Look to IAD

From Anchorage to Sarasota, from Baltimore to San Diego, citizens who oppose democracy's foes communicate with each other through IAD.

For them IAD is:

- A clearinghouse for information and insights;
- A source of usable materials;
- The stimulus that can enlarge their numbers;
- The fixed reference point with which all can identify.

Only a year ago, it wasn't that way. Good, active groups existed in San Diego, where Robert Sessions, a public relations man, donated much of his time; in Chicago, where Mrs. Norma Morrison, backed by the prestigious CCADP was a full-time volunteer; in Cleveland, where Hal Steigman was about to step aside under orders of a heart specialist; in Florida, where an early school assault on Sarasota triggered a healthy reaction; in New England, where "Birchwatchers" keep the Birch Society weakest where it is known best.

Not all the two-dozen groups existing a year ago were active then. Today most are doing something, some a great deal. And their ranks have grown.

Last month, Ken Legond, Dallas stockbroker and chairman of an ad hoc committee, gave a school superintendent materials which showed the true nature of a Revilo Oliver attack on mental health programs which a principal was circulating. The ad hoc committee was formed at a meeting addressed by an IAD staffer.

In Aurora, Ill.; Anchorage, Alaska; Westchester, Ind.; in Boise and Idaho Falls, Idaho, and elsewhere, groups identifying with IAD planned programs, where, a year ago, there were no such groups to meet.

Ad hoc committees are quietly at work in Pittsburgh and Salt Lake City; Ann Arbor and Oklahoma City and in other communities, all working toward a fullfledged program, backed by leading citizens. All are making some progress toward this goal.

In California, the response indicates a hunger for IAD appearances on the West Coast. Some community groups are forming themselves.

Here are the activists who, with the facts at hand, write letters-to-the-editor; object when local radio airs character besmirching attacks; expose the books and films and speakers and front committees which are part of the right-wing drive for power.

We have never personally met anyone from the Margaret V. Smith Discussion Group in Berryville, Va., or the Bergen Alert Committee in Ho-Ho-Kus, N. J., but they tell us they wouldn't be active without IAD's facts.

We have yet to meet with those carrying on the programs in Fort Wayne and Grand Rapids, Wichita and Trenton, but the committees exist and relate to IAD.

IAD is planning a series of seminars to help local groups get themselves formed. Anyone reading these lines want to help?

President, Council on Religion & International Affairs
Dr. A. William Loos

President, Neiman-Marcus
Stanley Marcus

Past President National Board of the YWCA
Mrs. Lloyd J. Marti

Literary Editor, The Christian Century
Dr. Martin E. Marty

U.S. Senator, (Wyoming)
The Hon. Gale McGee

Publisher, The Atlanta Constitution
Ralph McGill

Director, Dep't. of Prev. Psychiatry The Menninger Foundation
Roy Menninger, M.D.

Dep't. of Organ. Sciences, Case Inst. of Technology
Prof. Vernon C. Mickelson

Co-Chairman, Chicago CCADP
Mrs. Norma Morrison

U.S. Senator, (Utah)
The Hon. Frank E. Moss

Seminars, Speeches, Call-in Shows

[illegible]

On November 16, 1967, Dr. Franklin H. Littell is scheduled to participate in a seminar on extremism exclusively for 200 suburban Chicago pastors. It probably couldn't have happened a year ago.

The first such seminar was held at the University of Oklahoma's Human Relations Center, with IAD's Executive Director Charles R. Baker the resource.

In 1966, seminars on extremism were held in Cincinnati and San Diego, to IAD's knowledge. IAD will have participated in at least a dozen this year, with more seemingly in store for 1968.

IAD's Chairman has given at least 50 speeches on extremism before nationally significant audiences. The sponsoring groups range from the Southern Baptists to the National Education Association to Detroit, Dallas, Burlington, Seattle and other church councils.

The national bodies include the YMCA Council, National Civil Liberties Clearinghouse, the Boston Ecumenical Conference. He appears in many universities.

Both Dr. Littell and Charles Baker average about one appearance a month on a call-in radio program; appeared jointly on a National Educational Television documentary on H. L. Hunt shown to prime time audiences coast-to-coast.

IAD has had national exposure in *Senior Scholastic*, *TV Guide*, literally hundreds of religious, trade union, and civic publications. We have had coast-to-coast publicity on our initial announcement; Dr. Littell called for answering personal attacks on radio shows; press, radio and TV have covered most personal appearances by IAD's chairman and executive director.

Because of this, millions of Americans know at least a little more about the nature of extremism than they did a year ago. Scores of persons have used IAD's materials in addresses to luncheon clubs, on call-in radio programs, in articles and letters. There can be no precise measurement of the numbers.

One new IAD-relating group, noting the nature of this activity, calls itself (Midland, Mich.) Candle Lighters.

We Smile at the Postman Every Day

Many of America's most socially-responsible groups loaned IAD a priceless asset, leadership mailing lists to help us get started. We mailed three free copies of HOMEFRONT to 30,000 potential leaders; had almost 100,000 copies distributed by concerned groups who paid for them to encourage HOMEFRONT subscriptions. Each day the postman brings in more subscribers, and each day IAD speaks with a little larger voice. Each day more Americans purchase and use materials many could find only by contacting their new-found friend, IAD.

A Partial List of Materials

HOW TO COMBAT AIR POLLUTION
(2nd run of IAD's manual on how to utilize FCC's Fairness Doctrine) 50c

THE SHAKE-UP AMERICA CAMPAIGN
(Documenting the falsehoods used by the speakers—who are named—and in Birch films, books, tracts—aimed at fomenting race tensions—by IAD Staffer Barbara Hogan) 35c

ANALYSES OF JBS FILM ANARCHY-USA
(Anti-Defamation League's; Conn. Council of Churches; IAD's) 25c

GARY ALLEN'S "PLAN"
(IAD study documenting falsehoods in JBS writer's tract misrepresenting Watts conflict) 25c

SPECIAL HOMEFRONT REPORTS 15c
On JBS Petition Drive
Our Troubled Air (Radio)
Trade Union Stake
(100 for $10)

ROBERT H. HINCKLEY
The Politics of Extremism 10c

HANDBOOK FOR GRASS ROOTS COMMITTEES
(In the process of final revision) $2

THE SUNDAY PUNCHER
("Philadelphia Magazine" profile on Carl McIntire) 25c

DOOMSDAY MERCHANT ON THE FAR, FAR RIGHT
("Sat. Eve. Post" Hargis profile) 25c

THE NCC AND ITS CRITICS
(Sermon on Birchism by the Rev. Robt. C. Harvey, Great Falls, Idaho) 30c

IAD BIBLIOGRAPHY
(Of books, articles, films, etc.) 10c

RELYEA BIBLIOGRAPHY
(Graduate student's analysis of books on extremism) $2.50

RADICAL RIGHT IN 1966
Special Group Research Report $1

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Dr. Kenneth G. Neigh

Pres. Emeritus, National Farmers Union
James Patton

Assistant Secretary of Labor
Mrs. Esther Peterson

The Methodist Church
Bishop W. Kenneth Pope

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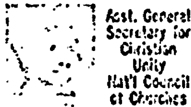
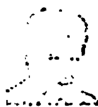


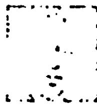
Asst. General Secretary for Christian Unity Nat'l Council of Churches

Mrs. Theodore O. Wedel



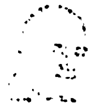
Dean, College of Education, University of Florida

Dr. Kimball Wiles



Executive Director, NAACP

Roy Wilkins



Executive Director, National Urban League

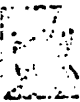
Dr. Whitney Young

Nat'l Chairman, Anti-Defamation League

Dore Schary

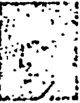
Editor, The Catholic World

The Rev. John B. Sheerin, C.S.P.



Ass't to President, University of Notre Dame

George N. Shuster



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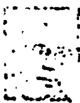
Adlai E. Stevenson III, Esq.



The Methodist Church

Bishop James S. Thomas

Stated Clerk United Presbyterian Church

Eugene Carson Blake

Professional Radio Radicals Charge IAD with Being No. 1 Air Purifier

"Pastor Bob" Walter is one of the stable of Radical Right "evangelists" broadcasting over Carl McIntire's station in Media, Pa.—WXUR.

On Sept. 24th, he called IAD a "gestapo-like" outfit—falsely accused IAD and Dr. Littell of wanting to silence all dissent.

WXUR has aired personal attacks on IAD before. This one was different.

Last month, IAD complained to the FCC that WXUR failed to notify it of the attack, failed to make time available for a reply.

A YEAR AGO, this would have been a matter of small concern. Now WXUR can be fined up to $500 a day (maximum $10,000) for failure to tell us of the attack and offer time to reply.

Sometime in November, IAD Executive Director Charles R. Baker will testify that WXUR also failed to notify IAD when Richard Cotten and Major Bundy attacked IAD over WXUR—at a virtually unprecedented hearing in which 19 civic organizations are urging the FCC *not* to renew WXUR's broadcasting license.

A year ago, most of the stations airing Radical Right broadcasts were not aware of the FCC's Fairness Doctrine. When the Rev.-Dr. William Steuart McBirnie and Richard Cotten made the first personal attacks on IAD and we demanded free time to reply, indications are that neither McBirnie nor Cotten realized we had that right.

Since then, we have also replied to attacks by Bundy, Bardwell, and a half-dozen moderators on call-in programs.

THE IAD SPECIAL "Contrasting Viewpoint" program rebutting McIntire's daily misrepresentations of the Fairness Doctrine was aired by many stations carrying his program. Finally, he used it as a quarter-hour segment of his daily half-hour show carried over some 600 stations.

Scores of professional radio personalities still compete for the millions of Radical Right radio dollars on an estimated 10,000 broadcasts a week. This is America's only ideological programming. It is bound to affect basic U.S. attitudes.

When IAD first demanded its rights under the Fairness Doctrine, just about every station involved resisted. Hundreds of letters and a half-dozen FCC complaints later, the whole multi-million grossing "hate-by-air" industry knows of its obligations.

Station managements are actually listening to what they broadcast, and some are shocked at what they hear. Some are dropping right-wing programs. Some are scrambling for "balancing" programs. Some are demanding that McIntire, Hargis, Burpo, Scott, Manion, Munn (Lifeline), Cotten, Bundy, Smoot, and their seads of imitators supply scripts.

Carl McIntire and Billy James Hargis, both of whom gross over a million dollars annually, are producing reams of written material charging IAD with being the chief "force" against them. Since our only "force" is appealing to reason and our chief ploy is answering personal attacks, their wrath illuminates their intentions.

All IAD aspires to do is to help make the FCC's Fairness Doctrine a living document. The howls of anguish from those seeking to use the kilocycles to impose their views on America are good evidence that IAD is making great strides in that direction.

IAD, 1530 Massachusetts Ave., N.W., Washington, D. C. 20005

(With Check)

Your checks help IAD carry on the kind of educational programs vital to the defense of democracy's broad middle ground.

You can count on me as a—

- ☐ $5 Associate (*Newsletter*)
- ☐ $10 Contributor (*Newsletter*)
- ☐ $25 Sustaining Associate (special reports)
- ☐ $100 Donor (special reports)
- ☐ $1,000 Honorary Member

YOUR NAME____________________

____

Mailing Address

____

City, State, and Zip Code

Penny's Thoughts

Local Imprint

EVERYONE CONTRIBUTING prayers, facts, ideas, time and funds has a right to feel a personal pride in IAD's achievements to date. Together we have shown what can be done to protect our nation from those who seek to undermine its basic precepts. The challenge of history is to do more of it.

THE EXTREMISTS TRY TO INTIMIDATE or discredit their opposition. Key trustees, contributors, and stockholders of organizations identified with IAD's sponsors get bombarded with "exposes" produced by Fred Schwarz, Carl McIntire, B. J. Hargis, Major Bundy and so on.

"Pete" White, part of Hargis' braintrust, calls for a boycott of goods and services identified with IAD's sponsors in the current issue of Christian (sic) Crusade. The Hargis spokesman said the faithful should even seek "some other fuel" instead of using Nat'l Rural Electric Co-op electricity. And that shows Hargis really does want to keep his followers in the dark.

WHILE THE F.B.I. keeps tabs on everybody even remotely connected with the Communist Party, the basic information on the Far Right is collected by the Anti-Defamation League of B'nai B'rith and Group Research. IAD has full access to these files. This gives us a depth of information without which we could hardly function.

We're a lightning rod for attacks from the ultra right. Here are some of the publications carrying tirades against IAD from Robert Welch, Carl McIntire, B. J. Hargis, C. W. Burpo, Major Bundy, W. S. McBirnie, Fred Schwarz, Christian Layman's League, Richard Cotten, et al.

McIntire Buys More Cape May—Burpo, Hargis Just Buy

Right-wing evangelism is big business. Tax records show that Dr. Carl McIntire, through his *Christian Beacon Press*, is the biggest taxpayer in Cape May, N. J., and *Christian Beacon Press* just acquired, for $550,000, the 100-room Congress Hall waterfront hotel to go with the Christian Admiral. Cape May papers report the McIntire interests are also spending $75,000 to enlarge another building to 3,000 seating capacity. In Tulsa, construction records show Billy James Hargis is adding a $50,000 annex to his $525,000 cathedral.

In Mesa, Ariz., a court ruled that C. W. Burpo's $300,000-grossing Bible Institute of the Air, Inc., was a business and hence could no longer be operated out of what he calls his "little 7-room cottage" (house in foreground of picture—ranch-style home in background with pool is Burpo's residence, a $50,000 package). Burpo, appealing for funds, told his radio audience he was under attack by "anti-Christian neighbors."

IAD

Institute for American Democracy, Inc.
1330 Massachusetts Ave. N.W.
Washington, D.C. 20005

U.S. POSTAGE
PAID
SILVER SPRING, MD.
Permit No. 18
NON-PROFIT ORG.

1

Form 990-A
U.S. Treasury Department
Internal Revenue Service

Return of Organization Exempt From Income Tax

Section 501(c)(3) of the Internal Revenue Code

For the calendar year 1968, or other taxable year beginning .... 1968, and ending .... 19....

Page 3

1968

Enter name, address, etc. as shown on Part I.

Name of organization: Institute for American Democracy, Inc.

Number and street: 30 Broad Street

City or town, State, and ZIP code: New York, New York 10004

Employer Identification No. (See instructions): 52-0822376

Is this a group return filed on behalf of subordinates (who are covered by a group exemption letter)? ☐ Yes ☒ No

Enter the name and address used on your return for 1967 (If the same as above, write "Same"). If none filed, give reason.
Same

PART II Part II information required pursuant to section 6033(b) and other applicable sections of the Internal Revenue Code must be submitted in duplicate as part of your return. This part will be made available to the public.

1 Gross receipts from all business activities (state nature). (Attach a statement explaining how each business activity not reported on Form 990T contributed importantly to your exempt purpose. See instruction E.)

Sale of Publications	4,904	
Sale of Newsletter "Homefront"	15,019	
Miscellaneous Sources	105	20,028

Line	Item	Amount
2	Less: Cost of goods sold and/or of operations for all business activities (attach schedule) Subscription Expense	10,965
3	Gross profit from all business activities	9,063
4	Interest	
5	Dividends	
6	Gross rents	
7	Gross royalties	
8	Gain (or loss) from sale of assets, excluding inventory items (See instruction 8)	
9	Other income (attach schedule—Do not include contributions, gifts, grants, etc. (Specify))	
10	Total gross income (lines 3 to 9, inclusive)	9,063
11	Expenses of earning gross income from column 3, Schedule A	

RECEIVED MAY 19 1969 26 IRS PHILA. PA.

DISBURSEMENTS MADE WITHIN THE YEAR OUT OF CURRENT OR ACCUMULATED INCOME FOR PURPOSES FOR WHICH EXEMPT, AND ACCUMULATION OF INCOME

Line	Item	Amount
12	Expenses of distributing current or accumulated income from column 4, Schedule A	
13	Contributions, gifts, grants, scholarships, etc. (See instruction 13)	
14	Accumulation of income within the year (line 10 less the sum of lines 11, 12, and 13)	9,063
15	Aggregate accumulation of income at beginning of the year ( )	
16	Aggregate accumulation of income at end of the year ( )	

RECEIPTS NOT REPORTED ELSEWHERE

Line	Item	Amount
17	Contributions, gifts, grants, etc., received (See instruction 17)	135,861
18	Less: Expenses of raising and collecting amount on line 17, from column 5, Schedule A	39,179
19	Net contributions, gifts, grants, etc., received	96,682

DISBURSEMENTS MADE OUT OF PRINCIPAL FOR PURPOSES FOR WHICH EXEMPT

Line	Item	Amount
20	Expenses of distributing principal from column 6, Schedule A	104,371
21	Contributions, gifts, grants, scholarships, etc.: (a) Paid out in prior years ( )	
	(b) Paid out within the year (See instruction 21)	

Schedule A—Allocation of Expenses (See Instructions for Attachments Required)

1. Item	2. Total	3. Expenses of earning gross income	4. Expenses of distributing income	5. Expenses of raising and collecting principal	6. Expenses of distributing principal
(a) Compensation of officers, etc.	22,500				22,500
(b) Other salaries and wages	31,419				31,419
(c) Interest					
(d) Taxes Employment	1,943				1,943
(e) Rent	4,059				4,059
(f) Depreciation (and depletion)					
(g) Miscellaneous expenses (attach schedule) Schedule #2	83,629			39,179	44,450
(h) Totals	143,550			39,179	104,371
		Enter on line 11	Enter on line 12	Enter on line 18	Enter on line 20

BEST AVAILABLE COPY

	Beginning of Taxable Year		End of Taxable Year	
	(A) Amount	(B) Total	(C) Amount	(D) Total
ASSETS				
1 Cash		13,894		15,166
2 Accounts receivable (see instructions)				
(a) Less allowance for bad debts				
3 Notes receivable (see instructions)				
(a) Less allowance for bad debts				
4 Inventories				
5 Gov't obligations: (a) U.S. and instrumentalities				
(b) State, subdivisions thereof, etc.				
6 Investments in nongovernmental bonds, etc.				
7 Investments in corporate stocks (see instructions)				
8 Mortgage loans (number of loans ______)				
9 Other investments (attach schedule)				
10 Depreciable (and depletable) assets (attach schedule)	4,606		4,599	
(a) Less accumulated depreciation (and depletion)		4,606		4,599
11 Land				
12 Other assets (attach schedule) Prepaid Expenses		738		738
13 Total assets		19,238		20,503
LIABILITIES AND NET WORTH				
14 Accounts payable (see instructions)				
15 Contributions, gifts, grants, etc., payable				
16 (a) Bonds and notes payable (see instructions)				
(b) Mortgages payable				
17 Other liabilities (attach schedule) Employment Taxes		833		1,571
18 Capital stock: (a) Preferred stock				
(b) Common stock				
19 Membership certificates				
20 Paid-in or capital surplus				
21 Retained earnings—Appropriated (attach schedule)				
22 Retained earnings—Unappropriated:				
(a) Attributable to ordinary income	18,405		18,932	
(b) Attributable to gains from sale of assets		18,405		18,932
23 Less cost of treasury stock		( )		( )
24 Total liabilities and net worth		19,238		20,503

1 Date of current exemption letter July 27, 1944

2 Attach a detailed statement of the nature of your charitable, business, and all other activities. Schedule #3

3 Have you attached the information required by
(a) Instruction I? Schedule #4 ☒ Yes ☐ No
(b) Instruction J? ☐ Yes ☒ No

4 Have you filed a tax return on Form 990-T for this year? ☐ Yes ☒ No
If "Yes," where filed? ______

5 In what year was your organization formed? April 2, 1943
In what State or country? New York

6 If successor to previously existing organization(s), give name(s), address(es), and employer identification number of the predecessor organization(s)
______
______

7 If you have capital stock issued and outstanding, state with respect to each class of stock:
(a) The number of shares outstanding ______
(b) The number of shares held by individuals N/A
(c) The number of shares held by organizations ______
(d) The number of shareholders at end of year ______
(e) Whether any dividends may be paid ☐ Yes ☐ No

8 If you acquired capital assets out of income, attach itemized list and amount thereof. Furniture and Equipment $102.49

9 Have any changes not previously reported to the Internal Revenue Service been made in your articles of incorporation or bylaws or other instruments of similar import? ☐ Yes ☒ No
If "Yes," attach a copy of the amendments.

10 Have you had any sources of income or engaged in any activities not previously reported to the Internal Revenue Service? ☐ Yes ☒ No
If "Yes," attach a detailed statement.

11 Did you hold any real property for rental purposes with respect to which there is an indebtedness incurred in acquiring the property or in making improvements thereto or which was acquired subject to a mortgage or similar lien? ☐ Yes ☒ No
If "Yes," attach detailed statement.

12 Have you during the year advocated or opposed (including the publishing or distributing of statements) any national, State, or local legislation? ☐ Yes ☒ No
If "Yes," attach a detailed description of such activities and copies of any such statements.

13 Have you during the year participated in, or intervened in (including the publishing or distributing of statements) any political campaign on behalf of or in opposition to any candidate for public office? ☐ Yes ☒ No
If "Yes," attach a detailed description of such activities and copies of any such statements.

14 After July 1, 1950, did: the creator of your organization; or a contributor to your organization; or a brother or sister (whole or half blood), spouse, ancestor, or lineal descendant of such creator or contributor; or a corporation owned (50 percent or more of voting stock or 50 percent or more of value of all stock) directly or indirectly by such creator or contributor—
(a) Borrow any part of your income or corpus? ☐ Yes ☒ No
(b) Receive any compensation for personal services from you? ☐ Yes ☒ No
(c) Have any part of your services or assets made available to him? ☐ Yes ☒ No
(d) Purchase any securities or other property from you? ☐ Yes ☒ No
(e) Sell any securities or other property to you? ☐ Yes ☒ No
(f) Receive any of your income or corpus in any other transaction? ☐ Yes ☒ No
If answer to any question is "Yes," attach detailed statement unless previously reported. If previously reported, give year(s).

15 Do you hold 5 percent or more of any class of stock in any corporation? ☐ Yes ☒ No
If "Yes," you must submit the information required by the instructions for Schedule B.

U.S. GOVERNMENT PRINTING OFFICE: 1958—O-290-[illegible]

NAME Institute for American Democracy, Inc.
ADDRESS 50 Broad Street
New York, New York 10004

52-0822376
YEAR ENDED 12-31-68

Research	18,100
Public Information	6,149
Contract Labor	3,140
Travel	2,870
Project Printing	2,860
Postage	2,509
Xerox	2,307
Telephone and Telegraph	2,105
Miscellaneous Office Expense	1,317
Office Supplies	1,291
Hospitalization	784
Project Material	411
Professional Services	250
Research Material	164
Workmen's Compensation Insurance	109
Meetings and Conferences	84
	44,450
FUND RAISING EXPENSES	
RETAINER FOR FUND RAISER	10,150
POSTAGE	13,321
PRINTING AND REPRODUCTION	11,525
MAILING LIST	3,447
MISCELLANEOUS	736
	39,179

Attachment to Pages 1, 3, 5
Schedule #2

INFORMATION COPY

A PETITION TO THE FEDERAL COMMUNICATIONS COMMISSION BY THE TRUSTEES OF THE "TRUTH AND JUSTICE FUND," RAISED BY POPULAR SUBSCRIPTION IN SUPPORT OF RADIO STATION KAYE, PUYALLUP, WASHINGTON; TOGETHER WITH THE REPLY OF SUCH TRUSTEES TO A PETITION DATED APRIL 14, 1969, AND SIGNED BY ONE EARLE K. MOORE, ALLEGEDLY ON BEHALF OF "PUGET SOUND COMMITTEE FOR GOOD BROADCASTING."

President Abraham Lincoln once said, "Those who deny freedom to others deserve it not for themselves." No more apt illustration of the force of this apothegm has come to the attention of the undersigned than the present situation with respect to the current cabal to silence Radio Station KAYE, Puyallup, Washington. In order to make clear to the Commission the situation actually obtaining here in Tacoma and surrounding Pierce County, it is necessary first to explain the political background which underlies this seeming plot.

The City of Tacoma has for some years been in the throes of a deep-seated controversy over the merits and demerits of the City Manager form of government now obtaining in this city, and which has ruled the city for a dozen years. The present City Manager has boasted publicly that he has been responsible for bringing to this city over $65 million of Federal-State funds; which has resulted, to the extent that it may be true, in the employment of large numbers of people, many imported from other areas, and in a vast program of "Urban Renewal," including a "Model City" program in a small area of the city where some 50% of the population are of a minority race. Inevitably, there have arisen vested interests in the continuation and the extension of these Federally financed programs, and in the additional, and often very well remunerated, employment which they provide. It is largely the direct and indirect beneficiaries of these Federal programs who constitute the signers of the petition of the "Puget Sound Committee for Good Broadcasting," of whom there are 69 names on the original petition.

At the same time, there has arisen a growing tide of dissatisfaction with this increasing dependence on Federal money, and increasing disillusionment with the City Manager form of municipal government as here applied, and a wide-spread public distrust of the integrity with which certain of these Federally financed programs have been handled. This public feeling resulted in the election in November, 1967, of Mayor A. L. Rasmussen, and two City Council members, all openly opposed to the City Manager form of government, and pledged in their campaign pronouncements to seeking a change. While granting virtually unlimited air time to both sides of this controversy, Radio KAYE editorially supported Mayor Rasmussen and his colleagues, who at this time constitute a four-person minority in the nine-member City Council. Thus the City Manager system, the City Manager himself and some of his appointees, and the beneficiaries of many programs which he has promoted, find themselves in a hazardous situation, since the continuance of the benefits they enjoy could very well hang on the slender thread of one vote on the City Council. The situation is further complicated for them by the fact that two of the five-man majority, uniformly favorable to anything the City Manager wishes to do, have announced that they will not be candidates for re-election when five members are elected this coming autumn, including the Mayor. It is perhaps understandable that a certain desperation now pervades the camp-followers of the City Manager system whose benefits they enjoy. As a consequence, one of the signers of the above-mentioned petition, associated with a financial institution, and associated with two other persons similarly connected, is now collecting funds for the avowed purpose of protecting the City Manager system, and of getting rid of

the present Mayor and seeking to assure a majority favorable to the City Manager and the system which he represents. This is an understandable expression of self-interest, and were the end it seeks pursued by ethical means, it would not be subject to justifiable criticism. The fact that ethical means were long ago abandoned justifies the criticism which will be contained in this petition, which criticism will form the basis for certain urgent recommendations with which we will conclude this document.

Complicating the entire situation, but by no means directly responsible for it, is what would appear to the undersigned to be some collusive activity of national scope to silence broadcasting stations all over the country whose political and economic and religious philosophy is distasteful to those involved. The undersigned have no personal information about this activity other than what they read in the public press. From that source, it would appear that there is an organization that purports to represent the United Church of Christ, address unknown, which is spear-heading a campaign in some twenty or more cities in this country, designed with the help of local satellite groups to prevail upon the Federal Communications Commission to deny license renewal to broadcasting facilities which fall under its disapproval. It appears to the undersigned that this activity has the cooperation of an organization known as the "Institute for American Democracy, Inc.," whose address is said to be Suite 101, 1330 Massachusetts Avenue, N. W., Washington, D. C., 20005; and whose Executive Director is said to be a Mr. Charles R. Baker. Again relying on the public press, it is said that this collusive grouping is financed by something over a quarter of a million dollars of money contributed by several tax-exempt Foundations. According to the press, the following, possibly amongst other, contributions have been made for the furtherance of this plot:

Ford Foundation	$160,000
AFL – CIO	$ 45,000
Marshall Field Foundation	$ 50,000

If these press reports are correct, it becomes evident that this plot for the suppression of free speech is remarkably well financed. It is the belief of the undersigned that the collaboration of the local satellite group, self-styled as the "Puget Sound Committee for Good Broadcasting," with the national grouping is merely fortuitous. It appears to us that the local group, primarily interested in the local municipal elections, is merely taking advantage of a convenient vehicle which would appear to them to be one that could assist them in silencing the radio station whose influence in next fall's elections they regard with understandable trepidation.

In this connection, it should also be pointed out that it is not Radio KAYE alone which has become the objective of the local collaborators. Radio KOOD, in nearby Lakewood, has already been silenced, in some measure by the same efforts used against Radio KAYE; namely, intimidation and boycott of advertisers, and various forms of threat and intimidation directed at the station itself. A similar campaign has been carried on against the programs on Radio Station KMO conducted by Mr. Burt McMurtrie. It is felt that the investigation which will be requested herein should also be extended to include those two broadcasting outlets.

In summary, then, it is the belief of the undersigned that the entire campaign of harassment, law suits, intimidation, violence, and attempted assassination as applied against Radio Station KAYE is based on the local political situation, though the extent to which the national grouping above described participates in this harassment is one of the avenues of investigation recommended to be pursued.

The plot which is seeking to bring about the closure of Radio Station KAYE has not been confined to simply seeking to have the FCC deny it a license renewal. Those active in it have resorted to much more direct means of coercion. These have included, and continue at this writing to include, direct violence against personnel connected with Radio Station KAYE, threats of violence against them and the advertisers on the station, intimidation by telephone calls and anonymous letters, burglary of documents from the office of Radio Station KAYE, attempted boycott of the station's advertisers, and several attempts at the assassination of station personnel. It is believed that these matters have already been called to the attention of the Commission, and that it is needless to go into further detail on them at this time. If and when the investigation which will herein be requested is initiated, full details and documentation are readily available.

A detailed reply to the petition of the "Puget Sound Committee for Good Broadcasting" will form an appendix to this petition and statement.

Meantime, the undersigned urgently request that there be instituted an investigation by the Federal Communications Commission, or by such other agency of the United States Government as seems appropriate, to develop, inter alia, evidence on the following points:

1. The background of the group purporting to represent the "United Church of Christ," and of the "Institute for American Democracy, Inc.," and the legality of their injection into a local political controversy.

2. The extent to which certain of the petitioners who sign themselves as members of the "Puget Sound Committee for Good Broadcasting" are operating in violation of the Hatch Act in being engaged in political activities while holding offices compensated in whole or in part from Federal funds.

3. The source of the financing which is paying for the various forms of harassment being applied against Radio Station KAYE, including the source of legal fees being employed in certain current harassment suits against that station; and to what extent this financing is national, and to what extent local, and whether or not Federal funds are involved.

4. The extent to which certain subversive organizations are participating in this harassment, and at whose behest.

5. The extent to which certain persons with criminal records are being employed in some aspects of this intrigue, possibly compensated by Federal funds.

6. The extent to which the office of the City Manager of Tacoma, either directly or through appointees, is involved in this collusive activity.

7. The extent to which certain of the signers of the petition of the "Puget Sound Committee for Good Broadcasting" are engaged in entrapment efforts to evade the vigilance of Radio KAYE personnel and to thus broadcast material designed to form the basis for additional litigation and additional complaints.

8. The extent to which the current harassment suits have been promoted and their basis, laid by entrapment.

9. The extent to which collusive activity to exclude from the air a Federally-licensed broadcasting facility is in violation of law and of Constitutional guarantees of free speech, with a view to the criminal prosecution of those participating in such actions.

10. The extent to which persons involved locally in this intrigue may be subversives on record as such with the Federal Bureau of Investigation.

11. Finally, it is suggested that a determination be made as to whether or not an effort has been made to mislead the Federal Communications Commission by seeking to make it believe that the firm of Moore, Berson, Hamburg and Bernstein, of New York, are in fact attorneys for the local "Puget Sound Committee for Good Broadcasting," when it well may be that in fact their employment and compensation derive from other sources.

Respectfully submitted,

Floyd Oles Marshall Riconosciuto Mrs. John R. Wiborg

Trustees, Truth and Justice Fund, raised by popular subscription for the defense from harassment of Radio Station KAYE, Puyallup, Washington.

APPENDIX I

PETITION OF THE TRUSTEES OF THE "TRUTH AND JUSTICE FUND," RE: RADIO STATION KAYE, PUYALLUP, WASHINGTON.

COMMENT ON PETITION OF "PUGET SOUND COMMITTEE FOR GOOD BROADCASTING," FILE NO. 2682, RADIO STATION KAYE, PUYALLUP, WASHINGTON.

First, the undersigned call attention to the fact that the petition of the "Puget Sound Committee for Good Broadcasting" is not formally before them nor before Radio Station KAYE at this time, their only information about it being in the form of what purports to be a copy of such petition with appendices, received from one Earle K. Moore, who signs himself as attorney for petitioners, and appears to be of the firm of Moore, Berson, Hamburg, and Bernstein, of 660 Madison Avenue, New York, N. Y., 10021. A communication from Mr. Moore is dated April 14, 1969, and came to the station in a cover postmarked New York. Since the undersigned are disinclined to believe that Mr. Moore is an agent for the Federal Communications Commission, it would appear that the petition is a private communication, and that any response whatsoever to it would appear to be gratuitous on the part of the station or the undersigned. Nonetheless, the allegations contained in that petition, which we have reason to feel is probably in the hands of the Federal Communications Commission, are so completely and outrageously contrary to fact that it is felt desirable to comment on them, regardless of what status, if any, they might have with the Federal Communications Commission, on which point the undersigned have no information.

These comments will be made on the basis of the numbered paragraphs of the above described petition, which is by its own terms designated as File No. BR 2682.

Para 1. We would suggest inquiry as to whether the "Puget Sound Committee for Good Broadcasting" is an independent group or merely the local branch of some other organization.

Para 2. No comment.

Para 3. This paragraph alleges that the petition is filed "on behalf of all other radio listeners within the signal area of Station KAYE." We need not belabor the fact that this is a palpably false statement.

Para 4. This paragraph is substantially and constructively false from start to finish. Contrary to its allegation, all views, whether concurring or not with those of Mr. James Nicholls, are freely aired. Failure and refusal of City Manager system proponents to take advantage of freely offered air time cannot be laid at the door of KAYE.

Station KAYE participates in dozens of worthy civic projects. Amonst those it supports are the Patriotic American Mothers, the Tacoma Servicemen's Center, a recent local school bond and millage issue, support of the local Association of the Handicapped, and many other civic activities.

The emphasis on the City Manager situation in Tacoma is pertinent to the entire surrounding area, due to the continuing campaign of the present City Manager to expand his jurisdiction by annexation of adjoining and nearby areas.

Para 5. This paragraph is entirely and demonstrably false, and without the slightest foundation in fact. Radio KAYE criticizes editorially issues and the conduct of public figures, as it has every right to do, and as all other local media also do. It does not attack either the character or motives of public figures, though even this is legally permissible, and often indulged in by other local media. No one is "subject to hostile and abusive questions" on KAYE, and any attempt of that kind is immediately suppressed, and particularly has had to be so in recent months, when City Manager proponents themselves repeatedly seek by entrapment to get onto the air items on which to base law suits and complaints. Invitations to appear and present contrasting views are often themselves met by abuse and ridicule, and we ourselves have heard the present City Manager do this on the air in response to such invitations. Furthermore, he has forbidden any city employee to appear on KAYE in defense of the official city position. We have heard him publicly say: "I would not dignify your station by appearing on it." Complaint that opponents are excluded, under these circumstances, is obviously hypocritical.

It would have been difficult to combine in one paragraph a more completely false set of complaints about Radio Station KAYE.

Para 6. Completely inaccurate except that it is true that sessions of the City Council are in fact broadcast, originally at the request of Mayor Rasmussen, and without comment. The initiative by Radio Station KAYE in broadcasting Council sessions has resulted in the sincerest form of flattery, in that two other broadcasting facilities habitually now do the same thing. Comment made by KAYE before and after Council sessions does not alter the fact that the sessions themselves are presented without comment.

Appeals to the citizenry to attend City Council sessions would seem to be an odd basis for complaint, especially since it has resulted in a large attendance and a rapidly broadening participation in city government by local citizenry.

Para 7. This paragraph is accurate as to the existance of the stated programs, and completely false with regard to their content. The innuendo contained in the words "particularly Negroes" is false and intentionally misleading. The station editorially continues to oppose violence, law breaking and the fomenting of racial discord, which critics seemingly interpret as "attacks on and innuendo about persons and groups," or as "naked abuse," all of which is a perversion of the truth. Such criticism seems to us to suggest that opposition to law breaking and to racial misconduct are regarded as offensive to those guilty of that conduct, and the complaint would thus appear to express the resentment of the guilty.

Para 8. This paragraph is completely false. The allegation that KAYE "manipulates its programs so as to favor supporters of its views" is the exact contrary of the truth, as is well known to the critics. In fact, our own criticism continues to be that KAYE goes much too far in its tolerance of the abuse, vituperation, and extremism of some of the signers of the petition under discussion, whose language frequently becomes so violent and crude as to require cutting them off the air. We who listen frequently to KAYE come to recognize many of the voices, and to realize that much of it is an attempt to "bait" or to "entrap" the station into airing something which could be used against it. Such entrapment has already

resulted in legal action against the station, presumably in the hope of getting it off the air for fear of its influence in the forthcoming municipal elections. All such suits, some of which are still before the courts, have thus far failed of their intended effect, but the entrapment efforts go on.

The entire paragraph is false and misleading. Music is never used to "drown out" speakers, and in fact it is used very sparingly at all on the "Party Line" and "Round Table Forum" programs, and then only either as part of an advertisement or to illustrate a point; i.e., the Washington State Song, the Tacoma Centennial Song, and so forth.

The station has no unpublicized telephone numbers, as alleged. Callers, friendly or not, are openly invited to call in on the business line, whose number is given publicly, when they feel they have something of unusual import to communicate, and the number of that line is well known.

Most of the "repeat" callers of which this paragraph complains are in fact station critics, who often try to monopolize the lines, in what appears to be a concerted effort to black out opponents of the present form of city government. Many of these callers are readily recognized as some of the signers of the petition. Furthermore, in the illustrations given in the body of the petition, things heard over Station KAYE are inextricably intermingled with things heard over two other stations; namely, KOOD and KTNT. The confusion is understandable, since KTNT is 1400 KC, KAYE is 1450, and recently closed KOOD was 1480.

Para 9. There is no paragraph 9.

Para 10. This paragraph is completely false and misleading. Personal attacks on the character or integrity of anyone are promptly cut off by the station, even though it is obvious to listeners that some of these callers are deliberate "plants." Criticism of the official conduct or policies of public officials is evidently interpreted by this paragraph as "personal attacks."

There is no basis for the criticism that callers are not required to identify themselves, as this is standard practice on dozens of such programs, local, regional, and national.

The allegation that critics are cut off and supporters permitted to carry on is not only false, it is in fact the reverse of the station policy. Our own criticism continues to be that far too much leniency is given critics, who often become abusive in the extreme, in an obviously concerted and continuing effort to get something on the air which can be used against the station later. It is this collusive effort, its personnel and motivation, financing and background, which the undersigned, in an earlier part of this document, seek to have investigated.

Para 11. This paragraph refers to the three harassment actions brought against KAYE in the continuing effort to get it off the air prior to the forthcoming municipal elections. These actions are still in the courts, and have been set for hearings at varying dates extending into next December and January.

Recognizing these actions for what we believe them to be, a part of the current municipal campaign, a concerned group of many hundreds of citizens has raised a substantial sum of money, under the exclusive control of the undersigned Trustees, who have secured legal aid in defending Radio KAYE from this kind of harassment. Through our

lawyers we have been trying to bring these actions to court as promptly as possible, hoping thus to expose the persons and influence behind this harassment, and thus to establish openly the nature and personnel behind these machinations. Due to court congestion, all three cases have been set forward many months, much to our disappointment, although this also has had the effect of defeating the attempt to use such actions to close the station down before the fall elections.

Having failed in attempts to close the station by the means thus far attempted, other means have been, and continue to be, employed as outlined elsewhere in this statement. These means have included beatings, threats, intimidation of station personnel and station advertisers, burglary of station records, anonymous threatening letters (for an example, see Appendix III hereto), continuing attempts at entrapment, and several attempts at assassination of station personnel.

In view of the fact that the three actions are still unresolved in the courts, hearings having been set forward many months, it is obvious that the statements contained in Para 11 are without foundation in fact.

Para 12. The financial condition of Radio Station KAYE is not an issue, and is wholly irrelevant to its license renewal, so long as it obeys the laws, as it is doing, and conducts itself in its present exemplary manner. We might point out that the financial condition of some of the petitioners is also open to a good deal of question, but equally irrelevant. If profits and a financial surplus were a pre-condition for licensing, there would be very few independent radio stations on the air, and radio broadcasting would be limited to stations owned by newspapers or wealthy groups or institutions. Radio KAYE is a relatively new enterprise, it is paying its bills to the satisfaction of all; even if, in common with any number of small businesses, its hopes for substantial profit lie still in the future.

Para 13. This paragraph seeks by innuendo to read some kind of sinister motives into perfectly normal activities. There is no excuse for the use of such adjectives as "ultra-conservative," and such unjustified clauses as "against everyone ------ whom it considers unduly sympathetic to minorities or the poor." The fact is that the station is editorially and openly patriotic, and to some kinds of people such conduct is habitually interpreted as "ultra-conservative." The station is certainly far from unique in criticizing U. S. Supreme Court decisions as unduly lenient to the kind of people and conduct championed by the signers to that petition. The station has never claimed that Mayor Rasmussen is "its biggest contributor," which is obviously ridiculous. Its solicitation of "bucks for broadcast" permits broadcast of City Council meetings without advertising breaks, and we see no basis for criticism therein. Other than as reporting news, KAYE has no connection with the publication to which those petitioners refer, nor with the organization referred to as the "CIA," nor does the station solicit contributions to either of them. In any case, the entire subject is irrelevant.

The reference to the "Testimonial Dinner" for Mr. Nicholls brings up a matter in which all of us take a good deal of pride. It was a birthday dinner for Mr. Nicholls on March 26, at Brad's Restaurant, and it brought together a distinguished company of many hundreds of citizens, amongst them high ranking state and local officials. At the dinner, Mr. Nicholls received congratulatory wires from this state's Senators and others in the Congress, and the award by the State of Washington of a plaque designating him as a "Distinguished Citizen of the State of Washington."

Para 14. The allegation of station insolvency is unwarranted as well as irrelevant. As to funds collected by public subscription to support the station and keep it on the air, the undersigned Trustees would gladly welcome any unbiased and impartial investigation. In their opinion, however, it would be still more important that such investigation should include a study of the source of funds being used in the continuing efforts to close the station, including the source of legal fees connected therewith.

In this connection, it has long been suspected by many concerned citizens of the area that certain Federal funds being lavishly distributed hereabouts, sometimes as salaries for persons with long criminal records, are being used to a substantial extent illicitly, and diverted to other than their intended uses. Mayor Rasmussen and a City Council minority have long and vainly demanded an investigation of this kind. It is our feeling that any investigation should include a study as to what extent, if any, these Federal funds, or funds substituted for them, are being used in the harassment of Station KAYE.

Para 15. The fact that KAYE presents syndicated religious and patriotic programs, in common with dozens of other stations in the area, seems to us a rather odd basis for criticism.

Para 16. This paragraph criticizes the broadcasting on KAYE of programs sponsored by, and advertising of the products of, the H. L. Hunt Enterprises, and alleges that "the products of H. L. H. Products are unknown in the service area."

This is a piece of bald-faced mendacity. The undersigned have repeatedly bought, and still find available throughout the area, many products of that firm. Furthermore, their availability or lack of it would appear to us to be completely irrelevant, as would the appearance of Mr. Wimpe on the station. The same broadcasts are also made on numerous other stations in the area.

Para 17. While the comment about rating claims seems to the undersigned completely irrelevant, we have been given access to reports which though indirect are regarded by us as reliable, that during certain of its broadcasting hours Station KAYE rates first in its service area. Certainly, it would appear to be the conviction of its critics that some such situation exists, since otherwise there would be no basis for what appears to be the desperation of their efforts to close it down.

Para 18. The allegations in this paragraph are completely false, in that KAYE has made no claim to having conducted any formal consultations with any of the persons therein named. On the contrary, it can claim honestly, and does so, that these people and many others have, in conversations sought for the purpose of securing such information, given the station personnel much valuable information as to community tastes and needs and problems. The substance of Para 18 is an attempt, by slanted semantics, to accuse Radio KAYE of a deception it never practiced, and of which in fact these critics are the ones who are guilty.

Para 19. This paragraph is substantially false and misleading. The petitioners have sought to give the impression that they speak for the organizations of which they allege they are members. This is an effort to mislead the Commission, since inquiry of the organizations mentioned uniformly develops that they do not regard themselves as bound by those who allege themselves to be their spokesmen. Any allegations made by KAYE with regard to conditions in certain OEO-supported areas are truthful statements, and can be substantiated. KAYE has never made an attack on the Tacoma Police Department, and has never criticized

it for employing Negro Police Officers, as alleged. It has criticized the City Manager Administration for what it regards as unwise and unjustified limitations placed upon the law enforcement activities of the Tacoma Police Department, and it is still of that opinion, as are the undersigned. KAYE has never referred to the League of Women Voters in the terms alleged, though this has been done and continues to be done repeatedly by others about an organization which is best characterized by its own statements, for which see Appendix II hereto, which would seem to indicate that the organization has an equal enthusiasm for the City Manager system and for the embracing of Communist China. KAYE continues editorially to endorse, and not oppose, the employment of Negro Officers in the Tacoma Police Department, within normal Civil Service rules. KAYE stands by its criticism of perversion in certain organizations using Federal funds, and asserts that truth justifies those criticisms. The fact that the law in this area is not enforced with even-handed justice against all law-breakers is demonstrable, and capable of documentation.

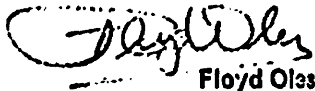
Para 20. This paragraph is completely false. Mr. Nicholls has given no medical advice, but in common with hundreds of other communications media has reported, as news, some remarkable cures seemingly effected by unconventional means. The same news is to be found in any number of newspapers and other periodicals. To refer to such news reporting as the offering of medical advice vividly illustrates the paucity of facts, as well as of integrity, in the petition under discussion.

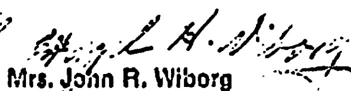
Para 21. This paragraph requests denial of license renewal to Radio KAYE, Puyallup, Washington, and appends the names of 69 signers, all allegedly represented by one Earle K. Moore, Attorney. The undersigned will refrain from personal comment on those signers, though many of them are guilty of falsehoods in their self-identification, both by inaccurate statements and by significant omissions. Nonetheless, we will confine ourselves to reference to them generically. We recognize in a majority of all the listed petitioners persons who are beneficiaries of, or publicly involved in, Federal spending programs in this area; which programs would presumably be adversely affected, as would the signers' benefits therefrom, by a change in the form or personnel of city government in Tacoma.

The entire petition is a self-serving document, primarily designed to protect the personal interests of most of its signers, and to try to enlist the help of the Federal Communication Commission in taking sides in the local political campaign. The entire anti-Radio KAYE campaign is clearly intended to protect the personal interests of most of its signers by seeking to eliminate a hazard which the popularity of Radio KAYE, and its editorial opposition both to the City Manager form of local government and to corruption is that government, poses to their individual and personal future financial security.

In contrast to this purely self-serving document, attention is called to the thousands of unselfishly concerned citizens of this area who have signed petitions in support of the continuance on the air of the fair and unbiased and informative programs which in this area are available to listeners primarily through that station's facilities.

Respectfully submitted,





Floyd Oles — Marshall Riconosciuto — Mrs. John R. Wiborg

Trustees, Truth and Justice Fund, raised by popular subscription for the defense from harassment of Radio Station KAYE, Puyallup, Washington.

APPENDIX II.

THE TACOMA NEWS TRIBUNE AND SUNDAY LEDGER

SUNDAY, APRIL 27, 1969

Women Voters Group Urges Ties With Red China

WASHINGTON (AP) — The League of Women Voters urged the U.S. government Saturday to work actively for normal, cultural, trade and diplomatic relations with mainland China.

In a position paper on the country often called Red China, the league said also: "The United States sould withdraw its opposition to representation of the Chinese People's Republic in the United Nations."

The statement is the outcome of a three-year study of U.S.-China relations by the 157,000 members in 1,202 local leagues in the country.

Mrs. Bruce B. Benson, Amherst, Mass., league president, said the statement represents a consensus of reports from the local leagues.

APPENDIX III

GOLD and Nichols will Die If

things that have been implied about us isn't stopped

Gold and his army are Cruel YELLOW dummies

MAYOR ROTTEN Manager David Rowlands

superb O If you have any doubts our people will

get tough try something

[illegible] Oil Station In Doubt

[illegible]

Consider this a public service announcement.

LEFT BANK—The Louis M. Rabinowitz Foundation

by LAWRENCE V. COTT and RUTH L. MATTHEWS

Where does the Left get its money? Speculation, not without merit, usually centers in two sources. Communist governments abroad or rich Red angels in this country. There are documented cases, some not yet on the public record, of funds flowing in from the Soviet Union, from Cuba, from Red China. Better known are the domestic fat-cats, befuddled liberals as well as Communists, passing out their inheritance for the Cause.

There is another source increasingly important in funding the Left: Non-profit foundations. They often deal in politics, under the thin veneer of "community" projects or whatever; and often in enormous sums.

For several months, COMBAT has been examining the public records of a non-profit foundation which annually pours hundreds of thousands of dollars into the Left, to finance propaganda films glorifying Communist China and revolutionary activity in Berkeley, to finance socialist conferences, and in effect to subsidize Marxist and Communist publishing houses. This is the Louis M. Rabinowitz Foundation of 30 E. 42nd St., New York City. There seems to be a "research project" waiting for any Leftist who knocks at its door.

The Foundation was established in 1944 by a self-made New York industrialist (garment industry hooks and eyes), primarily to finance research into Jewish contributions to American life. So long as Louis Rabinowitz lived, his foundation stayed close to its charter, funding libraries and museums, endowing chairs at major universities, equipping archeological expeditions- in short, financing a hundred projects in the tradition of philanthropy. Then in 1957 Louis Rabinowitz died and direction of the foundation bearing his name passed to the hands of his son, his daughter and his daughter-in-law. The son, New York lawyer Victor Rabinowitz, has over the years been defense counsel for scores of clients called before Congressional committees investigating Communist activities. For many years he was Fidel Castro's chief legal representative—and registered foreign agent -in the United States. Rabinowitz has invoked the 5th Amendment privilege against self-incrimination when questioned about Communist activities, before a Congressional committee. So has his wife, Marcia, Secretary-Treasurer of the Foundation. His sister, Mrs. Lucille Perlman, is Vice President.

COMBAT has examined the public tax statements of the Louis M. Rabinowitz Foundation for the years since the death of Louis M. Rabinowitz. The findings indicate the Foundation's original purpose has been all but abandoned. Most of its money is now going into the pockets of well-known leftists, generally for "research" on papers, articles and books on Marxist or Communist subjects.

Those on the take include some of the biggest names of the left: Frank Donner, Hunter Pitts O'Dell, Walter Lowenfels, Clinton Jencks, Marvin Gettleman, Morris Schappes, Joseph P. Morray, James Forman, William Worthy, William J. Pomeroy, Len de Caux, Paul M. Sweezy, Andre Gunder Frank, Sylvester Leaks, Philip Reno, Christopher Koch, Frank Cieciorka, John Gerassi, Eugene Genovese, Waldo Frank, William Mandel, James Petras, John Howard Lawson, Todd Gitlin, Herbert Marcuse, Howard Zinn.

COMBAT's investigation of the Louis M. Rabinowitz Foundation reveals:

- The Foundation formerly granted large funds to Jewish foundations but this has declined from 41 [illegible] in 1960 to only 37 in 1967.
- Several years ago Senator J. William Fulbright, Arab-oriented, investigated the sources of certain funds coming into the U.S. from the Jewish Agency for Israel and found out that some were going through the Rabinowitz Foundation to pro-Israel groups in the U.S. and to the American Jewish Congress to aid its investigation of anti-Semitism in the Soviet Union. Victor Rabinowitz, challenged by Fulbright, was shocked, promised his foundation would stop being a conduit. What transpired was this: Fulbright had stopped an activity offensive to the Arabs, and Rabinowitz stopped one offensive to the Soviet Union.
- The Foundation has over the years contributed funds for research for books on Marxism (in some cases disguised in the grant as "socialism") and these books have then been published by International Publishers, the Communist Party's publishing house in the United States. The other large identifiable group of authors has been associated with the "independent" Marxist publishing house, Monthly Review Press, and its magazine, *Monthly Review*. Its stable of authors, some of them also identified as CP members in Congressional testimony, has received tens of thousands of tax-free dollars for "research," with the publisher providing only a pittance as royalty.
- At least two other leftist magazines have received direct grants from the Foundation: the now defunct *Studies on the Left* (as well as its three principal officers, individually) and *Science and Society*, a Marxist journal described by an official government committee as a Communist publication. (Four of the six members of *Science and Society*'s editorial board have been identified as CP members at one time or another.)
- It provided seed money for the financing of two propaganda films: "China," a transparently one-sided view of Mainland China by Englishman Felix Greene, who received $1,500 in 1963 and $7,500 in 1964. The film was produced, incidentally, by Lester Cole, named as a CP member and one of the original Hollywood Ten. The other film was "Days of Protest," a documentary of the Vietnam Day Committee protest marches in California. Producer Jerry Stoll, who has been named as a CP member and has spoken at CP street rallies, received $700 in [illegible].
- It gave $1,500 in 196[illegible] to Clergy and Laymen Concerned About Vietnam, a pressure group organized chiefly to oppose U.S. policy in Southeast Asia.
- The Foundation provided large sums to fund "research" for books and articles portraying Cheddi Jagan, who has said he wouldn't reject description as a Communist, as a popular hero of Guyana. One of the Rabinowitz Foundation's officers, Marcia Rabinowitz, was an officer of Friends of British Guiana, cited as a Communist front after Congressional investigation. Other research projects emphasize Cuba and Castro, Victor Rabinowitz's long time benefactor.
- It provided funds for operation of at least two of the Socialist Scholars Conferences, both held in New York City. The conferences are widely viewed as mis-named: the socialism discussed most frequently and with the greatest admiration is the socialism of Cuba, the Soviet Union and Red China. In the case of the second conference, in September

BEST AVAILABLE COPY

1966, 14 of the official participants who delivered papers (i.e., 25% of the speakers) have been identified as recipients of Rabinowitz Foundation funds, and the Foundation provided $2,000 to help run the conference.

The Foundation's purposes are set forth in its charter, which repeats the Internal Revenue Service statute on tax-exempt foundations, specifying its interests to include "research into Jewish law and history, contemporary Jewish affairs and scholarships, civil liberties, education specifically in areas of social work, etc." The "etc." is obviously most important. But nowadays one man's "civil liberties drive" is another man's "outside agitation," one man's "education" is another man's "propaganda" thus the mischief is done.

In 1960 the Foundation disbursed about $107,000, almost all to well-recognized and long-established charities, but there was a small amount for the *Civil Liberties Docket* (of Berkeley), $1,500 to *Studies on the Left*, $2,500 to Joseph Papp's New York Shakespeare Festival, and $2,000 to the left-wing Pacifica Foundation. Stanford and the University of Wisconsin were down for tidy amounts. Jewish philanthropies received $47,000, or about 44%. In 1962 nearly $200,000 was distributed, again mostly to legitimate organizations. Grants and scholarships, unspecified by name or amount, came to $144,619; recognizable Jewish philanthropies of one kind or another received $38,825 (about 20% of the total). In that year the Shakespeare Festival went down to $200, where it's stayed ever since; Pacifica Foundation got $1,530, and Willard Uphaus' World Fellowship received $500.

In 1963 the Foundation handed out $182,000; it was the year of the major departure. Jewish philanthropies had dropped to just $28,700 (about 15%), with a few minor contributions going to Columbia, Yale, Haverford College, and a few small charities. The bulk of the money went to leftists, some of it itemized below.

In 1964 the Rabinowitz Foundation disbursed $177,000, so much that by the end of the year its net worth had been whittled down to just under $71,000. As usual, the left got the lion's share behind the protective coloration of a few small gifts to recognized charities—a civic ballet group in Brooklyn, a guidance center in Rabinowitz's home town, New Rochelle. The Foundation also donated $26,650 to Jewish groups (about 15%). The following year the Foundation, according to its tax records, made no contributions or grants (although there is some evidence it did). Its portfolio contained $79,000 in government bonds, $41,000 in non-government bonds, $154,000 in corporate stock, and nearly $10,000 in other assets. At year's end its net worth was $286,000.

Finances were thus well enough off in 1966 for the officers to scatter $114,000 to 53 recipients: a "legal rights" group in New Haven got $1,500, a group helping retarded children $200, the Freedom Information Center in Tougaloo, Miss., $2,000. The left walked off with most of the money, though; Jewish charitable institutions received their by-now ritual 15%.

The last year for which tax records are available for study is 1967, and the figures show heavy plunging on the Marxist-Leninist-Castroite-"socialist" crowd. A few small university grants, the highest $2,500 to University of Wisconsin, a small check to a Brooklyn youth center, and only $3,000 (about 3%) to Jewish philanthropies. The rest went to the likes of Clinton Jencks ($5,750) and Prof. Harvey Goldberg ($5,000), James Aronson ($3,000) and Mario Savio ($1,500).

Here is a rundown of some of the lucky winners of the Big Sweepstakes of 42nd Street:

James Forman. Now chief fund raiser for the National Black Economic Development Conference and author of its demand for $500 million reparations from churches for centuries of alleged ill-treatment of Negroes. Forman received four grants from the Rabinowitz Foundation in 1963, totaling $22,945.50. The next year Forman returned for $13,835, a grand total of nearly $37,000. Coincidentally, Forman is married to the former Anna Constancia Romilly, daughter of author Jessica Mitford, and stepdaughter of Oakland, Calif., attorney Robert Treuhaft, both of whom have been identified as CP members in the CP press. (In 1966 Victor Rabinowitz sent $50 to help in Robert Treuhaft's campaign for district attorney.) In the years he received $37,000 from the Foundation, Forman was an executive of the Student Non-Violent Coordinating Committee, later melded into and then out of the Black Panthers, where Forman was also named Minister of Foreign Affairs. It was in August, 1967 that SNCC, followed by the Panthers, adopted a stance which can only be described as anti-Semitic, as well as pro-Communist.

Albert E. Kahn. Now living at Glen Ellen, Calif., he received $2,500 in 1964. Kahn has been named as a CP member, has turned out books like *Sabotage: the Secret War Against Soviet Russia*, and *High Treason: The Plot Against the People.* In his books the traitors and plotters are the anti-Communists.

Philip Stevenson. Received $1,200 in 1963. Was identified as a CP member (Party name: Philip Sterling) in Queens, N.Y., later moved to California. An unfriendly witness before HUAC in 1951, he also used name Lars Lawrence, spoke at *People's World* celebrations. Deceased 1965.

Esther Jackson. A grant of $2,000 in 1963. Wife of James E. Jackson, former editor of the *Worker* and now one of CP's National Committee.

Robert K. Machover. Received $2,000 in 1966. One of the new breed of young radicals. Machover made illegal trip to Cuba in 1964. Last year moved to San Francisco area, where he exercises authority in leftist film company, San Francisco Newsreel.

Todd and Nancy Gitlin. Down for $4,000 in 1966. Todd is former president of SDS, has written for *Monthly Review* and the *Guardian*, played major role in organizing SDS Radical Education Project, [illegible] recently in San Francisco with the Newsreel film company, and was active in strike agitation at San Francisco State. Nancy Gitlin was in delegation of U. S. leftist women who met with Viet Cong women in Indonesia in 1965.

Christopher Koch. Received $2,100 in 1965. Koch is best known for his illegal trip to Hanoi, which cost him his job with Pacifica Foundation's New York station (WBAI). Once was president of Radio Tougaloo Association, spoke at meeting sponsored by National Council of American-Soviet Friendship.

Michael B. Folsom. Received $2,500 in 1964. Folsom, one of the original members of W.E.B. DuBois Clubs, has spent last four years putting together biography of Mike Gold, prominent Communist and long-time columnist for *Daily Worker* and *People's World*.

Paul M. Sweezy. Co-publisher, with late Leo Huberman, of the Marxist *Monthly Review*, whose authors are so favored by the Rabinowitz Foundation. Sweezy is a long time Marxist, his magazine especially enamored of the life-style of Castro, Jagan and Mao. Received $[illegible]5.56 in 1964, a curious amount. The Foundation records show Stanford University

refunded $685.56 that very same year, suggesting it covered Sweezy's expenses when Sweezy appeared on the Stanford campus April 3, 1964 to deliver remarks at the funeral service of the late Marxist professor Paul A. Baran.

Len de Caux. There's a name out of the past for you. Now living in Glendale, Calif., he was an *enfant terrible* of the leftist labor movement in the 1930's. An Oxford graduate, De Caux has lived in the U.S. since 1927, was one of CIO's chief radicals, edited the *March of Labor* (cited as a Communist publication), was identified as a CP member in 1953; invoked the 5th Amendment before HUAC. Received $3,250 in 1964.

Richard Krooth. Recipient of $2,500 in 1966. Krooth was in Madison, Wis., where he supervised economic research for the National Coordinating Committee to End the War in Vietnam. A former member of the Georgia bar association, by 1967 he was described in *Minority of One* (for which he wrote an article, "Capital Export and Leading Monopoly") as a "free-lance writer specializing in the economics of imperialism." Has also written for *National Guardian.*

J. M. Budish. Recipient of $3,000 in 1964. A well-known open member of the CP, whose critical articles are published in *Political Affairs*, the CP's theoretical journal.

Rose Russell. She received a lavish $5,500 grant in 1964. A long-time CP member, Mrs. Russell was one of the leaders of New York State's old Teachers Union, long noted for its Communist penetration. Now deceased.

William Marx Mandel. Received $2,000 in 1966. Has appeared before three Congressional committees, invoking the 5th Amendment when questioned about CP membership. A "star" of film *Operation Abolition.* Author of several books on USSR, generally painting rosy picture. His few criticisms of Moscow have cooled off his previous warm relations, but he can still get an article published in *Political Affairs.*

Robert Kaufman. Listed by the Foundation as Robert B. Kaufman of Berkeley, this is undoubtedly Robert Paul Kaufman, a chief organizer of W.E.B. DuBois Clubs on Berkeley campus, one of Bettina Aptheker's closest allies, and now a staff reporter for *People's World*, CP newspaper. Received $3,600 in 1966.

William J. Pomeroy. Received $3,000 in 1963 and $2,000 in 1964; Pomeroy was an American who joined up with the Communist-led Huks in the Philippines, was later captured, imprisoned and deported. Now lives in England and contributes to the *Guardian.* Editor of *Guerrilla Warfare & Marxism*, published by International Publishers.

Alexander Werth. Received $3,000 in 1963 to help him complete his book, *Russia At War* (E. P. Dutton & Co., 1964). Werth thanks the Foundation in the introduction. Russian-born Werth spent 1941-48 in the USSR as correspondent for the London *Sunday Times;* later was European correspondent of the left-wing U.S. magazine, *Nation.* Werth's writings generally were favorable to Stalin until he was attacked by Khrushchev, then favorable to Khrushchev until K was deposed.

Joyce Lewis Kornbluh. Received $1,000 in 1963. In her *Rebel Voices: An IWW Anthology* (Univ. of Michigan Press, 1964) she thanks the Foundation for "financial help at a critical time" which enabled her to complete her monumental work on the Industrial Workers of the World (the Wobblies; an almost-defunct early radical group which is on the Attorney General's list).

Bertrand Russell. The nonagenarian British pacifist, later to spawn an "International War Crimes Tribunal" to blame the U.S. for crimes in Vietnam, received $1,000 in 1963.

Ronald Radosh. Received $1,000 in 1966. In early 1960's, while a history graduate student at the University of Wisconsin, Radosh was an associate of *Studies on the Left.* More recently at Kingsborough College in N.Y.

John Gerassi. Former *Newsweek* correspondent turned radical. Made an illegal trip to North Vietnam in late 1966, the same year the Rabinowitz Foundation gave him $5,000. Made an illegal trip to Cuba in 1967. Author of *The Great Fear, the Reconquest of Latin America by Latin Americans* (MacMillan, 1963) and *North Vietnam, a documentary* (Bobbs-Merrill, 1968). When asked, in 1967, by *National Guardian* what white radicals should do in response to ghetto rebellion, answered, "Support them, and I mean militantly." Fired from San Francisco State College for leading students in breaking into administration building.

This is a rundown of the 1967 grants — the last year records are available:

James Aronson, N.Y., $3,000: Was editor of *National Guardian* (now *Guardian*) until staff revolted and took control; paper was cited by HUAC as "virtual official propaganda arm of Soviet Russia," but in recent years, with "polycentric" Communism, has shown fascination with Cuba and Red China. Like many other recipients, Aronson is luminary of (National) Emergency Civil Liberties Committee, cited by HUAC as Communist front, and edited "Bill of Rights Journal" of December, 1965, which curiously featured articles and advertisements by or about many other Louis M. Rabinowitz Foundation recipients.

Richard J. Barnet, Washington, D. C., $1,500: With left-wing think tank, Institute for Policy Studies, in Washington. Has written book (with Marcus Raskin) on Cold War alternatives in Europe, several others on disarmament. Active in get-out-of-Vietnam work, and a sponsor last year of New University Conference in Chicago, which called for "radical university reform."

Donald L. Barnett, Iowa City, Iowa, $2,500: A Marxist professor, refused to provide university with students' grades in effort to help them escape draft; close to SDS. Author of book, *Mau Mau From Within*, published by Monthly Review Press. Has written for *Monthly Review* and *National Guardian.*

Cedric Belfrage, Cuernavaca, México, $3,000: Former editor of *National Guardian;* named as CP member (Party name George Oakden) and deported to his native England. Now living in México, he contributes occasionally to *Guardian.*

Norman Birnbaum, N.Y., $1,625: Involved in anti-Vietnam War activity; participant in New University Conference; a prime mover in SDS Radical Education Project. Also received $1,625 from Foundation in 1966.

Bernard Conal, La Jolla, Calif., $3,000: Former official of Progressive Citizens of America, cited as CP front by California legislative committee, Conal was Stakhanovite in Henry Wallace's Progressive Party in 1948. (Conal's son, Robbie, was W.E.B. DuBois Club activist in San Francisco in 1964-5, where he was roommate of Steven Kahn, son of Albert E. Kahn, another Foundation recipient.)

Clergy and Laymen Concerned About Vietnam, N.Y., $1,500: A left-wing pressure group established to alter U.S. foreign policy in Southeast Asia; not a tax-exempt organization. "We act to influence public and legislative opinion - from our pulpits, in the courts, at draft boards, in the streets."

Frank Donner, N.Y., $500: A N.Y. attorney; identified as a CP member by witnesses before Congressional committees; invoked 5th Amendment in declining to answer questions. Author of book, *The Un-Americans*, a thoroughgoing leftist smear of

HUAC (Donner thanks Victor Rabinowitz, among others, for being "most helpful in furnishing information and suggesting leads").

Horace B. Davis, Jamaica Plain, Mass., $1,900: Has been identified in testimony as a CP member. In his 1967 book, *Nationalism and Socialism: Marxist and Labor Theories of Nationalism to 1917* (Monthly Review Press, naturally) Davis thanks the L. M. Rabinowitz Foundation for making it possible for him to visit Holland in 1965 to do basic research. The Foundation tax statements do not record any grant to Davis until 1967. Davis has taught economics at major universities and at two schools cited by Congress as Communist enterprises.

Harvey Goldberg, Madison, Wis., $5,000: Professor Goldberg earned his radical reputation at Ohio State, has been a member of the National Council of the Emergency Civil Liberties Committee (like many other Foundation favorites), has been involved in various anti-Vietnam War groups. His *American Radicals, Some Problems and Personalities* was published by Monthly Review Press in 1957.

Marvin Gettleman, N.Y., $1,800: Active in Vietnam protests; was contributor to *Studies on the Left* in 1962, *Science and Society* in 1965. Persons attending the First Socialist Scholars Conference in 1965 were instructed to make their checks payable to Marvin Gettleman.

Hashomer Hatzair, Inc., N.Y., $500: A very minor, but also the most leftist, of the Zionist groups. Once received $5,000 grant, but in recent years only $500 annually.

Len Holt, Washington, D. C., $2,000: Negro attorney and author of book on 1964 Mississippi voter registration drive launched with support of National Lawyers Guild, cited by HUAC as a Communist front. Board member of Southern Conference Educational Fund (also cited as CP front by HUAC); has written book reviews for *Guardian*, and was sponsor of 1966 Herbert Aptheker testimonial dinner.

Donald Jelinek, Selma, Ala., $5,000: Attorney now in San Francisco area with Office of Economic Opportunity, a protege of SF attorney Aubrey Grossman, who leads legal panel assisting draft resisters (Grossman has been a paid functionary of CP).

Clinton Jencks, Denver, Colo., $5,750: Was official of Communist-dominated Mine, Mill & Smelter Workers Union, and was convicted of falsely denying CP membership in Taft-Hartley affidavit; Supreme Court overturned conviction (the Jencks Decision) on grounds his attorneys could not see FBI reports. Now teaching economics at San Diego, Calif., university.

Gaylord Leroy, Philadelphia, Pa., $2,000: Of Temple University, Philadelphia; one of main speakers at Second Socialist Scholars Conference.

Walter Lowenfels, New Jersey, $1,500: Has been open CP member; convicted of Smith Act violation in Philadelphia. Regular literary contributor to CP newspaper, *Daily World*, and its predecessors. Book of poetry published by International Publishers, with acknowledgement of Rabinowitz Foundation help.

Julian Mayfield, N.Y., $3,000: Was Fair Play for Cuba Committee activist; sponsored the Monroe Defense Committee to help Robert F. Williams, a fugitive now living in Red China.

Jack Minnis, New Orleans, La., $1,500: A young white radical who was SNCC research director after most whites were persona non grata.

New York Shakespeare Festival, $200: Foundation regularly supports this arts festival, which is directed by Joseph Papp who has been identified as a CP member (also 5th Amendment before HUAC). In 1964 the festival received $2,500, has received only $200 annually in subsequent years.

Norman Rudich, Middletown, Conn., $2,520: Wesleyan professor, associated with Emergency Civil Liberties Committee, was sponsor of Herbert Aptheker testimonial dinner; active in anti-Vietnam War activity; speaker at Second Socialist Scholars Conference. Also received $2,200 in 1966.

Morris Schappes, N.Y., $1,000: Editor of CP-line magazine, *Jewish Currents*, identified as CP member by several witnesses, invoked 5th Amendment privilege.

Jack O'Dell, N.Y., $1,250: Jack O'Dell is J. H. O'Dell is Hunter Pitts O'Dell, former CP organizer in South. When New Orleans police raided his home they found it crammed with CP literature. Was closely associated with late Dr. Martin Luther King, who ritually fired him when questions were raised, would then re-hire him. Now lives NYC, writes for CP-line magazine, *Freedomways*. O'Dell also received $1,250 in 1966.

Daniel B. Schirmer, Cambridge, Mass., $2,000: Daniel Boone Schirmer, a descendant of the famous frontiersman, was a leading figure of the Communist Party in New England.

Mario Savio, Berkeley, Calif., $1,500. Born Robert Savio, alias Jose Marti. Leader of the Free Speech Movement at UC, Berkeley in 1964. Anyone who hasn't heard of Mario Savio is less than five years old.

Southern Students Organizing Committee, Kenbridge, Va., $1,000: Organized to radicalize students in South, SSOC operates in close liaison with Southern Conference Educational Fund, the cited Communist front run by Anne and Carl Braden, both identified as CP members. SSOC tried to be recognized as the SDS in the South, but was attacked by SDS hard-liners as not being revolutionary enough.

Thorne Sherwood, Jr., Hartford, Conn., $1,000: Candidate for PhD at Stanford; grant was for book on priest killed in 1966 when Colombian military ambushed a guerrilla band.

Michael Tanzer, N.Y., $7,200: An economic consultant (PhD, Harvard), who has written for the left-wing *Nation*, attended the Socialist Scholars Conferences. Received $1,800 in 1966 (for total of $9,000) to finish book, *The Political Economy of International Oil and the Underdeveloped Countries* (Beacon).

George Wiley, Washington, D. C., $1,000: Is the national executive of the National Welfare Rights Organization, which agitates for larger grants, fewer restrictions on welfare recipients, and similar raids on the Treasury.

Other grants went to the Brooklyn Heights Youth Center, Brooklyn; Lillian Boehm Foundation, N. Y.; Judith Coburn, Washington, D. C.; Columbia Survey of Human Rights Law, N. Y.; Foreign Policy Roundtable, Inc., St. Louis, Mo.; Jill Hamburg, Hoboken, N. J.; Ivan Kovacs, Bronx, N. Y.; Jon Katz, N. Y.; Debbie Louis, Venice, Calif.; Law Students Civil Rights Research Council, N. Y.; Floyd McKissick, N. Y.; Samuel Rohdie, Oxford, England; Leon G. Summit, N. Y.; Socialist Scholars Conference, N.Y.; United Jewish Appeal; Regents of UCLA, Los Angeles, Calif.; University of Wisconsin, Madison, Wis.

NAME Institute For American Democracy, Inc.
ADDRESS 30 Broad Street
New York, New York 10004

52-0822376
Taxable Year Ended 12-31-68

Instruction I

OFFICERS

President	Dr. Franklin H Littell
Vice President	Samuel Dalsimer
Treasurer	Dr. Edwin Davis
Secretary	Jacob Clayman

Directors

Morris Abram
Dr. Burton Marvin
John Cronin SS
Dr. Edwin Davis
Samuel Dalsimer
Dr Franklin H Littell
Richard Lederer
Howard Samuel
Jacob Clayman

Executive Director

	Time Devoted	Compensation
Charles Baker	100%	22510.00

No officer or director received any compensation during the taxable year.

Attachment to Pages 2, 4, 6
Schedule #4

Mr. BLACKBURN. One of the things I would like to call to the attention of the members of the committee is the fact that in looking over the list of the recipients of National Student Associations funds, we found listed numbers of organizations which have no identities. No one can find—the Library of Congress has done extensive research and they can't find—who these organizations are that have been receiving $25,000, $30,000, $40,000 a year from the National Student Association. And you understand for the last 2 years they haven't even bothered to file a tax return which is a matter that I think should direct itself not only to this committee, but to the Internal Revenue Service.

Now, the reason I make such a point of this is the fact that the whole reporting procedure for tax exempt organizations is, not to say, deficient but wholly inadequate. They can list the name of an organization, and we don't know who the principals are. Some of them may well be principals in the donor organization. The purpose for which the money has been granted doesn't appear on the tax return of the organization. So we know from looking at the returns that money is given to a group that may bear any name, XYZ Charities, whatever you want to call it. But we don't know what the purpose of the grant is and we don't know who actually handles the money or what it actually goes for. So if there is one grave area in which the Congress must give further attention it is in the area of requiring more complete reporting from recipient as well as donor organizations to show who handles the money by name, and the purpose for which the money was granted. Then if it is found, as a matter of fact, that the recipient organization and the managing individual have used the money for other purposes, in my opinion, there should be criminal sanctions.

Some feel perhaps that loss of tax privileges or perhaps civil penalties would be enough against the organization. But I frankly feel that some criminal sanctions would be required because if a person takes money and abuses it, he should be held accountable under the criminal laws.

Senator FANNIN. Congressman, so far as money I am certainly in agreement with you. But also isn't it true that many of these organizations use vast manpower, staffs that work on these programs and they are just as much in violation as if they contributed money.

Mr. BLACKBURN. Well, I can give you a current example. In Atlanta, Ga., we just had an election for mayor and for school board. The National Education Association, which again is a tax exempt organization employing special tax privileges, organized for the purpose of promoting education among the teaching profession and promoting the teaching profession which are worthy objectives. I have attached a copy of the return of that organization, and it doesn't bother to even list the funds that it has received or spent or who they went to or anything else. It is practically a blank piece of paper. But in a news story appearing in The Atlanta Constitution within the past week, a report filed or issued by the National Education Association was highly critical of some of the individuals who are incumbents on the Atlanta school board. Well, obviously, this report is going to have political repercussions in the sense that here is a report which supposedly has been issued by a nonpartisan, nonpolitically oriented organization which is highly critical of some individuals who are running for office.

Without question the staff people who were working for the National Education Association were being paid with tax exempt dollars; they were being paid for supposedly educational purposes. But a staff member admitted, as quoted in the paper, that the report was issued with political implications. In other words, they were telling the people of Atlanta, "don't re-elect certain members of the school board because they are not doing the proper thing in our opinion."

In my opinion this is clearly political activity, and one of the—and I recall the testimony of the gentleman preceding me from Illinois in which he stated in his opinion the use of tax exempt dollars for political purposes is very small by these organizations, I would have to differ with him very greatly. In fact, I would have to differ with him on two scores. First of all, nobody really knows to what extent staff personnel are used for political purposes and, secondly, the biggest functioning political organizations in this country are the labor unions, and if I recall from—and they make no bones about this, they don't attempt to cover this up. It is just that the Internal Revenue Service completely ignores their political activity.

Senator FANNIN. And the Congress.

Mr. BLACKBURN. And the Congress has been ignoring it. But I don't think the Congress should be ignoring it.

Senator FANNIN. I agree with you, and I have introduced a bill in that regard.

Mr. BLACKBURN. Senator, I have read your bill, and if you will forgive me for being presumptuous, I don't think your bill goes far enough.

Senator FANNIN. You stated that in the first part of your testimony and I will agree with you.

Mr. BLACKBURN. I would like at this point to read into the record the provisions which I would suggest relative to prohibitions against partisan political activity by a tax exempt organization. And here again I want to be sure that everyone understands that when I use the term "tax exempt organizations" I mean all tax exempt organizations, whether they be foundations, religious organizations, or labor unions. I would prohibit the promotion of political candidates. I would define, any organization described in section 501(c), which, (1) endorses—you understand that labor unions have no reluctance to endorse political candidates, in fact they have no reluctance to endorse candidates for the Supreme Court or oppose them—or opposes, directly or indirectly, political candidates or (2) expends directly or indirectly—and this would attack use of staff personnel—any of its funds to promote the candidacy of any political candidate or (3) provide goods, services or anything of value to any political party or political organization, shall not be exempt from tax under section 501 for the taxable year in which it so endorses or so expends funds and for the 3 suceeding taxable years; provided further, that activities prohibited by this section shall not be exempted from these prohibitions by being termed "education." Of course, that is the guise under which many political activities are carried out.

Senator FANNIN. This would also include registration, where, of course, we realize they just go into districts they desire and it is not a blanket registration, it is a specialized registration. That would also be included under your recommendation?

Mr. BLACKBURN. I would strongly recommend that the language be clear that that would be prevented because we do know that the registration drives are channeled in certain areas of the cities.

Senator FANNIN. Thank you.

The CHAIRMAN. Thank you very much, sir.

Senator GORE. Could I ask one question?

Congressman, could I ask you to exercise your imagination a bit?

Mr. BLACKBURN. I do it rarely.

[Laughter.]

Senator GORE. Well, change parties and you will be encouraged to do so more.

Mr. BLACKBURN. We are finding out it requires it when we are in control.

Senator GORE. I really want to ask you a serious question. Could you imagine the possibility that a family who was associated with and in indirect ways had control of, distribution of, a fund from a multimillion dollar foundation might very well succeed in identifying themselves with good and worthy causes in one important State after another, one rich State after another, might very well succeed to public favor in almost direct proportion to the distribution of the funds from a multimillion dollar foundation.

Mr. BLACKBURN. Senator, I can well recognize that possibility. I suspect the possibility might exist.

Senator GORE. It is possible for a common man, whether a Republican or Democrat, to recognize this, isn't it?

Mr. BLACKBURN. It certainly is and no matter what the partisan flavor of the individual or family concerned, I don't think it is a proper use of tax exempt dollars. In fact, Representative Rooney—I don't know if he has appeared before your committee or not, but he appeared before the Ways and Means Committee—pointed out how Mr. Richmond, whose family controlled the Richmond Foundation, ran against him in the Democratic primary and it turns out that the staff of the Richmond Foundation was also the campaign staff of Mr. Richmond. The Foundation would make it a point to go into certain areas of the city and perhaps purchase a building and donate it to the residents of the area for charitable purposes, and of course, Mr. Richmond, the political candidate, would be very prominent there in handing over the keys to the building, and otherwise participating in the ceremonies. I think that no matter whether you are a Democrat or Republican, you will concede Mr. Rooney was facing unfair competition in the funds that the foundation controlled.

Senator GORE. It might even be possible for scions of such a family to move to sparsely settled states and become political figures.

Mr. BLACKBURN. I have heard it speculated.

Senator BENNETT. Sparsely settled like New York. [Laughter.]

Senator GORE. Or Arkansas or West Virginia.

Mr. BLACKBURN. It is entirely possible, Senator.

Senator TALMADGE. Congressman, will you file for the record as part of your testimony the specific instances of any further specific charges of political activity on the part of these exempt organizations?

Mr. BLACKBURN. I will, and I want to thank you, Senator. Your questions were well put, Senator Gore.

The CHAIRMAN. Congressman, while you are here I might mention a story which I have heard concerning foundation abuses. Here were two men who set up foundations and part of their charitable purpose was to give young people a chance to get a college education. Let's say one is Mr. Black and the other is Mr. White. Mr. Black sends Mr. White's son to college and Mr. White sends Mr. Black's son to college. Neither one pays a penny out of his own pocket.

Senator GORE. Mr. Chairman, how dare you criticize such a charitable purpose. [Laughter.]

Senator GORE. Educating your neighbor's son.

Mr. BLACKBURN. I think this goes——

The CHAIRMAN. On a reciprocal basis.

Mr. BLACKBURN. I think this goes to the point that I was making earlier, gentlemen, and that is that the reporting procedures for these tax exempt organizations are wholly deficient. We have got to have them report the names of the recipients, not only organizations but the individuals who receive funds. If this were done, this sort of thing would turn up very quickly in a study.

The CHAIRMAN. Thank you so much.

Mr. BLACKBURN. Thank you.

(Hon. Ben Blackburn's prepared statement and attachments follow:)

STATEMENT OF HON. BEN BLACKBURN, A U.S. REPRESENTATIVE FROM THE STATE OF GEORGIA

Mr. Chairman: I appreciate your affording me the opportunity to appear before your Committee. We are all aware of the need for tax reform and the elimination of the abuses now occurring under the present Internal Revenue Code.

I would like to discuss the tax abuses of organizations enjoying special tax-exempt status under existing provision of law. Many of these organizations engage in political activities which by reason of tax privileges are being subsidized by the Federal Treasury. My purpose in being here today is to call the Congress' attention to some examples of political activities which I personally, and many others, consider to be improper activities by groups enjoying special tax privileges and to suggest possible ways of preventing future abuses.

Tax-exempt organizations are classified under Section 501(c) of the Internal Revenue Code of 1954. Under this section, 17 types of organizations are excluded from taxation. I would like to discuss those found under Section 501(c)(3) and Section 501(c)(5).

The organizations operating under the provisions of Section 501(c)(3) of the Internal Revenue Code exist for purposes of charity, scientific research, religious functions, public safety, promotion of literary or educational endeavors or the prevention of cruelty to children or animals. The Internal Revenue Code further provides that no substantial part of the activity of any such organization (generally referred to as a "foundation") is to carry on propaganda or otherwise attempt to influence legislation. The Internal Revenue Code further prohibits participation in political campaigns.

In my opinion some organizations have flagrantly violated this section of the Code. The violations have been tolerated due to ambiguity in construing the phrase, "substantial part." It has been commonly held by I.R.S. and other authorities in this field that 10% or more of the funds of any organization would be considered a "substantial part." 10% of the Ford Foundation's assets as of 1968 would be approximately $3,060,436, whereas 10% of some small church group could amount to less than $500.

Tax-exemption is a privilege! There are many different spokesmen for groups presenting their views on legislation before both Houses of Congress. Most of these spokesmen do not enjoy tax-exempt status. The government should not subsidize one group's political activities by allowing any tax-exempt organization to engage in lobbying activity.

As an example of this misuse of privilege, I would like to direct the attention of the Committee to a group which was recently formed to actively lobby against the ABM proposal. The Coalition on National Priorities and Military Policy. This organization is supported primarily by contributions from religious organizations. Its headquarters is in space granted to it in the Methodist Building at 100 Maryland Avenue, N.E. This group has lobbied against the proposed ABM system. A few days ago a representative from this group came to my office and presented my staff with further information concerning its opposition to the 1968 Military Authorization Bill. Attached as Exhibit A is a copy of the material which I received, along with a list of the organizations. The business of the nation's defense can in no logical way be related to religious undertakings.

I would also like to invite to your attention the National Students Association (NSA). I have closely reviewed the tax returns of this group. The group is clearly and heavily engaging in political activity. In fact, political activity has become such a large part of the group's activity that a subsidiary organization, the National Students Institute has been formed to conduct the non-political activities the NSA was previously performing. It appears that the National Students Institute, which is now a tax-exempt organization, will serve the function of raising funds through soliciting tax-deductible contributions and then contributing these funds to the National Students Association. The national convention of the National Students Association has advocated the abolishment of the House Un-American Activities Committee (now the House Committee on Internal Security), the repeal of the McCarren Act, passage of Civil Rights legislation, the admission of Red China to the United Nations and various "Vietnam Summer Activities." Attached as Exhibit B is documentation of these activities. Furthermore, I was distressed to learn that the new National Students Institute, as incorporated under laws of the District of Columbia, has a Board of Directors identical to that of the now tax-paying NSA. Its bylaws are very similar and it utilizes the same facilities as the NSA. The NSA has not filed tax returns for the past two years, and no explanation is forthcoming from the IRS.

The 1965 and 1966 returns of this organization list its specific grants and their purposes. Present reporting laws are wholly inadequate for any person to know whether or not the National Students Association is engaged in legal activities under its tax-exempt classification. The NSA granted in 1966 to the Southern Student Union Relations $36,317.18, the Fast for Freedom Fund $20,365.39, the Student Stress $890.52, and Southern Literacy Project $363.75. These are just a few of the specific grants listed by this organization which dispensed a total of $551,397 in 1966. The Library of Congress has advised me that it is impossible to discover the purposes or functions of the recipient organizations. A close examination of the tax returns does not provide sufficient information. For the Committee's information, attached as Exhibit C are copies of the NSA's tax return for 1965 and 1966.

Briefly, one more group I would like to bring to your attention is the National Education Association (NEA). This group, which is organized for the promotion of education has endorsed numerous political positions including Home Rule for the District of Columbia and fair housing legislation. I do not feel that this activity is related to the promotion of education.

I know that the members of this Committee have followed the revelations of various activities of tax-exempt foundations. In the hearings on Tax Reform before the House Ways and Means Committee, Representative John Rooney of New York presented a clear picture of the misuse of tax-exempt funds. In Representative Rooney's race in the Democratic primary, he was opposed by one Frederick Richmond. Mr. Richmond is head of the Richmond Foundation. During the election, Mr. Richmond's foundation gave numerous grants to different ethnic groups within the Congressional District. The campaign staff of Mr. Richmond was also the staff of the Foundation. In Mr. Rooney's statement he revealed that some of the expenses of the campaign were paid out of the Foundation funds under the title of such things as printing expenses and stationary accounts. Finally, Mr. Richmond encouraged his contributors to give directly to the Foundation, thus making their contributions deductible on their income tax returns. I would advise members of the Committee to read Mr. Rooney's testimony since it gives one of the best examples of political activities by tax-exempt groups.

In July of 1967, the Ford Foundation made a grant of $175,000 to the CORE Special Purpose Fund of New York to be used for: (1) a youth training in-

stitute; (2) an adult training institute; and (3) a voter regisration drive. This grant was supplemented in 1968 with another $300,000. These funds were actually used in voter registration drives in Cleveland, Ohio. Many political analysts believe that because of the registration activity by CORE through the financing of the Ford Foundation, Carl B. Stokes was elected Mayor of Cleveland, Ohio in 1967. By such activity the Ford Foundation through its economic power, augmented by special tax privileges, is having a decisive political power which is resulting in the election of political candidates. No more effective political influence can be found!

I have stated many times that in the political arena all combatants should operate under the same set of rules. I know that every member of the Committee would object strongly to having a tax-exempt group pour funds into his opponent's campaign. Under the Tax Reform Act recently passed by the House, foundations are precluded from engaging in voter registration drives except when the foundation supports voter registration drives in five states. Thus, the Ford Foundation, for example, can avoid the effect of the legislation by supporting five different voter registration drives in five different states.

No discussion of political activities by tax-exempt groups would be complete without some attention to labor organizations as classified under Section 501 (c)(5). From mutual experience in politics, I think we would all agree that money is the mother's milk of a political campaign. To the degree that one candidate receives direct or indirect financial or material support for his campaign from a source that enjoys financial subsidy through a special tax privilege, to that degree the equality of rules between two political candidates is greatly upset. Labor unions do not deny the use of union dues for political activities. When a member of a union pays his dues, he is paying for political action. The organization insists that their political activities are carried on by a separate organization known as the Committee on Political Education (COPE). However, as it was reported during the last election, the full staff of the national office of the AFL-CIO was brought to work for COPE and on the local level union officials were employing their union staff to engage in campaigning for favored candidates. Numerous cases have come before the Federal Judiciary in which union members have objected to political use of dues for political activity. For the information of the Committee the cases are as follows: *United States* v. *Anchorage Federal Labor Council* 193 F. Supp. 504 (1961); *United States* v. *Planters Local #481 et al* 172 F. sd 854 (1949); *United States* v. *International Union United Automobile, Aircraft and Agricultural Implement Workers of America* 352 U.S. 567 (1957); and *United States* v. *CIO* 335 U.S. 106 (1947).

There is a contention that political funds are contributed voluntarily. To work on an American flag ship, a seaman must be a member of the International Seafarers Union. Members of this union have been compelled at times to "contribute" (or as the union leaders would say, have voluntarily given) ⅛ of their income to political activities. I think it is insulting the intelligence of Congress to argue that these funds are granted voluntarily. Not even politicians devote ⅛ of their income to political campaigns.

The Internal Revenue Code provides that all 17 types of organizations classified under Section 501(c) cannot engage in support or opposition to any political candidate. However, for some strange reason, the IRS has consistently ignored the mandate of the law. Attached as Exhibit E are copies of letters sent by the Internal Revenue Service to one Mr. Reed E. Larson and one Mr. F. R. Dickerson attempting to explain why only labor unions are exempt.

The Federal Corrupt Practices Act provides that neither corporations, or trade organizations, or labor unions are allowed to contribute funds to the support or opposition of any political candidate or party. It seems that the IRS is not aware of the Corrupt Practices Act which is enforced by the Justice Department. In Baltimore, a Grand Jury hearing is now being conducted concerning campaign contributions by the Seafarers International Union to various candidates for Senatorial seats. I think it would be appropriate for the Congress to demand that the IRS investigate the tax-exempt status of the Seafarers Union.

During the course of my testimony today, I have cited several problems which exist under the present IRS Code. When the members of the Committee examine the tax returns of tax-exempt organizations, you will see that it is virtually impossible to determine how these funds are being used. I propose that the Com-

mittee require a full explanation of the purpose of each grant, contribution or gift made by a tax-exempt organization along with the identities of the chief officers and executive directors of recipient organizations. The law should provide criminal sanctions should such officers or executive directors use funds for purposes other than those permitted by law. Only by requiring full disclosure from tax-exempt organizations can we possibly curb the misuse of funds.

Earlier this year, when I appeared before the House Ways and Means Committee on this matter, I outlined for them the legislation which I was introducing. My ideas are contained in H.R. 7432. Essentially this bill is divided into two sections. The first section pertains to organizations classified under Section 501(c)(3). I will not take credit for the ideas found in this section since they were originally proposed by the Subcommittee on Tax-Exempt Organizations of the American Bar Association. The Subcommittee recommended that all organizations classified under this section shall have the right to defend themselves whenever their tax-exempt status is threatened. Furthermore, they should be permitted to appear before Congressional Committees and submit reports to them concerning matters of direct interest to the organization. By direct interest I specifically mean the purpose for which the organization was granted exemption.

The second purpose of my bill is to prevent any tax-exempt organization from directly or indirectly contributing any material support for the promotion or opposition to any candidate or any political party. I would sincerely urge the Committee to give consideration to my proposal. My bill, H.R. 7432 is attached as Exhibit F. I would request that the Committee review the House language with regard to voter registration drives conducted by tax-exempt foundations. In my opinion the present language is inadequate.

Finally, if meaningful control over the use of special tax-exempt funds is to be achieved, more complete reporting laws are essential. Criminal sanctions are a necessary adjunct to such control where abuse of funds for non-permissible purposes is discovered.

Mr. Chairman, I believe that you and the members of your Committee are anxious to provide the American people with needed tax reform. I appreciate your affording me the time to make this brief contribution.

COALITION ON NATIONAL PRIORITIES AND MILITARY POLICY, 100 MARYLAND AVENUE NE., WASHINGTON, D.C.

Phone: (202) 543-1151

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AFFILIATED ORGANIZATIONS

American Baptist Convention.
American Friends Service Committee.
Americans for Democratic Action.
Anti-Pollution League.
Christian Church (Disciples of Christ), Department of Church in Society.
Committee for Community Affairs.
Council for Humanist and Ethical Concerns.
Church of the Brethren.
Executive Council of the Episcopal Church.
Federation of American Scientists.
Friends Committee on National Legislation.
International Union, United Automobile, Aerospace & Agricultural Implement Workers of America, UAW.

Mennonite Central Committee.
National Council of Churches, Department of International Affairs.
National Federation of Temple Sisterhoods.
SANE.
Southern Christian Leadership Conference.
Teachers Committee for Peace in Vietnam.
Union of American Hebrew Congregations.
Unitarian Universalist Association, Department of Social Responsibility.
United Church of Christ, Council for Christian Social Action.
United Methodist Church, Board of Christian Social Concerns.
United Presbyterian Church, U.S.A., Office of Church and Society.
United States Catholic Conference, Division of World Justice and Peace.
William Penn House.
Women's International League for Peace and Freedom.
Women Strike for Peace.
World Federalist Youth, U.S.A.

The Coalition is a coordinating body for national religious, peace, liberal and scientific organizations which seek to reverse the militarizaton of Amerca's policies and resources. It serves the representatives of its affiliated organizations as a channel for communication and cooperative action to oppose deployment of new weapons systems, to support arms control and disarmament agreements and to redirect resources into programs to meet human needs at home and abroad.

The Coalition does not present policy positions for its affiliated organizations unless specifically agreed upon, since its function is not the making of policy but the coordination of action.

The Coalition is financed by contributions.

EXHIBIT A

COALITION ON NATIONAL PRIORITIES AND MILITARY POLICY,
Washington, D.C., September 24, 1969.

DEAR CONGRESSMAN: We understand that the Department of Defense Authorization bill will be reported by the House Armed Services Committee on Thursday and may come to the floor next week.

We appeal to you to participate in that most vital debate. If you are not already convinced of the need for major cuts, we urge you to give serious consideration to the broad cross section of amendments that will be offered. We ask this because we are deeply uneasy over the fact that last year a comparable bill passed the House in one day with only two hours allocated to general debate.

Surely the House would lay itself open to the charge of irresponsibility if a similar timetable were adhered to now when so many questions are being raised about U.S. priorities and the size and direction of the U.S. military establishment—so many questions, in fact, that the Senate spent two months discussing the bill. Couldn't the 435 Members of the House spend at least two weeks discussing these basic issues which affect so many aspects of their constituents' lives?

The American people are discouraged over the conflicts racking our society. Many are turning away from the legislative process. They need reassurance that their representatives in Congress are willing to come to grips with major problems—including the problems of the ever expanding arms race and the U.S. propensity toward unilateral military involvements. Some of our membership look forward to coming to the gallery and hearing you deliberate over the Department of Defense Authorization bill. Please do not disappoint them.

Most sincerely,

JOSEPH S. CLARK, *Chairman.*

[From Coalition, published by the Coalition on National Priorites and Military Policy]

TWO GIANT RALLIES PLANNED

Two rallies—one in New York City, the other in Los Angeles—have been planned for June 25.

The rallies will focus on the ABM and American militarism.

In New York, George Wald, Nobel Prize winner, and Jerome Wiesner, the science advisor to President Kennedy, will speak at Madison Square Garden. Members of Congress and several top entertainers will also be on hand.

Plans for the Los Angeles event are still underway, and details will be announced later.

The New York City rally will begin at 7:30 p.m. Tickets—priced from $1 to $10—are available at the boxoffice or from Hannah Weinstein, 101 W. 57th Street, New York, New York.

AN ERROR OF OMISSION

Because of an oversight, *the names of three organizations affiliated with the Coalition on National Priorities and Military Policy were omitted from the listing in the first edition of this newsletter last week.*

They are: The Federation of American Scientists, the Mennonite Central Committee and the *Department of International Affairs of the National Council of Churches.*

They're not listed this week either because the cover sheets were printed in advance in sufficient quantity for three weeks. But the omitted groups will be in week after next. In the meantime, our apologies.

GOP SENATOR SUSPECTS ABM PRESSURE

Although he's not charging cause and effect, Republican Senator James B. Pearson of Kansas told the New York Times last week that after he broke with the Administration on the ABM issue, the following things happened:

*An Army general told a plane manufacturer in Kansas that if the ABM were defeated, the Pentagon might not be able to go through with an airplane contract.

*The Agriculture Department decided that it would not publicly endorse a rural job development bill sponsored by Pearson, despite the Department's private expressions of support for the bill.

*The White House decided in Pearson's favor in a dispute involving the moving of some federal offices—but failed to give the Senator advance notice of the decision.

Pearson is one of some 15 Republican Senators who are opposed to the ABM.

ABM HARD SELL TO LABOR FLOPS

A Nixon Administration hard sell has failed to convince the 29-member AFL-CIO Executive Council to support the ABM.

The Washington Post reported that AFL-CIO President George Meany was "skeptical, to put it mildly" to please by Defense Secretary Melvin R. Laird and Secretary of State William P. Rogers to back the ABM.

Rogers and Laird met with the Council in early May.

ABM INFORMATION CENTER, UNITED METHODIST CHURCH, DIVISION OF WORLD PEACE, *Washington, D.C., July 14, 1969.*

DEAR CONGRESSMAN BLACKBURN: Enclosed for your use are several items pertaining to the Safeguard Anti-Ballistic Missile System which we hope will be helpful to you in the ABM debate.

1. Bibliography of selected information pertaining to the ABM which has appeared in the *Congressional Record* over the past several months.

2. Series of remarks by various Senators, prominent scientists, union and church leaders explaining why they oppose deployment.

3. Rebuttal to the Administration Press Packet on the ABM, prepared by an independent group of citizens including Dr. Jeremy J. Stone, a member of the Institute for Strategic Studies and currently working under a grant for the Social Science Research Council of New York.

If we can be of any assistance to you, please let us know.

Sincerely,

ABM INFORMATION CENTER STAFF.

EXHIBIT B

[From Human Events, Sept. 14, 1968]

ON-THE-SPOT CONVENTION REPORT: IS NSA HEADING TOWARD OBLIVION?

(By Harvey H. Hukari, Jr.)

During the same torrid month that the Republicans and the Democrats held their party conventions in the glare of national publicity, another convention, noteworthy in its own right, took place in the rather remote environs of Manhattan, Kans. There on the tree-lined campus of Kansas State University, the National Student Association (NSA), a loose amalgamation of some 360 colleges and universities, brought nearly 1,000 student delegates together for 10 days to plan programs, share ideas, and express their dissatisfaction with the state of the nation.

Over the past few years NSA conventions have been marked by vast quantities of leftist rhetoric and little meaningful action towards dealing with student problems. Customarily, this year's gathering was treated to an array of attacks by speakers on the evils of racism, the Selective Service System and the Establishment as well as the penultimate spectacle of an anti-war dissident burning his draft card. But after all the heated resolutions were proposed and the impassioned pleas were made by a galaxy of left-wing spokesmen, the summary tone of the convention differed only slightly from NSA's established tradition of oral radicalism and physical lethargy.

Founded in the summer of 1947 at the University of Wisconsin, NSA has sought for 21 years—with an embarrassing lack of success—to act as the legitimate representative for the needs and opinions of the American student. It has been handicapped in that role by the fact that its member schools account for only 15 percent of the more than 2,000 universities and colleges across the country. In fact, it is not individual students who are members of NSA but student body governments, which are all too frequently about as representative of student views as Walter Ulbricht is representative of the hopes and aspirations of the East German people.

The dramatic revelation by *Ramparts* magazine in February 1967 that NSA was being financed by the Central Intelligence Agency severely damaged the image of the organization and shocked even its most staunch supporters. Whereas condemnation of NSA had formerly been the exclusive prerogative of such conservative groups as Young Americans for Freedom, the disclosure of financial ties with the CIA brought almost universal outcry from the academic community.

CIA SCANDAL EFFECTS

A number of schools, including the University of Southern California, the University of Michigan, and the University of Houston withdrew their membership in the wake of the furor which erupted. At its 1967 congress, held at the University of Maryland, NSA faced the very real prospect of disintegration due to the dissension among delegates over the CIA scandal. Conservative and liberal students alike were outraged and members of the radical Students for a Democratic Society (SDS) broke away from the Maryland meeting and hosted their own rump convention to protest NSA's ties with the CIA.

By comparison with last year's tumultuous convention, this year's Kansas gathering was a rather pallid affair, enlivened only by the antics of a "guerrilla theatre" and various sophomoric protests against the draft. SDS, along with a number of other radical students groups, was conspicuously absent from the convention and even Young Americans for Freedom, which operates a Stop NSA Committee out of its Texas headquarters, declined to send any representatives. The radicals, nevertheless, made their presence felt at Kansas State, but their ranks were seriously depleted by the lure of demonstrations at the Democratic convention in Chicago.

While student power was the announced theme of the conclave, it became readily apparent that white racism, drugs and the draft were the issues uppermost in the minds of the majority of delegates.

The convention was immediately snarled by the charge that the all-white delegation from the University of Alabama was racist in composition. In

rebuttal, the Alabamians argued that it was inevitable that the school was not represented by Negroes since the black students had declined to participate in the selection of NSA delegates during the spring semester. Following a confusing round of parliamentary haggling, the convention responded to pressure from the black caucus and voted to replace one white delegate from Alabama with a Negro.

RADICAL SPEAKERS

The lengthy debate over the status of the Alabama delegation delayed consideration of other important business and created dissatisfaction among those who felt that Alabama was being treated unjustly. Many of the students who had been sent by their schools as observers to the convention for the purpose of deciding whether or not to join NSA were disillusioned by the abuse heaped upon Alabama and vowed to return to their campuses and campaign against affiliation.

Many delegates were also disturbed by the predominantly radical orientation of many of the programs and speeches. One of the featured speakers was Negro militant and self-proclaimed presidential candidate Dick Gregory. Addressing an overflow audience, Gregory labeled Chicago Mayor Richard Daley a "slick, slimy, racist hoodlum" and later received a standing ovation when he declared that people have a duty to destroy and abolish the present government. "We don't need white liberals anymore," said Gregory. "We need white radicals."

Typical of the "balanced" presentation of views which NSA afforded delegates was a panel entitled "Theories, Strategies, and Directions for Change." Participants in the discussion were Rev. Joseph Duffy, the Connecticut chairman of the McCarthy for President committee, Tom Hayden, founder of SDS and presently co-director of the National Coalition to End the War in Vietnam, and Robert Scheer, an editor of *Ramparts* and a well-known California radical.

The "dialogue" consisted of Rev. Duffy urging young people to stay in the political system and Hayden and Scheer calling for increased militancy on the part of students. Hayden, who was later arrested during the demonstration in Chicago, predicted that there would be more campus disorders like the one at Columbia and was applauded by the delegates. He went on to proclaim that "No presidential candidate will be safe speaking at any university in this country."

SELECTIVE SERVICE HIT

The Selective Service System was the subject of a panel presentation by Michael Ferber, convicted in Boston along with Dr. Benjamin Spock for counseling young men to avoid the draft, and David Harris, husband of folk singer Joan Baez, who is presently appealing a three-year prison sentence for draft evasion.

While Harris startled some with his comment that "I find no more honorable thing to be in modern America than a criminal," the high point of the panel discussion came when Wayne Hayashi, a 20-year-old pre-law student at the University of Hawaii, read a letter he had written to his draft board condemning the Selective Service System and then burned his draft card amid cheers from more than 500 delegates.

As if it were not enough for the speeches and panel presentations at the convention to be mostly radical in their orientation, the entertainment provided the delegates also had a distinctly left-wing flavor to it. Among the films that were shown were Felix Greene's "Inside Viet Nam," which gives a sympathetic view of North Viet Nam under communism, "The War Game," a British picture that attempts to illustrate the horrors of a nuclear missile attack on England, and "Point of Order," which deals with the Army-McCarthy hearings.

In past conventions, NSA has approved resolutions calling for the abolition of the House Committee on Un-American Activities, admission of Red China to the United Nations and repeal of the Internal Security Act of 1950. This year the delegates were somewhat more reserved in their approach towards legislation, but their bias was still apparent to even the most naive observer.

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While condemning the Soviet Union for its invasion of Czechoslovakia the convention could not resist including the fillip, "This denunciation is done in the same spirit that we denounce the act of aggression of the U.S. government against the people of Viet Nam." The convention also called upon local, state, and federal governments to "stop all punitive and criminal approaches to the use of Cannibus [marijuana], a mind-altering, non-additive drug, [and] re-evaluate their laws on hallucinogenic drugs in light of current research. . . ."

Perhaps the most significant measure passed by the delegates was one providing for the restructuring of NSA into a dual corporation. Under such a set-up, NSA would consist of two separate organizations, one which would continue to provide "student services" and remain tax exempt and the other which would pay corporate taxes and engage in political lobbying.

Maintaining a tax-exempt status is of crucial importance since around 40 percent of NSA's $800,000 budget consists of grants from such philanthropic groups as the Ford Foundation, which recently gave the student organization over $350,000, and the Federal Government, which funnels thousands of dollars to NSA through the Office of Economic Opportunity for various social service projects.

With the impact that the campaign of Sen. Eugene J. McCarthy for the Democratic presidential nomination has had on the college campuses across America, much has been made of the phrase "new politics"; i.e., the politics of candor, grass-roots participation in the democratic process and the involvement of youth in the political system. "New politics" connotes a force in opposition to the bossism and machine politics of the Establishment. Ironically, the anti-climactic election of the new president of NSA was almost the complete antithesis of this concept.

Bob Powell, the former student body president at the University of North Carolina and presently a graduate student at Princeton, was clearly the NSA establishment's choice to succeed Ed Schwartz, as president of the organization, and, like Hubert Humphrey in Chicago, Powell steamrollered over his opposition to win the post. The election of the other national officers was also merely a confirmation of the establishment's choices rather than a truly democratic contest.

NSA'S INEFFECTIVENESS

It was sad for some to watch the student delegates acting in much the same way that their older counterparts did in Miami and Chicago, declining to vote independently, participating in frivolous demonstrations for favorite son nominees and reading newspapers or flying paper airplanes when the convention proceedings became dull. A bit of tasteless levity was provided on the final night of the convention's legislative session when the guerrilla theatre, an amateur troupe of students that had played the role of pranksters throughout the 10-day congress, attempted a mock assassination of the newly elected NSA president as he was delivering his acceptance speech before a solemn gathering of delegates.

Given the nature of NSA it is appropriate to ask just what is it that causes even 15 percent of the nation's colleges to maintain their membership in such an organization. For most of the schools in NSA it is the services such as travel discounts, insurance and educational information which are important. The small colleges which comprise the bulk of the NSA membership often acknowledge that they do not agree with the policies of NSA or its radical complexion, but they do find the financial benefits of the various services to be of sufficient value to justify continuing their affiliation.

Some students are not so certain as others of the importance of NSA on college campuses. They attend NSA conventions and they find the organization to be unrepresentative of national student opinion and often irrelevant to student needs.

Reflecting on his experiences at this year's convention, Dean Henry, student body president at the University of Puget Sound, summed up the feeling of many delegates disturbed by the week's events. "A lot of schools will go back and give serious consideration to disaffiliating." Henry said, "I think that a of the schools should consider dropping out of NSA."

EXHIBIT C

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Form 990-A — RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX — 1965 — Section 501(c)(3) of the Code

For calendar year or other taxable year beginning Oct. 1, 19.., and ending Sept. 30, 1965

PLEASE TYPE OR PRINT

Name: UNITED STATES NATIONAL STUDENT ASSOCIATION — Employer identification No. 23-1421976

Number and street: [illegible] STREET, NW

City or town, State, and Postal ZIP code: WASHINGTON, D.C., 20008

Enter the name and address used on your return for 1964 (if the same as above, write "Same"). If none filed, give reason. Same

PART I Part I (items 1 to 21) information required pursuant to sections 6033, 6001 and other applicable sections of the Internal Revenue Code. NOTE: One copy of Part I and two copies of Part II must be filed.

Item	Amount
1. Gross sales or receipts from business activities	
2. Less: Cost of goods sold and/or of operations (attach schedule)	
3. Gross profit from business activities	
4. Interest	145.27
5. Dividends	
6. Rents	
7. Royalties	
8. Gain (or loss) from sale of assets, excluding inventory items (See Instruction 8)	
9. Other income (attach schedule — Do not include contributions, gifts, grants, etc. (See line 17)) EXH A	143,[illegible]
10. Total gross income (lines 3 to 9, inclusive)	143,[illegible]
11. Expenses of earning gross income from column 3, Schedule A	18,456.07
DISBURSEMENTS MADE WITHIN THE YEAR OUT OF CURRENT OR ACCUMULATED INCOME FOR PURPOSES FOR WHICH EXEMPT, AND ACCUMULATION OF INCOME	
12. Expenses of distributing current or accumulated income from column 4, Schedule A	
13. Contributions, gifts, grants, scholarships, etc. (See Instruction 13)	10,[illegible]
14. Accumulation of income within the year (line 10 less the sum of lines 11, 12, and 13)	31,[illegible]
15. Aggregate accumulation of income at beginning of the year Deficit EXH B (10,861.68)	
16. Aggregate accumulation of income at end of the year Deficit EXH B (36,776.43)	
RECEIPTS NOT REPORTED ELSEWHERE	
17. Contributions, gifts, grants, etc., received (See Instruction 17)	647,632.10
18. Less: Expenses of raising and collecting amount on line 17, from column 5, Schedule A	
19. Net contributions, gifts, grants, etc., received	647
DISBURSEMENTS MADE OUT OF PRINCIPAL FOR PURPOSES FOR WHICH EXEMPT	
20. Expenses of distributing principal from column 6, Schedule A	170,036.92
21. Contributions, gifts, grants, scholarships, etc.: (a) Paid out in prior years (2,787,802.79) EXH D	
(b) Paid out within the year (See Instruction 21)	551,397.53

Schedule A.—Allocation of Expenses (See Instructions for Attachments Required)

1. Item	2. Total	3. Expenses of earning gross income	4. Expenses of distributing income	5. Expenses of raising and collecting principal	6. Expenses of distributing principal
(a) Compensation of officers, etc.	7,693.00				7,693.00
(b) Other salaries and wages	65,287.49				65,287.49
(c) Interest					
(d) Taxes					
(e) Rent					
(f) Depreciation (and depletion)					
(g) Miscellaneous expenses (attach sch.)	115,612.50	18,456.07	EXHIBIT C		97,056.43
(h) Totals	188,492.99	18,456.07	EXHIBIT C		170,036.92

BEST AVAILABLE COPY

EXHIBIT C

Form 990-A–1953 — Schedule D.—BALANCE SHEETS (See instructions) — Page 2

ASSETS	Beginning of Year (A) Amount	Beginning of Year (B) Total	End of Year (C) Amount	End of Year (D) Total
1. Cash	41,303.26	[illegible]	[illegible]	[illegible]
2. Accounts receivable (See instructions) EXH. A		41,303.26		[illegible].21
(a) Less allowance for bad debts				
3. Notes receivable (See instructions)				
(a) Less allowance for bad debts				
4. Inventories				
5. Investments in governmental obligations				
6. Investments in nongovernmental bonds, etc.				
7. Investments in corporate stocks (See instructions)				
8. Mortgage loans (Number of loans ______)				
9. Other investments (attach schedule)	27,382.03		[illegible]	
10. Depreciable (and depletable) assets (attach schedule) F	27,382.03		[illegible]	
(a) Less accumulated depreciation (and depletion)				
11. Land		176,[illegible]		[illegible]
12. Other assets (attach schedule) EXH. E		[illegible].11		115,[illegible]
13. Total assets				
LIABILITIES AND NET WORTH				
14. Accounts payable (See instructions) EXH. A		100,759.47		33,[illegible]
15. Contributions, gifts, grants, etc., payable				
16. (a) Bonds and notes payable (See instructions)		35,000.00		
(b) Mortgages payable		108,026.32		118,236.01
17. Other liabilities (attach schedule) EXH. E				
18. Capital stock: (a) Preferred stock				
(b) Common stock				
19. Membership certificates				
20. Principal or other capital				
21. Reserves (attach schedule)				
22. Accumulated income or earned surplus:	(10,861.68)			
(a) Attributable to ordinary income		(10,861.68)		(36,766.43)
(b) Attributable to gains from sale of assets EXH. B				
23. Total liabilities and net worth		232,924.11		115,455.50

1. Date of current exemption letter: April 20, 1954
2. Attach a detailed statement of the nature of your charitable, business, and all other activities.
3. Have you attached the information required by:
   (a) Instruction 1? ☒ Yes ☐ No
   (b) Instruction 1? ☒ Yes ☐ No
4. Have you filed a tax return on Form 990-T for this year? ☐ Yes ☒ No
   If "Yes," where filed?
5. In what year was your organization formed? 1947
   In what State or country? Wisconsin
6. If successor to previously existing organization(s), give name(s) and address(es) of the predecessor organization(s)
7. If you have capital stock issued and outstanding, state with respect to each class of stock—
   (a) The number of shares outstanding
   (b) The number of shares held by individuals
   (c) The number of shares held by organizations
   (d) The number of shareholders at end of year
   (e) Whether any dividends may be paid ☐ Yes ☐ No
8. If you acquired capital assets out of income, attach itemized list and amount thereof. Exhibit G
9. Have any changes not previously reported to the Internal Revenue Service been made in your articles of incorporation or bylaws or other instruments of similar import? ☐ Yes ☒ No
   If "Yes," attach a copy of the amendments.
10. Have you had any sources of income or engaged in any activities not previously reported to the Internal Revenue Service? ☐ Yes ☒ No
    If "Yes," attach detailed statement.
11. Did you hold any real property in rental purposes with respect to which there is an [illegible] ☐ Yes ☒ No
    If "Yes," attach detailed statement.
12. Have you during the year [illegible] ☐ Yes ☒ No
    If "Yes," attach a detailed [illegible]
13. Have you during the year participated in, or intervened in (including the publishing or distributing of statements) any political campaign on behalf of or in opposition to any candidate for public office? ☐ Yes ☒ No
    If "Yes," attach a detailed description of such activities and copies of any such statements.
14. After July 1, 1950, did—
    The creator of your organization, or
    A contributor to your organization, or
    A brother or sister [illegible]
    A corporation owned [illegible] 50 percent or more of [illegible]
    (a) Borrow any part of your income or corpus? ☐ Yes ☒ No
    (b) Receive any compensation for personal services from you? ☐ Yes ☒ No
    (c) Have any part of your services or assets made available to him? ☐ Yes ☒ No
    (d) Purchase any securities or other property from you? ☐ Yes ☒ No
    (e) Sell any securities or other property to you? ☐ Yes ☒ No
    (f) Receive any of your income or corpus in any other transaction? ☐ Yes ☒ No
    If answer to any question is "Yes," attach detailed statement unless previously reported. If previously reported, give [illegible]
15. Do you hold 5 percent or more of any class of stock in any corporation? ☐ Yes ☒ No
    If "Yes," you must submit the information required by the instructions for Schedule B.

National Teacher Corps

FACT

The National Teacher Corps was established on May 13, 1966, with an initial appropriation from Congress of $9.5 million. Since that time 1600 persons (300 experienced teachers and 1300 recent graduates) have been selected from over 10,000 applicants and are presently undergoing the pre-service training.

Upon completion of the pre-service training, these Corpsmen will work in poverty and slum area schools while at the same time the teacher-interns will study for advanced degrees in Education or related fields at nearby universities.

"They will extend teaching beyond the classroom, and look for new ways to involve parents in the mysteries of the learning process. They will work with adults education programs, and with local health and welfare agencies, with youth organizations, social clubs, and civic groups." (NTC Brochure.)

At present, needed appropriations for the National Teacher Corps are bogged down in the Senate Appropriations Committee. Without these appropriations no salary funds are available for the Corpsmen except through already over-taxed school budgets in slum areas. The appropriations are necessary to insure that each Corpsman will be able to obtain a job in a slum area school district.

PRINCIPLE

In our world of rapidly advancing technological changes, it is important for all men to have the opportunity to receive adequate education. USNSA supports efforts to assure the maximum amount of education to all individuals. (BPD–XVIII, Equal Educational Opportunities-Free Public Higher Education.)

DECLARATION

USNSA reaffirms its support for the National Teacher Corps as a valuable supplement to the educational process in slum area school districts because it provides experienced and new teachers with opportunities to assist slum area children in new and relevant ways. Furthermore, USNSA feels that the NTC program will suffer if Congress fails to appropriate funds for salaries, since local school districts in slum areas cannot afford to hire additional teachers.

Therefore, USNSA expresses its belief that the Chairman and the members of the Senate Appropriations Committee should approve the appropriations for the National Teacher Corps and submit them to the floor of the Senate with a recommendation for passage.

MANDATE

The Nineteenth National Student Congress mandates the Educational Affairs Vice President to prepare copies of this special resolution and submit them to all interested parties.

Home Rule for the District of Columbia

FACT

Washington, D.C. was granted a Charter in 1802. For almost 75 years, the citizens practiced local self-government as had been anticipated by the drafters of the Constitution. Now, however, the legislative and fiscal responsibility for the District of Columbia rests with Congress. A limited amount of this authority has been delegated by Congress to a three-man Board of Commissioners who are appointed by the President.

Washington, D.C. has a population greater than that of 11 states (Alaska, Delaware, Hawaii, Idaho, Montana, Nevada, New Hampshire, North Dakota, South Dakota, Vermont, and Wyoming). And each of these states has a governor and an elected state legislature to administer local affairs; each is represented in Congress by two Senators and at least one Representative. The District of Columbia, however, enjoys neither representation in Congress nor local self-government.

Among the results of this situation are these:

—A significant number of school buildings in the District are in such a bad state of repair as to be unsafe for use. The Superintendent of schools has stated

that more money is spent for a child in white sections than in Negro areas. Half-day sessions and crowded classrooms are commonplace (the school population is 90% Negro; 10% white).

—Housing in Washington is inadequate. According to a report issued by the National Capital Planning Commission in April, 1966, 25% of the District's residents live in a state of "abject poverty, total deprivation." In the same report, 41% of the housing is called "inadequate"; 104,700 people live in "substandard" housing (lacking such common amenities as bathrooms); some 114,000 people are said to pay "too much rent." Other facts brought out in the report are that there are 27,500 families eligible for public housing for which there is no room; 5,800 families are on public housing waiting lists; there is no minimum wage for male employees except government workers; unemployment in the Negro slums is estimated to be as high as 10%; and underemployment (long hours for sub-poverty-line pay) is indeed much higher.

—Welfare benefits are totally insufficient. Thousands of school-age children have been forced to stay home from school during cold weather because of inadequate clothing.

—Medical facilities for the poor are not adequate. Even in serious cases, waits of 8-12 hours are frequent.

—Some city jails are, in fact, barbaric "human stockyards," in which up to 500 people have been crowded into a single room, 150' x 180', sometimes for months, awaiting trial—with no work or recreation.

The Metropolitan Board of Trade has thrown the weight of its powerful lobby against efforts to secure home rule for the District of Columbia and is, by far, the most effective local obstruction to reform. It opposes urban renewal, higher real estate taxes, and increased welfare payments.

In February, 1966, the "Free D.C. Movement" was organized by the Student Non-Violent Coordinating Committee and the leaders of other civil rights groups. The Movement has demanded that Washingtonians have the right to elect their own local government and has instituted action programs to implement its goal.

At present, the United States Senate District Committee favors self-government for the District; the House District Committee does not favor such a change.

PRINCIPLE

"The role of the student involves a commitment to an educational process that extends beyond classroom training . . . A student operating in this role . . . must be prepared to face the challenges of modern life and he must be willing to confront the crucial issues of public policy that affect him beyond the classroom and that determine the course of his society . . . USNSA recognizes the great value of student involvement in programs of political and social action and the integral connection of these programs with the educational process . . . And in this connection the student should be concerned . . . with those great problems and issues of our national . . . life." (BPD-XIII Student and the Total Community.)

DECLARATION

USNSA affirms its support for the "Free D.C. Movement," and its goal of home rule under the mayor-city council system for the District of Columbia. USNSA commends the leaders of the "Free D.C. Movement" for their efforts in this area. Furthermore, USNSA applauds the efforts of those members of Congress who have been in the vanguard of the home rule movement; particularly, Senators Morse (D-Ore.), Kennedy (D-N.Y.), Tydings (D-Md.), and Representatives Multer (D-N.Y.), and Mathias (R-Md.).

MANDATE

The Nineteenth National Student Congress mandates the Educational Affairs Vice President to give all forms of legitimate assistance to groups seeking to secure home rule for the District of Columbia under the mayor-city council system.

The Nineteenth National Student Congress further mandates the Educational Affairs Vice President to send copies of this resolution to all appropriate parties concerned.

EXHIBIT C

U.S. National Student Association, E.I. No. 23-1421976, year ended Sept. 30, 1966

Page 1, line 21, contributions, gifts, scholarships, etc.:

Item	Amount
Algerian scholarship program	$76,928.35
14th ISRS	436.37
African Freedom Fund	2,976.62
Domestic programs	18,556.45
Latin American representation, 1964-65	108.85
Southern student human relations	4,020.60
SCOPE, Ford Directory	22,426.01
Fund for the Advancement of Education	2,106.04
College community tutorial project	6,772.53
Literacy project	930.00
Student stress	6,680.10
Angolian scholarship program	11,990.76
Polish exchange	7,894.16
Representation in Latin America	901.85
Foreign student hospitality at National Student Congress	12,131.52
Publications program	43,020.45
Vietnamese Flood Disaster Fund	1,500.00
Sports affairs	18,320.19
Arab student leadership seminar	508.49
Student international responsibility project	2,016.03
Director campus programs	2,537.59
Publication Civil Rights	988.04
Nigerian Student Cultural Festival	641.01
Kenya Student Scholarship	4,163.44
Director of Cultural Affairs	2,400.61
Seminar on Cooperative Management in Israel	3,584.40
International Affairs Vice President	19,630.89
International Student Conference Dues	36,111.10
Overseas Representation	1,807.55
Technical Assistance	32,351.58
Middle East African	34,784.09
Film Festival	700.96
Algerian scholarship program	3,388.46
Southern Adult Education Fund	3,148.86
Fast for Freedom Fund	34,218.96
Student Services	7,011.65
Student stress	17,720.10
Asian student affairs	7,682.03
Christmas Freedom	7,790.00
Sports affairs	2,239.80
Latin American representation	29,005.76
Eighteen year old vote	3,000.00
Film Festival	1,264.32
Tutorial Assistance Center	47,495.36

EXHIBIT C

Form 990-A U.S. Treasury Department Internal Revenue Service

RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX 1965

Section 501(c)(3) of the Code

For the fiscal year beginning Oct 1 1964, and ending Sept. 30 1965.

PLEASE TYPE OR PRINT

Name: UNITED STATES NATIONAL STUDENT ASSOCIATION — Employer Identification No. 23-1421976

Number and street: 2115 S STREET, N.W.

City or town, State, and ZIP code: WASHINGTON, D.C. 20009

Enter the name and address used on your return for 1964 (if the same as above, write "Same"). If none filed, give reason.

United States National Student Association, 3457 Chestnut St., Philadelphia Pa. 19104

PART II Part II information required pursuant to Section 6033(b) and other applicable sections of the Internal Revenue Code must be submitted in duplicate as part of your return. This part will be made available to the public.

Line No.		
1.	Gross sales or receipts from business activities	
2.	Less: Cost of goods sold and/or cost of operations (attach schedule)	
3.	Gross profit from business activities	
4.	Interest	81.61
5.	Dividends	
6.	Rents	
7.	Royalties	
8.	Gain (or loss) from sale of assets, excluding inventory items (See Instruction 8)	
9.	Other income (attach schedule—Do not include contributions, gifts, grants, etc. (See line 17))	90,576.42
10.	Total gross income (lines 3 to 9, inclusive)	90,658.03
11.	Expenses of earning gross income from column 3, Schedule A	116,570.60

DISBURSEMENTS MADE WITHIN THE YEAR OUT OF CURRENT OR ACCUMULATED INCOME FOR PURPOSES FOR WHICH EXEMPT, AND ACCUMULATION OF INCOME

12.	Expenses of distributing current or accumulated income from column 4, Schedule A	
13.	Contributions, gifts, grants, scholarships, etc. (See Instruction 13)	
14.	Accumulation of income within the year (line 10 less the sum of lines 11, 12, and 13)	(25,912.57)
15.	Aggregate accumulation of income at beginning of the year (20,396.17)	
16.	Aggregate accumulation of income at end of the year (10,861.68)	

RECEIPTS NOT REPORTED ELSEWHERE

17.	Contributions, gifts, grants, etc., received (See Instruction 17)	761,497.04
18.	Less: Expenses of raising and collecting amount on line 17, from column 5, Schedule A	
19.	Net contributions, gifts, grants, etc. received	761,497.04

DISBURSEMENTS MADE OUT OF PRINCIPAL FOR PURPOSES FOR WHICH EXEMPT

20.	Expenses of distributing principal from column 6, Schedule A	142,772.54
21.	Contributions, gifts, grants, scholarships, etc.: (a) Paid out in prior years (2,254,259.39)	
	(b) Paid out within the year (See Instruction 21)	533,542.90

Schedule A.—Allocation of Expenses (See Instructions for Attachments Required)

1. Item	2. Total	3. Expenses of earning gross income	4. Expenses of distributing income	5. Expenses of raising and collecting principal	6. Expenses of distributing principal
(a) Compensation of officers, etc.	15,001.12	11,327.77			3,673.35
(b) Other salaries and wages	69,703.14	24,107.65			45,595.49
(c) Interest					
(d) Taxes	4,028.22	1,847.53			2,180.69
(e) Rent	5,275.30	1,754.40			3,520.90
(f) Depreciation (and depletion)	1,275.75	772.00			503.15
(g) Miscellaneous expenses (attach sch)	163,979.40	76,600.00			87,299.08
(h) Totals	259,343.14	116,570.60			142,772.54
		Enter on line 11	Enter on line 12	Enter on line 18	Enter on line 20

EXHIBIT C

Form 990-A—1963 **Schedule B.—BALANCE SHEETS (See instructions)** Page 6

ASSETS	Beginning of Year (A) Amount	(B) Total	End of Year (C) Amount	(D) Total
1. Cash				
2. Accounts receivable (See instructions)		32,024.45		20,805.47
(a) Less allowance for bad debts	24,710.09		41,303.26	
3. Notes receivable (See instructions)		24,710.09		41,303.26
(a) Less allowance for bad debts				
4. Inventories				
5. Investments in governmental obligations				
6. Investments in nongovernmental bonds, etc.				
7. Investments in corporate stocks (See instructions)				
8. Mortgage loans (Number of loans ______)				
9. Other investments (attach schedule)				
10. Depreciable (and depletable) assets (attach schedule)				
(a) Less accumulated depreciation (and depletion)	26,107.10		27,302.93	
11. Land	16,745.20	9,361.90	27,302.93	-------
12. Other assets (attach schedule)				
13. Total assets		~~103,710.70~~ 169,816.03		~~170,815.30~~ 232,924.11
LIABILITIES AND NET WORTH				
14. Accounts payable (See instructions)				
15. Contributions, gifts, grants, etc., payable		137,009.22		100,759.47
16. (a) Bonds and notes payable (See instructions)				
(b) Mortgages payable				
17. Other liabilities (attach schedule)				35,000.00
18. Capital stock: (a) Preferred stock		53,202.98		108,026.32
(b) Common stock				
19. Membership certificates				
20. Principal or other capital				
21. Reserves (attach schedule)				
22. Accumulated income or earned surplus:				
(a) Attributable to ordinary income				
(b) Attributable to gains from sale of assets	(20,396.17)		(10,861.68)	
23. Total liabilities and net worth		(20,396.17)		(10,861.68)
		169,816.03		232,924.11

1. Date of current exemption letter .... April 20, 1954
2. Attach a detailed statement of the [illegible] and all other activities
3. Have you attached the information required by:
   (a) Instruction 17? See pamphlet .... [ ] Yes [ ] No
   (b) Instruction 1? .... [X] Yes [ ] No
4. Have you filed a tax return on Form 990-T for this year? ... [X] Yes [ ] No
   If "Yes," where filed? X
5. In what year was your organization formed? 1947
   In what State or country? .... Wisconsin
6. If successor to previously existing org[illegible] [illegible] and address(es) of the predecessor organization(s) ....
7. If you have capital stock issued and outstanding, state with respect to each class of stock—
   (a) The number of shares outstanding ....
   (b) The number of shares held by individuals ....
   (c) The number of shares held by organizations ....
   (d) The number of shareholders at end of year ....
   (e) Whether any dividends may be paid .... [ ] Yes [ ] No
8. If you acquired capital assets out of income, attach itemized list and amount thereof.
9. Have any changes not previously reported to the Internal Revenue Service been made in your articles of incorporation or bylaws or other instruments of similar import? .... [ ] Yes [ ] No
   If "Yes," attach a copy of the amendments. X
10. Have you had any sources of income or engaged in any activities not previously reported to the Internal Revenue Service? .... [ ] Yes [ ] No
   If "Yes," attach detailed statement

11. [illegible] .... [ ] Yes [ ] No
   If "Yes," attach detailed statement X
12. Have you during the year [illegible] (including the publishing or distributing of statements) any [illegible] legislation? .... [ ] Yes [ ] No
   If "Yes," attach a detailed [illegible] of such activities and copies of any such statements X
13. Have you during the year participated in, or intervened in (including the publishing or distributing of statements) any political campaign on behalf of or in opposition to any candidate for public office? .... [ ] Yes [ ] No
   If "Yes," attach a detailed [illegible] of such activities and copies of any such statements X
14. After July 1, 19[illegible] —
   [illegible]
   (a) Borrow any part of your income or corpus? .... [ ] Yes [ ] No
   (b) Receive any compensation for personal services from you? .... [ ] Yes [X] No
   (c) Have any part of your services or assets made available to him? .... [ ] Yes [X] No
   (d) Purchase any securities or other property from you? .... [ ] Yes [X] No
   (e) Sell any securities or other property to you? .... [ ] Yes [X] No
   (f) Receive any of your income or corpus in any other transaction? .... [ ] Yes [X] No
   If answer to any question is "Yes," attach detailed statement unless previously reported. If previously reported, give year(s). X
15. Do you hold 5 percent or more of any class of stock in any corporation? .... [ ] Yes [ ] No
   If "Yes," you must submit the information required by the instructions for Schedule B. X

U.S. National Student Association EI No. 23-1421976, for fiscal year ended Sept. 30, 1965

Specific purpose grants expenditures:	
Southern student human relations	$36,307.18
Ford Foundation Directory	23,834.22
College community tutorial project	8,183.81
Student stress	890.52
Southern literacy project	363.75
Film festival	228.72
Wellington self-government	404.19
Books for equal education	621.69
Overseas Press Club	1,563.05
Fast for Freedom Fund	20,365.39
Student services	4,775.84
Student stress	353.84
Student leader delegate	2,080.25
New building and moving cost	56,907.84
College Editors' Conference	10,833.33
Research travel	38.64
International pilot project	3,919.19
International pilot project	3,047.96
Algerian scholarship program	3,919.19
U.S. Department of State Bureau of Education and Culture Affairs, Algerian scholarship program	88,124.04
Angolan scholarship program	8,124.04
Nigerian scholarship program	1,245.00
Polish exchange grant	4,880.44
Student international responsibility project	3,000.00
Scholarship—foreign student	1,500.00
Program director	5,983.50
Representation in Latin America	29,471.77
Special assistance for foreign student organizations	7,923.98
Foreign student hospitality	20,280.09
Publications program	7,117.84
Representative to Vietnam	2,131.35
Vietnamese Flood Disaster Fund	3,537.00
Sports affairs	11,588.66
Publication Department	6,206.27
Arab Student Leadership seminar	18,039.38
Scholarship assistances	8,950.94
East African press	5,599.06
Special assistant to international vice president	692.66
Director campus programs	3,514.03
UNEA representative, Switzerland	1,043.10
Dubrovnick seminar	677.80
Nigerian student cultural festival	8,830.55
American Student, publications	2,935.87
Swaziland Student Union	750.00
Scholarship assistances	8,950.94
Director of cultural affairs	5,949.60
NSA overseas representation	33,624.19
12th ISRS	1,472.20
13th ISRS	22,831.97
Technical assistance	3,507.01
ISC delegates	16,267.82
International affairs, vice president	3,718.09
Indonesia-Malaysia, problems and prospects	3,000.00
Latin American representation	8,786.89
Other anticipated	4,249.51
Total	$533,542.90

EXHIBIT D

DIVISION: NATAFF; PROGRAM: SD (NOV. 13, 1967)

Institution and project	Monitor and status of project	Unpaid Oct. 1, 1966	Changes during year: Approved or (reduced)	Changes during year: Payments or (refunds)	Unpaid Sept. 30, 1967
The University of Chicago, Chicago, Ill.: Total value, $100,000. Survey and Analysis of the Responses of Chicago Catholics to Archbishop Cody's 1967 campaign for racial integration (67-133).	FF Monitor: ----------; status: Duration: Feb. 24, 1967 to Feb. 23, 1968.	0	$100,000	0	$100,000
Citizens' Committee for Children of New York City, Inc., New York, N.Y.: Total value, $45,000. Study papers and a conference to consider the feasibility of children's allowances as an income security measure, (67-156).	FF Monitor: ----------; Status: Duration: Mar. 24, 1967 to Mar. 23, 1968.	0	45,000	$45,000	0
Citizens Crusade Against Poverty, Washington, D.C.: Total value, $883,500. Creation of a training institute for community development workers (66-410).	FF Monitor: Edley, C. F.; Status (A): Duration: Aug. 19, 1966 to Oct. 3, 1968.	$187,500	508,500	187,500	508,500
Community Progress, Inc., New Haven, Conn.: Total value, $5,050,000. Community development program for residents of New Haven's middle ground and urban renewal areas (62-328).	FF Monitor: Miller, S. M.; Status (A): Duration: June 13, 1962 to Feb. 28, 1968.	300,000	0	0	300,000
CORE special-purpose fund, New York, N.Y.: Total value, $175,000. Support of Cleveland activities including youth training institute, adult training program, and voter registration drive (67-446).	FF Monitor: Miller, S. M.; Status (a): Duration: July 21, 1967 to July 20, 1968.	0	175,000	75,000	100,000
State of New Jersey, Trenton, N.J.: Total value, $250,800. Support for the development of a comprehensive manpower system in the State of New Jersey (67-374).	FF Monitor: Feldman, M. J.; Status (a): Duration: July 19, 1967 to July 18, 1968.	0	250,800	0	250,800

DIVISION: NATAFF; PROGRAM: SD (OCT. 16, 1968)

Institution and project	Monitor and status of project	Unpaid Oct. 1, 1967	Changes during year: Approved or (reduced)	Changes during year: Payments or (refunds)	Unpaid Sept. 30, 1968
The Community Resources Institute, Washington, D.C.: Total value, $5,000. Partial support of Cabinet committee hearings on Mexican-American affairs, El Paso, Tex. (68-111).	FF Monitor: Miller, S. M.; status (a): Duration: Oct. 1, 1967 to Jan. 31, 1968.	0	$5,000	$5,000	0
CORE special-purpose fund, New York, N.Y.: Total value, $475,000. Support of Cleveland activities including youth training institute, adult training program, and voter registration drive (67-446).	FF Monitor: Miller, S. M.; status (a): Duration: July 21, 1967 to July 26, 1969.	$100,000	300,000	175,000	$225,000
Cornell University, Ithaca, N.Y.: Total value, $55,500. Program to extend and expand a research project on migrant labor at the School of Industrial and Labor Relations (68-086).	FF Monitor: Miller, S. M.; status (a): Duration: Dec. 21, 1967 to Dec. 20, 1969.	0	55,500	20,000	35,500
Cornell University, Ithaca, N.Y.: Total value, $16,714. Research on race relations (68-141).	FF Monitor: Miller, S. M.; status (a): Duration: July 1, 1967 to Dec. 30, 1968.	0	16,714	15,214	1,500
Council of Southern Mountains, Inc., Berea, Ky.: Total value, $35,000. Interim administrative support for experimental activities in economic and community development in Appalachia (68-112).	FF Monitor: Miller, S. M.; status (a): Duration: Jan. 11, 1968 to July 10, 1968.	0	35,000	35,000	0
University of Detroit, Detroit, Mich.: Total value, $77,000. Summer training institute for clergymen and laymen working to counteract white racist hostility (68-666).	FF Monitor: Cooney, T. E., status (a): Duration: June 21, 1968 to June 20, 1969.	0	77,000	38,500	38,500

EXHIBIT E

[91st Congress, 1st sess., H.R. 7432]

A BILL To amend the Internal Revenue Code of 1954 to deny tax exemption to organizations which endorse political candidates, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 501 of the Internal Revenue Code of 1954 is amended by redesignating subsection (e) as subsection (f) and inserting after subsection (d) the following new subsection:

"(e) APPEARANCES, ETC., WITH RESPECT TO LEGISLATION.—

"(1) None of the following activities by an organization described in subsection (c)(3) shall be deemed 'carrying on propaganda, or otherwise attempting, to influence legislation':

"(A) Appearances before, submission of statements to, or sending communications to, the committees, or individual Members, of Congress or of any legislative body of a State, a possession of the United States, or a political subdivision of any of the foregoing with respect to legislation or proposed legislation of direct interest to the organization.

"(B) Communication of information between th organization and its members or contributors with respect to legislation or proposed legislation of direct interest to the organization.

"(2) For purposes of this paragraph, matters of direct interest to the organization include—

"(A) those directly affecting its exemption under this section;

"(B) those directly affecting the deduction of contributions to such organization under sections 170, 642, 2055, 2106, 2522;

"(C) those directly affecting any exempt purpose or function for which the organization was organized and is operating, in the case of an organization which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under this section) from the United States or any State or possession or political subdivision thereof, or from direct or indirect contributions from the general public.

"(3) Activities described in paragraph (1) shall not include any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums."

SEC. 2. Section 170(c) is amended by adding the following new sentence at the end thereof: "For purposes of this subsection, the phrase 'carrying on propaganda, or otherwise attempting, to influence legislation' in paragraph (2)(D) shall be subject to the qualifications set forth in section 501(e)."

SEC. 3. Section 2055(a) is amended by adding the following new sentence at the end thereof: "For purposes of this subsection, the phrase 'carrying on propaganda, or otherwise attempting, to influence legislation' in paragraphs (2) and (3) shall be subject to the qualifications set forth in section 501(e)."

SEC. 4. Section 2106(a)(2)(A) is amended by adding the following new sentence at the end thereof: "For purposes of this subparagraph, the phrase 'carrying on propaganda, or otherwise attempting, to influence legislation' in clauses (ii) and (iii) shall be subject to the qualifications set forth in section 501(e)."

SEC. 5. Section 2522 is amended by redesignating subsections (c) and (d) as subsections (d) and (e) and by inserting after subsection (b) the following new subsection:

"(c) CARRYING ON PROPAGANDA, OR OTHERWISE ATTEMPTING TO INFLUENCE LEGISLATION.—For purposes of this section the phrase 'carrying on propaganda, or otherwise attempting, to influence legislation' in paragraph (2) of subsection (a) and in paragraphs (2) and (3) of subsection (b) shall be subject to the qualifications set forth in section 501(e)."

SEC. 6. The amendments made by the preceding sections of this Act shall be applicable to taxable years beginning after the date of enactment thereof and to estates of decedents dying after the date of enactment thereof.

SEC. 7. (a) Part 1 of subchapter F of chapter 1 of the Internal Revenue Code of 1954 (relating to exempt organizations) is amended by adding at the end thereof the following new section:

"SEC 505. EXEMPTION DENIED TO ORGANIZATIONS ENGAGED IN POLITICAL ACTIVITIES.

"(a) PROMOTION OF POLITICAL CANDIDATES.—Any organization described in section 501(c) which—

"(1) endorses or opposes directly or indirectly, any political candidate, or

"(2) expends directly or indirectly any of its funds to promote the candidacy of any political candidate, or

"(3) provides goods, services, or anything of value to any political party or political organization,

shall not be exempt from tax under section 501 for the taxable year in which it so endorses or so expends funds, and for the three succeeding taxable years: *Provided further*, That activities prohibited by this section shall not be exempted from these prohibitions by being termed 'educational'.

"(b) CERTAIN POLITICAL ACTIVITIES.—Any organization described in section 501(c)(3) which—

"(1) makes any contributions of goods, services, or anything of value to any person or organization when there is reason to believe that part or all of such contribution will be used—

"(A) to promote or oppose the candidacy of any political candidate, or

"(B) to support, directly or indirectly, any political party or political organization whose purpose is to provide candidates for political office or to promote the candidacy of persons for political office.

"(2) has any officr or employee who is actively engaged in a political campaign (within the meaning of section 7324 of title 5 of the United States Code) during his hours of employment by the organization

shall not be exempt from tax under section 501 for the taxable year ending after the date on which it so endorses, makes such a contribution, or has such an officer or employee and for the three succeeding taxable years.

"(c) POLITICAL CANDIDATE.—For purposes of this section, the term 'political candidate' means any individual whose name is presented for nomination for or election to public office."

(b) The table of sections for such part I is amended by adding at the end thereof the following:

"Sec. 505. Exemption denied to organizations engaged in political activities."

SEC. 8. The amendments made by section 7 of this Act shall apply to acts occurring after the date of the enactment of this Act.

EXHIBIT F

[Excerpt from the Congressional Record, Feb. 24, 1969]

SEPTEMBER 2, 1966.

HON. SHELDON COHEN,
Commissioner, Internal Revenue Service,
Washington, D.C.

DEAR MR. COHEN: As you know, for the past ten months the National Right To Work Commitee has been the subject of an intensive investigation by the Internal Revenue Service for the purpose of determining whether the Commitee is entitled to retain its tax exemption status under section 501(c)(4) of the Internal Revenue Code.

During the course of this investigation your representatives have made an intensive effort to find some evidence of political activity on the part of the National Right To Work Committee. They have quite frankly advised us that this is what they are looking for, and in this connection they have scrutinized all of our expenditures for printed material, staff travel, legal services, and membership promotion, have asked us for a breakdown of the activities of staff personnel particularly during the period preceding the 1964 national elections and even subpoened the books of those printers who have done business with us. We have been expressly told by your representatives that if they turned up any evidence of political expenditures or political activities by our staff on paid time our exemption could be cancelled.

We are, of course, well aware that as an exempt organization we cannot engage in any political action, and we have scrupulously avoided any involvement in

politics or political activities. The only purpose of the National Right To Work Commitee is to promote the principle of voluntary unionism. By reason of this we have incurred the enmity of union officials who have publicly expressed their intent to bury us by one means or another.

This brings us to the point of this letter. Are not labor unions, as tax exempt organizations under section 501(c) (5), subject to the same restrictions on political activities as the National Right To Work Committee and other exempt organizations? And, if this is so, why is it that labor unions can openly and flagrantly use the monies collected from membership dues to make contributions to political candidates, and assign their staff personnel to electioneering activities on behalf of union-endorsed candidates? That they do all of these things on a large scale is, of course, well known and well documented. Just by way of example, in *International Association of Machinists* v. *Street*, 367 U.S. 740 (1961), the defendant unions stipulated that the dues monies collected from their members under compulsory union shop agreements were "used in substantial amounts to support the political campaign of candidates for the offices of President and Vice President of the United States, and for the Senate and House of Representatives of the United States . . . and candidates for state and local offices." 367 U.S. 740, 745, footnote 2. In May of this year the newspapers in Washington reported a public announcement by Charles Della, president of the Maryland-District of Columbia (AFL–CIO, that that organization would contribute the sum of $200,000 to support the campaign of Carlton Sickles for Governor of Maryland. Enclosed is an article written for the May 1966 issue of *Commonweal* magazine by Sidney Lens, a long-time union staff official, which points out, among other things, that the United Auto Workers Union recently donated $30,000 to the campaign of Senator Paul Douglas of Illinois. The article goes on to point out:

"Equally important is manpower. Around election time labor mobilized thousands of workers from the shops as well as many full-time organizers. The office of the auto union, perhaps the most active of all politically, become depopulated by as much as one-half of the regular staff, all working the hustings for union-endorsed candidates. These are men, it should be noted, with considerable organizational talent, usually far above the caliber of ordinary Democrats. . . . Union-leased autos, painted over with the names of union-endorsed aspirants, plastered with signs, participate in parades and make tours with loudspeakers blaring their message. In small towns especially, such as Peoria, Illinois or Muncie, Indiana, big unions like steel or auto can mobilize the thousands of members to fill a meeting hall or listen to an open-air speech. On the first Tuesday in November innumerable union men, paid from the union treasury, can be seen driving voters to and from the polling booths, acting as watchers to assure an honest count, and calling on 'sure' voters who have not yet cast a ballot. Thus by concentrating on marginal areas, by doling out $1,000 to $5,000 for Congressional hopefuls who need just a little push to put them over, labor can make an important contribution."

Also enclosed is a recent article by one of the well known labor columnists, Victor Riesel, who points out that the AFL–CIO has assessed its 13.7 million members at a nickel a head for a special election fund of $850,000 to be spent for campaign activities in this year's national elections.

Since the Internal Revenue Service insists that the National Right To Work Committee must strictly observe the rule against political activity, and since the flagrant political activities of labor unions are largely ignored, it would seem that a double standard is applied under the Internal Revenue Code. As the public becomes more and more aware of this selective enforcement of the law the effect can only be to break down respect for the law, a trend which seems to be rapidly undermining the foundations of orderly society.

We feel that you can quickly restore public confidence in the integrity of the Internal Revenue Service by issuing directives to your agents and offices throughout the country to undertake a sweeping investigation of the political activities of organized labor in this year's state and national elections, and revoke the tax exemption status of any union that engages in such political activities.

Very truly yours,

REED E. LARSON,
Executive Vice President.

U.S. TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
Washington, D.C., September 28, 1966.

Mr. REED E. LARSON,
National Right To Work Committee,
Washington, D.C.

DEAR MR. LARSON: Thank you for your letter of September 2, 1966, with attachment, concerning the political activity of labor unions.

You asked whether labor unions, as tax-exempt organizations under section 501(c)(5), are subject to the same restrictions on political activities as other exempt organizations. Although certain sections of 501(c) of the Internal Revenue Code and their implementing regulations contain various definitions, limitations, and prohibitions relative to political and legislative activities, there is no such proscription with respect to a labor organization otherwise qualifying for exemption from Federal income tax under section 501(c)(5).

The qualifying character of a labor organization, as the term is used in section 501(c)(5), is that it has as its principal purpose the representation of employees in such matters as wages, hours of labor, working conditions and economic benefits, and the general fostering of maters affecting the working conditions of its members. *As a mater of law, a labor organization does not lose its right to exemption under section 501 because it engages in political activities*, unless by reason of the organization's improper activities it can be established that the organization is not sufficiently engaged in the union or labor activity to be characterized as a labor organisation in the sense that that term is used in section 501(c)(5).

As you may know, contributors to labor organizations are not entitled to a charitable deduction: however, under certain conditions payments may qualify as a business expense under section 162. With respect to the deductibility of dues paid to a labor union or trade association as a business expense, the Revenue Act of 1962 amended section 162 by adding a new subsection (e) which provides for the deduction of ordinary and necessary expenses paid or incurred in taxable years beginning after December 31, 1962, for certain activities directly connected with legislation or proposed legislation of direct interest to the taxpayer. In no event shall a deduction be allowed for that portion of a special assessment or similar payment (including an increase in dues) made to any organization for any activity which does not constitute an appearance or communication with respect to legislation or proposed legislation of direct interest to the organization.

We appreciate your concern in this matter and want to further assure you that the Service is primarily interested in applying the internal revenue laws fairly and unformly in all cases. We do everything we can to administer the applicable law and regulations without regard to the political leanings of any taxpayer or organization.

We trust this information will be helpful for your purposes.

Sincerely yours,

S. B. WOLFE,
Director, Audit Division.

U.S. TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
Washington, D.C., October 10, 1966.

Mr. F. R. DICKERSON,
President, Roper Industries, Inc., Commerce, Ga.

DEAR MR. DICKERSON: Thank you for your leter of September 6, 1966, concerning the political activities or organized labor and the tax-exempt status of the National Right to Work Committee and the Sierra Club.

The records of the National Office disclose that the National Right to Work Committee has qualified for tax-exempt status under section 501(c)(4) of the Internal Revenue Code, while the Sierra Club is exempt under section 501(c)(3), and labor unions frequently qualify under section 501(c)(5).

The Internal Revenue Service maintains a program of periodic audit and review of the operations of tax-exempt organizations. If it is determined as a result of the audit program that any tax-exempt organization is engaged in activities to an extent proscribed by that section of the Code under which it has been held exempt, we will take appropriate action to revoke or modify our prior ruling.

This is a factual question in each case, and the Service must examine all of the operations for the years involved.

You expressed concern regarding the possible nonuniform application of restrictions on political activities for various tax-exempt organizations. It should be noted that although certain sections of 501(c) of the Code and their implementing regulations contain various limitations and prohibitions relative to political and legislative activities, there is no such proscription with respect to a labor organization otherwise qualifying for exemption from Federal income tax under section 501(c)(5).

The qualifying character of a labor organization, as the term is used in section 501(c)(5), is that it has as its principal purpose the representation of employees in such matters as wages, hours of labor, economic benefits, and the general fostering of matters affecting the working conditions of its members. As a matter of law, a labor organization does not lose its rights to exemption under section 501 because it engages in political activities, unless by reason of the organization's improper activities it can be established that the organization is not sufficiently engaged in the union or labor activity to be charactized as a labor organization in the sense the term is used in section 501(c)(5).

As you may know, it is the responsibility of the Service to administer the Federal income tax laws enacted by Congress as efficiently and impartially as possible. We have no power to amend the laws or to act contrary to their provisions. Your concern in this matter is appreciated and we want to further assure you that the Service is interested in applying the internal revenue laws fairly and uniformly in all cases. We do everything we can to administer the applicable regulations without regard to the political leanings of any taxpayer or organization.

We trust this information will be helpful in explaining the varying limitations or organizations qualifying for tax-exempt status under different sections in the Code.

Sincerely yours,

FORREST P. NEAL,
Chief, Technical Coordination Branch.

The CHAIRMAN. Next we hear from the Honorable Justice Arthur Goldberg, representing the Denver Post Employees Stock Trust. He has served this Nation with great distinction. Aside from being a Supreme Court Justice he has served this Nation as its representative at the United Nations and as Secretary of Labor. We are glad to have you, Mr. Justice, or Ambassador, or Mr. Secretary.

STATEMENT OF HON. ARTHUR J. GOLDBERG ON BEHALF OF THE DENVER POST AND THE DENVER POST EMPLOYEES STOCK TRUST

Mr. GOLDBERG. Thank you very much for adverting to my service in various capacities. I am glad to be called as you have designated, mister. That is an honorable title in American life.

Mr. Chairman and members of the committee, it is a great privilege to appear before you as I have done in other capacities, and once again to discuss with you some of the problems that affect our country.

I appear in a very limited capacity. I am not appearing to testify broadly on the question of foundations and would not be qualified to do so, although in the spirit of public disclosure which should animate all of our actions in all capacities, I should say at the beginning that I once served as unpaid director of a foundation which we created in the memory of Phillip Murray, a great labor leader. That foundation had no administrative expenses and wound up all its activities in the course of 1 year. Having made that comulete disclosure I now turn to the immediate subject of my testimony.

I have a statement and in the interest of time, if you will permit me, Mr. Chairman and gentlemen of the committee, I would like to offer it for the record. I shall be very brief.

The CHAIRMAN. Your statement is already printed, Mr. Goldberg.

Mr. GOLDBERG. Thank you, Mr. Chairman.

Today I come before you on behalf of the Denver Post, which is the largest newspaper and only independent daily in Denver, and the Denver Post Employees Stock Trust.

Under the stock trust the employees of the Post purchase a beneficial interest in the trust under a formula price, and the funds supplied by the employees are then used by the trust to acquire Post stock.

They have a particular problem under this bill, and it is that particular problem that I want to address myself to.

I should say parenthetically that none of the employees of the employees trust receive any compensation whatsoever and no administrative expense is charged to the employees trust.

I am appearing in these hearings with your kind permission on a limited aspect of the foundation provisions of the tax reform bill as reported from the House, because the principal source of the Post stock to be purchased by the trust is the Helen G. Bonfils Foundation, which owns approximately 42 percent of the total outstanding Post stock, and having heard some of the earlier testimony, I should like to say that neither the trustees nor anyone connected with this foundation are compensated. The foundation is not charged with any administrative expenses and there were virtually no tax consequences involved in the transfer of the Post stock to this particular foundation. That is so because Miss Bonfils had virtually exhausted her charitable deduction. So this foundation, whatever may be said of others, is not involved in that aspect of the problems which the committee is considering.

The foundation stockholdings in the Post were acquired by gift in 1966 subject to a reservation of the income and voting rights for the donor's life for Miss Helen Bonfils, who was the daughter of the founder of the Denver Post. In order to have the value of that stock devoted to charitable purposes after her death while making the foundation stock available for the Post employees, the gift was made subject to a restriction that the foundation was to sell such stock to the trust from time to time, at a fair price determined by formula.

There was a purpose, an object in this plan, Mr. Chairman, and gentlemen of the committee, relevant to that aspect of the bill that I want to talk about.

A fundamental purpose of the plan was, by this daughter of the founder of the paper, to insure that the Post would survive as a vigorous and independent newspaper owned by its employees. That was a fundamental purpose of this particular arrangement.

Now, I am sure that this purpose, which Congress has been very much concerned with, which is to insure the independence of newspapers in a period when there has been a growing monopolization of the means of public communication, I am sure that this purpose is one that the members of this committee and certainly the Members of Congress generally would applaud.

Our first problem under the tax reform bill as it comes from the House, arises under proposed code section 4943. Under this provision a foundation which together with certain related parties, owns more than 20 percent of the voting stock of a business enterprise must divest itself of sufficient stock to bring such holdings to no more than 20 percent. All of the excess over 20 percent must be disposed of within 10 years and at least one-third of the excess must be disposed of within 5 years.

Now, I express no opinion here today about the general applicability of such a provision, but I do want to point out a special circumstance which arises in this particular instance. Under these provisions the Helen G. Bonfils Foundation would have to dispose of over two-thirds of its holdings of Post stock. However, while its deed of gift obligates it to sell these shares to the trust, the trust can purchase stock from the foundation only as funds are made available by the employees themselves, and it is up to the employees to decide when their resources will permit them to purchase shares.

As a result, it is almost inconceivable that the trust will be able to purchase all the foundation's execess holdings within 10 years or one-third of it within 5 years and, as written, to comply with section 4943 would, therefore, require sales to a third party which would violate the foundation's contractual obligations and, more importantly than that, defeat the entire purpose of the trust which is to give the employees the right to acquire controlling ownership of the newspaper.

The plan to have control of the Post transferred to the trust for employees is also threatened by proposed code section 4942, which requires a foundation annually to distribute for specified charitable purposes 5 percent of the value of its investment assets. This provision could require sales of Post stock to third parties who might be unwilling to pay a reasonable price for such stock since the Post stock is closely held and not publicly traded.

The ultimate result would be sales at inadequate prices which would violate the trust contractual rights and defeat the foundation's purpose.

Now, equally importantly, if these sections, as I have said, are rigidly applied to the foundation a grave injury would also be imposed upon the more than 400 employees who have purchased an interest in the trust with the legitimate expectation that the plan would be carried through, and one of the great aspects of the Post, as you will see from the exhibits attached to my prepared statement, one of the beneficial aspects of this plan which gives the employees an interest in the newspaper, are very harmonious labor relations exist at the Denver Post. This is in great measure due to this plan and also the fine leadership that the Post has in one of the great publishers and editors in America, Palmer Hoyt.

Now, I have said I do not wish, it is not my purpose here, to wander broadly into this question which this committee is considering.

My purpose is to suggest to the committee a very limited amendment which would propose that the Helen G. Bonfils Foundation and any other foundation which was given holdings in a business enterprise at or before the same time for the same purpose, which is to convey it to an employees trust, would be permitted to dispose of its interests in the enterprise to the trust for employees in accordance with the pre-

existing, I emphasize, preexisting plan adopted for that purpose. In other words, what I am proposing, Mr. Chairman and gentlemen of the committee, is a very limited amendment that does not deal broadly with the problems that you have to consider, which, in effect, says that where there is a plan under which a foundation has committed, obligated itself, to transfer its shares to an employees trust that such a plan, which was conceived a long time ago, without reference to any tax incidence, be exempt from the operation of section 4943 and 4942.

The amendment that I am suggesting to the committee, and I have suggested language, Mr. Chairman, in the prepared statement, which I am sure the staff and the members of the committee would like to review, is thus a very narrow application intended only to prevent the frustration of employee expectations and to protect the public interest in preserving independent newspapers in the case of preexisting plans for the sale of such newspapers to their employees.

As is apparent from my complete statement, in addition to the Denver Post, the Denver Post Employees Stock Trust Council, representing the employees who have beneficial interests in the trust, and the labor organizations representing the employees of the Post, join me in urging adoption of the amendment which I have proposed.

The CHAIRMAN. Thank you very much, Mr. Ambassador, Mr. Justice, and Mr. Secretary. We have your statement, it is already printed, and it starts at page 111 in our committee print.

Mr. GOLDBERG. Yes.

The CHAIRMAN. I would like to advise all the witnesses if they would like to they should take a look at their statement because it is the way they would want it to appear in the record and it is summarized. Both the summary of the principal points and also the back-up information of the statement that supports the information is printed. You have presented a very fine statement here and I think it is very well documented. I can assure you this will receive consideration.

Unfortunately, there are a lot of people who are going to be adversely affected by this bill if we pass it in its present form who do not even know about it. It may be that we will have no opportunity to consider their problem because they are not aware of it themselves and fail to bring it to our attention. But I appreciate your bringing us this information.

May I say to all members of the committee as well as to our witnesses, that we have at least 14 more distinguished witnesses to hear from today so I am going to suggest to all members of the committee if they wish to interrogate the witness tell our staff that you would like to interrogate the witness and they will inform the witness and you can meet with him here in our conference room and ask whatever questions that you would like to ask to be presented in the written record.

Senator MILLER. Mr. Chairman, I do not have any questions but I would like to request that Mr. Justice Goldberg furnish for the record an additional statement. I have filed an amendment number 222, which I think will cover your situation, but it is much broader and I would appreciate it if you would analyze it and then furnish for the record a statement as to whether or not that amendment would cover your problem.

Mr. GOLDBERG. Senator Miller, I would be very glad to do so.

(The information had not been received at the time of printing.)

The CHAIRMAN. Thank you very much.

Senator FANNIN. We do not get one question?

The CHAIRMAN. I would like the Senator, if you would like to interrogate Justice Goldberg, to meet with him in our executive room here but if you insist, go ahead.

Senator FANNIN. Do you think as a general principle, the divestiture stipulation is inequitable? As a general principle, in other words, you are being specific as to the type of organization that is involved, but cannot the public interest be protected in another manner without having this stipulation?

Mr. GOLDBERG. Yes. There could be a general provision, but I did not know what other problems might arise, if there would be a broad provision encompassing many situations where there might be differences.

Senator FANNIN. Yes.

Mr. Chairman, I would like to ask, since we have so many witnesses left that we meet in the other room.

The CHAIRMAN. Justice Goldberg, right next door here. Senator Fannin would like to interrogate you and get your statement.

Mr. GOLDBERG. Thank you very much, Mr. Chairman.

The CHAIRMAN. Our next witness will be Mrs. Bruce Benson, president of the League of Women Voters of the United States.

Mrs. Benson, the Senate seems determined to act on this bill before we go home Christmas and that being the case we have a very abbreviated fashion of doing business as I am sure you detected. We have your entire statement here in the record and we also have a summary, I believe, prepared by you. So you are invited to summarize your statement and make any points in addition to it that you would like to.

STATEMENT OF MRS. BRUCE B. BENSON, PRESIDENT OF THE LEAGUE OF WOMEN VOTERS OF THE UNITED STATES; ACCOMPANIED BY ALBERT E. ARENT, COUNSEL; AND MRS. JOHN CAMPBELL

Mrs. BENSON. Thank you, Mr. Chairman, I will be very brief. I have with me on my left the league's general counsel, Albert Arent and on my right Mrs. John Campbell of Indianapolis, Ind.

I am Mrs. Bruce B. Benson of Amherst, Mass., president of the League of Women Voters of the United States. I am appearing in behalf of the league and our two funds, the overseas education fund and the education fund. The league, which will be 50 years old next year, is an organization of nearly 160,000 members in 1,285 local leagues in the 50 States, the Virgin Islands, the Commonwealth of Puerto Rico, and the District of Columbia. During its history the league throughout the country has been actively involved in working to increase citizen participation in government at all levels.

In 1947 the League of Women Voters of the United States established a nonprofit, educational affiliate now known as the overseas education fund of the League of Women Voters. This fund was established in response to requests coming to the league from individuals and organizations in other parts of the world who were seeking as-

sistance in developing responsible citizenship and effective citizen action applicable to their own societies.

In 1957, we established the League of Woman Voters Education Fund to work within the United States to carry out educational programs.

The League of Women Voters itself is a social welfare organization exempt under section 501(c)(4) of the Internal Revenue Code. Our two funds are exempt under section 501(c)(3) and contributions to them are tax deductible.

Both the Treasury and the Ways and Means Committee have recognized the value of the nonpartisan work done by the League of Women Voters Education Fund in connection with voter education and registration and have tried to make it clear through a Treasury press release of May 9, 1969, and through a statement on page 34 of the committee report that the proposed legislation was not intended to inhibit such activities by the Fund. However, it appears to us that the House bill not only fails to achieve this objective, but actually creates some very serious problems for us as well as for many of the outstanding organizations working in the field of citizen education.

I would like to mention a few of the things that are troubling us. Under proposed section 4942, contributions to nonoperating private foundations are excluded from the definition of "qualified distributions" and, therefore, will not help a donor or foundation avoid the tax on undistributed income. Unless it is absolutely clear that our education fund and overseas education fund are not nonoperating private foundations, we fear that private foundations will withhold their contributions to these funds—contributions which are vital to the continuation of their work in teaching the responsibilities of citizenship.

The line between private foundations as defined in proposed section 509 and publicly-supported charities is a shadowy one and it will be difficult to predict from year to year whether the education fund and overseas education fund will qualify as publicly supported organizations. It appears unlikely moreover that they will be able to meet the precise requirements for qualifying as an "operating foundation."

We respectfully suggest (1) that an effort be made to define the category of private foundation more narrowly, (2) and that the effective date of the new legislation be deferred until sometime after the Treasury Department has promulgated its final regulations thereunder.

In addition, we support the very helpful proposal made by the Treasury Department in its technical memorandum of September 30 of this year that distributions to private foundations be considered qualified if the recipient organization applies the contribution directly to charitable activities within 1 year of receipt.

We are also greatly disturbed over the provisions of proposed section 4945, which impose a 100 percent tax on private foundations and a 50 percent tax on foundation managers for any amounts expended—(1) to carry out propaganda, or otherwise attempt to influence legislation or (2) to influence the outcome of any public election—including voter registration drives carried on by or for such a foundation.

With respect to the first of these provisions only, an exemption is made if the activity is making available the results of nonpartisan

analysis or research. However, any organization operating in the area of citizen education and dealing with subjects of civic concern, runs the risk that those who deem themselves adversely affected by the organization's activities, no matter how nonpartisan or objective, will accuse the organization of attempting to influence legislation and demand that the punitive taxes of section 4945 be imposed. This could easily happen right now, in fact, if H.R. 13270 were in effect.

Let me cite an example. With the funds provided by the Department of the Interior and various foundations and with the assistance of hundreds of voluntary workers of the League of Women Voters, our education fund has for many years studied the problem of polluting of our waterways. We have held seminars and produced a book and a number of brochures designed to increase public understanding of this dangerous problem.

There is right now in the House an attempt to increase the appropriation for pollution control. Undoubtedly there will be proposals before the State legislatures attempting to solve the problem of water pollution. There will likely be sharp differences of opinion as to the need for the expenditures involved. It would be relatively easy for unrelated persons to attempt to make partisan use of the fund's studies and it might be difficult for the fund to defend the nonpartisan character of its analysis and research.

Furthermore, there is the risk that such subjects may become issues in an election, in which case the exemption for nonpartisan analysis or research is not even applicable.

These risks are intrinsic to educational work in the field of government and politics. Organizations like our education fund, never certain whether in any particular year they will be held public or private, can continue to function only at great peril. Reasonable protection is given to foundation managers by imposing a penalty only if they make the expenditure knowing it is a taxable expenditure. The same good-faith defense, we believe, should be available to the foundation itself.

The League of Women Voters believes that even more intensified efforts are needed in our country to involve more citizens at all levels of Government, that a responsible democracy depends on citizens learning the importance and the responsibility of voting and of participating in the democratic process.

Private philanthropy plays a significant role in supporting the educational work needed to achieve the goal of an informed and active electorate. H.R. 13270 appears to go further than necessary to correct the abuses which have been revealed in the operation of the private charitable foundations.

Frankly, Mr. Chairman, we think this bill is bound to do much more harm than good. Unless these problems which I have outlined are cleared up, our education fund and our overseas education fund, like other organizations which have come into existence to carry out citizen education, will not know where we stand. We will not know if we are public or private and we undoubtedly will not be able to divine what is safe educational activity. It seems to us we will be hardly able to stay out of trouble.

Our two funds are managed by volunteers from all over the country. They work terribly hard to raise money to carry out education in citizen responsibility. This bill will make their job infinitely more

difficult especially in this 50th anniversary of the League of Women Voters when we are trying to raise funds to expand our work.

In addition to our education fund and our overseas education fund, we have several local and State funds which have been created by our members to carry out nonpartisan educational work—the citizens information service of the Chicago League of Women Voters and the Texas Fund of the League of Women Voters of Texas. It seems clear that they will be completely unable to meet the requirements of this bill.

We believe that our political parties are vitally important to our country. We also believe that our voluntary nonpartisan associations are an essential part of the political process as we all know it, and that it would be a mistake to jeopardize an important source of their funds.

There are already great difficulties involved in carrying out nonpartisan citizen education. To put more hazards in the way it seems to us, would be a disservice to the country.

Thank you.

The CHAIRMAN. Thank you. Certainly, your suggestions will be considered.

(Mrs. Benson's prepared statement follows:)

STATEMENT OF MRS. BRUCE B. BENSON, PRESIDENT, LEAGUE OF WOMEN VOTERS OF THE UNITED STATES

SUMMARY

H.R. 13270 raises serious problems for organizations like the League of Women Voters Education Fund and the Overseas Education Fund of the League of Women Voters, which are independently engaged in nonpartisan educational work but which receive a significant part of their financial support from private foundations.

I. Under proposed section 4942, contributions to non-operating private foundations are excluded from the definition of "qualified distributions" and therefore will not help a doner foundation avoid tax on undistributed income. Unless it is absolutely clear that the Education Fund and the Overseas Education Fund are *not* non-operating private foundations, we have reason to fear that private foundations will withhold their contributions to these Funds—contributions which are vital to the continuation of their work in teaching the responsibilities of citizenship. The line between private foundations as defined in proposed section 509 and publicly-supported charities is a shadowy one and it will be difficult to predict from year to year whether the Education Fund and the Overseas Education Fund will qualify as publicly-supported organizations. It appears unlikely, moreover, that the precise requirements for qualifying as an "operating foundation" can be met.

We suggest (1) that an effort be made to define the category of private foundation more narrowly and (2) that the effective date of the new legislation be deferred until some time after the Treasury Department has promulgated its final regulations thereunder. In addition we support the very helpful proposal made by the Treasury Department in its Technical Memorandum of September 30, 1969, that distributions to private foundations be considered "qualified" if the recipient organization applies the contributions directly to charitable activities within one year of receipt.

II. We are also greatly disturbed over the provisions of proposed section 4945 which impose a 100 percent tax on private foundations and a 50 percent tax on foundation managers for any amounts expended—

> "(1) to carry out propaganda, or otherwise attempt to influence legislation," or
>
> "(2) to influence the outcome of any public election (including voter registration drives carried on by or for such foundation)".

With respect to the first of these provisions only, an exception is made if the activity is limited to "making available the results of nonpartisan analysis or

research". However, any organization operating in the area of citizen education and dealing with subjects of civic concern runs the risk that those who deem themselves adversely affected by the organization's activities, no matter how nonpartisan or objective, will accuse the organization of attempting to influence legislation and demand that the punitive taxes of section 4945 be imposed. Furthermore, there is the risk that such subjects may become issues in an election, in which case the exception for nonpartisan analysis or research is not even applicable. These risks are intrinsic to educational work in the field of government and politics. Organizations like the Education Fund, never certain whether in any particular year they will be held public or private, can continue to function only at great peril. Reasonable protection is given to foundation managers by imposing the penalty only if they make the expenditure "*knowing* that it is a taxable expenditure". The same good-faith defense should be available to the foundation itself.

STATEMENT

I am Mrs. Bruce B. Benson of Amherst, Massachusetts, President of the League of Women Voters of the United States. I am appearing in behalf of the League and our two affiliated organizations, the Overseas Education Fund and the Education Fund. The League, which will be 50 years old next year, is an organization of nearly 160,000 members in 1285 local Leagues in the 50 States, the Virgin Islands, the Commonwealth of Puerto Rico, and the District of Columbia. During its history, the League throughout the country has been actively involved in working to increase citizen participation in government at all levels. Through election Voters Service the League encourages people to register and to vote and helps them to vote as informed citizens by providing objective nonpartisan information about candidates and pro and con information on issues. Our Voters Service work is not limited to election time. Throughout the year, the League works to involve people in learning about and participating in government and politics at all levels.

Overseas education fund

In 1947 the League of Women Voters of the United States established a nonprofit, educational affiliate now known as the Overseas Education Fund of the League of Women Voters. This was in response to requests coming to the League from individuals and organizations of other countries for assistance in developing responsible citizenship and effective civic organizations. It is the goal of the Overseas Education Fund to encourage and assist the development of citizen initiative, participation, and action in other countries within the framework of their own culture and to help voluntary groups work together to identify realistically their needs and evolve ways of meeting them. The methods employed by the Overseas Education Fund include briefing and scheduling travel of nationals of other countries who are in the United States and interested in aspects of United States government; conducting annual seminars for women community leaders from Latin America to observe citizenship and volunteer activity in the United States; and administering a four-month Institute presently based at Boston University for foreign women leaders which focuses on organization techniques and citizen involvement in community programs and includes field work in Boston and surrounding communities. Field representatives provide technical assistance and consultative services in organization techniques to groups in other countries upon request. The program is carried out through carefully coordinated efforts of volunteers and professional staff.

Education fund

In 1957 the League established the Education Fund to promote and carry out nonpartisan citizenship education within the United States. The work of the Education Fund falls into two categories: communicating to other organizations and individuals the experiences and techniques in citizen education that the League of Women Voters has developed over the years and, where these established techniques lack effectiveness, to carry out experimental projects resulting, hopefully, in adaptations that will be more effective. Specifically under these two categories the Education Fund has made surveys of local and state government structure for distribution in local communities, has disseminated information on selected issues of the day, and has helped teach citizen groups methods of stimulating the registration and involvement of voters. The Education Fund has no membership of its own. It depends upon the grass-roots support of League members in the 1285 local Leagues from coast to coast and of citizens who are not League members to carry out its activities.

Effects of H.R. 13270, the Tax Reform Act of 1969

The League understands the concern of Congress regarding the misuses of funds by some foundations and is sympathetic with the problems of writing legislation which will prohibit "self-dealing" and at the same time permit private resources to be used to encourage informed citizen participation in government. It appears to us, however, that the proposed legislation on private foundations goes far beyond what is necessary to remedy any known abuses. To avoid duplicating the testimony of others, I shall address myself only to the provisions which raise serious problems for the League of Women Voters Education Fund and the Overseas Education Fund.

Difficulty of distinguishing between private foundation and public charity

The League of Women Voters is a social welfare organization exempt under section 501(c) (4) of the International Rvenue Code. The Education Fund and the Overseas Education Fund are exempt under section 501(c) (3) and contributions to them are tax deductible. We believe that both of these Funds are publicly-supported charities, but the line between private foundations as defined in proposed section 509 and public charities appears to be a shadowy one. Under the mechanical test set forth in section 1.170-2(b) (5) of the Income Tax Regulations, defining a "publicly supported" organization under current law, an organization may be public one year and private the next. Because of the rule excluding from the catgory of public support that portion of large contributions which exceeds 1 percent of the organization's total support for a prescribed period, it is possible for one unusually large contribution to change the status of the organization overnight from public to private. This same situation would exist under the provisions of H.R. 13270.

Both the Education Fund and the Overseas Education Fund depend heavily for their support upon contributions from private foundations. Under proposed section 4942, contributions to nonoperating private foundations are excluded from the definition of "qualified distributions" and therefore will not help a donor foundation avoid the tax on undistributed income. Unless it is absolutely clear that the Education Fund and the Overseas Education Fund are *not* nonoperating private foundations, we have reason to fear that private foundations will withhold their contributions to these Funds—contributions which are vital to the continuation of their work in teaching the responsibilities of citizenshp.

Inability to qualify as operating foundations

The definition of an "operating foundation" in the proposed section 4942(j) (3) appears to exclude the Education Fund and the Overseas Education Fund for a variety of reasons. For example, if the present 50th Anniversary Campaign for $11 million to expand our work over a ten-year period is successful, both the Education Fund and the Overseas Education Fund will have substantial endowment and reserve funds and could not meet the requirement of subparagraph (b) (i) that substantially mor than half of their assets be devoted directly to the active conduct of their educational programs. Their income from Government grants might also present them from meeting the alternative test of subparagraph (B) (ii). The Education Fund, but not the Overseas Education Fund, might also fail under subparagraph (A) if its grants to the League of Women Voters for specific educational projects were not construed as direct expenditures for the active conduct of its program.

Accordingly, unless a narrower and more practical definition of private foundation can be devised, organizations like the Education Fund and the Overseas Education Fund stand in constant jeopardy and the significant public service which they render to this nation may be severely curtailed. At the very least an opportunity should be provided for organizations to clarify their status before the new structures on private foundations are made effective. Perhaps the effective date could be deferred until some time after the Treasury Department has promulgated its final regulations under the new statute. In addition we support the very helpful proposal made by the Treasury Department in its Technical Memorandum of September 30, 1969, that distributions to private foundations be considered "qualified" if the recipient organization applies the contributions directly to charitable activities within one year of receipt.

Exposure to drastic penalties

We are also greatly disturbed over the provisions of proposed section 4945 which impose a 100 percent tax on private foundations and a 50 percent tax on foundation managers for any amounts expended

"(1) to carry out propaganda, or otherwise attempt to influence legislation," or

"(2) to influence the outcome of any public election (including voter registration drives carried on by or for such foundation)."

With respect to the first of these provisions, attempting to influence legislation, an exception is made if the activity is limited to "making available the results of nonpartisan analysis or research." Any organization operating in the area of citizen education and dealing with subjects of civic concern runs the risk that those to whom the results of its analysis and research are displeasing will attack the nonpartisan character of the work or charge that the organization has gone beyond merely making the results available. The risk is intrinsic to educational work in the field of government and politics. Present law respects honest and fair educational efforts and provides a safety valve for error or misunderstanding through the "substantiality rule." No such safety valve exists in the proposed legislation, and organizations like the Education Fund, never certain whether in any particular year they will be held public or private, can continue to function only at great peril.

Let me cite an example. With funds provided by the Department of Interior and various foundations and with the assistance of hundreds of volunteer workers from the League of Women Voters, the Education Fund studied the problem of pollution of our waterways, held seminars, and produced a book and a number of brochures designed to increase public understanding of this dangerous problem. Undoubtedly there are and there will be proposals before the federal and state legislatures attempting to solve the problem of water pollution, with sharp differences of opinion as to the need for the restrictions and expenditures involved. Under such circumstances, when unrelated persons may attempt to make partisan use of the Fund's studies, it may be difficult for the Fund to defend the nonpartisan character of its analysis and research.

With respect to the second provision previously quoted, relating to the influencing of elections, it is also conceivable that anti-pollution legislation may become an issue in some election battle. At this point expenditures made for an objective study may be attacked as amounts paid to influence the outcome of a public election, in violation of section 4945(b) (2), as to which, it should be noted, no exception is provided for "making available the results of nonpartisan analysis and research."

In view of such possibilities, should the Education Fund be subject to the risk of a 100 percent penalty tax and its officers, directors, trustees and key employees be subject to the risk of a 50 percent penalty tax? The 50 percent penalty on foundation managers is imposed only if they make the expenditure "*knowing* that it is a taxable expenditure." At the very least, should not be same good-faith defense be available to the Fund itself?

Inadequacy of special provision for nonpartisan activities

Both the Treasury and the Ways and Means Committee have recognized the value of the nonpartisan work done by the League of Women Voters Education Fund in connection with voter education and registration and have tried to make it clear through a Treasury press release of May 9, 1969, and through a statement on page 34 of the Committee Report that the proposed legislation was not intended to inhibit such activities by the Fund. Unfortunately, if the Education Fund is determined to be a private foundation, the statute as drafted may not provide the intended relief. Among other things, the proposed section 4945(d), excluding from taxable expenditures "nonpartisan activities carried on by certain organizations," which was drafted with the Education Fund in mind, requires that substantially all of the income be expended directly for the active conduct of the Fund's program*—a requirement which may be difficult to meet if, as part of its program, the Education Fund continues to make grants to the League of Women Voters for its traditional nonpartisan voter education pro-

*Paragraph (3) of Section 4945(d). Paragraph (2), which requires that the *principal* activity be "nonpartisan political activity in 5 or more States," may also be troublesome for semantic reasons--the Education Fund is engaged principaly in nonlpartisan educational work, which may or may not be embraced within the term "political activity."

grams, such as its panel discussions between candidates, its factual presentation of their stated positions on the issues, and its voter registration drives. In any event, section 4945(d) deals only with the prohibition in section 4945(b)(2) on influencing public elections and leaves the Education Fund fully exposed on the proscription of section 4945(b)(1) against attempting to influence legislation, with the hazardous consequences previously mentioned.

Conclusion

The League of Women Voters and its affiliated organizations have a long and honorable record of constructive nonpartisan service to this nation. Unless the new legislation makes it absolutely clear that organizations like the Education Fund and the Overseas Education Fund are not to be treated as private foundations, enormous damage will be done. Furthermore, with respect to all organizations doing honest work in the area of political education, whether they are private foundations or public charities, a decent respect for human frailty requires either than the substantiality test be restored with respect to influencing legislation or that the penalty tax be limited to willful and premeditated attempts to influence legislation or the outcome of an election.

We believe that even more intensified efforts are needed in our society to involve more citizens at all levels of government; that a responsible democracy depends on citizens learning the importance and the responsibility of voting and of participating in the democratic process. Private philanthropy plays a significant role in supporting the educational work needed to achieve the goal of an informed and active electorate. H.R. 13270 appears to go further than necessary to correct the abuses which have been revealed in the operation of private charitable foundations. We hope this Committee will make the proper changes.

The CHAIRMAN. Now the next witness will be Mr. Paul Anthony, executive director, Southern Regional Council.

Senator TALMADGE. I would like to welcome Mr. Paul Anthony and his associates.

STATEMENT OF PAUL ANTHONY, EXECUTIVE DIRECTOR, SOUTHERN REGIONAL COUNCIL; ACCOMPANIED BY JOSEPH F. HAAS, SOUTHERN REGIONAL COUNCIL; AND VERNON JORDAN

Mr. ANTHONY. Mr. Chairman and members of the committee, thank you for this opportunity. As executive director, I represent the Southern Regional Council, a body of 100 distinguished southerners. With me are Mr. Joseph Haas, our legal counsel and Mr. Vernon Jordan, director of the council's voter registration.

Recognizing the demands made on you I shall be very brief. Before citing some of our specific concerns I should like to make two observations. One, for 25 years the Southern Regional Council has recognized that we enjoyed the benefit of tax exempt funds in proper exchange for certain restrictions on the use of those funds. We have attempted to operate within the spirit as well as the letter of the law. We do not appear before you to request that the existing regulations and laws which have created this method of operation, be altered.

Secondly, it may be that the present tax laws have allowed individuals to abuse those laws by creating so-called foundations for personal gain. We believe that the Congress is justified in seeking to stop those abuses. Our concern is that honorably conceived and legally operated foundations and those whom they support not be unduly restricted because of the activities of others. Among our specific concerns are section 4945(c)(1). The wording that prohibits an agency from engaging in any attempt to influence legislation through an attempt to effect the opinion of the general public or any segment thereof disturbs us greatly. That our publications are properly a part

of the dissemination of ideas in a free society, and are not an attempt to directly influence legislation, has been upheld by the Georgia courts. We feel that this bill is drawn too broadly. Literally interpreted the provision in the proposed legislation would prevent responsible agencies now engaged in serious research from making meaningful comment on the society. This is incompatible with a democratic society.

Section 4945(d). This section includes the provision that under certain circumstances a foundation could provide no more than 25 percent of an agency's support. We know of a number of worthy institutions that would not be in existence had this been the law. We believe the sole criterion for grant making should be the program's legality and merit and the ability of those connected with it to properly administer the funds.

Section 4945(f). This section requires foundations to be fully responsible for grants made. While the three requirements would seem to be reasonable on the surface, there are serious consequences. It is conceivable that the enforcement of this provision would require such stringent supervision of grants made that private agency staff would in effect, become merely employees of the foundations and their policy leaders. We urge you give serious consideration to the implications of this situation.

Slums, poverty, discrimination, misunderstanding, unemployment are as vital as support for medical research; university faculty salaries, laborers.

Furthermore, work in the immediate area not only must be done in the interest of the public welfare, they can be done honorably and legally.

You have had impressive testimony on the results of foundations supporting private efforts at basic research in medicine and food, for instance. We need equal and perhaps even more research in the area of our socioeconomic concerns. I would welcome the committee's exploration of this and questions for me and my colleagues.

In conclusion, we believe it most important to stress that this bill as it relates to foundations and those whom foundations support, is widely regarded to be punitive gains those agencies and those foundations dealing with social reform, poverty and minority affairs. Of those agencies of which the Southern Regional Council is one, that have attempted not only to contribute to the general welfare but to bring into reality the potential and the promise of this Nation for all our people, in a sense it could be said we occupy the middle ground, recognizing need, tragedy and aspiration on the one hand, and holding, on the other hand, a deep faith in the ability of the society and this government to be the means by which wrongs can be corrected and a wholesome society created. In this critical time of crisis, polarization, misunderstanding, we urge you do not cripple, as this bill would, those agencies which with increasing difficulty are attempting to occupy that middle ground where the faith remains that the capabilities and intents of our government can be equal to our promises.

Thank you again, Mr. Chairman.

The Chairman. Thank you very much, sir.

(Mr. Anthony's prepared statement follows:)

A STATEMENT BY THE SOUTHERN REGIONAL COUNCIL TO THE UNITED STATES SENATE COMMITTEE ON FINANCE RE. HR 13270

Mr. Chairman, Members of the Committee:

Thank you for this opportunity to be heard. As Executive Director, I represent the Southern Regional Council an organization formed in 1944 for the purpose of contributing generally to the development of the region and more specifically to race relations within the region and the nation. Our five incorporators were Bishop Arthur Moore of Georgia; the late Dr. Howard Odum of the University of North Carolina; the late Dr. Rufus E. Clement, president of Atlanta University; the late Dr. Charles Johnson, president of Fisk University; and the late Mr. Ralph McGill, publisher of the Atlanta *Constitution*. The Council consists of one hundred distinguished Southerners, black and white, Protestant, Catholic and Jew. There is maintained in Atlanta an office and a staff of approximately forty persons. As indicative of our interests we have on that staff, or use as consultants, specialists in urban planning, manpower resources, health and nutrition, community organization, and related areas. We emphasize in our work research and publication on those matters which we feel most pertinent to the region. We also sponsor special projects such as the Voter Education Project, which has been the subject of some interest to the Congress in the formation of this bill.

Our concern about HR 13270 arises from our belief that the bill before you jeopardizes a valuable and unique operation by which our society is served. That operation is the partnership which has been created between private tax-exempt foundations and private tax-exempt agencies. We are confident this partnership has been to the public good. And, it is important that a significant part of the needs and the stimulation of the private sector are served by private funds, under private control, apart from the undue involvement of government.

Before we cite those particulars of the bill which most concern us, we should like to make two general observations:

(1) For twenty-five years the Southern Regional Council has recognized that we enjoyed the benefit of tax-exempt funds in proper exchange for certain restrictions on the use of those funds. For instance, our implementation of the requirement that no substantial portion of our effort be partisan has been to attempt to see that *no* portion of our activity is political. We have attempted to operate within the spirit of the law as well as the letter of the law. We are confident this is true of many other agencies. We do not appear before you to request that the existing regulations and laws which have created this method of operation and our reasoning be altered.

(2) It may be that the present tax laws have allowed individuals and groups to abuse those laws by creating so-called "foundations" for personal gain rather than to serve the public interest. We believe the Congress is justified in seeking to stop those abuses. Our concern is that honorably conceived and legally operated foundations—and those whom they support—not be punished and unduly restricted because of activities of others.

Our particular concerns with HR 13270 are as follows:

(1) SEC. 306—TAX ON PRIVATE FOUNDATION INVESTMENT INCOME

While the precedent may be ominous, the proposed 7½% tax probably would neither significantly alter foundation operations nor add substantially to the public treasury. The true effect would be to reduce by 7½% those funds available to the private agencies. These private tax-exempt groups are, therefore, those really being taxed. This must be recognized by those who believe that there are limitations on the capability of the public sector and that there is, therefore, an important role for private agencies.

(2) SEC. 4945(C)(1)—TAXES ON TAXABLE EXPENDITURES

It is extremely important to note that this section of the bill removes from the current Internal Revenue Service regulations the requirements that no substantial part of a tax-exempt organization's resources be used in partisan political activity or in support of a candidate for office. Rather, there is substituted excessive stipulations to preclude any political activity.

We have been told this has been done because some tax-exempt agencies have abused the present regulations by engaging in substantial partisan political

activity. These abuses may have occurred. But, if they have it has not been because of the inadequacy of current laws and regulations, but rather because of the failure of adequate enforcement of those laws and regulations.

* * * * * * *

While we subscribe completely to the concept that tax-exempt funds should not be used for partisan purposes, we are gravely concerned, for instance, by the wording in the proposed legislation, "any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof, . . ."

Literally interpreted, we believe this provision would prevent responsible agencies now engaged in serious research and publishing from making any meaningful comments on the society in which we operate. We assume, for instance, that at best the Council could publish statistics on migration from the region, but not offer opinions on the causes or impact of that migration. We assume that, at best, we could publish a medical report on hunger and malnutrition, but not offer remedial proposals. We assume we could publish statistics on black-white registration, but not offer any analysis of processes which affected that registration. We would not expect, and do not request, that we be allowed to propose specific legislation nor to support or oppose legislation being considered. However, under the provisions of this bill we assume that regardless of the effort and integrity we invest in forming them, we could not share our opinions with "the general public or any segment thereof."

It is in the public interest that agencies such as the Southern Regional Council be allowed not only to collect information but analyze and comment on that information. Our publications have been used extensively by the media, by scholars and others, and they have figured in the deliberations of the Congress. This contribution to public consideration and to public debate is, we believe, not only valuable, but non-partisan.

We have been upheld by the courts of Georgia in that opinion. In 1963 the Georgia Department of Labor informed the Council that we had been held taxable by virtue of their interpretation that we had a point of view, shared it with the public, and, thereby, engaged in "propaganda" and influenced legislation.

In Court, the State readily accepted the fact that the Council did not lobby, did not support or oppose any specific legislation, nor any candidate for public office. Rather, the State introduced as evidence a collection of Council publications and rested its case on the statement of the executive director that these publications were circulated to the general public.

The Superior Court found in favor of the Council and that decision was appealed to the Supreme Court of the State of Georgia. That Court unanimously upheld the decision of the lower court. We would like to quote the following statement from the Court's decision, *Williamson vs SRO, Inc.*, 223 Ga. 179:

"If the word 'propaganda' is given the broad meaning that it is any dissemination of ideas, then no religious or educational institution could qualify under Code Anno. 64–657(h)(7)(H), since a substantial part of the activities of such institutions is the dissemination of ideas and beliefs. Under the constitutionally protected right of freedom of speech, an organization cannot be penalized for disseminating ideas and beliefs which are not opposed to our system of government, even though such ideas may not meet with the approval of all of the people in the area in which they are advanced."

* * * * * * *

We submit that the process of public dialogue and the dissemination of ideas is essential in a democracy. We submit, further, that such dialogue should be especially encouraged, not prohibited, by organizations that have established themselves in that society.

(3) SEC. 4945(D)

We are grateful that the report of the Ways and Means Committee of the House of Representatives specifically recognized the Council as an agency which could—subject to the information they had available—engage in programs in support of voter registration.

Within this section of the bill, however, and perhaps more importantly elsewhere in the bill, there are requirements that certain programs can receive no more than 25% of their support from any one source. There are implications to this stipulation which may not be readily apparent.

The most important of these are:

(a) There are still relatively few foundations which are willing to support programs of social reform. These foundations and the programs they have supported should be commended, not discouraged, for venturing substantially into new areas since frequently these programs—like the Council's Voter Education Project which could not have come into existence under this provision—have made an important contribution to the public welfare.

(b) Occasionally an unusually imaginative foundation has had the courage and foresight to support exclusively, or almost exclusively, a new group which has promise and a sound idea. We know of a number of now established agencies—many of which now enjoy the financial support of federal, state, or local governments—which would not be in existence had one foundation been limited to providing no more than 25% of a beginning budget.

Subject to other proper consideration, there is no more rationale to restricting a foundation to a maximum of 25% support for a deserving effort than restricting an agency of the federal government to the same limitation on any publicly funded program.

(4) SEC. 4945(F)—EXPENDITURE RESPONSIBILITY

This section would require that foundations be "fully responsible" for the use of grants made. While the three requirements under this section would, on the surface, seem to be reasonable, there are serious consequences to these requirements if they are literally enforced. We believe the enforcement of the three requirements of this section of the bill would be severely damaging to foundations and cause recipients to loose a substantial degree of their independence and autonomy. It would also probably mean that the smaller foundations would have to cease giving to those affected by this provision, since they have neither the staff nor the resources to meet these requirements.

Please do not misunderstand us. We are for the full and complete reporting on the use of tax-exempt funds. During the 25 years of our existence the great majority of our support has come from foundations. During the current year the Council will receive support from at least fourteen foundations totalling more than a million dollars. During all this time and dealing with foundations, large and small, we have never known an instance where a foundation staff did not satisfy itself beforehand as to the pertinence of our request and our competence to administer any funds granted. Nor, have we known of an instance where this process was not further reviewed by the foundation board. Further, we always at least annually issue a full audit of our expenditures and a complete report on our activities for the foundations and other interested parties.

However, the current situation is that the Internal Revenue Service is charged with determining whether or not an agency is tax-exempt and this serves as a guide to foundations. Earlier, we made a request to the IRS regarding our own process of granting funds to other agencies and in a letter dated March 22, 1960 the IRS stated:

(1) "If you make a distribution of your funds to an organization which presently has exemption as a charitable or educational organization described in Section 501(c)(3) of the Code, there is no further obligation on your part to satisfy yourself as to the use of the funds distributed.

(2) "Contributions made by you to organizations, which have not established an exempt status for Federal income tax purposes, will not jeopardize your exempt status if the contributions are made and used only for one or more of the exempt purposes specified in Section 501(c)(3) of the Code. In such an event you should use reasonable care in ascertaining that the contributions will be used only for an exemption purpose and you will be able to substantiate that fact if called upon to do so by the Internal Revenue Service."

We submit this is a workable and efficient method. The burden of requiring foundations to be "fully responsible," as interpreted in the bill, would be harmful to all concerned. Small foundations, with small staff, do not now generally give to non-tax-exempt agencies because they do not have the resources for the necessary supervision, and few large foundations make such grants because the requirements are too burdensome. Under this bill, small foundations would likely have to treat currently exempt organizations as they have non-tax-exempt ones in the past; simply removing them from their list of potential recipients of funds.

Equally disastrous, from the standpoint of all concerned, large foundations would probably have to be so vigorous in complying with these provisions, including their own on-the-spot staff supervision and auditing of their funds being spent, that they would in effect become the supervising grantee as well as the grantor. It is not an exaggeration to state that under these conditions, the independent tax-exempt agency staffs become employees of the donating foundations and the boards of those tax-exempt agencies become bystanders. We urge you to give the most serious consideration to the implications of this situation.

In conclusion, we believe it most important to stress that this bill, as it relates to foundations and those whom foundations support, is widely regarded to be punitive against those agencies and those foundations dealing with social reform, poverty, and minority affairs.

There are those agencies, of which the Southern Regional Council is one, that have attempted not only to contribute to the general welfare but to bring into reality the potential and the promise of this nation for all of our people. In a sense, it could be said we occupy the middle ground; recognizing need, tragedy and aspirations on the one hand, and holding on the other hand a deep faith in the ability of this society and this government to be the means by which wrongs can be corrected and the wholesome society created.

In this critical time of crisis, polarization and misunderstanding we urge you, do not cripple—as this bill would—those agencies which, with increasing difficulty, are attempting to occupy that middle ground where the faith remains that the capabilities and intent of our government and our society can be equal to our promises.

PAUL ANTHONY,
Executive Director, Southern Regional Council.

THE SOUTHERN REGIONAL COUNCIL, INC.

OFFICERS*

President: John H. Wheeler.

Vice-presidents: Paul R. Christopher, C. G. Gomillion, Lucius H. Pitts, Josephine Wilkins.

The executive committee: Raymond M. Wheeler, Chairman; Samuel DuBois Cook, James McBride Dabbs, Julius L. Chambers, Vivian W. Henderson, Frank Smith, McNeill Smith, H. Franklin Williams, Marion A. Wright.

Legal counsel: Joseph F. Haas.

Executive director: Paul Anthony.

MEMBERS OF THE COUNCIL

Class of 1969:

Mr. J. Bill Becker, President, Arkansas AFL–CIO, 1408 Rebsamen Park Road, Little Rock, Arkansas (72202)

Mrs. Joe R. Brewer, Box 314, Route 1, Scott, Arkansas (72142)

The Reverend Caxton Doggett, Hyde Park Methodist Church, Platt at Cedar & Magnolia, Tampa, Florida (33606)

Dr. Luther H. Foster, President, Tuskegee Institute, Tuskegee Institute, Alabama (36088)

Dr. C. G. Gomillion, 308 Bibb Street, Tuskegee Institute, Alabama (36088)

Dr. John A. Griffin, Executive Director, Southern Education Foundation, 811 Cypress Street, NE., Atlanta, Georgia (30309)

Mr. Joseph F. Haas, Attorney, 2709 First National Bank Building, Atlanta, Georgia (30303)

Mrs. Grace T. Hamilton, 582 University Place, NW., Atlanta, Georgia (30314)

Miss Ruth L. Harvey, Attorney, 453 South Main Street, Danville, Virginia (24541)

Mr. Donald L. Hollowell, Regional Director, Equal Employment Commission, 1776 Peachtree Street, NW., Atlanta, Georgia (30309)

Dr. Guy B. Johnson, Professor of Sociology, University of North Carolina, Chapel Hill, North Carolina (27514)

Miss Barbara Jordan, Attorney, 5303 Lyons Avenue, Houston, Texas (77020)

Mr. William H. Maness, Attorney, 603 Florida Theatre Building, Jacksonville, Florida (32202)

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*Addresses of officers are given in the attached list of Members of the Council. All organizations and positions are shown for identification purposes only.

Mrs. Vivian Carter Mason, 2630 Chesterfield Boulevard, Norfolk, Virginia (23504)

The Reverend M. D. McCollom, District Superintendent, The Methodist Church, 209 Bowling Avenue, Columbia, South Carolina (29203)

Mr. Benjamin Muse, Heron House, Reston, Virginia (22070)

Mr. John P. Nelson, Attorney, 1100 Medallion Tower, 344 Camp Street, New Orleans, Louisiana (70130)

Dr. Lucius H. Pitts, President, Miles College, Birmingham, Alabama (35208)

Dr. Hollis F. Price, President, LeMoyne College, Memphis, Tennessee (38126)

Mrs. Tom Ragland, 3821 Abbott Martin Road, Nashville, Tennessee (37215)

Mr. Claude Ramsay, President, Mississippi AFL–CIO, 133 South Lamar Street, Jackson, Mississippi (39201)

Mr. David H. Scull, President, Turnpike Press, P.O. Box 170, Annandale, Virginia (22003)

The Reverend Kelly M. Smith, First Baptist Church, 319 Eighth Avenue, North, Nashville, Tennessee (37203)

Mr. McNeill Smith, Attorney, 700 Jefferson Standard Building, Greensboro, North Carolina (27402)

Class of 1970

Mr. Bradford D. Ansley, Jr., Businessman, 7501 Midnight Pass Road, Sarasota, Florida (33581)

Mr. Julius L. Chambers, Attorney, 216 West 10th Street, Charlotte, North Carolina (28202)

Mr. Edward E. Elson, President, Atlanta News Agency, 3875 Green Industrial Way, Chamblee, Georgia (30005)

Dr. Edward E. Haddock, M.D., 1133 West Franklin Street, Richmond, Virginia (23220)

Dr. Robert J. Harris, Dean, Division of Arts and Sciences, University of Virginia, Charlottesville, Virginia (22903)

Mrs. Martin L. Harvey, Businesswoman, 145 N. Farish Street, Jackson, Mississippi (39202)

Dr. Vivian W. Henderson, President, Clark College, Atlanta, Georgia (30314)

Mr. Harry Huge, Attorney, Alexandria, Virginia, 1823 Jefferson Place, N.W., Washington, D.C. (20036)

Mr. Henry Marsh, Attorney, 3211 "Q" Street, Richmond, Virginia (23223)

Mr. L. D. Milton, President, Citizens Trust Company, 212 Auburn Avenue, N.E., Atlanta, Georgia (30303)

Dr. Samuel Nabrit, Executive Director, The Southern Fellowships Fund, 795 Peachtree Street, N.E., Atlanta, Georgia (30308)

Mr. J. Allen Parker, President, Alabama Exchange Bank, Tuskegee, Alabama (36083)

Mr. J. Rupert Picott, Executive Secretary, Virginia Teachers Association, 316 Clay Street, Richmond, Virginia (23219)

Dr. Jewel Prestage, Chairman, Department of Political Science, Southern University, Baton Rouge, Louisiana (70813)

Rabbi Jacob Rothschild, The Temple, 1589 Peachtree Street, N.E., Atlanta, Georgia (30309)

The Rt. Rev. Msgr. Alexander O. Sigur, P.O. Box 2250, Lafayette, Louisiana (70501)

Dr. Vascoe A. Smith, D.D.S., 505 Vance Avenue, Memphis, Tennessee (38126)

Mr. Walter Sharp, Route 2, Beech Creek Road, Brentwood, Tennessee (37027)

Mr. James Stokely, Author and Poet, 405 Clifton Heights, Newport, Tennessee (37821)

Dr. William H. Townsend, Optometrist, 1304 Wright Avenue, Professional Services Building, Little Rock, Arkansas (72206)

Mr. Nat Welch, Executive Director, Community Relations Commission, 1203 City Hall, Atlanta, Georgia (30303)

Mr. Avon Williams, Attorney, McClellan-Looby Building, 327 Charlotte Avenue, Nashville, Tennessee (37201)

Dr. T. Franklin Williams, M.D., 405 Whitehead Circle, Chapel Hill, North Carolina (27514)

Class of 1971

Mrs. Lawrence Coe, Member, School Board, 262 Stonewall Street, Memphis, Tennessee (38111)

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Mr. Martin L. Harvey, Dean of Student Affairs, Southern University, Southern Branch Post Office, Baton Rouge, Louisiana (70813)

Mrs. Julien J. Hohenberg, 91 Morningside Park, Memphis, Tennessee (38104)

Mrs. Helen Howard, Director, Vine City Foundation, Inc., 558 Magnolia Street, N.W., Atlanta, Georgia (30314)

Mrs. Paul Johnston, Attorney, 1142 Brown-Marx Building, Birmingham, Alabama (35203)

Mr. Sylvan Meyer, Editor, The Daily Times, Gainesville, Georgia (30501)

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Mr. Robert J. Palmer, Businessman, 304 South Main Street, Sumter, South Carolina (29150)

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Mrs. Jane Schutt, 955 Pecan Boulevard, Jackson, Mississippi (39209)

Mr. John Siegenthaler, Editor, The Nashville Tennessean, 1100 Broadway, Nashville, Tennessee (37203)

Mrs. Alice N. Spearman, 3401 Brookwood Court, Columbia, South Carolina (29204)

Mr. Lee B. Thomas, Jr., President, Vermont American Corporation, 500 East Main Street, Louisville, Kentucky (40202)

Mr. John W. Walker, Attorney, 1304-B Wright Avenue, Little Rock, Arkansas (72206)

Mr. John H. Wheeler, President, Mechanics and Farmers Bank, Box 1932, Durham, North Carolina (27702)

Dr. Raymond M. Wheeler, M.D., 3724 Warrington Drive, Charlotte, North Carolina (28211)

Dr. Bell I. Wiley, Professor of History, Emory University, Atlanta, Georgia (30322)

Miss Josephine Wilkins, Sheraton-Biltmore Hotel, 817 West Peachtree Street, N.E., Atlanta, Georgia (30383)

Dr. H. Franklin Williams, Professor of History, University of Miami, Coral Gables, Florida (33146)

Mr. Paul D. Williams, Publisher, 3320 Gloucester Road, Richmond, Virginia (23227)

Mr. Marion A. Wright, Attorney, Top Knot, Linville Falls, North Carolina (28647)

Mr. Jack Young, Attorney, 213 Redmond Building, Suite 207, 115½ N. Farish Street, Jackson, Mississippi (39201)

Mr. James E. Youngdahl, Attorney, 711 West Third Street, Little Rock, Arkansas (72201)

Class of 1972

Mr. Fred D. Alexander, Realtor, 2140 Senior Drive, Charlotte, North Carolina (28208)

The Reverend Hubert Beckwith, Congregational Christian Church of Fairfax County, P.O. Box 288, Annandale, Virginia (22003)

Dr. A. D. Beittel, American Friends Service Committee, P.O. Box 4325, Fondren Station, Jackson, Mississippi (39216)

The Honorable Julian Bond, State Legislator, 162 Eurahlee Street, S.W., Atlanta, Georgia (30314)

Mr. H. A. Hank Brown, President, AFL-CIO, Texas, Box MM—Capitol Station, Austin, Texas (78711)

Mr. Irving E. Carlyle, Attorney, P.O. Box 84, Winston-Salem, North Carolina (27102)

Mrs. John Cashin, 416 Owens Drive, S.E., Huntsville, Alabama (35801)

Mr. Paul R. Christopher, Regional Director, AFL-CIO, 216 Flatiron Building, Knoxville, Tennessee (37917)

The Reverend Walter B. Clancy, Director, Catholic Social Services, Diocese of Little Rock, 2415 North Tyler, Little Rock, Arkansas (72207)

The Reverend Philip Cousin, St. Joseph's A.M.E. Church, Markham Educational Building, 804 Fayetteville Street, Durham, North Carolina (27701)

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Mr. Neil O. Davis, Editor-Publisher, The Auburn Bulletin, Auburn, Alabama (36830)
Dr. Albert W. Dent, President, Dillard University, New Orleans, Louisiana (70122)
Mr. Nils Douglas, Attorney, 1110 Medallion Tower, 344 Camp Street, New Orleans, Louisiana (70130)
The Reverend Duncan M. Gray, Jr., St. Paul's Episcopal Church, 1116-23rd Avenue, Meridian, Mississippi (39301)
Dr. Charles M. Grigg, Director, Institute for Social Research, Florida State University, Tallahassee, Florida (32306)
The Honorable Brooks Hays, Attorney, Little Rock, Arkansas, (314-2nd Street, S. E., Washington, D. C.—20003)
Dr. Aaron E. Henry, Pharmacist, 213 Fourth Street, Clarksdale, Mississippi (38614)
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Dr. Herman H. Long, President, Talladega College, Talladega, Alabama (35160)
The Reverend Powers McLeod, District Superintendent, The Methodist Church, 2252 Allendale Road, Montgomery, Alabama (36111)
Mrs. Helen Mervis, 1422 Valence Street, New Orleans, Louisiana (70115)
Mr. Daniel Pollitt, Professor of Law, University of North Carolina, Chapel Hill, North Carolina (27514)
Mr. Frank Smith, Director, Tennessee Valley Authority, 405 New Sprankle Building, Knoxville, Tennessee (37902)
Dr. C. H. Thomas, Jr., Professor of Political Science, South Carolina State College, Orangeburg, South Carolina (29115)

Life fellows

Mrs. Jessie Daniel Ames, '62, The Wren's Nest, P.O. Box 626, Tryon, North Carolina (28782)
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The Reverend Theodore R. Gibson, '66, Christ Episcopal Church, P.O. Box 6, Coconut Grove Station, Miami, Florida (33130)
Dr. Frank P. Graham, '67, Chapel Hill, North Carolina, (Room 951, United Nations, New York, New York 10017)
Mr. Paul E. Green, '65, Author, Playwright, University of North Carolina, Chapel Hill, North Carolina (27514)
Dr. Gorden B. Hancock, '62, Educator & Newspaper Columnist, P.O. Box 6056, Richmond, Virginia (23222)
The Rev. Edward A. McDowell, '62, 270-D Peachtree Hills Avenue, NE, Atlanta, Georgia (30305)
Rabbi Charles Mantinband, '68, Temple Emanuel, Box 1502, Longview, Texas (75601)
Colonel Francis P. Miller, '66, Charlottesville, Virginia, (2810 "P" Street, N. W., Washington, D. C. 20007)
Dr. Riley B. Montgomery, '66, President Emeritus, Lexington Theological Seminary, Lexington, Kentucky (40508)
Dr. C. H. Parrish, '68, Department of Sociology, University of Louisville, Louisville, Kentucky (40208)
Mrs. J. N. Rayzor, '68, 3207 Groveland Lane, Houston, Texas (77019)
Dr. Harry V. Richardson, '68, Interdenominational Theological Seminary, 671 Beckwith Street, S. W., Atlanta, Georgia (30314)
Miss Dorcas Ruthenburg, '68, 1202 Kentucky Home Life Building, Louisville, Kentucky (40202)
Mrs. David Terry, '64, 411 East Seventh Street, Little Rock, Arkansas (72202)
Mrs. J. Fount Tillman, '68, Palmetto Farm, RFD 1, Lewisburg, Tennessee (37091)
Mrs. M. E. Tilly, '64, Director of Women's Work, Southern Regional Council, 5 Forsyth Street, N. W., Atlanta, Georgia (30303)
Dr. W. D. Weatherford, '64, Black Mountain, North Carolina (28711)

Mr. Carter G. Wesley, '64, Publisher, Houston Informer, Box 3086, Houston, Texas (77001)
Dr. Benjamin E. Mays, '68, President Emeritus, Morehouse College, 3316 Pamlico Drive, S. W., Atlanta, Georgia (30311)

THE SOUTH OF THE FUTURE

(A Statement of Policy and Aims of the Southern Regional Council December 12, 1951)

Eight years ago, the Southern Regional Council was born out of the conscience and high resolve of a democratic nation at war. Today, in another period of international tension, we are faced with a renewed challenge to provide leadership and direction in a troubled region. It is essential that we assess clearly and wisely the role that the Southern Regional Council is to perform in this critical time.

We do not believe in the exclusive validity of any single approach or any single organization. There is not only room, but a desperate need for a wide variety of programs concerned with broadening democracy through legal, economic, legislative, religious, and educational means. Moreover, such programs are needed on all levels—national, regional, state, and local. Every group, like every individual, should chart its course with due regard for the special contribution it is fitted to make.

The role appropriate to the Southern Regional Council is evident in its origin and make-up. The Council's main asset is and has always been the people of the South who understand and want the full practice of democracy, and who at the same time know intimately the old evils that burden the South, and their causes. From such people is the Council's membership drawn. They have wanted a regional organization, not out of any provincial desire to separate the South's problems from the nation's, but out of the conviction that such an organization has unique advantages. It can express the best and often neglected elements of Southern thought and conscience; it can serve as a convincing demonstration of Southerners working together as fellow citizens without regard to race; and it can tap local resources and initiative often inaccessible to agencies outside the region.

The Council seeks to be a practical organization, emphasizing working solutions rather than spectacular pronouncements. Indeed, that philosophy is basic to an organization which hopes to open closed minds and substitute reason for prejudice.

The Council, by its very nature, is not a "mass pressure" organization. The number of persons in the South who are able and willing to reject the taboos on interracial effort in their own communities is growing, but it has not yet reached mass proportions. Meanwhile, the Council's membership can function effectively as enlightened citizens acting through the civic life of their communities in behalf of our common principles. Their methods are the established ones of conference, factfinding, and persuasion.

The Council takes no part in political activity. However, it can and does consult with public agencies and officials and makes its influence felt for truly representative government.

The council's functions may be briefly summed up as follows:

To serve as a meeting ground for citizens of all races, occupations, and religious persuasions.

To present the facts about the region, and their implications, through newspapers, radio, magazines, pamphlets, and other public media.

To counteract appeals to prejudice and violence by demagogues, professional bigots, and hate organizations.

To provide a program adaptable to local need in both the relatively backward and the relatively advanced areas of the South.

To translate appropriate research findings from universities and other centers to the practical situations with which the action program will be concerned.

To give special emphasis to the development of leadership among promising young Southerners of all races.

To convene, by interest group, key persons in the various fields of Southern life, so that steps to genuine integration may be representatively agreed upon.

To stimulate local initiative to work for local solutions in full democracy, so that legislation and judicial rulings may be translated into justice for the individual in his everyday life.

The basic machinery necessary to enable the Council to work effectively at these tasks is: (1) trained, competent, professional persons of both races working in each Southern state as agents of improvement in public life; and (2) staff in a central office of the Council to direct and service the field people.

The declared purpose of the Southern Regional Council is "to attain through research and action the ideals and practices of equal opportunity for all peoples in the region." This objective has lost none of its timeliness since it was first adopted. Although the past eight years have brought notable progress in the South, the job remaining is a vast one, and the pressures of national and international events demand an even speedier advance. Many of our institutions continue to make unfair and unwarranted distinctions between citizens solely on the basis of race. Outmoded tranditions, unjustified fears, and ancient prejudices continue to exact a heavy toll on the unity, productiveness, and integrity of our society.

It is the ultimate hope and aim of the Council that it may help in bringing solution to regional problems that transcend the question of race—problems economic, social, ethical, which affect impartially people of all races. But, for the present, the unique liability under which the South labors arises out of an unreasoning racial disharmony. The first task of informed and conscientious Southerners is to strive to create here the atmosphere in which artificial distinctions and discriminations based upon race will no longer persist. Only when that goal has been attained will the energies of enlightened men be fully released for the great task of realizing all our potential resources, natural and human.

The south of the future, toward which our efforts are directed, is a South freed of stultifying inheritances from the past. It is a South where the measure of a man will be his ability, not his race; where a common citizenship will work in democratic understanding for the common good; where all who labor will be rewarded in proportion to their skill and achievement; where all can feel confident of personal safety and equality before the law; where there will exist no double standard in housing, health, education, or other public services; where segregation will be recognized as a cruel and needless penalty on the human spirit, and will no longer be imposed; where, above all, every individual will enjoy a full share of dignity and self-respect, in recognition of his creation in the image of God.

Equal opportunity, truly defined, includes all this and more. We have no illusion that it can be realized in the South quickly or easily or perfectly. Nor do we imagine that the Southern Regional Council can play more than a modest but creditable part toward its achievement. Yet it is the ideal toward which we strive and, short of which, we have a duty to remain dissatisfied. For it is nothing less than the American ideal.

A Statement on the Voter Education Project of the Southern Regional Council, Inc.

The Southern Regional Council launched the first Voter Education Project in 1962. A major purpose of the new undertaking was to be research into the causes of low political participation, particularly among blacks, in the South. And a major method of this research was to be the direct funding of voter registration drives in the South as a means of determining the types of difficulties encountered.

While the SRC Executive Committee felt this project to be of the first importance, it stipulated that the Council could not sponsor this effort without review and assurance from the Internal Revenue Service that this program would be in accordance with tax-exempt activity as interpreted by IRS. The Council received that assurance from IRS on March 22, 1962. In addition, of course, the Southern Regional Council has filed annual reports with IRS on this as well as all of its programs and expenditures.

SRO's first Voter Education Project began in March of 1962 and ended in the fall of 1964. As a result of these efforts, an increase in Negro registration of nearly 700,000 was recorded in 11 Southern states.

The Voting Rights Act of 1965, suspending literacy tests in six states and otherwise providing new protection for prospective black voters, substantially changed the circumstances of civic participation in the South. Accordingly, the Southern Regional Council decided to launch a second Voter Education Project.

This second VEP began work in early 1966 and remains in operation today. Research into the causes of low political participation remains a major function. Support of voter registration activities continues to be a method of determining the causes of low political participation. However, the second Voter Education Project has placed an increasing amount of emphasis on non-partisian citizenship education and leadership training programs, particularly the latter.

As Congress recognized in the adoption of the Voting Rights Act of 1965, the recent history of the South is darkly stained by the systematic exclusion of Negroes from the political process. A summary of the repressive statutes and practices which enforced this exclusion can be found in "Political Participation," published in May of 1968 by the Civil Rights Commission, and in "Climbing Jacob's Ladder," by Pat Watters and Reese Cleghorn, published by Harcourt, Brace and World in November of 1967. The latter book is largely a description of the work of the Voter Education Project. A feeling for the importance of the research activities of VEP may be gained by noting the number of citations of VEP material in the Civil Rights Commission's report.

The activities of the Voter Education Project have unquestionably brought more Negroes into the political process in the South. With the passage of the Voting Rights Act a contributing factor, the second Voter Education Project—like the first—estimates that its programs have added 700,000 blacks to the registration rolls in the South. Year-by-year progress can be seen in the following table:

INCREASES IN BLACK REGISTRATION, 11 STATES

Year	Black registration	White registration
1960	1,463,333	12,276,127
1962	1,480,720	12,109,680
1964	2,164,200	12,263,820
1966	2,689,000	14,309,704
1968 (summer)	3,112,000	15,702,000

It should be noted that although black registration has risen to 62 per cent of the black voting-age population in the region, white registration stands at 78 per cent of the white voting-age population. Much remains to be done before it can be said that Negroes in the South are full partners in the regional and national political process.

The amount of money allocated for each project hardly can be described as large (although it must seem large to an organization with no other source of support). An average grant for voter registration runs between $1,000 and $2,000. The allocation generally covers a period running from one to two months.

A grant letter is sent to the local organization (see attached sample) which sets out in unequivocal terms that the money is to be used only for non-partisan voter education and voter registration and may not be put to any partisan or other use, and specifically not to serve any political campaign. The grant letter is followed by a research letter which sets our reporting requirements. Organizations receiving funds are required to submit both financial and status reports weekly. These reports are reviewed in the VEP office in Atlanta. All money spent must be accounted for precisely.

Money is supplied on a cash-draw basis. No lump-sum grants are given. This furnishes VEP with a means of cutting off support instantly when a report indicates partisan activities or any other irregularity.

In addition to all this, VEP employs a full-time field diretcor. The field director makes both announced and unannounced visits to all projects receiving VEP support. The field director also visits projects prior to funding to determine that they qualify for support. Non-partisanship is a major item checked by the field director in these on-the-spot inspections.

It should be pointed out that VEP does not endeavor to pay the entire cost of voter registration activities in the South. Local organizations, to the extent possible, are expected to raise funds of their own, particularly in urban areas. Candidates and others directly connected with political campaigns are not permitted to hold positions of responsibility in VEP-supported registration activities or in any way utilize VEP-supported projects, funds or facilities in aid of their own campaigns. While VEP has never found instances of partisan activity to warrant terminating a grant, several grants have been discontinued on other grounds.

Registration activities are not limited to blacks. Several projects have involved registration of Indians and Mexican-Americans. A few projects have reported registering some white Southerners. Relevant to the last point, however, is the fact that white registration in most of the South already is quite high.

The weekly reports are the backbone of VEP research. It is through these reports that VEP learns of difficulties Negroes continue to encounter in their attempts to register and vote in the South. Directors of voter registration projects supply the research department with a wide variety of facts and figures relating to Negro political participation in the South. VEP is the central point of such information by government, the press, scholars and universities, publications, research organizations, authors, and foreign visitors.

As already mentioned, the registration drives provide tremendous amounts of information and knowledge that otherwise would not be available. For many years, the Southern Regional Council has been the main source of information about black registration and voting in the South. Because several states have discontinued publication of registration figures by race, these local registration drives have become increasingly important in arriving at registraton figures by race. The Voter Education Project continues to be the main source of this information.

OTHER ACTIVITIES

During the last three years, VEP has held a number of seminars, workshops and conferences for candidates and officeholders.

We have felt that black candidates and black officeholders, like black voters, have been so long denied a part in the political process that these special educational programs were warranted and, indeed, necessary.

The seminars and conferences are restricted to discussions of the duties and responsibilities of candidates and/or officeholders. Discussion of campaign techniques and strategy, of how to get elected, etc. is not permitted. Incidentally, VEP has consistently rejected requests for funds for get-out-the-vote activities and has cautioned grant recipients against using VEP funds for this purpose. Similarly, we have felt that the new voters should be informed about the government they now are helping elect, and that is the basis for the programs in the field of citizenship education.

As the number of black elected officeholders in the South climbed rapidly toward 400 last year, VEP scheduled the first Southwide Conference of Black Elected Officials. The conference was held in Atlanta last December with approximately 200 black elected officials attending. With the total number of black elected officials now standing at about 460, VEP has set up service centers for elected officials at five predominantly black colleges in the South. Although these centers now serve mostly black officials, we look forward to the day when they will be serving officials of any race who need technical and research advice. The centers may be compared, in terms of techniques and approach to the problems of government, with the Institutes of Government of the Universities of North Carolina and Georgia.

FINANCES

The Voter Education Project is but one of the many programs conducted by the Southern Regional Council, but it is the largest. Although VEP continues to receive small gifts from individuals, the bulk of funds comes from foundations.

Between 1966 and 1968 VEP received $1,163,446. Foundations which gave $2,500 or more each during this period include Aaron Norman, Abelard, Field, Ford, Irwin-Sweeney-Miller, Mary Reynolds Babcock, New World, New York, Rockefeller Brothers, Robert E. Moton Memorial and Taconic.

Grants for 403 programs, most of which involved voter registration totaled $736,956.70, for an average of approximately $1,830 per grant. The rest of the expenditures went for publications research and consultants, scholarships, student interns, meetings and seminars (including the Southwide Conference), and salaries and administration.

The first Voter Education Project (1962–64) received $870,371. Principal supporters were Taconic Foundation, Field Foundation, and the Edgar Stern Family Fund.

CONCLUSION

The Voter Education Project was formed as a result of widespread urgings from many concerned persons and groups, including high government officials, particularly in the Justice Department, that the energies of the sit-ins and

freedom rides of the early '60s be channeled also into voter registration and citizenship education. It should be noted that there was some resistance within youthful civil rights circles to this development, the objection being that the idea sounded like an "Establishment" effort to blunt the thrust of activist undertakings.

It is true that the voter registration, citizenship education and leadership training programs have sought to bring black Southerners into the political process as a means of correcting the injustices that black people have historically suffered. The registration of thousands and the election of scores of black people have given many blacks in the South some hope of improving their lives through the existing political structure.

The Voter Education Project is the only organization conducting such programs on a region-wide basis. VEP could not have undertaken its task without foundation support. Without foundation support, VEP could not have existed. And without VEP, the black registration in the South would be substantially less than it is today.

Yet, as already pointed out, much remains to be done. Some two million voting-age Negroes in the South have not been registered to vote. Gradually, there are signs that white officeholders are responding to the needs of black voters. There are encouraging signs, here and there across the South, that blacks and whites can work together in the councils of government.

In large part these gains were made possible through voter registration, which in turn was made possible in large part through foundation support. To continue and sustain these gains will require a continuing effort, which in turn hinges upon continued foundation support. Gradually white southerners are becoming accustomed to Negroes as a part of the political process. To roll back that trend now would be tragic. Discontinuance of foundation funds for voter registration, coupled with the prospective expiration of the Voting Rights Act, would surely halt and reverse the trend toward full political participation in the South.

Sustained registration campaigns are needed to test the willingness of Southern registrars to follow non-discriminatory procedures (especially if the Voting Rights Act is not extended). However, most black people in the South are poor and can scarcely meet their daily needs. A few communities would be able to raise local funds to finance a voter registration campaign, but most would not. For all practical purposes, voter registration in the South would grind to a halt without foundation support.

In the years after Reconstruction came a dark period called Redemption. During this period, white Southerners turned back the clock and reasserted their control over the lives of black people. Tragic and bloody years followed, and the nation is still undoing the damage. Total exclusion of blacks from the political process was a major factor in that Redemption period.

A second Redemption is unthinkable if the region—and the nation—is to survive as a multi-racial society.

Approved by the Executive Committee of the Southern Regional Council, Inc. in Executive Session, June 14, 1969, Atlanta, Georgia.

The CHAIRMAN. Our next witness is Mr. Lawrence Speiser. He is the director of the Washington office. We had scheduled Miss Victoria Popkin, assistant director of the office, to testify for the American Civil Liberties Union. Unfortunately for all of us, Miss Popkin passed away and Mr. Speiser is presenting her testimony and testifying in her stead. We are pleased to have you today, Mr. Speiser.

STATEMENT OF VICTORIA POPKIN, ASSISTANT DIRECTOR, WASHINGTON OFFICE, AMERICAN CIVIL LIBERTIES UNION, AS PRESENTED BY LAWRENCE SPEISER, DIRECTOR

Mr. SPEISER. Thank you, Mr. Chairman. I am glad you made it clear for the record the testimony I am giving was prepared by Miss Popkin and I hope it is indicated in the record in that fashion.

We are here concerned with the provisions of H.R. 13270, to drastically restrict the so-called political activities of private tax-exempt foundations.

We believe that although there may be some specific abuses that they should be taken care of by legislation, and not this blunderbuss approach to make the changes that are proposed in this law. The bill would impose severe tax penalties ranging from a tax of 100 percent for improper expenditure to loss of tax-exempt status, and also to a tax of 50 percent on the officer authorizing improper expenditure of a foundation which carried on propaganda or otherwise attempted to influence legislation.

Specifically barred are attempts to influence legislation by affecting the opinion of the general public or private communications of legislative bodies. It would eliminate a substantial part of active qualification which exists under present law. There is a specific provision which would permit nonpartisan analysis and research. We do not feel that exemption from the provision is a satisfactory one.

Our first objection to this in considering the penalties that can be imposed, is that the restriction is too broad and too vague. What is meant by the term "propaganda"? Is this publishing materials that would draw one irrevocably to a single conclusion? There have been, for example, studies made by foundations which have had an impact on legislation that have been to the benefit of the general public. I could think, for example, not only of a study but of a conference that was held jointly by the Department of Justice and the Vera Foundation, primarily financed by the Vera Foundation, which highlighted the bail abuses within this country. Obviously, that conference was held to focus attention on that very critical problem, and it was aimed, it was fairly clear, to make changes in not only Federal law but to institute bail projects throughout the country in order to change the laws in the various States.

Under this provision that kind of conference would be prohibited for the Vera Foundation, which was set up to improve criminal justice, and there would be penalties imposed in attempts to hold conferences of that kind even in joint sponsorship with the Federal Government. This also shows the vagueness of the term of the "attempt to influence legislation."

Although the American Civil Liberties Union does not fall within the 501(c)(3) category because it feels it would not be affected by this legislation, we are not quite sure. We do have a tax-exempt foundation called the Roger Baldwin Foundation, which is engaged in litigation involving constitutional rights and rights of individuals, and much of it is test-case litigation to highlight problems and has done so successfully in the past. For example, the man-in-the-house rule was involved in a case brought by the Roger Baldwin Foundation, and which was declared unconstitutional by the Supreme Court; highlighting defects in the social security law. Would engaging in litigation of that kind be considered an attempt to influence legislation?

The exemption for nonpartisan analysis does not seem to be a satisfactory one. The various kinds of studies that have been made could be considered partisan, depending on whether political parties would be likely to make them part of their political program. Studies such as the defects in mental commitment procedures throughout the country may very well be major political problems. Studies on the effect of violence or sexual materials on television, on movies, may very well become political issues, and picking up with studies that have been

made in foreign countries, with recommendations made in foreign countries, and circulating that may very well be considered to be partisan activity.

The effect of this vagueness and uncertainty is bound to be self-censorship. When you are in doubt as to whether or not you are going to be subjected to a penalty, the easy way out is not to extend yourself to it because you do not want to chance it.

As has been pointed out in a number of Supreme Court cases that are referred to in the full statement, this has been considered in the first amendment area as a sufficient basis for striking down legislation, where the fear of a sanction lies overhead—which gets me to the second question, the first amendment activity problem. There has been a Supreme Court case which is usually used as the justification for this proposal of *Commarano* v. *The United States*, which barred the deduction as a necessary business expense for attempts to influence legislation. That is far different than imposing a penalty of 100 percent for doing so. The penalization is a different kind of situation than refusing the tax deductibility.

For those who contend we are only talking about privileges, that tax deductions are privileges, Congress does not have to give, and you do not have to create, tax-exempt organizations. True enough. But in a number of cases the court has has pointed out that even though Congress has created some kind of thing by bounty, by grace you may not impose limitations on it which would have the effect of infringing on first amendment rights even though in the first case you did not have to grant the tax exemption at all.

Lastly, on voter registration activity, the prior speaker can speak with a good deal more knowledge and concern about that, and it would seem that if there is a congressional concern about the use of funds by foundations for partisan political activity or for campaigns that aimed at particular candidates can be done in a far less violent fashion than this bill would do it because it really makes it—it imposes limitations on the smaller foundations and I had always thought that is not really the major concern. The concern was about the larger ones. But you are suggesting that the smaller foundations, those who may not be able to engage in activities in more than one State, are going to have limitations, and they are prevented from doing anything at all, again it seems to me that this is a throwing out the baby with the bath water kind of approach, and if there are abuses, and I think there are abuses, I think it has been highlighted both in congressional hearings and in the public press, by some foundations, that the proper way of doing it is aimed at the abuses themselves and not the broad overall approach which I think is implicit and explicit in these provisions of the tax reform bill.

Thank you very much.

Senator WILLIAMS (now presiding). Thank you, Mr. Speiser.

(Mrs. Popkin's prepared statement follows:)

STATEMENT OF VICTORIA POPKIN, ASSISTANT DIRECTOR, WASHINGTON OFFICE, AMERICAN CIVIL LIBERTIES UNION

SUMMARY

The ACLU opposes and urges deletion of provisions in H.R. 13270 to drastically restrict the so-called "political activities of private tax-exempt foundations."

While there are undoubtedly a number of specific abuses by these foundations which can and should be corrected, the contemplated restrictions jeopardize the continued effectiveness if not the very existence of these unique institutions which have made an enormous contribution to our national well-being.

Attempts to influence legislation

H.R. 13270 would impose severe tax penalties—ranging from a tax of 100% on an improper expenditure, to loss of tax-exempt status, to a tax of 50% on the officer authorizing the improper expenditure—on foundations which "carry out propaganda or otherwise attempt to influence legislation." Specifically barred are attempts to influence legislation by affecting the opinion of the general public or private communication with a legislative body. Specifically permitted is "non-partisan analysis and research."

1. As a standard by which a foundation is to guide its activities, the proposed restriction is too broad and too vague, raising substantial questions under the First Amendment which guarantees the right to publish, to speak and to petition the government. To cite just a few of many possible examples:

> What is propaganda? Is it published material espousing a particular *political* point of view? Publication by a foundation of a "scientific" opinion on the effects of malnutrition on intelligence could be banned.
>
> What is an attempt to influence legislation? Is it the mere publication of an opinion with the hope that it will spur a legislative response or must the publication include specific recommendations? Does it include "test-case" litigation, as in the welfare rights cases which have exposed some glaring infirmities in current law?
>
> What is "non-partisan" analysis? Is it only that analysis specifically sponsored by a recognized political party or does it extend to any analysis likely to be endorsed by such a party? The well known "One Year Later" report on the effects of the Kerner Commission might be precluded.

The effect of this vagueness and uncertainty will be a rigorous self-censorship by foundations far beyond any that exists under present law which provides a "safety-valve" in that its restrictions apply, only to activities which are a "substantial part" of the foundations program.

2. There is also a fundamental question as yet unresolved by the Supreme Court as to the underlying permissibility of so broad a regulation of First Amendment activities. *Cammarano* v. *United States*, 358 U.S. 498 (1959), for example, which is usually cited to advance the proposition that restrictions on lobbying are clearly constitutional decided only that Congress was not *required* to provide a tax deduction to business for lobbying. It did not deal directly with the question of severe penalties in the form of complete denial of a tax-exemption and individual tax liability for enaging in First Amendment activities.

Moreover, recent cases have made clear that to be valid, a condition attached to a government benefit which broadly limits First Amendment rights must advance a "compelling" government interest and be no broader than is absolutely necessary to do so. The proposed restriction is apparently intended to ensure that foundations not be used as "tax-dodges" to support a narrow private interest instead of to advance a broader public interest. That admittedly proper interest is adequately protected by present law.

Voter registration activity

H.R. 13270 also unduly restricts voter-registration activity supported by tax-exemption foundations. If Congress is truly worried about the use of funds for partisan drives or in campaigns aimed at a particular candidate, that can be prevented without curtailing legitimate on-going voter registration merely because the resources available to a foundation be insufficient to support activities in five or more states.

STATEMENT

I am Victoria Popkin, Assistant Director of the Washington, D.C. Office of the American Civil Liberties Union. The ACLU is a private, non-profit organization which devotes its entire resources to the protection of the Bill of Rights of the United States Constitution. We are neither a tax-exempt organization under § 501(c)(3) of the Internal Revenue Code nor are contributions to the Union tax deductible, although we do have a separate tax-exempt and tax-deductible arm, the Roger Baldwin Foundation of the ACLU, which engages in litigation and other charitable activities, primarily in the emerging areas of poverty and welfare law. Thus, we appear here today neither as tax "experts" nor as an

organization necessarily affected directly by the proposed tax law changes contained in H.R. 13270. Rather, we appear to voice our profound concern for the deleterious impact on orderly and progressive social change which would result from proposals to restrict the activities of private foundations, and to raise with you important constitutional considerations which must be brought to bear in weighing the proposed restrictions.

There can be no doubt that tax-exempt private foundations have made an enormous contribution to our national well-being and continued social progress. Traditionally, they have engaged in a wide variety of philanthropic work and have been an important source of artistic, cultural and scientific endeavor. In recent years, with the rapid acceleration of social and technological change, both within the country and without, their activities have expanded to include the experimental and the innovative, and, more importantly, to support and direct the forces of change to which government has been slow to respond. Often this has involved criticism of government action or inaction. As a result, foundations have inevitably engendered controversy and now encounter opposition. Current attempts to restrict their activities are in large part manifestations of his reaction.

We have no doubt that there a number of abuses by private foundations which can and should be corrected—as, for example, when a private foundation which enjoys tax-exempt status as an incentive to engage in activities for the social welfare fails to distribute its income or engages in self-dealing. H.R. 13270, however, is not limited to correction of specific abuses such as these. While the provisions in H.R. 13270, as passed, are less restrictive than those originally reported by the House Ways and Means Committee, they remain sufficiently broad and ambiguous to pose a major threat to the independence of private foundations, the inevitable effect of which will be to curtail severely the constructive contribution which these unique institutions have made to American society. Some specific abuses of tax-exempt status which Congress can legitimately prevent may well be cured, but at the expense of crippling the very institutions created by the Congress to carry out what it has deemed to be important and beneficial social ends. A tax on foundation investment income, for example, while contributing little in terms of revenue to the public treasury, will serve only to assure that fewer private funds are available to meet social and charitable needs and that ultimately the public treasury, itself, will have to take up this slack.

Of primary concern to the ACLU are the provisions in Title I of the bill which restrict so-called "political" activities of private foundations, the violation of which would result in severe tax penalties to the foundation and/or its officers and trustees, and, ultimately, to loss of tax-exempt and tax-deductible status.

Any attempt to curtail "political activities," whether those activities are undertaken by individuals, business organizations or, in this case, private foundations, must be reconciled with the First Amendment guarantees of freedom to speak, to publish and to petition the government. While it may be clear that the government is not *required* to subsidize these activities by way of a tax-exemption or any other means, it does not follow that it is therefore wholly free to limit or ban them as a condition of receiving a benefit to which the taxpayer would otherwise be entitled. See e.g. concurring opinion of Douglas, J. in *Cammarano* v. *United States*, 358 U.S. 498 (1959); *Speiser* v. *Randall*, 357 U.S. 513 (1958); *Sherbert* v. *Verner*, 374 U.S. 398 (1963). Thus, the proposed restrictions on foundation "political activities" must be velwed and judged in the light of established limits on governmental regulation of speech, press and the right to petition the government.

First, the bill would impose a tax of 100% on expenditures by a private foundation, "to carry out propaganda, or otherwise attempt to influence legislation." Such taxable expenditures specifically include (but are not limited to):

"(1) any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof, and (2) any attempt to influence legislation through private communication with any member or employee of a legislative body, or with any other person who may participate in the formulation of the legislation," but specifically permit, ". . . making available the results of nonpartisan analyses or research." Trustees and officers of the foundation who knowingly authorize such expenditures incure an individual tax liability equal to 50% of the amount improperly expended. Flagrant or repeated violations can result in the loss of tax-exempt status.

As a standard by which a foundation is to guide its activities on pain of incurring severe financial penalties, the ban on propagandizing or otherwise attempting to influence legislation is both too broad and too vague. It is fundamental that

"a law forbidding or requiring conduct in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application violates due process of law." *Baggett* v. *Bullitt*, 377 U.S. 360 (1964); *Cramp* v. *Board of Public Instruction*, 368 U.S. 278 (1961). The tremendous "chilling" effect of a vague and uncertain rule on the exercise of First Amendment freedoms has consistently been underlined by the Supreme Court. In *Keyishian* v. *Board of Regents*, 385 U.S. 589 (1966) the Court stated,

"We emphasize once again that [p]recision of regulation must be the touchstone in an area so closely touching our most precious freedoms, *NAACP* v. *Button*, 371 U.S. 415 (438); [f]or standards of permissible statutory vagueness are strict in the area of free expression . . . . Because First Amendment freedoms need breathing space to survive, government may regulate in the area only with narrow specificity. Id. at 432–33 . . . When one must guess what conduct or utterance may lose him his position, one necessarily will steer far wider of the unlawful zone . . . *Speiser* v. *Randall*, 357 U.S. 513, 526. For '[t]he threat of sanctions may deter . . . almost as potently as the actual application of sanctions, *NAACP* v. *Button*, supra at 433 . . . . (at 603)"

The total lack of "precision of regulation" in the proposed restrictions in H.R. 13270 is apparent from even the most cursory examination of their terms.

What is "propaganda?" Is it published material espousing a particular *political* point of view, or any particular point of view? As commonly used, the term can include spreading a scientific or artistic point of view. Is it forbidding, then, only if it becomes a topic of political controversy or if it is merely likely to become such a topic. Realizing that the restriction has an exemption for non-partisan analysis and research, which we deal with specifically below, it still must be noted that there may be specific "scientific" opinions which are not strictly speaking objective research reports, for example as to the therapeutic effect of fluoridation of water, or the pathological effect of cigarette smoking, or the effect of television violence on children, or the effect of hunger and malnutrition on a child's intelligence and performance, all of which are highly controversial matters, which could be termed "propaganda" by those who disagree with the opinion expressed as opposed to "analysis" by those who concur. Are foundations to be precluded from sponsoring and disseminating the results of all studies in such areas? If so, the restriction is virtually without limit.

Similarly, what is an attempt to influence legislation? Is it the mere publication of an opinion with the hope that the problem will spur some kind of legislative or executive action? Must the report contain specific legislative recommendations, or is it enough that it be relevant to a specific proposal already known to be under consideration? For example, a study of efforts in European countries to deal with the problems of obscenity and pornography, which reaches a specific conclusion and postulates recommendations for legislative solutions here might be forbidden only if it includes legislative recommendations, or not forbidden at all.

The two specific statements of what the general ban on attempting to propagandize or influence legislation is to include, and the one statement of what it is to exclude, provide little more in the way of precision or clarity of meaning. (And, significantly, it is stated in the bill that the ban is not *limited* to these examples.)

First, making "available non-partisan analysis and research" is specifically allowed, but, as we have seen, the line between analysis and propaganda is indeed a fuzzy one. Moreover, what does "non-partisan" mean in this context? If it is to include all analysis and research except that specifically sponsored by or to promote a recognized political party it would not appear to be overly restrictive. The same cannot be said, however, if it is to include any analysis or research with which a particular party may or may not agree, or indeed, any analysis and research which has an element of advocacy to it. If the latter is the case, foundation sponsored studies such as the Urban Coalition's "One Year Later" report on the effects of the Kerner Commission would be proscribed. So too would be studies by the American Bar Foundation or the Conservation Foundation and so forth.

Secondly, what is meant by an "attempt to affect the opinion of the general public," which is specifically disallowed? Any published study or report which is circulated to the public whose conclusions are other than benignly neutral could come within this category. Last year's well-publicized and effective studies exposing hunger in America are examples. Moreover, important activities other than studies and reports could be affected, as well. Litigation, for example, is

often more than an attempt to vindicate the rights of a specific individual, but is also an important means of bringing injustices to the attention of the public in the hopes of securing a change in the law. For example, last year's Supreme Court decisions exposing violations of individual rights in administration of welfare programs have had an important impact in focusing public opinion on the need for welfare reform. Such reform has been proposed by the Administration and is becoming a prime legislative topic. One of those cases, *Smith* v. *King* was funded by the Roger Baldwin Foundation of the ACLU. Under the new law, is this a forbidden activity?

Lastly, precisely what is included in the prohibition on private communication with any member or employee of a legislative body, or with any other person who may participate in the formulation of the legislation. Is an individual to incur liability by explaining the results or recommendations of a foundation-sponsored study to someone planning to testify before Congress on a bill, and, thus, "participating in the formulation of the legislation?" Government cooperation is often essential to philanthropic projects carried on by private foundations. An example is the renowned Carnegie libraries. Before these could be built, consultation with numerous local officials and actual legislation to make available the land used and guarantee the maintenance costs was necessary. This type of "communication" and activity is surely an attempt to influence legislation, and would be forbidden by H. R. 13270.

The effect of this vagueness and uncertainty on foundation activities will necessarily be profound and far-reaching. Under present law "no substantial part" of the activities of a tax-exempt (§ 501(c)(3)) organization may be used in "carrying on propaganda, or otherwise attempting to influence legislation." While obviously some of the same problems of vagueness inhere in this, the effect on foundation activities is far less severe. While undoubtedly some self-censorship results, in cases of uncertainty a particular project judged to be important may nevertheless be undertaken if it is not a "substantial" activity of the foundation. The proposed changes would eliminate this "safety-valve". Moreover, the new danger of individual liability by the foundation officers and trustees would obviously mitigate in favor of erring on the safe side. Furthermore, the elimination of the "no substantial part" provision in present law would bring a complete halt to joint government-foundation activities which have been so promising in recent years. Where government and foundation join in sponsoring a pilot project or program (such as a children's TV workshop) in which the government itself is interested, since the government funding aspect of this, even though already authorized by specific legislation, will be a line item in its budget, its implementation involves "formulating legislation."

In short, since the proposed changes are obviously intended to be more restrictive of so-called "political activities" than is current law, foundation officers and trustees, fearing that the foundation may be taxed or that they, themselves, may be subject to severe financial liability, will resort to a kind of rigorous self-censorship, previously unknown, which will likely expand the limitations on First Amendment activities far beyond even those intended by the bill.

"Seeking to stay on the safe side of an uncertain, often unknowable line . . . [foundations] are likely to eschew any activities that might incur official displeasure. Beneficiaries of government bounty fear to offend, lest ways and means be found in the obscure corners of discretion to deny these favors in the future." Reich, "The New Property," 73 *Yale L.J.* 5 (April, 1964), at 751.

While the problem of vagueness is the most readily apparent constitutional difficulty evidenced by these restrictions, another more fundamental question also arises which has yet to be finally resolved by the Supreme Court. That is the problem of the underlying permissibility of this kind of broad regulation of First Amendment activities. There have been only a few Supreme Court cases dealing with federal "lobbying" legislation, and for the most part these have been resolved without reaching this constitutional question.

In *Cammarano* v. *United States*, 358 U.S. 498 (1959), which is usually cited to advance the proposition that restrictions on lobbying in the form of denial of a tax-exemption are clearly constitutional, it was held that expenses incurred in an attempt to defeat certain legislation threatening the continued existence of petitioner's business were not deductible from income as "an ordinary and necessary" expense of doing business.

The Court dismissed the taxpayer's First Amendment claim, stating,

"Petitioners are not being denied a tax deduction because they engaged in constitutionally protected activities but are simply being required to pay for

those activities entirely out of their own pockets, as everyone else engaging in similar activities is required to do. . . ."

That was of course true with regard to the business expense deduction being considered in the case but is not true with regard to a 100% penalty tax or to the complete denial of a tax-exempt status to a foundation because it engages in First Amendment activities or to the individual tax penalty on its officers for authorizing these. As Justice Douglas concurring in *Cammarano*, noted,

"If Congress had gone so far as to deny all deductions for 'ordinary and necessary business expenses' if a taxpayer spent money to promote or oppose initiative measures, then it would be placing a penalty on the exercise of First Amendment rights."

Under H.R. 13270, a foundation could be denied its tax exemption, and its officers penalized if they attempted to influence legislation.

In *United States* v. *Rumley*, 345 U.S. 41 (1952), decided on statutory grounds, the Court interpreted a Congressional resolution authorizing the investigation of "all lobbying activities intended to influence, encourage, promote or retard legislation" as limited to inquiry into representations made *directly* to Congress, explicitly recognizing that

". . . the power to inquire into efforts of private individuals to influence public opinion through books and periodicals, however remote the radiation of influence which they may exert upon the ultimate legislative process, raises doubts of constitutionality in view of the prohibition of the First Amendment." (At 46)

Justices Black and Douglas, concurring specifically pointed out that—

"The privilege of pamphleteering, as well as the more orthodox types of publications, may neither be licensed (*Lovell* v. *Griffen*, 303 U.S. 444) nor taxed, *Murdock* v. *Pennsylvania*, 319 U.S. 105."

H.R. 13270 apparently places a tax on certain kinds of "pamphleteering" and publications, among other things.

Finally, in *United States* v. *Harris*, 347 U.S. 612 (1953), the Court, dealing with a case in which petitioner had failed to register under the Federal Regulation of Lobbying Act (2 U.S.C. §§ 261–270), again avoided the constitutional question of regulating lobbying activities other than direct communication with Congress by construing the Act as *only* applying to that kind of activity. Moreover, it stressed that Congress was not prohibiting attempts to influence legislation but was merely seeking to make the public so as to enable Congress to evaluate the pressures being brought to bear upon them. Thus, the case lends no support to the proposition that regulation of propagandizing or influencing the opinion of the general public is constitutionally permissible. Moreover, Justices Black and Douglas dissented, stating:

"Can Congress require one to register before he writes an article, makes a speech, files an advertisement, appears on radio or television, or writes a letter seeking to influence proposed legislation? That would pose a considerable question under the First Amendment as *Thomas* v. *Collins*, 323 U.S. 516 indicates . . . I mention the First Amendment to emphasize why statutes touching this field should be narrowly drawn to prevent the 'supposed evil' (see *Cantwell* v. *Connecticut*, 310 U.S. 296). . . ."

H.R. 13270 clearly attempts to restrict foundation political activities in ways which have been untested in the Court, and in ways which the Court has itself consistently acknowledged raised profound First Amendment difficulties. In our view, there is reason to believe that even apart from problems of vagueness it could not overcome constitutional barriers. Recent cases have made clear that a condition attached to a government benefit which has the purpose and effect of drastically limiting First Amendment rights is not constitutionally permissible unless a compelling governmental interest is demonstrated. *Speiser* v. *Randall*, *supra; Sherbert* v. *Verner*, 374 U.S. 398 (1963), and even then, the condition will survive constitutional scrutiny only if it is no broader than necessary to protect that interest. Similarly, a condition used to distinguish those who are eligible for a benefit from those who are not, which in effect broadly restricts First Amendment rights, does not meet the constitutional requirements of due process and equal protection unless it can be shown to be a carefully limited means of advancing a compelling government purpose. *Shapiro* v. *Thompson*, 37 U.S. Law Week 4333 (April 21, 1969).

It has not been demonstrated that the government's interest in protecting against propagandizing or attempting to influence legislation by private foundations, or, indeed, any other group is a sufficiently compelling one to justify a

prohibition of the breadth contemplated by this bill. The concern which has been evidenced is not that the public be able to evaluate the pressures brought to bear upon it by foundations, or that a large amount of tax-free funds will be channeled into political campaigns, so that foundations can exercise an inordinate influence on elections or on government policies. Rather, it is apparently that such private foundations not become "tax-dodges" allowing funds to be spent to support narrow private interests to secure a benefit intended to advance a broader public interest. That admittedly proper interest on the part of the government, however, can be adequately protected by present provisions denying a tax exemption only when a "substantial" part of the organization's activities can be deemd "lobbying."

The argument is made that to permit private foundations to attempt to influence legislation either by direct communication with legislators or by affecting the opinion of the general public is to give them an advantage not enjoyed by all others and thus inequitable. We disagree. Since the *Commarano* case, the Internal Revenue Code has been amended to allow corporations, businesses and other profit-making organizations to deduct expenses incurred in influencing legislation which directly affects them, by direct communication with legislators. (Sec. 162) H.R. 13270 would deny similar benefits to private foundations. Thus if, for example, Congress was considering proposals to tax motion pictures deemd objectionable for minors, theatre owners lobbying against this would receive tax benefits to spur their drive. Non-profit parent's or citizens' groups who might support it would be denied similar benefits and thus be handicapped in their efforts. The same effect is possible in controversies over commercial development of a natural resource and countless other areas.

Furthermore, while it is still true that businesses and corporations are prohibited from deducting expenses of attempts to influence the general public on legislative matters, they can often accomplish this by way of advertising, the costs of which are deductible. Thus the Internal Revenue Code as a whole under these new provisions would be sharply skewed in favor of those corporate and business interests already most financially able to make their voices heard in the legislative process, and against those traditionally least able to do so, such as consumer groups, the poor, conservationists and so forth, and who in recent years have increasingly relied on private funds channeled through foundations to make their muscle felt. A tax exemption has been a significant incentive for private funds to support these groups, reducing their overall reliance on government to itself initiate and support change. To attempt to reverse this trend at this time would only serve to increase and spur the alienation and frustration already dividing our country and threatening our institutions, and to deny Congress and the country an important source of information and opinion.

Turning briefly to the second major "political activity" restriction of concern to the ACLU, H.R. 13270 provides that amounts payed, "to influence the outcome of any public election (including voter registration) drives carried on by or for such foundation" are "taxable expenditures" and thus prohibited. Excepted are amounts paid or incurred by a § 501(c)(3) organization, the principal activity of which is non-partisan political activity in five or more States, if that organization expends substantially all of its income directly for such activities, is supported by other tax-exempt organizations or by the general public, does not receive more than 25% of its income from a single source, and does not accept contributions earmarked for use in a particular state or election. These provisions amount to legislative "overkill."

If Congress is truly worried about the use of such funds for "partisan" voter activity or in selected campaigns aimed at a particular candidate, surely that possibility can be prevented with a more narrow restriction that does not threaten to curtail legitimate and important on-going voter registration activity merely because the resources available to a foundation may be insufficient to support activity in five or more States.

The danger which inheres in these new restrictions is not to any one group of persons or single ideological persuasion. Rather it is to the unique role which the tax-exempt foundation so effectively fills in our pluralistic society. Restrictions of this kind, strictly interpreted and enforced, could remove the incentive to innovate, to experiment, to persuade and to act as a source of ideas, which is, after all, both one of the primary purposes for which tax-exempt foundations were created and one of the main advantages of their continued existence. Ultimately it could reduce foundations to mere financial conduits for charitable giving, and dry up a source of information and ideas vital to both the public and the Congress itself.

H.R. 13270 was considered by the House under a closed rule so that amendments could not be proposed. The Senate Finance Committee thus presents the first, if not the last, occasion to consider closely and hopefully to revise the proposed restrictions on foundation political activities. We believe that they are both unwarranted and ill-advised. The grave constitutional questions which they raise cannot be swept under the rug and should not be left to the courts to resolve. We urge that the Finance Committee delete the proposed changes in the law relating to political activities of private foundations from the bill.

The CHAIRMAN. Our next witness is Hon. Ralph Harvey of New Castle, Ind.

Senator WILLIAMS. Mr. Chairman, may I take just a moment of the committee's time to introduce a good friend and former Congressman from Indiana. For 9 years, Mr. Harvey was a Member of the House of Representatives, and among other responsibilities he served on the Select Committee on Small Business. During that time, the Select Committee inquired into the matter of tax-exempt foundations. I know his testimony will be most helpful to the committee in our deliberations on the foundations sections of the bill. Mr. Harvey, you may proceed with your statement.

STATEMENT OF HON. RALPH HARVEY, FORMER CONGRESSMAN, NEW CASTLE, IND.

Mr. HARVEY. My name is Ralph Harvey, a former Member of the House of Representatives. During my 9 terms of service, the last three were as a member of the Select Committee on Small Business. This statement relates particularly to the subcommittee chaired by Congressman Wright Patman and devoted to the study of tax-exempt foundations.

It was my privilege to serve as the ranking Republican on this subcommittee until my retirement at the end of 1966. During this period —1961–66—Mr. Patman conducted—almost single-handed—an investigation into the activities of tax-exempt foundations and held numerous hearings. In addition, a detailed questionnaire was sent to a select group of several hundred foundations in an effort to determine the nature of their philanthropic activities. The Secretary of Treasury and Commissioner of Internal Revenue were questioned and cross-examined in public hearings on the treatment and auditing of such foundations. During the period of which I speak, there was much acrimony between those involved and the hearings sometimes developed more heat than light. Anyone who sat through these hearings could not help developing some convictions * * * it will be my purpose to set them forth as objectively as possible.

Permit me to state in the beginning that I do not have any prejudice with regard to foundations, in fact most of them are devoting their resources to worthy projects. They are able to explore various possible social developments in an unfettered fashion, to make mistakes and to proceed along given lines of activity without regard to public opinion or fiscal accountability in contrast with the limitations of the Government. The history of such foundations extends more than 50 years. Two very early ones, the Carnegie and Rockefeller contributed much to the advancement of health and knowledge. In fact their names became synonymous with humanitarianism and progress. Since World

War II the number of tax-exempt foundations has proliferated immensely.

Out of this welter of charges and countercharges, one fact has become obvious to me. This is that a life expectancy limitation should be enacted as an amendment to that provision of the Revenue Code that gives license to tax-exempt foundations. Reasons for my conviction are as follows:

1. The present Federal tax system encourages those who hold vast estates to convert them to a tax-exempt status to avoid estate taxes.

2. This tendency has become more obvious during recent years because our affluent times have enabled many to become very wealthy.

3. As we continue to have more and more wealth sequestered from the Federal tax base, the burden upon those who are not so privileged becomes greater.

4. While most of these foundations have not had enough longevity to date to become tools of professionals to use for selfish purposes there is ample evidence that this is a growing tendency * * * especially is this true as these self-perpetuating organizations become further removed from their founders.

5. While it is not my purpose to recommend a specific period of life expectancy for tax-exempt foundations, it would be my recommendation that consideration be given to a 50-year period with another 10 years in which to phase out the holdings of those so licensed. Of course, no such provision be retroactive.

6. That enough IRS agents be employed to audit the accounts of such foundations regularly to insure that the bad eggs among them do not use their authority for either selfish economic or personal gain.

Senator Williams. Mr. Harvey, that was a fine statement. We do appreciate your being with us.

The next witness is Mr. Reed Larson, executive vice president of the National Right to Work Committee.

STATEMENT OF REED LARSON, EXECUTIVE VICE PRESIDENT OF THE NATIONAL RIGHT TO WORK COMMITTEE

Mr. Larson. Members of the committee, I want to thank you for the opportunity to appear before this group. What we have to discuss, I think, is an extremely important aspect of this question and one which to a large extent has escaped the attention of all those who are considering the question.

My name is Reed Larson, I am executive vice president of the National Right to Work Committee. We are a single purpose organization, a citizens organization, devoted to the concept that no individual should be compelled to pay money to any private organization in order to work.

Our appeal to this committee, we believe, is in keeping with the spirit in which this broad review of tax legislation has been undertaken, that is to insure that all persons and organizations receive fair and even handed justice under the tax law. We are not here to oppose any specific provisions of H.R. 13270 or to ask for relief from any of its provisions for any group or segment of society.

In fact, we are completely in accord with the Executive Council of the AFL–CIO in its resolution calling on the Senate to improve and strengthen the tax reform proposal.

We agree strongly with the drafters of this bill and their recognition of the fact that a comprehensive drive for tax justice must seek not only to broaden the base of tax revenues but also must reexamine the structure of tax exemption to insure that it serves the public interest and does not confer undue privileges on any special interest group.

In that connection, the present bill endeavors to restrict, as we have heard in testimony this morning, certain tax exemptions of foundations, groups, those exemptions which tend to distort or thwart the will of the electorate in choosing its governmental officials.

As you know, section 101(b) of this bill takes a step in this direction by limiting the political and lobbying activity of certain tax-exempt organizations. It imposes a heavy tax on any foundation and on the manager of that foundation which uses any of its funds "to carry out propaganda or otherwise attempt to influence legislation or to influence the outcome of any public election including voter registration drives carried on by such foundation."

The bill drafters must be credited with exceptional insight for recognizing how supposedly nonpartisan registration drives may be transformed into highly effective partisan political operations. This factor was confirmed by AFL–CIO president, George Meany, whose organization probably spends more money for voter registration and get-out-the-vote drives than all of the tax-exempt organizations combined.

Mr. Meany has observed and I quote:

> When you pay a candidate's bills you are not sure where the money is going. When you make a donation to a candidate you cannot be sure. But when you spend your money to get people registered, and then spend a lesser proportion to get them out to vote, you know you have got a vote in the ballot box.

Mr. Meany continues—

> Of course, we are a little bit choosy when we choose districts in which we want to better those votes in the ballot box, so when they go in we have a pretty good idea of how they are going to vote.

Due in a large measure to special privilege loopholes in our tax laws, millions of Americans are today being denied basic civil rights and political freedom. They are compelled, in order to work at their jobs, to help finance political and ideological objectives with which they may strongly disagree.

Thomas Jefferson wrote:

> That to compel a man to furnish contributions of money for the propagation of opinions which he disbelieves and abhors is sinful and tyrannical.

Supreme Court Justice William O. Douglas placed this principle in a contemporary setting in 1961 when he wrote and I quote:

> If dues are used or assessments are made to promote or oppose birth control, to repeal or increase taxes on cosmetics, promote or oppose the admission of Red China into the United Nations or the like, then the group compels an individual to support with his money causes beyond what gave rise to the need for group action.

Justice Douglas continues:

I think the same thing must be said when union dues or assessments are used to elect a Governor, a Congressman, a Senator or a President.

This committee, we believe, has an opportunity and, we suggest, a responsibility, to address itself to one of the most basic, albeit politically sensitive, needs in the whole spectrum of tax reform. That need, in our judgment, is to apply broadly and evenly the restrictions on political activity by tax-exempt organizations, including particularly those tax-exempt organizations which spend for political purposes funds collected from individuals as a condition of employment.

While officials of labor unions are the most notorious offenders in this connection, the practice is equally objectionable when carried on by any private organization.

The present bill recognizes this topic as germane to the tax reform issue but it touches only the remote edges of the problem.

Tax-exempt foundations whose political activity would be curtailed by this bill, at least use voluntary contributions to finance any politically oriented undertaking.

On the other hand, labor unions, whose open and undisguised politicking dwarfs that of all other tax-exempt organizations, finance their multimillion-dollar political education campaigns and highly selective voter registration drives largely with funds collected from individuals as a condition of employment.

Our tax laws, as presently written and interpreted, encourage this practice. Here is what the Internal Revenue Service told us in a letter dated September 26, 1966:

A labor organization does not lose its right to exemption under 501 because it engages in political activity.

Mr. Chairman, I request that the full text of that letter from the Internal Revenue and the letter to which it responded, be placed in the record.

Senator WILLIAMS. Your letter and your statement in its entirety, will be placed in the record.

Mr. LARSON. Thank you, sir.

I have some more in summarizing this, if I might run on through.

Senator WILLIAMS. If you will make it short.

Mr. LARSON. Some apologists for the union hierarchy have endeavored to maintain the fiction that all union spending for political activity is carried on with voluntarily contributed funds. This is patently untrue. The record of union activity, including admissions by many union officials, demonstrates conclusively that the backbone of union political activity is based on compulsory dues and fees.

I have here and have summarized in this statement, a wide assortment of authoritative articles and documents citing union officials' statements and other authoritative sources and will summarize a couple and will request, if I might, the full text——

Senator WILLIAMS. It will all be placed in the record if you can summarize it.

Mr. LARSON. To summarize the gist of these documents, Joe Rauh, attorney for the United Auto Workers, told the U.S. Supreme Court as far back as 1956, and I quote:

> The only funds available to the union are those that come from dues for the purpose of buying radio time, television time, and newspaper advertising. The small amount that has been collected as voluntary dollars has all gone as very small contributions to the candidates. When a union member pays his dues he has paid for this political action.

From the United Auto Workers counsel.

Justice Hugo Black of the U.S. Supreme Court wrote in 1961:

> There can be no doubt that the federally sanctioned union shop contract here, as it actually works, takes a part of the earnings of some men and turns it over to others who spend a substantial part of the funds so received in efforts to thwart the political, economic, and ideological aims of those whose money has been forced from them under authority of law.

From this record, and from the documents that I am providing, I think it is very clear that the spending by union officials of compulsory dues for politics is indeed astronomical.

In our judgment, this practice, whether carried on by chambers of commerce, a labor union, the National Right to Work Committee, or any other special interest group, threatens the underpinnings of representative government.

Contrary to a widely held misconception, there is no effective means of escape for the compulsory union member who objects to the use of his dues for politics. The idea that union members can successfully withhold their dues from politics is a snare and a delusion of the cruelest sort.

In the only two cases in which such a challenge was successfully made the employees involved spent more than 12 years in litigation at a cost hundreds of times the relief they obtained. And the court acceded to the pleas of union lawyers that the case be decided on a basis which would prevent its being applied as a general rule.

In fact, other cases of employees now making a similar challenge have dragged on for more than 2 years, and not even the first step toward granting relief has been made.

We believe a golden opportunity now confronts those Members of Congress who are interested in achieving genuine tax justice. Removing the special tax privileges of all private organizations using compulsory dues for any kind of political activity will gain the applause of overburdened taxpayers. It will also demonstrate the willingness of the Congress to deal equitably with a powerful special interest lobby.

This recognition is reflected in editorials which I have summarized here, letters, and it is growing throughout the country.

Senator Fannin's proposed amendment to H.R. 13270 represents a giant step in the right direction and merits your favorable consideration. It would deny tax exemption to unions which use compulsory dues for political partisan purposes. We support this proposal and we recommend that it be broadened to include not just labor unions but all private organizations. The principle is the same.

This committee has an unusual opportunity to strike a blow for the freedom of all Americans by applying to all tax-exempt organizations the same basic standards of conduct insofar as political activities are concerned. We urge that you amend the bill to achieve that end.

I thank you.

Senator FANNIN. Mr. Chairman, since he referred to my bill, could I just ask one question? Do you have knowledge of any tax-exempt

organizations, other than labor unions, which are using compulsory dues or fees for political purposes?

Mr. LARSON. Well, there is growing evidence that this practice is occurring among affiliates of the National Education Association. In Michigan, teachers are being fired for their refusal to pay dues to locals of the NEA, and they, of course, engage, as many private organizations do, in some legislative and possibly politically oriented activities. I cite this only as one superficial evidence, and I would say it would need to be checked out more thoroughly.

Senator FANNIN. Is it your opinion that the staff manpower provided candidates by unions is more vital than the monetary contributions given candidates by unions?

Mr. LARSON. Yes, it certainly is. Union officials acknowledge this themselves, as I have cited in my documents.

Senator FANNIN. Are these available for the committee to check?

Mr. LARSON. Yes, they are. The committee reported expenses amounted to about $7,600,000, but that if we are to include the manpower expenses, the total will exceed $600 million.

Senator FANNIN. According to the very recent Wall Street Journal article quoted in your statement, voter registration drives sponsored by the AFL-CIO were formerly financed by voluntary donations to COPE, but are now underwritten with funds from the AFL-CIO's general treasury. Is there a ruling by the Internal Revenue Service which permits the practice of financing voter registration campaigns with money from a union's general treasury?

Mr. LARSON. There is no evidence to my knowledge that Internal Revenue Service places any restrictions whatsoever on spending general union funds on voter registration drives. I do know that a ruling sanctioning union political spending was issued by the IRS in 1966. We have asked recently for an updating. We received just a form letter in reply.

Senator FANNIN. Did the form letter state that it was still in effect?

Mr. LARSON. Yes.

Senator FANNIN. Your statement effectively documents the active participation of an army of salaried union personnel in partisan politics. Would you state how the salaries of these people are paid and from what source during political campaigns?

Mr. LARSON. According to the statements of union officials themselves (which are in the record) these salaries are paid from union general funds—made up mostly of compulsory dues and fees.

Senator FANNIN. I noticed in your statement that you said Japanese and Filipino merchant seamen would contribute, although not voluntarily, some of whom have never even voted in an election. Do you have documentation of that?

Mr. LARSON. I have the newspaper report.

Senator FANNIN. If you do have additional information, I would appreciate it if it could be furnished for the record. Any other information you would like to furnish at this time would be helpful.

Mr. LARSON. I might mention that as a trustee of a foundation myself, we certainly believe that foundations should be treated no differently from anyone else on the question of political spending. The same rule should apply to all.

Senator FANNIN. Thank you very much for your comments, Mr. Larson.

(Mr. Larson's prepared statement and attachments referred to follow:)

STATEMENT OF REED LARSON, EXECUTIVE VICE PRESIDENT, NATIONAL RIGHT TO WORK COMMITTEE

SUMMARY

Due in a large measure to special-privilege loopholes in our tax laws, millions of Americans are today being denied basic civil rights and political freedom. They are compelled, in order to work at their jobs, to help finance political and ideological objectives with which they may strongly disagree.

This Committee has an opportunity and, we suggest, a responsibility to address itself to one of the most basic—albeit, most politically sensitive—needs in the whole spectrum of tax reform. That need, in our judgment, is to apply, broadly and evenly, the restrictions on political activities by tax-exempt organizations which spend for political purposes funds collected from individuals as a condition of employment. While officials of labor unions are the most notorious offenders in this connection, the practice is equally objectionable when carried on by any private organization.

The record of union political activity, including admissions by many union officials, demonstrates conclusively that the backbone of union political activity is based on compulsory dues and fees.

Contrary to a widely-held misconception, there is no effective means of escape for the compulsory union member who objects to the use of his dues for politics. The idea that union members can successfully withhold their dues from politics is a snare and a delusion of the cruelest sort.

A golden opportunity now confronts those Members of Congress who are interested in achieving genuine tax justice. Removing the special tax privileges of all private organizations using compulsory dues for any kind of political activity will gain the applause of overburdened taxpayers. Senator Fannin's proposed amendment to H.R. 13270 represents a giant step in the right direction and merits your favorable consideration.

STATEMENT

Mr. Chairman and Members of the Committee: I am Reed Larson, Executive Vice President of the National Right to Work Committee. Ours is a single-purpose citizens' organization devoted to the concept that no individual should be compelled to pay money to any private organization as a condition of employment.

Our appeal to the Committee is, we believe, in keeping with the spirit in which this broad review of tax legislation was undertaken—that is, to insure that all persons and organizations receive fair and even-handed justice under the tax law. We are not here to oppose any portion of H.R. 13270, or to ask for relief from its provisions for any group or segment of society.

We are, in fact, in complete accord with the Executive Council of the AFL–CIO in its Resolution calling on the Senate to "improve and strengthen" the tax reform provisions. That same body has pointed out the need to "guard against attempts by lobbyists to preserve and widen their special interest loopholes." It is difficult to believe they mean this since AFL–CIO officials themselves enjoy one of the most flagrant of all "special interest loopholes."

We agree strongly with the drafters of this bill in their recognition of the fact that a comprehensive drive for tax justice must seek not only to broaden the base of tax revenues, but also must reexamine the structure of tax exemption to insure that its serves the public interest and that it does not confer undue privileges upon any special-interest group. In that connection, the present bill endeavors to restrict certain tax-exemptions which tend to thwart or distort the true will of the electorate in choosing its governmental officials and policies. As you know, Section 101(b) of H.R. 13270 takes a step in this direction by limiting the political and lobbying activities of certain tax-exempt organizations. It imposes a heavy tax on any foundation, and on the manager of that foundation, which uses any of its funds "(1) to carry out propaganda or otherwise attempt to influence legislation, or (2) to influence the outcome of any public election including voter registration drives carried on by such foundation . . ."

The bill's drafters must be credited with exceptional insight for recognizing how supposedly nonpartisan voter registration drives may be transformed into highly effective partisan political operations. This fact has been confirmed by AFL-CIO president George Meany, whose organization probably spends more money for voter registration and get-out-the-vote drives than all other tax-exempt organizations combined.

Mr. Meany has observed:

"When you pay a candidate's bills you are not so sure where the money is going. When you make a donation to a candidate you can't be sure.

"But when you spend your money to get people registered, and then spend a lesser proportion to get them out to vote, you know you got a vote in the ballot box. Of course, we are a little bit choosy when we choose districts in which we want to better these votes in the ballot box, so that when they go in we have a pretty good idea how they are going to vote."

Due in a large measure to special-privilege loopholes in our tax laws, millions of Americans are today being denied basic civil rights and political freedom. They are compelled, in order to work at their jobs, to help finance political and ideological objectives with which they may strongly disagree.

Thomas Jefferson once wrote "that to compel a man to furnish contributions of money for the propagation of opinions which he disbelieves and abhors is sinful and tyrannical."

Supreme Court Justice William O. Douglas placed this principle in a contemporary setting when he wrote in 1961:

"The collection of dues for paying the costs of collective bargaining of which each member is a beneficiary is one thing. If, however, dues are used, or assessments are made, to promote or oppose birth control, to repeal or increase the taxes on cosmetics, to promote or oppose the admission of Red China into the United Nations, and the like, then the group compels an individual to support with his money causes beyond what gave rise to the need for group action.

"I think the same must be said when union dues or assessments are used to elect a Governor, a Congressman, a Senator, or a President. It may be said that the election of a Franklin D. Roosevelt rather than a Calvin Coolidge might be the best possible way to serve the cause of collective bargaining. But even such a selective use of union funds for political purposes subordinates the individual's First Amendment rights to the views of the majority. I do not see how that can be done, even though the objector retains his rights to campaign, to speak, to vote as he chooses. For when union funds are used for that purpose, the individual is required to finance political projects against which he may be in rebellion."

This Committee has an opportunity, and, we suggest, a responsibility to address itself to one of the most basic—albeit, most politically sensitive—needs in the whole spectrum of tax reform. That need, in our judgment, is to apply broadly and evenly the restrictions on political activities by tax-exempt organizations—including particularly those tax-exempt organizations which spend for political purposes funds collected from individuals as a condition of employment. While officials of labor unions are the most notorious offenders in this connection, the practice is equally objectionable when carried on by any private organization.

The present bill recognizes that this topic is germane to the tax reform issue, but it touches only the remote edges of the real problem. Tax-exempt foundations, whose political activities would be curtailed by this bill, at least use voluntary contributions to finance any politically-oriented undertakings. On the other hand, labor unions, whose open and undisguised politicking dwarfs that of all other tax-exempt organizations, finance their multi-million dollar political "education" campaigns and highly-selective voter registration drives largely with funds collected from individuals as a condition of employment.

Our tax laws, as presently written and interpreted, encourage this practice. Here's what the International Revenue Service told us in a letter dated September 28, 1966: "Although certain sections of 501(c) of the Internal Revenue Code and their implementing regulations contain various definitions, limitations and prohibitions relative to political and legislative activities, there is no such proscription with respect to a labor organization otherwise qualifying for exemption from federal income tax under section 501(c)(5) . . . As a matter of law, a labor organization does not lose its right to exemption under Section 501 because it engages in political activity . . ." Mr. Chairman, I request that the full text of this letter and the letter to which it responded be placed in the record.

Some apologists for the union hierarchy have endeavored to maintain the fiction that all union spending for political activities is carried on with voluntarily-contributed funds. This is patently untrue. The record of union political activity, including admissions by many union officials, demonstrates conclusively that the backbone of union political activity is based on compulsory dues and fees.

I have here a wide assortment of authoritative articles and documents which I will summarize as briefly as possible and then request that the full texts be placed in the hearing record.

As far back as 1956 Mr. Joe Rauh, attorney for the United Auto Workers, told the U.S. Supreme Court that "The only funds available to the union are those that come from dues, for the purpose of buying radio time, television time, and newspaper advertising. The small amount that has been collected as voluntary dollars has all gone as very small contributions to the candidates . . . when he (a union member) pays his dues, he has paid for his political action."

Spokesmen for fifteen labor unions who were defendants in the lawsuit filed in 1953 (International Association of Machinists et al v. Street, et al, 367 U.S. 74 (1961)) admitted using compulsory union dues "to support ideological and political doctrines and candidates which plaintiffs . . . were, are and will be opposed to and not willing to support voluntarily." The plaintiffs were employees who objected to the use of their forced dues for political purposes.

Justice Hugo Black of the U.S. Supreme Court wrote in 1961: "There can be no doubt that the federally-sanctioned union shop contract here, as it actually works, takes a part of the earnings of some men and turns it over to others who spend a substantial part of the funds so-received in efforts to thwart the political, economical and ideological aims of those whose money has been forced from them under authority of law."

The late Senator Dirksen, revered member of this Senate Committee, dealt with the subject at some length in an article published three years ago by the DePaul University Law Review: "It is well known to everyone that American unions have for the past many years been highly active in politics and have played a very important role in election campaigns of members of Congress, of state legislators, state officials, and local city and county officials. The union chiefs make no apologies for this, but rather assert that it is their right to make sure that those elected to public office are sympathetic towards the aims and purposes of labor unions. Large armies of union staff personnel are assigned to work in political campaigns at the precinct level in getting out the vote for "union-endorsed candidates; union newspapers and other publications are heavily devoted to promoting favored candidates, and union funds derived from membership dues and fees are liberally distributed to such candidates.

"Where does this leave the individual worker who is required under a compulsory unionism agreement to pay his dues and fees into the union as a necessary condition to holding his job?"

The official magazine of the AFL-CIO for January 1968 reported on that organization's convention held a month before: "The Convention called for top priority for political action . . . All unions are urged to assign as many full-time staff members as possible for full-time political education work as early as possible in 1968 . . ."

On November 11, 1968, U.S. News & World Report stated: "Organized labor reported that it spent more than ever before—in money and effort—in the drive to elect Hubert Humphrey and save as many pro-union votes as possible in Congress . . . the reports to Congress, however, do not reveal the true extent of the labor campaign. Politicians say the manpower provided by unions is a big asset, going mainly to Democratic candidates."

A long-time union official, Sidney Lens, wrote in the *Commonweal* magazine May 27, 1966: "Around election time, labor mobilized thousands of workers from the shops as well as many full-time organizers. The offices of the auto union, perhaps the most active of all politically, become depopulated by as much as one-half of the regular staff, all working the hustings for union-endorsed candidates . . . On the first Tuesday in November innumerable union men, paid from the union treasury, can be seen driving voters to and from the polling booths, acting as watchers to assure an honest count, and calling on 'sure' voters who have not yet cast a ballot."

Authoritative labor columnist Victor Riesel, in a column printed November 11, 1968: "But all this ($7,600,000 in officially reported campaign spending) is petty cash when compared with the local spending from the kick-off, massive

Labor Day Parade up Fifth Avenue to the last-minute caravans and get-out-the-vote telephone squads. There were hundreds of radio and television broadcasts. Mr. Labor, himself, George Meany, hit a network of some 330 stations five times. The Ladies Garment Workers put on four national broadcasts . . . America's labor leaders poured out well over $60 million for Hubert H. Humphrey."

An AFL–CIO spokesman said that raising money for favored candidates is not the federation's primary political function, according to a Daily Labor Report article published on October 29, 1964, by the Bureau of National Affairs. " 'Skills and manpower are what labor has to contribute,' says its spokesman."

In his nationally-syndicated column of May 17, 1968, David Lawrence observed: "It is possible in America for a labor organization with a vested interest in legislation to spend a huge sum of money to bring about the defeat of a Member of Congress even though the Federal Corrupt Practices Act bars any corporation or labor organization from contributing 'anything of value' to a federal election, including primaries. Frank J. Lausche . . . was defeated in a Democratic primary for a third term a few days ago by the expenditure of a large sum of money collected in part from dues of labor union members."

"A labor union has shown how to hand $100,000 to Presidential-campaign committees and avoid a law limiting donations to $5,000," U.S. News & World Report disclosed in its issue of August 5, 1968. "This lesson in practical politics was given by the Seafarers Union with the money starting to flow to Democratic groups shortly after Secretary of State Dean Rusk declined to extradite a former official of the union . . . Union spokesmen said the money came from members as voluntary contributions for political purposes—not from regular union dues."

Methods used by the Seafarers Union to obtain "voluntary" contributions for political purposes were questioned by a comprehensive article in the January 3, 1969, edition of the Wall Street Journal. It reported: "The most ardent opponents of Richard Nixon's incoming Administration apparently are some Japanese and Filipino merchant seamen who have never even voted in an American election. That, at any rate, is the case if dollar donations to election campaigns are a reliable guide to political convictions. For, month after month, these sailors have been contributing as much as a third of their wages to American political candidates, mostly Democrats. The sailors, hundreds and perhaps thousands of them, have given as much as $500 each after a single sea voyage . . . Ostensibly, the money comes in the form of voluntary donations . . . In reality, though, much of the union's contributions represent payments accepted—or exacted—from alien seamen who work on high-paying U.S. flag ships bound for Vietnam. Most of these seamen are not even members of the union, which distributes the collected cash to favored political candidates."

In a column headlined "Unions' Wallace Line Out of Line," Washington Star writer Frank Getlein wrote on September 4, 1968: ". . . in theory, if the members of a union want to support George Wallace, what the leadership ought to be doing is either finding ways to help the members in this political desire or else resigning and going to work for people more in tune with their own feelings . . . When you get right down to it, people don't join labor unions to get their brains washed by their elected leaders on questions with only a remote connection to the conditions and wages of their employment."

According to the September 5, 1968, edition of the St. Louis Post-Dispatch, "A Cape Girardeau steamfitter told a federal court jury here today that he was 'laid off without reason' in 1963 several days after he refused to make increased contributions to the voluntary political fund of Steamfitters Local 562 . . .(William W.) Copeland was the first witness today in the trial against Local 562 and three of its top officers who allegedly made illegal political contributions through their so-called voluntary political fund."

Four days later the same newspaper reported that another steamfitter "told a jury today that he had signed political fund pledge cards when working on jobs under the jurisdiction of Steamfitters Local 562 because 'I knew I had to sign them or I wouldn't work.' Norman Baker . . . was the first Government witness called today at the trial of Lawrence L. Callanan, business manager of Local 562, and two assistants. They are facing charges of illegally contributing $140,800 to political candidates and campaign organizations."

At the conclusion of the Callanan trial, the St. Louis Globe-Democrat editorialized on September 20, 1968, as follows: "Conviction of Steamfitters Local 562 and three of its top officers on the charge of conspiring "to violate federal election laws brings nearer a successful close to a long, hard fight by The Globe-

Democrat to bring these men to justice . . . While it is a vindication of The Globe's efforts, this conviction is a greater victory for the people. It represents the first time that any union has been convicted for this offense. The impact of this verdict will undoubtedly be felt nationwide and could result in a federal crackdown on other unions circumventing the law."

On September 19, 1968, the Wall Street Journal revealed that "the chieftains of organized labor are about to launch a massive rescue operation designed to save the foundering Presidential campaign ship of their candidate, Vice President Hubert Humphrey . . . participants in the huddles here say the 15-state battle plan envisions putting 'hundreds' of union staff men to work full-time on the Humphrey drive. They report that Mr. Meany has released the entire AFL-CIO organizing staff, totaling around 100 men, to work steadily on recruiting voters for Mr. Humphrey rather than new members for unions. In addition, individual unions are being asked to assign squads of their staff members to the drive."

In its October 2, 1968, issue, the Wall Street Journal characterized "the AFL-CIO's use of hundreds of paid union staffers to aid Mr. Humphrey's campaign" as "a move that is, at best, in the gray area of legality."

"Many of the political activities of labor and management, conservatives and liberals, border on illegality," according to an article published by the Los Angeles Times on October 21, 1968. With reference to the Federal Corrupt Practices Act, it quoted a Washington lobbyist for the UAW as follows:

"This law makes us all terrible fakers. The amount of chicanery being used on all sides to help candidates is becoming a tragic situation."

The same article attributed this statement to AFL-CIO publicity director Al Zack: "Sure, the AFL-CIO News, our official publication, runs pro-Humphrey stories, not pro-Nixon or pro-Wallace ones. But the giant, conservative daily newspapers around the country have been doing just that for years, and still do." (For reasons that are readily understandable, Mr. Zack did not add that American workers are not compelled to subscribe to certain newspapers as a condition of earning their livelihood.)

The Daily Oklahoman reported on October 30, 1968, that "Richard Nixon's Oklahoma campaign organization accused the AFL-CIO Tuesday of using dues of union members to campaign for Democratic presidential nominee Hubert H. Humphrey . . . 'This misuse of funds is in direct violation of the regulations that give the AFL-CIO tax-exempt status and it violates the moral obligation of the organization to its members who are not for Mr. Humphrey,' Broaddus (the Nixon spokesman) said."

On June 10, 1969, Victor Riesel wrote about the 1968 political operation of the United Auto Workers. "Virtually all of the union's $2.1 million 'Citizenship Fund' went for political stakes in the '68 race," he reported. "This does not include the pay and expenses for 916 national headquarters field men known as 'International Representatives.' In the final months of the campaign, virtually all of these men spent virtually all their time campaigning against the Republican front runner. On the cost line, as the accountants say, this would come to many millions of dollars."

"AFL-CIO president George Meany—worried about prospects for Senate and House liberals in the 1970 elections—already is gearing organized labor for a mighty political effort next year," the Chicago Daily News Service disclosed on September 1, 1969. "He praised the AFL-CIO's Committee on Political Education (COPE) and its director, Al Barkan, for running 'one of the best political machines ever put together.' In a backward glance at the 1968 campaign, Meany aired one of his rare public criticisms of the Democrats. 'Even though the party of our presidential candidate, the Democratic Party, was woefully ineffective and torn asunder by internal strife, the fact that Hubert Humphrey came close is to the credit of COPE, not to the party whose label he carried,' the labor leader said."

Last Friday (October 3, 1969), the Wall Street Journal reported the AFL-CIO "has also begun to conduct annual rather than biennial voter registration drives, financing them from its general treasury; in the past, COPE had to depend on voluntary union contributions for such work . . . Labor politicians say that Mr. Meany, who once doubted the need for an organization such as COPE, has never been more responsive to their needs. In fact, it was Mr. Meany who proposed in February that registration drives be financed out of the AFL-CIO treasury and conducted on a continuing basis whenever and wherever registration books are open."

From this record, I believe it is clear that the spending by union officials of compulsory dues money for politics is, indeed, astronomical. In our judgement, this practice, whether carried on by a Chamber of Commerce, a labor union, or any other special-interest group, threatens the underpinnings of representative government. Sixty-three years ago, Samuel Gompers, founder of the AFL, recognized this danger when he said: "It is doubtful to my mind if the contributions and expenditures of vast sums of money in the nominations and elections for our public offices can continue to increase without endangering the endurance of our Republic in its purity and in its essence . . . the necessity for some law upon the subject is patent to every man who hopes for the maintenance of the institutions under which we live . . ."

Contrary to a widely-held misconception, there is no effective means of escape for the compulsory union member who objects to the use of his dues for politics. The idea that union members can successfully withhold their dues from politics is a snare and a delusion of the cruelest sort.

In the only two cases where such a challenge was successfully made, the employees involved spent more than twelve years in litigation at a cost hundreds of times the relief they obtained. And the court acceded to the pleas of union lawyers that the case be decided on a basis which would prevent its being applied as a general rule. In fact, the cases of other groups of employees now making a similar challenge have dragged on for more than two years, and not even the first step toward relief for the aggrieved employees has been made.

The high-handed arrogance of union officials operating under their special tax-exempt shelter was reflected in a recent incident reported in the Philadelphia Inquirer, Thursday, November 7, 1968: "A group of 104 employes at Leeds & Northrup's North Wales plant have asked for a refund of dues paid to the United Auto Workers which were used for political campaign promotion.

"All members of UAW Local 1350, the workers sent individual letters to local president Arthur Stump stating their demands.

"Stump told The Inquirer that he reacted in direct fashion.

"'When I got the letters, I threw them all in the wastebasket,' he said."

A golden opportunity now confronts those Members of Congress who are interested in achieving genuine tax justice. Removing the special tax privileges of all private organizations using compulsory dues for any kind of political activity will gain the applause of overburdened taxpayers. It will also demonstrate the willingness of the Congress to deal equitably with a powerful special interest lobby.

The growing public recognition for the need of action in this area is reflected on the editorial pages of hundreds of newspapers across the country. For your interest here are highlights of what a few of them have been saying in recent weeks:

The Chicago Tribune on September 8: "One trouble with trying to eliminate tax loopholes is that the people who holler loudest about loopholes available to others are often trying to divert attention from even bigger loopholes of their own . . . in short, tax reform is for others—not for the unions."

Wheeling Intelligencer on September 15: "What is hard to understand is why the House has seen fit to tax this type of income if it goes to a church but not if it goes to a labor union."

The Milwaukee (Wisc.) Journal, on July 8: "The tax reformers should show no fear or favoritism. They should close the loophole on labor organizations which have investments in a wide variety of unrelated business activities "as surely as on churches and any other tax-exempt organizations."

Jacksonville (Fla.) Times Union on September 18: "What's good for tax-exempt foundations and commercial interests of churches should be good for labor unions."

Lancaster (Pa.) New Era, on September 8: "The Senate should most certainly consider taxing private organizations that use compulsory dues for political purposes."

The Daily Oklahoman on August 30: "No justification exists for the taxation of the charitable foundations when the unrelated business activities of the not-so-charitable union bosses continue to be the most noxious tax haven in sight."

The St. Louis Globe Democrat on August 28: "Certainly Congress has an obligation to see that unions neither abuse their members' funds, nor enjoy special benefits from the use of them at the expense of taxpayers . . . And organized labor, which prides itself on being a watchdog against social ills, should volunteer its help in bringing about equitable tax reforms for all—including unions."

The Richmond Times-Dispatch on September 1: "Congress has an obligation to insure that the funds of union members are not used for political or other purposes without their approval, and to see that unions do not enjoy other special privileges at the expense of the tax payer."

And finally, the *New York Daily News* said on August 30:

"It is beyond argument, we believe, that political activities of some foundations should cause those outfits to lose some or all tax-exempt status. Nonreligious enterprises of some religious organizations could with justice be taxed . . . So how about labor unions whose leaders habitually (1) take compulsory dues out of their members, and (2) spend large wads of the dough for political purposes—backing favored candidates, financing lobbies, etc.?

Senator Fannin's proposed amendment to H.R. 13270 represents a giant step in the right direction and merits your favorable consideration. It would deny tax exemptions to unions which use compulsory dues for political purposes. We support this proposal, and recommend that it be broadened to include not just labor unions, but all private organizations. This Committee has an unusual opportunity to strike a blow for the freedom of all Americans by applying to all tax-exempt organizations the same basic standards of conduct insofar as political activities are concerned.

We urge that you amend the bill to achieve that end.

NATIONAL RIGHT TO WORK COMMITTEE,
Washington, D.C., September 2, 1966.

Hon. SHELDON COHEN,
Commissioner, Internal Revenue Service,
Washington, D.C.

DEAR MR. COHEN: As you know, for the past ten months the National Right To Work Committee has been the subject of an intensive investigation by the Internal Revenue Service for the purpose of determining whether the Committee is entitled to retain its tax exemption status under section 501(c)(4) of the Internal Revenue Code.

Duing the course of this investigation your representatives have made an intensive effort to find some evidence of political activity on the part of the National Right To Work Committee. They have quite frankly advised us that this is what they are looking for, and in this connection they have scrutinized all of our expenditures for printed material, staff travel, legal services, and membership promotion, have asked for a breakdown of the activities of staff personnel particularly during the period preceding the 1964 national elections and even subpoened the books of those printers who have done business with us. We have been expressly told by your representatives that if they turned up any evidence of political expenditures or political activities by our staff on paid time our exemption could be cancelled.

We are, of course, well aware that as an exempt organization we cannot engage in any political action, and we have scrupulously avoided any involvement in politics or political activities. The only purpose of the National Right To Work Committee is to promote the principle of voluntary unionism. By reason of this we have incurred the enmity of union officials who have publicly expressed their intent to bury us by one means or another.

This brings us to the point of this letter. Are not labor unions, as tax exempt organizations under section 501(c)(5), subject to the same restrictions on political activities as the National Right To Work Committee and other exempt organizations? And, if this is so, why is it that labor unions can openly and flagrantly use the monies collected from membership due to make contributions to political candidates, and assign their staff personnel to electioneering activities on behalf of union-endorsed candidates? That they do all of these things on a large scale is, of course, well known and well documented. Just by way of example, in *International Association of Machinists* v. *Street*, 367 U.S. 740 (1961), the defendant unions stipulated that the dues monies collected from their members under compulsory union shop agreements were "used in substantial amounts to support the political campaigns of candidates for the offices of President and Vice President of the United States, and for the Senate and House of Representatives of the United States . . . and candidates for state and local offices." 367 U.S. 740, 745, footnote 2. In May of this year the newspapers in Washington reported a public announcement by Charles Dalla, president of the Maryland-

District of Columbia AFL-CIO, that that organization would contribute the sum of $200,000 to support the campaign of Carlton Sickles for Governor of Maryland. Enclosed is an article written for the May 1966 issue of *Commonweal magazine* by Sidney Lens, a long-time union staff official, which points out, among other things, that the United Auto Workers Union recently donated $30,000 to the campaign of Senator Paul Douglas of Illinois. The article goes on to point out:

"Equally important is manpower. Around election time labor mobilized thousands of workers from the shops as well as many full-time organizers. The offices of the auto union, perhaps the most active of all politically, become depopulated by as much as one-half of the regular staff, all working the hustings for union-endorsed candidates. These are men, it should be noted, with considerable organizational talent, usually far above the caliber of ordinary Democrats. . . . Union-leased autos, painted over with the names of union-endorsed aspirants, plastered with signs, participate in parades and make tours with loudspeakers blaring their message. In small towns especially, such as Peoria, Illinois or Muncie, Indiana, big unions like steel or auto can mobilize thousands of members to fill a meeting hall or listen to an open-air speech. On the first Tuesday in November innumerable union men, paid from the union treasury, can be seen driving voters to and from the polling booths, acting as watchers to assure an honest count, and calling on 'sure' voters who have not yet cast a ballot. Thus by concentrating on marginal areas, by doling out $1,000 to $5,000 for Congressional hopefuls who need just a little push to put them over, labor can make an important contribution."

Also enclosed is a recent article by one of the well known labor columnists, Victor Riesel who points out that the AFL-CIO has assessed its 13.7 million members at a nickel a head for a special election fund of $850,000 to be spent for campaign activities in this year's national elections.

Since the Internal Revenue Service insists that the National Right To Work Committee must strictly observe the rule against political activity, and since the flagrant political activities of labor unions are largely ignored, it would seem that a double standard is applied under the Internal Revenue Code. As the public becomes more and more aware of this selective enforcement of the law the effect can only be to break down respect for the law, a trend which seems to be rapidly undermining the foundations of orderly society.

We feel that you can quickly restore public confidence in the integrity of the Internal Revenue Service by issuing directives to your agents and offices throughout the country to undertake a sweeping investigation of the political activities of organized labor in this year's state and national elections, and revoke the tax exemption status of any union that engages in such political activities.

Very truly yours,

REED E. LARSON,
Executive Vice President.

U.S. TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
Washington, D.C., September 28, 1966.

MR. REED E. LARSON,
National Right to Work Committee,
Washington, D.C.

DEAR MR. LARSON: Thank you for your letter of September 2, 1966, with attachment, concerning the political activity of labor unions.

You asked whether labor unions, as tax-exempt organizations under section 501(c)(5), are subject to the same restrictions on political activities as other exempt organizations. Although certain sections of 501(c) of the Internal Revenue Code and their implementing regulations contain various definitions, limitations, and prohibitions relative to political and legislative activities, there is no such proscription with respect to a labor organization otherwise qualifying for exemption from Federal income tax under section 501(c)(5).

The qualifying character of a labor organization, as the term is used in section 501(c)(5), is that it has as its principal purpose the representation of employees in such matters as wages, hours of labor, working conditions and economic benefits, and the general fostering of matters affecting the working conditions of its members. *As a matter of law, a labor organization does not lose its right to exemption under section 501 because it engages in political activities*, unless by

reason of the organization's improper activities it can be established that the organization is not sufficiently engaged in the union or labor activity to be characterized as a labor organization in the sense that that term is used in section 501(c)(5).

As you may know, contributors to labor organizations are not entitled to a charitable deduction; however, under certain conditions payments may qualify as a business expense under section 162. With respect to the deductibility of dues paid to a labor union or trade association as a business expense, the Revenue Act of 1962 amended section 162 by adding a new subsection (e) which provides for the deduction of ordinary and necessary expenses paid or incurred in taxable years beginning after December 31, 1962, for certain activities directly connected with legislation or proposed legislation of direct interest to the taxpayer. In no event shall a deduction be allowed for that portion of a special assessment or similar payment (including an increase in dues) made to any organization for any activity which does not constitute an appearance or communication with respect to legislation or proposed legislation of direct interest to the organization.

We appreciate your concern in this matter and want to further assure you that the Service is primarily interested in applying the internal revenue laws fairly and uniformly in all cases. We do everything we can to administer the applicable law and regulations without regard to the political leanings of any taxpayer or organization.

We trust this information will be helpful for your purposes.

Sincerely yours,

Director, Audit Division.

U.S. TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
Washington, D.C., October 10, 1966

Mr. F. R. DICKERSON, *President, Roper Industries, Inc.*
Commerce, Ga.

DEAR MR. DICKERSON: Thank you for your letter of September 6, 1966, concerning the political activities of organized labor and the tax-exempt status of the National Right to Work Committee and the Sierra Club.

The records of the National Office disclose that the National Right to Work Committee has qualified for tax-exempt status under section 501(c)(4) of the Internal Revenue Code, while the Sierra Club is exempt under section 501(c)(3), and labor unions frequently qualify under section 501(c)(5).

The Internal Revenue Service maintains a program of periodic audit and review of the operations of tax-exempt organizations. If it is determined as a result of the audit program that any tax-exempt organization is engaged in activities to an extent proscribed by that section of Code under which it has been held exempt, we will take appropriate action to revoke or modify our prior ruling. This is a factual question in each case, and the Service must examine all of the operations for the years involved.

You expressed concern regarding the possible nonuniform application of restrictions on political activities for various tax-exempt organizations. It should be noted that although certain sections of 501(c) of the Code and their implementing regulations contain various limitations and prohibitions relative to political and legislative activities, there is no such proscription with respect to a labor organization otherwise qualifying for exemption from Federal income tax under section 501(c)(5).

The qualifying character of a labor organization, as the term is used in section 501(c)(5), is that it has as its principal purpose the representation of employees in such matters as wages, hours of labor, economic benefits, and the general fostering of matters affecting the working conditions of its members. As a matter of law, a labor organization does not lose its rights to exemption under section 501 because it engages in political activities, unless by reason of the organization's improper activities it can be established that the organization is not sufficiently engaged in the union or labor activity to be characterized as a labor organization in the sense the term is used in section 501(c)(5).

As you may know, it is the responsibility of the Service to administer the Federal income tax laws enacted by Congress as efficiently and impartially as possible. We have no power to amend the laws or to act contrary to their provisions. Your concern in this matter is appreciated and we want to further

assure you that the Service is interested in applying the internal revenue laws fairly and uniformly in all cases. We do everything we can to administer the applicable regulations without regard to the political leanings of any taxpayer or organization.

We trust this information will be helpful in explaining the varying limitations of organization qualifying for tax-exempt status under different sections in the Code.

Sincerely yours,

FORREST P. NEAL,
Chief, Technical Coordination Branch.

[From U.S. News & World Report, Nov. 11, 1969]

LABOR WEEK: UNION SPENDING ON CAMPAIGN SETS A NEW RECORD

(NOTE.—As the campaign drew to a close, spending by organized labor hit the 4-million-dollar mark. Never before had unions spent so much in a single election. Prounion candidates for Congress got the bulk of the funds, more even than Humphrey.)

Organized labor reported it spent more than ever before—in money and effort—in the drive to elect Hubert Humphrey and save as many prounion votes as possible in Congress.

By late October, a check of reports filed with Congress showed that more than 3.5 million dollars had been spent by unions on the 1968 campaign.

When the final reports are in, the total is expected to run well above 4 million dollars. Some went to help Mr. Humphrey, but, as in the past, most was in contributions to candidates for the Senate and House.

In the 1964 campaign, labor organizations reported expenditure of more than 3.8 millions, according to a compilation by "The Congressional Quarterly." The "Quarterly" also said that union spending ran to nearly 2.5 millions in 1960; 1.8 millions in 1956; and 2 millions in 1952—as reported to Congress.

The reports to Congress, however, do not reveal the true extent of the labor campaign. Politicians say the manpower provided by unions is a big asset, going mainly to Democratic candidates.

Volunteers from labor organizations help in many ways, such as passing out leaflets, taking voters to the polls, telephoning to get out the vote.

"Education" funds.—The financial statements required by law also do not reveal union expenditures for so-called "educational" programs, which legally can be paid for with members' due money. The AFL-CIO alone, for example, expected to spend about 1 million dollars this year in political education.

Part of this money went for more than 55 million leaflets distributed to union homes—attacking Richard Nixon and George Wallace while praising the Humphrey record on labor issues. Unions had to put on an extra drive this time because many members defected to Mr. Wallace early in the campaign.

More than 1.2 million persons were added to voting lists through AFL-CIO efforts, financed by union funds.

The campaign contributions for candidates, however, are supposed to come from special funds made up of voluntary donations by union members.

Each labor group is required to report to Congress on such voluntary funds, and their distribution.

What one union spent.—One of the big surprises of this year's campaign was the large size of the contributions made to candidates by the Seafarers Union. With some 85,000 members, it is one of the smaller affiliates of the AFL-CIO.

Two "voluntary" funds set up by the Seafarers reported political expenditures totaling $536,814 through August "for federal and nonfederal elections." That was nearly four times as much as the same union reported for 1964's campaign.

The national AFL-CIO, led by George Meany, told Congress it spent $1,013,470 through October 23 from its voluntary fund.

This indicated that another million dollars was expended by area branches of the AFL-CIO's Committee on Political Education, or COPE. Half of the money members gave to COPE was to be kept in the local areas for campaigns there.

Other labor expenditures listed in the official reports included $253,599 by the Machinists, $197,817 by the Steelworkers, $128,290 by the Trainmen, $104,-

555 by the Auto Workers, $99,049 by the Carpenters, $75,057 by the Laborers, $63,045 by the Building and Construction Trades Department, $48,816 by the Brotherhood of Electric Workers, and $26,657 by the Painters.

In each case, the figures were those reported spent by the voluntary funds. Any dues money used for "educational" efforts would not be included.

Where the money went.—Most of the donations went to campaign committees in races for the Senate and House, although AFL-CIO spent part of its money on radio broadcasts backing the Democratic presidential ticket. One contribution of $5,000 to a Humphrey committee was reported by AFL-CIO.

The Seafarer reports, covering the period up to August 31, showed contributions totaling $114,000 to various Democratic committees and $21,000 to Republican groups.

The $114,000 given to Democratic committees included $95,000 in donations of $5,000 each—the legal limit—to 19 different committees backing the presidential ticket. There also was $5,000 to the Democratic National Committee and $14,000 to the Democratic campaign committees of the Senate and House.

For the Republican groups the total came to $20,000—$15,000 to congressional-campaign funds and $5,000 to the Republican Campaign Committee.

In addition to money going to congressional candidates through their Senate and House committees, the Seafarer funds listed payments of $1,000 or more for six senatorial candidates and for 49 House members and five new candidates for House seats. Dozens of other nominees got smaller amounts. Most of those on the long lists were Democrats, although 10 House Republicans received checks of $1,000 or more.

One of the larger donations went to committees backing Representative Emanuel Celler (Dem.), of New York, chairman of the Judiciary Committee.

Seafarer reports showed payment of printing bills totaling $5,096 plus a donation of $2,000.

The chairman of the House Merchant Marine and Fisheries Committee—Edward A. Garmatz (Dem.), of Maryland received $3,500 for his campaign.

Among Seafarer donations to senatorial candidates were: $7,500 for Democrat Allen Cranston, in California; $7,000 for Senator Daniel B. Brewster, Maryland Democrat; and $5,000 for Democrat John J. Gilligan, in Ohio.

Few details on candidates backed from cash were visible in the reports filed by AFL-CIO's COPE. Listings showed mainly money sent from the national fund to State COPE funds, which in turn shifted it to candidates' committees. * * *

Special interest was indicated by COPE through the larger amounts handed over to State groups, such as $63,000 to Texas, $29,000 to Ohio, $30,000 to California, and $23,000 each to New York and Michigan committees.

Extra effort.—Reports filed by individual unions gave some indication of extra labor effort in certain senatorial races.

The Gilligan campaign in Ohio, as an example, got $10,000 from the United Auto Workers and $5,000 from the Steelworkers. Also, some COPE money went to Mr. Gilligan; who defeated veteran Senator Frank J. Lausche in the Democratic primary with heavy union support.

For the final election, Mr. Gilligan faced Republican William B. Saxbe.

Another hard-fought race was in Oregon, where union leaders sought to keep Senator Wayne Morse in office. He will be the chairman of the Senate Labor and Public Welfare Committee if re-elected over Republican Robert W. Packwood.

Mr. Morse survived a bitter contest in the primary, although the Machinists Union fought him. For the November test, however, the Machinists switched to support him, even with money. The Auto Workers gave $2,500 to the Morse drive; the Steelworkers, $1,000.

In the California battle, union help for Democrat Cranston included $6,500 from the Machinists and $5,000 from the Auto Workers. Other unions also aided the Cranston effort against Max Rafferty, the Republican nominee, and Paul Jacobs, nominee of the Peace and Freedom Party. The three were seeking the seat of Senator Thomas H. Kuchel, who lost out in the Republican primary.

Labor also was working hard for Democratic Senator Joseph S. Clark in Pennsylvania. The UAW gave $4,500. The Steelworkers reported $9,800 of its voluntary funds went to Clark committees.

Various other Democratic Senators got financial aid for their campaigns, including Warren G. Magnuson, Washington; Birch Bayh, Indiana; and Abraham A. Ribicoff, Connecticut.

On the Republican side, Senator Jacob K. Javits, of New York, was aided by various unions.

In most of the Senate and House races, it was the Democratic nominee who had the support of organized labor.

The House elections were viewed as extremely important by union officials this year, because they feared heavy losses there among their supporters.

The unions were confident that a majority of Senators would back most labor bills in the next Congress.

The labor effort in the House races was to hold the losses to a minimum. To accomplish that, organized labor was willing to spend its millions.

[From Commonwealth, May 27, 1966]

LABOR AND POLITICS: THREAT TO THE DEMOCRATS

(By Sidney Lens)

There were some raised eyebrows not too long ago when George Meany laid down the gauntlet to the Democratic Party. "I don't buy the idea," said the AFL–CIO President, "and there is nothing in the record to sustain the idea that labor needs the Democratic Party. I am sure it is the other way around."

Could it be that Meany was prepared to sunder an alliance that had survived through thick and thin for three decades—especially now that Great Society reforms were running off the Congressional assembly line at a greater pace than at any time since the New Deal? Was he threatening to reduce labor's participation in politics, back to where it was, say, in Sam Gompers' or William Green's time? Did he have a labor party in mind? Or was he just speaking out of pique?

The element of pique was certainly obvious—and justified. Congress, for the second time around, was rebuffing labor on Section 14(b). The repeal of this portion of the Taft-Hartley law, which would have legalized the union shop in 19 states where it is now outlawed, was only a small payment to expect from the Democratic administration. But Mr. Johnson has failed to deliver. The suggested guidelines of 3.2 percent maximum wage increase proposed by the President and his Council of Economic Advisers also rankled Meany, and above all his friends in the building trades. Furthermore, with the war in Vietnam diverting Congressional and Executive thinking from domestic reforms, proposals for improving the minimum wage laws and unemployment compensation, seemed to be evoking less than robust enthusiasm. Efforts by Secretary of Labor Willard Wirtz and other Administration stalwarts to twist labor's arm on these matters did not sit well with Meany. His outburst therefore was an understandable reflex action, and though it exaggerated labor's importance in the alliance with the Democratic Party, was not wholly without substance.

But is pique was a factor, Meany's ploy also was a calculated move. Assuming its present policies, labor's leadership, admittedly, had no place else to go. Meany himself made it categorically clear that he entertained no farout notions about building a labor party, as in England or elsewhere in Europe. Nor was there much prospect of a modus vivendi with the Republicans, as was once practiced by John L. Lewis or the elder Hutcheson of the Carpenters' Union—if for no other reason than the paucity of liberals in the Grand Old Party.

But there was room for a better deal between the partners, and Meany was intent on squeezing what he could from his Democratic Party allies. He is not naive enough to believe, as do some unreconstructed rightists, that the AFL–CIO can deliver the vote of thirteen million workers and their wives on a gilt-edge platter. He knows the limitations of his organization. But he is also aware of the increased bargaining power he enjoys in this mid-term election. In *this* sense Johnson and the Democrats need labor more than vice versa.

The Administration is certainly bound for trouble come November; only a bumbling Republican leadership can save it from a severe rebuff. In addition to the normal losses for the ruling party in off-year voting, which over the last sixty years has averaged thirty-seven seats in the House and five in the Senate, there is the pervasive anxiety over Vietnam. Gallup poll or no, this is a most unpopular war, and the inflation and contemplated tax increases that go with it make it even more so. Though President Johnson has enjoyed clear sailing on most of his program, some of his victories (on the rent subsidy, for instance) have been razor thin. There are 51 first-term liberals in the House whose tenure can be cut short by a small shift of two or three percent in the electorate. Trouble looms in the Senatorial race in Michigan; a four-tenths of one percent change in Montana

would retire Senate Lee Metcalf and a seven-tenths of one percent shift on Oklahoma would have the same effect on Senator Fred Harris. Four or five other incumbent Democratic Senators are fishing in turbulent waters.

It is with this in mind that labor's role becomes significant. In many marginal districts, union efforts, though far from overpowering, nevertheless represent the difference between defeat and victory. AFL–CIO's COPE raises $800,000 or $900,000 in dollar contributions from individual members, which are then dispensed around the country where needed. In addition various international unions have their own "free funds" to distribute; the auto union, for instance, recently donated $30,000 to the campaign of Senator Paul Douglas of Illinois. Here and there a labor organization finds its way around the strictures of the Taft-Hartley law, which prohibits direct contributions to federal campaigns from the union's own treasury, by making a gift to a local candidate with the quiet understanding that he himself will pass some of the funds on to Congressional or Senatorial aspirants. A million or two million dollars can make a difference if it its spent wisely in close races.

Equally important is manpower. Around election time labor mobilizes thousands of workers from the shops as well as many full-time organizers. The offices of the auto union, perhaps the most active of all politically, become depopulated by as much as one-half of the regular staff, all working the hustings, for union-endorsed candidates. These are men, it should be noted, with considerable organizational talent, usually far above the caliber of ordinary Democrats. In the central offices of COPE the lists of perhaps half the local unions in town are broken down by ward and precinct so that they can be polled by the activists and enrolled in the cause. A special effort is made to get union men to register, on the theory that workers are more apt to disregard their function as voters than members of the middle-class, and this can sometimes be a major factor in the election itself. Union-leased autos, painted over with the names of union-endorsed aspirants, plastered with signs, participate in parades and make tours with loudspeakers blaring their message. In small towns especially, such as Peoria, Illinois or Muncie, Indiana, big unions like steel or auto can mobilize thousands of members to fill a meeting hall or listen to an open-air speech. On the first Tuesday in November innumerable union men, paid from the union treasury, can be seen driving voters to and from the polling booths, acting as watchers to assure an honest count, and calling on "sure" voters who have not yet cast a ballot. Thus by concentrating on marginal areas, by doling out $1,000 to $5,000 for Congressional hopefuls who need just a little push to put them over, labor can make an important contribution.

SOLID LABOR SUPPORT

Someone like Congressman Roman Pucinski in Chicago, who has solid labor support, can expect union watchers to man every one of the 472 precincts in his district on election day. Perhaps 50 or 100 will work some of these same precincts for three or four weeks prior to the balloting, distributing shopping bags at shopping centers, handing out leaflets, visiting a few homes. Pucinski is now fairly safe, but when he won the first time, some years ago, the unions certainly were the decisive factor; without them he would have lost.

How much COPE's activity (and that of DRIVE, the teamster union equivalent) translates into actual votes is difficult to say. An old-time Chicago union leader claims that he gauges his effectiveness by the number of ballots his man gets over and above the highest man on the local party ticket. That can be five or seven percent, he says, no small figure where a few percentage points determines the outcome. Labor theorists estimate that their work is decisive in some 35 or 37 districts. It may be only 10 or 20, but in a Congress so delicately balanced as ours that is enough to tip the scales on many pieces of legislation.

UNIONS LICKING COSTLY WOUNDS, LABOR CAMPAIGN BILL $60 MILLION

By Victor Riesel

NEW YORK.—For the union chiefs, this campaign was a labor of love and hate, at a cost so fantastic only a computer's memory box could count up the millions of dollars.

Sabotaged by the Kennedy clan, mocked by the McCarthyites, derided as old fuddy-duddies by the Americans for Democratic Action, gleefully walloped by

George Wallace in their own strongholds, America's labor movement poured out well over $60 million for Hubert H. Humphrey.

Of course, reaction of weary labor chiefs to this figure will be derisive denunciation. This is understandable. No powerful political force is enthused over listings of the gold flow. But never in labor's history has it given so much heart and treasury to crush its opponents. In this campaign, George C. Wallace, even more than Richard M. Nixon, was the enemy.

The high cost of living through a campaign such as labor unleashed is inconceivable until you put a pencil to work on just a few projects and unions.

Labor's central headquarters mailed and shipped over 55 million pieces of literature—some of it mighty expensive printing. Easily, the rest of the labor movement deluged the nation with several times that central mailing. This printed flood was so vast even Al Barkan, director of the AFL-CIO's Committee on Political Education (COPE) had no way of keeping track of what was happening in the field among the 60,000 local unions.

Thus, on Oct. 21, he urged regional labor leaders to send COPE "two copies of all campaign materials you produced and distributed to members. This would include special campaign editions and other heavily political editions of your international union or state AFL-CIO journals, as well as leaflets, pamphlets, etc."

In two months of this campaign, these came to tens of millions of pieces and full newspapers.

The Carpenters spent almost $100,000 on one membership mailing alone.

On the record, the Machinists (1,900 lodges) spent over $500,000; the Ladies' Garment Workers (200 locals), another $500,000; the Seafarers, $1 million; the National Maritime Union, half a million; the Teamsters (900 locals), over two million; the Auto Workers (1,275 locals), another two million; Steelworkers (3,250 locals), about a million.

But all this is petty cash when compared with the local spending from the kickoff, massive Labor Day Parade up Fifth Avenue here to the last-minute caravans and get-out-the-vote telephone squads.

There are hundreds of radio and television broadcasts. Mr. Labor himself, George Meany, hit a network of some 330 stations five times. The Ladies' Garment Workers put on four national broadcasts. Thousands of locals hit the airwaves with their own appeals. There were special drives for the "nationalities" vote—sometimes known as the foreign language appeals. From labor's point of view, it was their most splendid hour.

All these are on-the-record expenditures. There are thousands of indirect costs. No Humphrey caravan, on land, sea or in the air, by ship, jet or truck, was without its share of international union presidents. They were seafarers, longshoremen, plasterers and electricians, building service leaders and retail clerks. They were advance men—though some of them lead unions of a million members in less political moments. They were fellow travelers. And they stayed behind to make certain the candidate's visit would not be forgotten.

"It was the most all-out effort the labor movement ever has made," said Al Zack, one of a handful of men close to George Meany. "It was more intense than the effort to beat Barry Goldwater. I never saw anything like it. I saw more hard work, more intensity, more evidence of union signs, sound trucks, billboards, union registration drives, than ever before. We even had union registration headquarters deep in Watts. It was American labor's greatest political push."

Whatever else it did, it did not wipe out George Wallace. His nine million votes put him permanently in the political party business. Those votes came from AFL-CIO members and their families. Local labor leaders will have to reckon with this every minute from now until 1972.

In the early hours of the morning after, as I wandered from my radio and TV studio mikes to the Democrats' plush Bastille at the Hotel Pierre and Richard Nixon's posh 35th floor soft music and tinkling glasses retreat at the Waldorf, I thought that most of my colleagues had missed one essential point in the final election commentaries.

They talked of Wallace "running a poor third." For the man from Montgomery, it was a victory. He was a sideshow this time. He'll be the main eventer next time. His nine million votes gives him a powerful base now—and much of it is inside labor.

The campaign is over, but the past is prelude.

[From Daily Labor Report, Oct. 29, 1964]

BIGGEST POLITICAL DRIVE EVER PUT ON BY AFL–CIO

The pamphlet writers are relaxing after a record outpouring but the speakers are still out exhorting and the organizers are preparing to give their all to get out the vote in the biggest political campaign organized labor ever has put on.

Its purpose: To elect Lyndon B. Johnson and Hubert H. Humphrey to the Presidency and Vice Presidency, and as a bonus, to get a more liberal House and Senate.

AFL–CIO President George Meany told the labor federation's general board meeting at the beginning of September that the 130 national and international union affiliates should assign all their organizers to work on registration and get out the vote campaigns.

Meany himself has worked overtime on the election. On a recent day, he flew from Washington to San Francisco to address the Iron Workers, then back to New York to speak to the Stone Workers, and went on to a Liberal Party rally at night. Since September 1, every convention of a national affiliate of or a State AFL–CIO Council has been addressed by Meany or a vice president with the single theme, plugging the Johnson-Humphrey ticket.

As a result of the new fervor, internationals that have disdained political endorsements in the past have come out for the Johnson-Humphrey ticket. The Printing Pressmen, the Chemical Workers, and the State, County, and Municipal Workers are examples.

AFL–CIO and COPE (Committee on Political Education) publicists turned out 12 special pieces of campaign literature, loosing a flood of 60 million pieces of paper. This was two to three times the number produced by labor for the Kennedy campaign.

The material is designed for easy consumption. The smallest piece is a four-page folder no bigger than a business card. The cover says, "The issue is PEACE" and the inside asks, "whose finger do YOU want on the nuclear trigger?" Quotations from President Johnson and Senator Goldwater, the Republican Presidential candidate, are given for the answer. Five other folders, the size of a post-card, were kept very simple. They are devoted to different issues: Unions, jobs, peace, "so-called 'right-to-work,'" and hospital card for the elderly.

Two larger folders are devoted to the nuclear bomb issue and to "20 Questions." The questions are this type: "Do you believe the federal government should launch programs to reduce unemployment and help create jobs?" According to the folder, Goldwater has answered "no" to all the questions, on the basis of his record and statements, and President Johnson has answered "yes."

Another COPE publication is headed "The Republican Hidden Labor Plank." It reproduces the heading on S. 87, a bill introduced by Senator Goldwater on January 14, 1963. The leaflet says that bill would outlaw union security agreements in all 50 States, require a government strike vote on petition of 30 percent of the workers, "force the federal government to sue any union if a member complains that he has been denied his rights under the Landrum-Griffin Act," and block use of union funds for non-bargaining activities such as legislative work, community services, education, etc. Still another campaign piece purports to give Goldwater's voting record 1961–1964. The biggest piece, decked out in red, white, and blue, tells "Where They Stand" on issues of concern to working people.

AFL–CIO itself took on the job of dealing with the reported "white backlash." It had distributed at plant gates, union meetings, and every place it could a leaflet, "Civil Rights: Facts v. Fiction."

It gives the basic provisions of the Civil Rights Act in capsule form, and the "fact" to answer three pieces of "fiction." The "fictions" are that "If you sell a house, you have to sell to a Negro." Your children will be sent out of the neighborhood to some Negro school," and "A certain number of Negroes will have to be hired on every job, even if white people have to be fired to make room for them."

The Administration gave potent help in the fight against the backlash, sending Acting Attorney General Nicholas Katzenbach to speak to the AFL–CIO state convention in Indiana where Alabama's Governor George Wallace made a strong primary showing in the Gary steel district.

As a result of all this activity, an AFL–CIO spokesman thinks the backlash has subsided. He ticks off "peace, the 53 wrong votes on the COPE list, and identifying Goldwater as the right-to-work man" as the three factors that have negated the Republican candidate's repeal.

Still, a "Labor for Goldwater" label pops up every now and then. The AFL-CIO spokesman calls any such source "pure crackpot—way out."

Meany goes beyond the charges made by COPE in his speeches and compares Goldwater's candidacy to the early days of Hitler in Germany—not that Goldwater is the same as Hitler, but the forces behind both men are similar, he claims.

The labor federation's chief activities have been to get workers and the population generally registered to "educate" its own members, to organize get-out-the-vote programs for November 3, and to collect voluntary contributions of $1 or more in order to help its chosen candidates.

In all except the last activity, union funds are used. The AFL-CIO affiliates have pitched in $1 million for a registration campaign, run by Roy Reuther of the United Auto Workers. The literature has been paid for out of regular income because unions have the right to educate their members on the issues and tell them the union position on candidates under the *CIO News* case that went to the Supreme Court, as AFL-CIO lawyers see it. None of the AFL-CIO material is for general distribution.

But the federation doesn't look at its primary political function as being that of money raiser for its favorite candidates. "Skills and manpower are what labors has to contribute," says its spokesman.

Even so, COPE has been doing somewhat better than it did four years ago. On October 24, 1960, it had collected $527,928 (DLR 210-1960-A-1). On October 23, 1964, it had collected $579,460, according to its latest report to the Clerk of the House of Representatives, required under the Corrupt Practices Act. And it shows greater optimism about more coming in than it did in 1960. On October 24 that year, it had spent $728,405. On October 23 this year, it had spent $885,407. This deficit spending is common on the part of most of the union political organizations, because the money has to be spent when it will do some good, while the donations get bigger as the election nears and some has not cleared the pipeline by election day.

Half of COPE's income goes back to the state COPE's for them to dole out. The other half is used nationally and in states with little labor organization. Even with one-half, its direct contributions to candidates are very minor, adding up to only $27,500 all of this year up to October 23. Senator Williams (Dem., N.J.) has been the biggest beneficiary, receiving $10,000. The only other Senatorial nominee listed as getting a direct contribution is Robert Byrd, the Democratic incumbent in West Virginia, down for $2,500.

Other direct COPE contributions have gone to the following Democratic candidates for reelection to the House: James Roosevelt (Calif.), Frank Thompson (N.J.), and Charles Joelson (N.J.), and Joseph Minish (N.J.), $2,000 each; Joseph Addabbo, (N.Y.), John Murphy (NY.), and Hugh Carey (N.Y.), $1,000 each.

William T. Cahill, a Republican Congressman, has received New Jersey COPE's endorsement and $2,000 from national COPE. Paul J. Krebs, former United Auto Workers staff member and a Democratic candidate for the House in New Jersey, is the only non-incumbent to get a direct contribution, which was $2,000.

Several CIO unions have pulled out of the AFL-CIO state and COPE organization in New Jersey, which have have something to do with the number of direct contributions in that state.

[From the Washington (D.C.) Evening Star, May 17, 1968]

Unions Spend To Defeat Lausche

(By David Lawrence)

It is possible in America for a labor organization with a vested interest in legislation to spend a huge sum of money to bring about the defeat of a member of Congress even though the Federal Corrupt Practices Act bars any corporation or labor organization from contributing "anything of value" to a federal election, including primaries.

Frank J. Lausche, former mayor of Cleveland who served five terms of two years each as governor of Ohio, is perhaps one of the most objective and conscientious members the United States Senate has ever had. Yet he was defeated in a Democratic primary for a third term a few days ago by the expenditure of a large sum of money collected in part from dues of labor union members.

Although most of the prominent newspapers in Ohio supported Lausche for renomination, he went down to defeat at the hands of Cincinnati Councilman

John J. Gilligan, presumably because the senator did not have available financial support sufficient to overcome the intensive drive made by the state labor federation, which is affiliated with the AFL–CIO.

Up to now, the courts have ruled that labor unions could conduct "educational" campaigns and could participate in "get-out-the-vote" movements. But the many ways by which labor-union members are at the same time individually told how to vote are not specifically covered in any existing law. Does "education," for instance, include "electioneering"?

Ken W. Clawson, Washington Post staff writer, tells of the methods by which the campaign in Ohio was conducted directly into the homes of 800,000 union members. He writes:

"Gilligan, who said that he wouldn't run against Lausche unless labor put up a $1 million kitty, reportedly settled for somewhere around $300,000 . . .

"The chain that eventually led into the home of nearly every union member in Ohio started with international unions affiliated with the AFL–CIO. From these unions, the Ohio federation obtained the much-guarded membership lists for the Buckeye State.

"These lists were sent to local unions where telephone numbers, political party membership, registration status and address changes were added. Back to Columbus went the lists and then to the International Association of Machinists Building in Washington, where a computer indexed over 800,000 Ohio union members by party, registration status, Congressional District and by respective union.

"Canvassers, when they knocked on doors, were equipped with information about the fellow trade unionist and his family ahead of time. This efficiency was particularly helpful the Monday before the election when the AFL–CIO distributed a million pieces of literature. Knowledge of the identities and addresses of Ohio unionists permitted the AFL–CIO for the first time to get directly into 800,000 members' homes."

The state labor federation selected the strategic industrial areas in which Democratic primaries may be won and concentrated on them, so the "educational" campaign was not necessarily applied throughout the state in every district. Per-capita union dues were used to pay the expenses for political work in the primaries.

Some of the national unions made direct contributions of their own and gave political dollars to district and regional offices. The Ohio AFL–CIO will report to the state government that $8,750 was contributed to the "educational" campaign. But it is estimated that the cost of just setting up the computer-program system for identifying union members would alone run between $80,000 and $100,000.

If the executives of a group of corporations turned over their mailing lists to a campaign committee, supplied the money to canvass voters, told them to "register and get out the vote," and urged them to support a particular candidate, it may be taken for granted this would be called "scandalous." Many members of Congress would promptly introduce legislation to mete out severe punishment for the use of money to buy an election.

But the "civil rights" of a senator or member of the House who votes according to his conscience in an endeavor to serve the public interest impartially seem to be ignored. It is doubtful whether either the House of Senate will take any corrective action, as labor unions now believe they control a majority of both Houses of Congress.

[From U.S. News & World Report, Aug. 5, 1968]

LABOR WEEK: A LESSON FROM ONE UNION ON HOW TO FINANCE THE CAMPAIGN

(NOTE.—The law seemed clear enough: No single contribution bigger than $5,000 to a presidential campaign committee. Yet one labor union managed to donate $100,000 to the Democrats—after an Administration ruling favorable to one of its leaders.)

A labor union has shown how to hand $100,000 to presidential-campaign committees and avoid a law limiting donations to $5,000.

This lesson in practical politics was given by the Seafarers Union, with the money starting to flow to Democratic groups shortly after Secretary of State Dean Rusk declined to extradite a former official of the union.

The labor leader had jumped bond in Canada after being sentenced in 1964 to serve five years on his conviction of hiring a man to beat up an official of a rival union.

Advice rejected.—Mr. Rusk disregarded recommendations of Department aides in making the decision to reject Canada's request for extradition of Harold C. Banks, the former head of the Seafarers Canadian branch.

Banks fled to the U.S. in 1964. Under the extradition treaty involved, assault is not an extraditable crime. Perjury is, however.

Canada in August, 1967, asked that Banks be sent back because of a perjury charge based on a contention that he lied four years earlier at an inquiry in denying knowledge about the assault. Banks is an American citizen.

The State Department said no political considerations were involved in Mr. Rusk's decision not to surrender Banks. It said the ruling was based on the fact that "the charge of perjury arose directly out of a denial of guilt of a nonextraditable offense."

Secretary Rusk later commented that "a man has the right to protest his own innocence."

Mr. Rusk added that he knew nothing of any contributions from the Seafarers to political funds. He said that no one in the White House or Democratic National Committee tried to influence his decision.

The Seafarer contributions were reported in June, in a list sent to Congress by the Seafarers committee on political-activity donations.

Curbs on contributions.—Union spokesmen said the money came from members as voluntary contributions for political purposes—not from regular union dues.

Federal law prohibits use of dues funds in primary or election campaigns for the White House or Congress.

The statutes also say that no person or group can give more than $5,000 a year to any campaign committee for a person seeking federal office.

With that rule in mind, the Seafarers officials split their $100,000 into 20 checks for $5,000 each and sent them to different campaign committees. Some of these committees have been described as committees in name only, lacking offices or officers—a device for helping big contributors chip in more cash.

Supporters of candidates for both political parties have used this method to comply with the limit of $5,000 on donations to a particular committee. This time the distribution attracted attention in the press, in Congress and in Canada's Parliament.

Where checks went.—It was noted that the union's checks at first went to the President's Club, the Democratic National Committee, several Johnson-Humphrey committees and groups in Texas, Illinois and Rhode Island.

That first outlay was made early in April, soon after Mr. Rusk on March 25 rejected a Canadian appeal on Banks. The checks went out despite President Johnson's March 31 withdrawal from the presidential race.

Later, 10 checks for $5,000 each went to committees backing Vice President Hubert H. Humphrey's campaign for the presidential nomination—after he got into the race formally.

Labor Secretary Willard Wirtz, a supporter of the Vice President, conceded, when the Seafarers' contributions were publicized, "It worries me greatly." He expressed concern that the incident could hurt Mr. Humphrey.

Mr. Wirtz said he had known nothing about any Seafarers' contributions. In December, the Labor Secretary had sent a memorandum to Mr. Rusk about the Banks case. This memo was described as outlining the violence that had marked the Canadian Seafarers in recent years.

Query from a Senator.—A Republican Senator—Paul Fannin, of Arizona—wrote to Mr. Wirtz asking for a copy of the Banks memo and for an explanation of "any possible recommendation" against extradition.

Senator Fannin also asked for the names of any union or Administration officials who might have asked the Secretary to intervene in the case.

Senator Fannin stated: "I am particularly alarmed by the published reports of sizeable political contributions that are reported to have followed in the wake of this intervention and the subsequent release of Mr. Banks."

Protests came, too, from Canadians. On March 18, after Mr. Rusk's original decision, H. W. Herridge told his fellow members of Parliament that the ruling "is an insult to this country."

Mr. Herridge, who later retired from Parliament, referred to reports "that some political influence and pressure have been used in this regard." He said this was "the first failure to apply the extradition treaty in 50 years."

In his speech, Mr. Herridge asked the Canadian Government to "make inquiries whether there was any union influence on this decision because this is an election year in the United States."

Heward Grafftey, another member of Parliament, since defeated for re-election, demanded to know if U.S. officials "suggested that Canada's plea might fall on more favorable ears after the forthcoming election in the United States."

In reply to Secretary Rusk's first denial of extradition—on March 13—the Canadian Government said it believes perjury is included in the treaty list of extraditable crimes "without differentiation or distinction as between various types of perjury."

Canada sought reconsideration by Mr. Rusk or international arbitration of the case, but the American Secretary of State reaffirmed his decision and rejected arbitration.

As for the Seafarers' checks, union spokesmen said that Paul Hall, president of the union, has been a consistent supporter of the Johnson Administration. He is a member of the labor committee backing Mr. Humphrey's candidacy.

A Seafarers' statement said: "Political activity is nothing new for the Seafarers . . . . These political contributions were made openly, as are all Seafarer contributions. They were made legally [and] reported publicly . . . . Any suggestions that the exercise of this right is linked to any other situation or circumstance is wholly without justification."

[From the Wall Street Journal, Jan. 3, 1969]

FEEDING THE KITTY: UNION'S POLITICAL FUND IS SWELLED BY DONATIONS FROM FAR EAST SEAMEN—SEFARERS USE MONEY TO AID DEMOCRATS, BUT THE DONORS DON'T KNOW WHO GETS IT—SOME GIVE $500 AT A CRACK

(By Jerry Landeur)

WASHINGTON.—The most ardent opponents of Richard Nixon's incoming Administration apparently are some Japanese and Filipino merchant seamen who have never even voted in an American election.

That, at any rate, is the case if dollar donations to election campaigns are a reliable guide to political convictions. For, month after month, these sailors have been contributing as much as a third of their wages to American political candidates, mostly Democrates. The sailors, hundreds and perhaps thousands of them, have given as much as $500 each after a single sea voyage.

But the contributions—many of which violate Federal law by going unreported—aren't simple, direct gifts to candidates that the foreign seamen happen to admire. The sailors don't know to whom they are contributing, and the recipients don't know the source of their windfalls.

Ostensibly, the money comes in the form of voluntary donations, as the law requires, from members of the Seafarers International Union, an American maritime union affiliated with the AFL-CIO. In reality, though, much of this union's contributions represent payments accepted—or exacted—from alien seamen who work on high-paying U.S.-flag ships bound for Vietnam. Most of these seamen are not even members of the union, which distributes the collected cash to favored political candidates.

THE SECRET, CIRCULAR ROUTE

All told, several hundred thousand dollars have traveled this secret, circular route:

From the U.S. Treasury to operators ships owned by the Government or chartered by the Pentagon's Military Sea Transportation Service; from the operators to foreign seamen in the form of premium wages; from the seamen to the union, and from the union to elected officeholders—some of whom try to tap the Treasury for more dollars in the form of maritime subsidies that tend to strengthen the union.

Officials of the union won't comment on allegations that the union takes political contributions from the foreign seamen. "We file all the necessary information in Washington, and that's all the information we give out," says a spokesman at the union's Brooklyn headquarters. But records the union files with the clerk of the House of Representatives do not name individual contributors of over $100, as required by law.

In the most recent election, the union backed some winners and some losers. It put up at least $185,000 for President Johnson, who withdrew, and Vice President Humphrey, who lost. It contributed $20,000 to a voter registration drive to help Daniel Brewster, Democratic Senator from Maryland, and it gave another $7,000 to his campaign, but the Senator lost.

BACKING SOME WINNERS

However, it contributed $15,000 to Washington state's Warren Magnuson, chairman of the Senate Commerce Committee; it offered him even more. It gave $10,000 to Brooklyn's Emanuel Celler, chairman of the House Judiciary Committee. It gave $7,800 in cash and kind (the union prints campaign literature for some politicans at its own plant) to New York Congressman Jacob Gilbert, who was recently assigned to the House Merchant Marine Committee. And it contributed at least $9,000 to Edward Garmatz of Maryland, chairman of that House committee. These men, all Democrats, all won.

With friends sprinkled through Congress, the union seems well protected on Capitol Hill, no matter who rules in the White House. Indeed, observers say that the Seafarers, together with other maritime unions and associations of ship owners and shipbuilders, probably are strong enough to strangle any Nixon Administration attempts to make the U.S. merchant marine less dependent on subsidies.

These observers say there is no reason to believe the shipping interests will fare worse in the 91st Congress than they have in the past. The 90th Congress, which was known for being economy-minded, didn't tamper with the Johnson Administration's suggested appropriations of $110.8 million for ship-construction subsidies and $206 million for ship operating subsidies in the fiscal year that started last July 1.

In fact, the maritime bloc nearly succeeded in persuading Congress to boost construction subsidies. And it helped persuade Congress to reject Johnson Administration proposals to stop subsidizing the operations of passenger liners and to build some subsidized ships in cheaper, foreign yards.

HELPING 150 CONGRESSMEN

One major element in the maritime lobby's extraordinary strength is the secret payments from the alien seamen. Lacking these payments, the Seafarers Union couldn't keep doling out sizeable campaign gifts to as many as 150 Congressmen, from ship-conscious Maine to landlocked Utah. Nor could the union so easily have raised the $100,000 given to the Democrats last summer, a contribution that, perhaps coincidentally, followed the State Department's refusal to honor Canada's request for extradition of former Canadian Seafarers boss Hal Banks on a charge of perjury.

Generally, the foreign sailors who contribute so generously come aboard the American ships as replacements for American union members at Subic Bay in the Philippines, a stopping-off point for Vietnam-bound ships, and at Yokohama in Japan, terminus of a shuttle service to Vietnam.

The foreign seamen are needed because many of the original American crewmen get sick, yearn for home or jump ship for pleasure spots after months of strenuous, high-paying duty sailing in the Far East.

The unions, which handle hiring, have no difficulty signing up the foreigners. Wages are high, with seamen on Vietnam-bound ships getting $700 a month against $500 for other duty. With overtime and other extra pay, a foreign sailor can draw as much as $1,000 a month working on a U.S. ship. "You can't imagine how eager those fellows are to sign on," says one Naval officer.

Frequently, however, the foreign sailors don't get to keep all they earn. Often, they must pay so-called service fees to union agents who control hiring, and if the agent is a Seafarer, he remits all or part of these fees to Brooklyn, where the money goes into a special fund for political activity. The fund is maintained by one district of the Seafarers, the Atlantic, Gulf, Lakes and Inland Waters District.

The fund is by far the lushest electioneering kitty maintained by any American union. Not all the money in the fund comes from foreigners, of course, but it is the aliens' payments that help explain how one union district, with just 12,800 men at sea, manages to raise more money for Federal candidates than the giant Steelworkers, Auto Workers or Teamsters unions.

If the American members were the only contributors to the district's fund, the average gift from the 12,800 men would have to to top $35 to yield the $497,338 collected through Nov. 10 this year. In contrast, the average Steelworker or Auto Worker gives a $1 a year, at most, for union political activity. But the Seafarers Union sees nothing extraordinary in its members' munificence.

THE UNION'S STATEMENT

"For years our members have voluntarily contributed to our political activity funds and have thus expressed their right to participate in the American political process," says a statement issued from the union's headquarters in Brooklyn.

"Our political contributions to various candidates for public office are made openly. They are made legally. They are reported publicly. Any suggestion that the exercise of this right is linked to any other situation or circumstance is completely without justification."

Perhaps, as the union suggests, sailors are more interested in politics than land-based wage earners are. But it seems significant that only the Seafarers district headed by Internation Union President Paul Hall operates a political action arm of any size. None of the parent union's 32 other affiliates has reported any political activity to Federal authorities.

At any rate, the union's statement that its contributions are legal is at least partly right. In fact, in at least one respect the Seafarers exceed legal requirements to disclose political income and disbursements. The loosely enforced Federal Corrupt Practices Act requires public accounting of donations to candidates for only these posts: President, Senator and Representative. But the union, going beyond the law, this year reported $20,000 in speaking fees paid to Congressmen and $313,000 in campaign contributions to candidates for state and local offices.

At the same time, however, the union fails to comply with another—and more significant—legal requirement. It neglects to identify by name and address every individual whose contribution to the political fund exceeds $100.

This is a requirement the union could meet only at the risk of exposing the undercover payments flowing in from Asia. If the donors' names were listed, of course, all would be legal. But a listing of hundreds of Asian contributors to American political campaigns might prompt investigations into whether the contributions were voluntary.

[From the Washington (D.C.) Evening Star, Sept. 4, 1968]

WASHINGTON CLOSE-UP: UNIONS' WALLACE LINE OUT OF LINE

(By Frank Getlein)

A number of big unions have commissioned the writing and distribution of a booklet exposing George Wallace for the right-wing, fascist-minded, anti-labor, bigotted racist he seems to them to be. That's O.K. They're entitled, within the laws of libel and defamation, which are increasingly difficult to apply for the protection of public, political figures.

What is interesting is not that unions are engaging in political propaganda. They've been doing that since they invented Labor Day, and they ought to. The interesting thing is that the object of the propaganda is not the voting public at large but specifically union members. The leadership is finding it necessary to haul its own membership back from the fleshpots of racism and onto the path of righteousness.

To the most casual observer of appresticeship procedures in the construction trades and other craft unions, it will come as no surprise that there is racism among the rank and file of organized labor and even, in some cases, among the leadership itself. In the case at hand, all signs tell us that a very large percentage of Wallace's northern support comes from union labor.

From the point of view of right-thinking, therefore, the new expose seems to be addressed to exactly where it is needed most and where it may do some good.

Except that:

When you get right down to it, people don't join labor unions to get their brains washed by their elected leaders on questions with only a remote connection to the conditions and wages of their employment. They join labor unions to deal more effectively with their employers.

It can be argued that politics obviously affects labor relations and that therefore organized labor has both a right and a duty to be involved in politics. This right and duty, in the nature of our politics, extends also to the backing and non-backing of specific candidates.

But does it extend also to instructing the members to correct their thinking on political candidates?

A labor union is, in theory at least, a membership organization. The self-perpetuating nature of the leadership is only de facto, not de jure. Therefore, in theory, if the members of a union want to support George Wallace, what the leadership ought to be doing is either finding ways to help the members in this political desire or else resigning and going to work for people more in tune with their own feelings.

On the record of primary voting patterns, there have to exist union locals—in Indiana, in Wisconsin and in Maryland, among other states—which if they followed the wishes of the majority of the members, would endorse Wallace. It won't happen.

What does this say about participatory democracy? Or is democracy only supposed to apply when right thinking is in the majority?

This is far from being a problem of unions alone. It is prevalent among most groups with official representation, official voices in the public dialogue. Suddenly we discover that what has been touted as the fervent demand of millions of members is in fact the demand of the president, or the executive committee, or merely of the permanent paid secretary.

Examples are everywhere. One is always running into medical doctors who are relaxed, civilized and genuinely interested in their patients and in the progress of health generally, despite the American Medical Association's strident insistence that doctors are exclusively interested in the big dollar and will fight against any improvement in public health that doesn't pay them.

Again, for years the Roman Catholic Church lobbied effectively for the retention of anti-birth control laws in Massachusetts and Connecticut on the presumption that the official spokesmen for millions. It now appears that they spoke chiefly for themselves, their bishops and their monsignori. Among laymen and the lower clergy, the sentiment was and is the other way.

Among organizations in business chiefly for legislative ends, the situation is different. No doubt the vast majority of members of the truckers lobby really do want to take over the national highway system with their three-trailer monsters. And the lumber lobby can count on 100 percent membership support in the battle to ruin the redwoods.

But most people are not in unions or churches or professional associations to choose candidates for public office. It is high time the hired hands of such organizations got off their power dreams and back back to work.

[From the St. Louis (Mo.) Post-Dispatch, Sept. 5, 1968]

Pipefitter Refused To Give and Lost Job, He Testifies

A Cape Girardeau steamfitter told a federal court jury here today that he was "laid off without reason" in 1963 several days after he refused to make increased contributions to the voluntary political fund of Steamfitters Local 562.

The witness was William W. Copeland, a member of Steamfitters Local 318 in Cape Girardeau. He said several attempts to find new employment in St. Louis later under Local 562 jurisdiction met with failure.

Copeland was the first witness today in the trial against Local 562 and three of its top officers who allegedly made illegal political contributions through their so-called voluntary political fund.

ADMITS DISLIKE

Under cross-examination later, Copeland admitted that he had "strong feelings" against Local 562. He said, "As I understand the law, I'm not required to make any political contributions. This is why I'm bitterly opposed to it."

In reply to questions from Government attorneys, Copeland said he signed a pledge card for the voluntary fund "because I was afraid I wouldn't work if I didn't."

Shortly after the lunch hour today, United States District Judge John K. Regan announced that he would hear testimony in the case until 4 p.m. today and then adjourn court until 9 a.m. Monday. A death in the family of defense attorney Murray Randall prompted the decision to adjourn.

Copeland testified that he was laid off in August 1963 when working as a steamfitter at Anheuser-Busch, Inc. He said he refused to pay an additional 50 cents a day into the political fund when requested to do so by a foreman. Copeland told the jury he already was paying $1.50 a day into the fund, and that the increase would have brought his dues and assessments to $80 a month.

LOAN OFFERED

The foreman, Copeland related, offered to lend him the money, but Copeland said he refused. At the time Copeland was working under Local 562 jurisdiction and held a travel card from his home local for that purpose. He now operates his own business, but maintains his membership in the Cape Girardeau local.

In later testimony, Emil C. Endermuhle, a Local 562 foreman, told the jury that Copeland's brother in 1963 refused to pay anything into the voluntary fund. Endermuhle said the man continued to work without any problems for about three months, and then quit his job of his own free will.

Defense attorneys established also that Copeland had been laid off at an earlier steamfitter job in Farmington, Mo.

Throughout testimony yesterday and today, Government attorneys attempted to establish that the political fund was not voluntary as its name implies. The official name of the fund is the Voluntary Political, Educational, Legislative, Charity and Defense Fund.

Two veteran union members testified yesterday that most members contributed to the fund, but emphasized that no attempt was made to coerce them.

They were Edward W. Gissing and Thomas J. Williams, shop sewards, who said that as foremen they had collected money for the fund from union members on the job. Both said they had used contribution sheets to keep track of the donations, and that the contributions were usually made on Mondays.

United States Attorney Veryl Riddle, after noting that the word "owe" was written by some names on the contribution sheets, asked Gissing what would happen if a steamfitter did not donate to the fund.

"Very seldom would something like that happen," Gissing said.

The Government has charged that Local 562 and three of its top officers conspired to make illegal political contributions from the fund. The indictment names Lawrence L. Callanan, Local 562 business manager; John L. (Doc) Lawler, assistant business manager, and George Seaton, vice president.

Gissing and Williams were two of six witnesses for the Government called yesterday.

Riddle asked Gissing why the contribution sheets were kept if the donations to the voluntary political fund were in fact voluntary.

Gissing said that the "purpose of bookkeeping was to know who contributed and who didn't."

FBI TESTIMONY

Earlier John J. Buckley, a Federal Bureau of Investigation agent and an accounting specialist, said that the St. Louis steamfitters had contributed to organizations backing candidates for federal office in several states.

Buckley said the fund had collected a total of $1,230,986 in a four-year period ended with 1966 and that $151,412 of the total amount collected was spent for federal political contributions between 1964 and 1966.

Under cross-examination by Randall, one of four defense attorneys for the union leaders, Buckley read into the record canceled checks that had been sent to the candidate's groups in several states.

These checks included ones sent to organizations backing both Missouri Senators—Stuart Symington and Edward V. Long; Senator Fred Harris of Oklahoma; Senator William Proxmire of Wisconsin; Senator Philip A. Hart of Michigan and the late Senator Robert F. Kennedy of New York.

Randall made the point that all candidates receiving contributions were Democrats. Some checks were sent also to the Democratic National Committee.

[From the St. Louis (Mo.), Post-Dispatch, Sept. 9, 1968]

CONTRIBUTED TO KEEP JOB, PIPEFITTER SAYS

A former Cape Girardeau steamfitter, now a member of Pipefitters Local 798 at Tulsa, Okla., told a jury today that he had signed political fund pledge cards when working on jobs under jurisdiction of Steamfitters Local 562 because "I knew I had to sign them or I wouldn't work."

Norman Baker, 37 years old, said that at the time he signed the cards he was a member of Steamfitters Local 318 in Cape Girardeau.

Baker was the first Government witness called today as the trial of Lawrence L. Callanan, business manager of Local 562, and two assistants. They are facing charges of illegally contributing $140,800 to political candidates and campaign organizations. The trial entered its second week in the court of United States District Judge John K. Regan.

Baker, who is working on the Mississippi river pipeline construction job near the Jefferson Barracks bridge, identified two pledge cards he had signed.

He said he signed one in 1963 and the other in 1965 when he was a member of Local 318 in Cape Girardeau and was working on jobs under the jurisdiction of Callanan's local here.

Asked by United States Attorney Veryl Riddle why he signed the cards, Baker said, "I knew I had to sign the cards or I wouldn't work. It was my understanding that, if I wanted to work, if I wanted the job, I had to sign them."

Baker referred to the donations as a "doby" and in response to a question by Riddle said that "assessment and doby mean the same thing." He testified that he had never "paid a doby" to any local other than Local 562.

Riddle asked him whether he knew what was done with the money paid into the political fund of Local 562. Baker replied that he did not know and never had asked anyone because "I always thought it was better if I did not ask."

On cross-examination defense attorneys asked Baker whether he ever had been told by any steward or officer of Local 562 that he had to pay into the fund. He said he had not been told, "but it was understood that if you don't pay you don't work."

Three witnesses, members of Local 562, later testified that they had collected money for the political fund. They said that the donations were voluntary, although sometimes they were incorrectly referred to as "assessments."

One of them, John Patrick O'Laughlin, a riding foreman, at one point in his testimony referred to the contributions as "assessments," but hastened to correct himself and said that the contributions were voluntary.

Two other union members who testified that they had collected funds were James M. Stiffler and Eugene J. Marshall, both foremen.

Charged with Callanan in an indictment returned by a federal grand jury May 9 are John L. (Doc) Lawler, assistant business manager of Local 562, and George Seaton, vice president of the local.

[From the St. Louis (Mo.) Globe-Democrat, Sept. 20, 1968]

GLOBE INITIATED STEAMFITTER PROBE: PRECEDENT-SETTING CONVICTION

Conviction of Steamfitters Union Local 562 and three of its top officers on the charge of conspiring to violate federal election laws brings nearer a successful close to a long, hard fight by The Globe-Democrat to bring these men to justice.

All of this newspaper's efforts would have been in vain, however, had it not been for the determined and skillful preparation and presentation of the case against the union and the defendants by United States Attorney Veryl L. Riddle and the conscientious performance of duty by the jurors who had to weigh a veritable mountain of evidence.

It was in August of 1965 that the late Globe Publisher and crusading newspaperman Richard H. Amberg ordered a full investigation of the steamfitters. This probe was continued under the direction of Publisher Duncan G. Bauman who succeeded Mr. Amberg.

Two outstanding reporters, Denny Walsh and Al Delugach, conducted the non-stop investigation. In the fall of 1965 they wrote their first article of a series that was to run to more than 100 articles exposing the steamfitter finances, productivity and political activities.

As a result of these stories the Justice Department in early 1966 began a federal grand jury inquiry in South Bend, Ind., into one phase of The Globe-Democrat exposures by Walsh and Delugach; a stock bonanza given in connection with a pension insurance purchase by Local 562 from First United Life Insurance Co. of Gary, Ind.

Edward Henry, director of Local 562's welfare and pension funds, and William E. Long, president of First United, are among four persons now under indictment and awaiting trial in Indiana on charges from this million-dollar kickback conspiracy in the insurance deal.

Hugh J. Gorham, steamfitter and former Florissant city councilman, another defendant in this kickback case, was convicted last year and has served a prison term on a charge of perjury before the federal grand jury in South Bend.

In July of 1967 The Globe dropped another bombshell by printing a story by Walsh and Delugach revealing that Steamfitters Local 562 had poured thousands of dollars into federal elections in states all over the country and has failed to report these to the United States government as required by the federal Corrupt Practices Act.

Contributions were shown to have gone to Rep. George Fallon of Maryland, Sen. Philip Hart of Michigan, Rep. Melvin Price of Illinois, Rep. Donald Fraser of Minnesota and Senator William Proxmire of Wisconsin. Earlier stories had unearthed contributions to President Johnson's political campaign of 1964 of about $60,000 and $10,000 to the senatorial campaign of the late Robert F. Kennedy of New York.

The Justice Department showed little interest at first. So The Globe pounded away with more articles exposing the illegal contributions until the Department agreed to look into the case. In October of 1967 a federal grand jury was convened and heard evidence until late January.

But once again there was a strange silence as the case lay dormant, apparently under heavy political pressure from high places to keep the issue from coming to trial during an election year.

The Globe ran more articles and editorials demanding that the case be brought to a conclusion. On May 9 of this year the indictments were returned against Lawrence L. Callanan, the ex-convict business manager who has run the union with an iron hand for years; John L. (Doc) Lawler, assistant business manager, and George Seaton, vice president of the local.

The Globe-Democrat is proud of its role in bringing the power-lusting steamfitter leaders to book and for exposing the odious practice of putting a "lug" on workers to try to spread the corrupting Callanan-Lawler tentacles into the highest echelons of government.

While it is vindication of The Globe's efforts, this conviction is a greater victory for the people. It represents the first time that any union has been convicted for this offense. The impact of this verdict will undoubtedly be felt nationwide and could result in a federal crackdown on other unions circumventing the law.

[From the Wall Street Journal, Oct. 2, 1968]

Meany's All-or-Nothing Political Bet

(By James P. Gannon)

Washington.—George Meany is staking the future of his powerful AFL–CIO on the gamble that the "old politics" is not yet dead.

Daring to bet all his chips that labor's own political machine and the remaining old-line Democratic Party bosses can somehow save Hubert Humphrey from defeat, the old man of organized labor has put his 13.5-million-member institution in a dangerously exposed position. Consider the situation confronting labor's hierarchy less than six weeks before the Presidential election:

—Their own house is in deep disorder, beginning to break apart, as United Auto Workers chief Walter Reuther and his newfound Teamster allies form a sort of "new politics" movement to the left of the old-politics AFL–CIO.

—A substantial segment—perhaps a third or more—of labor's ranks is in open stampede toward the racist blandishments of third-party candidate George Wallace.

—The Meany hero, the Vice President, is running such a poor race that he threatens to drag down with him some of the very Senate and House candidates whom the movement may desperately need next year to defend itself against anti-union legislation.

LUNGING AHEAD

Faced with this grim triple threat, the 73-year-old plumber and his claque of aging yes-men lunge ahead with an all-out Humphrey campaign, scarcely seeming to consider how they got into such a mess or how they'll get out in November if they fail. Though many of their problems stem from a backward-looking approach, they respond with more of the same. With characteristic heavy-handedness, they:

—Worsen the division in the labor movement with a hard-line decree (which could have been avoided) that any member of the club who throws in with the Reuther crowd gets thrown out;

—Mount an anti-Wallace drive that key labor politicos consider doomed to failure by its irrelevance to the Alabamian's basic appeal;

—Concentrate their resources on the Humphrey campaign ("It's hard to get anyone's attention, including mine, on anything else," says a Meany aide) rather than hedge what looks like a long-shot bet by channeling more money and manpower toward liberal Congressional candidates with better chances to win. In fact, some of these candidates are being short-changed by the AFL–CIO because of their unforgivable lack of enthusiasm for Mr. Humphrey and the Administration's Vietnam policy.

The breakup of organized labor into two hostile camps is itself a consequence of the "old politics" methods and mentally of the AFL–CIO. Walter Reuther's revolt is rooted in many causes, not excluding his personal ambition to lead the labor movement but certainly going beyond that. It is, among other things, a protest against a system in which a chief executive can hand a supposedly democratic organization's endorsement to a Presidential candidate without so much as consulting his alleged peers. (It was September before the AFL–CIO general board rubberstamped Mr. Meany's Humphrey endorsement of last April.)

Mr. Reuther's breakaway is also a rejection of the mentality that moved AFL–CIO leaders to condemn as anarchistic "invaders" the youths who demonstrated in Chicago in August during the Democratic convention, when those protesters were using much the same tactics that union "radicals" employed in the great organizing strikes of the 1930s and 1940s. At that time labor chiefs were outraged when police cracked skulls of pickets and strikers; now, viewing the protest from a lofty Establishment perch, labor's leaders applaud police for routing the "dirty-necked and dirty-mouthed group of kooks," as Mr. Meany branded the protestors.

So now Mr. Reuther and friends are trying to build a second union coalition, the Alliance for Labor Action, along the lines of the new politics of participation rather than the old bossism. Whether they'll succeed is highly uncertain. The relevant fact at this time is that Mr. Reuther's move, and Mr. Meany's typical cold-war-style response, have weakened the forces of labor at a most critical hour.

In dealing with the Wallace threat, the AFL–CIO is again falling back on a traditional union tactic whose 1968 efficacy is open to serious question. Though their own membership surveys show that newly affluent unionized workers are much more concerned about rising taxes, climbing welfare costs and Negro integration into their suburban neighborhoods, the AFL–CIO's anti-Wallace drive rests on such old-line issues as right-to-work laws, unemployment compensation and minimum wage.

ON THE REAL ISSUES

Alexander Barkan, Mr. Meany's top political operative who heads the AFL–CIO's Committee on Political Education, has a stock speech for union groups in which he attacks George Wallace and Richard Nixon for trying to "sidetrack" the voters' attention onto "phoney issues," such as riots, crime waves and war frustration. The real issues, in Mr. Barkan's unique book, are such things as what Mr. Nixon might do to the National Labor Relations Board if he's elected, and Mr. Wallace's record on minimum wage legislation as governor of Alabama.

Candid union politicians privately admit it's foolish to pretend that the race problem, lawlessness and the war aren't the real issues swaying voters in 1968.

"I make a speech to the membership about the NLRB," confides one union's top political aids, "and they listen quietly and say, 'Well, that's nice, but what does it all mean?' " Another union politico concedes doubt that members attracted to Mr. Wallace's tough law-and-order stance will be much put off by hearing that as governor he wasn't a champion of labor legislation.

So labor's anti-Wallace effort is an anachronism of bread-and butter concerns in a steak-and-mushroom age, purposely avoiding the Alabamian's gut issues. But an organization whose leader has cheered rough police action against "kooks" who demonstrate, and has decried an "atmosphere of arson and anarchy" in America, may be in a difficult position to fuss over Mr. Wallace's use of similar terms to stir up the electorate.

The AFL–CIO decision to direct the vast bulk of its effort toward Mr. Humphrey's campaign may prove a costly mistake, some labor lobbyists worry. They fret that COPE won't have the money and manpower available to help liberal Congressional candidates who'll be coming around to Mr. Barkan soon pleading for just a little more help.

Whether by design or coincidence, is seems that the candidates least likely to get what they want from COPE are those who display less than full loyalty to Mr. Humphrey and the Administration's Vietnam line.

In Ohio, national COPE officials have told dovish Democrat John Gilligan to find other sources of funds for his Senate race, saying they gave him more than his share of help in the primary. In Illinois, Democratic Senate candidate William Clark, who bucked Mayor Richard Daley and union backers in supporting war-critic George McGovern for the party's Presidential nomination, is also apparently finding union dollars hard to come by. And in New York, the state AFL–CIO refused to endorse Senate candidate Paul O'Dwyer, a liberal Democrat, because he has declined to support Mr. Humphrey; with baffling logic, it instead endorsed incumbent Jacob Javits, a liberal Republican who supports Mr. Nixon.

The irony of labor's lukewarm or non-existent support for such dissident Democrats could become grim indeed if their defeat helps tip the Congressional scales toward the sort of anti-union legislation that the AFL–CIO can see on the 1969 horizon. Consider the situation that will confront labor's hierarchy next year if the Humphrey gamble fails.

They will have pushed to the limit of Federal laws—and perhaps beyond—their efforts to defeat the man moving into the White House. He will owe them nothing, except perhaps a retaliatory jab, and they will have almost no lines of communication open to him. A Congress turned more conservative on the strength of Mr. Nixon's coattails would obviously be responsive to his bidding. And the pressures for restructuring the labor movement will have been multiplied in the ignominy of defeat and the distasteful prospect of at least four years in political exile.

"There will be a major realignment in the labor movement if Nixon wins the election, just wait and see," predicts an official of one big union unhappy with Mr. Meany's leadership.

But a Humphrey defeat might present an external threat even more serious than internal division. One key Meany aide worries that a President Nixon, though trying to establish ties with Negroes, disaffected youth, intellectuals and liberal doves in order to govern more effectively, would reward his conservative backers with proposals to Congress for curbing union power. And the AFL–CIO's use of hundreds of paid union staffers to aid Mr. Humphrey's campaign—a move that is, at best, in the gray area of legality—wouldn't be forgotten.

TREMENDOUS MISTAKE

Outside the closed doors of an AFL–CIO political huddle in New York City's Commodore Hotel last month a Javits campaign aide shook his head and said grimly: "These guys are making a tremendous mistake by not trying to throw out some lines to the Republicans. Admittedly, Nixon doesn't make that easy, but they aren't going to have a single line into him when he's elected." Yet any thought of trying to quietly open some communication with the Nixon camp, if there ever was such a thought, has surely been banished by Mr. Meany's all-or-nothing bet on Mr. Humphrey.

The spectre of defeat that haunts many labor politicians today may prove to be merely a shadow without substance. Mr. Meany's old politics may yet usher in a Humphrey Administration, in which case he'd be one of the top barons in the court while Walter Reuther, who played a political Hamlet before supporting Mr. Humphrey, would be labor's lesser light.

But in their private moments, labor's nervous political operators worry that all those AFL–CIO eggs in the Humphrey basket will create the year's costliest political omelet.

[From the Los Angeles (Calif.) Times, Oct. 21, 1968]

UNIONS TAKING IT ON CHIN IN POLITICAL ARENA

(By Harry Bernstein)

Organized labor, battered by a series of political blows, is failing in its effort to make 1968 its greatest political year.

Major reasons are:

—Union leaders are either fighting with or, worse, being ignored by New Left militants, by black nationalists and by antiwar liberal intellectuals.

—Richard M. Nixon and George C. Wallace are getting more union membership support than Vice President Humphrey.

—Old coalitions are breaking up. Within the unions, this is evidenced by the fight between Walter R. Reuther's United Auto Workers and the AFL–CIO leadership.

—Outside the unions the coalition of unions with liberal intellectuals is being shattered by their differences over Vietnam and police treatment of war protestors and black revolutionaries.

—Pro-labor, liberal senators and congressmen who opposed President Johnson's Vietnam policies are getting lukewarm support from the AFL–CIO.

MAY BE ONLY HOPE OF UNIONS

Yet the election of these men may be the only hope unions have of beating back proposed laws aimed at weakening the economic and political muscles of unions.

Despite these contradictory factors, unions today remain the nation's biggest single political force other than the major parties themselves.

With widely varying degrees of effectiveness, local and national union bodies function politically in all states, in every major city, and in most small towns.

No precise estimate can be made of how much clout there is in labor's political actions, but a cross-country look at unions reveals much of their strengths and weaknesses.

Unions—with 19 million members—can be expected to put between $20 million and $30 million into all political campaigns this year, including both cash and manpower. In comparison Nixon is expected to spend $20 million on his campaign.

Unions propagandize for liberal causes all year long. But that effort costs far less than the estimated $50 million a year spent by the right wing forces on radio and TV programs, preaching views that are mostly antiunion.

Many of the political activities of labor and management, conservatives and liberals, border on illegality—yet in estimating the political strength of unions, this activity must be taken into account.

The law says, "It is unlawful for a union as well as any corporation to make a contribution or expenditure for any national election, primary, political convention or caucus."

This law "makes us all terrible fakers," admits Bill Dodds, legislative representative for the United Auto Workers in Washington.

Dodds, sitting at a table stacked with union newspapers filled with Humphrey's pictures and favorable stories about him, knows that those publications are not listed as a political contribution for Humphrey.

"The amount of chicanery being used on all sides to help candidates is becoming a tragic situation," he said.

Al Zack, publicity director of the AFL–CIO, observed:

"Sure, the AFL–CIO News, our official publication, runs pro-Humphrey stories, not pro-Nixon or pro-Wallace ones. But the giant, conservative daily newspapers around the country have been doing just that for years, and still do."

Andrew Biemiller, legislative director of the AFL–CIO, said labor is pushing for a law which would require "truly full disclosure" of all political contributions, but they will fight "the halfway measures aimed at unions alone."

Unions want new laws to take into account the corporation which gives an executive a $10,000 pay raise, with the understanding that he will "volunteer" about half of that to a political candidate the corporation officers feel will best represent their interests.

There is a law which prohibits any individual from contributing more than $5,000 to a federal political campaign.

But the law is violated so openly that nobody complained when Mr. and Mrs. Richard K. Mellon, of the Pittsburgh Mellons, formally reported their $23,500 joint contribution to the Republican Party in the 1964 election, even though that was $13,500 more than they were legally entitled to make.

Company planes are used by political candidates on many occasions. For example, the plane of a San Diego firm just happened to be en route from San Diego to San Francisco when a friendly politician wanted to go there for a fund-raising dinner.

He and his entourage had free, unreported transportation from San Diego to San Francisco then back to Los Angeles for another meeting.

Do such activities violate the law? Generally the courts have said no, and the same goes for the border-line cases of labor's political contributions.

The AFL-CIO will have about 100 full-time staff members working in a 15-state target area to help the Humphrey campaign, while additional hundreds of others from local, state and national labor bodies are being enlisted while they remain on their union's payroll.

This procedure is deemed legal because the courts have held that unions can use staff personnel to reach the union membership.

Unions say they are aiming their political efforts at their members, and if the general public hears or sees those efforts, it is incidental.

Recently, William Clark was going to give a speech in Peoria during his campaign for the U.S. Senate seat from Illinois.

He had no one to meet him on his arrival in Peoria, nor plans for getting to his next stop, Springfield, about 80 miles to the south.

One phone call to a union official solved that problem. Clark was met by a union staff man at the airport, delivered by car to the Peoria rally, then, along with his aides, taken down to Springfield in time for the next rally.

At the Springfield session, a large portion of the audience was turned out by union leaders.

The assist to Clark was not unlike the San Diego corporation's plane ride for another candidate, but it points up a major asset unions have:

The San Diego company operates its plane only for the benefit of a few politicians. Unions are usually able to coordinate their efforts on a national scale for hundreds of political candidates.

Businessmen are often dismayed that their own organizations are less effective than labor's Committee on Political Education, and they are trying now to copy it with such groups as BIPAC (Business-Industry Political Action Committee).

An example of the difference between union and business support for a political candidate is seen in Rep. James Corman's 22nd Congressional District in the San Fernando Valley, where he has the endorsement of all organized labor.

Recently Corman talked far less about labor and more about a Volkswagen dealer in Van Nuys.

"Life has been good to Jack Foreman. He is an auto dealer who sees politics as a way to help people. And he alone will produce more cash for my campaign this time than all of organized labor."

ARRANGES DINNER

Foreman calls 20 or so of his business friends, has a "little dinner" for which he charges a nominal amount, then asked for contributions to the man he admires most in Congress: Corman.

Corman estimates he will spend about $60,000 in this year's race against Republican Joe Holt, but only 15% will come from labor.

While the Volkswagen dealer will collect more from his fund-raisers, the difference is that he is an individual, and his influence is limited to Van Nuys.

Unions usually support not just Corman in Van Nuys, but most other liberal congressmen.

This is not always true, of course, but it is this kind of potential coordinated strength which labor is beginning to realize more and more.

But that strength is not always coordinated. For instance, AFL-CIO President George Meany was pushing Humphrey into the campaign this year within hours after President Johnson announced he would not run for reelection.

Other union leaders were urged to do the same.

Shortly thereafter, the Chicago Federation of Labor leaders drafted a resolution to endorse Humphrey.

But Chicago's Mayor Richard J. Daley said, "No," and the idea was dropped.

Daley wanted to withhold support for Humphrey until the last minutes of the Democratic Convention, and he did—not just his own political machine's support, but that of Chicago labor, too.

While that kind of local pressure weakens labor's political muscles, the Vietnam war is cutting even further into the strength of labor in politics.

In Ohio, the AFL–CIO unions gave a reported $400,000 to John J. Gilligan for his successful primary campaign against Democratic incumbent, Sen. Frank J. Lausche.

Lausche had long been a target of unions because of his conservatism. Gilligan is pro-labor and liberal, and dovish on the Vietnam war.

After the primary, Al Barkan, AFL–CIO political director, at Humphrey's request, wrote Gilligan for clarification of his Vietnam position. When Gilligan stuck to his anti-war stance, reports circulated that labor money to him had been halted.

"Sure we slowed down our support for him," said one labor official. He said Gilligan's war position "was like a kick in the rear to his labor friends . . . and to President Johnson."

Barkan, however, insisted that labor money and manpower is still going to help toward the election of Gilligan, "although maybe there is a little less ethusiasm for him."

This kind of dilution of labor's strength in politics because of the Vietnam issue is evident in other Senate races, including those of Sens. J. William Fulbright of Arkansas, George S. McGovern of South Dakota; Wayne Morse of Oregon; Gaylord Nelson of Wisconsin, Frank Church of Idaho, and Sen. Joseph Clark of Pennsylvania.

Clark said recently that "I have got to get the peace vote in Pennsylvania, or I am dead."

Yet if he pushes too hard for that peace vote, the far more hawkish labor leaders at the national AFL–CIO level are going to be less than enthusiastic in pushing for Clark's election.

The battle between union leaders and the antiwar doves was also clearly in evidence in New York where Paul O'Dwyer, the Democratic candidate for the Senate charged that "Meany laid down the law in an effort to punish me for my refusal to back Hubert Humphrey and my opposition to the war in Vietnam."

JAVITS BACKED

The AFL–CIO has endorsed Sen. Jacob K. Javits, a liberal Republican, who generally supports Administration policy on the war, against O'Dwyer.

Another weakening effect on labor's political clout for liberalism are local self-interests of unions.

Charles Halleck, the former House Republican leader, had the support of the Northern Illinois building trade unions even though to most union leaders he was the symbol of the Republican-Dixiecrat coalition which has often blocked labor-backed legislation.

The building trades backed Halleck because he supported their opposition to creation of the Dunes National Park on Lake Michigan, a project which the building trades saw as a damper on industrial construction along the lakeshore.

These local self-interest situations go contrary to the generally broad-based effort of unions to back liberal legislation even if it is unrelated to unionism, such as federal aid to education.

NOT MONOLITHIC

But they also disprove the charge by labor's enemies that it is a monolithic operation, with no local level control.

Some of the most active unions politically spend most of their money and manpower on issues pertaining almost exclusively to their own industry.

Paul Hall's Seafarers' International Union raises about $500,000 a year from its 80,000 members, and most of it goes to support congressmen sympathetic to the maritime legislative goals of the union.

This raises another point in connection with labor's political strength: How much of the voluntarily collected money unions raise is truly voluntary?

Hall says all of it. But his opponents contend that when a sailor docks at his home port and is paid off, he is hard-pressed to reject an SIU port agent's request for political donations when the agent may have a voice in the sailor's next trip.

Spot checks of voluntary collections indicate that while many unions use high-pressure political salesmanship to get the donations, there are no widespread instances of improper tactics being used.

OPPOSITE EXAMPLES

But there are examples to the contrary. Take Lawrence L. Callanan, head of the Pipefitters Local 562 in St. Louis, who was recently convicted of falsely claiming that his union's political fund was voluntarily given.

Callanan, a major power in St. Louis politics for the last 20 years, has a political fund of between $400,000 and $600,000 a year.

After Callanan was fined $1,000 and sentenced to a year in jail for conspiring to make illegal contributions to a federal level political campaign, he issued a statement, saying:

"The very least we hope that will result from this trial is that Congress will see fit to pass realistic laws governing election and campaign expenses that are fair and equitable to everyone."

The case is being appealed.

Plans for the future intensification of union activities in politics are elaborate, ranging from computerized crosschecks of every union member in the country to payroll deductions for union political funds.

NINETY PERCENT PARTICIPATION

The Teamsters Union is pushing a program in which its members authorize employers to deduct $5 a year from their paychecks.

Ted Merrill, head of the Southern California Joint Council of Teamsters, said that while the program is just getting started in the Los Angeles area, "we are getting up to 90% of those asked to okay the deductions."

And the only pressure used, he said, is to "explain what it means for workers to join in electing political candidates who are pro-labor."

Unions are still the strongest organized force for old-fashioned liberalism in the country, backing almost every piece of liberal legislation whether or not it is related directly to labor matters.

Union leaders did play the major role in getting Vice President Humphrey the Democratic nomination, and if he is elected, they will have played the decisive role in that now unexpected achievement.

But as of today the unions are not only failing to deliver the political clout they hoped for, but they are suffering the most severe wrenchings of their political muscles in modern times.

[From the Daily Oklahoman, Oct. 30, 1968]

GOP ACCUSES UNIONS OF USING DUES FOR DRIVE

Richard Nixon's Oklahoma campaign organization accused the AFL–CIO Tuesday of using dues of union members to campaign for Democratic presidential nominee Hubert H. Humphrey.

Goodwin Broaddus, Jr., state chairman of the Republican presidential nominee's state campaign committee, called for an investigation by the state corporation commission, the internal revenue service and the state tax commission.

"It is absolutely unfair to members who are opposed to Mr. Humphrey to spend their union dues to support a man in whom they have no faith and cannot believe," Broaddus said.

Broaddus said the state AFL–CIO last week mailed tens of thousands of letters to both union and non-union members over the signature of Humphrey.

"This mis-use of funds is in direct violation of the regulations that give the AFL–CIO tax-exempt status and it violates the moral obligation of the organization to its members who are not for Mr. Humphrey," Broaddus said.

Broaddus said the letters carry a postage meter stamp granted to non-profit organizations, which he said permits the organization to mail letters for 1¼ cents each. He said the meter is registered by the post office to the Oklahoma State AFL–CIO.

Officials of the union could not be reached for comment.

REUTHER'S CONGLOMERATE: AUTO UNION WORTH HITS $125 MILLION MARK—PREPARES FOR NEW GLOBAL CAMPAIGNS

(By Victor Riesel)

WASHINGTON, D.C.—Walter Reuther, now preparing for national and global campaigns, hates thinking of himself as part of the establishment. But he is. The red-haired, new revolutionary, rhetoric notwithstanding, is deep in the black. As a union chief who has been needling other labor leaders with "charges" of "banker's mentality," the auto union head now runs a labor conglomerate worth at least $125 million.

If he is not careful, the United Auto Workers (UAW), of which he is chief executive officer, soon will rival some of those 200 capitalist corporations he denounces so passionately so regularly.

A shuffling of the UAW's latest financial records disclose some startling Keynesian spending.

The small print reveals that Mr. Reuther and his board of directors spent mightily last year to defeat Richard Nixon. Virtually all of the union's $2.1 million "Citizenship Fund" went for political stakes in the '68 race. This does not include the pay and expenses for 916 national headquarters field men known as "International Representatives." In the final months of the campaign, virtually all of these men spent virtually all their time campaigning against the Republican front runner. On the cost line, as the accountants say, this would come to many millions of dollars.

Nor does the "Citizenship Fund's" $2.1 million spent last year, include the monies poured out by the national union's regions and its 1,383 local unions.

The money is there—it all comes out of an average dues payment of $7 per member per month—or roundly some $126 million annually.

Some of this money goes regularly into the "Strike Insurance Fund"—now well over $86 million. But this figure apparently still is in the petty cash stage. Mr. Reuther plans to have a record-breaking $120 million in this strike fund by August, 1970—when the "Big Three" car company contracts start expiring.

The union's high command just doesn't want to get caught short again as it was during the 1967-1968 rounds of negotiations. At that time, the UAW spent some $80 million paying its people an average of $35 a week in strike relief.

Mr. Reuther knows that the phasing out of the Vietnam War will hit his membership hard, for his conglomerate union reaches into the aerospace, aircraft, jet engine and agricultural implement fields as well as the car and truck factories.

It's too early to predict a strike wave. But certainly the redhead is preparing for long walkouts as it gets tougher to overheat a deflating economy.

The Union's records show that this division spent almost one million dollars abroad last year. And that the cash source, known as the "Free World Labor Defense Fund", has still another million dollars in reserve.

Much of this money goes for Mr. Reuther's own brand of global unionism. The UAW supports quite heavily, an international Swiss-based metalworkers federation. In it is an automotive division headed by Mr. Reuther. In it is a network of "Automotive Councils" headquartered in Geneva, Switzerland. One council covers all locals in General Motors' plants ranging from Britain to Australia, another council covers Ford. Still a third covers Chrysler-Roote.

They are nurtured by the continent hopping Victor Reuther, who with his brother, hope some day to be able to run simultaneous world-wide strikes. It is not difficult to spend a million dollars to dig deeply into labor movements abroad.

At the same time the big union will spend over $3 million organizing on the home front. This will not include another $1.7 million annually to help subsidize the Alliance for Labor Action.

Rarely has a single international union poured out so much of its cash. Rarely has a union experimented so readily with its funds.

Rarely has a union been able to turn conglomerate so easily, for rarely has one been so deeply in the vortex of war production with its constant steady employment.

Rarely has a union had a steady income of $126 million annually.

It's indeed an establishment of its own.

MEANY GEARING LABOR FOR BIG POLITICAL EFFORT

WASHINGTON.—AFL–CIO president George Meany—worried about prospects for Senate and House liberals in the 1970 elections—already is gearing organized labor for a mighty political effort next year.

"This is where the blue chips will be down," Meany said in a recent speech to the painters' union convention. "We could be badly hurt in 1970 if we lost a few friends in the Senate and a few more in the House."

He said at least eight labor-backed senators who won by less than 5% of the vote in 1964 are "facing a real tough election" in 1970. The same holds true for 30 liberal House members who scored narrow victories last year, Meany added.

"The John Birchers, the so-called right-wing forces, would like to take control of the Senate in 1970, and you know what that means," said Meany. "That would put us under the domination of 'old curly locks'—an obvious reference to Senate Republican leader Everett McKinley Dirksen of Illinois.

"There is not much sense in thinking about 1972 until we have solved the election problems of 1970," Meany added.

He praised the AFL–CIO's Committee on Political Education (COPE) and its director, Al Barkan, for running "one of the best political machines ever put together."

In a backward glance at the 1968 campaign, Meany aired one of his rare public criticisms of the Democrats.

"Even though the party of our presidential candidate, the Democratic party, was woefully ineffective and torn asunder by internal strife, the fact that Hubert Humphrey came close is to the credit of COPE, not to the party whose label he carried," the labor leader said.

Although Meany did not mention any names in his address to the painters' union delegates, labor sources said substantial AFL–CIO support probably would be extended to the following Democratic senators in 1970: Quentin A. Burdick, North Dakota; Philip A. Hart, Michigan; Vance Hartke, Indiana; Henry M. Jackson, Washington; Gale W. McGee, Wyoming; Joseph Montoya, New Mexico; Frank E. Moss, Utah; Joseph D. Tydings, Maryland, and Ralph W. Yarborough, Texas.

Republican senators who may receive some labor backing include Hugh Scott, Pennsylvania, and Hiram L. Fong, Hawaii.

Meany warned against candidates who used the "law and order" slogan to fight against progressive public officials.

"The high-power publicity people of this country, who are employed by the extreme right wing, by the Birchers, have converted the so-called 'law and order' slogan into something that is antiliberal and antiprogressive," Meany said.

"In other words, they are trying to make crime synonymous with liberalism," he added. "This campaign has been used recently in a few city elections and this gives us a great deal of concern."

He apparently referred to mayoral contests in Los Angeles, Minneapolis and New York City where candidates most strongly espousing "law and order" won upset victories.

[From the Philadelphia (Pa.) Inquirer, Nov. 7, 1968]

WORKERS PROTEST DUES FOR POLITICAL PURPOSES—104 DEMAND REFUND FROM UAW LOCAL

(By Gerald McKelvey)

A group of 104 employes at Leeds & Northrup's North Wales plant have asked for a refund of dues paid to the United Auto Workers which were used for political campaign promotion.

All members of UAW Local 1350, the workers sent individual letters to local president Arthur Stump stating their demands.

Stump told The Inquirer that he reacted in direct fashion.

"When I got the letters, I threw them all in the wastebasket," he said.

DO NOT RECOGNIZE

"These men are not proceeding in a proper fashion. If they write to me individually and express real sincerity, I'll be glad to take the matter up with the local's executive committee and from there to the top," Stump stated.

He added that the letters were all sent in one envelope, with the imprint of Montgomery Employes for Right-to-Work, "an organization I do not recognize."

The county group is affiliated with Pennsylvanians for Right-to-Work, a group which advocates abolition of compulsory union membership in industry.

William Lemon, an employe at the eastern Montgomery county plant and chairman of the county Right-to-Work chapter, said the refund request was a test of the UAW's "sincerity" on changes in its constitution which allow members to request a return of that portion of their dues for political purposes.

"We want to find out whether the changes in the UAW charter are really meaningful or just a smokescreen to dodge more lawsuits like those filed by UAW employes in California and Oklahoma challenging the use of compulsory union dues for political purposes as a violation of their constitutional rights," Lemon said.

Informed of the junking of the letters, Lemon said his group "will take action, but right now, we're not sure what action."

OUTLINES DIFFERENCES

Lemon added that he was surprised at Stump's action and went on to outline differences which have arisen at the North Wales plant since the union entered it about a year ago.

"The Right-to-Work group has been forming for the past six months," said Lemon, "and is the outgrowth of a larger unit, Workers for Leeds & Northrup for an Honest Union."

He explained that before the UAW arrived on the scene, the approximately 2000 workers at the plant had their own, independent bargaining unit.

When a vote was taken for accepting UAW as the bargaining agent, the ballot was marked three ways: For the UAW, for retaining the independent union, or for having no union at all.

"The UAW got in on a little less than 50 percent of those voting," Lemon said, "so it had the support of less than half of the workers to start. It's been slipping since then."

Stump suggested that the letters asking for a refund were prompted more on political grounds than on the basis of testing the UAW's sincerity.

"Most of these people are not Republicans (the union supported Humphrey and Muskie) but are Wallaceites," Stump said.

He went on to say that the UAW local had not violated any political rules and that it was within the law in supporting the Democratic standard-bearers.

"We are not allowed to directly contribute to a candidate's campaign," said Stump, "but according to our counsel, we're all right in soliciting support." This would not apparently invalidate the refund request, however.

Under a 1961 decision by the U.S. Supreme Court, which was written for the railway union but has been extended to all unions, a man who was compelled to join a union was given the right to ask for a refund of dues money spent for political purposes.

[From the Wall Street Journal, Oct. 3, 1969]

UNION VERSUS THE GOP: LABOR MAPS BIG DRIVE TO ASSIST DEMOCRATS IN RACES FOR CONGRESS—WORK BEGINS AT THE DISTRICT LEVEL FOR 1970—AFL-CIO TO HIT NIXON TAX STAND—GEORGE MEANY AIDS EFFORT

(By Richard J. Levine)

ATLANTIC CITY—Organized labor's political strategists, starting earlier than ever before, are readying a massive defense of their last major national stronghold—the Democratic Congress.

Though the 1970 Congressional elections are still more than a year away, AFL-CIO politicos have been hard at work for the last half-year on ways to help elect or reelect liberal lawmakers friendly to union causes. These include such Senate Democrats as Labor Committee Chairman Ralph Yarborough of Texas, Albert Gore of Tennessee and Vance Hartke of Indiana, to name just a few.

Building on lessons learned in 1968, when it played a crucial role in Hubert Humphrey's fast-closing finish, the AFL-CIO is developing new techniques that demonstrate the growing sophistication and scope of its political operation.

For the first time, the Committee on Political Education (COPE), the AFL-CIO's political arm, has quietly set up a special subcommittee to concentrate on

close House races. The committee has already assigned to one union or another the responsibility for coordinating all political activity in each of some 80 House districts. The closely guarded assignment list shows, for instance, that the United Steelworkers' responsibility includes the 3rd in Colorado, held by Democrat Frank Evans; the 4th in New Jersey, represented by Democrat Frank Thompson, and the 2nd in New Mexico, where Republican Edgar Foreman is considered beatable.

REGISTERING UNION VOTERS

The federation has also begun to conduct annual rather than biennial voter registration drives, financing them from its general treasury; in the past, COPE had to depend on voluntary union contributions for such work. COPE expects to dole out about $500,000 this year for registration activity. About $250,000 has already been approved for operations in 17 states. These efforts, while broad and nonpartisan, will concentrate first on registering union members, their families and others likely to vote for labor's friends.

A particularly intensive drive is just now getting under way in Texas, where registration opened Wednesday for a four-month period and where voters must be registered anew for each Congressional election. COPE plans to pour $20,000 into Texas and expects local labor groups will add perhaps $140,000. Union politicians figure Sen. Yarborough will be nearly unbeatable if 4.5 million voters register. "We're going to win this election in the registration period," says one Yarborough backer.

"In two decades," declares James Cuff O'Brien, the steelworkers' savvy and dapper political action director, "I haven't seen as early and thorough preparation" by labor for an election.

The importance to labor of the 1970 elections will be strongly stressed during the AFL-CIO biennial convention, which opened here yesterday. According to federation President George Meany, who proudly describes COPE as "one of the best political machines" in the country, "1970 is the year when the chips are really down."

GAINS IN SPECIAL ELECTIONS

"There isn't much sense in thinking about 1972 until we solve the election problems of 1970," he said recently. "This is no time to rest on our laurels."

Heeding such advice, labor has plunged into the five special House elections held so far this year. The results have been encouraging to union men: Four victories, three of them in districts formerly held by Republicans.

To snatch GOP seats in Wisconsin, Montana and just this week in Massachusetts, labor committed considerable money and manpower. John Schmitt, president of the Wisconsin AFL-CIO, estimates that unions contributed about $20,000 to the successful campaign of state Assemblyman David Obey for the seat formerly held by Melvin Laird, now Secretary of Defense. Mr. Obey had the help of nine full-time and nine part-time volunteers from the ranks of labor.

Montana Democrat John Melcher says union support was "a strong factor in my election." Labor contributed $10,400 to his $73,000 campaign, in which the International Brotherhood of Electrical Workers, the Carpenters, the Steelworkers and the Oil, Chemical and Atomic Workers were active.

Even in their one losing battle—the California race in which Barry Goldwater Jr. defeated Democrat John Van de Kamp—labor men figure their efforts helped to reduce the Republican margin from the previous election. In the final four days of the campaign, the Machinists Union had 60 members working full-time.

FEARS OF NEW CURBS

Spurring this unprecedented off-year activity is the contention of labor officials—whether right or wrong—that loss of Congress next year could produce a flood of legislation designed to curb union power. Declares COPE's national director, Alexander Barkan:

"We've lost the White House. We've lost the Supreme Court. Our only hope is holding the Congress. . . . We're well aware of the stakes."

The dimensions of the task confronting labor's political strategists are formidable, particularly in the Senate, where the Democrats now hold a 57–43 edge. Next year 35 Senate seats will be contested, 25 of which are occupied by Democrats and only 10 by Republicans. Among the Democrats, 21 are ranked by the AFL-CIO as "liberals on labor and social welfare issues," with a combined record of 707 "right" votes and only 95 "wrong" votes.

COPE officials figure that nine of these Senators—including Howard Cannon of Nevada, Joseph Montoya of New Mexico, Quentin Burdick of North Dakota, Frank Moss of Utah, Gale McGee of Wyoming and Stephen Young of Ohio along with Sens. Yarborough, Gore and Hartke—face tough races in 1970. Some of these men were elected by less than 55% of the total vote in 1964.

On the House side, where the Democrats outnumber Republicans 245 to 188, union politicos believe 78 seats could easily go either way; of these, 48 are now Democratic and 30 Republican.

To maintain Democratic control of both Houses in the face of this arithmetic, labor planners readily concede they'll need the right issues as well as effective organization.

Until recently, says a top AFL–CIO staffer, "Nixon has kept a low profile. There hasn't been a helluva lot to swing at." But, he adds, "he laid himself wide open" when he proposed that the corporate income-tax rate be reduced while tax relief provided low-and-middle-income families in the House-passed reform bill be cut back.

A glance at almost any union newspaper these days shows how labor is using this issue. Under a bold headline in the Machinists' paper that reads "Nixon Tax Plan Reverses Steps Toward Tax Justice" is a story that starts: "The Nixon Administration has bowed to Wall Street and the corporation lobbies and is now moving to halt Congress' modest progress toward tax justice. . . ."

KEEPING THE ISSUES FRESH

Many labor strategists believe the health of the economy may prove the key issue in 1970. If the Administration's anti-inflationary policies produce "an additional million unemployment, another million on short-time and a few million more worried that they're next, anything can happen," observes Mr. Barkan of COPE.

The efforts of union lobbyists on Capitol Hill next year will dovetail with labor's election goals. Most of Congress' work on Nixon proposals opposed by labor, including welfare reform, job safety and unemployment compensation, will be left till 1970. For tactical reasons, "it's good the fights in Congress will come next year," says the AFL–CIO's chief lobbyist, Andrew Biemiller. "That way the issues will be fresh in our members' minds."

As part of the get-ready-early-for-1970 process, the COPE operating committee held a three day meeting here this week before the convention started. On the agenda were status reports on voter registration drives and the subcommittee dealing with close House contests.

That subcommittee, headed by Amalgamated Clothing Workers Vice President Howard Samuel, was formed last February. Represented on it are 15 unions, among them the Steelworkers, Seafarers, Machinists, Meatcutters, Airline Clerks, Clothing Workers and Ladies Garment Workers. The Steelworkers and the Machinists, the AFL–CIO's two largest affiliates, have been assigned political coordinating responsibilities in 12 Congressional districts apiece.

ASSIGNING STAFF MEMBERS

The top officials of the unions designated to coordinate efforts in Congressional districts are just starting to call meetings of other unions in their areas to form COPE district committees. In some places, they have also begun to designate union staff people to work on political activities.

Mr. Samuel views the project as an attempt to organize the labor movement for political activity "along Congressional lines." By getting staff people who know a district involved in politics well before Election Day, it's hoped that labor's efforts will be more productive. "Staff people can't be effective when they're thrown into a strange district on Aug. 30," Mr. Samuel says. "By the time they're operating at full capacity it's Election Day."

In addition, Mr. Meany has given his okay to tentative plans to assign union presidents as coordinators in states were labor's political organization is weak or the races are especially tough.

Indeed, labor politicians say that Mr. Meany, who once doubted the need for an organization such as COPE, has never been more responsive to their needs. In fact, it was Mr. Meany who proposed in February that registration drives be financed out of the AFL–CIO treasury and conducted on a continuing basis whenever and wherever registration books are open.

CONTRIBUTIONS LAG

Not so promising at this point are individual union efforts to raise voluntary contributions for COPE that can be used for partisan political activity. While a few unions such as the Communications Workers and the Allied Industrial Workers report donations are running ahead of last year, many others are encountering difficulty.

Don Ellinger, national director of the Machinists Nonpartisan Political League, says COPE contributions are running about $100,000 behind last year's pace, when rank-and-filers contributed a total of $480,000.

As they look ahead to 1970, COPE officials find it difficult to avoid a proud backward glance at their accomplishments in 1968, when in Mr. Barkan's view labor proved itself as a "major political force." Recently the AFL-CIO distributed an excerpt from Theodore H. White's book The Making of the President 1968, in which he details the federation's effort on behalf of Mr. Humphrey. Writes Mr. White:

"The dimension of the AFL-CIO effort . . . can be caught only in its final summary figures: The ultimate registration, by labor's efforts, of 4.6 million voters; the printing and distribution of 55 million pamphlets and leaflets out of Washington, 60 million more from local unions; telephone banks in 638 localities, using 8,055 telephones, manned by 24,611 union men and women and their families; some 72,225 house-to-house canvassers; and, on Election Day, 94,457 volunteers serving as car-poolers, materials-distributors, baby-sitters, poll-watchers, telephoners."

Comments Mr. Barkan:

"We're going to try to mount the same kind of campaign among our members in 1970. We think our organization is getting more effective each campaign."

[From the Wall Street Journal, Sept. 19, 1968]

LABOR AND HUMPHREY: UNIONS MAP BIG DRIVE FOR DEMOCRATIC TICKET BUT REMAIN PESSIMISTIC—AFL-CIO PLAN CALLS FOR USE OF ORGANIZERS IN CAMPAIGN—15 KEY STATES ARE TARGETS—FIGHTING LOSSES TO WALLACE

(By James P. Gannon)

NEW YORK—The chieftains of organized labor are about to launch a massive rescue operation designed to save the foundering Presidential campaign ship of their candidate, Vice President Hubert Humphrey.

The elaborate scheme, rated the most detailed vote-getting plan ever drafted by the AFL-CIO's political agents, is an admission by union leaders that they believe the Humphrey ship is headed for disaster on its current course. The effort involves an unprecedented mobilization of labor's resources, including money, machinery and especially manpower, in 15 big industrial states with lots of union members and enough electoral votes to elect a President.

This campaign plan was approved by AFL-CIO President George Meany this week as he met with top union men in closed-door sessions at the Commodore Hotel here; the sessions were climaxed yesterday as the AFL-CIO's general board of 125 union presidents formally ratified Mr. Meany's earlier endorsement of the Humphrey candidacy.

ORGANIZERS ASSIGNED TO CAMPAIGN

Many details of the save-Humphrey drive remain secret, but participants in the huddles here say the 15-state battle plan envisions putting "hundreds" of union staff men to work full-time on the Humphrey drive. They report that Mr. Meany has released the entire AFL-CIO organizing staff, totaling around 100 men, to work steadily on recruiting voters for Mr. Humphrey rather than new members for unions. In addition, individual unions are being asked to assign squads of their staff members to the drive.

The goal is to get at least two union staffers working for candidate Humphrey in each Congressional district of the 15 states. To oversee their work and to signify the importance of the effort, the AFL-CIO's top brass has been assigned specific states. For example, P. L. Siemiller, president of the million-member Machinists Union, will command the Illinois operation, and United Steelworkers Chief I. W. Abel will direct the campaign in his home state, Pennsylvania.

The tasks of the 15-state army will include spurring Democratic voter registration, organizing volunteer door-to-door canvassers and starting telephone get-out-the-vote drives. The union staff workers, says one labor politico, are "versatile, mobile guys, who have organizational skills, contacts in the community and access to a union hall and facilities."

The campaign will feature a blizzard of pro-Humphrey, anti-Nixon, anti-Wallace leaflets and other handouts. The AFL-CIO's political arm, the Committee on Political Education (COPE), is reportedly preparing over 50 million pieces of such literature for distribution by unions. A top planner says: "We want our people who may not have seen an organizer in years to see that guy out at the plant gate at 5:30 in the morning passing out leaflets so they'll realize just how important this election is."

WALLACE'S INROADS

The rescue operation seeks to shore up or even supplant the deteriorated and disorganized Democratic Party machinery and reverse the phenomenal tide toward third-party candidate George C. Wallace among labor's rank and file, a development that has shocked and embarrassed labor's hierarchy and has severely shrunk Mr. Humphrey's support within this usually solid Democratic voting bloc.

Despite the grandiose scheme, labor political experts remain worried that Mr. Humphrey is running so far behind Republican Richard Nixon that no amount of effort by labor can save him. "I'd feel much better if someone could explain to me how to win an election without carrying either New York or California," remarks one strategist, reflecting on Mr. Humphrey's uncertain prospects in the two most populous states.

At a press conference here yesterday, Mr. Meany did offer some apparently cheerful tidings for labor's political warriors. He disclosed that the national COPE has received a record-smashing $800,000 in voluntary contributions from union members so far this year, up from about $600,000 four years ago. And he reported that a COPE drive in eight major industrial states has so far registered an additional 1,160,000 union members to vote in November.

But most of the dollars raised will go into Congressional campaigns rather than the Presidential race. And many of the newly registered union voters are far from being sure Humphrey supporters.

Indeed, the decision to use union staffers for political operations on an unprecedented scale reflects labor's judgment that the regular Democratic organization is in sad shape.

"Lyndon Johnson left the party machinery almost in ruin," says one union's top political agent, complaining that the Democratic National Committee has shrunk in size and effectiveness during the Johnson years. Adds another: "The labor movement is the crutch Hubert Humphrey has to lean on" because of the crumbling of city and state Democratic machines.

A DISTURBING POLL

But the labor crutch now looks wobblier than ever because of the Wallace appeal to union members. Tales of "the Wallace problem" dominated corridor talk at the strategy sessions here. From one official's recounting of a Hammond, Ind., Wallace rally that was "wall-to-wall Steelworkers" to another's lament about union locals that are 65% to 75% for Wallace, the evidence of the Alabamian's inroads into the labor vote piled up. Even Mr. Meany has publicly admitted that "Wallace is fooling a lot of people, and among the people he is fooling are our members."

A Louis Harris poll, released during the three-day meeting here, underscored labor's political problem. It showed that 27% of union members preferred Mr. Wallace and as many picked Mr. Nixon, leaving Democrat Humphrey with a shockingly low 40% of the labor vote (the other 6% were undecided). There's quibbling, of course, over the exact size of Mr. Wallace's union support, but none of the strategists here doubts it is substantial.

Labor's counterattack against Mr. Wallace will vary from place to place and from union to union, but basically it will stress a bread-and-butter message: That he's antilabor. This line came through strong in yesterday's AFL-CIO statement endorsing Mr. Humphrey; expressing "open contempt" for the Wallace candidacy, it said "his pretense to be the friend of the worker is especially galling to the American labor movement."

The union's anti-Wallace campaign will involve a barrage of carefully conceived propaganda. In Maryland, the state AFL–CIO is putting out a four-page tabloid newspaper, to be distributed to workers at plant gates, which is headlined: "Do Maryland Workers Want Birmingham Wages?" and "How George Wallace Would Drag Our State Down to the Alabama Level." Inside, readers are told that per-capita income is only $2,166 a year in Alabama, compared with $3,454 in Maryland. On a similar pitch, a COPE pamphlet proclaims: "George Wallace could cost you $1,000 a year."

Besides stressing Alabama's lower-than-average wages, poorer unemployment benefits and "anti-union" right-to-work law, some of the anti-Wallace propaganda will try to hit back at the Alabamian's strong point—his law-and-order pitch.

The Pennsylvania AFL–CIO, for instance, plans blanket mailings to the state's 1.2 million AFL–CIO members of a pamphlet called "A Letter From Alabama." The state is identified in headline type as "The Crime Center of the United States." A handwritten message, purported to be a real letter from someone in Alabama to a friend in Pennsylvania, is reproduced. An excerpt: "Would (you) believe that Alabama actually has much more violence and murder than Pennsylvania or almost any other state in spite of Wallace's propaganda?"

But the unions generally won't attack the Alabamian as a racist. "If we talk about his civil rights record, half our members would shout 'hurray!'" says one strategist.

Significantly, it's understood that union officials are having trouble getting some local leaders to stand up against Mr. Wallace because of his popularity among the rank and file. Any local leader who senses a Wallace tide running among his constituents may fear to struggle against it. "If Mr. Meany had to face his members for reelection, he might change his tune, too," snaps one bold union politician.

Also bothering some union men is the thought that their voter registration drives, for which COPE has budgeted $695,000, may partly backfire by putting lots of Wallace supporters on the voting rolls. Of every 100 union members registered, one labor strategist figures, the yield of sure Humphrey votes will be "maybe 55 or 57."

Another worry nagging some labor officials is that the stress on bread-and-butter issues won't effectively counter the Wallace appeal. Frets a Steelworkers official: "I just don't think our people could think that the threat of anti labor legislation is as important an issue this year as the riots in Newark or Detroit. I just don't think that message reaches them."

Many labor officials, it's true, believe the members can be wooed away from Mr. Wallace on the basis of bread-and-butter issues, but they fear that the campaign messages grandly conceived at COPE headquarters don't ever filter all the way down to the rank and file. Not many members attend union meetings regularly, and many don't pay much attention to their union newspapers, these officials worry.

Finally, there are pessimists in the labor camp who doubt that even a brilliantly executed COPE campaign can win the election for Mr. Humphrey. Says one: "I think Humphrey should resign as Vice President and really go out and cam-

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[From the Detroit (Mich.) News, May 27, 1969]

Livonia To Fire Teacher for $96 Dues

(By Mary Lou Butcher)

Refusal to pay annual dues of $96 to the Livonia Education Association (LEA) under an agency shop agreement has cost Mrs. Ruth E. Williams her job as a teacher in the suburb's school system.

The Livonia Board of Education voted, 6–1, last night to fire the Garfield Elementary School fourth grade teacher when the term ends next month.

Mrs. Williams, 57, a Livonia teacher for six years, said she had belonged to the LEA but dropped out last fall when the clause was included in the contract with the board of education.

In an agency shop, workers are not required to join the union, but they must pay dues.

Mrs. Williams said she regards this as "coercive and unprofessional."

"I have always believed that if one prepared and qualified himself for a profession and did a commendable, conscientious job, there would always be a place for him in that profession," she told a hearing last week. "Apparently, Livonia educators do not agree with this concept."

The board and LEA spokesmen said her dismissal was required if she refused to make the payment.

"The board had no alternative," said School Supt. Benton Yates. "They were merely following the advice of their attorney to honor the contract."

Roger Stephon, LEA executive secretary, called the action "unfortunate," and said Mrs. Williams is a "fine teacher whose professional qualifications were never in question."

"The purpose of the agency shop," he declared, "is to encourage people to pay what we consider their fair share for negotiation and representation."

Mrs. Williams was the only one of 1,600 teachers in the Western Wayne County district to be fired for refusing to pay. Another who balked at the agency shop requirement resigned last month.

Senator WILLIAMS. The next witness is Roger A. Clark, of the Morris and Gwendolyn Cafritz Foundation.

STATEMENT OF ROGER A. CLARK, COUNSEL, MORRIS AND GWENDOLYN CAFRITZ FOUNDATION; ACCOMPANIED BY CHARLES SIMMONS

Mr. CLARK. Thank you, Mr. Chairman. I appreciate the opportunity to appear before this committee. I am a partner in the law firm of Royal, Koegel & Wells, which is counsel to the Morris and Gwendolyn Cafritz Foundation. I am accompanied this morning by my partner, Charles Simmons, who is, unlike myself, a tax lawyer.

My testimony this morning is limited to three narrow aspects of the business ownership and self-dealing provisions of H.R. 13270 which will have severe, unintended, and completely unwarranted consequences for the Cafritz Foundation and, I believe, other foundations similarly situated.

The Cafritz Foundation was formed in 1948 by Morris Cafritz, a major builder and developer in the Washington area. Until recently it has had relatively minor assets amounting to at the end of last year only $2.4 million. But over the past 15 years this small foundation has contributed over $1.7 million to charitable causes which represents over 123 percent of its earned income during that period.

Now in addition to regularly supporting established charities in this community, the Washington community, the foundation has made significant contributions to many special projects, many of which is helped formulate itself. I just want to mention briefly some of these contributions to illustrate the diversity of worthwhile charitable causes that a small foundation can serve and how these foundations can play a special role in the community in enriching its social and cultural life.

In the social field, for example, the foundation has made a major contribution which enabled the construction of a new hospital in Anacostia, contracted to pay the renovation cost of a community center in the Adams-Morgan area, and funded a program whereby District schoolteachers can work on masters degrees during the summer. These are things that the Government cannot effectively do and the private foundations are capable of doing.

In the cultural area, the foundation has purchased a monument for the Smithsonian Institution, which is located at the west end of the new Smithsonian building and it is currently financing an exhibit of the

works of the famous sculptor David Smith at the Corcoran Art Gallery, a program which all children from the fourth to the sixth grades in this community will have an opportunity to see by special tours.

This foundation is soon to receive a substantial increase in its assets. It is the principal beneficiary under the will of Mr. Cafritz who died in 1964. Mr. Cafritz left a substantial real estate empire consisting primarily of stock in numerous corporations which directly or indirectly own a number of highly valuable real estate investments, office buildings, apartment houses, warehouses, and, in some instances, unimproved real estate. In addition, there is a hotel, a construction business, and a real estate management business.

Mr. Cafritz' will adopted a very common estate plan, which is still highly recommended although it may be changed by this legislation. But anyway, it was a very common estate plan at the time it was adopted. The effect of that estate plan is that a fractional two-thirds interest in most of his assets goes to a private foundation, the Cafritz Foundation, with the remaining one-third interest in each asset owned by a marital trust for the benefit of his wife.

Thus, the foundation will soon receive two-thirds of the voting stock of each of these corporations with one-third owned by the marital trust which would be a disqualified person.

Since Mr. Cafritz' death in 1964, the executors, with the approval of the directors of the foundation and the trustees of the marital trust, have acted to conserve these valuable real estate investments so that upon distribution they can be operated in a manner to yield the maximum annual income for charity and for the marital trust—their interests coincide in that regard.

In anticipation of receiving these funds, the foundation has formed an advisory committee of leading citizens in this community which are active in the arts and public service. They included William Walton, Chairman of the Fine Arts Commission; Congressman Fulton; Dillon Ripley, Secretary of the Smithsonian Institution; Quincy Mumford, Librarian of Congress; and John Walker and Carter Brown, the past and present Directors of the National Gallery. Thus the Cafritz Foundation is well-prepared to make wise use of the substantial income which it expects to receive from these valuable investment properties.

Continued ownership of these assets by the foundation presents no realistic basis for potential abuse. At the same time it offers the clear prospect of a high yield for worthwhile charitable causes.

Now, I said when I started that my testimony would be limited to three narrow aspects of the legislation. I am not discussing the policy considerations for or against the business ownership limitation in general. I merely want to point out to you that two very narrow aspects of the business ownership limitation as it is presently drafted could, I believe, unintentionally require the foundation to sell its entire interest, possibly within a 2-year period, not only in the hotel business, the construction business, and the real estate management business, but also in the remaining real estate investment properties which are of a passive nature and which constitute the bulk of Mr. Cafritz' assets.

Moreover, because of the practical limitations upon the sale of fractional interests in closely held real estate ventures—it is simply not realistic to think we can sell 10 percent on the market with the large ownership interest held by the marital trust—it may also be necessary for the marital trust to dispose of some or all of its holdings during that period. Thus, it is possible that under the present bill both the foundation and the marital trust will be deprived of their entire interests in these valuable income-producing assets left to them by Mr. Cafritz.

Moreover, a forced sale of real estate properties of this magnitude in a single metropolitan area, even over a 10-year period, will undoubtedly risk substantial losses in value.

What are the two narrow aspects of the bill I am talking about?

First of all, the broad language of the business ownership limitation would appear to limit foundation ownership of real estate investments of a passive nature which traditionally have been recognized as appropriate investments for charitable foundations.

Second, the transition provisions do not provide the necessary flexibility whereby the foundation and the marital trust or other disqualified parties can separate their combined ownership of these properties in an orderly manner.

Both of these narrow aspects of the bill can be remedied without in any way blunting the effectiveness of the business ownership limitation.

As I pointed out, real estate holdings of a passive nature have traditionally been recognized by the Congress and by others as appropriate investments for private foundations. The Treasury Department has consistently recommended in its 1965 report and again in 1969, that these investments be excluded from the business ownership limitation.

More importantly, there is simply no evidence in the extensive hearings before the Ways and Means Committee and the Patman committee, that real estate investments of a passive nature present a potential for abuse or they are in any way contrary to the public interest.

Now, in view of this absence of any evidence of potential abuse, we feel that the failure of the House to pick up the Treasury recommendation and expressly exclude real estate investments from the business ownership limitation was inadvertent. In any event, it is completely unwarranted and the Senate ought to correct it.

The need for adequate transition provisions is equally clear. The estate plan adopted by Mr. Cafritz is a very common one whereby fractional interests are left to a foundation and to members of a family. To avoid hardship in this situation, a foundation and disqualified persons should be given an opportunity to unscramble the eggs in a way that will not unnecessarily cause risk of loss. This can be done simply by allowing the foundation and the marital trust during the 10-year disposal period, to exchange stock or property interests in commonly held assets or to employ any of the wide range of corporate techniques such as liquidations or redemptions that would achieve the same purpose. This should reduce the risk of serious loss since fewer forced sales may be necessary if the parties can unscramble their interests, and foundations will be able to sell what excess business holdings they have left much more readily because they will be able to sell

full ownership interests which should be more marketable than fractional interests in closely held companies.

At the same time, the purposes of the bill, and of the business ownership provision in particular, will be fully served.

To produce a fully equitable result in this regard it is also necessary to have nonrecognition of gain or loss in connection with the exchanges of stock for stock. The reasons for this and the precedents in the code in similar situations are set forth in my statement.

Senator BENNETT. Mr. Chairman, I would like to call the witness' attention that his time went out with the bell and I hope he is not about halfway through.

Mr. CLARK. I did not realize the time was going that fast.

The last point I would make, Senator Bennett, and very quickly, is that all of these properties are managed by a common management company. The problem that we face is that in order to maintain the value of that company as an asset of the foundation and in order to allow the properties to be managed in an orderly fashion, we believe that a limited exception from the self-dealing rules is required. Otherwise there will be a substantial loss in the value of this company, and the foundation will be deprived of an opportunity to realize its maximum return from these investment properties.

Accordingly, we request a limited exception from the self-dealing rules which would permit continuation of these common management services. In the alternative, we request a transition provision that would allow us to provide such services during the disposal period so we can dispose of the company without a substantial loss in value.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator MILLER. Mr. Chairman, may I ask Mr. Clark, would you furnish for the record your comments on whether you can live with amendment No. 222.

Mr. CLARK. I will. Thank you.

The CHAIRMAN. Thank you very much.

(The comments referred to above had not been received at the time of printing. Mr. Clark's prepared statement follows:)

STATEMENT OF ROGER A. CLARK, COUNSEL, MORRIS AND GWENDOLYN CAFRITZ FOUNDATION

SUMMARY

Three narrow aspects of the business ownership and self-dealing provisions of H.R. 13270 will have severe, unnecessary and completely unwarranted consequences on the Cafritz Foundation—which during the past 15 years has distributed over 123% of its annual income to charity—and other foundations similarly situated. These consequences can be avoided or their impact reduced without in any way blunting the effectiveness of the proposed reforms.

These three aspects of H.R. 13270 and the reasons that they warrant revision or clarification can be summarized as follows:

1. *Passive real estate investments should be expressly exempted from the excess business holdings provisions of the bill.* The reasons for this are:

(a) Real estate investments of a passive nature have traditionally been recognized as appropriate investments for private foundations.

(b) The Treasury Department has consistently recommended that they be excluded from the business ownership limitation.

(c) There is no evidence in the extensive hearings that they present a potential for abuse or are otherwise contrary to the public interest.

(d) Neither of the arguments advanced for the business ownership limitation apply to passive real estate investments.

2. *The transition provisions of the bill need additional flexibility so as to permit orderly separation of interests owned by foundations in combination with disqualified persons.* Under the will of its donor, the Cafritz Foundation will receive a ⅔ interest in a number of business and investment assets while the remaining ⅓ of each asset will be owned by a marital trust. The resulting combined ownership of assets is probably common to many foundations. To avoid unnecessary hardship and the risk of serious loss, foundations and disqualified persons need to be expressly allowed to separate their combined ownership during the 10-year disposal period by

(1) exchanging stock or property interests in commonly owned assets and

(2) employing any of the wide range of corporate techniques, such as liquidations or redemptions, which would achieve the same purpose.

This will result in reduction of risk of serious loss since fewer forced sales will be required and foundations will be able to sell full ownership interests, which are far more marketable. At the same time, the purposes of the bill will be fully served.

In this regard, it is also important that nonrecognition of gain or loss be permitted in connection with exchanges of stock for stock which are made in order to comply with the bill.

3. *Continuation of common management services should be permitted.*—

(a) All Cafritz real estate properties are managed by a common management company which will also be owned ⅔ by the foundation and ⅓ by the marital trust.

(b) Unless this management company can continue to manage all of the properties, its business will be severely disrupted and the value of its stock as an asset of the foundation will sharply decline. Moreover, the foundation's ability to maximize its income from its real estate investments might also be diminished since it would not have the services of a highly efficient managerial staff which is fully familiar with the properties involved.

(c) There is no possibility for abuse in permitting a continuation of common management services on a nonpreferential basis since such services are commercially available and their value can be readily determined.

STATEMENT

My name is Roger A. Clark and I am a partner in the law firm of Royall, Koegel & Wells which is counsel to The Morris and Gwendolyn Cafritz Foundation. My testimony is limited to the following narrow aspects of the business ownership and self-dealing provisions of H.R. 13270:

1. The apparent limitation upon ownership by private foundations of real estate investments of a passive nature.

2. Inadequacies in the transition provisions with respect to divestitures of excess business holdings in the common situation where a testator has left fractional interests in business and investment assets to a private foundation and other members of his family.

3. The self-dealing rules insofar as they prohibit a disqualified person from supplying services to a foundation at nonpreferential commercially available rates.

These aspects of the bill will have severe, unintended and completely unwarranted consequences for the Cafritz Foundation and many other private foundations similarly situated—consequences which can be avoided without in any way blunting the effectiveness of the reform proposals. This statement outlines these consequences, the public policy considerations which require that they be remedied, and our recommendations as to the technical modifications of the bill necessary.

The Cafritz Foundation

The Cafritz Foundation was formed in 1948. Until recently, the foundation has had relatively modest assets amounting at the end of last year to approximately $2.4 million. Over the past 15 years, however, it has contributed over $1.7 million—amounting to over 123% of its income—to charity. In addition to regularly supporting established charities, major contributions have been made to the Cafritz Memorial Hospital in Southeast Washington and to the Smithsonian Institution, the latter in the form of a gift of the monument by the renowned sculptor, Alexander Calder, located at the west end of the New History and Technology Building.

The foundation is the principal beneficiary under the will of Morris Cafritz, a major builder in the Washington area who died in 1964 leaving an estate of very substantial value. Mr. Cafritz's will adopted a common estate plan, the effect of which is that a fractional ⅔ interest in most of his assets is soon to be distributed to the Cafritz Foundation with the remaining interest in each asset going to a marital trust for the benefit of his widow. These assets consist primarily of stock in numerous corporations which directly or indirectly own a number of highly valuable real estate investment properties such as office buildings, apartment buildings, warehouses and unimproved land. In addition, there is a hotel, a construction company and a real estate management company. Thus, the foundation will soon own ⅔ of the voting stock in each of these corporations, with the remaining ⅓ stock interest owned in each instance by a marital trust.

Since Mr. Cafritz's death in 1964, the intention of the executors of his estate, the directors of the foundation and the trustees of the marital trust has been to conserve the valuable assets of these corporations so that, upon distribution, they can be operated in a manner which will maximize annual income to the foundation and the marital trust.

Continued ownership of these assets by the foundation presents no realistic basis for potential abuse—and at the same time offers the clear prospect of a high yield for worthwhile charitable causes.

Unless H.R. 13270 is clarified or modified in the respects requested herein however, the foundation may be forced to sell—possibly within a two-year period—its entire interest not only in the hotel, construction and real estate management businesses, but also in the remaining real estate investments which are of a passive nature. Moreover, because of practical limitations upon the sale of fractional interests in real estate ventures, it may be necessary for the marital trust to dispose of some or all of its holdings during the same period. Not only would the foundation and the marital trust be deprived of valuable income-producing interests, but a possible forced sale of very substantial real estate holdings in a single metropolitan area—even over a 10-year period—would undoubtedly risk serious losses.

Such drastic consequences would be completely unwarranted and contrary to the public interest. They can be avoided—or at least reduced—without undermining the proposed reforms if:

1. foundations are premitted to own real estate investments of a passive nature, *and*
2. there are adequate transition provisions to allow the foundation and the marital trust to separate their combined ownership of the various holdings.

Passive real estate investments should not be limited

Real estate investments of a passive nature have traditionally been recognized as appropriate investments for charitable foundations. When the Congress in 1951 first provided that normal tax rates would apply to unrelated business income of charitable foundations, it specifically excluded from such taxation all rents from real property (except with respect to business leases in excess of five years on property acquired with borrowed funds). (Code § 512(b)(3)) The rationale for this exclusion was clearly stated in the report of the House Ways and Means Committee of the 81st Congress as follows:

"The tax applied to unrelated business income does not apply to dividends, interest, royalties (including, of course, overriding royalties), rents (other than certain rents on property acquired with borrowed funds), and gains from sales of leased property. Your committee believes that such 'passive' income should not be taxed where it is used for exempt purposes because *investments producing incomes of these types have long been recognized as proper for educational and charitable organizations.*" (Emphasis supplied) H. Rep. 2319, 81st Cong., 2d Sess., p. 38.

The propriety of foundation real estate investments was reaffirmed in the 1965 Treasury Department Report on Private Foundations which concluded that real estate investments of a passive nature should be excluded from its recommended business ownership limitations. Thus, the report stated (p. 36):

"Appropriate standards should be developed to identify leases of real property (and associated personal property) which are of a clearly passive nature, and rent arising from such leases should not be deemed to derive from the conduct of a business."

Elsewhere in the report, it was assumed that a private foundation could properly own an office building or other type of commercial building. See e.g., pp. 22–3.

In 1969, the Treasury again recommended to the House Ways and Means Committee that the proposed business ownership limitations specifically exempt "holding of leases of real property (and associated personal property) of a passive nature." *Hearings on Tax Reform Before the Committee on Ways and Means*, 91st Cong., 1st Sess., Pt. 14, p. 5100.

There is nothing in the hearings before the Ways and Means Committee or in the earlier Patman Committee Hearings on private foundations (*Hearings Before Subcommittee No. 1 on Foundations of the Select Committee on Small Business*, 88th Cong., 2d Sess., 90th Cong., 1st Sess.) that challenges these consistent recommendations by the Treasury that private foundations should be allowed to retain their real estate investment holdings provided they are of a passive nature.[1]

H.R. 13270, in its present form, however, does not expressly exempt passive real estate investments from the 20% business ownership limitation. Moreover, while the bill qualifies the broad term "business enterprise" by reference to the definition of unrelated business income in Section 513 of the Code, it fails to pick up the long-standing exception to that definition for passive rental income contained in Section 512(b)(3) of the Code. As a result, there is a real danger that H.R. 13270 will be construed to require that foundations severely limit their real estate investments despite the fact that such investments are completely passive in nature.

Such a drastic limitation—which would require wholesale divestitures of foundation real estate holdings with attendant risks of substantial loss—clearly cannot be justified in view of the complete absence of any evidence in the extensive hearings with respect to private foundations that such real estate investments present a potential for abuse or are otherwise contrary to the public interest.

Indeed, the principal argument advanced for the business ownership limitation is that a foundation's ownership of an operating business will tend to divert the interest of the foundation managers to the maintenance and improvement of the business and away from their charitable duties.[2] This argument is completely inapplicable to foundation ownership of passive real estate investments for three reasons:

1. Under present law, passive real estate investments by definition cannot involve substantial activity on the part of the foundation or its managers. Thus, the regulations interpreting Section 512(b)(3) of the Code strictly proscribe any activities by the foundation beyond simply renting the premises and maintaining the public areas. See Reg. § 1.512(b)-1.(c)(2).
2. Most commercial buildings are managed, like the Cafritz buildings, by professional real estate management companies which make all of the day-to-day decisions with respect to the operation of the buildings. In the normal situation, the foundation managers consult with the management company only as to general policy questions in much the same manner as they would need to consult with a broker or investment advisor with respect to a securities portfolio.
3. The proposed income distribution requirement in H.R. 13270 and, to a lesser extent, the proposed *Clay Brown* provision will effectively deter foundation managers from any temptation to attempt to expand the foundation's real estate-holdings by accumulating tax-free earnings or borrowing.

Thus, there is very little possibility that the interest of foundation managers will be diverted from their charitable duties as a result of foundation ownership of passive real estate investments.

These same reasons equally refute the other argument advanced in support of the business ownership limitation, which is that a foundation may operate a business "in such a way that it unfairly competes with other businesses whose

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[1] Foundation ownership of passive income-producing property was criticized in these hearings in only two respects, neither of which is relevant here. The first situation involved acquisitions through borrowing and will be adequately covered by the proposed *Clay Brown* provisions (§ 121 of H.R. 13270). The second situation involved the alleged tying up by a single foundation of large tracts of undeveloped real property which will be effectively prohibited in the future by the mandatory distributions of income provisions (Proposed Code § 4942).

[2] Summary of H.R. 13270 prepared by the staffs of the Finance Committee and the Joint Committee on Internal Revenue Taxation, p. 15.

owners must pay taxes on the income they realize."[3] Indeed, the complete lack of relevance of this argument to passive real estate investments—as distinguished from operating businesses—was recognized by the Congress in 1951 when, as noted above, it exempted the income from such investments from the tax on unrelated business income.

The only specific example of possible unfair competition developed during the hearings was the alleged ability of private foundations to accumulate tax-free earnings to acquire additional business interests at higher prices than could be paid by taxpaying businessmen.[4] As noted above, this is effectively precluded in the future by the requirement that the foundation pay out to charity its entire net income annually. If anything, this requirement will place the foundation at a slight disadvantage vis-a-vis other real estate owners who will be free to accumulate their earnings for expansion or other competitive purposes.

Thus, there is no real or even theoretical justification for limiting foundation ownership or passive real estate investments. Accordingly, it is urged that Section 4943 of H.R. 13270 be amended to expressly exclude such investments from the proposed business ownership limitation. This would be accomplished by adding a new subsection (5) to proposed Section 4943(d) [pp. 41–2 of the bill] which would provide as follows:

> (5) OWNERSHIP OF REAL PROPERTY.—The term "business enterprise" does not include ownership of real property the income from which, except for the provisions of Section 514 (relating to debt financed property), would not constitute unrelated business income under Section 512(b) (3).

Two important collateral points with respect to foundation ownership of passive real estate investments are:

1. *Depreciation Deductions Should be Expressly Allowed.*—The proposed income-distribution requirements do not expressly allow deductions for depreciation to computing "net investment income" under Section 506 and "distributable amount" under Section 4942. As a practical matter, a foundation could not continue to own real estate investments unless a deduction for depreciation is allowed in these computations. The foundation would not only have to pay the investment income tax on the depreciation allowance, but it would incur a confiscatory penalty if it failed to fully distribute that allowance as income. As a result, the foundation would be left without funds for necessary capital improvements and replacements. Accordingly, we suggest that the phrase "and depreciation provided for in Section 167" be added at the end of Section 506(b) (3) [pp. 5–6]and Section 4942(f) (3) (A) [p. 20] and that the following new paragraph be inserted after Section 4942(e) (3) [pp. 27–8]:

> (4) ADJUSTMENT FOR DEPRECIATION.—The minimum investment return for any taxable year shall be reduced by the deduction for depreciation allowable with respect to such taxable year by Section 167.

2. *Combined Ownership May Be Prohibited.*—The Treasury has recommended that passive real estate investments be subjected to the 20% business ownership limitation to the extent that they are owned jointly by a foundation and disqualified persons.[5] The Cafritz Foundation is not opposed to separating its ownership interests in the various properties from that of the marital trust provided there are adequate provisions for doing so in an orderly and equitable manner. *The transition provisions should provide full flexibility for separation of combined ownership.*

The business ownership limitation will require divestitures by private foundations of substantial business assets. The bill contains two principal transition provisions—a 10-year disposal period and a limited exception from the self-dealing prohibitions for sales to disqualified persons—which are designed to enable the required divestitures to be made in an orderly manner thereby minimizing the risk of losses. The transition provisions, however, do not provide adequate flexibility where there is combined ownership of business and investment assets by a private foundation and disqualified persons.

The problem of combined ownership should not be unique to the Cafritz Foundation. The plan of distribution adopted by Mr. Cafritz in his will, whereby fractional interests in his estate were left to a foundation and a marital trust, is, and has been for some time, a very common and frequently recommended

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[3] Summary of H.R. 13270 prepared by the staffs of the Finance Committee and the Joint Committee on Internal Revenue Taxation, p. 15.

[4] *Hearings on Tax Reform Before the Committee on Ways and Means*, 91st Cong., 1st Sess., Pt. 3 at 968.

[5] *Hearings on Tax Reform Before the Committee on Ways and Means*, 91st Cong., 1st Sess., p. 5103.

estate plan. It would not be surprising, therefore, if there are a number of other foundations similarly situated.

Unless adequate provision is made for the separation of these combined ownership interests in an orderly and equitable manner, the number of the divestitures required may be greater and their potential adverse effect unnecessarily magnified. This clearly will be the case in the Cafritz situation—particularly if the 20% combined ownership limitation is applied to those passive real estate investments that are owned jointly by a foundation and a disqualified person. For, unless the Cafritz Foundation and the marital trust—which will be a disqualified person—can separate their combined ownership interests, the Foundation may have to sell its entire ⅔ interest in all of the Cafritz companies to comply with the 20% limitation.

The risk of possible loss would be great not only because of the magnitude of the divestitures required, but also because the substantial minority interest of the marital trust in the properties might well inhibit outside purchasers and make it extremely difficult for the foundation to realize full value.

The marital trust, on the other hand, would be faced with a "Hobson's Choice" of either also selling its ⅓ interest in the companies, thereby reducing its corpus—at least to the extent of any capital gains taxes payable—and possibly its income, or retaining its stock as a minority owner vis-a-vis new owners who may not share its desire to maximize current income. In this latter regard, most potential customers for large commercial real estate holdings are likely to be interested in speculative development and capital appreciation rather than in simply collecting rents and distributing them as ordinary income.[6]

These consequences can be avoided—or at least minimized—if during the 10-year disposal period the foundation and the marital trust are given full flexibility to, in effect, "swap out" between themselves their respective fractional interests in the various companies. To the extent that the foundation ended up with full ownership of real estate investments of a passive nature and such investments are not limited by the bill as previously recommended, forced sales would be avoided. Conversely, if the foundation ended up with an operating business, the greater salability of its full ownership interest in that business would facilitate its divestiture and reduce the risk of loss. In both cases the purposes of the bill would be fully served.

The proposed transition provisions, however, do not provide the flexibility needed to achieve this result. The inadequacies that exist and our technical suggestions for remedying them are set forth in Appendix A. Briefly, we recommend that H.R. 13270 be clarified or modified to clearly allow private foundations and disqualified persons to separate their combined ownership of business or investment assets during the 10-year disposal period—without incurring confiscatory tax penalties—by (1) exchanging stock or property interests in commonly owned assets and by (2) employing any of the wide range of corporate techniques, such as redemptions or liquidations, which would achieve the same purpose. Existing law would, of course, require that the foundation receive full value in any such transactions.

To produce a fully equitable result, provision must also be made for nonrecognition of gain or loss in connection with exchanges of stock for stock to comply with the bill. Otherwise the marital trust—which except for the bill would have no need or desire to enter into such exchanges—may be severely penalized in that it may be forced to incur substantail capital gains taxes which would reduce its corpus and earning capacity. There are ample precedents in the Code for comparable relief in connection with forced divestitures. See, for example, Section 1071 relating to gain from sales or exchanges pursuant to orders from the Federal Communications Commission; Section 1081 relating to the nonrecognition of gain or loss on exchanges or distributions pursuant to orders of the Securities and Exchange Commission; Section 1101 pertaining to distributions pursuant to the Bank Holding Act of 1956, and Section 1111 pertaining to distributions pursuant to an order enforcing the antitrust laws.

The appropriateness of similar relief here is particularly compelling since the stock interests involved were acquired pursuant to an estate plan encouraged by the Code which was adopted well before the proposed stock ownership limitation was even suggested.

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[6] For this reason, while the Foundation and the marital trust might try to dilute their combined ownership below the 20–35% limitation by a public offering or merger with a large company, it is doubtful that such a solution would meet their common need for maximum distributable income.

Accordingly, we suggest that a new provision be added to the Code patterned on Section 1071, allowing: "the sale or exchange of property (including stock in a corporation) between a private foundation and a disqualified person (within the meaning of Sections 509 and 4946(a), respectively) pursuant to a plan, approved by the Secretary or his delegate, to enable the foundation not to be liable for tax under Section 4943 (relating to taxes on excess business holdings)" to be treated by either party as an involuntary conversion of such property within the meaning of Section 1033.

Continuation of common management services

The third area in which H.R. 13270 will have a severe impact upon the Cafritz Foundation raises a more difficult problem of balancing legislative interests.

All of the Cafritz real estate investment properties are managed by a common management company, the Cafritz Company, which in turn will be owned ⅔ by the Foundation and ⅓ by the marital trust. Through the years, the Cafritz Company has developed a highly efficient staff which is familiar with the properties involved.

In order for the Cafritz Company to continue to function efficiently, it is necessary for it to be able to continue to provide management services for all of the various Cafritz buildings. This will not only maximize the income to the foundation from its holdings in the various buildings, but it is essential to maintain the value of the Cafritz Company stock itself as an asset of the foundation. For unless the foundation and the marital trust were both willing to enter into long-term management contracts with respect to all of their properties, which might well be unwise in connection with a change-over in management, it would be very difficult to find any purchaser for the company at a reasonable price.

If Cafritz Company's services are provided to all of the properties on a non-preferential basis, i.e., at the same rates commercially available from outside companies in the same business, the potential for abuse is negligible, the interests of charity will be better served and the unnecessary and unwarranted destruction of this valuable business will be avoided.

Section 4941(d)(2)(C) [p. 21], however, excludes from prohibited self-dealing the furnishing of goods, services or facilities by a disqualified person to a private foundation only if "the furnishing is without charge and if the goods, services or facilities so furnished are used exclusively for purposes specified in Section 501(C)(3)." The effect of this provision will be to prevent the Cafritz Company from continuing to render management services at least to those properties which the foundation holds outright.[7]

The harsh consequences of the self-dealing rule in this situation can be avoided by a limited exception permitting services to be provided by disqualified persons with respect to property in which the foundation and the disqualified person had a joint or common interest on the operative dates in Section 4943. Such an exception is fully warranted since it is necessary to prevent a substantial loss in value of the business involved and the services to be provided are generally available commercially so that their fair market value will be readily evident and the potential for abuse nonexistent. Accordingly, we suggest that a new Section 101(k)(2)(E) be added as follows:

"(2) SEC. 4941. Section 4941 shall not apply to—

* * * * * * *

> "(E) the furnishing of services by a disqualified person to a private foundation with respect to property in which the foundation and the disqualified person had a joint or common interest (either directly or through ownership of stock in a corporation which owned such property) on May 27, 1969 (or acquired under the terms of a will executed on or before July 28, 1969, which are in effect on such date and at all times thereafter) if the compensation received by the disqualified person for such services is at a rate comparable to that at which such services are commercially available and such rate does not exceed the lowest rate charged by the disqualified person for furnishing similar services with respect to any other property."

[7] Since there is no prohibition against self-dealing between disqualified persons, Cafritz Company presumably could continue to manage those properties which the foundation continues to hold in corporate form. If this were not the case, Cafritz Company's business would be seriously disrupted and possibly destroyed immediately upon the effective date of the self-dealing provisions.

At the very least, such an exception is absolutely essential during the full 10-year divestiture period in order to permit an attempt to dispose of the Cafritz Company in an orderly manner without a substantial loss in its value.

Conclusion

H.R. 13270 will have a severe, unnecessary and completely unwarranted adverse impact upon the Cafritz Foundation and many other foundations unless (1) the apparent limitation upon foundation ownership of passive real estate investments is removed and (2) necessary flexibility is provided in the transition provisions for separating the combined ownership of business and investment assets by foundations and disqualified persons in an orderly and equitable manner.

Real estate investments of a passive nature have traditionally been recognized as appropriate investments for charitable foundations, and the Treasury Department has consistently recommended that they be excluded from the business ownership limitation. Moreover, there is a complete absence of any evidence in the extensive hearings with respect to private foundations that such real estate investments present a potential for abuse or are otherwise contrary to the public interest.

The need is equally clear for adequate transition provisions to avoid unnecessary forced sales by foundations of partial interests at the risk of substantial loss.

With respect to the third concern of the Cafritz Foundation—the need for continuation of common management services—we recognize that the Congress may be concerned about granting an exception to the general prohibition against self-dealing. We respectfully urge, however, that any such concern should be more than outweighed by the severity of the consequences to charity and upon a valuable business of blind application of the self-dealing rules in a situation that presents no realistic potential for abuse.

Appendix A

Technical Recommendations With Respect to the Transition Provisions

To avoid severe and unnecessary hardship, foundations and disqualified persons should be given full flexibility during the 10-year disposal period to eliminate or separate their combined ownership of business and investment assets in an orderly and equitable manner by (1) exchanging stock or property interests in commonly owned assets and (2) employing any of the wide range of corporate techniques for achieving the same purpose.

The 10-year divestiture period in Section 4943 and the limited exception from the self-dealing rules for divestiture sales in Section 101 of the bill are clearly not adequate to permit such a necessary unscrambling of property interests and an orderly divestiture of the excess business holdings that remain outstanding for the following reasons:

A. Exchanges

Section 101(k)(2)(B) [p. 81] excludes from the self-dealing rules only "the *sale* of property which is *owned* by a private foundation on May 26, 1969. . . ." Limiting the exemption to the "*sale*" of property could be construed to prevent exchanges of stock or property. Moreover, keying the exemption to property which is "owned on May 26, 1969" may make it completely inapplicable to the stock interests which are yet to be distributed to the Cafritz Foundation under Mr. Cafritz's 1964 will. It is suggested that Section 101(k)(2)(B) be amended to provide as follows:

"(2) Sec. 4941. Section 4941 shall not apply to—

* * * * * * *

"(B) The sale or exchange of property interests held by a private foundation or a disqualified person on May 26, 1969 (or acquired under the terms of a will executed on or before July 28, 1969, which are in effect on such date and at all times thereafter) if such sale or exchange is required in order for the foundation not to be liable for the tax under Section 4943 (relating to taxes on excess business holdings) and the foundation receives in such sale or exchange an amount, or an interest in property having a fair market value, which equals or exceeds the fair market value of the property sold or exchanged by it; and

B. SECTION 351 ORGANIZATIONS

Section 4941(d)(2)(F) [p. 22] does not specifically encompass a Section 351 organization which might be necessary to consolidate the various corporations if a public offering of the foundation's stock interests proved to be the only feasible method of divestiture. For complete clarity, it is suggested that the word "organization" be inserted after the words "corporation adjustment" on page 22, line 10.

C. NON-PRO RATA REDEMPTIONS

The report of the Committee on Ways and Means [p. 21, n. 1] clearly envisions a non-pro rata redemption by a corporation of its stock which is excess in the hands of a private foundation as one method of achieving a divestiture required by the excess business holdings rule. Section 4941(d)(2)(F) [p. 22], however, may cast doubt on the availability of this necessary divestiture technique since it permits redemptions and other corporate adjustments only if "all of the securities of the same class as that held by the foundation are subject to the same terms. . . ." It might be argued that all of the securities of the same class in a non-pro rata redemption are not "subject to the same terms." The possible ambiguity regarding this important corporate technique can be eliminated by (1) deleting the phrase quoted above from Section 4941(d)(2)(F); or (2) clarifying what is meant by "subject to the same terms"; or (3) the following amendment to Section 101(k)(2)(A):

(2) SEC. 4941. Section 4941 shall not apply to—

"(A) Any transaction between a private foundation and a corporation which is a disqualified person (as defined in Section 4946), pursuant to (i) the terms of securities of such corporations in existence at the time acquired by the foundation before May 27, 1969; or (ii) any liquidation, merger, redemption, recapitalization or other corporate adjustment, organization or reorganization, the purpose of which is to enable the foundation to dispose of property in order not to be liable for tax under Section 4943 (relating to taxes on excess business interests) and the foundation receives in return an amount, or an interest in property having a fair market value, which equals or exceeds the fair market value of its stock interest; and

D. CARRYOVER OF THE HOLDING PERIOD

It is not clear that the 10-year divestiture period would carry over to assets acquired by the foundation as a result of an exchange or a corporate redemption, liquidation, organization or reorganization. Unless there is such a carry-over of the holding period, such transactions will not be a meaningful method of complying with the excess business holdings requirement since the foundation would be required to immediately divest itself of any business holdings received as a result thereof. It is recommended that the following provision be added to the bill, possibly as a new Section 101(k)(2)(D):

"(D) The divestiture periods provided for in Section 4943(c)(4) shall carry over to any property interests acquired by a private foundation pursuant to a transaction referred to in subsection (B) above or Section 4941(d)(2)(F).

The CHAIRMAN. Now, the next witness will be Mr. Lyman C. Conger, chairman of the board of Kohler Co.

STATEMENT OF LYMAN C. CONGER, CHAIRMAN OF THE BOARD OF THE KOHLER CO.

Mr. CONGER. Thank you for allowing me the privilege of appearing here.

My name is Lyman Conger. I am chairman of the board of Kohler Co., of Kohler, Wis., also vice president of the Kohler Foundation.

Kohler Co. is a large manufacturer of plumbing fixtures and engines. It is a privately held company. Its stock is not on the public market and there is no publicly established marketplace for the stock.

Kohler Foundation is a relatively small foundation. It was organized as a nonprofit, nonbusiness corporation in 1940. All of the organizational incorporators are now deceased and all of the organizational contributors are now deceased. In fact, all of those who ever made any contribution are now deceased. It does not engage in political activity. It operates no business, and has no business connections except stockownership in a business corporation. It does own 28⁴⁄₁₀ percent of the stock of Kohler Co., and has held almost half of that stock for 25 years, most of the stock for over 15 years.

In its past 10 years of operation it has disbursed $1,812,000 for educational, cultural, and charitable purposes, and I might say that relative to its net income and its expenses through that period, its operating expenses have been seven-tenths of 1 percent of the income. That is because all the officers and directors serve without salary or compensation.

We do not oppose all the provisions of this bill, some of them are very good, we think, but we do think the bill goes beyond the correction of abuses and in particular it would disrupt long-established relationships. The divestiture provisions and the ex post facto application of them creates a severe problem for us. In our case it would require the Kohler Foundation to devest itself of the Kohler Co. stock that it now owns and practically all of it. And that would require creating a public market for the stock that does not now exist. That could probably be done in one of two ways. It would mean the Kohler Co. would have to become a public corporation or, alternatively, it would have to merge with some conglomerate organization, and the latter course appears the easiest although possibly not preferable.

I think other corporations and small foundations that own stock in privately held corporations are faced with the same situation, and we believe that this bill would force many small companies into conglomerates, probably against their will.

Now, it is not my purpose to condemn all conglormerates or go into the pros and cons of conglomerates but what we do suggest is that the conglomerate form of organization has not proved itself so distinctly superior to the privately held small corporation that it ought to be encouraged by legislation at the expense of the privately held corporation.

Turning to the specific provisions of the bill, the definition of "substantial contributor" includes anyone who contributed more than $5,000 in any one year. We think that is very unrealistic because it bears no relationship to the size of the foundation. A foundation may have millions of dollars of assets, I think there is one in excess of a billion dollars, but still a $5,000 contribution establishes one as a substantial contributor. We are suggesting in the amendment that I am filing as part of my prepared statement, that that be changed, and that a substantial contributor be defined as one who contributed 5 percent or more of the total assets of a corporation.

In our case, the bill has a strong effect on us because one contributor, now deceased, and who contributed less than 2 percent of the stock of the foundation, nevertheless is defined as a substantial contributor, and all his descendants are disqualified persons.

With respect to the control aspects of the bill, we think it makes several quite unrealistic assumptions. As it is now drafted it assumes that 20 percent voting stock ownership is control, and has a conclusive presumption that 35 percent is control. In our prepared statement we have shown instances where this definitely is not true.

What percentage of stock is control or is not control varies from time to time and from company to company, and from time to time in the very same company. There seems to be an implied assumption in the bill that members of the family always act in concert and if they belong to the same family they will always be voting the stock unanimously, but I would submit to you that family feuds and battles for control are just about as common as unanimity of operation. In our particular case we have had one such case of interfamily litigation that even went up to the circuit court of appeals.

This amendment would make actual control of the foundation immaterial. These disqualified persons may not even be members of the foundation, yet their ownership, the fact one of their ancestors donated stock, would prevent the foundation from continuing to hold their stock.

We are suggesting an amendment which would substitute fact for theory and make actual control of the foundation and actual control of the corporation the criterion.

We agree that a foundation, together with people who control it, should not own more than 50 percent of the stock of a corporation. But we think that should be based on actualty, and not on assumptions that people who may actually be fighting each other are acting in concert.

Our last serious objection to the bill is on the distribution-of-income provision, and that has a serious impact on a company whose stock is not publicly listed and has no regular market value, because it requires distribution of 5 percent of assets by the foundation. In the case of a closed corporation, I think there is no more difficult subject than valuation of the stock of a closed corporation. I know in all the estates and gifts we have had involving Kohler Co. stock we have always had controversy with the Internal Revenue Service and in one case even went to the Tax Court. So we would not know, the foundation

would not know, on what basis to base this 5 percent distribution. We might base it on a good faith estimate of the value of stock, yet maybe years later the Internal Revenue comes along and says no, your value of the stock is too low, you should have distributed more than you did, and then the very heavy penalties of this bill would be automatically put into effect.

We would have no objection at all to a requirement that a foundation distribute its actual income within a reasonable period, although we think a year is a little too long. Actually——

Senator BENNETT. Long or short?

Mr. CONGER. Too short, excuse me.

We are suggesting a period of 2 years. And our foundation has over the last 10 years distributed practically 100 percent of its actual income. What we do object to is a distribution requirement on hypothetical rather than actual income.

In our prepared statement we have displayed a table showing that of the 30 companies listed on the Dow, Jones stock average, only four would yield a return of 5 percent or more, and the average would be three, I think 3.64. So that would practically bar any foundation from investing in the stock of most industrial companies.

We are suggesting as an alternative to that, that a foundation be required to distribute its actual income within a certain period, which we are suggesting is 2 years.

We are also suggesting that if the foundations choose to invest in non-income-producing property and, I suggest, there is an objective in this bill which prohibits a foundation from making such an investment which is contrary to the purposes of the foundation; that, therefore, a simple amendment there saying that investments solely for capital gain would be considered as contrary to the purposes of the foundation would solve the problem.

The CHAIRMAN. Thank you very much, sir.

Mr. CONGER. Thank you.

Senator MILLER. May I ask the witness, Mr. Conger, would you be good enough to furnish the committee for the record, a statement as to whether or not amendment 222 would satisfy your problem.

Mr. CONGER. Yes, I will.

(Mr. Conger's prepared statement follows:)

STATEMENT ON BEHALF OF KOHLER CO., KOHLER, WIS., PRESENTED BY LYMAN C. CONGER, CHAIRMAN OF THE BOARD

SUMMARY

Kohler Co., a privately held corporation, opposes the proposed tax reform legislation as passed by the House because it unjustly requires the Kohler Foundation, an eleemosynary organization, to divest itself of its stock holdings in Kohler Co.

For Kohler Foundation to sell this stock would require the creation of a public market for the Kohler Co.'s stock which is now privately held or a merger of Kohler Co. with some conglomerate.

The proposed legislation goes beyond the raising of revenue and correction of abuses and penalizes foundations which have not been guilty of abuses.

The proposed legislation is harsh and punitive. It affects—not only foundations—but corporations in which foundations own stock. It requires drastic changes in existing ownerships—ownerships established years ago in reliance on then existing law. As a consequence it would force a drastic reorganization of Kohler Co. (p. 9)

The definition of "substantial contributor" in the bill as presently drafted has no relevance to the size of the foundation, and is consequently unrealistic. The definition of "substantial contributor" should bear a reasonable relationship to the size of the foundation. In our proposed amendment we propose defining "substantial contributor" as one who has contributed more than 5% of the total assets of the foundation. (pp. 9-10)

The bill is aimed at private control of corporations and assumes that private control of a corporation is an evil to be tolerated as short a time as possible. This is an unsound assumption. (pp. 11-12)

An alternative to private control is the conglomerate or merger route. (pp. 13-14)

The conglomerate-merger type of organization is not so clearly superior to the private corporation that it should be encouraged

by legislation which discourages and makes the continuance of private corporations more difficult. (p. 13)

If this bill is enacted into law it will force a drastic reorganization of Kohler Co., requiring it to change its status as a private corporation—and, quite likely, to merge with a conglomerate. (pp. 14-15)

The bill, as drafted, goes far beyond the mere objective of preventing the use of foundations to control business enterprises. It establishes presumptions of control, not realistic in many cases. Unrealistic presumptions are:

(1) that a percentage of voting stock less than 50 per cent can be presumed to constitute control;

(2) that all "disqualified persons" will always act in unison and never disagree among themselves, and

(3) that the stock of any private foundation will always be voted the same as the stock of "disqualified persons" regardless of the extent of control of the foundation by such "disqualified persons".

We submit that regulation should apply on the actual facts of the situation—not on arbitrary and unrealistic presumptions.

The amendment which we suggest makes actual control the test and—if the disqualified persons in fact control the foundation —adds their stock to that of the foundation in determining control. (pp. 15-18)

The provision relating to the distribution of income has objectives with which we do not quarrel, i.e., (1) to insure that the income of a foundation will be distributed on a reasonably current basis and not be re-invested for "growth" purposes, and (2) to require that the resources of the foundation be invested mainly for the production of distributable income and not principally for capital gain. But the bill attacks the problem circuitously rather than directly and goes too far.

The "minimum investment return" prescribed in the bill, or any "minimum investment return", is unrealistic. Of the 30 industrial corporations whose stocks are included in the Dow Jones

averages only 4 had a dividend yield of over 5 per cent and the average dividend yield was 3.54 per cent. The bill creates enormous administrative difficulties where a foundation's investment is in stock of a private corporation, or in other property not having an established market value.

The objectives can be accomplished by requiring a reasonable concurrent distribution of actual income and by prohibiting foundations from investments solely for capital gain. (pp. 18-20)

The harshness of the bill has been recognized by tailoring exemptions to fit the specific circumstances of two foundations. This is the wrong approach. The bill as a whole should be amended so that it will be fair and equitable to all foundations, regardless of their specific circumstances. (pp. 20-21)

We believe that our proposed amendments would accomplish this purpose.

STATEMENT - KOHLER CO.

Kohler Co., a Wisconsin corporation founded in 1873, is a prominent manufacturer of plumbing fixtures and fittings, small gasoline engines, engine driven electric generating plants and precision controls.

It has, since its inception, been a privately held corporation. Its stock has never been listed on any stock exchange or over the counter market and there has never been any public market or established market price for its stock.

Its outstanding common (voting) stock is distributed as follows:

Employees	8.4%
Individuals or trusts whose stock was acquired through inheritance	58.5% [1]
Kohler Foundation	28.4%
Others	4.7%
	100.0%

Only one of its eleven directors is a "disqualified person" as defined in H.R. 13270. Only one of its eleven officers (one of five vice presidents) is a "disqualified person".

Kohler Co. has an outstanding record of length of service of employees.

With a present complement of approximately 5,500 employees, over 1,300 have become members of the 25-year club (25 or more years of continuous service) of whom over 780 are still actively employed.

Many Kohler Co. employees including management personnel have been attracted to and remain associated with Kohler Co. because it is a privately owned corporation and they can expect to receive, and do receive, more individualistic treatment

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[1] Included in this percentage is 31.7 per cent of the outstanding stock owned, directly or by beneficial interests, by individuals who are within the definition of "disqualified persons" in H.R. 13270.

than they would from an absentee owned company under policies made elsewhere and applied arbitrarily and sometimes ruthlessly. One of the most unsalutary features of the present rash of mergers and conglomerates has been the disruption of personnel of acquired companies, and the arbitrary and often ruthless dumping of management personnel, many of whom have devoted much of their lives to the acquired company and are at an age where they find it difficult or impossible to secure equivalent employment elsewhere.

For Kohler Co. to be forced to merge with a conglomerate or to be subjected to "raiding" would seriously disturb the personal plans and expectations of its present personnel.

KOHLER FOUNDATION, INC.

Kohler Foundation is a Wisconsin non-profit corporation, incorporated in 1940. It is restricted by its articles of incorporation to charitable, religious and educational activities.

It conducts no foreign activities or philanthropies and is limited by its articles of incorporation to disbursement of funds exclusively within the State of Wisconsin.

The original incorporators were—

Evangeline Kohler
Marie C. Kohler
Lillie B. Kohler
Herbert V. Kohler
O. A. Kroos

All the original incorporators are now deceased.

All persons who made any contributions to Kohler Foundation are now deceased.

The principal contributors were Marie C. Kohler (by bequest) and Lillie B. Kohler (by inter vivos gift).

All of the incorporators, with the exception of O. A. Kroos, would be "substantial contributors" as defined in H.R. 13270, Sec. 507(b)(2)(A). Although Herbert V. Kohler gave no Kohler Co. stock to the Foundation and contributed less than 2 per cent

of its total assets, he is within the definition of "substantial contributor" contained in H.R. 13270 since he gave more than $5,000 in a single calendar year. Consequently his "lineal descendants" would be "disqualified persons" as defined in H.R. 13270.

Kohler Foundation has 10 members (reduced from 12 by two recent deaths) of whom only 3 are "disqualified persons" as defined in H.R. 13270. It has 5 directors of whom only 2 are "disqualified persons". Only 2 of its 6 officers are "disqualified persons".

Kohler Foundation does not operate any business or commercial enterprise and has no interest in any business or commercial enterprise other than as a stockholder.

Kohler Foundation presently owns a beneficial interest in 47,606 and a fraction shares of Kohler Co. common (voting) stock which is 28.4 per cent of the 167,403 and a fraction shares outstanding and 23.8 per cent of the 200,000 shares authorized. It has owned most of this stock for 15 years and nearly half of it for 25 years.

It also presently owns 4,154 shares of preferred (non-voting) stock of Kohler Co., a Wisconsin Corporation, which is 43.2 per cent of the 9,625 shares outstanding and 10.4 per cent of the 40,000 shares authorized.

Kohler Foundation makes direct expenditures of approximately 15 per cent of its total disbursements for certain cultural programs, scholarship awards, and for the operation and maintenance of a building used as a meeting place for Girl Scouts and a woman's club.

The balance of its income is distributed by contributions to organizations conducting educational, historical and cultural, religious or charitable activities.

Kohler Foundation, in the past ten years, has made actual disbursements of $1,812,562.45 for educational, cultural and other philanthropic purposes out of a total income (before expenses) of $1,826,486.11.

No officer, director or member of Kohler Foundation receives any salary or compensation for his services. It employs no professional managers.

In the past ten years Kohler Foundation's administrative expenses have been less than $13,500.00 or seven-tenths (00.7%) of one percent of its income.

Thus Kohler Foundation has, over the past ten years, distributed practically 100 per cent of its *actual* net income after expenses.

PROVISIONS OF H.R. 13270 RELATING TO PRIVATE FOUNDATIONS

Alleged Purposes of the Bill

The bill purports to be a revenue bill and in some respects it is.[2] On the other hand some of the regulatory provisions of the bill, by increasing administrative costs, will reduce net revenues.

The bill also purports to correct abuses by foundations. We do not deny that *some* foundations have been guilty of abuses, although we would not agree that all practices which are characterized by some as abuses actually are abuses. But we do deny that the majority of foundations have abused their status or have been guilty of acts detrimental to the public welfare.

But the bill goes further than the mere prohibition of abuses. There is a clear distinction between prohibition of abuses and regulation of details of operation of foundations which deprives foundation managers of the ability to exercise sound judgment in good faith in the management of the assets of the foundation.

KOHLER CO. POSITION ON H.R. 13270

We do not oppose all of the provisions of H.R. 13270 relating to foundations.

We recognize the objectives of raising revenues and correcting abusive practices and to the extent that the bill would actually accomplish these purposes we do not oppose it.

But the legislation should not penalize foundations which have not been guilty of true abuses. The innocent should not be punished along with the guilty.

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[2] The 7½ per cent tax imposed by Sec. 506 (a) (p. 5) is a revenue provision.

Because it applies retroactively the proposed legislation is harsh and punitive.

It does not seek merely to regulate *future* conduct.

It would seriously disrupt existing ownerships and corporate organizations—ownerships and organizations which were established many years ago in reliance on then existing law.

As we show later, it would force a drastic reorganization of Kohler Co. making it difficult, if not impossible, for it to continue as a private corporation—and making it likely that its best course would be to merge with some conglomerate.

We submit that legislation having such disruptive and retroactive effect is not warranted.

SUBSTANTIAL CONTRIBUTOR

The definition of "substantial contributor", Sec. 507(b)(2)(A)(B) p. 8, is unrealistic in the extreme.

It bears no relationship to the size of the foundation, its total assets or the total of contributions by others.

One who contributed $5,000 in any one year would have contributed only one-half of one percent of the assets of a foundation having assets of one million dollars. He would not be a "substantial contributor" in any ordinary or common meaning of the term.

Yet under the definition of Subsection (A) he is a "substantial contributor" as are also his children, grandchildren, great-grandchildren and other "lineal descendants" in perpetuity.

Many foundations have assets of more than a million dollars and at least one is reputed to have assets in excess of three billion dollars.[8]

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[8] Subcommittee Chairman's report to Subcommittee No. 1 Select Committee on Small Business, House Representatives, 90th Congress, Sixth Installment 3-26-68, p. 242, Ford Foundation. See also Kellogg Foundation Trust p. 236.

The same source reports 26 foundations having assets in excess of 100 million, pp. 228-259, yet anyone who donates $5,000.00 or five-thousandths of a per cent would be "substantial contributor" under the definition of H.R. 13270.

The definition of subsection (B) is even more unrealistic. One who gave a donation of $1,000 or one-tenth of one percent of the total assets of a foundation having assets of a million dollars would be a "substantial contributor" if that fortuitously happened to be the only contribution in that calendar year.

We submit that what is a "substantial contributor" or a "substantial contribution" should be *relevant to the total contributions.*

One who contributed less than 5 per cent would not be considered a "substantial contributor" in the general understanding of the term, nor would he be in a position to exercise much domination over the foundation.

The amendment which we suggest (Proposed Amendment—Exhibit 1) would make one who contributed more than 5 per cent of the total contributions to a foundation a "substantial contributor".

BASIC PHILOSOPHIES UNDERLYING THE BILL

Our main objection to the bill in its present form is to the basic economic philosophies underlying some—but not all—of its provisions.

Implicit, albeit unstated, are certain economic assumptions which are accepted as truisms.

The bill departs from basic revenue purposes and enters the field of economic regulation. And it does so on the basis of certain economic assumptions which we believe to be false.

Certainly they are not so self-evident as to be accepted without consideration on their merits and hearing arguments against them.

We submit that Congress should not adopt these far-reaching regulatory measures—which affect not only taxes but the general economy—as an appendage to a revenue bill but that if they are to be considered at all they should be considered as

frankly regulatory measures with full appreciation of their consequences and after adequate hearing on the objections to them.[4]

Assumptions basic to the bill to which we object are—

PRIVATE CONTROL OF CORPORATIONS

The underlying philosophy behind the bill (particularly Sec. 4943 which limits the *combined* holding of a foundation *and* "all disqualified persons" to 20 per cent of any corporation's voting stock)[5] is that private control of a corporation is bad per se—that it is an evil to be discouraged as much as possible and to be tolerated, if at all, only for a limited time.

That this is the assumption and the purpose clearly appears from the report of the House Committee on Ways and Means accompanying H.R. 13270 (Part 1, Page 28) where it is suggested that the limit of 20 per cent combined holding of corporate stock by foundations and "disqualified persons" may be met without the foundation disposing of its so-called "excess holdings" but by the "related parties" disposing of *their* stock.

Clearly the bill is directed not at *foundation* control but at private control of a corporation.

This is also shown by the suggestion (Id. p. 28) that if "disqualified persons" hold more than 20 per cent of the voting stock, the foundation's holding of *non-voting* stock "might effectively remove from *outsiders* any practical opportunity to gain control."[6] (emphasis supplied)

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[4] There has, up to now, been no hearing or opportunity for hearing on the provisions to which we object. The House Ways and Means Committee did hold hearings but that was *before* any bill had been drafted. The present bill differs in important respects from proposals considered at the hearings. The present definitions of "substantial contributor", "disqualified persons", etc. appeared for the first time in the draft of the bill, little more than a week before passage, with no hearing held on them or opportunity given to consider objections or to present amendments.

[5] Under some circumstances an additional 2 per cent would be permitted under the so-called "de minimus" provision, Sec. 4943 (c)(2)(C) p. 37.

[6] Of course the statement that ownership of non-voting stock can, as a "practical" matter, affect the control of the corporation—which rests in the *voting stock*—is far-fetched in the extreme.

Implicit in this statement is the assumption that battles for control of corporations are in the public interest. We *question this assumption.*

The "raiding" tactics which have accompanied some of the present mergers and attempted mergers are one of the most unsalutary features of our present corporate financial picture.

The managements of many corporations are today spending more time trying to defend the corporation against "raiding" tactics, than in the actual operation and management of the business. We cannot see how this is in the public interest.

It is significant that the control provisions of this bill have no relevance to any *revenue* objective. Whether a corporation is or is not privately controlled makes no difference in the taxes it will pay on its income. Nor would it result in any increase in revenue from tax on the income received by a foundation. So long as the foundation avoids owning more than 20 per cent of the stock of any corporation having "disqualified persons" as stockholders, it may still receive 100 per cent of its income tax exempt.[7]

The proposal is clearly directed against private control of corporations.

Respectfully we ask, why this bias against private corporations? The private corporation has traditionally played an important role in the economic development of this country. Individuals start a small business as individual owners or partnerships. If the business serves the public need, is successful and grows it becomes a private corporation. If it continues to grow and prosper it may become a public corporation—but it will do so as a result of economic conditions—by a process of natural development and at a favorable time—not by legislation.

Many, if not most, of the large commercial enterprises today had their start through the private corporation route—Du Pont, Chrysler, Ford, Allis Chalmers, Kimberly Clark, etc. to name but a few.

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[7] Except for the flat 7½ percent tax proposed by Sec. 506 (a) p. 5.

We submit that it is not in the public interest to destroy or to sterilize this seed bed by legislation.

The *assumption* that private control of a corporation is an evil to be terminated as soon as possible deserves more careful consideration than it has received in the drafting of this bill.

In particular it demands consideration of the *alternatives* to private control.

Corporations must be controlled by someone.

If this proposal is adopted it will make mandatory the disruption of many private corporations.

The alternative is obvious. The past few years have seen an amazing proliferation of a relatively new form of commercial organization—the "conglomerate" corporation created by mergers.

The impact of this development on the economy is questionable. Some view it with alarm.[8]

It is not our purpose to review the pros and cons of the present trend toward mergers, acquisitions, conglomerates and toward debt rather than equity financing.

What we do want to point out is that if—through adoption of this proposal—liquidation of private control is made mandatory—the presently most available market is through the conglomerate merger route. Unquestionably most private or foundation holdings would be divested in that manner.

For Congress to adopt this proposal would be tantamount to saying "We think that private control of a corporation is evil—the conglomerate merger is preferable—therefore we will force private corporations to merge with conglomerates."

We submit that Congress should not adopt a proposal having such implications without careful consideration of the consequences—which go far beyond any revenue consideration.

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[8] Burck—"The Merger Movement Rides High"—Fortune Magazine, February 1969, p. 79 et seq.

The conglomerate-merger type of organization is not so clearly preferable to a privately controlled corporation that it should be made virtually mandatory by legislation.

If this bill, as presently drafted, is enacted into law, it will:

1. Require Kohler Foundation to dispose of 28.4 per cent of the outstanding common (voting) stock of Kohler Co.
2. Require Kohler Foundation to dispose of 43.2 per cent of the outstanding preferred (non-voting) stock of Kohler Co.[9]

There is no presently established market for either of these securities. They are not listed on any exchange or traded on any over-the-counter market.

Since sale to any "disqualified person" is restricted, (Sec. 4943(c)(1)), for the Kohler Foundation to sell this stock would require either:

(a) The creation of a now non-existent public market for both classes of stock thus forcing Kohler Co. to become a public rather than a private corporation, or

(b) The sale to a single purchaser. In practical effect this means a merger or conglomerate.

This appears at present to be the easiest way out of the dilemma which would be created by the enactment of this bill as presently drafted.

Either alternative would mean a drastic reorganization of Kohler Co.—a reorganization not compelled or induced by any economic or business considerations.

We submit that such drastic reorganizations of corporations and disruption of long existing situations should not be compelled by purportedly tax reform legislation, particularly when the purposes of tax reform can be accomplished by less drastic and disruptive means.

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[9] Even to apply the so-called "de minimus" rule would require an estimate of the value of each of these two classes of stock (Sec. 4943 (c)(2)(C) p. 37), an estimate which would always be subject to challenge by the Internal Revenue Service.

THE PRESUMPTION OF CONTROL

The Bill (Sec. 4943(C)(2) p. 36) seeks to prevent the use of foundations to control business enterprises.

But, as drafted, it goes far beyond this objective and becomes a punitive rather than a remedial measure, particularly as it requires *change and divestiture* of ownerships established long ago in reliance on the then existing law.

This is because it seeks to base the regulation on arbitrary and unrealistic *presumptions* rather than on the *actual* facts existing in each particular case.

This proposal is based on several unrealistic presumptions, namely:

(1) The prima facie presumption that ownership of 20 per cent of the voting stock (one-fifth of the total) constitutes control of a corporation.

(2) An *irrebuttable* presumption that ownership of 35 per cent of the voting stock constitutes control of a corportation.

(3) An *irrebuttable* presumption that *all* "disqualified persons", regardless of the number, will always be in agreement and will vote their stock unanimously.

(4) An *irrebuttable* presumption that the stock of "any private foundation" will always be voted the same way as the stock of "disqualified persons" regardless of the extent of participation in or control of the foundation by "disqualified persons".

The basic defect of this proposal is that it seeks to do the impossible—to substitute some arbitrary percentage assumed, usually incorrectly, to constitute control—for the *actual facts*.

Obviously complete and permanent control of a corporation requires ownership of more than 50 per cent of the voting stock. It may be true that at times ownership of less than 50 per cent can enable an individual or group to appear to exercise control but this apparent control is always subject to divestiture by the

owners of a majority of the stock whenever they become dissatisfied with the manner in which the enterprise is being run.

The assumption that 20 per cent constitutes control means that there could be at *least four groups each having control.* The 35 per cent assumption means that there could be two groups each *conclusively* presumed to have control.

Such situations are neither impossible nor unlikely. Privately held corporations frequently develop out of partnerships —not merely out of individual or one family ownerships. Hence there may well be two or more individuals or family groups each conclusively presumed to have control.[10]

Nor is there any arbitrary percentage of stock ownership having universal application which can be said to afford even temporary control. The percentage varies from company to company and even *from time to time with the same company.*

In these days of mergers, raids, acquisitions, etc. numerous examples could be cited where 20 per cent, 30 per cent or even 40 per cent voting stock ownership has not constituted control —but three will suffice.

WESTINGHOUSE AIR BRAKE CO.

1. As shown by the attached Exhibit 2, Crane Co. desired to effect a merger with Westinghouse Air Brake.

In pursuance of this objective Crane Co. acquired 31 per cent of the stock of Westinghouse Air Brake Co., 11 per cent more than the 20 per cent which the bill presumes constitutes "control".

So, Crane Co. having "control", the merger should have proceeded without difficulty.

But, on the contrary, despite Crane Co.'s "control", Westinghouse Air Brake merged with American Standard, Inc., a *competitor* of Crane Co.

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[10] Kohler Co. developed out of a partnership—Kohler, Hayssen & Stehn.

ALLIS-CHALMERS CO.

2. As shown by the attached Exhibit 3, White Consolidated Industries, Inc. announced its intention to acquire Allis-Chalmers Manufacturing Company. In pursuance of that objective it acquired one-third of Allis-Chalmers stock, 13 per cent more than the 20 per cent which, according to the bill gave it "control".

But the acquisition did not take place. 33⅓ per cent was *not* "control".

PIPER AIRCRAFT CORP.

3. As shown by the attached Exhibit 4, Bangor Punta Corp. and Chris Craft Industries both desired control of Piper Aircraft Corp.

Although *each* owned more than the 35 per cent of voting stock—which under the bill is *conclusively* presumed to constitute control—neither was able to exercise control. Bangor Punta was forced to acquire 50.7 per cent of the stock to have *actual* control.

THE ASSUMPTION THAT FAMILIES ALWAYS ACT IN CONCERT IS CONTRARY TO HUMAN EXPERIENCE

This bill impliedly assumes—as an *irrebuttable presumption* —that members of a family or related parties always see eye to eye and act in unison. This is contrary to all human experience. Families fall out—family feuds develop as frequently, perhaps more frequently, than feuds between unrelated individuals. And they are often pursued more intensely and obdurately than disagreements between unrelated persons.

Family feuds and interfamily litigation may be unfortunate—but they are not uncommon. The history of Kohler Co. includes an instance of such interfamily litigation.[11]

Members of a family may be engaged in a family feud and battling each other for control of a corporation yet under this bill, as presently drafted, they are *conclusively* presumed to be acting in concert.

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[11] *Kohler* v. *Kohler Co., Herbert V. Kohler, et al.*, 208 F. Supp. 808, 319 F.(2d) 634.

Similarly the bill *conclusively* presumes that stock owned by a foundation will be voted the same as that owned by the "disqualified persons".

Proof that the "disqualified persons" did not control the foundation—or even had no connection with it—or that the foundation stock was actually voted differently than that of the "disqualified persons" would not overcome the conclusive presumption of the bill as presently drafted. The foundation would still have to dispose of its stock at a probable loss.

We submit that rather than relying on percentages and presumptions which will fit few if any actual cases, the regulation should be based on the *actual facts.*

The question is "Does the foundation together with any 'disqualified persons' who actually control the foundation, *in fact* have control of the corporation?"

The amendment which we suggest, (Proposed Amendment—Exhibit 5), makes this the test by providing that no foundation together with any "disqualified persons" who actually control the foundation may own more than 50 per cent of the voting stock of a corporation. It substitutes fact for fallacious theory.

DISTRIBUTION OF INCOME

Sec. 4942 (p. 25 et seq.), has, as we understand it, two principal objectives:

1. To insure that income of a foundation will be distributed on a reasonably current basis and not re-invested for growth of the foundation, and
2. To insure that the resources of the foundation would be invested with the main purpose of producing distributable income and not mainly for capital gain.

We do not quarrel with these purposes but here again the bill, as presently drafted, attacks the problem circuitously rather than directly, and in so doing goes too far and creates more problems that it solves.

"MINIMUM INVESTMENT RETURN"

Subsection (e)(3) prescribes a "minimum investment return" of 5 per cent for 1970 and thereafter such return as is fixed in the discretion of the "Secretary or his delegate".

This provision casts almost intolerable burdens on the managers of foundations. It requires foundation managers to commit themselves to obtain a minimum fixed return on investments, each and every year, regardless of economic conditions. Yet, at the same time, it greatly restricts their investment opportunities.

How are foundation managers to meet this new and onerous responsibility?

1. As shown by attached Exhibit 6, of the 30 companies the market price of whose stock is included in the Dow Jones average, only 4 had a dividend yield for 1968 of 5 per cent or over on the basis of the market price. The average dividend yield was 3.54 per cent.

Furthermore were foundation managers to invest in one of these four companies that do presently yield 5 per cent in dividends they would constantly have to watch the fluctuations of the market, guess at probable dividends and dump the stock, possibly at an inappropriate time whenever it appeared likely that market fluctuations and/or dividend prospects might reduce the yield below 5 per cent.

This proposal, as a practical matter, bars foundations from investing in the stock of any industrial corporation.

2. The situation is still worse where stock in a private corporation, having no established market value is concerned.

This bill requires foundation managers to guess, at their peril, what market value the Internal Revenue Service will agree to.

Suppose the managers of Kohler Foundation in good faith determine that the market value of Kohler Co. common stock would be $125 per share and make the 5 per cent distribution on that basis.

But the Secretary, perhaps years later, says "Oh, no. The stock is worth $200 a share. You should have distributed 5 per cent of $200. A penalty of 15 per cent is due and if you do not yield to my arbitrary edict within 90 days, no matter how unreasonable you deem it to be, the penalty becomes 100 per cent."

If this bill passes in its present form there appears to be only one logical thing for a foundation owning unlisted corporate stock to do—dump it as fast as possible no matter what the loss to the foundation and to charity or the damage to the corporation may be.

It is not necessary to prescribe a harsh and arbitrary rule which requires foundation managers to obtain a fixed minimum return on investments to accomplish the objectives of the bill.

PROPOSED AMENDMENT—EXHIBIT 7

The purposes can be accomplished by

1. Requiring a reasonable distribution of *actual* net income within a reasonable period.

   We think that the requirement of 100 per cent distribution is too rigid and the distribution period of one year too short. A more realistic requirement would be 90 per cent of actual income distributed within two years.

2. Amending Sec. 3944 to specify that investments made solely for capital gain purposes be considered investments which would jeopardize the carrying out of the exempt purposes of the foundation.

THE DRAFTERS OF THE BILL HAVE RECOGNIZED THE HARSHNESS OF THE BILL BY MAKING SPECIAL EXCEPTIONS FOR INDIVIDUAL FOUNDATIONS

The drafters of the bill have recognized the harshness of the bill by making special exceptions, tailored to fit the specific circumstances of two individual foundations.

Subchapter F(4) Section 4943

p. 83 (Kellogg Foundation)
p. 83-84 (Benwood Foundation)

We agree that the Kellogg Foundation and the Benwood Foundation are deserving of relief from the harsh and punitive provisions of the bill.

But to give them this relief by exemptions tailored to meet their peculiar circumstances is the wrong approach.

There are many other foundations equally deserving of exemption from the harsh and punitive provisions of the bill.

We submit that the bill should be amended to treat *all* foundations fairly and equitably—without discrimination or favoritism.

The bill should be amended so that its effect will not be harsh or punitive as to any foundation which has not been guilty of abuses.

CONCLUSION

We submit that any legislation passed should be remedial—not punitive. It should not penalize the many for the misdeeds of a few. It should be directed to revenue purposes and the prevention of true abuses—not to the prescription of arbitrary rules which will damage or destroy legitimate, properly conducted foundations nor to discourage or destroy private corporations.

Respectfully submitted,

KOHLER CO.

By: /s/ L. C. CONGER
L. C. Conger
Chairman of the Board

Exhibit 1

PROPOSED AMENDMENT TO H.R. 13270

Sec. 507(page 8)

Substitute the following in paragraph (2) hereunder as a definition of "Substantial Contributor":

"(2) SUBSTANTIAL CONTRIBUTOR: For purposes of paragraph (1), the term 'substantial contributor' means—

"any person who (by himself or with his spouse) contributed or bequeathed more than 5 percent of the total contributions to the foundation since it was originated. Contributions or bequests other than cash shall be valued as of the date of such contribution or bequest.

"In the case of a trust, such term also includes the creator of such trust."

Exhibit 2

THE WALL STREET JOURNAL,
Monday, June 3, 1968

Westinghouse Air Holders Approve Merger With American Standard; Judge Bars Delay

A WALL STREET JOURNAL News Roundup

Westinghouse Air Brake Co. announced in Pittsburgh that its shareholders approved a proposed merger with American Standard Inc., and a Federal judge in New York said he wouldn't interfere with the merger despite pending lawsuits that seek to prevent it.

Westinghouse Air Brake management promptly filed certificates of merger with the secretaries of state of Pennsylvania, where Westinghouse Air, is incorporated, and Delaware, where American Standard is incorporated. The companies could merge as soon as Wednesday if further legal action doesn't interfere.

The lawsuits seeking to prevent a merger were filed in recent weeks by Crane Co., New York, which owns directly or beneficially about 31% of Westinghouse Air's outstanding stock. Crane has challenged both the validity of proxy statements sent out by Westinghouse Air concerning the merger and the validity of certain votes cast by shareholders in favor of the merger.

The suits filed by Crane challenging the merger attempt have been combined into a single action before Federal Judge Sylvester J. Ryan in New York. He hasn't yet ruled on the case, but said Friday that he would permit the merger to proceed nonetheless.

Approved by American Standard Holders

Crane has sought to merge with Westinghouse Air and continued to acquire Wabco stock through a tender offer even after its merger offer was rejected. The Wabco-American Standard merger was announced in March and already has been approved by American Standard holders.

In trading on the New York Stock Exchange Friday, Westinghouse Air rose $1.875 to $47.50; American Standard climbed $2.375 to $38.

Westinghouse Air, based in Pittsburgh, makes railway, construction and mining equipment; Crane and American Standard are competitors in the plumbing and heating-supply field and both are engaged in other manufacturing businesses as well.

Westinghouse Air holders approved the proposed merger by a vote of 2,903,868 to 1,180,298, company officials announced at a special shareholders meeting on Friday. The meeting originally was convened on May 16, but was postponed three times while judges of election conducted their tally of ballots.

As soon as the results were announced, Crane lawyers objected on the ground that the proxy statements were invalid, that certain votes were invalid and that Crane was entitled to vote more shares than it had been permitted to vote—essentially the same contentions contained in Crane's lawsuits.

However, A. King McCord, chairman of Westinghouse Air, declared the merger resolution adopted and adjourned the meeting.

Annual Meeting Convened

Immediately afterward, Mr. McCord convened the annual meeting; this also had been postponed pending outcome of the merger vote.

But the annual meeting was recessed immediately to permit a tally of votes cast on a Crane Co. proposal to eliminate staggered terms for Westinghouse Air directors. The meeting is scheduled to reconvene today.

The Crane proposal would reverse an action taken by Westinghouse Air directors in December, when they changed the company's bylaws to permit election of only three of the nine directors at a time for staggered three-year terms. Mr. McCord stated then that the company feared a take-over attempt.

Crane has nominated three candidates to the Westinghouse Air board, including Thomas Mellon Evans, Crane's chairman. Voting on directors also is scheduled today—though, of course, election of directors will be moot if the Westinghouse Air-American Standard merger is completed.

Exhibit 3

8 THE WALL STREET JOURNAL, Thursday, February 20, 1969

Allis-Chalmers Is Sued By White Consolidated To Rescind Acquisition

White Says $8 Million in Common Paid by Allis for Standard Steel Was an 'Unconscionable Price'

Special to THE WALL STREET JOURNAL

MILWAUKEE — White Consolidated Industries Inc., a Cleveland conglomerate, filed suit in Delaware Chancery Court, Wilmington, asking that the acquisition of Standard Steel Corp. of Los Angeles by Allis-Chalmers Manufacturing Co. be rescinded.

Allis-Chalmers completed the acquisition in January. Standard Steel, a manufacturer of asphalt plants, fishmeal plants, small kilns and rotary dryers and coolers, has factories at Los Angeles and Decatur, Ill.

The agreement called for Allis-Chalmers to purchase the assets of Standard Steel for 280,000 Allis-Chalmers common shares, then trading at $28.75 each. That represented a market value of about $8 million.

The White suit charges that Allis-Chalmers paid an "unconscionable price" for Standard Steel, and that Standard Steel knew the price to be unconscionable.

The suit also says the purpose of the acquisition of Standard Steel was an attempt by Allis-Chalmers management to dilute White's holdings in Allis-Chalmers, which White has announced it intends to acquire.

White currently owns about one-third of Allis-Chalmers' 10,365,000 outstanding common shares. It purchased 3,248,000 of them last Dec. 6 from Gulf & Western Industries Inc., a New York conglomerate.

Allis-Chalmers has filed several suits in an attempt to stave off acquisition by White, which in turn has filed counter suits for the acquisition.

White's newest suit asks for damages from Allis-Chalmers' directors and Standard Steel for the alleged dilution of White's interest in Allis-Chalmers. The suit also asks that Allis-Chalmers directors be enjoined from entering into certain other negotiations or acquisitions in the future.

Allis-Chalmers attorneys called White's action "a nuisance suit brought in an effort to harass the Allis-Chalmers management. The facts are that negotiations for purchase of assets of Standard Steel Corp. began long before White purchased its block (of stock in Allis-Chalmers) from Gulf & Western. Also, the purchase of Standard Steel's assets was a good and wise investment for Allis-Chalmers."

Exhibit 4

* * *

Bangor Punta said it has won the battle for control of Piper Aircraft by boosting its holding to 50.7% from 44.3% in open-market purchases. But rival suitor Chris-Craft Industries, which owns 40% of Piper, replied that ownership of a 15% Piper interest claimed by Bangor Punta is being contested.

(Story on Page 4)

4 THE WALL STREET JOURNAL, Thursday, September 11 1969

Bangor Punta Claims 50.7% Piper Control; Rival Chris-Craft Insists Fight Isn't Over

By a WALL STREET JOURNAL *Staff Reporter*

NEW YORK—Bangor Punta Corp. claimed victory in the battle to acquire control of Piper Aircraft Corp. But Chris-Craft Industries Inc., rival suitor for Piper, contended the battle isn't yet over.

Bangor Punta said it raised its Piper holdings to 50.7% of Piper's 1,640,000 shares outstanding by purchasing, on the open market, an additional 101,564 shares. The purchases, at prices that weren't disclosed, were made after approval was given Aug. 7 by Bangor stockholders to Bangor's recent exchange offers for Piper stock, Bangor said. Bangor said it filed a statement with the Securities and Exchange Commission reporting the purchases and stating that a portion of the shares haven't yet been delivered.

In its last previous public announcement of its holdings, Bangor said it owned 44.3% of Piper stock.

Chris-Craft, which previously reported a 40% ownership of Piper, said it currently owns 42% of Piper stock outstanding.

Chris-Craft contended that Bangor Punta owns only 35% of Piper on an uncontested basis. Chris-Craft has filed suit against Bangor, asking that Bangor be required to divest itself of blocks representing 15% of Piper stock.

Last month, a Federal district judge denied a preliminary injunction requested by Chris-Craft to restrain Bangor from retaining the stock in question. But Chris-Craft announced yesterday that the U.S. Court of Appeals for the Second Circuit has granted an "expedited hearing" Sept. 19 on an appeal of the lower court's ruling.

Chris-Craft said its appeal is based on an alleged "irreconcilable" conflict between the district court ruling and an SEC action that resulted in Bangor agreeing to cease "gun jumping" in making statements about its exchange offers.

Bangor Punta also has filed suit against Chris-Craft. When asked if Bangor would continue its suit, David W. Wallace, Bangor's president and chief executive officer, said yesterday that the suit was filed "in response" to Chris-Craft's, seemingly, indicating that if Chris-Craft withdrew its litigation, Bangor would reciprocate.

Mr. Wallace said also that Bangor has "no immediate plans" to bid for Chris-Craft's stock in Piper.

Last month, Bangor gained control of Piper's eight-man board. Four Bangor officers were elected and a fifth member, William T. Piper Jr., president of Piper, said that "with my affirmative vote" Bangor would have a 5-to-3 majority. Piper management and the Piper family has supported Bangor's bid for the company.

Piper is a Lock Haven, Pa., maker of low and medium-priced airplanes. Bangor makes pleasure boats, textiles, and law-enforcement equipment and operates farms, a railroad, and consulting firms. Chris-Craft makes pleasure boats, plastic and latex foams, organic chemicals, carpet yarns and operates television stations.

Mr. Wallace said Piper's operating results will be consolidated with Bangor's by 1970. Aircraft sales then will represent about 25% of Bangor's revenue, he said.

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Exhibit 5

PROPOSED AMENDMENT TO H.R. 13270

Sec. 4943 (C)(2)(A)(B) (page 36)

Substitute the following for Subsections (A) & (B)

"(A) In General

No private foundation shall have voting rights in more than 50 percent of the voting stock of any incorporated business enterprise.

If said foundation is controlled by one or more disqualified persons the permitted percentage as above shall be diminished by the percentage of stock owned by said disqualified persons."

Change the heading of (C) to (B)

Exhibit 6

DIVIDEND YIELD OF INDUSTRIAL CORPORATIONS INCLUDED IN DOW JONES AVERAGES

	December 31, 1968		
	Yearly Dividend	Market Price	Yield
Allied Chemical	1.725	36	.0479
Aluminum Co. (Alcoa)	1.80	73	.0247
American Can	2.20	57¼	.0384
American Tel & Tel	2.40	53	.0453
Anaconda	2.25	64½	.0349
Bethlehem Steel	1.60	31⅜	.0510
Chrysler	2.00	56	.0357
Du Pont	5.50	165	.0333
Eastman Kodak	1.74	73¼	.0238
General Electric	2.60	93⅞	.0277
General Foods	2.40	81½	.0294
General Motors	4.30	79⅛	.0543
Goodyear	1.425	56	.0254
International Harvester	1.80	37¼	.0483
International Nickel	2.10	39	.0538
International Paper	1.38¾	37⅝	.0369
Johns Manville	2.20	87¼	.0252
Kimberly Clark	2.20	72⅞	.0302
Owens-Illinois	1.35	71½	.0189
Procter & Gamble	2.30	86½	.0266
Sears Roebuck	1.20	62¼	.0193
Standard Oil of California	2.70	72⅛	.0374
Standard Oil of New Jersey	3.65	78⅝	.0464
Swift & Co.	.90	29¾	.0303
Texaco	2.90	83¼	.0348
Union Carbide	2.00	45¼	.0442
United Aircraft	1.70	65⅞	.0258
U. S. Steel	2.40	42⅞	.0560
Westinghouse Electric	1.80	68¼	.0264
Woolworth	1.00	32⅞	.0304

Average
.0354

Exhibit 7

PROPOSED AMENDMENT TO H.R. 13270

Sec. 4942 (page 25)

Substitute the following in paragraph (a)

"(a) Initial Tax—

There is hereby imposed on any undistributed income under 90 per cent of a private foundation for any taxable year, which has not been distributed before the first day of the third (or any succeeding) taxable year following such taxable year (if such first day falls within the taxable period) a tax equal to 15 per cent of the amount by which the undistributed income is less than 90 per cent of the adjusted net income at the beginning of such third (or succeeding) taxable year. This section shall not apply to a private foundation which is an operating foundation (as defined in subsection (J)(3)) for the taxable year.

(b) No change

(c) Undistributed Income

For purposes of this section, the term 'undistributed income' means, with respect to any private foundation for any taxable year, the amount by which—

(1) the distributable amount for such taxable year, exceeds

(2) the qualifying distributions made out of such distributable amount prior to the first day of the third taxable year thereafter.

(d) Distributable Amount

For purposes of this section, the term 'distributable amount' means, with respect to any foundation for any taxable year, 90 per cent of the adjusted net income.

(e) Eliminate

(f) Change subsection designation to (e)—no other change

(g) Change subsection designation to (f)—no other change

(h) Change subsection designation to (g)—no other change

(i) Change subsection designation to (h)—no other change

(j) Change subsection designation to (i)—no other change

Sec. 4944

Substitute—

INVESTMENTS WHICH JEOPARDIZE CHARITABLE PURPOSE

(a) Tax On The Private Foundation

If a private foundation invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes there is hereby imposed on the making of such investment a tax equal to 100 per cent of the amount so invested. The tax imposed by this subsection shall be paid by the private foundation. Any investment in non-income producing property solely for capital gain will be considered as jeopardizing the carrying out of the exempt purposes of the foundation for purposes of this section, to the extent of such investment.

SUPPLEMENTAL STATEMENT ON BEHALF OF KOHLER CO., KOHLER, WISCONSIN, RE: AMENDMENT NO. 222, TO H.R. 13270 BY SENATOR MILLER, SUBMITTED BY LYMAN C. CONGER, CHAIRMAN OF THE BOARD

This statement is filed, with a request that it be made part of the record, in response to the request that we submit a record statement of our position on proposed amendment No. 222 and the extent to which it would obviate our stated objections to H.R. 13270 in its present form.

PERMITTED HOLDINGS IN A CORPORATION

The proposed re-definition of "permitted holdings" in amendment No. 222 [Sec. 4943(c)(2), amdt. p. 4] bases the test of control or lack of control of a corporation by a foundation on *activities* rather than on *presumptions*.

This, we think, is the only logical approach. (Our statement pp. 15–18).

In our opinion the proposed revision of subsection (2) would not only be an adequate substitute for our proposed amendment (our statement Exhibit 5, p. 26) but is, in fact, superior thereto. We request permission to amend our statement to substitute Subsection 2 (p. 4) of amendment No. 222 for our Exhibit 5.

CONTROL OF A FOUNDATION

The proposed revision of subsection (2), in effect, adds the stock of those who actually control the foundation, i.e., the officers, directors, trustees and related foundations to the stock owned by the foundation itself.

It relies on realities rather than on theoretical presumptions of control by "substantial contributors" or "disqualified persons".

Adoption of amendment No. 222 would therefore obviate the necessity for our proposed amendment relative to the definition of "substantial contributor". (Our statement Exhibit 1, p. 22.)

Of course if the realistic approach of amendment No. 222 should not be adopted and the theoretical presumptions of control by "substantial contributors" and "disqualified persons" retained, we believe that the definitions should be made more realistic, as suggested in our Exhibit 1.

TAXES ON FAILURE TO DISTRIBUTE INCOME

The suggested revisions of Sec. 4942, Pages 1 and 2 of amendment No. 222, are a very considerable improvement to the bill as now drafted, since they apply the 5% "minimum investment" only to excess business holdings. They do not leave the determination of the minimum investment standard applicable to "permitted holdings" to the sole discretion of the Secretary but provide a reasonable standard upon which exercise of his determination must be based.

However it still leaves one problem for foundations like Kohler Foundation, which have assets in the form of corporate stock which is unlisted and has no established market value or quotation. Such foundations will still be unable to predetermine, *in advance of income distribution*, that the basis upon which they apply the distributable percentage will be acceptable. They would still face the hazard that the value which they place upon the stock in good faith might not be accepted by the Internal Revenue Service, with the result that a distribution made in good faith would be held to be inadequate.

We would suggest revising subsection B of amendment No. 222 (p. 2) by rewriting Sec. 4942(e)(2) to read:

> "(2) VALUATION.—For the purposes of paragraph (1) (A) the fair market value of securities for which market quotations are readily available shall be determined on a monthly basis. The fair market value of securities for which market quotations are not readily available but as to which a fair market value has been agreed to by the Internal Revenue Service for estate or gift tax purposes shall be the most recent such determination of market value. For all other assets the fair market value shall be determined at such times and in such manner as the Secretary or his delegate shall by regulations prescribe."

We wish again to thank the Committee for affording us the opportunity to present our views.

The CHAIRMAN. The next witness is Albert E. Arent, Phoebe Waterman Foundation, Inc.

STATEMENT OF ALBERT E. ARENT, COUNSEL, PHOEBE WATERMAN FOUNDATION, INC.

Mr. ARENT. I am appearing here today as a member of the law firm of Arent, Fox, Kintner, Plotkin & Kahn, in behalf of the Phoebe Waterman Foundation.

Like all the others who have appeared here, I profess our purity and virtue by having contributed all of our income to the standard charities, health, education, cultural, and welfare organizations, organizations of which I am sure all of you thoroughly approve.

The foundation owns 19 percent of the stock of the Rohm and Haas Co. of Philadelphia, a corporation 51 percent of whose stock is traded on the New York Stock Exchange.

The foundation was established in 1945. Its donors, Mr. and Mrs. Otto Haas, are both deceased, and we state without apology that the establishment of this foundation was designed to effect two purposes: One, to achieve a major philanthropy, and I am talking now in terms of $100 million; and, secondly, to enable the family to satisfy their desire for such philanthropy without jeopardizing their control of a family business which has been a credit to the State of Pennsylvania and other States in which it has plants, which has been the source of employment and stability and good citizenship of admirable character.

It is a company which is a prime target for raiders, and is protected from the corporate raiders only by the fact that as much as 49 percent of the stock in the company can be considered to be in friendly hands.

Under the constructive ownership rules of this bill, perhaps 36½ percent is the combined percentage of all sources, but certainly the family can muster support to the extent of 49 percent, and we think this is good. We think that our laws for many years have fostered the independence of family businesses.

They have adopted——

The CHAIRMAN. Let me just ask you, do you think you establish these foundations for the purpose of helping a family to control a corporation in perpetuity; is that why we established a corporation?

Mr. ARENT. No. It was a collateral purpose to achieving a philanthropy. People who have their fortunes in self-made businesses cannot give major sums of philanthropy except in terms of the stock of those businesses, and if they have respect for their businesses and a desire to operate them well in the community in which they live, they are unwilling to dispose of so much stock that the conglomerates will gobble them up.

The CHAIRMAN. How do you know the fellow who might buy some of that stock, might not be a very good American and a very good businessman? That is always possible. You proceed on the assumption that if your foundation loses control of that corporation, whoever gains that control is going to be some big first-class crook or some big monopolistic giant in violation of the law.

But is it not quite possible that whoever might buy control of it might be a good American?

Mr. ARENT. We would not want to take that chance, sir, because magazines like Finance.

The CHAIRMAN. It happens all the time on the Wall Street Stock Exchange where all kinds of corporations can be bought if people have the desire and the money.

Mr. ARENT. This company has been listed in Finance Magazine recently as a target for a takeover were it not for the family-controlled stock.

I would also say that a bill like this present H.R. 13270, which goes to such trouble to adopt legislation throwing roadblocks in the way of conglomerate acquisition of independent businesses, is doing something inconsistent and undesirable when it forces a very substantial group of independent family businesses into a position of jeopardy with respect to those conglomerates, as it does by requiring the disposition of this stock.

The CHAIRMAN. But now, isn't that a matter for the antitrust law, for the antitrust division of the Federal Trade Commission laws?

We here in the Tax Committee are trying to say who should control your corporation?

Mr. ARENT. I can only throw that question back to the committee, in view of the legislation that it has included in this bill, which attempts to deal with the conglomerate problem.

But with respect to this kind of family foundation, as a member of many organizations doing this kind of charitable work that nobody disputes, I know how much money comes to them, the dimensions of the giving that has been encouraged by the existence of these private foundations; and with respect to their threat of domination of our country, I can only refer back to the testimony that Prof. John Simon gave here yesterday which demonstrates that the private foundations are a very small factor compared to the other major organizations like insurance companies, and so on, that control our corporate wealth, that they do not represent any real risk of impact upon the control structure of our country; that they have done enormous good, and that they are expiring as rapidly as they are being created.

What Professor Simon was pleading for was a healthy atmosphere for the creation of this kind of philanthropy in order to maintain the present balance, which is a good one, and he admits frankly, as I do that without the collateral benefit of being able to maintain the family relationship to your business with this philanthropy, the philanthropy simply could not go on. I think that one should regard the fact that family control is involved in the same way one regards charity to a university. When the donor says, "I want in 4-foot letters my name on that building." Sure, it serves a private purpose, too, but the charity gets the money. The dollars go to charity, and I think that is the basis for the tax exemption.

Well, so that I do not take too much of your time, permit me to go on and make a couple of points which I think are really a kind of summary of what has been said by a number of other clean, worthwhile foundations.

One, that it is against our national public policy to force a private foundation to divest itself of stock in a family-controlled business, and unfairly retroactive in stripping away family control, because whether you agree with my statement of public policy or not with respect to the future, it is unfair, really contrary to our traditions, to take people who have planned their whole estate in terms of protecting a family relationship to a business, rooted in a local community, to expose them retroactively to movement out of the community, to Wall Street centralized control, when they have given away the beneficial

aspects of most of their wealth, in order to let their families continue to play their constructive role in the business and in the community.

Now, existing policy has been encouraging the retention of family control of businesses. I think our statutes and the legislative reports on section 303 and section 6166 demonstrate that our policy has been to encourage the use of family foundations to preserve the independence of family-controlled businesses.

The policy has unquestionably enlarged the scope and dimensions of charitable giving.

There are abuses in the foundation field. I think many of them have been magnified beyond their perspective in terms of the overall performance of the private philanthropy. But still these abuses can be and are being dealt with very effectively by provisions, other provisions, of the bill.

A measure as extreme and damaging as divestiture is unnecessary.

Finally, the persons, who, in reliance upon our longstanding public policy favoring the creation of private foundations, have committed to charitable purposes stock needed for the protection of the family business from corporate raiders should not have their control jeopardized by new ground rules having retroactive effect.

To anticipate a question from Senator Miller, whether or not you buy the point of view I have expressed with respect to national policy, this particular clean, meritorious foundation will be protected adequately by his amendment No. 222.

The CHAIRMAN. Thank you.

(Mr. Arent's prepared statement follows:)

STATEMENT OF ALBERT E. ARENT, IN BEHALF OF THE PHOEBE WATERMAN FOUNDATION, INC., PHILADELPHIA, PA.

SUMMARY

I. The provisions of H.R. 13270 (proposed section 4943 of the Internal Revenue Code) which would force a private foundation to divest itself of stock in a family-controlled business are unsound as a matter of public policy and unfairly retroactive in stripping away family control.

II. Existing policy which encourages the use of business holdings to fund charity has —

A. enlarged the scope and dimensions of charitable giving, and

B. helped to preserve the independence of family-controlled businesses.

III. Specific abuses arising in connection with the operation of private foundations can be and are dealt with by specific provisions relating to the abuses. A measure as extreme and damaging as divestiture is unnecessary.

IV. Persons who, in reliance upon the long-standing public policy favoring the creation of private foundations, have committed to charitable purposes stock needed for the protection of a family business from corporate raiders should not have their control jeopardized by new ground rules having retroactive effect.

STATEMENT

My name is Albert E. Arent. I am an attorney in Washington, D.C. and am appearing before the Committee on behalf of the Phoebe Waterman Foundation, Inc. of Philadelphia, Pennsylvania. This Foundation, established in 1945 by Mr. and Mrs. Otto Haas, who are now both deceased, owns approximately 19 percent of the stock of the Rohm and Haas Company, a manufacturing company listed on the New York Stock Exchange. Haas family interests beneficially own approximately 14 percent of the stock and nonexempt trusts, paying their entire income to charity, own approximately 16 percent.

Under the provisions of H.R. 13270, the Phoebe Waterman Foundation would be classified as a private foundation and, pursuant to proposed section 4943 of

the Internal Revenue Code (which would be added by section 101(b) of H.R. 13270), would be forced to dispose of practically all of the stock it owns in the Rohm and Haas Company. I respectfully submit that these provisions are unsound as a matter of public policy and unfair in their retroactive effect of stripping a family of management control of the business which it created and successfully developed.

Public policy favors family control of business

A significant number of private foundations now in existence, and probably the great majority of them, came into being primarily because of the impact of the Federal estate tax on family businesses. The availability of private foundations has permitted a family to fund its charitable activities with the principal wealth of the family—its business holdings—without jeopardizing the family control of the business. Were it not for the available alternative of creating private foundations to hold substantial interests in such businesses, the extremely high rates of estate tax would have caused the disassembly of a great many successful family businesses. Unquestionably, the charitable deductions provided in the tax laws, and available for contributions to private foundations, have intentionally encouraged the establishment of private foundations.

This was no loophole. It was not an abuse or perversion. Rather, it was a matter of national policy. Giving up beneficial ownership of substantial interests in a family business in favor of charity was the price to be paid for preserving to the family voting control of the business. Private foundations so established have played two important roles: (1) the public and social role of supporting charitable endeavors and supplying human needs; and (2) the private role of preserving the independence of family businesses.

These are not inconsitent roles. They can and do co-exist. Thousands of private foundations have performed both functions with complete fairness and without abuse. In their charitable functions they have relieved both taxpayers and Government of the burden of such social obligations. They are a major source of funds for local hospitals, schools, churches, and other community services. Because of the zealous interest of the founding family, they are usually among the group most responsive to the special needs of the community and most ready to take the initiative in meeting new problems or bringing new solutions to old problems.

The preservation of family control of a business originated, managed, nurtured, and brought to a position of outstanding success by an individual family cannot be socially undesirable, sinister, or evil in itself. On the contrary, the traditions of the United States have fostered such enterprises. Congress has previously recognized this policy in the tax laws: section 303 of the Internal Revenue Code precludes dividend treatment on the redemption of stock to pay death taxes, and section 6166 of the Code provides a ten-year period for the payment of the estate tax in respect of a closely-held business.[1] No aspect of national or other public policy would be served by legislation which would either deter the creation of new charitable foundations or force existing foundations to dispose of those business interests which enable the founding family to preserve management control of the very businesses that begot the foundations.

Indeed, the forced sale of business interests held by private foundations would make the businesses highly vulnerable to acquisition by conglomerates and lead to a field day for corporate "raiders". This would be inimical to the public interest and in conflict with national anti-trust policy. Does it not seem strange that the same House Bill which seeks in section 411 to impede conglomerate mergers by limiting the deductibility of interest on corporate acquisition indebtedness, should by the divestiture provisions of section 101 weaken or destroy the ability of many independent businesses to ward off the corporate raiders and avoid being swallowed up by corporate giants?

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[1] See Report of Committee on Finance to Accompany Revenue Act of 1950, relating to Section 303, and Report of Committee on Ways and Means to Accompany Small Business Tax Revision Act of 1958. Relating to Section 6166. S. Rept. 2357, 81st Cong., 2d Sess. (1950) states:

"It has been brought to the attention of your committee that the problem of financing the estate tax is acute in the case of estates consisting largely of shares in a family corporation. The market for such shares is usually very limited, and it is frequently difficult, if not impossible, to dispose of a minority interest. If, therefore, the estate tax cannot be financed through the sale of the other assets in the estate, the executors will be forced to dispose of the family business. In many cases the result will be the absorption of a family enterprise by larger competitors, thus tending to accentuate the degree of concentration of industry in this country."

That there have been some instances of abuse does not warrant wholesale punitive legislation unjustly affecting the hundreds of private foundations and family-controlled businesses which have long functioned in exemplary fashion. The instances of abuse—which must certainly be comparatively few in the whole broad range of private foundation endeavors—can be corrected by adequate enforcement of existing laws and by the enactment of narrow remedies limited to the specific problem areas, as provided in other provisions of H.R. 13270.

Unfair retroactivity

In any event, if there is to be a change in national policy it should be prospective only. Even if it should be deemed socially desirable for the future to take away the incentive for the creation of new private foundations, principles of fair play and elementary justice dictate that there be no retroactive legislation penalizing existing foundations and the families who created them.

It must not be forgotten that Government policy until now offered the inducement—the consideration so to speak—for the establishment of private foundations. In reliance thereon the creators of private foundations contributed to charity far more stock than would have had to be reserved for estate taxes. In forcing the divestiture, the proposed section 4943 has the brutally retroactive impact of stripping a family of the control of its business even though the family has irrevocably relied upon the existing law to satisfy its philanthropic goals without endangering such control.

Although the bill purports to allow reversion of control to the family by exempting from the self-dealing provisions arm's-length sales of stock in the family business by the foundation back to the family, this does not provide the necessary relief. The proposal in H.R. 13270 to limit the deduction of interest to acquire or carry investment assets, as well as Federal Reserve Board margin requirements, will probably preclude financing of the purchase of substantial blocks of stock; and, in any event, family resources may be insufficient in relation to the present value of the stock which must be repurchased in order to maintain control.

At the very least, the divestiture provisions of the bill should not apply to existing arrangements. This can be accomplished simply by inserting the words "acquired after May 26, 1969" in the definition of "excess business holdings" contained in proposed section 4943(c)(1) of the Code. It may be noted that this would eliminate the need for the three pages of the bill (sec. 101(k) (4) and (5)), containing the special exemptions for two existing foundations.

Without any doubt private charitable foundations fulfill an urgent social need. They have played a vital role in the betterment of mankind. They can and do perform some functions which neither individuals nor public agencies can do as well. Society would be the loser if new legislation should either impair the effectiveness of existing foundations or discourage the creation of new ones.

The CHAIRMAN. The next witness is Mr. Isaac Stokes, who is chairman of the board of trustees and general counsel of the Phelps-Stokes Fund.

STATEMENT OF ISAAC N. P. STOKES, CHAIRMAN OF THE BOARD AND GENERAL COUNSEL, PHELPS-STOKES FUND

Mr. STOKES. Mr. Chairman and Senators, I appreciate the opportunity to lay before this committee the problems created by this bill for a relatively small foundation which has been in operation for more than 50 years, performing a somewhat specialized function; namely, improving the quality of education for Negroes in the United States and in Africa.

This organization has a small endowment, as foundations go, of about $3 million. Its income from this endowment is spent almost entirely on its overhead expenses, maintaining its staff of experts in the education field and operating in its office.

The actual programs which it carries out are financed by contributions which it receives and has received over many years on usually

an annual basis or for 2 or 3 years at a time from the larger foundations, sometimes from business corporations, and in very large measure in recent years from the U.S. Government itself.

During the past 5 years grants made to the Phelps-Stokes Fund for the conduct of its operations have averaged $500,000 a year or a total of $2,500,000, of which approximately $1 million came from the Federal Government.

Now, this organization would be very seriously affected by the proposed bill in a number of respects, which I have described in detail in my statement, and will only touch on at this time.

It would apparently, within the definition of a private—come within the definition of a private foundation. This is because of one feature in the bill which I hope and believe is not intended.

The bill excludes from the definition of private foundations organizations which receive a specified proportion of their income from broadly diversified sources. Unfortunately, private foundations are, in fact, tax-exempt foundations are, excluded from that category. Thus in determining whether this organization is a broadly supported organization, contributions which it receives would be largely excluded because of the provision that contributions in these tax-exempt private foundations which largely support it would not be counted.

I do not think that that is necessary to achieve the purposes of this bill.

Another feature of this definition, and again I think, perhaps, unintended, is in the defining of these broadly supported organizations which are excluded from the definition of a foundation, of foreign governments are excluded.

Now, the Phelps-Stokes Fund has performed many important services in improving the level of education in Africa. So far these services have, in general, been financed by grants from larger foundations.

But as African countries improve their own economies, it is entirely possible that they will be in a position to pay for these services. There is no reason why they should not pay for them. But this definition would discourage the fund from receiving payment for services rendered in the field of technical assistance and in improving education from foreign governments.

The changes which I have suggested and which are spelled out in detail in my statement would, I believe, remove the Phelps-Stokes Fund from the definition of a private foundation. If so, the problems that I am now going to describe will not exist for the fund.

But assuming that it remains a private foundation, it will be seriously hampered by the fact that it will not come within the definition of an operating foundation. The major foundations are very drastically discouraged by this bill from making contributions to other foundations unless they are operating foundations.

Although the fund is essentially an operating organization it does not come within the technical definition, again because of the sources from which it receives assistance.

In this respect also I have proposed some specific amendments which would eliminate this problem.

The major foundations would also be discouraged from contributing to organizations such as the Phelps-Stokes Fund by the very strict requirements of expenditures responsibility which would appar-

ently require the granting foundation to audit the books of the receiving foundation, and to satisfy itself by its own efforts that these funds were being properly spent.

Of course, we do not question the purpose of this provision. It would, however, impose a very heavy burden on the granting foundation, which would discourage its contributions, and in cases where, as in many of our programs, contributions received from several granting foundations to give each of them this expenditure responsibility would involve an almost impossible duplication of supervision.

I believe there is a simple solution to this which would achieve the purposes of the framers of the bill, namely, to require very precise audits of the expenditures of the funds received. These audits to be made by a certified independent public accountant, and satisfactory to the granting foundations. This is the normal responsibility of auditors, and it seems to me that the granting foundations should be entitled to rely on audits made by professional auditors rather than to have to undertake to supervise themselves the expenditure of the funds which they grant.

I will touch only briefly on the provisions regarding influencing legislation. As a citizen and as a lawyer, I am very deeply concerned with the constitutional issues involved. Those, however, have been, I think, very adequately represented by the American Civil Liberties Union.

I would like to point out a specific problem that may well confront organizations as the one I represent, namely, that where an organization is actually operating on behalf of the U.S. Government or a State government—we have done both—situations may well arise where it is imperative in order to determine what contributions should be made by the Government to the organization to have conferences with the interested Government officials.

These may well involve legislation in the form of appropriations.

I suggest, therefore, that contacts with legislators regarding appropriations for funds to be spent by a foundation in the public interest should be excluded from the category of activities influencing legislation which is outlined in the bill.

Thank you very much.

Senator BENNETT (presiding). Thank you very much, Mr. Stokes.

(Isaac N. P. Stokes prepared statement follows:)

STATEMENT OF ISAAC N. P. STOKES, CHAIRMAN OF BOARD AND GENERAL COUNSEL, PHELPS-STOKES FUND

SUMMARY

1. The Phelps-Stokes Fund is a relatively small, independent foundation (with assets of about $3,000,000), devoted primarily to the improvement of Negro education in the U.S. and Africa. Its investment income (about $100,000) is substantially all required for staff and other administrative expenses, and the Fund depends on grants (averaging about $500,000 a year for the past five years) from larger foundations, the U.S. government, and other contributors to finance its operations. The Bill would subject it to restrictions on its activities and on grants to it that would seriously impair its usefulness.

2. Contributions to a foundation from unrelated tax-exempt organizations—as distinct from individuals or business corporations—should be included without limitation in determining whether it comes within the description of broadly supported organizations that are excluded from the definition of "private foundation" by proposed section 509(a)(2)(A) of the Code.

3. In the same definition, payments from foreign governmental agencies for services or facilities should likewise be included without limitation.

4. The waiting period for termination of status as a private foundation under section 507(e) should be left to administrative discretion instead of being fixed at 60 calendar months.

5. The provisions regarding influencing legislation in sections 4945(b)(1) and 4945(c) would involve unreasonable restrictions on the rights of foundations and their managers to communicate with legislative and other officials. The constitutionality of these restrictions on free speech should be studied. As a minimum, section 4945(c) should be amended to permit communications regarding a government grant to a foundation in the public interest.

6. The requirement of section 4945(b)(4) that a private foundation making a grant to another private foundation must assume expenditure responsibility, would unnecessarily discourage grants from large private foundations to small ones like the Phelps-Stokes Fund. The definition of "expenditure responsibility" in section 4945(f) should be amended to place reliance on audits by approved independent certified public accountants.

7. The definition of "operating foundation" in section 4942(j) should be clarified. The 25% limit on support from any one exempt organization should be increased to 33⅓% or, preferably, made in applicable to grants that are subject to expenditure responsibility. Government support should be included without limit.

8. The statement includes the text of proposed amendments.

Statement

I am appearing before this Committee to urge that the proposed Tax Reform Act be modified so that it would permit the Phelps-Stokes Fund and other foundations similarly situated to carry on their present valuable functions of performing specialized services for the benefit of the public with funds largely furnished by the bigger foundations and the United States Government itself. I represent the Fund as Chairman of its Board of Trustees and general counsel. Its address is 22 East 54th Street, New York, N.Y. 10022.

THE PHELPS-STOKES FUND

The Phelps-Stokes Fund was incorporated in 1911 by special act of the New York State legislature to receive and administer a bequest under the will of Caroline Phelps Stokes.[1] Its purposes, as stated in the act of incorporation, are to apply the income from this bequest and such other funds as it may receive "to the erection and improvement of tenement house dwellings in the City of New York for the poor families of that city . . .; and for the education of Negroes, both in Africa and the United States, North American Indians and needy and deserving white students, through industrial schools, the founding of scholarships, and the erection or endowment of school buildings or chapels." The corporation is authorized "to use any means to such ends which shall from time to time seem expedient to its members or trustees including research, publication, the establishment and maintenance of charitable or benevolent activities, agencies and institutions, and the aid of any such activities, agencies or institutions already established."

The Fund has concentrated its activities in recent years on improving the education of black Americans and Africans, and on related services. In the field of New York City housing, it has confined its activities recently to the making of small grants to other organizations, because it has not found it practicable to develop a staff with the experience to operate directly in this field, as it does in the educational area.

Over the period of more than half a century during which it has been in operation, the Fund has achieved a reputation as, I think it is fair to say, the outstanding institution devoting its activities specifically to the improvement of the education of Negroes. I will mention only a few of its principal contributions.

In 1916 a survey entitled *Negro Education in the United States*, prepared by the Phelps-Stokes Fund was published by the United States Government. This provided the first authoritative compendium of information about all Negro

[1] The official corporate name of the organization is "The Trustees of the Phelps-Stokes Fund." It is generally known as the Phelps-Stokes Fund.

institutions of learning in the United States, together with studies of public facilities for Negro education in the states operating separate facilities for Negroes. Among other things, this study brought to public attention the relative expenditures per student devoted to the public education of Negroes and whites in separate school systems.

Before the end of official segregation in state public school systems, the Fund undertook an extensive program for improving the standards of education in public high schools for Negroes, with the active cooperation of state school officials. This involved conferences and refresher courses for Negro high school teachers to enable them to keep up with improvements in teaching methods.

In Africa, the Fund conducted surveys in the 1920's of the educational facilities and programs of the British colonies. The resulting reports were important landmarks in the development of the educational policy of the British Colonial Office and resulted in redirection of that policy to give the Africans an education more suited to their local needs. Although most of the recommendations of these reports have been overtaken by events, they are of such historical importance that they were recently republished to meet the demands of students of African education.

The major current activity of the Fund is the Co-operative College Development Program, under which thirty predominantly Negro colleges have learned the techniques of efficient planning and financing. The results have been most encouraging in terms of greatly increased alumni support for these institutions and also improved relations with, and financial support from, the communities in which they are located. With funds contributed by the United States Government under Title III of the Higher Education Act of 1965 as well as one of the larger foundations, this program has been expanded to include 70 institutions of which four are predominantly white colleges.

The full-time President of the Fund, Dr. Frederick D. Patterson, formerly President of Tuskegee Institute, has devoted a substantial part of his time, with the encouragement of the Fund, to service on the boards of educatonal institutions and to service with committees of the United States Government, international organizations and other institutions concerned with Negro education in the United States and Africa, and related activities. The Trustees of the Fund feel that this is a very important part of the contribution of the Fund to the public service, although he acts in these capacities as an individual rather than as a representative of the Fund.

The Fund played a leading role in establishing the Robert R. Moton Memorial Conference Center, at Capahosic, Virginia, which has been the scene of many important interracial conferences on education, housing and related matters of interracial concern, attended by educators, students, governmental officials and representatives of interested organizations.

In cooperation with two other foundations which provide the financing, the Fund administers a program which grants fellowships for post-graduate study by Africans in the United States. The Fund also provides financial assistance to African undergraduates in this country to enable them to complete their studies.

The recognized special competence of the Fund in the field of its activities is evidenced by the many grants it has received for the purpose of carrying out programs either proposed by it or undertaken at the suggestion of the grantors. In the past five years, these grants have included over $1,000,000 from the United States Government and nearly $1,500,000 from other sources, mostly larger foundations. In addition, two old established organizations, the American Colonization Society and the New York Colonization Society, recently turned over all their remaining assets to the Fund for use in improving education in Africa.

With the exception of one activity, the Fund does not seek support from the general public. The contributions on which it depends for its operations come from larger foundations, the United States Government, and occasionally from corporations or other organizations or individuals who are especially interested in its work. The only exception is that it has organized an affiliate known as the African Student Aid Fund, which actively seeks and receives public support for the specific purpose of furnishing financial assistance to destitute African students in the United States.

The Phelps-Stokes Fund is small as compared to the well-known major fundations. It has total assets of approximately $3,000,000 including partial ownership of the small building which it uses for offices. Its annual income from investments is approximately $100,000, which does not even cover salaries of its seven pro-

fessional and seven secretarial staff members and other expenses of administration. To carry on its services, it is dependent on the contributions I have mentioned, averaging over half a million dollars a year during the past five years.

After the original bequest from the founder, the Fund received a gift of about $65,000 from the founder's sister during the latter's lifetime and bequests of $87,000 at her death in 1927. Otherwise, it has received no financial support from the family of the founder other than a bequest of $500 from a nephew of the founder who died in 1957. Its investments are in no way connected with any business of the funder or the founder's family except for a holding in a small, inactive family corporation, which is expected to be liquidated shortly on a basis that will provide a final distribution of less than $1,000 to the Fund. The Fund has no other connections with the founder's family, except that four of the eighteen members of the Board of Trustees, including myself as Chairman, are grandchildren of a brother of the founder.

STATUS AS PRIVATE FOUNDATION

The Fund is near the borderline between publicly supported "thirty-percent organizations", as to which contributors may take income tax deductions up to 30% of income, and organizations as to which deductions are limited to 20%. Which side of the line the Fund will fall on, depends on the amount of contributions received from the federal government, which vary substantially from year to year, and on detailed analysis of the varying sources and amounts of other contributions in the light of the applicable Treasury Regulations defining public support. The sources and amounts of future contributions are so uncertain, that we must assume that the Fund will not be excluded from the definition of "private foundation" in proposed section 509(a)(1) as a "thirty-percent organization" described in section 170(b)(1)(B).

Nor will the Fund come within the second excluded category, described in proposed section 509(a)(2) and referred to in the House Committee Report as "broadly supported organizations", receiving more than a third of their support from certain sources. This is because the specified sources exclude grants or contributions from any "disqualified person" as defined in section 4946 and that definition includes any "substantial contributor", a term which is defined, by reference to section 507(b)(2), as any person who either contributes more than $5,000 to the foundation in a year or is the largest contributor in a year.[2] This brings me to the first specific changes in the Bill which I would like to propose.

PROPOSED AMENDMENTS OF SECTION 509(a)

In view of the undesirable influence which large individual or corporate contributors may exert over foundations to which they contribute, there are obvious reasons for treating them as "disqualified persons" for purposes of the definition of a private foundation. I submit, however, that the position of contributors that are themselves tax-exempt organizations is quite different, as long as they have no connection with the organization to which they are giving. If such contributing organizations are not themselves private foundations, their gifts are not likely to involve any risk of the sort of impropriety which the Bill aims to prevent. If they are private foundations, any abuse should be adequately discouraged by the provisions of the Bill (especially section 4941 regarding self-dealing) which will be applicable to them as contributors. An organization which otherwise meets the test of being a broadly supported organization exempt from treatment as a private foundation, should not be disqualified by accepting a contribution of any size from a tax-exempt charitable organization. I suggest, therefore, that section 509(a)(2)(A) be amended by inserting after "with respect to the organization," the words "from any unrelated organization described in section 170(c)(2) which would not be a disqualified person as so defined if it were not a substantial contributor as defined in section 4946". The term "unrelated organization" could be defined by regulation so as to preclude undesirable relationships between granting and receiving foundations.

The category of broadly supported organizations that are excluded from private foundation treatment contains another limitation which I believe should be likewise amended. This is the provision that gross receipts from performance of

[2] "Thirty-percent organizations" that are substantial contributors are apparently qualified sources for the "broadly supported" category, but this would not substantially affect the Fund's status because most of its large contributions are from organizations that are not "thirty-percent organizations."

services exclude receipts from any person which are in excess of 1% of the organization's support in the year of receipt. As in the case of contributions from substantial contributors, I submit that this limitation should also be qualified to exclude receipts from non-profit institutions. For example, in the Cooperative College Development Program of the Phelps-Stokes Fund, which I referred to in describing the functions of the Fund, a substantial part of the financing of the program comes from payments made by the participating colleges. An organization which, like the Phelps-Stokes Fund, is engaged in furnishing extensive services to unrelated tax-exempt organizations, should not be discouraged from making reasonable charges for such services but should, on the contrary, be encouraged to make its services as broadly available as possible by receiving payment from those recipients that can afford to pay. I would, therefore, suggest that section 509(a)(2)(A)(ii) be amended by inserting after "receipts from any person" the words "(other than an unrelated organization described in section 170(c)(2) or which would be so described if it were created or organized in the United States)".

A further difficulty with the present definition of the category of broadly supported organizations is that the reference to support from "any person other than a disqualified person . . . , or from any organization described in section 170(b)(1)(B)" excludes contributions from foreign governments. Organizations like the Phelps-Stokes Fund, whose services include technical assistance to foreign governments, should not be discouraged, or perhaps precluded, from receiving payment for such services. There is always the possibility that newly discovered mineral wealth or other resources will put the governments of the developing countries in a position where they will have ample funds but will still be desperately in need of the kind of technical assistance which an organization like the Phelps-Stokes Fund can furnish. I therefore suggest adding to the language I have quoted the words "or from any governmental agency of a foreign state in payment for performance of services or furnishing of facilities".

TAX ON PRIVATE FOUNDATION INVESTMENT INCOME

For the reasons already stated, I would hope that the Bill will be amended in a manner that will exclude organizations such as the Phelps-Stokes Fund from the definition of private foundation. In case these amendments are not adopted, however, I feel I should call the Committee's attention to certain other provisions which would affect the Phelps-Stokes Fund as a private foundation.

The first of these is the tax on private foundation investment income under proposed section 506. I will not discuss the general arguments against this tax, which are well known to the Committee, but I would like to point out that it would impose a special hardship on organizations, like the Fund, which now devote substantially all their investment income to administrative expenses, relying on outside support for their operating budgets. Unless contributors can be induced to make bigger allocations than they now do for the overhead expenses involved in the programs which they finance, this tax will probably require a substantial reduction of staff on the part of the Fund or its gradual liquidation.

TERMINATION OF STATUS

The provisions of sections 507 and 508 relating to termination of status as a private foundation apparently require that an organization which in all respects has ceased to come within the definition of a private foundation must nevertheless continue to be treated as such for a minimum of five years, unless it terminates its entire existence by distributing all of its assets to other organizations meeting specified requirements. Since the Secretary has complete discretion under the proposed provisions to impose a drastic tax upon termination of status, it would seem that this would provide sufficient deterrence to termination for improper purposes. There does not appear to be any reason why a private foundation whose sources of support and methods of operation have changed so that it no longer comes within the category of private foundation should nevertheless continue to be treated as one for five additional years. I suggest that section 507(e)(1) be modified by changing the words "for a continuous period of at least 60 calendar months beginning after December 31, 1969" to read "for such period as the Secretary or his delegate deems appropriate to establish termination of its status as a private foundation."

INFLUENCING LEGISLATION

The provisions regarding the influencing of legislation by private foundations in proposed section 4945(b)(1) and (c) give me grave concern as a private citizen and a lawyer, because I believe that they would violate the constitutional guarantee of free speech. They would cut off, with certain narrow exceptions, any private communication between foundations and legislators "or any other person" (including apparently even private citizens) participating in the formulation of legislation. This, I submit is to preclude foundation managers from exercising the normal rights of citizens in a democracy. I believe that the remedy for improper pressures on the legislative process lies in enforcement and, if necessary, revision, of existing legislation with respect to lobbying.

I hope the Committee will instruct its staff to make a careful study of the constitutional issues involved. However, if these provisions are not to be eliminated, I would like to propose a specific modification to take care of a practical problem that could be faced by organizations such as the Phelps-Stokes Fund which receive grants from governmental agencies that enlist their aid in service to the public. Such grants may require legislative approval in the form of authorization or appropriation. Private communication between the organization which will administer a grant and legislators or officials concerned with the necessary legislative action will often be a normal part of this process, and may even be requested by the legislators or officials involved. I suggest, therefore, that the exceptions contained in the last sentence of proposed section 4945(c) be expanded by inserting a reference to any communication with respect to "a government grant to the private foundation for activities to be conducted in the public interest."

EXPENDITURE RESPONSIBILITY

The most serious effect on the operations of the Phelps-Stokes Fund from treatment as a private foundation would probably arise from the taxable expenditure provisions of proposed section 4945(b)(4) which would preclude any other private foundation from making a grant to the Fund unless the granting foundation exercises "expenditure responsibility". Under proposed section 4945(f) the grantor would apparently have to supervise the Fund's conduct of the program and audit the Fund's books with respect to expenditures under the grant. It is obvious that grantor foundations will find this a burdensome responsibility and will prefer, wherever possible, to make their grants to foundations which are not private fuondations, so that they will not have to undertake this task. Moreover, in the case of organizations like the Phelps-Stokes Fund, which often receive grants from several foundations for a single program, the duplication of expenditure responsibility would be a virtually insuperable obstacle to multiple grants.

I believe that the purpose of the provision for expenditure responsibility could be adequately achieved in a way that would avoid all the duplication of effort involved in having the granting foundation supervise and audit the operations of the receiving foundation. This would be to place the responsibility where it normally rests: in the hands of independent certified public accountants. I suggest that section 4945(f) be revised by changing subparagraphs (1)-(3) to read as follows:

"(1) to see that the books of the grantee are audited by an independent certified public accountant approved by the auditors of the grantor,

"(2) to provide as a condition of the grant that any failure to spend the grant solely for the purpose for which granted must be fully corrected to the satisfaction of the grantor's auditors, and

"(3) to make such reports with respect to the foregoing as the Secretary or his delegate may require."

DEFINITION OF OPERATING FOUNDATION

The amendment which I have suggested regarding expenditure responsibility would remove one of the impediments to the receipt of grants by the Phelps-Stokes Fund from the larger foundations, but it would not remove the other: the fact that grants by the big foundations to the Fund would not be qualifying distributions for purposes of their own compliance with the mandatory distribution requirements of proposed section 4942, because proposed section 4942(g)(1) excludes from the definition of a qualifying distribution a payment to a private foundation which is not an operating foundation. It is therefore important that organizations such as the Phelps-Stokes Fund should, if they are to be treated as private foundations, be included in the category of operating foundations.

I trust that the description which I have furnished of the operations of the Fund indicates that it comes within the class of organizations which the House Committee had in mind when it made the following statement regarding operating foundations:

". . . it has come to the attention of your committee that a number of charitable foundations are regularly used by many private foundations to funnel charitable contributions into certain areas. The operating foundations, in such circumstances, have developed an expertise which permits them to make effective use of the money through grant programs or otherwise." House Report, p. 26.

But the definition of operating foundation in proposed section 4942(j)(3) does not fit organizations such as the Phelps-Stokes Fund. The first requirement of the definition is that substantially all of the income must be "expended directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated". This provision is difficult to understand, since every non-profit organization is required by law to use its income only for its authorized purposes. If "expended directly for the active conduct" excludes grant making organizations, then the Phelps-Stokes Fund would apparently not qualify, because it does make grants to students and to other organizations. A possible interpretation is that "income" in this context means only investment income. If so, the Fund could probably arrange its expenditures so that grants made by the Fund would be made out of grants received, but it is difficult to see what public purpose would be served by this arrangement. I submit to the Committee that the language of proposed section 4942(j)(3)(A) needs substantial clarification or that the entire requirement be eliminated.

To qualify as an operating foundation the Phelps-Stokes Fund would also have to comply with one of the limitations of proposed section 4942(j)(3)(B) with respect to more than half the assets being devoted to its lawful activities and with respect to sources of support. If the former limitation means that half the assets cannot be in the form of investments, which is the apparent intention, then the Fund could not qualify under the first test. As to the second, or support test, the language of the Bill requires that substantially all of the support, excluding investment income, come from five or more unrelated exempt organizations, or from the general public, and that not more than 25% of such support be received from any one such exempt organization. In recent years, the exempt organizations contributing to the Fund have been normally five or more in number, and we hope that this situation will continue. However, it is very likely that in some years more than 25% of such support will come from a single organization. Generally speaking, different organizations support different programs of the Fund, and if one program happens to be much larger than the others, it is quite likely that the support received from the organization sponsoring this program will constitute more than 25% of the Fund's entire support from sources other than investment income.

This 25% limitation must be considered in relation to the expenditure responsibility which is placed by proposed section 4945 on the granting foundation. It may be possible, especially if this responsibility is modified in the manner which I have suggested, to get private foundations to make grants to other private foundations for specific programs. But if a program is to be supported by grants of more than one private foundation, it will obviously be highly impractical to impose expenditure responsibility on each of them. In other words, the expenditure responsibility provisions of section 4945 are designed to limit the financing of a particular program to a single foundation grantor, whereas, the 25% limitation in section 4942(j)(3)(B)(ii) would preclude this in the case where the program in question represents 25% or more of the activities of the recipient organization. I suggest that the 25% limit be increased to 33⅓% or, preferably, that it be made inapplicable to grants which are subject to expenditure responsibility on the part of the grantor.

A third difficulty, as far as the Phelps-Stokes Fund is concerned, with the support test for qualification as an operating foundation is that it eliminates support from governmental agencies unless these are deemed to be included in support "from the general public". There would seem to be no reason why an organization which otherwise qualifies as an operating foundation should lose this status merely because a government agency thinks well enough of it to make a large contribution to its support. I suggest that the definition of operating foundation be amended to include government support as described in the definition of private foundation in section 509(a)(2)(A) with the additional inclusion of payments from foreign governments which I have proposed above for that denfinition.

CONCLUSION

The Phelps-Stokes Fund is an independent foundation engaged primarily in operations which are financed by grants from the United States Government, larger foundations and various other sources. As such, it should not be treated as a private foundation. The Committee is requested to consider the amendments I have proposed, which would exclude foundations of this kind from the definition of private foundation. Private foundations should not continue to be treated as such for five years after their activities cease to come within the statutory definition. The provisions regarding influencing legislation and expenditure responsibility would impose impractical restrictions on grant-receiving foundatons, which would be alleviated by the amendments I have suggested. Finally, the definition of operating foundation should be broadened to include organizations of the type I have described.

Senator BENNETT. The next witness is Mr. William H. Baldwin, president and trustee of the Kresge Foundation.

STATEMENT OF WILLIAM H. BALDWIN, PRESIDENT AND TRUSTEE, THE KRESGE FOUNDATION

Mr. BALDWIN. Thank you, Mr. Chairman.

My name is William H. Baldwin. I am the president and chief executive officer and a trustee of the Kresge Foundation. I will try not to belabor the obvious.

There are one or two points I think may be mentioned to the committee with respect to this particular foundation.

The Kresge Foundation was established in 1924 by Sebastian Kresge, and he was the sole doner of all the assets of the foundation. The market value of the gifts at the time he made them was approximately $16 million. The present market value is about $410 million.

For the year 1969 approximately $8.3 million had been granted largely on a conditional challenge basis to some 158 grantees out of a total of 514 applicants who made requests. Including the year 1969 to date, The Kresge Foundation has, in the 45 years of its existence, made grants from income totaling approximately $100 million to over 1,800 recipients.

Reports have been published covering each of these years containing complete financial and grant data. The report for 1968, for example, was sent out in about 8,000 copies. The distribution was made, among others, to every member of Congress, to every member of the legislature of the State of Michigan, and to most of the libraries in the United States.

The foundation has been audited by Price Waterhouse since its inception.

In the main, our grants are concerned with construction projects and capital equipment for colleges, universities, hospitals, graduate theological schools and homes for the aged.

In addition, we make grants for the providing of buildings to house projects involving music and the arts, youth development and medical research, and such grants are customarily made on a challenge or conditional basis.

In general, our feeling about the tax reform act, insofar as it applies to foundations is that the longstanding policy of the Congress favoring foundation existence should not be changed by indirection or by first step taxation, which is simply a punitive beginning of the end.

If foundations are taxed out of existence, however slowly, and if private philanthropy founders because of tax policies, it will remain for Government to be the sole source of support for all educational, scientific, and charitable activities, and if there is only one doorbell to ring for funds, then those who prefer not federalism, but variety, flexibility, dispersion of initiative, and competition of ideas will too late realize the stultifying burden of a conformed central control of all such support, and I make that statement regardless of the ability and the dedication of those administering such a centralized source.

Specifically we, as others, oppose the 7½ percent tax. It will be a tax on our grantees, not on ourselves.

You might be interested in knowing if the net investment income tax had been applicable in 1968 it would have meant $544,350 less for us to give away. Such a tax, moreover, conflicts with your congressional policy of 50 years standing and the revenue effect is minimal for the Government but is critical for the persons to whom we might give.

For example, it would not just simply be a loss of the assumed 1968 tax of $544,350 to potential donees. In view of the fact that the foundation makes most of its grants on a challenge basis, it seems likely that the raising of, 20 times that amount might fail by reason of our inability to make the grants.

If we are to have some sort of provision for funds for surveillance, our tepid preference would be for an audit fee of 1 percent.

The required distribution section No. 4942 bothers us, as a matter of fact. That section, as you know, requires us by the end of the year following the close of the accounting period, to distribute or use the larger of our minimum investment return or adjusted net income in qualifying distributions. These must be paid out. Regardless of the fact that we will not be subject to the minimum investment and distribution provision for taxation for years prior to January 1, 1972, since we obviously were in existence before May of this year, this concept presents major investment difficulties to us.

Approximately 75 percent of the Kresge Foundation assets are represented by some 6,057,000 shares of S.S. Kresge Co. common stock. This, I might say parenthetically, represents only 17 percent of the total outstanding issues and, therefore, we do not have an excess of business holdings problem, and it seems likely that the adjusted net income of our foundation will be under 5 percent for the foreseeable future if we retain the Kresge stock.

Assuming, however, we were to decide to further diversify it—at one time we owned 34 percent, some 10 or 8 years ago—assuming we decided to further diversify this investment in an effort to bring up the adjusted net income to equal or exceed the 5 percent figure which would become effective, you see, January 1, 1972, it would require, according to our best present analysis, the sale of about $150 million of such stock and the investment of the proceeds in fixed income proceeds which would yield 7 percent, this would get us pretty close to the 5 percent requirement. But it is literally impossible, gentlemen, to contemplate the disposition of such an amount of stock in 2 years, even assuming that that would be the move, the most desirable investment move, we could take.

There are important and presently unknown market considerations which apply, and in addition it would probably be unwise or unworkable to sell such shares, which we would have to register with the SEC, in one offereing.

The point is that application of the minimum investment return concept as early as 1972 for us might force us into possible premature and unwise investment decisions.

In addition, it seems unlikely to us that the curbing or continuation of present inflationary trends will be sufficiently understood prior to January 1, 1972 so as to permit us to adopt with some degree of sanity the proper investment decisions.

We are suggesting to this committee that the effect of the minimum investment portion of the act be delayed for 5 years to apply on January 1, 1975, rather than 1972. This will give us 5 years then to consider what investment decisions we might make and, of course, this sort of disposition is taken account of in the excess business holdings portion which permits 10 years in the event that you have over 20 percent or control.

We think it would be fair to allow a variant of that particular measure here, which would be longer than 2 years and might be as long as five.

The qualifying distribution concept bothers us. We receive applications, 500 or 600 a year. Most of our grants are on a challenge basis. Folowing investigation we will make the grants for building purposes, and it might go on as long as 3 years.

For example, we just made a grant to Meharry Medical College of a million and a half dollars upon the condition that they will raise the balance of $2 million my January 1 of 1970.

The conditional grants are considered by us as a charge to income at the time of the appropriation. Under the act it seems to us, at least, as far as I can read it correctly, in order to be a qualifying distribution in a given year you have got to pay it out.

Now, gentlemen, as far as we are concerned, when we appropriate it this is a charge to income, and we would like to have that considered as a qualifying distribution because otherwise we are simply going to have to tighten the time within which the conditions will be met. Money-raising is a tough business at best, and there is no sense, in our view, of imposing an additional unwarranted burden on the colleges and universities to whom we make grants.

So we would like to have these challenge grants which we show always as appropriations income to be considered as qualifying distributions under the act.

The taxable expenditures section, 4945, does not bother us in its present form. We have never made any grants, individual grants. We have never contributed to voter registration drives, and have not attempted to influence legislation. I do not suggest that others who have done similar things are on the wrong side of the fence. We just have not done it.

We, therefore, cannot say that the section as presently drafted constitutes a restriction on our present program.

We are very much concerned, however, about the precedent established by the section. The Kresge Foundation is mainly in the business, as I said, for making grants for construction purposes, except for cer-

tain program grants in Metropolitan Detroit, and we wonder, for example, will the next step be to require that we may only give to certain types of building projects, and then only if they are built in a particular sort of way.

It seems to us this is an extremely delicate area and should be approached with the greatest caution.

In summary, as far as we are concerned, taxing our income and burdening us in the other respects that I have mentioned in this act—and if I have not mentioned them we have no objection to them—if they are not in my statement—does not assist us in performing our assigned tasks.

Moreover, since many of our challenge grants join Federal challenge grants, about 30 percent of our grants do this—in the same project, it seems a questionable dilution of institutional fundraising to cut our challenge grant by taxing us. It would seem to follow up that if we give less because we have less to give, then someone else will have to give more, your constituents.

This foundation is in its 45th year, and we are glad to share our deeply held belief that we have operated—and I say this with great sincerity—we have operated usefully, honorably, legally, and openly. We have no doubt there are foundation abuses. Regretably, the correction of man's nature has not proceeded as rapidly as one might wish.

In brief response, however, we would say that this foundation has done and can do some things better and quicker than Government, some things very nicely in tandem with Government, and that the derelictions of the very few should not cripple our contributions or stifle our independence.

Thank you.

Senator BENNETT. Thank you.

Senator MILLER. Mr. Chairman—Mr. Baldwin, I have been troubled by the 5 percent payout rule in the bill, too.

Mr. BALDWIN. Yes, sir.

Senator MILLER. And with a view to trying to meet that problem, part of my amendment No. 222 dwells on that point.

Mr. BALDWIN. I see.

Senator MILLER. If you would be good enough to check that amendment and furnish a statement for the record as to whether or not this would meet your problem, I would appreciate it.

Mr. BALDWIN. I will be glad to do that, sir. Does the office here have a copy of it?

Senator MILLER. I am sure they can supply it.

Mr. BALDWIN. Thank you very much.

Senator BENNETT. Thank you, Mr. Baldwin.

(Mr. Baldwin's prepared statement follows:)

STATEMENT OF THE KRESGE FOUNDATION, PRESENTED BY WILLIAM H. BALDWIN, PRESIDENT AND TRUSTEE

SUMMARY

1. The Kresge Foundation has net assets with a present market value of approximately $410,000,0000 and has given away about $100,000,000 in grants during the forty-five years of its existence.

2. The proposed 7½% tax on net investment income is discriminatory, reverses long, standing policy and deprives both public and private health, welfare and educational institutions of badly needed support. If the foundations must provide

funds for their own supervision, it should be done by an audit or filing fee of 1%.

3. Long term capital gains should not be included in the concept of net investment income.

4. Allowable deductions from gross investment income should include all expenses reasonable and necessary to carry out the exempt purpose which are not excessive. This formula should also be used in calculating adjusted net income in the distributions section of the Act.

5. The application of the minimum investment return concept in connection with required distributions should be delayed until taxable years following January 1, 1975. In addition, the applicable percentage of 5% used to calculate such return is too high and should be reduced to 3½% or 4%.

6. The valuation provisions to be used in calculating minimum investment return should be clarified.

7. Conditional challenge grants which are charged to income at the time of appropriation should be given the status of qualifying distributions.

8. The provisions concerning speculative investments (sec. 4944) should be eliminated or clarified.

9. Restrictions on program, explicit and implicit, in the taxable expenditures section, create a dangerous precedent for future more wide-spread regulation of foundation activities.

STATEMENT

The history and policies of the Kresge Foundation

The Kresge Foundation is a private trustee coporation organized under the laws of the State of Michigan. Its purpose is the promotion of the well-being of mankind and its six trustees are authorized to expend the income of the Foundation toward this purpose. The Foundation is not associated or affiliated with any other corporation or organization.

The Foundation was established in 1924 by Sebastian S. Kresge and he was the sole donor of all of the principal assets of the Foundation. The market value of such gifts when made by him was approximately $60 million. The present market value of the net assets of the Foundation is approximately $410 million. For the year 1969, approximately $8.3 million has been granted largely on a conditional challenge basis to some 158 grantees out of the total of 514 applicants who made requests. Including the year 1969 to date, The Kresge Foundation has, in the 45 years of its existence, made grants from income totaling approximately $100 million to over 1800 recipients. Reports have been published covering each of these years containing complete financial and grant data. In the main, Kresge Foundation grants are concerned with construction projects and capital equipment for colleges, universities, hospitals, graduate theological schools and homes for the aged. In addition, the Foundation makes grants for the providing of buildings to house projects involving music and the arts, youth development and medical research. The Foundation ordinarily makes grants on a challenge or conditional basis and its grants are principally extended to non-profit tax exempt well established institutions which combine sound character and stability with progressiveness and purpose. The Foundation generally excludes from consideration all applications for grants for operating budgets, for loans of all types, for debt retirement, for endowment, for church building programs, for educational institutions of less than four-year college and university levels, for scholarships, for research programs and for grants to individuals for any purpose.

Kresge Foundation comment on private foundation portion of Tax Reform Act of 1969 (H.R. 13270)

General:

At the joint request of the Senate Finance Committee and The House Ways and Means Committee the Treasury Department in 1965 reported at length on private foundations and repeated many of their 1965 findings in part 3 of the 1969 Treasury Department Tax Reform Studies and Proposals. In brief, The Treasury Department findings were and are that foundations play a special and vital national role, have the virtues of quickness, flexibility and dedication and that they perform functions not possible for government to fill. In this assessment, we concur. The Report also set out certain specific serious tax abuses of the foundation form. We agree that abuses exist and should be corrected. The Report indicated that such abuses existed among a "minority" of private foundations. We have never seen figures from the Treasury Department or any other source which would demonstrate more precisely the quantative or qualitative

extent of such abuses. Using either total number of foundations or total amount of foundation assets as a base, we would guess the percentage of those abuses to be an extraordinarily small "minority." If we are correct in the assumption, and if the Congress is not to repudiate the affirmative statements by the Treasury Department about Foundations, then great care should be taken to be certain that the means of correcting admitted abuse is not horrendously disproportionate to the amount of abuse.

Foundations by and large do their work well. They, quoting from the 1965 Treasury Department Report, "play a special and vital role in our society; government service cannot provide a satisfactory substitute"; they "possess important characteristics which modern government necessarily lacks"; they "have also preserved fluidity and provided impetus for change within the structure of American philanthropy"; and they "evoke great intensity of interest and dedication of energy—these values in themselves, justify the tax exemptions and deductions which the law provides for philanthropic activity." The long standing policy of the Congress favoring their existence should not be changed by indirection or by first-step taxation which is simply a punitive beginning-of-the-end. If foundations are taxed out of existence, however slowly, and if private philanthropy founders because of tax policies, it will remain for government to be the sole source of support for all educational, scientific and charitable activities. And, if there is only one doorbell to ring for funds, then those who prefer federalism, variety, flexibility, dispersion of initiative and competition of ideas will too late realize the stultifying burden of a conformed central control of all such support. This would be true, we feel, regardless of the abilities and dedications of those administering such a centralized source.

Investment income tax (section 506):

The 7½% tax proposed by this section will, in fact, be borne by the organizations who would have received the funds and not by the foundations. In 1968 for example, applying the 7½% tax to Kresge Foundation "net investment income" would have meant $544,350 less for us to give away. The tax is discriminatory in that it applies alike to foundations who have not abused the law and to those who have. And, having taxed foundations, would that precedent be used to permit taxation of pension funds and churches? The proposed tax prevents the foundations who have conformed to the law from giving away as much as they could and, at the same time, is not a sufficiently high tax to end the abuses intended to be corrected. To the extent that the tax is a means of providing resources for the Treasury Department to oversee the activities of foundations, its yield at 7½%—estimated as somewhere in the neighborhood of $50 to $75 million—is far too large for such an office. Moreover if the intent of the tax is to provide such funds for such an office its places foundations in the unique situation as being the only entities who are asked to give up money which would otherwise go to charity to provide for their own supervision. The tax moreover conflicts with fundamental congressional policy of over fifty years standing and the revenue effect is minimal for the government but is critical for the persons to whom The Kresge Foundation might give. For example, it would not simply be just a loss of the assumed 1968 tax of $544,350 to potential donees. In view of the fact that The Kresge Foundation makes most of its grants on a challenge basis it seems likely that the raising of perhaps twenty times that amount might fail by reason of our inability to make the grants.

While we see no justification for any tax on foundation net investment income, if it seems necessary to have the foundations provide funds for foundation surveillance, then our tepid preference would be for an "audit" fee (not a "tax") which would be at the rate of 1%. Certainly such a fee would provide ample means for the establishment of a capably staffed office within the Treasury Department which could provide any supervision which Congress may think is required.

In further criticism of Section 506, there is no justification, in our view, for the inclusion of net long term capital gain within the concept of net investment income. We would have no objection to the inclusion of short term capital gains but the inclusion of long term capital gains, even using a stepped-up basis of stock, would violate equity and could well occasion the making of investment decisions on an unwise basis.

In addition, the deductions allowable from gross investment income seem extraordinarily restricted. We know of no reason why ordinary and necessary expenses should be limited to those of investment advice or property management only. We see no reason why all expenses of the foundation should not be allowed

assuming that such expenses are reasonable and necessary to carrying out the exempt purpose of the private foundation and if such expenses are not excessive. This is precisely the formula allowed in the computation of compensation paid to disqualified persons and it should be used to define allowable deductions in arriving at net investment income.

Required distribution (section 4942):

This section requires us, by the end of the year following the close of our accounting period, to distribute or use te larger of our "minimum investment return" or "adjusted net income" in "qualifying distributions." Regardless of the fact that The Kresge Foundation will not be subject to the "minimum investment return" distribution provision for taxable years prior to January 1, 1972, this concept presents major investment difficulties to us. Approximately 75% of The Kresge Foundation assets are represented by some 6,057,000 shares of S. S. Kresge Company common stock (approximately 17½% of all outstanding shares), and, it seems likely that the "adjusted net income" of our Foundation will be under 5% for the foreseeable future if we retain the Kresge stock. Assuming the trustees were to decide to further diversify this investment in an effort to bring up the adjusted net income to equal or exceed the 5% figure it would, according to our best present analysis, require the sale of approximately $150 million of such S. S. Kresge Company common stock and the investment of the proceeds thereof in corporate bonds or stocks yielding at least 7%. It is literally impossible to contemplate the disposition of such an amount of stock over a two-year period of time—even assuming that such a move is the most desirable investment direction we could take. There are important and presently unknown market considerations which apply and in addition it would probably be unwise or unworkable to sell such shares (which would have to be registered with the Securities and Exchange Commission in every instance) in one offering. The point is that application of the "minimum investment return" concept as early as 1972 places an unduly heavy burden on this foundation and might force us into possible premature and unwise investment decisions. In addition, it seems unlikely to us that the curbing or continuation of present inflationary trends will be sufficiently understood prior to January 1, 1972 so as to permit us to adopt, with some degree of sanity, the proper investment decisions.

The portion of the Act having to do with excess business holdings indicates its awareness of the difficulty of disposing of large blocks of stock except over an extended period of time and it seems to us that the "minimum investment return" portion of the Act should likewise show this recognition. In our view, in the case of organizations organized before May 27, 1969, section 4942 should, for taxable years beginning before January 1, *1975*, (instead of January 1, *1972*, as presently proposed) apply *without* regard to the "minimum investment return" provision. In addition, it is our opinion that the applicable base point percentage of a 5% return is unreal. It would seem to us that a more proper point of beginning might well be 4% or less. All fair applicable market indicators known to us and the yields of other well managed funds, would seem to make the 5% figure too high—especially in the light of present market instability.

In Section 4942 as well as in the investment income tax section, we see no reason why deductions should be limited to simply the ordinary and necessary expenses paid or incurred for the production or collection of gross income or for the management or maintenance of property. Once again we would suggest that the more proper and fair definition of deduction should be one which allows expenses which are reasonable and necessary to carrying out the exempt purpose of the private foundation and which are not excessive.

The valuation portion of section 4942 indicates that the fair market value of securities for which market quotations are readily available shall be determined "on a monthly basis." This definition surely needs more precision. The method of determining value on a monthly basis is not spelled out and should be made clear by statute and not by regulation. Shares of S. S. Kresge Company stock owned by The Kresge Foundation are traded on the New York Stock Exchange but, in view of the large number of shares held by the Foundation, would, for example, the concept of "blockage" apply to any such monthly valuation?

The concept of "set-asides" creates some problems for The Kresge Foundation. The Foundation accepts applications during the first two months of a given year. During this period of time we will receive, on an average, approximately 500–600 applications. Based on prior experience, the total aggregate amount requested in such applications will exceed $100 million. Approximately 95% of

our grants are made on a conditional or challenge basis—this is, the successful applicant is told that we will give him so much money if he is able to raise the balance required for the project involved. Following consultation, a time is set by which he must raise such balance of funds. Upon his certification to us that such balance of funds have been raised—our money is paid over. In many cases—especially where the balances required to be raised are large—up to three years may be given to meet the conditions of our grant. All such conditional grants made by us are considered as a charge to income at the time of appropriation. As far as we are concerned the definition of qualifying distribution should be expanded to cover any contribution which we make on a conditional basis which is listed as a charge to income at the time of appropriation. It is impossible for us to tell, under the present wording, whether the so called "set-aside" provisions mean to apply to such conditional grants.

If our present practice of making contributions charged to income at the time of appropriation is disallowed as a "qualifying distribution" and is not considered as "paid", it will probably mean that our challenge grants can be no longer than one year in duration—so as to assure their pay out prior to the end of the year following the year in which the income was earned—and it will mean a general tightening of the time within which conditions must be met. Money raising is a tough business at best and there is no sense in imposing additional unwarranted burdens on the colleges, universities, hospitals, etc. to whom we make grants. Since we make grants largely for construction purposes the amounts to be raised are often considerable and it takes time to raise such funds. In addition, more often than not government funds are involved and, regrettably, the length of time required to process a government grant is great. And, if our challenge grants are not allowable as qualifying distributions we are certain that it would unduly and unnecessarily hamper our grant system if it was necessary to establish to the satisfaction of the secretary or his delegate that the amount to be paid out will be paid out within five years *and*, in addition, that the project is one which can be better accomplished by such set-aside and by the immediate paying out of funds. The imposition of such a bureaucratic clearance would surely cause us to seriously consider discontinuance of our present carefully considered and liberal challenge conditions.

Apparently the act proposes that, where the distributions during the preceding five year period have exceeded income, the distributable amount for the taxable year should be reduced by an amount equal to such excess. In the wording of the section, however, the five-year prior period is referred to as "the five *taxable* yeaı immediately preceding the taxable year." This raises the question of whether or not the five years preceding the effective date of such an act is involved or whether we will have to go five "taxable years" before any excess can be used against distributable amounts. It appears to us that any "excess" availabl at the time of effect of the Act should be available for use.

Speculative investments (section 4944)

Under this section foundations may not invest funds so as to "jeopardize" exempt purposes. It seems to us that this provision is not only vague but impossible to understand. Regulations and court cases defining it would take years. In the interim the private foundation would find itself in an almost impossible condition with respect to investments. Obviously there are some extreme situations which would clearly fall under the concept of the section but there is a very large grey area in which greater definition is absolutely required. Or, in the more desirable alternative, the provision should be dropped completely. In its present form, its meaning is not only unclear and its purpose cloudy, but it lends itself to almost endless interpretations.

Taxable expenditures (section 4945)

None of the activities restricted by this section have ever been engaged in by The Kresge Foundation to our knowledge. We have never made individual grants, have never contributed to voter registration drives and have never attempted to influence legislation. We, therefore, cannot say that the section as presently drafted constitutes a restriction on our present program. We are very much concerned, however, about the precedent established by this section. The Kresge Foundation is mainly in the business of making grants for construction purposes, excepting for certain program grants in the Metropolitan Detroit area.

Will the next step be to require that we may only give to certain types of building projects, for example? And then only if they are built in a particular sort of way? It seems to us that this is an extremely delicate area and should be approached with the greatest caution.

Summary

As far as we are concerned, taxing our income in the time of vastly increasing social and financial complexity would hardly make it easier to perform our assigned task of promoting the well-being of mankind. Lack of funds causes us to decline many meritorious applications as it is. Moreover since many of our challenge grants join federal challenge grants in the same project, it seems a questionable dilution of institutional fund raising to cut our challenge grant by taxing us. It would seem to follow that if we give less because we have less to give, then someone else will have to give more.

This Foundation is in its forty-fifth year and we are glad to share our deeply held belief that we have operated usefully, honorably, legally and openly. Nonetheless, we have no doubt that there are foundation abuses. Regretably, the correction of man's nature has not proceeded as rapidly as one might wish. In brief response, however, we would say that this foundation has done and can do some things better and quicker than government, some things very nicely in tandem with government and that the derelictions of the very few should not cripple our contributions or stifle our independence.

Senator BENNETT. The next witness is Sydney Howe, president of The Conservation Foundation.

STATEMENT OF SYDNEY HOWE, PRESIDENT, THE CONSERVATION FOUNDATION

Mr. HOWE. Mr. Chairman, I am Sydney Howe, president of the Conservation Foundation of Washington, D.C.

We appreciate this opportunity to testify on H.R. 13270 with particular reference to title I.

The Conservation Foundation conducts programs of research, education and training in the field concerned with the conservation of air, water, and land.

In general, our efforts are designed to advance the conservation and wise use of the physical environment.

We are financed by grants from endowed foundations, from the Federal Government, from other organizations and individuals. We are not an endowed foundation in the normal sense. We do not have an endowment. We are not a membership organization.

We are, and we have been declared tax exempt under section 501(c)(3) of the Internal Revenue Code, and we have been declared a publicly-supported corporation under section 170(b)(1)(A) of the code. We doubt that our own tax status is directly affected by this legislation.

Our status, in other terms, however, might be profoundly affected. We are deeply concerned. Specifically we oppose the 7½ percent tax that might be inflicted upon the net investment income of private foundations simply because of the corresponding cut in funds available to organizations like our own.

We suggest a registration fee upon endowed foundations in lieu of such a tax, set at a level designed to fund full enforcement of whatever law may be pertinent to the operation of endowed foundations.

We oppose the provision that private foundations must distribute all net income currently and distribute it to entities other than private foundations or pay a tax. There are a number of concerns about this provision, but we would emphasize that some very good organizations that would be described as private foundations would lose their funding.

We oppose the complex accounting and legal procedures as they would affect the very small private foundations under this legislation. Perhaps the large ones, by substantial effort and expense, could handle it, but we fear that the small operations might be so overburdened with attorneys' fees and tax documentations that it would be a real hindrance and, perhaps, put them out of business.

We oppose section 4945 in its levying of a hundred percent tax penalty upon, and I quote, the funding of "any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof," and I am still quoting, "any attempt to influence legislation through private communication with any member or employee of a legislative body, or with any other person who may participate in the formulation of the legislation, other than through making available the results of nonpartisan analysis or research."

We consider this the most dangerous portion of this bill. We believe that tax counsel to endowed private foundations would advise support of only the safest theoretical and technical work of 501(c)(3) organizations.

We are already advised by private foundation officers whose organizations support ours that they will be reluctant to support some of the kinds of public affairs analysis that would be conducted in the environmental field unless there is careful clarification of these provisions I have just read.

A specific kind of clarification that is needed is as follows:

Section 501(c)(3) of the code now says that an organization qualified thereunder may devote no substantial portion of its activity to influencing legislation. This already puts us in a kind of limbo because the definition of "no substantial portion" is very awkward. The proposed legislation would allow an endowed foundation to fund the purposes of 501(c)(3) organizations. Our question is would no substantial influencing of legislation be defined as a purpose. This is not clear in the bill as now written, and would be very troublesome.

We are deeply concerned also about what we foresee as an inevitable delay in IRS implementation of regulations to carry out such legislation as this. There might well be a period of years, and there has been in the past on IRS implementation in this kind of legislation, a period of years in which our donors and our organization would be in limbo. We would be without funds because donors were waiting to see what the actual impact upon them of support of our organization might be.

We would like to endorse heartily Mrs. Benson of the League of Women Voters' suggestion that the effect of this legislation take place only sometime after the completion of IRS regulations implementing it.

In general, from the conservation point of view, we would like to note that there are many organizations throughout the country whose staff work is funded by the gifts of endowed foundations. Many of these staff activities are helping citizens who in increasing numbers care about what is happening to their environment, helping them to understand what is going on and how they can play an effective role in conserving their environment.

These staff services would be crippled as they are funded by private foundations, because you cannot do this work without dealing with

public policy that might well lead to legislation, whether you take it up with that in mind or not.

Obviously, legislation is one major kind of solution to environmental problems. The Congress now provides tax benefits that encourage business expenditures for public information programs dealing with legislation. At the same time section 501(c)(3), as now written, discourages information programs concerned with legislation affecting the broad public interest in our field and many others.

We believe that 501(c)(3) organizations should be permitted to conduct the same kind of information programs that private businesses carry out as normal, tax-deductible activities.

In lieu of the approach taken by H.R. 13270, we believe Congress should hold hearings to explore thoroughly the accuracy of existing legislation on lobbying—in a positive instead of a punitive framework, and with full consideration of the impact of any new legislation upon all institutions in our society.

We strongly recommend that if this legislation is acted upon, at the very least section 4945 be revised by (1) deleting the words "or otherwise attempt" in subparagraph (b)(1); (2) deleting in its entirety subparagraph (c) which I read a moment ago; and (3) revising subparagraph (f) to require a simple reporting function from the donee to the donor foundation. With reference to title II of the act, we urge that the committee reconsider provisions reducing tax incentives for gifts of appreciated property. We do appreciate that some abuses of foundation privileges have caused legitimate concern in the Congress and among the public. But if this bill becomes law, as it is now written, many conservation organizations could not continue to serve the public usefully.

Thank you.

The CHAIRMAN (presiding). Thank you very much, sir.

(Mr. Howe's prepared statement follows:)

STATEMENT OF SYDNEY HOWE, PRESIDENT, THE CONSERVATION FOUNDATION

Mr. Chairman and members of the Committee, The Conservation Foundation appreciates this opportunity to appear before you to present our views on H.R. 13270, specifically on certain provisions of Title I, Subtitle A, dealing with a newly-proposed category of organizations called "private foundations."

The Conservation Foundation conducts research, education, and training programs designed to expand and apply knowledge regarding the earth's resources—its water, soils, minerals, air, plant and animal life—and the interrelationships among them. We believe that pollution, blighted surroundings, inadequate open space, and development which degrades landscapes and natural systems—all intensified by growing population and advancing technology—represent high priorities for positive conservation programs.

Our activities include environmental studies and surveys, demonstration planning projects to minimize conflict between preservation and development, information services, consulting services to civic groups and educational institutions, and, to a lesser extent, comparable international programs. Our work is financed by grants and gifts from endowed foundations, the Federal government, and other organizations and individuals. The Conservation Foundation does not have an endowment and is not a membership organization within the usual meaning of that term.

The Conservation Foundation is a nonprofit corporation established in 1948 and certified as tax-exempt under Section 501(c)(3) of the Internal Revenue Code. By a ruling of the Internal Revenue Service we are a "publicly supported" organization within the meaning of Section 170(b)(1)(A) of the Code, and therefore our donors can qualify for the additional 10% deduction allowed by that section.

As a so-called "30%" organization we doubt that our own *tax* status would be altered by H.R. 13270. However, the bill as now written will seriously impair our ability to carry out our tax-exempt purposes. Equally important to us is the probability that several of the provisions of Title I will inhibit or cripple the work of a large number of other conservation groups throughout the country. Our concern about the proposed legislation centers in three areas.

First, Section 506 of Title I of the bill imposing a 7½% tax on the net investment income of every so-called "private foundation" will harm this Foundation and other conservation organizations by reducing the amount of funds available for grants to us and to them from private foundations. We believe that the resulting limitations upon our activities and those of other conservation organizations are not in the public interest. We suggest, in lieu of a tax upon the investment income of private foundations, that a foundation registration fee be imposed. Such fee should be set at a level necessary to finance full enforcement of existing law and any new legislation needed to correct existing abuses, and no higher.

Second, under Section 4942 private foundations, as defined in Section 509, must distribute all income currently to avoid graduated tax sanctions. For the purpose of this mandatory payout requirement, qualifying distributions include distributions to public charities and direct expenditures for charitable purposes, but *not* distributions to private foundations—unless the recipients can meet the complicated test specified in Section 4942(j) for an "operating foundation."

We fear that a host of educational, research and civic organizations, large and small, which constitute a major constructive element of our public life, could not qualify as private operating foundations under the present definition. Thus they would cut be down by the inability of their major contributors, which are frequently endowed private foundations, to finance their work. We doubt that any endowed private foundation would continue to make grants to another private foundation if this would subject the donor to tax.

One limited alternative, of course, is simply to amend Section 4295 by broadening the definition of "operating foundations." Such revision, however, would not affect the overwhelmingly complex accounting and legal procedures required throughout the bill for the small private foundations whose value we have noted. Ambiguous provisions on "disqualified" persons (Section 4946) and "termination of private foundation status" (Section 507) are only a few examples of legal intricacies that may eventually cripple small 501(c)(3) organizations—a result stemming both from restrictions on the organizations themselves and on the new rules for donors. It may well be that if the bill passes, as written, only the large "private foundations" will be able to survive.

Our third area of concern, and perhaps the one that troubles us most, is Section 4945. This section imposes a 100% tax penalty on each "taxable expenditure" by a private foundation. Under subparagraph (c), the term "taxable expenditures" includes but is not limited to:

> "(1) any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof, and
>
> "(2) any attempt to influence legislation through private communication with any member or employee of a legislative body, or with any other person who may participate in the formulation of the legislation,

other than through making available the results of nonpartisan analysis or research . . ."

We believe that subparagraph (1) quoted above is perhaps the most dangerous provision in the bill. It is so broad and general that it places under a cloud all but the most theoretical or scientific and technical work of many 501(c)(3) organizations.

The most fanciful semantic exercise could never clearly define what is and what is not an "attempt to affect the opinion of the general public or any segment thereof" for the purpose of influencing legislation. Furthermore, the difficulties of defining what is or is not "nonpartisan analysis or research" are even more serious. For, in one sense, every charitable organization is and should be "partisan" in the performance of the charitable duties and objectives for which it was established.

Let us assume for a moment that one private foundation makes a grant to a second private foundation organized by concerned citizens to enable them to study the causes of environmental pollution in their community or state, or to analyze existing attempts to protect the environment from further degradation. Assume that the results of such study are made public—as one would certainly hope—

and that the findings then become part of the justification for a variety of remedial actions, including new local, state or federal legislation to deal with environmental pollution. Would the Internal Revenue Service, under the provisions of Section 4945(c) quoted above, then be in a position to impose a 100% tax on the expenditures made by receipient foundation for the study, on the grounds that such study was an illegal attempt to affect public opinion and influence legislation?

This is an incredible spectre, but apparently one we must take your time to contest.

There is another aspect of this matter which causes us real concern. Under another provision of Section 4945, any grant by one private foundation to another is subject to a 100% tax, unless the grantor polices the grant and verifies that it is spent for a proper purpose. In the hypothetical situation outlined above, might not the Internal Revenue Service also seek to assess a 100% tax on the grant made by the donor foundation, on the basis that the donor had failed to properly police the grant and verify that it was spent for a proper purpose?

In light of this policing requirement, we fear that tax counsel to endowed private foundations might simply conclude that for several reasons it would be wise to support only 100% "safe" projects. First, there are obvious practical difficulties in supervising grants made to other 501(c)(3) organizations. Second, under Section 4945(b)(5), questions will arise regarding 501(c)(3) "purposes." For example, could some small portion of a private foundation grant support an insubstantial attempt by a publicly-supported organization to influence legislation? Finally, and most conclusively, the cost to private foundations, should they violate these provisions, would be excessive. If private foundations are to be guarantors of the activities of their grantees, tax counsel may be expected to be conservative. Already, we have indications that endowed private foundations may withhold support from publicly-supported organizations if the grant could by any stretch of the imagination be considered an attempt to affect the opinion of the general public.

The practical effect of Section 4945 would be to stifle innovation. Exploration of many public problems would be seriously curtailed. The new and the experimental would be shunned. The role that endowed foundations would play in stimulating public programs would be vastly diminished. Even if IRS regulations eventually seek to alleviate some of these effects, the inevitable IRS delay may nevertheless cause irreparable damage to 501(c)(3) organizations as they and their donors wrestle with the ambiguities and risks of the bill. The absence of funds during such a period of delay might well force some organizations out of business.

If this spectre should be realized, it would be a tragedy of immense proportions for our nation. Open inquiry and discussion of public issues are central to our way of life. Foundations have financed independent studies which have led to innovations and improvements of benefit to the people of the United States and of the world. They are often the only source of funds for such studies. It is simply beyond comprehension that Congress would now seek to impose prohibitive tax penalties upon this major source of free and open inquiry and discussion.

We are also troubled by the provisions of the second subparagraph quoted above which defines as a taxable expenditure "any attempt to influence legislation through private communication with any member or employee of a legislative body or with any other person who may participate in the formulation of the legislation."

Many conservation organizations are from time to time asked by members of Congress, as well as by state and local legislative bodies, to comment—formally or informally—upon contemplated or pending legislation. For example, our Foundation has, on request, provided information in recent months to members of Congress, state legislatures and administrative agencies on offshore oil exploration, pesticides, highway route selection, mineral leasing, water pollution control, and other environmental subjects. In fact, our present resources permit us to supply only a small portion of the assistance sought on such subjects.

Does Congress intend that private foundations shall no longer finance basic information services for the public? If part of an organization's operating funds is received from private foundations, should the organization refuse to submit a statement to a legislative body, to return a congressional telephone call, to reply to a letter, or to meet personally with "any member or employee of a legislative body," lest the result be prohibitive tax penalties against the organization and/or the foundation?

Throughout the country, many local, state and national organizations are working to conserve the American environment. The more substantial among these are 501(c)(3) organizations whose trained staffs serve educational or scientific needs of literally thousands of unstaffed citizen conservation groups. Much of the support of these staffed organizations is received from endowed foundations, with a large number of small donations coming from the general public. If these organizations are found to be private foundations under Section 509, which seems possible, many of them could not function. At best, their limited resources would be sapped by tax attorney bills and by a morass of clerical work and reporting requirements.

We urge the Committee to consider the problems of handling public information directed toward the solution of environmental problems. In the environmental field, virtually all issues require decisions based on social, economic, scientific and political considerations. The resolution of environmental consrevation problems may—and most often does—encompass "legislation." We suspect that legislators and their staffs would welcome more information on legislative solutions, because their constituents are demanding better environmental management. Informed natural resource and environmental specialists employed by 501(c)(3) organizations are often a legislator's only non-governmental source of such information, aside from the delegations of commerce and industry.

Private businesses, of course, may take tax deductions for expenses incurred in connection with legislation directly related to their interests. Congress thus provides tax benefits that encourage business expenditures for public information programs dealing with legislation. At the same time, Section 501(c)(3), as now written, discourages information programs concerned with legislation affecting the broad public interest.

We believe that 501(c)(3) organizations should be permitted to conduct the same kind of information programs that private businesses carry out as normal tax-deductible activities. While private businesses and their associations could continue to lobby, H.R. 13270 would make private foundations pay a 100% penalty for funding activities which are somehow determined to be attempts to influence public opinion and legislation.

Existing law already prohibits foundations from carrying on or financing propaganda or other efforts to influence legislation if such activities are "substantial" in relation to other activities of the organization. Existing law also prohibits 501(c)(3) organizations from engaging in any activity on behalf of a candidate for public office.

In lieu of the approach taken by H.R. 13270, we believe Congress should hold hearings to explore thoroughly the adequacy of existing legislation on lobbying—in a positive instead of a punitive framework, and with full consideration of the impact of any new legislation upon *all* institutions in our society.

We strongly recommend that, *at the very least*, Section 4945 be revised by (1) deleting the words "or otherwise attempt" in subparagraph (b)(1), in order to limit the scope of this restriction to the carrying out of "propaganda to influence legislation"; (2) deleting in its entirety subparagraph (c), which was quoted in part above and which drastically expands the restrictions of subparagraph (b)(1); and (3) revising subparagraph (f), so that the "expenditure responsibility" imposed upon a donor private foundation making a grant to another foundation would be satisfied by the donee executing and sending to the donor a certificate setting forth the manner in which the grant was spent.

We have touched only a few of the disturbing elements of the bill, but there are many others, such as the new complications and restrictions affecting charitable contributions in Title II. We urge that the Committee re-examine provisions concerning gifts of appreciated property and less than fee interests in real property, in the light of their potential damage to many organizations.

The Conservation Foundation shares the concern of Congress and the public for the need to correct abuses which have been disclosed in the foundation world. We endorse reform which will prevent the misuse of foundations as tax havens and which will prevent manipulation of foundation funds for the personal benefit of donors. The provisions of Title I, Subtitle A, of H.R. 13270 would, however, constitute a radical departure from a public policy which has encouraged private scientific, educational and research efforts in support of public objectives. We feel that many conservation organizations could not continue to serve the public usefully if this bill becomes law as written.

To conclude, we would like to reiterate the recent words of John W. Gardner, former Secretary of Health, Education and Welfare and former president of

the Carnegie Corporation. Mr. Gardner wrote in an article in the June 8, 1969, *Washington Post:*

"* * * tax exemption is a means of preserving the strength of the private sector and insuring that our cultural and educational life is not wholly subject to the monolithic dictates of government. It would be quite possible for a nation to insist that government be the sole source of support for all educational, scientific, charitable and perhaps even religious activities—and in some nations, the government is precisely that. But our policy of tax exemption asserts that it is in the public interest for many varied groups outside of government to be engaged in charitable, religious and educational activities.

"The policy is based on the wise conviction that we will be better off if these activities so crucial to the core of our national life are participated in by individuals and groups with a wide range of points of view. We don't believe that Big Government has all the answers; we want a lot of people in the act."

We share Mr. Gardner's views, and we urge Congress not to restrict the pioneering role which foundations play in our society.

The CHAIRMAN. I would like to ask the indulgence of the committee because I will have to leave on an airplane shortly, and I would like to call out of order for just a few minutes Dr. Albert W. Dent, president of Dillard University in New Orleans. Is Dr. Dent here?

We are pleased to have you, Dr. Dent. Could you summarize your statement briefly.

I will be glad to put your entire statement in the record.

STATEMENT OF ALBERT W. DENT, PRESIDENT, DILLARD UNIVERSITY, NEW ORLEANS

Dr. DENT. Thank you very much, Senator.

I would like to have Dr. Henderson join me and Dr. Patterson.

I am Albert W. Dent. Until August 31 of this year, I had been for 28 years president of Dillard University in New Orleans, but today I am here representing the United Negro College Fund, an organization of 36 private colleges all located in the South except one.

The primary purpose of the United Negro College Fund is to raise funds for the support of these institutions.

Most of the funds which the United Negro College Fund raises for distribution to its member colleges for current operating expenses come from the foundations of the country. Now, this group of colleges has a peculiar history. Most of them are approximately 100 years old. For many years they received quite inadequate support and, as of today, these colleges are receiving quite inadequate support as compared with the other colleges of the country.

One of the reasons for this is that for reasons well known to all of you on the committee and to the American public generally, we have not been able to develop a wealthy group of alumni who can make contributions to their colleges, as is true with other colleges. So that we have had to seek contributions from people who were in position to make the contributions.

Now, we think that our problems with regard to the proposed tax reform——

The CHAIRMAN. Let me ask you, has the Rosenwald Foundation been helpful to Dillard?

Dr. DENT. It was very helpful to us, and the successor foundation, which you know, Mr. Chairman, the Stern Family Fund.

The CHAIRMAN. Well, Edgar Stern, senior and junior, I think, have both been helpful to you, and also Mrs. Edgar Stern.

Dr. DENT. They have been on the board of trustees for 30 years, and that entire family has been very helpful through that private foundation to support the work of the institution.

The CHAIRMAN. We are very proud of the fine work they are doing, you might say.

Dr. DENT. Thank you very much.

Our position here, representing all of these colleges, is that these private foundations are one of our primary sources of support, and we will need to continue to rely on that support for some time, and anything which is done through the amendments to the tax structure which will cut down the amount of money which these foundations have for grant purposes will very directly affect us.

We do not have, as the other colleges of the country have, wealthy alumni and other sources to which we can go for substantial support.

So I will file a written statement with some documentation for the record. But I simply wanted to make this very special case for a group of colleges in the country which would be very seriously affected if the amount of money which foundations have to give is seriously curtailed through the tax which is being proposed.

Thank you very much.

The CHAIRMAN. Dr. Dent, you and others have made such a fine case for the universities with regard to this foundation area that I would be tempted to vote to say that anything we raised over and above the cost of a reporting fee for foundations ought to be distributed to the colleges and universities so that they would have the benefit of it.

Dr. DENT. One of your constituents would strongly support that position.

The CHAIRMAN. I am certainly happy you came up here.

Dr. DENT. Thank you.

The CHAIRMAN. The next witness will be Mr. Herman W. Liebert, curator and librarian, Beinecke Rare Book and Manuscript Library, Yale University.

STATEMENT OF HERMAN W. LIEBERT, LIBRARIAN, BEINECKE RARE BOOK AND MANUSCRIPT LIBRARY, YALE UNIVERSITY, NEW HAVEN, CONN.

Mr. LIEBERT. My statement is addressed only to that aspect of the Tax Reform Act of 1969 (H.R. 13270) on which I can claim competence: the provisions concerning gifts to public and institutional libraries and museums, treated at title II, subtitle A, section 83, certain gifts to charity treated as sales of property, which appears at page 125, line 9 and following of the printed act.

This provides that the taxpayer who elects to treat the fair market value of property as the amount of the contribution shall regard this contribution as a sale and shall be liable for the tax on the gain.

Because our library receives many grants from foundations and gifts of securities from individuals, I have a natural interest in the tax provisions with respect to these. So does our whole university and the whole national structure of charitable and educational institutions. But I believe that gifts in kind (books, manuscripts, pictures) present a more complicated and less well-understood problem, and I

will limit myself to this area, feeling confident that the foundations and potential donors or recipients of securities have already been fully heard, but that donors or recipients of gifts in kind have not.

There has certainly been abuse of the existing credits which taxpayers are allowed for gifts to libraries and museums. Reforms are desirable, and the new statute should be drawn to bar abuse by greedy persons masquerading as patrons.

But such persons are a very small minority among donors to libraries and museums, the overwhelming majority of whom are, according to my experience, genuinely motivated by a wish to contribute to the preservation in America of man's cultural heritage. And the ability of our libraries and museums to continue increasing their resources for the use of all students and scholars and for the educational enjoyment of the public is far too important to be endangered by a few persons who use the role of donor for selfiish profit. The law must not destroy great benefit in pursuit of lesser evil. The bathwater yes, but not the baby.

No staff members of any legitimate libraries or museums oppose legislation to prevent the abuse of gift benefits; indeed, such a reform would provide welcome relief from the constant vigilance they now exercise to avoid involvement with donors of questionable motive. But it is not necessary, it is not tolerable to endanger the whole structure of benefits for legitimate gifts which has made possible the unique growth in America of resources, both in quantity and in quality, for education, research, and public edification.

I have spoken in generalities, with which Senators must already be surfeited, and surfeited sufficiently to know that there are generalities of two kinds: those designed to sweep inconvenient facts under the rug, and those which extract for consideration the essence of a mass of disparate data. Let me for a moment present some facts.

The first fact is that, under the present regulations, however abused, the collections of American libraries and museums have in recent years grown at such a rate as is not equaled, except by conquest or theft, in the whole history of the world. Let me speak of what I know best. The Beinecke Rare Book and Manuscript Library at Yale, since it opened in 1963, has acquired material for special research, through contributions in funds or in kind, equal in importance to similar material acquired during the entire 260 years since the founding of Yale. I do not say this boastfully, for it is not of my doing. It is the concrete result of (among other factors such as loyalty to the institution) the tax benefits presently allowed.

Disbelief will quickly be dissipated by looking abroad. There are no similar provisions in the tax laws of foreign countries. And, as a result, libraries and museums there are starving. One of the world's greatest libraries, the Bodleian Library at Oxford University, depends on major help from American friends who believe in the growth of libraries everywhere. The flow of books, manuscripts, and pictures to this country results from private purchase or from institutional purchase made possible by gifts. It would slow to a trickle if foreign owners of books, manuscripts, and pictures were not driven to sell by the absence of tax benefits in their own countries.

Such limitation of tax benefits for legiitmate gifts as are proposed will produce the same result here. Not only will American acquisitions

of culturally important material decline, but the tide will also reverse. It will become more attractive for American owners of private collections to dispose of them by sale abroad, where prices are higher, and the yields from such sales may not be repatriated. But much more important than any financial consideration is the dissipation of cultural resources already in America or accumulated in the future. Those who have the instinct of the collector will, in any country and under any statutes, bring together material which is much more meaningful for world scholarship when it is together than when it is scattered. Gifts to institutions of such whole collections, often the result of a lifetime of effort, preserve for future scholars all these related materials in one place where they can be consulted not only together but also in association with the whole array of reference works.

Among many across our country, let me adduce three examples in this city: the National Gallery of Art, the Smithsonian Institution, and your own distinguished Library of Congress. All of these are places of recourse for scholars from all over the world. None of them would be as great as it is without the encouragement of gifts by existing tax benefits, or would grow at the same rate as it has in the past, if tax benefits for gifts are restricted in the manner proposed in H.R. 13270.

I do not know whether the heads of these great national collections have testified before this committee. I do not know whether gifts to them will be excepted from the provisions of the 1969 act. But I am sure that if gifts to these three national collections are to be subject to the act, the heads of these three institutions will agree with me that gifts to them will be seriously curtailed, and the national cultural heritage will be the poorer.

The second fact, which I am sure this distinguished committee understands is that rare books, manuscripts, pictures, are not rich men's playthings. Such visual, literary, and historical materials, for whatever motive they may have been collected, are the necessary ingredients, the very stuff (through use and exhibition) of education, research, and public improvement.

The fact that rare books and manuscripts are used I can confirm from my own experience. At the Beinecke Library we have over 10,000 registered readers; we supply for readers' use between 65,000 and 70,000 books and manuscripts in an average year; and about 90,000 visitors come to see our exhibitions. Other rare-book libraries will exhibit similar statistics, and of course attendance figures at the major art museums of the country are very much larger. And the great majority of the books, manuscripts, and pictures that these visitors come to use or to see have been given to the institutions through the encouragement of the existing tax benefits.

Let me, for the next fact, take my own circumstance as an example. For 40 years, on a modest income, I have collected books and manuscripts relating to the English author Samuel Johnson. I have used this collection for my own research; it has been used by the editors of the various volumes of the Yale edition of Samuel Johnson; it is available to all other scholars in the field; and I have always intended to give it to Yale. Indeed, it has been formed in concert with Yale, and I have purchased books for my own collection that are not at Yale with the understanding that they will be given to the library.

I estimate that the present fair market value of the collection is about 10 times my cost. If my gift of this collection to Yale is to be treated as a sale by which I become liable to tax on the gain (as the act proposes) I will not be able to afford the gift, the collection will be sold at auction abroad, and the aim of a lifetime of collecting for the benefit of my alma mater will be vain.

Tax reform that is truly responsible must distinguish between the speculator who purchases for the sole purposes of establishing a future tax benefit by a gift that has appreciated in value, or the artist, writer, or public figure who seeks an inflated valuation of the gift of self-created materials, on the one hand, and, on the other hand, the financially disinterested collector who assembles pictures, books, manuscripts for his own purposes, holds them for his own use and that of other scholars, and then wishes to benefit future scholarship by the gift of his collection to an institution.

It is a matter of great difficulty to determine the criterion for tax liability on account of gifts. I suggest that the fairest criterion might be the motive for which property is acquired. If property is a grandfather's dairy, of no monetary value when it was created, preserved by family piety, later proved to be of both historical and financial value, or if the property has been collected by purchase for scholarly purposes and has incidentally increased in value, then it would be possible to find a form of words for a test which would preserve the scholarly value permanently by gift to an institution without incurring a tax liability.

I do not pretend to be a legislative draftsman. I would not presume to tell this committee how the just distinction I perceive between the profit motive and the true collecting motive should be translated into statute. But I know that, if the distinction is not made, every library and museum in this country will suffer bitterly by a decline in gifts, and that later generations of scholars will wonder at the legislation by which in 1969 gifts to libraries and museums were suddenly dried up. The tax structure may in future years be amended so as at one time to favor and at one time to impede gifts to libraries and museums, but the gifts themselves, the books, the manuscripts, the pictures, that will be lost to institutions by the act of 1969 will then be gone beyond recovery. They will not be lost just to our library, or just to our university; they will be lost to the whole American people. The responsibility for the preservation of our cultural heritage which rests on you gentlemen who will frame this year's statute is both heavy and haunting.

The public good is served if cultural materials privately assembled are given to places of public use, and it is the business of the law to encourage such gifts within legitimate limitations. A law that will prevent such gifts, and encourage the dispersal of collections by public sale instead of their gift to institutions where they will be available to all comers, is contrary to the public interest. I cannot believe that this committee in its wisdom will sponsor such an act.

I am deeply grateful to the committee for the opportunity to present my views, and I shall gladly attempt to answer any questions its members may care to put to me.

Senator BENNETT. Thank you very much, Mr. Liebert. Under the chairman's rule we may not ask any questions unless you have some.

Thank you.
Did Dr. Kenneth Clark return?
All right. The last witness then is Mr. John M. Stalnaker, president emeritus, National Merit Scholarship Corp.
Mr. STALNAKER. Thank you, Mr. Chairman.
Senator BENNETT. Mr. Stalnaker, I think you are No. 369, and that is the number of witnesses this committee has heard since it began these hearings.
Mr. STALNAKER. Thank you.
Senator BENNETT. I asked them if they could not please turn up one more so we could have a nice round figure, but I am not going to call for volunteers.

STATEMENT OF JOHN M. STALNAKER, PRESIDENT EMERITUS, NATIONAL MERIT SCHOLARSHIP CORP.

Mr. STALNAKER. My name is John M. Stalnaker, and I am president emeritus of the National Merit Scholarship Corp., with which I have been associated since its founding and development.
This corporation operates the Nation's two most widely known and influential but privately supported public scholarship competitions, the national merit program and the national achievement scholarship program for outstanding Negro students. Some 800,000 students enter these programs each year, representing about 17,500 high schools in the country.
We are supported by some 500 sponsoring organizations which sponsor merit and achievement scholarships. These include corporations, colleges, labor unions, professional societies, individuals, and private foundations, including many corporate foundations.
In no case, however, are the awards of their scholarships directed to individuals. The awards are made by the National Merit Scholarship Corp. The programs are extremely competitive, as is detailed in our written testimony.
Many of the sponsors provide funds for completely unrestricted scholarships that anyone can win. Almost all of them also offer scholarships for the most outstanding students who meet certain criteria of interest to them. Thus, the Army and Air Force central welfare funds limit their scholarships entirely to children of members of these services.
Corporations and corporate foundations provide awards for the most highly qualified children of employees.
Labor unions specify children of members. Those wishing to help Negro students use the facilities of the national achievement scholarship program for outstanding Negro students.
National Merit Scholarship Corp. has been ruled to be an exempt organization under section 501(c)(3) of the Internal Revenue Code.
We believe that it will continue to be an exempt organization under the changes in the tax reform bill of 1969, and would also qualify as a publicly supported organization.
Most of the 500 scholarship donors are also not private foundations.
However, a significant number are, and while they do not make their scholarship grants directly to individuals, the restrictions of this bill dealing with direct grants to indivduals may be subject to differ-

ing interpretations. This may result in interruption or widespread cancellation of completely desirable scholarship programs, and we do not believe this to be in the national interest.

We are concerned with section 4945(e), pertaining to taxable expenditures, which requires that individual grants be "awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary or his delegate."

We fear that this standard may be so imprecise as to cause a private foundation to hesitate to award scholarships, even to the winners of bona fide scholarship competitions such as that conducted by National Merit Scholarship Corp. Because an advance ruling must be obtained and because of the severe penalties attaching should such a grant be ruled to be a taxable exenditure, some private foundations may be inclined to suspend their scholarship support activities pending clarification.

We do not believe that the word "nondiscriminatory," as read in the bill, is meant to affect competitive scholarship programs with criteria similar to ones that are limited to children of members of the Armed Forces, to children of employees of corporations, or who are Negroes, or American Indians, or children from low-income families. But some private foundations may not wish to risk the severe penalties to find out.

We are also concerned with the employment of the word "nondiscriminatory" because of the possibility that the wording and interpretations which may develop concerning it in the context of the provisions governing private foundations will be extended and used as precedents in Treasury rulings on other scholarship programs.

National Merit Scholarship Corp., for instance, operates one of the Nation's major competitive scholarship programs for Negro students. We think that the Nation truly would be the loser if this voluntary program, which is entirely privately supported, were to become the unintentional and indirect victim of this bill.

The black community would have lost a valued friend.

We are also concerned that some private foundations which are donors to national public scholarship competitions administered by organizations which the Treasury has ruled tax exempt may now conclude that for safety's sake, they should now also get a Treasury ruling themselves for their scholarship grants to that program.

Obtaining a ruling typically requires many months, and could result in substantial interruptions of these activities and the Nation's more able students would be the losers.

Some clarification of the bill is needed where grants to individuals are concerned, especially to undergraduate students. The public supports public scholarship competitions which are important to the national welfare, as interest in the Merit program attests. Private foundations play an important part in making such competitions possible. Regardless of the intent if this bill, we believe that some interpretations may place new restrictions on these worthy activities.

The possible severe penalties associated with misinterpretations may cause some donors who want to be certain beyond a shadow of a doubt to cancel their scholarship programs.

There are undoubtedly a number of ways in which the ambiguity of section 4945(e) might be eliminated.

One possibility might be to simply exempt from the bill expenditures for undergraduate scholarships, the winners of which are chosen in a bona fide competition conducted by an independent organization which has been ruled exempt by the Treasury.

We believe that the problem areas we perceive in the tax bill as now written could cause interruption or curtailment of important scholarship programs which are in the Nation's best interest.

There may also be unfortunate implications in section 4941 and 4946 for scholarship programs supported by private foundations. Our detailed testimony suggests modifications to avoid these results.

We would hope that modification will be made in these provisions.

Thank you very much.

Senator BENNETT. Thank you very much, Mr. Stalnaker.

(Mr. Stalnaker's prepared statement follows:)

STATEMENT OF THE NATIONAL MERIT SCHOLARSHIP CORPORATION, PRESENTED BY JOHN M. STALNAKER, PRESIDENT EMERITUS

SUMMARY

My name in John M. Stalnaker. I am president emeritus of National Merit Scholarship Corporation of Evanston, Illinois, and have been associated with it since its founding in 1955.

I am executive director of the Commission on Presidential Scholars, chairman of the Midwest Regional Panel for White House Fellows, and have served as chairman of the Board of Foreign Scholarships (Fulbright Program). Presently I am also a member of the Board of Higher Education of the State of Illinois.

National Merit Scholarship Corporation operates the nation's two most widely known and most influential public scholarship competitions—the National Merit Scholarship Program and the National Achievement Scholarship Program for outstanding Negro students. Some 800,000 students enter these programs each year representing over 17,500 high schools. Over 25,000 scholarships have been awarded to date.

Some 500 organizations sponsor the scholarships, including corporations, colleges, labor unions, professional societies, other organizations, individuals, as well as private foundations, including many corporate foundations.

In no case do the 500 sponsoring organizations of the Merit and Achievement programs award their scholarships directly to individuals; the awards are made by National Merit Scholarship Corporation.

The programs are extremely competitive as is detailed in our written testimony. Most of the winners are in the upper one half of 1% of the secondary school graduates.

Many of the sponsors provide funds for completely unrestricted scholarships that anyone can win. Almost all of them also offer scholarships for the most outstanding students who meet certain criteria of interest to them. Thus, the Army and Air Force Central Welfare Funds limit their scholarships entirely to children of members of these services. Corporations and corporate foundations provide awards for the most highly qualified children of employees. Labor unions specify children of members. Those wishing to help Negro students use the facilities of the National Achievement Scholarship Program for outstanding Negro students.

National Merit Scholarship Corporation has been ruled to be anexempt organization under Section 501(c)(3) of the Internal Revenue Code. We believe that it will continue to be an exempt organization under the changes in the Tax Reform Bill of 1969, and would also qualify as a publicly supported organization. Contributions to it would continue to be deductible by the donors under Section 170 of the code.

Most of the 500 scholarship donors are also not private foundations. However, a significant number are, and while they do not make their scholarship grants directly to individuals, the restrictions of this bill dealing with direct grants to individuals may be subject to differing interpretations. This may result in interruption or widespread cancellation of completely desirable scholarship programs, and we would not believe this to be in the national interest. We are

concerned with Section 4945(e), pertaining to taxable expenditures, which requires that individual grants be "awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary or his delegate."

We fear that this standard may be so imprecise as to cause a private foundation to hesitate to award scholarships, even to the winners of bona fide scholarship competitions such as that conducted by National Merit Scholarship Corporation. Because an advance ruling must be obtained and because of the severe penalties attaching should such a grant be ruled to be a taxable expenditure, some private foundations may be inclined to suspend their scholarship support activities pending clarification.

We do not believe that the word nondiscriminatory, as read in the bill, is meant to affect competitive scholarship programs with criteria similar to ones that are limited to children of members of the armed forces, to children of employees of corporations, or who are Negroes, or American Indians, or children from low income families. But some private foundations may not wish to risk the severe penalties to find out.

We are also concerned with the employment of the word nondiscriminatory because of the possibility that the wording and interpretations which may develop concerning it in the context of the provisions governing private foundations will be extended and used as precedents in Treasury rulings on other scholarship programs. National Merit Scholarship Corporation, for instance, operates one of the nation's major competitive scholarship programs for Negro students. We think that the nation truly would be the loser if this voluntary program, which is entirely privately supported, were to become the unintentional and indirect victim of this bill. The Negro community would have lost a valued friend.

We are also concerned that some private foundations which are donors to national public scholarship competitions administered by organizations which the Treasury has ruled tax-exempt may now conclude that for safety's sake, they should now also get a Treasury ruling themselves for their scholarship grants to that program. Obtaining a ruling typically requires many months, and could result in substantial interruptions of these activities and the nation's more able students would be the losers.

Some clarification of the bill is needed where grants to individuals are concerned, especially to undergraduate students. The public supports public scholarship competitions which are important to the national welfare, as interest in the Merit Program attests. Private foundations play an important part in making such competitions possible. Regardless of the intent of this bill, we believe that some interpretations may place new restrictions on these worthy activities. The possible penalties associated with misinterpretations may cause some donors who want to be certain beyond a shadow of a doubt to cancel their scholarship programs.

There are undoubtedly a number of ways in which the ambiguity of Section 4945(e) might be eliminated.

One possibility might be to simply exempt from the bill expenditures for undergraduate scholarships, the winners of which are chosen in a bona fide competition conducted by an independent organization which has been ruled exempt by the Treasury.

Another approach might be to exclude from the term taxable expenditures, "scholarship and fellowship grants which are subject to the provisions of Section 117(a) and are to be used for study at an educational institution described in Section 170(b)(1)(B)(ii)", the language used in section 4941(d)(2)(G)(ii) of the Tax Reform Bill of 1969.

There may also be unfortunate implications in Sections 4941 and 4946 for scholarship programs supported by private foundations. These have to do with self-dealing and disqualified persons. As our more detailed testimony indicates, these sections might be interpreted to bar a highly qualified student from winning a scholarship because the father was a substantial stockholder of a corporation. Our detailed testimony suggests modifications to avoid this result.

We believe that the problem areas we perceive in the tax bill as now written could cause interruption or curtailment of important scholarship programs which are in the nation's best interest. We also believe that some modification in the manner which we have suggested or in some other appropriate manner is necessary to eliminate these problem areas. We urge that such modification be considered.

We are at your disposal to explain further any aspects of this testimony either with the committee or with the appropriate members of your staff.

STATEMENT

My name is John M. Stalnaker. I am president emeritus of National Merit Scholarship Corporation of Evanston, Illinois, and have been associated with it since its founding in 1955.

I am executive director of the Commission on Presidential Scholars, chairman of the Midwest Regional Panel for White House Fellows, and have served as chairman of the Board of Foreign Scholarships (Fullbright Program). Presently I am also a member of the Board of Higher Education of the State of Illinois.

National Merit Scholarship Corporation operates the nation's two most widely known and most influential public scholarship competitions—the National Merit Scholarship Program and the National Achievement Scholarship Program for outstanding Negro students. Some 800,000 students enter these programs each year representing over 17,500 high schools.

The primary objective of these two nation-wide programs is to identify publicly each year the most promising high school seniors in the 50 states—on a state by state basis—and to encourage scholarship donors throughout the United States to provide these students with the financial assistance they need to attend college.

The National Merit Scholarship Program is now in its 15th year, and over 25,600 scholarships have been awarded in these Merit and Achievement programs to date. This year some 12,000 students will be in college with assistance from NMSC and several times as many will have been benefitted in some way from participation in the program.

The scholarship assistance awarded to students through the Merit and Achievement Scholarship programs comes from some 500 sponsoring organizations, a total which has increased each year. These include corporations, colleges, labor unions, professional societies, other organizations, individuals, as well as private foundations, including many corporate foundations. This complex of sponsors, nearly all non-governmental, but including such federal instrumentalities as the U.S. Army and Air Force Central Welfare Funds, makes it possible for this country to have a massive public talent search and the stimulation of a 50-state scholarship competion without dependence upon federal or state funds.

In no case do the 500 sponsoring organizations of the Merit and Achievement programs award their scholarships directly to individuals. A group of Merit and Achievement finalists are selected by rigorously defined procedures.

The selected students in the Merit program for example, are in the upper one half of 1% of the secondary school graduates. They are so highly selected that all are assumed to be fully qualified for scholarship help. The object of the Merit program is to obtain financial assistance to the extent such assistance is required by the student so that all of the finalists will be able to attend the college of their choice and to study in the field of their interest. Sponsors are invited to support scholarships for any of the finalists since every finalist is qualified and they may define the type of person they wish to have receive their awards. However, the awards are made by NMSC and where appropriate, the need for financial aid is determined by NMSC and NMSC handles all details administering the scholarship.

While no Merit scholarships are awarded to anyone who does not qualify as a finalist, some sponsors wish to offer a fixed number of awards each year and in those cases NMSC, where it cannot meet the full requirements from the finalists, will award a special scholarship to the next candidate in line who meets the criteria for that award. The selection of special scholars is made by NMSC and the scholarships administered by NMSC and all details handled in a way which is parallel to that of the Merit program.

The Merit Scholarship sponsors, collectively, offer some 1000 Merit Scholarships each year that can be won by any student in the country—they are completely unrestricted as to who can win. Winners are chosen by a national committee of educators skilled in academic selection.

Nearly all the sponsors, including the private foundations, also offer Merit and Achievement and Special scholarships for the most outstanding students who meet criteria of interest to the sponsors and these total 2700 a year at present.

For example, the Army Central Welfare Fund and the Air Force Central Welfare Fund limit their Merit Scholarships to children of members of the U.S. Army and the U.S. Air Force.

Several hundred corporations and corporate foundations, besides giving unrestricted Merit Scholarships, provide awards for the most highly qualified children of employees.

Over a hundred and fifty colleges provide that their Merit Scholarships be awarded to Merit finalists who choose to attend their colleges.

Labor unions specify some of their awards for children of members, a medical research fund for potential workers in the health care field, etc. Organizations wishing to award scholarships to the nation's outstanding Negro students use the facilities of the National Achievement Scholarship Program in a similar manner.

National Merit Scholarship Corporation has been ruled to be an exempt organization under Section 501(c)(3) of the Internal Revenue Code of 1954. We believe that it would continue to be an exempt organization under the changes in the Tax Reform Bill of 1969 and would also qualify as a publicly supported organization. Contributions to it would continue to be deductible by the donors under Section 170 of the code. National Merit Scholarship Corporation itself will be affected by the Tax Reform Bill of 1969 chiefly if the influence of the bill causes sponsors to withdraw scholarship support in the face of possible severe government penalties.

Most NMSC donors are not private foundations and would not be directly affected. However, a significant number of the donors are private foundations that do come under the bill. These sponsoring foundations do not make their scholarship grants directly to individuals, but to NMSC, and to this extent they would not constitute the type of activity at which the bill seems to aim.

However, it appears to us that the sections of this bill dealing with direct grants to individuals may be subject to differing interpretations, and could unintentionally affect the continuity of various independently operated scholarship activities which are in the public interest but which make scholarship awards directly to able students.

We fear that the enactment of this legislation in its present form will cause sponsors of completely desirable scholarship programs to suspend their scholarship programs until further clarification is made. Such effects could result in widespread cancellation of privately supported scholarship activities and thus would be undesirable for education generally. It would not be in the national interest if there were, at this time, a significant reduction in undergraduate scholarship support by private foundations, both because it would reduce the amount of student aid available nationally, and even more significantly because the nation would lose the very important side benefits of these activities—talent search and student encouragement.

In particular, we are concerned with Sections 4945(e), 4941 and 4946 of the Tax Reform Act as they may relate to grants made by private foundations directly to individual undergraduate students and students about to enter college.

Specifically, Section 4945(e), pertaining to taxable expenditures, requires that individual grants must be "awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary or his delegate." We fear that this standard may be so imprecise as to cause a private foundation to hesitate to award scholarships, even to the winners of bona fide scholarship competitions such as that conducted by National Merit Scholarship Corporation. Because an advance ruling must be obtained and because of the severe penalties attaching should such a grant be ruled to be a taxable expenditure, some private foundations may be inclined to suspend their scholarship support activities pending clarification.

In a sense, any scholarship competition by its very nature must be discriminatory. A scholarship competition distinguishes winners from losers.

This point aside, a great many scholarship activities in this country are discriminatory in the sense that the donor, even if it be the federal government, limits eligibility to students who meet some specified criteria. Some examples are programs that are:

1. Limited to children of members of the Air Force and Army.
2. Limited to members of certain churches.
3. Limited to children of employees of companies.
4. Limited to Negroes, or American Indians.
5. Limited to students willing to attend a certain college.
6. Limited to members of a Boys' Club from a certain city.
7. Limited to students from low income families.
8. Limited to students wishing to major in certain fields.

There are many other types.

One commonly used criterion is that of being a child of an employee of a sponsoring corporation. Many corporate foundations have scholarship programs for children of employees. In fact, many of the Merit Scholarships and Achievement Scholarships for outstanding Negro students are designed for children of employees. The number of students receiving awards is a very small fraction

of the total number of employee children of the age group—the programs are extremely competitive. There is a very large number of non-winners for every winner.

We do not believe that the word nondiscriminatory as read in the bill, is meant to affect such programs, but some private foundations may not wish to risk the severe penalties to find out.

We are also concerned with the employment of the word nondiscriminatory because of the possibility that the wording and interpretations which may develop concerning it in the context of the provisions governing private foundations will be extended and used as precedents in Treasury rulings on other scholarship programs. National Merit Scholarship Corporation, for instance, operates one of the nation's major competitive scholarship programs for Negro students. We think that the nation truly would be the loser if this voluntary program, which is entirely privately supported, were to become the unintentional and indirect victim of this bill. The Negro community would have lost a valued friend.

We are also concerned that some private foundations which are donors to national public scholarship competitions administered by organizations which the Treasury has ruled tax-exempt may now conclude that for safety's sake, they should now also get a Treasury ruling themselves for their scholarship grants to that program. Obtaining a ruling typically requires many months, and could result in substantial interruptions of these activities and the nation's more able students would be the losers.

Some clarification of the bill is needed where grants to individuals are concerned, especially to undergraduate students. The public supports public scholarship competitions which are important to the national welfare, as interest in the Merit Program attests. Private foundations play an important part in making such competitions possible. Regardless of the intent of this bill, we believe that some interpretations may place new restrictions on these worthy activities. The possible penalties associated with mis-interpretations may cause some donors who want to be certain beyond a shadow of a doubt to cancel their scholarship programs.

There are undoubtedly a number of ways in which the ambiguity of Section 4945(e) might be eliminated.

One possibility might be to simply exempt from the bill expenditures for undergraduate scholarships, the winners of which are chosen in a bona fide competition conducted by an independent organization which has been ruled exempt by the Treasury.

Another approach might be to exclude from the term taxable expenditures, "scholarship and fellowship grants which are subject to the provisions of Section 117(a) and are to be used for study at an educational institution described in Section 170(b)(1)(B)(ii)", the language used in Section 4941(d)(G)(ii) of the Tax Reform Bill of 1969.

There also may be unfortunate implications in Sections 4941 and 4946 for scholarship programs which are supported by private foundations. Section 4941 pertains to self-dealing between private foundations and disqualified persons. Section 4946 defines disqualified persons to be, among others, members of families who own more than 20% of the voting control of a corporation which is a substantial contributor to the private foundation. Among the acts which will be considered to amount to self-dealing under Section 4941 are the "transfer to or use by a disqualified person of the income or assets of the private foundation" and "agreement by the private foundation to make any payment of money or other property to a government official. . . ." Section 4941(d)(2)(G)(ii) specifically exempts scholarship and fellowship grants from the penalties for self-dealing, but only in the case of government officials. The presence of this limited exemption in the statute in its present form leads to the implication that other scholarship payments will not be so exempted. As a result, it could be interpreted that the child of a substantial stockholder of a corporation, qualified in every other way as a recipient of a scholarship, would be disqualified. While we do not believe that this result was intended, even if it was intended we believe any abuses at which it might have been directed are adequately prevented by Sections 117 and 1170.

The absence of any significant number of either Treasury rulings or reported cases indicates to us that this has not been an area in which there has been abuse by private foundations. Our personal experience supports this conclusion.

Therefore, we would again suggest some modification of the bill as presently written. One possible way of taking care of this problem might be to extend the exemption of qualified scholarship payments from the self-dealing provisions so

that it would apply to all such scholarship payments and not just to those made to government officials or their children. Of course, there may be other ways of solving this problem.

We believe that the problem areas we perceive in the tax bill as now written could cause interruption or curtailment of important scholarship programs which are in the nation's best interest. We also believe that some modification in the manner which we have suggested or in some other appropriate manner is necessary to eliminate these problem areas. We urge that such modification be considered.

We are at your disposal to explain further any aspects of this testimony either with the Committee or with the appropriate members of your staff.

Senator BENNETT. I understand Dr. Kenneth Clark has just come in. Is he here?

Will you come forward, then, and you become the last witness.

Senator FANNIN. The most sought-after witness of all the witnesses we have had before use.

Senator BENNETT. Dr. Kenneth Clark of Metropolitan Applied Research Center.

STATEMENT OF DR. KENNETH B. CLARK, PRESIDENT, METROPOLITAN APPLIED RESEARCH CENTER, INC.

Dr. CLARK. I want to thank the committee for permitting me to testify. I think this is the first testimony that I have ever given on my own initiative, but I feel this matter before us is so important——

Senator BENNETT. Will you talk into the microphone a little more clearly? It is hard for us to hear you.

Dr. CLARK. I believe that the legislation being discussed is of such importance that I sort of broke a long-standing rule of my own never to initiate a request for testifying.

I am particularly concerned about this legislation, as my written remarks indicate, for two reasons:

First, because of my life involvement and career as a social scientist who believes that desired social change, the struggle for justice and equality and decency in our society, can be obtained through rational process, through man's attempt to use his intelligence to plan how to make a society more equitable.

In my work as a social scientist, both with graduate and undergraduate students, I assert in the very beginning that this is my faith and my hope—that human intelligence can counteract human irrationality.

The second reason is very closely related to the first, namely, my role as president of the Metropolitan Applied Research Center in New York, which is attempting to test whether the rational intelligent planning approach to social change can be effective.

I believe that there are some serious questions about this proposed legislation, particularly the section which would prohibit any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof or any attempt to influence legislation through private communication with any member or employee of a legislative body or with any other person who may participate in the formulation of legislation other than through making available the results of nonpartisan analysis or research. I believe that those are the most disturbing and dangerous portions largely because of a meeting from which I have just come. The committee should

know that I just left the office of Herbert Stein, a member of the President's Council on Economic Advisors, where in my role as president of the Metropolitan Applied Research Center, and as the former coordinator of the Institute for Black Elected Officials, I was doing precisely what this legislation would prohibit.

Mr. Stein, a representative from HEW, a representative from the office of the Secretary of the Treasury, and four Negroes were sitting around the table rationally, calmly, with mutual respect and understanding, discussing the implications of some of the administration's policies for the black community throughout the Nation, North and South.

I was doing this in my role as president of the Metropolitan Applied Research Center. Dr. Phyllis Wallace, an analyst in my office, had put together a plan containing various subjects to be discussed with Mr. Stein and which reflected our concern that Federal programs could be administered in such a way as to increase problems rather than to solve problems.

My associate, Dr. Farrar, who came with me here, said, "Do you think it would be wise to share this fact with the Senate Finance Committee?

I said, "Yes, it is wise because it is directly related to our concern."

Restrictive legislation, legislation which would interfere with the right of responsible social scientists to do relevant research, research relating to social action and social policy and social change, any such legislation which would impair this would not only interfere with academic freedom but would, it seems to me, increase the chances of nonrational, volatile, emotional, and what I have been criticized for calling, mindless rhetoric and action becoming the dominant ways in which deprived people sought social change.

The MARC Corp. was founded by foundations at my request to test the degree to which it is possible to use intelligent and rational analysis and methods to bring about social change.

Some of the more extreme "militant" members of the minority community criticized this approach from the very beginning, with the usual cliches, such as "lackeys of the establishment." For these individuals any Negro or white or minority group person who sought and obtained grants from foundations was by virtue of that fact demonstrating that he was an Uncle Tom or that he was an agent of the establishment; they sometimes have been rather explicit in saying that the rational approach to achieving social change is doomed to failure, it just cannot work. And those of us who are identified with this approach have been called all sorts of names.

It is my deep belief that this type of legislation would strengthen the nonrationalists, would strengthen not just their rhetoric, but their reality, and would certainly weaken those of us who are identified with seeking admittedly difficult, frustrating, not-easy-to-come-by rational and democratic answers to long-standing social problems.

In summary, then, our statement maintains that the proposed legislation restricting foundations' support of social action oriented groups would be dangerous, and that it would deny congressional support for action research in the public interest while Congress itself continues to subsidize nonsocial change, private, profitable interests.

We believe it would be dangerous, also, because it would undermine the uniquely American system of private support for the public good through the foundations, and would thereby increase reliance upon already heavily committed public funds.

My own feeling is that if such legislation were passed the availability of public funds for social change and social change activity would be limited.

Senator BENNETT. I am sorry, they are voting on the floor of the Senate, and we have no choice but to run. Your statement will be put in the record complete.

Dr. CLARK. Thank you, Sir.

(Dr. Clark's prepared statement follows:)

STATEMENT OF DR. KENNETH B. CLARK, PRESIDENT, METROPOLITAN APPLIED RESEARCH CENTER, INC.

SUMMARY

The proposed legislation restricting foundation support of social action-oriented research would be dangerous because:

1. It would deny congressional support for research in the public interest while the Congress continues to subsidize profitable private interests;

2. It would undermine the uniquely American system of private support for public good through foundations, and would, thereby, increase reliance upon already heavily commited public funds;

3. It would withhold from legislatures and from the public the significant findings of action-oriented applied research;

4. It would curtail or destroy many promising experiments in education, social welfare, and civil rights by denying the right of a "private operating foundation" to receive more than 25% of its income from a single source;

5. It would injure the poor, the deprived, and minorities most of all;

6. It would encourage foundations to withdraw from applied social research or to "play it safe" by avoiding areas of public policy;

7. It would gravely weaken the confidence of the poor and deprived and those in urban ghettos—particularly the young—in the feasibility of non-violent rational means of social change of just grievances and encourage a cynical reliance on non-rational devices, stimulating urban explosions and other violent responses consistent with hopelessness and despair.

American democracy has survived precisely because it has developed flexible means for rational processes of necessary social change. Therefore, it is urgent that the proposed legislation, which would endanger that flexibility, be reconsidered.

STATEMENT

Mr. Chairman, my name is Kenneth B. Clark. I am professor of psychology at the City University of New York and President of the Metropolitan Applied Research Center, an organization incorporated in New York State.

Let me begin by thanking you, your committee, and the members of your staff for enabling me to appear today to testify on the Tax Reform Act of 1969 as it affects private foundations. From time to time during the past 20 years or so, I have been asked to testify before a Congressional Committee. If my memory is accurate, I have never previously initiated a request to be heard in these chambers. I have done so now because I am deeply concerned about the implications of the legislation before you.

I should like to address my own remarks in regard to the Tax Reform Bill not to the specific prohibitions against the expenditure of funds by foundations—against voter registration, against activities intended to effect legislation, and a tax on foundation income—but, rather, to the implications of the bill as they would affect the democratic process.

The bill now before this committee would prohibit foundations from:

(a) any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof, and

(b) any attempt to influence legislation through private communication with any member or employee of a legislative body, or with any other person who may participate in the formulation of the legislation, other than through making available the results of non-partisan analysis or research.

Through this provision that no program can be undertaken which is intended to influence legislation through approaches to members of legislative bodies or through public opinion, Congress would attack action-oriented social research devoted to the public interest while it continues to permit intensive lobbying by vested private interests, such as oil, medicine, agriculture. Groups concerned for self-interest are many and rich. They do not need tax exemption (though many are heavily subsidized by various forms of tax exemptions and governmental subsidies, and in other ways). Those concerned with the public interest, on the other hand, are few, and their total assets are relatively small compared to the wealthy coffers of private interests. How ironic if Congress should abandon its primary responsibility, which is the public interest, while continuing to give support to profitable private interests.

Private foundations are uniquely American institutions. With the exception perhaps of our public education system, there is nothing quite so American as the means we have found over generations to apply private wealth to public causes—private help for public causes instead of public help for private causes.

That part of the legislation with which I am primarily concerned would have the effect of crippling or killing foundation activities in support of social programs the government itself has supported. It would place more and more emphasis on the growth of the central government and public sector, stemming the balancing contribution of the private sector, discouraging American institutions from participation in social research and (relevant) public education. In a representative society, public opinion, and those who will mold legislation, need more not less access to non-governmental and non-profit perspectives.

The pending legislation would also have the effect—through its dangerous provision that no "private operating foundation" can receive more than 25% of its income from a single source—of curtailing or destroying many promising experiments in education, social welfare and civil rights, since the fact is that the number of foundations willing and eager to support such experiments are few, not many. It would encourage competition among agencies concerned with social action research and divert administrative time and talent away from study to wasteful soliciting of funds.

Those who would be hurt by such legislation are the poor, the deprived, and those minorities who have not yet been incorporated into the economic and political power of our societies, those who have for so long been excluded from the political process—not the affluent, and not the foundations themselves (as presently defined), most of whom do not engage in imaginative action-oriented applied social research. The masses of your constituencies would be the direct victims of such a bill; and, in the end, the surest victim would be this democratic society itself.

Rather than compel foundations to withdraw from social action research, or to "play it safe" by avoiding areas of public policy, Congress should devise all manner of enticements to encourage foundations to invest even more widely than they do in social research and social programs, and to encourage dissemination of findings and to advocate policies to legislatures. This would certainly increase the chances that desired social change would occur within the context of rational, systematic and democratic process—and decrease, I hope, the chances of irrational and demogogic approaches to social change. We must increase the capacity of the society to solve its problems peacefully. To prevent the fruits of the free inquiry of applied social research from reaching the members of the Congress and of State Legislatures would be to deprive them of essential knowledge as a basis for their own actions. In addition, it would deprive the public, who is responsible for the Congress, of an informed perspective on social need.

It is extraordinary that such a bill would see the light of day at this particular time, when the confidence of minority groups and others in the orderly process of social change is at a low ebb. In my testimony before the Kerner Commission, I expressed my frustration about the failure of government to heed the findings of its own research. To document a need, and then to refuse to act on that need is to provide fuel for the cynical who do not believe our government is capable of rational change. For if ever we needed a demonstration of the possibilities of rational and orderly change, it is now. Many in the urban ghettos—particularly the young—are convinced that democracy is not flexible enough to provide for

necessary change. They observe that riots, melodramatic rhetoric, a militant stance, reliance on the irrational, are far more likely to stir leadership to action than are the rational attempts of nonviolent persuasion based on informed research. The legislation proposed would feed this cynicism, this distrust of reason, and the democratic process. For it would legislate rigidity, fear of change, penalizing American institutions for seeking rational nonviolent means to achieve necessary change. This, without question, would encourage, if not stimulate, the resort to the non-rational explosions of frustration and cynical explosions of just grievances.

American democracy has survived precisely because it has been a flexible institution. It has survived longer than any freely elected government because it has adapted to new requirements; the Constitution has proven extraordinarily flexible for the needs of each new age. This legislation would weaken this living vital instrument and raise doubts about the nation's capacity to admit to past error or new needs. This nation should have nothing to fear from the search for knowledge, and nothing to fear from rational change.

Should this legislation circumscribing the role of foundations pass as it stands, the Congress must assume responsibility for an impetus toward the final abandonment of the process of reason that is the foundation of any orderly democratic government, and must assume responsibility for any irrational acts of civic disorder engaged in by those despairing people not yet admitted to equality in this society, those for whom the force of reason has become no longer possible. So this legislation would go far beyond a crippling of the freedom of foundations to experiment with new approaches to social problems. It would be a declaration that social research, relevant to social change, is not sanctioned by this society, that human values and the struggle for justice are regarded as unpatriotic, and unworthy of governmental support, and that peaceful social change is now seen as improper and illegal. Two alternatives alone would remain to the deprived should any such stand become the policy of this nation—acquiescence in continued degradation and despair, or a resort to violent, irrational means.

This Congress has given wide support to scientific research in weapons of war—nuclear farfare, nerve gas, and other devastating chemical instruments of destruction. But it has also enabled the nation to achieve scientific triumphs of peace. A nation that has willingly spent billions to send two men to the moon cannot now reject men here on earth. It would be an irony of historic proportion if the strongest and greatest nation on earth retreated in fear in the face of social-action research that could help man to a better life. If social science research is rejected by this Congress, it will be rejecting the essence of democracy—respect for humanity and unquestioned faith in the rational process.

It is, Mr. Chairman, because I believe that this is contrary to the best in the American tradition and in conflict with the urgent needs of our time, that I hope this Committee and the Senate of the United States will reconsider these measures.

Thank you.

Senator BENNETT. The committee is adjourned until 10 o'clock tomorrow morning when we begin the pleasant task of trying to winnow all the advice you have given us and make a bill out of it.

(Thereupon, at 1:20 p.m. a recess was taken in the hearing to reconvene at 10 a.m., Thursday, October 9, 1969, in executive session at 10 a.m.)

TAX REFORM ACT OF 1969

WEDNESDAY, OCTOBER 22, 1969

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10:05 a.m., in room 2221, New Senate Office Building, Hon. Clinton P. Anderson, presiding.

Present: Senators Long (chairman), Anderson, Gore, Talmadge, Byrd Jr. of Virginia, Williams of Delaware, Bennett, Curtis, Miller, Fannin, and Hansen.

Senator ANDERSON. The hearing will come to order.

The Committee on Finance has interrupted its executive sessions on the Tax Reform Act of 1969 to receive a report from Mr. Peter G. Peterson, chairman of the board and president of the Bell & Howell Corp., in Chicago. Mr. Peterson serves as chairman of the Commission on Foundations and Private Philanthropy, a commission comprised of a group of distinguished Americans who have spent several months looking into the impact of private foundations on philanthropy in this country. A considerable portion of the study has concerned itself with abuses of the foundation privilege.

Mr. Peterson, we will be pleased to hear what you have to say this morning. Next week, we take the foundation provisions of the tax reform bill under consideration in executive session. I know the thoughts you will express today will aid us in the work we do next week.

Mr. Peterson, we will start with you now, if you please.

STATEMENT OF PETER G. PETERSON, CHAIRMAN OF THE BOARD AND PRESIDENT, BELL & HOWELL CORP., CHICAGO, ILL., CHAIRMAN, COMMISSION ON FOUNDATIONS AND PRIVATE PHILANTHROPY

Mr. PETERSON. Good morning, gentlemen. If I could introduce myself, my name is Peter G. Peterson, chairman and president of Bell & Howell Co., in Chicago. But today I am here in my capacity as chairman of the Commission on Foundations and Private Philanthropy. If I may, I would like to handle this presentation this morning in the following way: I would like to suggest, first of all, that my written statement be inserted in the record.

Senator ANDERSON. Without objection, that will be done.

Mr. PETERSON. Off the record, Mr. Chairman.

(Discussion off the record.)

Mr. PETERSON. I think, in the interest of time, what I would like to do is present you a summary of our key findings. First of all, I would like to tell you about our group.

I was approached last spring by Mr. John Rockefeller III, on behalf of several of the major foundations, who asked me if I would head a group of private citizens to launch this study. I indicated to them that I would accept the assignment on three bases: First, that leaders in the executive and legislative branches of the Government would be contacted to see whether they felt a study of this type would be helpful. As I indicated in my written testimony, this was done.

Secondly, I told them that I thought it was extremely important that a study of this kind be as objective as possible, both in substance and in appearance. For that reason, I told them I would have to insist on selecting my own commission and my own staff. I thought this independence should extend to financing of this effort as well. Thus, we are raising our money from individuals, from companies, labor unions, all kinds of institutions, and we have not accepted any money from the foundations.

As to the commission itself—I would like to show you who they are so you can arrive at your own judgment about their competence. I guess everybody is an advocate in this world for something. My bias is toward audiovisual presentations and I hope you will not be bothered by that.

Let me show you who is on this commission. We wanted representatives of several sectors of the society. We wanted to be awfully sure the revenue aspects were looked at, someone who really knew the question of abuses and revenue; thus, Sheldon Cohen, former Commissioner of Internal Revenue.

Senator GORE. Mr. Chairman, I suggest we accept the validity and authenticity of the organization and get to the substance of this presentation.

Senator ANDERSON. Without objection.

Mr. PETERSON. Thank you, sir.

To tell you how we went about this work, we first listened and made note of the criticisms of foundations from a wide variety of sources. Briefly stated, the allegations go as follows: First, many or most foundations are nothing more than tax dodges for millionaires.

Second, that foundations are heavily involved in politics and not in charity and why should these activities be fostered at the public expense?

Third, foundations often use their money to further extreme ideologies, left and right.

Fourth, that many foundations represent great concentration of in-perpetuity power and money controlled by an Ivy League, self-appointed establishment.

Fifth, that foundations spend a great deal of money internationally and ignore the needs of our own society.

Sixth, that they squander money that would otherwise go to charity and they squander it on high salaries and high overhead expenses.

And finally, that foundations hoard money as though it were their own when it belongs to the public and should be spent on charity.

Now, I am sure that you have heard many of these criticisms and others besides. But the one thing this commission determined early in its life was that while these allegations were common, there was remarkably little evidence to either support or refute them. One of the

first major surprises of this commission was to find how little was really known about what foundations did with their money.

For example, the question of abuses bothers many people. It certainly bothered us on this commission. But when we tried to find out how frequently each kind of these abuses occurred and whether the allegations were a single anecdote or part of a real pattern, we could get no evidence.

We had, therefore, to launch our own studies of abuses. The Arthur Andersen Co., accounting firm in Chicago, anonymously, interviewed some 200 tax accountants across America to get them to estimate the nature and frequency of tax abuses. The National Opinion Research Center acted as consultants and Market Facts, Inc., in Chicago, did what is perhaps the first systematic set of field interviews of foundations across America, of all sizes and types. While our study is not complete and I am going to present to you a preliminary report only, I believe that most of the trends are pretty well established by now.

We took a look at a significant number of 990–A forms, which I think many of you realize are an annual report for the Government required of each foundation. May I say parenthetically and perhaps gratuitously that while we think that 990–A forms can be greatly improved so as to help you gentlemen understand much better what foundations do, I find it very ironic that, in view of some of the widespread concerns and equally widespread ignorance, this form remains one of the less utilized forms in the Government information warehouse.

Today I will present to you as a result of these studies recommendations that deal with further abuses that we think should be covered in the legislation. I will talk to you about our recommendation for much more intensive auditing of foundations by the IRS, and some different concepts and we hope valid concepts for a much expanded form of public disclosure and public reporting.

Today I will also explore our findings on the question of whether the money is spent on politics or on charity and where the money is spent. Frankly, gentlemen, as we tried to get evidence on this question, we found nothing more than guesses. We found some people thinking this was a sizable portion of the activity of foundations. Today I will report to you how foundations do in fact spend their money and how much is spent on various kinds of grants.

On the allegation of whether they are hoarding their money and the payout of funds to charity, we are going to show you today the rate of return of foundations and how much they do pay out to charity. You will see how this evidence has led us to make a fundamental recommendation to you: that you consider legislating a high payout requirement for foundations.

I should also say that we have been a bit appalled by the lack of really basic descriptive information. You have heard testimony that there are 22,000 foundations; you have heard testimony that the assets are $20.5 billion. You have heard others say there are 45,000 foundations. And may I say, on the reported assets of foundations, it is very clear from our in-depth examination of 990 forms that a fair number of foundations are reporting those assets on a cost basis instead of a market-value basis, with the result that we think it is distinctly pos-

sible that the estimates of foundation assets that you have heard are substantially understated.

Senator TALMADGE. May I ask a question at that point?

Mr. PETERSON. Yes.

Senator TALMADGE. Do you have any idea of how many foundations there are in the country and what their total assets are at the present time?

Mr. PETERSON. The question of how many there are is really beyond our scope. I can tell you, Senator, we went to the IRS and got their total list. It is a number slightly over 30,000. As far as the assets are concerned, they are reported at $20.5 billion, which I believe is a substantial understatement. In our final report, we are going to take the largest ones and make our own appraisal of the market value.

I indicate in my testimony we are already doing that on one large one from which you heard testimony, the Irvine Foundation, which is, interestingly enough, listed as having assets of $6 million. You had testimony that I think could have strongly suggested that the foundation was worth $120 million or so. Our information suggests that the value, the true value, of that foundation may be much higher than that number. In our final report, we hope to be able to answer that question of total assets more specifically.

Senator GORE. Mr. Chairman?

The CHAIRMAN (now presiding). Senator Gore.

Senator GORE. We are finally beginning, just beginning, to focus upon the problem of tax exemption for foundations. I suggest that our Government and our society need to focus upon charity and upon our policy, Government policy, with respect to charity. Though you say the number of foundations is not known, the fact that the U.S. Treasury has been unable to give us any sort of reliable estimate, number, yet is it not true that foundations are only a relatively small part of the tax-exempt organizations? I have heard estimates of as high as 400,000 tax-exempt organizations in our country. This illustrates, Mr. Chairman, it seems to me, the need to focus finally in the development of our organized society upon governmental policy with respect to charity. I hope no one would think this statement would indicate an uncharitable attitude on my part toward charity. But a great many selfish acts of various, myriad kinds have been undertaken under the cloak of charity. We are subsidizing bogus, phony charities.

Would you respond to that at this time?

Mr. PETERSON. Our study, of course, focused necessarily on foundations. I would like to focus on an answer to one of your questions, Senator.

I think it is fair to say that one of the reasons that no one knows how many foundations there are is that I do not think enough time has been taken to define what is meant by a foundation. I think the current legislation, for example, makes it very clear that certain institutions that have never thought of themselves as foundations can be considered so. In the interest of making clear that my testimony may not be without prejudice, I am a trustee of the National Educational Television, Inc., and Brookings Institution here in Washington. I found after accepting this assignment that, by definitions in the House bill, these are considered foundations. I think a point you are making is an important one: First, that we should define carefully what we

mean by various kinds of charitable organizations and a study of the type we have taken on one small segment might be in order for the society as a whole.

Senator GORE. And once an organization has achieved tax-exempt status, there is no Federal agency adequately equipped for regulation, supervision, recordkeeping, or knowledge of what happens. Under the present law, the organization enjoys that status forever.

Senator BENNETT. May I make the point, there has been a very dramatic demonstration that, pushed hard enough, IRS will remove the exemption. They took the exemption away from the Sierra Club for engaging in political activity about 2 years ago.

Senator ANDERSON. Well, did it not?

Senator BENNETT. Yes, it did, and they took it away. But you say nobody is watching it; at least in that one case they watched it.

Senator GORE. I am not sure that "watched" is the right description there. It was called to their attention by the flare of publicity. Here is one out of perhaps 400,000. I think we have a problem here. I am not sure that I have the correct solution. But at least a start, it seems to me if I may interject at this point, a start would be to put some limit on the time for which tax exemption would be granted.

Now, you describe foundations as having the various purposes, some of which may be charitable, some of which may not. Purposes become entirely out of date.

I was reading in a book the other night that some rich dowager had left her estate to a foundation to build a sanitarium for the protection of needy cats and kittens. Well, maybe they need protection, but we have some hungry children, too.

Anyway, I am diverting here. I am sorry.

Mr. PETERSON. We will make precise recommendations in an area in which I feel we have some competence: much increased auditing of the foundation segment very shortly.

Mr. Chairman, we have thought it was very important to remember something that some of us tend to forget; namely, that foundations exist to support charity. Until we have some idea of the needs of charitable organizations in America, it is very hard for us to see how we can make rational recommendations to you on the role of foundations.

Thus, in our final report, we will present to you our projection of needs of these charitable organizations in the year 1975. We have now about 10 experts in each of those fields attempting to project those needs. I understand you gentlemen have done something similar to this in the field of medicare, in the field of medicaid. I can simply tell you that our original estimates of what the needs of these charitable organizations are going to be in 1975 is so high as to cause us to go back and reexamine them. But it would now appear to us there will probably be a deficit in the range of tens of billions of dollars for these charitable organizations, if we think in terms of projecting current trends of private giving and Government support.

Now, how else might we take a look at what the needs of these charitable organizations are? One approach, gentlemen, was to get interviews with 750 distinguished and informed citizens all the way across America. We talked, for example, to a sample of labor leaders, a sample of presidents and chairmen of major business companies; we talked to religious leaders, to scientists, Nobel Prize winners; we talked to

medical people in medical organizations, others running medical educational institutions. We think we have here a pretty good cross section of the people who do take a lot of the responsibility in this country for the operation of charitable organizations.

We asked these people to tell us what field of charity they felt most knowledgeable in. We then asked them if they would kindly tell us what they thought the needs of these kinds of organizations were going to be over the next 5 years or so. I would like now to report to you what they tell us.

The way we asked them the question was as follows: "Over the next 5 to 10 years, what would you expect to be the trend in the financial needs of the charitable organizations in the section of society about which you know the most? Would you think that the trends are going to go up rapidly over this period, significantly more than the gross national product? Do you expect them to go up about like the gross national product? Do you expect them to stay about the same as they are now, or do you expect them to go down over this next 5- to 10- year period?"

Senator Gore. Could I interrupt?

Mr. Peterson. Yes.

Senator Gore. I am having difficulty seeing the label on this projector. Is that a Kodak or Bell & Howell?

Mr. Peterson. Unfortunately, our company doesn't make transparencies. If you are having trouble seeing, it is obviously a deficiency in the transparencies, and not the equipment.

You will notice that 77 percent of these distinguished citizens told us that they expect the needs of charitable organizations over the next 5 years to go up significantly more rapidly than the gross national product. This is very important, I think, gentlemen, because charitable giving in this country has tended to follow the gross national product pretty closely. About 21 percent said they expect it to go up about like the gross national product and a very small percentage said they expect it to stay about the same.

Senator Anderson. Where are you reading it from? Nobody can see it.

Mr. Peterson. I will show it to you now, gentlemen, by group. I hope you can see that.

We then asked people in each field to tell us how they felt the needs were going up. Here is what the people in medicine said, the people in arts, science, education, and so forth. Two points I would make: In the field of education, 86 percent of these knowledgeable people, as I say, the leaders of our society, felt that the needs would go up much more rapidly in education than the gross national product. Science is a little lower than the rest of them; perhaps they have been chastened a bit by recent funding experience.

In all the heat and furor and anger over foundations, it is easy to miss, I guess, that the recipient is the charitable organization. Thus we also decided to take a careful look at charitable organizations themselves.

Senator Gore. How did you reach the conclusion that charitable organizations are generally the recipients?

Mr. Peterson. We shall show you very shortly, Senator, what foundations do with their money.

What we did, gentlemen, with our limited resources of time and money was to interview about 50 leading charitable organizations in Chicago. These organizations were very cooperative and generous. They gave us 2 to 3 hours, they permitted us to go in and look at their cost records so we could see what their problems were.

Now, you might say that every good charitable organization is also a good fund raiser and you would not expect them to say they did not have financial problems. However, after a look at their books and deficits that some of these major organizations are now experiencing, such as the Chicago Symphony, the YMCA, and the Art Institute, we had considerable faith in their answers.

We said: "Looking ahead to 1975, which of these statements do you lieve comes closest to representing your own situation as a hospital, as a university, as an art museum, et cetera?" The first statement is "to be sure, costs are rising, needs are growing, but I am confident we are going to be able to get the money from our outside needs and contributions"; 17 percent felt that way.

Twenty-six percent said they are concerned, they are not at all sure they can get the money, they think there are going to be some cutbacks necessary. But we are impressed with the fact that 57 percent of Chicago charitable organizations indicate to us that they think they will be facing a budget crisis unless major new sources of money are found.

One might ask how can this possibly be in view of the enormous funds that are being pumped into the charitable and social sector by the Federal Government itself? As a businessman, I should have known this. But what was not clear to me until we had done this study is that the charitable activities of this country, this business of charities, is essentially a people business. Let me show you some numbers: In 1963, 59 percent of the budgets of these charitable organizations were spent on people and people-related expenses. In 1968, for the same institutions, you will notice that they have risen 5 percent as a percentage of the total. This is a striking increase and you might ask: "How did this happen?"

What we did, gentlemen, was to look at salaries of charitable organizations which account, as I have indicated, for the significant majority of their total expenses. Notice here what we find: For example, if you will look at the average production worker in America, you will see that since 1963 the wages rose 23 percent. Now we are looking at salaries of charitable organizations. There is good reason to believe that the salaries are rising at a significantly higher rate than that.

For example, hospital interns, up 81 percent in Chicago since 1963; nurses up 50 percent. We have gone to the universities. Their academic salaries are up 34 percent in 5 years. Social caseworkers, up 42 percent, and so forth. There is no question but there is a great pressure on the salary levels of charitable workers.

Senator MILLER. May I ask a question at that point?

Mr. PETERSON. Yes.

Senator MILLER. Is it not true, however, that there was an abnormal increase in, especially, hospital employees because for so many years they had been so far behind, and that in view of the fact that in the last few years they have come up fairly well to what other related

types services in private industry are we could expect that that would level off from here on out?

Mr. PETERSON. I was just going to make the point, Senator, that part of this, there is no question, there is a catching-up phenomenon. That is what you are saying. In our final report, we intend to show you what their own budget estimates are for the year 1975. As a trustee of the University of Chicago, however, I can say that I can see no current evidence that the pressure, for example, on faculty salaries is now off and that they have caught up.

Senator BYRD. May I ask a question, Mr. Chairman?

Do I interpret this correctly, that 64 cents of each dollar goes—put it this way: For each dollar which an individual contributes to charity 64 percent goes to administrative personnel costs?

Mr. PETERSON. For all people costs, sir, in the charitable institution. To professors, nurses, doctors. In other words, charitable organizations are made up largely of people, only some of them in what you would call administration. The very vast majority of them are case workers, the nurses, the teachers, people actually doing the work of charity.

Senator BYRD. Thank you.

Mr. PETERSON. Now, another thing that we are now trying to study on charitable organizations is this very delicate question of productivity of the charitable organizations. It is a subject that raises both the temperature and the blood pressure, I might say, of charitable organizations. What we seem to be finding is the following: that, in many charitable organizations in America, it is taking more people to serve the same number of people simple because the services are getting more complex, more sophisticated. This is true in hospitals. It is true in universities where they are teaching many more courses. Therefore, the cost per person is going up very substantially, and even when prices to the public have been raised substantially as in hospital room rates, university tuitions, and symphony tickets, these organizations still face a budget crisis.

Now, with all this financial news, we asked these distinguished leaders: "What do you think the national policy should be?"

There are clearly three alternative policies, though this oversimplifies it a bit. One can take the position that the thing to do is to have the Federal Government take on the preponderant part of the load of these charitable organizations and be quite content to have the role of private giving diminish substantially. The second basic policy position is to say the Government is going to have to take a good deal of the load. Frankly, gentlemen, as I look at the financial projections of some of these charitable sectors I do not care what the private incentive system is, it is going to be very difficult to get all the additional money from the private sector. But it is the policy to encourage the private sector to maximize its role. And the third policy, which I do not think many people are supporting, is the policy of letting a significant number of these charitable organizations simply fade or decline.

We asked this question of our distinguished leaders. We find that the vast majority of American of all political parties, all backgrounds, all categories, take the point of view that it would be very unfortunate indeed if charitable organizations got to the point where the pre-

ponderance of their money came from Government sources at the expense of a diminishing private sector.

Now, it is already true that in some fields, such as science, this Government preponderance has already happened. I want to report to you that I think if you were to have talked to these 750 leaders you would see very quickly that most of them, even in science, greatly respect this private sector and want not to see it diminished.

Now, we asked these people "What do you think the tax policy of this country should be? Do you think the tax policy of this country should be as it is? Do you think we should put disincentives into the system? Do you think we should put more incentives into the system?" Here is what happens. 70 percent of these leaders of our country said: "We believe that the policy of the United States should be to further encourage private philanthropy, to increase the incentives that are now given." Only 6 percent, who suggested present incentives should be reduced; that is, that we should not encourage private giving—a significant portion of that small percent are concerned with the problem that I am going to talk about a little later, the question of abuses by some of the people who give the money and we will have some recommendations to make about that.

The CHAIRMAN. Let me get this straight. The people that you are talking about, whose opinion you asked, are those in the foundation field already?

Mr. PETERSON. I am sorry, Mr. Chairman. I did not make this clear. We are not now reporting on what foundations are saying, because I think the place to start this analysis is at the charitable level, not at the foundation level.

The CHAIRMAN. Are you talking about charitable organizations who receive money from foundations?

Mr. PETERSON. Who receive money from the foundations and from the leaders of the country who, incidentally, are people who play a leadership role. For example, people in my position are often on the board of several charitable organizations, and presumably know something about their problem. So, I am now talking at this precise point not to foundations, not to charitable organizations, but to the leaders of the country to find out what they think the policy should be.

The CHAIRMAN. Are not those the people who depend on receiving donations from the foundations?

Mr PETERSON. Charitable organizations are, yes.

The CHAIRMAN. So, to some extent at least, they are prejudiced in favor of foundations?

Mr. PETERSON. But the people I was just talking about, Senator, are not charitable organizations or foundations, they are individuals of the following type: We are taking leaders of labor organizations, presidents and chairmen of businesses in America, Nobel Prize winners, medical prize winners, heads of AMA State organizations, a section of America that I think has interest and knowledge about these private, charitable organizations.

Now, you may argue their prejudice. On the other hand, most of these people are leaders, I think, of our society and we wouldn't know where else to go to get really informed judgments.

Now, another aspect of the private sector that we are looking at is the enormous value of volunteer labor. This is just one of the reasons we think it is so important to preserve this sector. We find in Chicago, for example, a very impressive number of charitable organizations—YWCA, Red Cross, the Girl Scouts, Boy Scouts, Cerebral Palsy group, where if you only put a value of $3 on the volunteer labor that is contributed to that institution, and $3 these days does not buy a great deal in either talent or motivation, we will show you a whole list of charitable organizations in Chicago where the value of that volunteer labor is more than the total personnel budget of the institution.

We think for those reasons, dollars and cents, and for deeply philosophical reasons that lie at the very heart of what makes this country what it is, you should in your tax policy reaffirm your faith in this private sector.

Now, against this broad policy let us evaluate the House bill in terms of what its impact might be on these charitable organizations. I have listened carefully, I hope, to what people tell me about this bill. It goes something like this. We have no intention to hurt charitable organizations at all. All that we are doing is to close loopholes, to broaden the tax base and eliminate special preferences so that the very rich cannot get away with paying a pittance in taxes.

Now, I do not think there is any question that the vast majority of the Americans are very much interested in tax equity and certainly I am. But one of the interesting questions we want to explore with you briefly before we get to the foundation question is what the total effect of this bill is. I use a word in my testimony to describe these effects, a new word I would like to share with you, that I learned from a doctor friend of mine. It is the word "iatrogenic" and I asked him what that means. He said it is a word used in medicine to describe the situation where, in the course of treating a patient, the side effects are more serious, even though unintended, than the original disease that doctor was trying to cure. It comes from the Greek, meaning diseases caused by the doctor.

I think in some ways what we have here in the House bill is a very understandable attempt to do something about tax equity and, in the course of doing that, I think we may see some very significant negative effects on the charitable giving, and therefore on these very precious American institutions.

Now, there is no private commission in America that can tell you gentlemen exactly what these dollar effects are. I can tell you that I have tried very conscientiously at several levels of the Government to try to find out what the effect of each of these House bill provisions is likely to be on charitable giving in America.

As yet, I have been unable to get the answer to that question. And I think the reason is certainly no lack of cooperation but the people in Treasury and elsewhere have been so busy with other aspects of this bill that they have not had the time to make this determination. I would strongly urge anybody in coming to a final decision to be sure he understands what the effects of this bill are on the charitable organizations of this country.

We have made one small effort to get some facts for you on this.

Anybody that has done any fund raising for charitable organizations in America will tell you that some of the key gifts, some of the

large gifts, are enormously important. I do not pretend that what I am going to show reflects the effect of the House bill on all charitable giving but only on those large charitable givers in America.

I would like to describe these men to you that we studied. These are 85 large donors that we got from a variety of sources across the country and if there is any question about their being large donors let me show you what they report having given to charity over the last 5 years on an annual basis. Their median annual giving is $375,000. I must say that this finding is sobering to some of us on the commision. We had not realized what failures we were, how impoverished we were. In my own case I recently made a grant to the University of Chicago, my favorite university, of $25,000 over 5 years. I had not thought that was picayune but there is obviously a group in America who made really large and really decisive contributions. Seventy-four percent of these people that we interviewed had foundations, 82 percent had reached the 30-percent ceiling.

My reasons for going through this is to be sure you understand this is the large giver we are talking about. This is not anything like a cross section of America.

Senator WILLIAMS. Are these cash gifts?

Mr. PETERSON. These are total gifts, Senator, and I will show the form of the gifts shortly.

Senator ANDERSON. Where you did the work, the foundation?

Mr. PETERSON. These are large donors to charity, Senator, large donors to charity. You might be interested that 78 percent of these people had discussed the House bill with their tax advisers and certainly this finding and many others make it clear to me that taxes are very important as part of this philanthropic picture.

Now, what do these big givers in America give?

Senator GORE. So is personal profit.

Mr. PETERSON. So is what?

Senator GORE. So is personal profit a large part of it. When the ordinary citizen gives to his church or his community charity, he digs down in his pocket and gives, but the big professional eleemosynary individuals are improving their cash flow and their cash position.

Mr. PETERSON. Well, I think I will now show you what form they do use for making these good.

Senator GORE. Good.

Mr. PETERSON. For example, 67 percent of the gifts of the large donors is in the form of appreciated property, the most significant class being stocks, bonds, items of that sort; 25 percent is reported as cash. I think we probably made a mistake in our study because some of these people counted in here grants that were made from foundations and what we were trying to really determine was the original gift, not the grant. But 25 percent was reported as cash, 8 percent were future interests.

The main point I am trying to make here is that, in the case of large givers, a very significant part of the giving is not in the form of cash. It is in the form of property of one form or another.

The CHAIRMAN. Let us just be fair about that. A lot of those gifts involve money which they owe the Government anyway, and the Government would have received almost 100 percent if they had not given it.

Mr. PETERSON. It depends when they would have sold it, of course. I am not equipped to——

The CHAIRMAN. In some instances those people actually made a profit. The Government would have collected 105 or 110 percent of what they gave if they had not given it.

Mr. PETERSON. Senator, very shortly we will make some specific recommendations for abuses of this type. They are not covered appropriately, in our opinion, in current legislation. In our view, the people should not make money in the course of giving money to charity. That is our position.

The CHAIRMAN. I am happy to hear that. They ought to give something of their own.

Mr. PETERSON. You will find, I believe, unanimity on this.

Senator WILLIAMS. How near do you think they should break even?

Mr. PETERSON. This discussion could take me a long, long way.

Senator GORE. All of this illustrates, it seems to me, that the average citizen who is genuinely charitable he must comply with a tax law that gives him a deduction from taxable income, a fair system of taxation. But for the large donor, there are unfair provisions of law which give him a chance to make a profit out of charity.

Mr. PETERSON. Sir, I would like to repeat, we do not believe that people should make a profit out of charity and we will have some specific recommendations on that score.

Senator GORE. Well, I think a majority of this—well, I cannot speak for a majority. At least, there is one member of this committee who is dedicated to taking profit out of charity and that is not uncharitable.

Senator MILLER. Mr. Chairman, may I ask a question at this point? You have given us a result of a survey of 85 large donors?

Mr. PETERSON. That is right.

Senator MILLER. When we were discussing the problem of the unlimited charitable-contribution deduction, our staff advised us that, out of some 154 of the very large income people who paid no income tax, that 52 of that total had traced their position to the unlimited charitable-contribution deduction. So, my question would be, do you know how many of those 85 relied upon the unlimited deduction?

Mr. PETERSON. Yes, I am sorry I went over it very quickly. Of the 85, 13 percent of this 85 are qualifying for or have qualified for the unlimited deduction; 86 percent have not qualified of the group I am now ——

Senator BENNETT. That is 12 people?

Mr. PETERSON. That is right, out of the 85. Who did not qualify. The vast majority of these did not qualify. However, if you will look here, 82 percent of this group did reach the 30-percent ceiling.

Now, where did these big givers give money? And again, I have to emphasize they may not be representative but we think they are important. Higher education got 45 percent of the money from these particular people; 12 percent to welfare, social community services; hospitals got about 10 percent. There is probably some overlap between higher education and hospitals because of university affiliations. Cultural institutions got 10 percent. Education other than higher education, seven, et cetera. It is very interesting to see that the patterns of the large giver, I think it is fair to say, are quite different from the patterns of the population as a whole. For example, if you

were to look at charitable giving in America, roughly 50 percent of all charitable giving goes to religious organizations and churches, but of the large donor you will notice here that only 5 percent of their gifts go to religious activity. A much higher proportion goes to higher education.

Senator CURTIS. Mr. Peterson, what percent of that 45 percent goes to institutions that are operated by churches?

Mr. PETERSON. You mean higher education institutions?

Senator CURTIS. Yes.

Mr. PETERSON. I am not sure we asked that question, but I think I would guess it would be not too large a number. We did not ask the question that way. We simply said: "What is the kind of institution you gave it to?"

Senator CURTIS. In your native State of Nebraska, church colleges carry 30 percent of the load of higher education and that might—some of those 85 people have money in it.

Mr. PETERSON. I can only guess, Senator, because the categories in our study were "church or religious affiliated," and "higher education" that there is some in both categories. I just cannot separate it out for you. But the point I am trying to make is that a smaller portion of the large-giver giving goes to churches than is true of society as a whole.

Senator CURTIS. Did you say you were on a hospital board or two?

Mr. PETERSON. I am on the board of the University of Chicago, which has a hospital, yes.

Senator CURTIS. Could hospitals stand a 5-percent cut in receipts?

Mr. PETERSON. We asked these institutions, Senator, what would happen to them if their private giving were reduced 25 percent. Approximately 82 percent of them reported either a budget crisis or, perhaps a little melodramatically, that they would go out of existence. It is clear that the private giving is vitally important to virtually all of these institutions.

Senator GORE. Why is it that foundations are not listed on the chart you just took off there?

Mr. PETERSON. Senator, the purpose of this study was to show the charitable organization that was the recipients of the gifts, where they made the gifts to the charitable organization directly.

Senator BENNETT. The end recipient.

Mr. PETERSON. The end of the process, in other words, the institutions that get the money. This is intended to show the recipients.

Senator GORE. In other words, this chart is not to show who gave the gift and for what purpose, but who got it and for what purpose.

Mr. PETERSON. Who got the money from these large givers. Where does this money flow.

Senator MILLER. In other words, what you are saying here is that this chart has nothing to do with foundations at all because if there were any foundations giving to higher education, and, of course, there were, they are not included in these 85 large donors.

Mr. PETERSON. This was intended to focus on the gifts essentially, Senator, and I am going to come to foundations very shortly.

Senator MILLER. If a large donor gave to a foundation which in turn gave to higher education, that is not in here?

Mr. PETERSON. I think in most cases that probably would not be here.

The CHAIRMAN. If I might just suggest, I am as bad an offender as anybody at this table, but I think we ought to let Mr. Peterson go ahead and make his presentation in chief, because some of the questions, I think will be answered in the course of the presentation.

Mr. PETERSON. I think so. I hope so, anyway. Members of your staff, Mr. Vail and others, who, incidentally, were terribly helpful to us in posing questions we should look at.

Senator TALMADGE. Will you yield at this point? In your testimony here, these 85 largest donors, you state that 69 percent currently give through their own family foundation.

Mr. PETERSON. That is right, sir.

Senator TALMADGE. I presume, then, that this money first flowed to the foundation and then from the foundation to the ultimate recipient. Is that correct?

Mr. PETERSON. Could I answer that question shortly by referring to my staff member, who is here, who did the analysis and I will have him tell me the answer to that question very shortly.

Now, something that your staff was very much interested in was what the importance is of tax benefits on charitable giving. Is it important to large givers to get tax benefits? We asked the question, "If there were no tax benefits at all; that is, if you gave money to charitable organizations out of your after tax income, what effect would this have on your charitable giving?"

Now, this is obviously a statement of their opinion of the effect on their giving. I will show you some facts shortly. But the median effect was a reduction of 75 percent. They said without tax incentives their giving would go down 75 percent.

Only 4 percent of the large givers said there would be no reduction at all if there were no tax incentive at all. This chart shows you the range of estimated reduction in giving and the middle point is about in here or reduction of 75 percent.

We then went to these big givers and to get some harder facts. We said: "We would like you to take the House bill. We would like you to imagine that your income is the same as last year, that your charitable giving is the same as last year What is the effect on your taxes?" A fair number of the people who answered this question actually had their tax people make the computation. The median increase in taxes of these large givers under the House bill, if their contributions remain the same, if their income remains the same, if their distribution among various kinds of income remains the same, the median increase in their taxes would have been 25 percent.

Senator GORE. Have you got the median effective rate of these same donors?

Mr. PETERSON. Senator, when I say that a private commission works under certain limitations that is one of them. We thought we were being a little presumptuous maybe even to ask them to compute what the increase was. We do not have subpena powers obviously. We did not see their tax return, and I do not know what their tax rate was.

Senator GORE. You might be interested to know that the committee in executive session has had information to show that the median effective rate paid by taxpayers with over $1 million annual income is less than 30 percent, a lesser effective rate than is paid by many salaried persons making only a fraction of that amount.

Mr. PETERSON. We then said to these people. "Now that you have a feel of the effect of the House bill on your taxes, what do you feel will be the effect of this bill, if any, on your level of charitable giving?"

This is clearly an opinion, gentlemen. I am not presenting this as a fact. None of us could possibly tell you what they are in fact going to do. But what I am trying to report is that these large givers reported their charitable giving will be reduced by 50 percent. Three percent told us they thought their giving would go up or remain the same. Seven said it would remain the same, but the vast majority of the people indicated they will reduce their charitable gifts if this bill were to go into effect.

Now, what are the provisions of the bill that, on these people, had the largest effect on their charitable giving? Gentlemen, there is no way without a computer and without looking at their tax returns that we can answer that question precisely. We can tell you what appeared to be the important provisions of this bill in affecting gifts. The most important as you can see by this chart, by a significant margin, was the allocation of the deductions provision.

Second was the limit on tax preferences followed by this particular set of categories.

Another comment I would want to make about this bill for your judgment and considerations is the complexity of the calculations. We had a number of these people tell us that, in order to calculate the tax, it was necessary to solve several simultaneous equations simultaneously. Several of them thought they might need computer help in order to determine the effect of this bill on them. Edward Levi, the president of the University of Chicago, is on our commission. Edward is a brilliant man. He is a man that also has to raise money for the university. Edward pointed out to the commission that it is hard for some to believe that for most people it is kind of difficult to make a gift. It is a difficult decision because in a significant majority of the cases the donor does end up with less money. Mr. Levi and other people in hospitals and universities we have talked to are concerned about a bill that gives the donor a series of new excuses for waiting until he determines whether to make a gift. For example, under the House bill, I think it is true that a fair number of people would not know what their effective tax rate was until the latter part of the year.

I think I should simply say that there is a strong feeling of great complexity in the computations that are required with this bill.

This commission would not want to take the position, I know I would not, that one should encourage charitable giving to the point that there are strong inequities in the giving. On the one hand, we think this would be a very inappropriate time for the leaders of this country to be saying to the citizens of the United States that you do not want to strongly encourage private giving. I think it would be a serious problem if that was what the American people thought this bill meant. Incidentally, 92 percent of our distinguished citizens who were familiar with the bill think this bill discourages private giving.

Now, we think there are at least three specific areas where this can happen and we would recommend specific surgical legislation that aims at those specific abuses.

First, we think it is very obvious that as long as a significant portion of the giving is in the form of appreciated property, and particularly

with so-called bargain-sales provisions, an overevaluation of the appreciated property can result in the effect that the person clearly ends up with more money as a result of having given something away than by having sold it or even kept it. You will note, I think, that in the case of art in this country, big pieces of art, techniques have been developed for the independent appraisal of the true value of the property. We would urge that the legislation should carry with it requirements of objective appraisals quickly verified and validated on any significant appreciated property contributions where there is any question as to its value.

We think there is a potential here for abuse, and may I add that a charitable organization is unlikely to report that abuse for the simple reason, if I can be a bit crude about it, that one rarely bites the hand that feeds him. I do not think we could expect logically that charitable organizations, if a donor overvalues a gift, will report that. I think it is very important that procedures be set up to prohibit the overevaluation of appreciated property.

Second, we think there are situations, our tax experts tell us, where the donor has fully depreciated what he is giving away and which would have produced ordinary income—I think that is the case, Senator, you are probably talking about—and, therefore, the donor can improve his after-tax position by giving something away. We believe that such efforts should be dealt with in this legislation. We see examples, for example, where somebody has already written off the cost of the item he is giving away. I refer to farm products, for example, where he has already taken a deduction for the expense of growing that product. Then, if he gives the product away, he gets the deduction for the full market value. I do not think there is any question but that that can be specifically handled.

Finally, there is a third category of what I would call moneymaking from charity. This is the case where, for example, a company makes a product. It is a very low cost product in relation to its sales. In this category, for example, might be items like drugs, items like certain categories of equipment. For example, if you are making a product where the cost of goods sold is 10 percent of the value and you give it away, and get a 50-percent deduction for it, it is clear that you can end up with significantly more money after you have given it away than had you not made a gift.

We think rather than a bill that lumps all charitable contributions in this moneymaking class, and in so doing I am told by experts have a very significant negative effect on charitable giving, that perhaps another approach you might consider is to define those cases where people make money off charity and specifically prohibit that kind of abuse.

Our final recommendation on broad tax policy—we have made two. One, that we would urge you to consider getting detailed estimates of the effect of the House bill on charitable giving. We have been unable to get official estimates. Leading tax experts tell us that they could be very significant.

Second, that you prescribe those cases where people can make money off of charity and specifically, surgically, eliminate those.

Our third recommendation is a longer term recommendation but I think we should make it anyway even though you cannot deal with it now.

Senator MILLER. Mr. Chairman, I do not think that Mr. Peterson has covered this point. I would like to clarify the chart which shows the percent of donors who are concerned about various provisions in the House bill. One of those provisions, which I have heard a lot of complaint about, provided in the case of a gift of appreciated-value property, that the donor would have to make up his mind whether to take only a deduction for his low basis or, if he took the deduction on the fair-market value, that he would have to report the appreciation of capital gains. I do not find that phase of the House bill in this chart.

Mr. PETERSON. Senator, thought I am both a nonlawyer and a nontax expert and those are not very good qualifications for doing this job, I believe that provision you refer to applies only to foundations where appreciated property given to foundations must be either considered at cost or after the taxes are paid on the appreciation. But I do not believe that is the case on charitable gifts generally. Am I right on that or not? That is my impression.

Senator MILLER. Thank you.

Mr. PETERSON. In the material that will be in your written report, we asked these citizens of this country to tell us what they thought the total effect of this tax bill would be on private giving. Sixty-one percent of these people thought they knew enough to have opinion. These interviews were completed in August and early September. The bill, you recall, was reported out, I believe, in early August. Ninety-two percent of these distinguished people—these are not big givers, now, this is the leadership segment of the country—92 percent of those people felt that this House bill discouraged private philanthropy. That was its total effect, to discourage it.

We have demonstrated most people would like to encourage private giving and we would suggest that you give consideration to the following concept. It is not something you can do in time for this bill but we think most Americans would like to see a new kind of tax incentive for private giving that meets the following four criteria.

First, one that provides significantly more money for charity in the range of several billion dollars more. I think there is no question that the seventies are going to be a period of great crisis for charitable organizations and, if we want to preserve the position of the private sector, we will need to greatly accelerate private giving.

Second, a tax incentive that is equitable, that is not a device a few can use to avoid paying any taxes.

Third, a tax movement that spreads the giving among people more. There is no question, gentlemen, that the wealthy are the people who, by definition, will make large gifts and they obviously need to be encouraged to make large gifts. On the other hand, we think an ideal tax incentive for philanthropy would be one that would encourage more people to make gifts than are making significant gifts at the present time. I say this not only because it will produce more money. I say this philosophically. I think the more people in America who make charitable gifts and who participate in how these decisions are made, the better off we are going to be. And while we currently de-

pend very heavily on a few wealthy people, I think we should try to figure out ways of broadening that base.

Four, that we should do this at the lowest possible cost to the Federal Government consistent with these guidelines.

In the course of our commission efforts, gentlemen, we have reviewed with tax economists, tax lawyers, I think the best ones in the country, this general need for a new tax approach. They have reported the following to us:

First, that very little attention has been given in tax circles to really new tax-incentive approaches to charitable giving. I think it is fair to say that very little thought in this particular bill was given to incentives. For example, the raising of the deduction, of the limit on charitable giving, from 30 to 50 percent, in our studies, at least, is not likely to have a large effect because of the other provisions of the bill.

Secondly, much of the data that is needed to develop that kind of tax incentive is simply not available anywhere except in the Government where the Treasury has it.

Thus, every expert we have talked to about tax incentives to philanthropy is not satisfied with the current system, and believes that a better system of tax incentives for private philanthropy can be developed that meets these criteria. It is clear that this is not something that is going to be done in the next days or weeks. We simply would urge Congress and the administration to come up with a really new set of approaches to philanthropic giving.

Among the criteria we suggest for a better system of tax incentives is not only one that takes the moneymaking out of charity but one that spreads the giving across more people in the country. Tax experts tell us they think such a system could be evolved if it were assigned to them as a very specific assignment.

Senator GORE. Well, in view of your statement that without tax incentives they would cut back their charity by 75 percent, can you think of any way other than tax that we can really stimulate charity?

Mr. PETERSON. No, I am saying, sir, it clearly has to be a tax incentive. It is our feeling that a better tax-incentive system can be developed that not only produces more money in total but does spread the giving more among more people. That is not something that we have a specific recommendation on at this time.

Senator GORE. My question is, is there not some way to motivate charity other than tax reduction? It seems to me that there should be a matching system or some way other than tax gimmicks to stimulate charity.

Mr. PETERSON. Of course, Senator, the words "tax gimmicks" mean different things to different people.

Senator GORE. I know.

Mr. PETERSON. We have already defined one of the problems as one where people make money out of charity and that is something we would propose your doing something specific about and which I think is in the distinct minority. You still have the situation today, do you not, where most people share in the giving, that is, the Government gives some and the person gives some. And all I am reporting to you is that of 10 top tax economists we have talked to, they are unanimous in feeling that a better system can be evolved than the one we have now

and we would urge that this be given very systematic attention in time for action perhaps next year.

The CHAIRMAN. The kind of thing you are talking about is making it more attractive for people in the middle-income brackets, particularly upper-middle-income brackets, to donate money to charity. Is that the kind of thing you are talking about?

Mr. PETERSON. Yes. For example—and this may seem a little self-serving, I hope not—there is a group of people in this country who do have significant incomes but it tends to be earned income rather than income from other sources. One might be able to imagine an incentive system that makes it attractive for those people as well. I am not prepared to indicate what that specific system is. I think it is an assignment that is indeed worthy of tax reform.

Senator CURTIS. Mr. Chairman, may I make a point? This bill, features that have not been mentioned, destroys that very thing. I know a great many people of very modest income that give generously to things, and they are going to be put at a great disadvantage under this bill. And it is through standard deduction and the problem is accentuated by allowing a minimum standard deduction and now the minimum standard deduction in this House bill is increased, and you can have a situation where someone, probably in about the $7,000 to $14,000-a-year income, a person who gives generously to his church, to the Red Cross, to the United Givers Fund, gives a few hundred dollars to his alma mater, will not get 1 cent of tax incentive because the individual who does not support anybody can take the standard deduction plus the minimum standard deduction and have his taxes reduced by an equal amount.

Mr. PETERSON. I would include that, Senator, in my recommendation of an in-depth appraisal of the effects of this bill on charitable giving. I can only tell you that 92 percent of the leaders of the country who do talk to people think that this bill is a disincentive to charitable giving. Most of the tax counsel on our commission, and we think we have got some very good ones, tell us that by any standard this bill is antiphilanthrophic in its total effect and, rather than simply make a general statement to that, I think all I can suggest is that you get in-depth studies of what those effects might be. I do not think many people intended that effect. I certainly do not think the country wants that effect. I certainly do not think the country wants that effect and I am simply suggesting that it be reviewed in detail.

Senator WILLIAMS. Mr. Peterson, may I just make one point. Earlier in your statement you placed great emphasis, very properly, upon one phase of charitable work which is done by the volunteers of the various organizations. You mentioned several of them.

Now, is it not a fact that they are not in any way affected by the bill? They are voluntary charitable contributions made through their work giving their services on a basis that they want to do something for charity?

Mr. PETERSON. That is right.

Senator WILLIAMS. And it is really that type of charity which we are referring to and this bill only affects those who are giving charity on the basis of the tax incentive. Those who are really charitably motivated are not in any way affected by the bill.

Mr. PETERSON. Senator, I think the discussion of mixed motives and incentives would take us all day to cover. I do not think there is any question that tax incentives in our system are a very important part of giving. It is a part of our whole system. And personally I think in many ways it is a pretty good system. All I am suggesting is that you study what the effects of this will be on giving with the experience and data that must reside in the Treasury and elsewhere.

Senator WILLIAMS. I agree that we need some tax incentives. I am not speaking against that. But I am just pointing out as you did earlier, that much of the charitable work is done by those who do not get the benefit of any tax incentive.

Mr. PETERSON. That is right.

Senator WILLIAMS. While we may need tax incentive in the law, we do want to guard against moving off to the point where it stops being charity and becomes rather a self-serving device.

Mr. PETERSON. I hope I have commented sufficiently on that to indicate my agreement.

Senator WILLIAMS. Thank you.

Mr. PETERSON. Now, can I move on to foundations?

The CHAIRMAN. Might I say that I will let you ask a——

Senator MILLER. May I?

The CHAIRMAN. I will let you ask a question but this witness is going to have to accelerate this statement. We are just getting to foundations and the witness is about one-third the way through his statement in chief and we had hoped to have time to ask some questions in closed session that might be of a confidential matter.

Senator WILLIAMS. I think the questions could be asked in open session and I would want to ask my questions and get the answers publicly.

The CHAIRMAN. That is perfectly all right but there are a few things that this witness can tell you in confidence that he cannot tell you in open session. I would suggest that we accelerate this matter because if each of us keeps interrogating the witness before he tells us what he wants to say here, we might never hear it.

Mr. PETERSON. All right. Let me move on now to foundations and our studies there.

First of all, I have said there is no accepted definition of a foundation. This is simply a sample of the list of foundations as defined by the Treasury. Some of you have been interested in where the foundations are located in America.

It is true as this chart shows that there is a higher proportion in the East and Northeast sections of America than is true otherwise.

The first bar on the chart shows you the percent of population in each region and the second bar shows you the percent of the foundations.

Notice, for example, that New York has 9 percent of the population and 22 percent of the foundations. New England has 5.7 percent of the population and 9.9 percent of the foundations.

On the other hand, in other sections of the country, a number of Southern States, for example, there is a somewhat lower proportion of foundations to population.

We think there are many reasons for this but one of the reasons is that some of the older wealth, the businesses that have been established

the longest have been established in the East and we would expect to see this trend change.

We also tried to find out, gentlemen, how many of the foundations operate regionally in their efforts and how many operate nationally.

Let me tell you the various kinds of foundations that we covered in our field study, which I should emphasize is not yet complete. We covered various sizes of foundations because there is no question as we look at the evidence that patterns, giving and operating patterns, vary significantly depending upon the size of the foundation.

We have analyzed separately foundations under $1 million in assets, $1 to $10 million, $10 to $100 million, over $100 million in assets. Also, we show company foundations separately. I do not wish to confuse these with a foundation on which a donor has put company control stock. This is a foundation that companies use for the company's giving.

The reasons companies set up foundations are several. Many companies in America today have decided to give a certain percentage of their earnings over a period of time. One of the advantages of a foundation to them, gentlemen, is that it permits them to even out their charitable contributions. In a good year they put in more and in a not so good year they put in less. They also put appreciated property in the foundation.

The community foundation is another type—I do not know how many of you are aware of those. They are not well known, though they are quite an interesting institution to us. These are foundations that usually have public trustees on them. The trustees are often appointed by political officials. The mayor may appoint one, for example. They are located in major cities. Often the bar association will appoint a trustee—the head of a university, et cetera.

Now, what is the geographical focus of foundations? We asked these foundations that we interviewed, "Do you essentially make grants in a city? In a State? In your region? Are you national or what?" You will notice here that about 61 percent of the foundations could be categorized as being regional or local. That is, they give the vast majority of their money to local areas. Towns, 43 percent. State, 9 percent. Regions, 9 percent.

About 21 percent of the foundations are what you might call nationally oriented. That is, they give their money across the entire country but they do not give it internationally. About 9 percent of the foundations in America give their money both nationally and internationally and a small percentage, 6 percent, give their money for international purposes alone.

Now, what do foundations give their money for? What is the kind of organization that gets the money from foundations?

The reason we thought it was terribly important to get this for you is there has been a great deal of concern about the amount of foundation money going to individuals, money going to international organizations, and we wanted to get from these foundations where and who got the grants.

Now, these numbers, I should tell you, have to be weighted very importantly by the assets of the foundation because the foundation movement, as you have heard before, is characterized by a good deal of concentration. Too much of the previous data on foundations has

been done on the basis of numbers of foundations rather than in terms of dollars of grants. Of all the grants made in America, according to our studies, here is where the money goes in terms of the category of recipient.

You will see that 74 percent of the foundation dollars go to so-called 30 percent public charity organizations. Nineteen percent of the money goes to other qualified charitable organizations. Thus, 93 percent of foundation money goes to a qualified charitable organization. Five percent of the money goes to individuals. About 1 percent goes to foreign organizations. And 1 percent goes to tax exempt, for profit, and other kinds of institutions.

Now, this is rather interesting because in terms of the reasons for setting up a foundation, I believe you know that foundations can make grants that individuals cannot make. Foundations can make grants to individuals. They can make grants to international purposes. They can make grants to other tax-exempt organizations.

What I think this tells you is that the very substantial majority of the money goes for purposes to which an individual could also have given and, therefore, this wider grant authority that foundations have is not something that is widely used. Ninety-three percent of the money that foundations give, in other words, goes to qualified organizations that individuals can also give to and get a deduction.

Another reason foundations are set up is that they can have a staff to give them more expertise in giving. An individual cannot do that currently.

Now, let us look at the sizes of the staff of foundations of various types. You will notice here something that surprised us, that a significent percentage of the foundations do not have any professional staff. That is, the donor, someone closely related to the donor, is the essential person involved. In 84 percent of the foundations we studied there was no professional staff.

You notice here that 11 percent had a part-time professional staff and only 5 percent of the foundations interviewed in our study have full-time professional staff.

You can appreciate that this is importantly a function of the size of the foundation. Ninety-three percent of the big foundations have a staff. But rather surprisingly, only 42 percent of the foundations between $10 million and $100 million assets have full-time professional staffs.

In our final reports we are going to be able to tell you, we hope, the number of people on the staffs of foundations. I would have to say that it is likely to be a surprisingly small number. I would guess that it numbers in the very low thousands across the entire country.

Another reason given for people setting up foundations, of course, is that they can even out their gifts between bad years and good years and we have evidence that in practice this is important to some.

Still another reason for setting up a foundation is to insulate people from the charitable organization. Many companies receive almost unlimited numbers of requests to give. For example, at Bell & Howell, I suppose we feel rather offended if we do not receive eight or 10 letters a day asking for money.

I think the honest thing to say is that another purpose a foundation fills is to act as a kind of a buffer between the giver and the recipient

and indicate that the "foundation will look into this matter and review it."

We think, however, that one of the more important reasons for setting up a foundation has to do with the desire to perpetuate the owner's name and his charitable interests at his death.

Finally, I think it would be fair to say that one of the very attractive features of the use of the foundation is in some way to enable the donor to have his cake, as it were, and to eat it, too. By that I mean while on the one hand having given a gift to charity and received a deduction, he maintains some control over what happens to that gift.

Now, I am not one, frankly, that believes it is appropriate to speculate unduly on the motives of people for giving because there are obviously many motives and they are mixed. I think rather we should focus, which is what I intend to do, on the more objective question of what charity and society gets. So, if I may elaborate on the appeal of having your cake and eating it, too, I think, on the one hand, if we take away this opportunity there will simply be significant numbers of donors who will not make the cake available to society.

On the other hand, I think it is very fair for the public to ask that the society get their share of the cake. One of our recommendations deals with this subject.

Now, what is the form of giving to foundations? You will recall that the House bill excludes appreciated property except on the basis, Senator, that I mentioned. It also has some very important restrictions on the giving of stock in companies where there is in effect a control provision that amounts to about 20 percent in total. I think as you evaluate those provisions it would be helpful to you to know what form contributions have been made to foundations.

Now this shows you the form of contributions to foundations. Tangible appreciated property which, of course, deals with works of art, personal objects of various kinds, is a very small percentage of the total. Intangible stocks, appreciated property, are clearly a very important part of the giving of foundations, about 80 percent of the total. You can see that in every category of foundations that we studied, appreciated property is very significant.

What I am trying to indicate is that any provision that puts appreciated property in a different category as far as foundations are concerned could be expected to have a very serious effect on the formation of new foundations.

The finding that in some ways has surprised us a good deal in our study is to see how important, particularly in the large foundations, contributions of stock are in companies in which the donor or the family has a controlling interest. In the past, gentlemen, much of this information has been reported in terms of percentages of foundations having control stock and not in percentage of assets. As this study makes very clear, it tends to be the very largest foundations which get a very important part of their money from this kind of stock.

Notice, for example, the Ford Foundation. We have the permission of the Ford Foundation, in view of your deep interest in that foundation, to report these findings separately to you. Ninety percent of their contribution came from company-control stock; 48 percent of the over $100 million foundations came from that kind of situation. Of all the foundations over $100 million, you will notice that 62 percent of those

particular foundations, the contribution came in that form. Notice in the foundations between $10 and $100 million; 75 percent of the original contribution was in control stocks. So there is no question but that in terms of total assets going into foundations, company stock in this form is one very important part.

We do not show it here, but in total it is about 53 percent of the total contributions; 53 percent of all of the contributions to foundations in their original form was in the form of control stock.

I, therefore, suggest to you that if the provisions in the House bill on the one hand deal with restrictions of gifts of any appreciated property and, on the other hand, restrictions on company control stock, that the practical effect of the legislation will be to, in very substantial ways, reduce the contributions that go into foundations since those are clearly the major sources of the money to foundations.

You can see the pattern of cash contributions. In the case of the smaller foundations cash is more important. Stocks are still quite important; 40 percent of the small foundations, for example, use appreciated property in the form of stocks. And even here 18 percent of them are company control situations.

So, what we are trying to report to you is that across every category of foundation, regardless of size, the substantial majority of the contributions are either in the form of appreciated property of company control stock and, therefore, those two provisions will have a very significant negative effect.

Now, we have told you about the company control stock in terms of percentage of contributions. We would now like to report this data to you differently.

First, how many of the foundations ever had company control stock and how many of the foundations today have company control stock? You can see once again what is happening. In this column we show the percentage of foundations by size that have company control stock in them. You can see that for the smaller foundation the number is much smaller but as you look at the larger foundations, 57 percent of the over $100 million foundations had stock in them that was control stock.

If you look at where it sits today, you can see there has been some reduction on those percentages. But even today for the two size categories of large foundations over $10 million, 39 and 36 percent of those foundations still own 20 percent or more of the stock in companies. In terms of total current assets it is clear it is still a significant percentage of the total.

I think I would like now to talk very briefly about a problem we grappled with which is how do you go about assessing the contribution of foundations? You have heard a great deal of testimony here on the contributions of foundations and I will not elaborate on that because I know you know there are many, many such contributions. But we are a private citizens group who saw our mission as trying to come up with an objective appraisal. I think I would have to say it is one of the world's most difficult tasks because an objective appraisal of what the contribution of foundations it would require that, on the one hand, a person would have an idea of what would have happened with that money if it had been given directly by the donor or if the Government on the other hand, had supported it

through the tax dollar, it is not clear to me how we, at least, could make that kind of an analysis.

So, what we have tried to do in our study is to do two things.

First, to go to our distinguished leaders in various fields who presumably are aware of what happens in those fields—the 750 men that we interviewed, scientists, artists, people in medicine—and get their report on what they thought the overall contributions were. Members of your staff were interested in finding do the people in these fields feel that we would be better off with foundations or would we be better off just letting people give the money directly.

The 750 people who are in these various fields, not donors, not charitable organizations, but the people in the field, were asked this question:

"In your view is our society better off with foundations or would it be better off if they did not exist and all private charity went directly from the giver to the recipient?"

I can simply report to you that of the 750 distinguished citizens that we interviewed, 95 percent said we would be better off with foundations rather than giving the money directly, a truly preponderant percentage of the leadership of country. We wanted to be sure to find out if they knew what they were talking about so we said in our written questionnaire to them, "Could you give us examples of contributions in your field that represent significant developments?"

We found that about 81 percent of these people in a written questionnaire were able to identify contributions from their field.

We then said, "Will you kindly give us the following rating of foundations in your field of specialty, scientists, doctors, artists, educators, et cetera."

We gave them their choice of five ways of rating the contributions of foundations. First, that they played a very significant role. Without them, some very important things would not have happened. That they have played a positive role. They have tended to support——

Senator MILLER. On that point there, do I read this correctly, that first one, or at least "would not have been delayed."

Mr. PETERSON. I marked that out. That is a typographical error. It should have said the development "would have been delayed" without foundation contributions. I am sorry, Senator.

The second category, they played a positive role, they supported worthwhile projects. On balance they have been worthwhile.

The third is a mixed one. You know, some good things, some not so good things, some significant, et cetera.

Finally, very little contribution in my field, and last, that foundations played a negative role. In short, our field would be better off without them.

We tried to present this matter fairly so they could pick whatever they thought was the appropriate rating of foundations in their field. Here are the results of that study; 85 percent of the distinguished leaders, citizens, said something quite positive, with 60 percent of the distinguished citizens telling us they felt foundations had played a significant role in their field.

Those thinking they played a negative role is 1 percent of the people. Those saying they have not made much difference in our society are 2 percent. Those saying it is good and bad, it is spotty, I am not sure,

is 12 percent. But I think it is fair to say that about 85 percent of the distinguished citizens in the country do feel that they have made a significant contribution.

Now, I would like to move on to this appraisal field by field. In other words, we asked the experts in medicine, the experts in the arts, how they felt. You will notice that in all fields, medicine, in the arts, and education and other fields, a substantial majority felt foundations had made a significant development in that field.

In the field of science you will notice that significantly fewer felt that way about foundation contributions; 43 percent felt foundations had made a significant contribution. We would speculate that perhaps one of the reasons for this is that, in the last 10 years or so, a very high amount of Government funding has gone into the scientific arena.

Now, let us talk about what the roles of foundations might be in our society. I thought you might be interested in what these distinguished citizens told us they thought the role should be, particularly with regard to the Government. These citizens are intelligent people. They are aware of the fact that the Government is playing an increasing role and the question we asked them was, "What do you think the roles of foundations, if any, should be with regard to Government programs in these fields?"

What we observe here is the following. About 18 percent said we think foundations should be a partner of the Government and cooperate very closely, almost on joint programs, 25 percent said we think they should cooperate but still be quite autonomous.

Very interesting I think is the preponderant number of these people feel that a significant role of foundations should be to carve out new areas that later might receive public support. There is a pretty widespread feeling, I would say, in the country that the Government is now ideally suited for doing some of these kinds of work; 20 percent said that foundations should act as evaluators and critics of government programs since in many cases they are at least concerned as to whether these programs are being evaluated and, of course, this segment talks about support of the private philanthropic sector.

Now, let us tell you what our commission has concluded about possible roles of foundations vis-a-vis Government programs because in most areas the Government expenditures are much larger, much, much larger than the foundation expenditures.

The first conclusion that we reach about Government programs is that it is much easier, we believe, for a private institution, a foundation being one of them, to carry out experiments, even noncontroversial ones, than it is for the Government. We have looked at cases where experiments have been tried in the Government and there certainly have been some. We are impressed with the fact, gentlemen, that there are certain aspects of experimental programs in Government that may not be the ideal atmosphere for such experiments. Fore example, it is quite possible that if the experiment has early negative results it will be killed very promptly.

On the other hand, we know that political administrations have a way of not lasting over a long period of time. The administration in power is impatient to get ahead, to make a record. If the experiment in reality takes 5, 6, 7 years before one knows whether it works, there

is at least a question we have as to whether the Government will wait in some cases for that.

You gentlemen are much better informed than I am of the great tendency in Government programs to want to move them out into the districts very, very rapidly. In some cases perhaps before anybody really knows whether they have or have not been effective.

Senator MILLER. On that point, Mr. Peterson, you said that a great many of them do not think that the foundations should get into innovative areas which may later receive public support.

Mr. PETERSON. Yes.

Senator MILLER. But you would not conclude from that, I suppose, that they should get into areas which are contrary to a public policy announced by Congress. Granted that the public policy announced by Congress may change later on at a particular time——

Mr. PETERSON. Is that another way of saying foundations should not engage in illegal activities, for example, like certain political activities?

Senator MILLER. Well, that is not illegal. But if Congress has, for example, voted against a certain program, demonstrated they are opposed to it as a matter of public policy, then are you suggesting foundations should be permitted to get the tax deductions and go ahead and—tax exemptions to go ahead and pursue that policy?

Mr. PETERSON. Well, of course, that is a much broader question, as you know, Senator, because in the entire private charitable sector in America, the foundation is clearly a small part of that total picture. I think the identical question should be asked about the total charitable sector of America and whether it should engage in programs that are or are not consistent with a national policy.

Senator MILLER. Precisely.

Mr. PETERSON. This is a personal opinion that you may not agree with. In my view, one of the great strengths of the private sector is its freedom, is its ability to engage in programs that it believes are important. My answer to your question, therefore, would be that unless something is specifically prohibited or illegal, which in the area of foundations, I think you would agree certain kinds of partisan activity are not charitable activity, my bias would be in the direction of giving these institutions the freedom to perform the kinds of activities that they think are in the public interest.

Senator MILLER. Is it not anomalous, Mr. Peterson, to have the Congress and taxpayer in general keep money from going into the Treasury through the tax exemption and then turn around and say go ahead and use that tax-exempt money for purposes which Congress itself has indicated are contrary to public policy?

Mr. PETERSON. Would it be fair, though, Senator, to suggest that the logical extension of that reasoning would be perhaps to have all the money flow through some public mechanism and allocate the money the way the Congress thinks it should be allocated?

Senator MILLER. No. I do not think that follows. I am troubled by having Congress legislate over here against something and then turn around and letting a private foundation through the tax-exempt process, spend the money for something contrary to what Congress has already decided.

Mr. PETERSON. Can you give me an example?

The CHAIRMAN. Gentlemen, we cannot be debating all this. I would like to know what the witness wants to recommend here on behalf of his commission and with all due deference to the gentleman, he will make it known what he recommends to us and we will find that out for a certainty.

Mr. PETERSON. I think in the interests of time, Mr. Chairman, you have my written statement. We think there are many areas of our society where there are very important roles for foundations where the Government is unlikely to act with leadership or perhaps objectives. I spell these out in our testimony.

Now let me move on to the regulation of foundations which I know is a subject of great interest to you.

It seems to us that there are three kinds of concerns that any private citizen can legitimately have about the operation of foundations. The first is the category of what we call financial abuses, self-dealing, transactions in which the individual benefits in a material way, as a result of having a foundation.

The second category of abuse in our opinion, and this is only partly responsive, Senator Miller, to your question, are what we call grant making abuses. That is where money for which a deduction has been taken, for which an exemption has been granted, is spent for purposes that are not charitable.

And the third abuse and one I am going to spend some time on today, because I think in some ways it is the most important question for you gentlemen to consider, is the question of the amount of money that is paid out to charity. It is our view after all, that the purpose of the foundation is to help charity, to pay money to charity, and we think a very important question that you should address yourselves to is how much money is in fact going out to charity.

Let us take each of these abuses separately. The first category of abuses deals with the whole field of self-dealing, various kinds of transactions where the donor has a relationship with his foundation. In effect, the donor is in some ways on both ends of the transactions. He is both the benefactor and the recipient of that transaction.

There have been a lot of allegations as to the extent of these abuses. There is no way that I know of that a private commission can give you a precise percentage because you need subpoena powers, you need auditing power, and all we have tried to do, Mr. Chairman, is give you a rough idea of the magnitude that might exist.

On the current 990 form, foundations by law are required to report to you certain kinds of self-dealing transactions. Borrowing money, receiving compensation for services, et cetera. We have taken a significant sample of these foundations and this tells you the extent to which these transactions take place.

In 1½ percent of the cases they said they borrowed income; 2½ percent, they receive compensation; 0.5 percent reporting used services or assets in common; 3.5 percent reported purchased securities or property, one from the other; 5.5 percent said they sold services or property and they received income.

We looked at 492 forms picked at random and we analyzed them. I want to be sure I emphasize that under the current laws it is not illegal for a foundation to have this kind of a transaction between the foundation and the donor. All this indicates, therefore, to you is that the per-

centage of times that this kind of event happens where there is a potential for abuse.

Now, whether the transaction is a fair one or done at arm's length is a second question. I think one of the things that these findings tell us is that in a very substantial majority of the foundations there are not these kinds of relationships.

We did a second thing to try to get some data on abuses. I do not have to tell people as sophisticated as you that you do not find out whether an abuse takes place by simply asking the person whether he is engaged in an abuse. Clearly, those who have engaged in abuses are either inclined not to answer the question or perhaps not to answer it honestly.

Thus, what we asked the Arthur Andersen Co., a national accounting organization located in Chicago, to ask 200 tax accounting people across America anonymously so that there was no possible problem here of any self or client implication.

Here is what Arthur Andersen asked these tax accountants, all of whom have had personal experience with foundations, "There are loose financial self-dealings between small foundations and the donor or friends which work to the advantage of the donor or friends.

"Tell us how frequently in your experience this happens."

The answers speak for themselves. In about 9 percent of the cases the tax accountants say they think this happens either fairly common or very common and the other 91 percent not so common.

"There is loose recordkeeping by small foundations which makes it difficult to know whether personal advantage is being taken by the donor or his friends."

Here, about 8 percent report some pretty loose recordkeeping by foundations.

Next, "There are high operating expenses relative to the assets or income." About 6 percent of the tax accountants felt this kind of situation occurred quite frequently.

Our commission's recommendation to you on the question of abuses is as follows.

First we argue that the integrity of the tax system is at stake here. Unless there are very clear benefits to society from permitting transactions between the donor and his foundation, the suspicions that are aroused, the enormity of the regulative process to make such definitions as what is reasonable, what is arm's length, and so forth, are of such a magnitude that we do not believe that the benefits of such transactions are equal to the potential damage. Therefore, we would strongly support legislation that prohibits any self-dealing transactions between the donor and his foundation.

We have also gone beyond this and, through our many studies, have identified a series of additional abuses that we would recommend that you consider including in your recommendations.

For example, in much of the legislation, company foundations have been largely ignored. You recall the company foundation is the one that the company uses as a conduit largely for its charitable contributions. We believe that you should seriously consider drafting provisions that make it clear that the company cannot run through its foundation expenses that are more legitimate business expenses rather than charitable expenses. We do not know the incidence of this possi-

bility but its very existence suggests to us that something should be done.

I believe this is the equitable thing to do for the following reason. Let us compare a company that does not have a foundation and a company that does have a foundation. The company with a foundation not only gets a deduction which the company could get anyway for its business expense deductions, but the company foundation also gets a tax exemption as well on the income from the money that has been contributed that the company without the foundation does not get. For that reason, we think it is very important that it be made clear that only charitable expenses can be supported through a company foundation.

Now, what kind of cases are we talking about? I am reasonably sure they are not too frequent. For example, suppose a company supports research in its particular industry through its foundation. I think some of the questions that need to be asked carefully and thoughtfully are: How is the public at large made aware of that research because at this point the public has a large interest in the expenditures since a major deduction has been granted? How do the competitors of that firm learn of the research that is being done by that foundation?

Likewise, you have situations where gifts of various kinds may be made from the foundation to a charitable organization. These charitable organizations, these recipients, may also be customers of that company. We think it is important that you give some thought to this question and at the very least the disclosing of any transactions between the company foundation and the outside world that could be considered a business expense rather than a charitable expense.

Senator GORE. Do you think this is a matter for tax law?

Mr. PETERSON. What?

Senator GORE. Is this a proper subject of a tax bill or what are you suggesting here?

Mr. PETERSON. I am suggesting, Senator, that our business tax laws say in effect that reasonable business expenses obviously are deductible for the purpose of computing your profits to be taxed. I am suggesting that, if a foundation engages in practices that could be considered a business-related expense rather than a charitable expense, that some precautions be taken to be sure either that it is disclosed very carefully. In other cases it may be prohibited, because I do not think it is proper to permit business expenses through a foundation.

I think another potential abuse that is not adequately covered in the current legislation, either contributions to charitable organizations or contributions to foundations, is the problem of overevaluation that I mentioned earlier. I would think that the legislation should be made more specific with regard to the evaluation of property given to foundations. We would recommend that you require valuation procedures on any significant contributions of property whose value cannot be easily determined.

Next, as we have already shown you, there is some substantial overlap between the ownership of stock in a company by individuals and stock that is owned by the foundation. I think as a private citizen group, looking and hopefully representing the public interest, we need to be concerned about whether the portfolios and the investments of the foundation are being handled in a reasonable manner to further the

best interests of the foundation. Clearly, if a donor who has stock in his own name also has stock in the foundation, there are conflict of interest opportunities here that should be looked at, probably handled best through some kind of disclosure procedure.

Incidentally, these same provisions now apply, for example, to insiders in the case of business corporations, and I am simply suggesting to you that since the same opportunity exists in the case of foundations, that you make it clear that those kinds of transactions should be ventilated.

On the subject of abuses by foundations, we have seen a few cases, not many but a few, where excessive administrative expenses result in a diversion of funds to charity.

Now, in the case of business corporations, you will recall that the code makes it very clear that the only business expenses that are deductible are those that are categorized as ordinary and necessary and this is an important part of the code as it relates to business. We would suggest that you consider that a similar rule of reason be applied to foundations so that the IRS agents in making their particular investigations could explore whether the expenses are in fact, ordinary and necessary or not for the operation of the foundation.

Senator BENNETT. You skipped No. 4.

Mr. PETERSON. I am sorry. I did not mean to. The tax accountants that were in the Arthur Andersen study said that in a few cases, Senator, it is possible—and this, incidentally, applies not to foundations alone but to any charitable gift—to give money to a charitable organization but to have an individual be the beneficiary of that contribution.

Perhaps this is most likely, sir, in a case where the institution in addition to being, for example, a religious institution also supports educational institutions. We do not think this is very frequent but the possibility exists where a charitable contribution is, in some part at least, really a payment for the education of an individual and we think you should take a look at that kind of problem.

Now, let us talk about auditing. Clearly with all the questions you and others have about foundations and the level of abuses, we think the first step to this problem is to be very precise and complete about the abuses that you wish to be limited. Then, I think it is extremely important that you also use the weapon and regulatory tool that you already have, which you very clearly use in the case of business corporations, which is, of course, very intensive IRS auditing.

Our study asked the foundations whether they had been audited or not and with what frequency over the last 10 years.

Here is what the question was:

> To the best of your knowledge, has the foundation been audited in the last 10 years or so by State officials or by the Federal Internal Revenue Service?

Only 34 percent of the foundations reported to us that they had been audited in the last 10 years by any Government agency, either State or local—only 8 percent by a State body, and 29 percent by the IRS.

We understand why the IRS with limited budget and with an understandable desire to focus its efforts where it can increase Federal revenues has perhaps not done this. On the other hand, I think it is very inconsistent if I may say so, and quite irrational at the same time,

to have widespread doubts about the extent of certain abuses and on the other hand, not to use the regulatory tool that is available for this purpose.

You might be interested, for example, that in our interview of the Ford Foundation, even though it is the largest foundation by far, we find that it is now being audited for only the second time in its history. I do not wish to suggest by this that there is any improper behavior there. I simply use it by way of illustration to indicate that if this were a business institution of this relative size, you can rest assured that there would be very intensive auditing.

Our specific recommendation is the following: that all foundations will be audited at least once over the next 3 years. We know this will take a significant step-up in IRS activity. We know as some of you pointed out, that it will require additional personnel but it is our view that you gentlemen and the public need a period of time where you can find out what the level of abuses is, particularly when you have prescribed the kinds of abuses that should be prohibited.

The question has come up who should pay for such audits. You recall that the original proposal was a 7½-percent tax on income of foundations.

Our Commission would strongly oppose that provision for several reasons.

In the first place, I think I have demonstrated to you, and I will demonstrate shortly in greater detail, that the very substantial amount of money that flows out of foundations goes indeed to charitable organizations that have already been qualified by the IRS to receive individual contributions, to be specific 93 percent of foundation grants. It seems clear to me, therefore, that any significant tax on foundation income is in effect, a reduction in the amount of money that is going to charity at a time when these charitable organizations are having very serious problems.

If, as a matter of principle, you decide that you think that foundations should bear the cost of IRS supervision, we would argue as follows:

First, that you should take a 3-year period, announce this 100% auditing policy.

Second, that you should ask the Department of the Treasury and IRS to cost justify to you what these costs are and to set up an earmarked fund for this purpose. At the end of that period we think you will be in a better position to decide whether as a matter of long-term policy you want to charge a tax on the income of foundations.

Therefore, we would propose a fee for this purpose rather than a tax on the income.

Our Commission looked at State regulation. We have had many suggestions from many people, I think most of them well meaning, that resented the notion of too much Federal or IRS intervention in the foundation process. They suggested to us that the States should play a much more important role in the regulation of foundations.

We have looked thoughtfully, I hope, at State regulatory agencies and resources. We have looked at the personnel and staffs that they have. The fact that only 8 percent of these foundations have ever been audited by a State, I think, is some testimony to the fact that a very significant percentage of the States in this country at the present time

do not have adequate staffs, and have not assigned a high auditing priority to the foundation area.

It is our view, therefore, that until there is a good deal more assurance of both adequate resources and motivation that shifting of the responsibility to the States would in effect be no regulation at all.

Senator ANDERSON. So, if the States do not do it and the Federal Government does not have time to do it, who does it?

Mr. PETERSON. I am suggesting, sir, that the IRS engage in 100 percent auditing over the next 3 years of all foundations. Our suggestion is that the IRS audit the foundations in this country on a much more intensive basis than they have done to date.

There have also been many people who have proposed to this Commission that we should rely on self-regulation. We are sympathetic to the notion that free institutions of this sort do flourish best with the least amount of regulation consistent with lack of abuse. Quite frankly, gentlemen, we have looked at the self-regulation effort. While we applaud it, while we think it is a step in the right direction, we are not persuaded at this time that it represents a sufficient percentage of the foundatiton world. Quite frankly, we are concerned that the people that would cooperate with such an effort are the people who in some ways need regulation the least. Therefore, while we applaud it as a long-term effort, we do not think at this time that self-regulation is sufficient as a way of getting at this problem.

Senator GORE. The fellow who needs regulation most is likely to be the last to self-regulate.

Mr. PETERSON. That is quite possible, sir.

Senator GORE. It is likely.

Mr. PETERSON. I now would like to talk about public disclosure because we think some new dimensions are required in public disclosure with regard to foundations.

You might be interested that when we asked these 750 distinguished citizens in the country what do you think are the right approaches for making foundations more accountable to the public, here is what they said. They said full public disclosure—58 percent, said this—is a very important way of regulating foundations. Following this were suggestions of full reporting and audits, increased Government regulatory activities. But it is clear that many Americans feel that public disclosure as in many fields, is an important, even though indirect regulatory process.

We have some specific recommendations in our report to make to you on public disclosure. I think there is a very important distinction between making information available in some technical or legal sense and really making it available so that the public is really aware of it.

Let me give you an example of this. At the present time foundations do report annually on a 990(a) form. They do report the sizes of their grants, their administrative expenses, the grants themselves. In many cases actually they list the grants. The fact that so little is known about foundations is perhaps testimony to the fact that these forms have not been widely referred to.

Why have they not been referred to? The experience of this Commission, I think, is revelant. We needed the 990A forms to draw a random sample of foundations across America. We found in order to get them we, as a number of private institutions, had to go to Philadelphia and

look them up on microfilm. While our company sells microfilm and I support the medium, I do not feel one can argue the availability of centralized microfilmed source, and having to go to Philadelphia where it costs us $3 or $4 to get a copy, is adequate disclosure. Thus, we would like to recommend a change in public disclosure of foundations.

First, we would like to suggest that a major overhaul be made in the 990A form for several reasons. First, anybody in the business world understands that until you have uniform accounting standards, until it is clear what certain terms mean, then putting all the numbers together they by definition are meaningless because the original data had different meanings.

We are prepared to aid in such an effort because Peat, Marwick & Mitchell, the accounting firm in New York, have assigned some people to define meaningful terms in uniform charts of accounts for foundations.

Let me illustrate this. What do you mean by the value of an asset? Do you mean its cost or its market value? What do you mean by an administrative expense? And I can give you 20 different examples. But until you gentlemen can be assured that the original data has meaning that you can put your arms around, then it is quite possible that the reporting will not be as good as it should be.

We would also propose that the 990 form define the purposes of the grants in certain categories. I will show you in a moment that in our research we have some 15 categories of purposes for foundation grants. I would suggest that it is important for the country, and this is only partly responsive, I think, Senator Miller to your point, that the country know systematically what the allocation of foundation grants is. We think, therefore, that if the foundation forms reported the purposes of the grants, you could annually get a much clearer picture than you can get now as to the total allocation of those funds.

Third, in the investment activities, I am going to talk later about the investment returns and the investment practices of foundations, I think we have discovered enough in the course of our study to suggest that substantially more detailed reporting is suggested in the area of various kinds of investment transactions. We think the starting place in this effort is a very significant overhaul of the annual reporting form.

There is another concept of disclosure that we would like to talk about. As we have looked at several kinds of activities of foundations, and other charitable organizations that might be in sensitive areas, about which men of reason and good will might debate, it occurs to us that annual disclosure after the fact may be adequate. For example, if money has been used for quasi-political purposes that offer significant opportunity for abuse of the grantmaking activity, it might be argued that an after-the-fact handling of the situation is not adequate.

We would like to propose for your consideration, therefore a concept of not only annual disclosure, but instant disclosure on certain kinds of grants about which there is concern and about which public ventilation in advance could make a significant difference.

Let me illustrate this point. I know that some of you, for example, are sensitive about grants made to Government employees. I will show you in a moment that while that number is very small in terms of dollars, I can report to you in our study that a significant number of distinguished citizens in this country are concerned about grants made

to Government employees. As a matter of fact, while in general these distinguished citizens opt for a great deal of freedom on the part of foundations to do a pioneering job, but in the area of grants to Government employees, partly, I think, as a result of some of the unfortunate incidents of recent years, there is some concern about this.

One can envision a process, for example, of instant disclosure of certain categories of grants such as these as being an important process that you might want to consider.

We would like to make a second broad recommendation in the area of grants. If you accept our premise that there are certain kinds of improper grants which should be prevented and stopped rather than simply reported and penalized after the fact, it is clearly important that some governmental unit shall have equity jurisdiction in order to act promptly to enjoin such activities. At the present time our Commission, and I would like to report to you that we have a couple of members who have outstanding legal backgrounds, Prof. Paul Freund, from Harvard, who many people consider one of the greatest authorities on constitutional law, and Edward Levi, current president of the University of Chicago, and dean of the law school prior to that, feel there is a great deal of ambiguity in the current situation with regard to who does have the equity jurisdiction to enjoin activities that are abuses of this sort.

One of our recommendations, therefore, is that you consider thoughtfully whether that equity jurisdiction should not be assigned to the Federal level. Dr. Freund tells us that he believes that there is adequate precedent here to allow such jurisdiction for specified purposes and still be completely constitutional. At the present time we think there is some considerable ambiguity about this legal authority. Taking this into combination with the fact that the only penalty now is to remove exemption we can clearly see why rarely does anyone move into these kinds of grants.

So, we are proposing disclosure in two senses. First, full public disclosure, not only statistically, but in annual public reports that are made readily available across the country, of the activities of foundations. For example, we think those reports should be indexed and abstracted, so, for example, anywhere in America where a given researcher or given institution wants to know who supports his kind of of activity, he can very quickly find out.

We also suggest for your consideration the concept, and we can go into more detail later on this if you would like, instant disclosure on certain kinds of grants about which there is concern; instant public disclosure, that is, and instant disclosure to people who are specifically involved and have jurisdiction.

On the question of penalties, this Commission agrees that the current situation is not defensible, since the only penalty currently is removal of the tax exemption of the institution. This is indeed a fatal remedy and is not likely to be imposed in any event without intensive audits. While it is true that in a few cases the tax exemption has been removed, it is also true that in many cases that is a remedy that seems far too severe. So, we would approve of a number of different kinds of sanctions and penalties because we think that is the way to make the whole system more responsive.

We have a few very brief principles we would like to articulate. First, we think if you approve a system of penalties the purpose should be to make charity whole, not to collect taxes for the Government. We think, therefore, that if a person has been enriched by virtue of his foundation activity, he should make the foundation whole to the degree of that enrichment so that charity has not been hurt by this particular abuse.

Second, we would urge that you be careful in applying fines in areas that by definition are ambiguous. I say this with some feeling because I think one of the great aspects of these private institutions is getting the leaders of our private sector to serve on the boards of these institutions. I think they provide a great deal of leadership and judgment to these activities. If one has an onerous system of fines, particularly in areas that are ambiguous, I think it could have a very chilling effect on getting the best citizens of this country to serve on foundation board of trustees.

Finally, we think the sanctions should be geared to the seriousness of the violation and whether it is willful or inadvertent. We do not think these distinctions are properly made in the current bill.

Now, could I move to the grant making activities of foundations because this is clearly a second abuse area that I know you are considering.

Let us look now at where foundations grant their money, and this is for the year 1968. As I reported earlier, you will see that 93 percent of the money goes to qualified charitable organizations of one type or another. You will see that this number is high in virtually all categories. I apologize for an error in community foundations. It is going to take us a week or two to straighten this out. Some of the recipients here have considered their bequests as a grant and we are sure that is what they mean. For the moment please exclude this group, you will see that most of the foundations give a very substantial amount of their money to qualified charitable organizations. Foreign organizations get about 1 percent of the total.

I want to discriminate here now between grants for international purposes and grants made to foreign organizations. I will cover in a moment how how much of the money goes for international purposes. What I'm showing you now are grants made directly to foreign organizations. Five percent of the money of foundations in our preliminary study goes to individuals. You will see that it is a larger number in the over $100 million class and in a moment I will show you what the distribution of those grants is.

But I think the fundamental point that we are trying to make here is that the substantial majority of grants are made to qualified charitable organizations and I might say now that the very substantial distribution of grants to individuals is made for scholarship programs of various types.

Now, let us talk about——

Senator MILLER. May I ask a question? In this analysis did you draw any distinction between grants and payouts which some people might regard as grants but which are treated as expenses?

Mr. PETERSON. As what?

Senator MILLER. As expenses?

Mr. PETERSON. Our handling of that problem, Senator, would be as follows:

We think one of the important functions that a foundation can do is to make a systematic professional evaluation of areas to spend money and of alternative grantees and programs. We would handle the problem, I think you are referring to, in the following way. You will recall we proposed a reasonable and necessary provision be put on the administrative expense of foundations and it not be allowed if it is unreasonable. We think any highly precise legislation is not an appropirate way of handling this. If it is reasonable, then it is part of the pay out.

Here we are talking about the grants of the foundations, the actual grants made.

Now, the purposes are shown in the written testimony. I am just going to show you here the broad categories.

First, education gets 36 percent of the total foundation grants in America. This is denfined as educational research, elementary, secondary, higher, et cetera. Health and medicine gets 25. General welfare—here what we are talking about is the community chest, the united fund, et cetera, 7 percent. Community action or services gets 7 percent. These are described as groups planning for community improvements of various kinds. Cultural organizations—here we mean museums, symphonies, activities of that sort. Religion—once again, you will see that only a small percentage of the foundation dollar goes into that area compared with private giving and you can see there listed all of the other categories.

I think it is of interest to see that one area that I know there is a great deal of interest in is the area of projects related to the political process. Obviously, this is a question of definition, but we asked the foundations to include voter registration, voter education of any kind, schools for political candidates, et cetera. I will elaborate on this a little later. Less than one-half of 1 percent of all grants goes for that particular purpose.

Senator ANDERSON. May I interrupt for just a second here. You talked about auditing.

Mr. PETERSON. What?

Senator ANDERSON. You talked about auditing a while ago. What do you propose for that?

Mr. PETERSON. One hundred percent auditing, over a 3-year period. That is, every foundation would be audited over a 3-year period, is our recommendation.

Senator FANNIN. And a continuing program?

Mr. PETERSON. What we are proposing is a 3-year intensive program with earmarked funds. We think at the end of that period you can be a great deal more informed than anybody possibly can be at the moment and at that point, I think you will be in a better position to decide what the ongoing program should be.

You might be interested in looking at the purpose of the grants by kind of activity. In general, what this makes clear is that educational grants are significantly more important in some of the larger foundations than in the smallest ones where education gets about 10 percent of the total. Health and medicine, on the other hand, you will

notice is considerably more important for the smaller foundations than it is for the larger ones.

Also, general welfare is much more important for the smaller foundations. The reason for this, gentlemen, we think is that in the case of the smaller foundations in particular, the foundation is simply a way that these people channel grants that they would have probably largely made as an individual anyway. You know that community funds and united funds are a very important part of most local giving. Since most of these operations have a local character to them, you can see why they get a large percentage of the money.

You can go through our findings and study them as you will. I think it is interesting that even in the largest foundations, a very significant amount of the money is going to education, health, medicine, general welfare, and so forth, and a very small percentage for some of these other purposes.

We cannot help but be aware in the course of our studies that there is a great deal of interest in the amount of foundation money that is going for certain purposes about which there is concern, certain purposes that might have either a political or a so-called social change aspect to them. We thought you would be interested, therefore, in knowing what our best estimate is of how much money goes to these purposes. I list them here. Voter registration and education that I know has caused a good deal of interest and concern in some parts account for about two-tenths of one percent as best we can estimate it of the total foundation giving in this country.

The Ford Foundation, which I know has been identified with some of this activity, has given me permission to release to you what their total grants are in this area over a 3-year period. The total grants that they report to us during the past 3 years for voter registration, and we believe they are the, if not the largest, certainly a very significant part of the total, is $440,000 over a 3-year period. This is out of total annual grants of foundations of about a billion and a half.

Schools for political candidates, you can see, a very, very tiny number. We have only found one or two examples of that.

Grants to student organizations are minimal. Public policy studies account for about 1.9 percent. You can read those categories from the chart.

Grants to Government employees, I know, is a subject of interest. Here in the case of the Ford Foundation, grants to individuals employed by the Government or persons acting as assistants to the Government employees accounted for $123,000 over that entire 3-year period.

What we are trying to say, gentlemen, is that the grants for these purposes turn out to be substantially smaller than I would have to say some of us expected them to be.

Senator WILLIAMS. Therefore, if it is eliminated it will not bother anybody.

Mr. PETERSON. Well, that involves a judgment as to the value of some of these innovative activities which we believe should be performed somewhere in the society. We think it is an important function of this Commission to ventilate the incidence and importance of some of these activities.

In our earlier research we found many people feeling that a great deal of the money the foundations were spending was not going to charitable organizations, was going for other purposes, and all we are trying to establish here is that it is a very small number.

There has been a great deal of interest in the amount of money foundations spend for international purposes. I mean, for purposes that involve international activity. 90 percent of the dollars of foundations spent go to domestic projects and 10 percent go to foreign programs or projects and a very large percentage of this money has gone to Americans, we find, who engage in various foreign policy studies, scientific studies, research studies of various kinds, but they do these studies about another country.

The area of grantmaking to individuals which we have shown you accounts for about 5 percent of the total. You might be interested in knowing what those grants are. We asked them to specify in detail the purpose of grants to individuals. You will see here that 87 percent of the individual grants, which account for about 5 percent of total foundation grants, go for scholarships and fellowships, 5 percent for research, et cetera.

There is a category called travel and study grants that you are well aware of, and in this case about 2 percent of their grants to individuals go for that purpose.

What we are trying to suggest here is that the very substantial part of the individual grants goes to scholarship programs of various types.

Some of the current legislation that you are considering deals with this whole question of the legislative process and public issues. And our Commission has a fairly strong view about these two areas.

In the first place, there is this whole question of public policy studies which you probably know in the current legislation are pretty substantially limited, by using such words as foundation grants only for nonpartisan analysis and research, nor influencing legislation, etc. I think will have the effect of significantly chilling studies in the public policy area and it may even have some larger effect than that which I do not think are intended.

I would like to use our own Commission, if I may, as an example of this and ask you how you would interpret some of the current legislation. For example, such words as nonpartisan analysis and research that does not lead to the influencing of legislation.

I would submit to you, gentlemen, that I do not know how you can get a group of top people, hopefully well motivated people, to spend a lot of time studying an issue and not end up with specific recommendations. I certainly could not have attracted this group of talent with the limitation that their work would be analysis and research but that they would not be involved in the question of public policy recommendations. So, we think that——

Senator MILLER. May I ask a question here?

Mr. PETERSON. Yes.

Senator MILLER. I used to go through that in connection with some activities I had and we drew the line between drawing conclusions and making recommendations. Now, I can see where you could make some conclusions based upon research and findings, draw some conclusions and then leave it to somebody else to make the recommendations and those conclusions and the findings and research could be invalua-

ble. But I am wondering if you have given any consideration to cutting it off at conclusions and excluding recommendations.

Mr. PETERSON. We have, Senator, and if I may say so, I think I will stand on my earlier position. I think the higher quality the group is, particularly if they are private citizens, the less likely it is that they will not want to be restricted from participating in making recommendations.

I use this Commission as an example. I do not think this group of people could possibly have spent a large segment of their weekends for the last 7 months on any basis that restricts it in that way. And, as a matter of fact, I think the country wants and needs various kinds of public policy studies made by outside groups. In our view, this is a very important contribution that foundations can make and it is very hard to get money from other sources for this purpose.

In the cases where there is the potential for lobbyings which we would certainly understand, we think there, Senator Miller, instant disclosure and activities of that kind will take care of that but we are afraid that the current legislation would have a chilling effect on a very important aspect of foundation activity.

Senator HANSEN. Mr. Chairman, may I interrupt a moment? There are some of us who have 12:30 luncheon engagements. I am very interested in the presentation that is being made by Mr. Peterson this morning. What are your thoughts as to——

The CHAIRMAN. I thought we would quit at 12:30 and come back at 2 o'clock, if that is all right with you.

That means you will be on your feet for 4 more minutes, Mr. Peterson. You will get a well deserved rest.

Mr. PETERSON. On the question of elective politics, we fully endorse the prohibition of foundation involvement in elective politics. There can be no question about that. We think some of the definitions that you find in the current bill are a bit restrictive. And we have some specific recommendations to make about that.

Senator, our next recommendation really in some ways is one of our most important ones which has to do with the suggestion that you consider a high payout requirement from foundations and I think that is such an important recommendation I would rather not split it in the middle, if that is agreeable with you.

The CHAIRMAN. Fine. You have been on your feet now for 2½ hours, Mr. Peterson, so we will give you a rest and be back here at 2:30.

Thank you very much.

(Whereupon, at 12:30 p.m., the hearing was recessed, to reconvene at 2:30 p.m., this day.)

AFTERNOON SESSION

The CHAIRMAN. Mr. Peterson, I would suggest you go ahead with your presentation to us. I hope we will have other Senators in as we go along, but we are voting and they are required to be in two places right now.

Mr. PETERSON. Thank you, Senator.

You will recall I started out by saying that there were really two problems that had to be thought about before you got to the problem

of payout. The first problem was the prolem of financial abuses, self-dealing and so forth. We have told you what we would do with that problem.

The second problem is grants that are made for purposes that are not charitable. We have discussed ways of handling that. If in fact, as I think we have demonstrated, a great deal of the money does in fact go to charitable organizations, and if in fact we can handle the grant making abuses, then I think we can now come to the third problem, which is the question of how much does society and charity get out of the foundation, once the money has been put in.

Our position in short, gentlemen, is that we think foundations are valuable and an important American institution and we should be concerned about two things. First, putting more money into foundations, because there are important sources of money that will be put into a foundation that probably will not be given in other ways, and second being awfully sure you pull this money out of foundations into our society. So how do we achieve that?

Well, one way of looking at this is to assume for the moment that instead of $20 billion there are $25 billion or more of assets in foundations. Let us assume further that every percentage point that you get higher return on the investments in these foundations means $250 million a year more that is available to be given to charity. Two percent is a half billion dollars, 4 percent would be $1 billion more being available at a time when, as I hope we have demonstrated, many of these charitable organizations have got a real financial crisis.

Now the question is what is a reasonable return for someone to get on an investment. What can society reasonably expect? It is the view of this Commission that there are many many outside measures of what a reasonable return is, and we have shown several here.

You probably know, gentlemen, that there are a large number of balanced funds in America. These are funds that are made up of equity stocks as well as debt instruments and debentures of various kinds. In short, they are balanced to give you a fair amount of growth in the future, a fair amount of income and growth consistent with safety and security. These are the so-called balanced funds and it is the direction in which some of the more progressive pension plans and university endowment funds are moving.

For example, our company has a profit-sharing plan. It is the entire retirement plan for the employees. We have followed such a practice of balanced investment. The plan has been in effect for approximately 15 years and we have enjoyed about a 10-percent compounded return over the 15 years.

Senator MILLER. Is that based upon the fair market value of the assets?

Mr. PETERSON. Yes, sir.

Senator MILLER. Adjusted annually?

Mr. PETERSON. Yes, sir. Now, let us talk a little bit about return and what we mean by total return. It is the position of this Commission that there is only one way really to measure return in a really objective way, and that is to look at return from all sources. First, interest or dividends, in other words, income, capital gains that are realized, as well as capital gains that are not realized, and we would like to indicate why.

In the first place, if you deal only with realized capital gains, as the basis for determining income, you are going to obviously bias decisions in the direction of not selling a market security when perhaps it should be sold. In other words, if only after it is sold it is included in some payout requirement then there might be some incentives toward not selling and in some cases doing something that is not in the best interests of the foundation's portfolio.

To make a distinction between income and capital gains does not really make a good deal of sense to those of us on the Commission, simply because it is a tax exempt institution. It does not pay taxes on any kind of income, whether capital gains or interest, and therefore we think the total return is the way to look at this.

Incidentally, I think if you were to talk to most of the banks and pension plan people around the country, you would find that this new notion of total return is the way they look at the return on their investments.

What I am going to show you therefore, is total return which as I have said is about the only way it is measured by the people who measure this kind of thing. The balanced funds hit 9.2 percent on the last 10 years, and the 10 large general growth funds, these are largely equities rather than debt, have hit 15 percent compounded growth.

The reason, gentlemen, that we present this information to you is to make the point that we believe one needs an objective standard—and there are objective standards available that you gentlemen can look at of what people do independently invest their money, without any other considerations, are getting as a return on their money.

Let's take the year 1968. The reason 1968 is important for me to mention to you is that we computed the return as best we could from quite a number of 990 foundation returns, so that you gentlemen could compare the return in general with the return from foundations as such.

I would want to say at the outset that these data are not as good as we would like, because in some cases we are sure that they are not using market value. It may cause some inaccuracies. We would hope to have had more time to check into some of these, and better raw data, but again we used an outside accounting firm to look into it as best we could.

This is what this information tells us. This is how the total return to foundations in 1968 on their investments, by various sizes of foundations: this is the median return, 6 percent, 7 percent, 8 percent, 6 percent, 6 percent, depending upon the size of foundation you are talking about.

Senator MILLER. May I ask you a question?

Mr. PETERSON. Yes.

Senator MILLER. Did I understand you to say that this rate of return was not based on fair market value or was based on fair market value?

Mr. PETERSON. Senator, what I meant to say was the following. There is some percentage of the 990 forms, I am not at all suggesting it is the majority, it is some percentage, is probably a rather small percentage, which are based on cost. By taking a median calculation, we think we have washed out a good deal of that effect. It is supposed to be recorded on market value on the 990 form, but in some cases it may not be.

Senator MILLER. You can see what a tremendous difference it would make if even a small percentage of those were based upon cost or book value compared to what the current market value might be.

Mr. PETERSON. And incidentally, in our detailed distribution of cases, Senator, you will see those cases way out at the extremes where it is clear that it was probably caused by their using a cost basis where they got a tremendous return. That is why we did not use an average return. We picked a median number that would be less susceptible to that effect.

Clearly then if these numbers are anywhere near right, and this is 1968, the rate of return is significantly lower than is true for investments in general * * * in other words, about half of what a typical balanced fund earned in 1968 (about 15%).

Now, we did another thing. We were able to get data that we think is quite reliable on 14 of the largest foundations, where we are quite sure the data are reported on a market basis, and Senator, we do not have the problems that you refer to.

In the case of those, the median return was about 8 percent, so once again we see a number that is significantly lower than it is for investments in general in 1938.

We have discussed this problem with a number of people who, unlike myself, spend their lives in this particular world of investments. I would say we get substantial confirmation that there is concern about whether the foundation investments are yielding the return that they could yield. I quoted here from an article in Institutional Investor, by a man that I am told is quite respected in the field.

He refers to the foundation's investment situation as "Foundations the Quiet $20 Billion." The point he makes is the following. He says:

> Is there a place as yet untouched by the revolution in money management, where the winds of performance are not felt, where the opportuning cries of ambitious brokers are not heard? A last redoubt so quiet that the clocks can be heard ticking? There is such a place and it is called foundation land. Their tax exempt is $20 billion, one of the bigger pools of capital in capitalism and it is still run the way that money used to be, the way it used to be that is for widows and orphans before currency began to depreciate.
>
> In foundation land the verities are preservation of capital and yield. The managers do not often buy their stocks because they already have them. They were given them many years ago, and now they sit quietly watching.

This article also refers to a study by the SEC which I have not seen, but which apparently indicates that the turnover of stocks in a group of foundations they looked at is in the range of only 1 to 2 percent. We have interviewed some investment experts who operate balanced funds as well as other kinds of funds. They report to us that a more typical stock turnover for funds who are engaged in optimizing their total return would be a number significantly larger than that. I have heard numbers that range from a minimum of 10 percent and many tell me 20 percent stock turnover and even above.

Now, one can only speculate as to what the reasons are for this low turnover. Certainly one of the reasons is that a good deal of the stock in foundations is often in controlled stock and perhaps it has not been considered appropriate by these foundation managers to trade these securities.

Others point out that getting a high return has not been considered a top priority of some foundations, and they simply have not spent a

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good deal of time on this problem. In some cases the legal instruments that drew up the foundations prohibit the sale of certain securities.

In short, the Commission has received expert advice on this point from many many people. We would certainly be the first to say that the investment performance deserves very detailed additional study by people who indeed can go in and can get the actual data on investment practices of the foundations. However, from any standpoint we have been able to look at foundation investment performance, we have to conclude that the investment performance is sub-par, and that the cost to society of this sub-par performance could amount into the hundreds of millions and perhaps billions of dollars as I have indicated earlier, annually.

We would welcome and we would encourage not only the new public reporting techniques that we mentioned earlier, but also additional information on trading of stocks which would enable you gentlemen in the future to look at this investment problem much more systematically than we have been able to do it so far.

Now, let us talk about the second part of this equation, which is the payout to charity from these investments, which is more of a short-term question. How much is society getting now out of this investment? Over the long term, society has a deep interest in the total return on investment. Over the shorter term we have an interest in how much is coming out now?

This is something that we are in a position to measure a little more accurately. Once again we took a very substantial variety of foundations from the 990 A forms, and I will show you now the payouts to charity from the foundation.

Now, here, Senator Miller, is where we have the opposite effect, to the extent that cost is used as a basis for determining value, the payout factor is obviously less than this number we are reporting, not higher than this.

What we show here, gentlemen, is in each size category of foundation what the payout is: 4.8 percent, 4.9 percent, 5.7 percent, 5.2 percent, and 22½ percent in the case of company foundations. The reason for this high figure for company foundations is that they are much more likely to be conduits to which the company puts in money quite frequently. Also it comes out much sooner than it does in many other kinds of foundations, based on earnings, for example, in a given year.

I would like to emphasize, therefore, that to the extent that the cost basis is the one that has been used for the assets, this payout number if anything is high rather than low. In any event, it is quite clear that it is a number substantially below what a decent return by an independent third party would probably have settled for during this period.

Now, we have done one other thing that may be of interest to you. We have determined what the payout percentage is for foundations in our sample and this payout goes all the way from zero to much higher numbers. We found that about a third of the foundations pay out less than 4 percent on the assets that they report.

The very substantial majority of the Commission believes two things. First, that society should receive a significant current benefit to charity, particularly at a time when, as I have demonstrated earlier, the charitable organizations of this country are facing very important financial problems.

Secondly, we believe foundations should be encouraged to make reasonable and productive investments of their funds, so that over the long term amounts can be earned in foundations that are comparable to what could be earned in our society generally by people that invest money independently.

How would one go about assuring himself that society does get a payout currently to charity? We have approached it, gentlemen, in the following way.

We have said that over the last 40 years or so the rate of inflation has been about 1.6 percent, and over the last 10 years or so it has been higher than that, about 2 percent. Now, if the objective were one of saying that with reasonable investments one were to maintain the purchasing power of the assets that remain in the foundation, one way of thinking about this problem is to say; First, this is the total return that a reasonable man could get. Here is the amount that represents inflation. Subtract the inflation adjustment from the total payout and come out with an annual payout figure.

Now, if in this kind of a situation you were to accept the notion that a balanced fund did represent a prudent and yet progressive way of looking at investments, and you will recall that that number is in the range of 10 percent compounded growth. You can do a good deal better than that, but I think that is a fairly balanced number. We would arrive therefore at a payout number that would take some number like 10 percent subtract out of the inflation effect, perhaps a little bit due to the fact that you have to keep some money liquid in most foundations, and come up with a payout factor in the range of 6 percent to 8 percent under current conditions.

Now, we would strongly advise against your legislating a specific number because clearly this is something that requires looking at every few years. If the returns were to go up significantly, it could be changed upward. If they went down it could be changed downward over a several year period. We think the Secretary of the Treasury is perhaps the appropriate place to lodge such a rulemaking procedure.

Senator WILLIAMS. Based on today's analysis what would you suggest that be?

Mr. PETERSON. The return over the last 10 years is about 10 percent, Senator, from balanced funds. Our Commission, the very substantial majority of us came out between 6 and 8 percent, which allows something for inflation. Frankly, which end of the scale you pick depends a little bit on how important you think current problems of charity are in society compared to long-range problems.

I indicate in the testimony that my view is the following.

Having looked at these Chicago charitable organizations, having looked at the budget problems they have, having looked at the tough future that they face, and believing as I do in the enormous importance of private funding, I would tend to opt toward the higher end of that particular range, because I believe that it is important that society does receive a current payout.

Senator WILLIAMS. That is a payout of 8 to 10 percent?

Mr. PETERSON. No, my payout would be toward the high end of 6 to 8, because I do think that you can allow for inflation, which is a couple of percent, so my number might be in the 7 to 8 percent range.

Others on the Commission might be in the 6 to 7 percent range, but the point is that most of us are certainly agreed that a high payout principle does make sense.

Senator WILLIAMS. The 5 percent rate you think should be raised even?

Mr. PETERSON. That is right. We think it should be higher, Senator.

Senator FANNIN. Mr. Peterson, didn't you say that you would not recommend legislation in this regard? Would you recommend legislation where you would have flexibility?

Mr. PETERSON. Yes.

Senator FANNIN. With the limits?

Mr. PETERSON. Senator, what I would do is the following. I would recommend that you legislate that the Secretary of the Treasury be given the authority every few years to call in relevant experts in the field of investments, endowment funds, pension funds, balanced funds et cetera, determine what in his view is what a prudent and reasonable man would do if it were his job to invest this money. If you would accept my formulation that a balanced fund is a pretty prudent thing to do, it is not too conservative and it is not too aggressive, he could reassess that number every few years and set it and you would define the principles, but not the specific number.

Our purpose in picking a number now is to simply say from what we have seen, it would be a number in that range.

Senator MILLER. Suppose the Secretary set 7 percent, and a year later a foundation finds that because of maybe some antitrust activities directed against the corporation in which it owns the stock, that the corporaion has lost money, so it does not have any money to pay out dividends to the foundation. There certainly would have to be some discretion given to the Secretary so that he would not be stuck with that percentage from year to year until he revised it, shouldn't there?

Mr. PETERSON. Senator, I will discuss very shortly some flexibility that we would suggest you put into it, but first if you do not mind, I would like to lay out the reasons we think a high payout approach is in the best interests of society, and quite frankly, though some may not agree, in the best interests of foundations as well.

In the first place, it results in a substantial benefit to charity at a time when everything we know tells us that more money is desperately needed in the charitable sector.

Secondly, I do not know how you can legislate to tell a foundation to improve its investment practices, but I think it would be a very interesting and indirect incentive to such investment practices if, over a period of time, the payout were substantially larger than the return, and it was necessary as it obviously would be to divest of some of the assets that they have. I think this might be quite an effective incentive to improving their investment return.

Third, the disposition of controlled stock is an extraordinarily important question as our review of the data have established.

The House bill, as you gentlemen know, takes the view that the disposition of this stock in 5 years and in some cases 10 is required. Now, as we step back and look at the fact that a great deal of the important money in this country is necessarily earned through the increase in value of company stocks, we think anything that is that harsh will have

the effect of proving to be a disincentive to charity, because these men will not be inclined to put control stock into foundations.

Now, we believe, therefore, that the public interest is not best served when one spends perhaps too much time questioning precisely what the motives of the man were in putting the stock into the foundation. Frankly, gentlemen, if one is going to spend too much time questioning motives in all kinds of activity in life, and certainly in philanthropic giving, it is clear there are many motives, many reasons why people give money to all kinds of charitable institutions. Except for Saints, I doubt there is much of a pure motive. It usually involves a mixture of motives.

What we are saying is the following. That if you are satisfied that the abuses have been taken care of, and we think you can be satisfied, if you are satisfied that the noncharitable grants have been stopped, then I think it is in the best interests of the society to encourage the formulation of foundations, but to set up a performance factor of foundation payout to society rather than any speculation about what the motives are.

It is for this same reason that we strongly oppose the restrictions on appreciated property to foundations. We think they are punitive. We think they are potentially disastrous to the birth rate of new foundations. In short, gentlemen, if you pull out money from the foundation and if you do not give encouragement to setting up new ones, then you will only have assured a heavy death rate of a valuable institution. The substantial majority of the assets put into foundations are appreciated property.

We asked the large donors who set up foundations what would be the effect of several of these provisions on their setting up a foundation. Now, what we found here is the following.

Sixty-three percent of the large donors who are the kind of people that I demonstrated earlier set up foundations indicated that this appreciated property provision "would lead me not to want to set up a foundation at all." Twenty-five percent said it would lead to give less and 12 percent say "have no effect."

You can see that the appreciated property restrictions have critical effect upon the setting up, and putting of more money into, foundations.

The tax on income of foundations obviously has some effect in setting up new foundations but not as serious an effect as the appreciated property restrictions. The effect of the distribution equivalent of 5 percent of the assets is as follows:

Sixty-three percent said it would have "no effect on my giving" at all, 24 percent indicated it would lead them not to want to set up a foundation, and 13 percent said "lead me to give less."

So I think one of the key points I want to make is the appreciated property provision as well as the control stock restriction in the House bill would have a very serious damaging effect on the setting up of new foundations and more important would reduce charitable giving.

Now, what is the relevance of payout requirement to this perpetuity problem that we have heard a deal about? There are people in the society who take the position that they are concerned about the perpetual existence of foundations. You have heard some of the concern. There are those who have suggested that we put a life on foundations

of a fixed limit. We have heard many suggestions that one has a 20-year fixed life on foundations, or a 25-year life.

We question whether that is a good idea; putting a fixed life on the foundation. In the first place, this does not discriminate between foundations that perform well and those that do not perform well.

Secondly, we are convinced it will have the effect of seriously discouraging the setting up of new foundations.

Third, I think as this testimony and as others have established, trying to define the difference between various kinds of charitable organizations is indeed a serious problem, and putting fixed life on foundations we think has the effect of being antiphilanthropic in its total impact of setting a precedent for legislating the life of charitable organizations.

On the other hand, I do think we understand the concern of people who wonder whether a foundation having a perpetual life is justified, if in fact its performance and its contribution to society is not by some objective standard a substantial one.

Let us look now at the high payout requirement and see how perhaps that might, in a more natural way, take care of this particular problem. In the first place, it is clear that if a foundation keeps its assets in very low return situations, and that you gentlemen agree to put a significant payout factor on the foundation, this will in effect mean, because they will have to divest themselves of their assets in order to meet the payout requirement, that over a period of years there will be a certain number of foundations who will go out of existence.

One, then, has to ask the question why is the return low? Why isn't the return at a level where this is not necessary to do, inasmuch as we would set a flexible standard where it would be set at a level that a reasonable man could earn that kind of money.

Clearly one of the reasons that the return would be low would be a reason that might have to do with the nature of the holding that the foundation has, and perhaps the unwillingness of the donors, for reasons that appear I am sure reasonable and good to them, not to invest in other kinds of investments.

Now I think in those cases, if one is going to ask the question what is in the benefit of charity, what is in the benefit of society, we probably have a pretty interesting example of mixed effects, where there is some of this insisting on having your cake and eating it, too.

There is no question that a payout requirement of this sort will have an effect on these foundations, where there is close control with company stock, and where the donors do not wish to invest the stock in reasonable return situations.

I think the judgment of this Commission is the following. If one does not put an objective test of payout on foundations, he then is left with arbitrary rules of the type I think you see in the current House bill, that says in effect get rid of the stock in 5 years, get rid of it in 10 years, and in my opinion that will have a very serious negative effect on the putting in of stock into charitable purposes such as foundations.

The reason for such a payout rule is twofold. First, we believe the problem has a legitimate concern about the payout to society and charity, secondly, and quite important, I think there are important policy considerations here of to what extent considerations such as

controlling companies should play in an institution that has already gotten a deduction for charity.

Our approach we think, while it may seem harsh to some at least puts an objective measurement of performance and payment to charity into this equation.

We certainly would not want to seem unfriendly to foundations where company stock is important because many have made great contributions. We would want to be awfully sure that the Treasury tried to be quite flexible in how it dealt with this payout requirement. We would like to suggest two or three things here for your consideration.

It may well be that provision should be put into the bill that makes it possible for the foundation to sell back the stock that it may have to dispose of in order to make its payout contribution to charity at a fair market price to the donor's family. So that there cannot be any destructive self-dealing aspect, we think this could be easily handled by a special provision in the law, so that you can be sure that that price is an independently-arrived-at price.

Another thing that could obviously happen to the companies that desire not to distribute their stock, for a variety of reasons, is to recapitalize those companies in a way in which the equity that was placed in the foundation had a high yield.

For example, one might put into the foundation a debenture of some sort, or a preferred stock or something of that sort that had considerably higher payout than the common stocks have. I am not saying this is easy. I am saying it is another possibility.

Another possibility still is to have the Internal Revenue Department be given administrative authority where in situations of unusual difficulty, they might be given more time in order to handle this divestment.

But we think the principle that we should stick to is that foundations should be treated alike with regard to what the payout is to society, and if, for example, there is no way of divesting of the stock in less than 5 years, that at that time the requirement should be that you make up the previous 5-year payout to charity so that all of them are treated alike.

Senator WILLIAMS. To make these payments would you give consideration to the fact that they may be able to give their stock as a charitable contribution?

Mr. PETERSON. That is another possibility, Senator. The problem, of course, is if a person does not want to distribute his stock, for reasons of control, he of course will not be attracted by any of these proposals, but that is clearly another possibility, that he does distribute the stock.

Still another possibility is that the foundation, for example, might merge itself into another foundation. You have heard of the community foundations that I mentioned earlier. In many ways these are collections of a number of trusts and smaller foundations, that have been put together. One, I believe, could visualize that kind of a situation in which this stock might not be sold but the foundation could meet the payout from other funds.

I am not saying, gentlemen, that this problem is easy in any sense of the word. I am simply saying that as we have looked at this as private citizens, and as we have tried to imagine that every person got the same

deduction when he put the stock into the foundation, we think there is something to be said for an operational objective test for payout to society.

The effect of this provision on additional amounts to charity incidentally cannot be guessed at quite as precisely as I would like, but if you will go through my assumptions, I can give you a rough idea.

Let us assume there indeed are $25 billion worth of market value of foundation, and let us assume as our studies indicate that a significant number are paying out in the range of 3, 4, 4½ percent. A payout at this particular level would probably add at least a half billion dollars and perhaps a billion dollars annually to charity at a time when I think most of us feel the needs are quite serious and important.

The CHAIRMAN. It might add how much to charity did you say?

Mr. PETERSON. Well, what you have to do, Senator, to answer that question accurately——

The CHAIRMAN. I just want you to repeat what you said, Mr. Peterson.

Mr. PETERSON. I think our people would say a half billion dollars to $1 billion a year.

The CHAIRMAN. So if we follow the recommendation that you are making here for a higher payout, and you think that is practical, you do not think that is an undue burden on them, although some may find it a burden, you think that we would increase the amount of money that charity would receive by more than a half billion dollars a year?

Mr. PETERSON. I think it is quite possible, yes.

The CHAIRMAN. Well, now, if we do that should it not allay the fears of some of those who came here speaking for the charities and speaking for the universities saying that they needed more money, not less?

Mr. PETERSON. Senator, the needs of the charitable organizations as I see it are growing at an extremely high rate. The estimates we have on 1975 needs, I am almost hesitant to name the size of the dollar gap, but it turned out to be a number in the $35 to $45 billion deficit arena, that is $35 to $45 billion more money that is going to be needed for these charitable organizations. One of the reasons I recommended a whole new look at tax incentives is that the amount of money that charitable and education needs are such that I think our discussion should not be on whether this half billion dollars makes up for some other half billion dollars but can we come up with a way where we can pump several billion dollars of new private money into this sector. Long term, Senator, I am convinced that it is going to take Government money anyway, and that the private sector route is a more efficient way of doing it.

The CHAIRMAN. But you just came up with an estimate and that if these foundations were required to make a high payout, charity, and I am sure you included education—

Mr. PETERSON. Oh, my, yes.

The CHAIRMAN. Charities, including education, would receive somewhere between $500 million and some higher figure you named.

Mr. PETERSON. Yes.

The CHAIRMAN. What was the higher figure that you named?

Mr. PETERSON. I said a half billion dollars to $1 billion.

The CHAIRMAN. So if we do what you think we ought to do, and raise the required payout, then it is your judgment that education and charity would receive somewhere between $500 million and $1 billion more, not less?

Mr. PETERSON. That is right.

The CHAIRMAN. That is the kind of thing that some of us have been interested in hearing. You are saying that as one who is sympathetic to the foundations I take it?

Mr. PETERSON. I am very sympathetic to foundations.

The CHAIRMAN. And you do want more foundations, not less?

Mr. PETERSON. But I would also say, Senator, that I think the needs of charitable organizations are moving at such a rate that half a billion dollars more or less is not the kind of problem we are talking about. What I am saying is that I think new incentives are needed for this segment.

The CHAIRMAN. That is right, but as I understand it though, you are not trying to get people to go out of the foundation business. You want more people in it. But you also think if they were run the way they should be run and you have made a study now of several thousand of them, that charity and education would receive somewhere between $500 million and $1 billion more than they are presently receiving.

Mr. PETERSON. Right.

The CHAIRMAN. And frankly that is in line with what I have been thinking about this subject. If we pursue a wise policy, we are not going to hurt education and charity, we will help them. I do not want to hurt education or charity. I do not think anybody does. I do not think anybody on this committee does.

Mr. PETERSON. You might wonder why I say I think it is in the best interests of the foundations, because I am sure you will find many who disagree with that statement.

The CHAIRMAN. Let me ask you this: Is it not true that you were urged to make this study by quite a few people who are connected with some of the better regarded foundations in America?

Mr. PETERSON. Yes, sir, it is true. The reason, I think that this is in the best interests of the foundations, though it may not be a popular move in the short term, is the following. In the first place I think these hearings have made very clear that there is not much understanding, not much of a public constituency for foundations, they are not a very well understood phenomenon in our lives.

I think anything that gets them helping society more and putting more money into charity will increase the acceptance of foundations.

Secondly, I think the high payout factor will encourage them a great deal to earn a higher yield on the assets they have. As I have indicated to you, $25 billion is a great deal of money. An extra 2, 3 or 4 percent yield will not only pay out more money now, Senator, but long term will add a great deal of money to charity, and I think that the high payout route is an interesting way of giving them that incentive.

Third, I think the payout rate has this virtue of avoiding dealing with problems of motives, of control stocks and so forth, in an arbitrary way where you have an arbitrary rule and say get rid of the stock in 5 years, which I think will be very antiphilanthropic. It at least says "We are not going to worry about your motives. We are

going to be concerned with your performance and your contributions to society," and it puts everybody on an equal basis.

In that sense I think it is a desirable thing for foundations as compared to the other approaches I have seen. It is certainly a more desirable alternative than telling a foundation that it has got to go out of existence in 20 years, which is another way that people have decided to get at this perpetuity problem that I mentioned.

Senator WILLIAMS. As I understand it, the higher payout that you are suggesting is on private foundations and not related to the operating foundations?

Mr. PETERSON. Yes, this is on so-called private grantmaking foundations. Incidentally, one of the small suggestions we make, and perhaps you might be willing to accept this suggestion, is I think the words "private foundation" is an extraordinarily unfortunate word.

Senator WILLIAMS. I agree with you.

Mr. PETERSON. Because the word "private" implies that it is still this person's money. I think we would suggest a word like "philanthropic foundations" to put the emphasis where we think it belongs, that the purpose of these institutions was to help philanthropy, and that there is too much of this feeling that it is "my" money to handle. I think the more emphasis you put on charity and philanthropy the better off this entire movement is going to be.

Senator WILLIAMS. What I was thinking about is there are operating foundations like Williamsburg and you would not want to liquidate an operating charitable organization such as that?

Mr. PETERSON. You have to come up with definitions. Our definition, Senator, of a foundation is essentially a grantmaking institution, not an operting institution.

Senator WILLIAMS. That was my understanding.

Mr. PETERSON. That is right.

We have one final recommendation, Senator.

Senator MILLER. Before you get to that may I ask a question?

I understand that you think that the 5-year or 10-year divestiture rule would be harsh, but if you are going to permit these foundations to hang on to this low payout stock for 5 or 10 years, then how long are we going to have to wait before a charity can get this extra half million dollars that you are talking about?

Mr. PETERSON. Senator, I guess I was not understood. I would not permit foundations to hold on to this stock. I would simply say that you set a requirement for what you think the amount is that has to be paid out, and every foundation meets that requirement. If the stocks cannot be converted to stocks that earn a higher yield, then a high payout requirement does require some divestment, and the amount of the divestment, sir, is computed in the following way:

If, for example, somebody has got a yield of 4 percent or something of that sort, he will have to divest a certain amount of the stock in order to hit the total yield of say 7%.

Senator MILLER. I understand that, but I had the impression that you would not be proposing to put this into effect overnight, that there was going to be a transition period, and I am just wondering how long that transition period is going to be. I am sure you will not say starting in 1970 you have got to meet this payout requirement, and I am wondering how long you are going to permit the transition, and how

many years it will be before that half billion dollars would be achieved?

Mr. PETERSON. Well, even for the moment if you were to make exceptions for company control situations, clearly you would get an immediate impact from the 50 percent of the foundations so that they have got nothing to do with that phenomenon obviously.

Secondly, I think one could argue that this is an important enough concept that you might decide that it will take some time for these foundations to readjust their portfolios, to go back to their indenture agreements and make changes and so forth.

If you are asking a personal opinion, I would wonder whether this should be any extended period of time. I think a period of 6 months or a year or perhaps the beginning of 1971 or something of that sort, which gives them an opportunity to make one of these new arrangements we talked about, might be appropriate. I would worry, I think, Senator, about waiting as long as 5 to 10 years in order to make that determination.

The CHAIRMAN. Proceed.

Mr. PETERSON. Thank you.

I would like now to move on to our final recommendation. We think it is an important one. This experience, gentlemen, has told us that very little is known about many of our charitable organizations, that very little is known about their problems and their needs, very little is known about incentives to giving, and why people give, how they might be induced to give more at lowest cost and so forth.

We would like to suggest that you consider that a quasi-government board be set up, one of whose very important purposes would be to represent the philanthropic sector of our society.

We have considered whether you should have a new agency that regulates philanthropy in the government. We have decided against a new agency for philanthropy, for two reasons.

In the first place, we think the much more rigorous auditing that we have recommended can be done within the existing structure, namely the Internal Revenue Service.

In the second place, our experience with government agencies suggests that in general they do have a tendency, I believe, to create new problems, to perpetuate their own existence. If there is one aspect of our lives where I would like to suggest that privacy and freedom should be preserved, it is in the private charitable sector, because this is probably the most free and private sector we have. Therefore we do not feel there should be a government agency.

On the other hand, we propose the notion of something we call the Philanthropic Policy Board, this would be made up largely of very top private citizens, the substantial majority. They would be approved perhaps by the Senate, perhaps appointed by the President, but this group would have a quasi-public status in the following way:

They would have full access to the information that can only be gotten at the present time from the Federal Government and from the revenue sources. They would be able to answer some of the questions that I cannot answer today, because I do not have access to that kind of information. They would also do the following:

They would report to Congress, to the President and to the country once a year on the state of philanthropy in America. They would pro-

vide public reports, in which all the statistical information, much of which is not available today would be made available to the public, so that we would not, in the future, find ourselves in the kind of information vacuum that I think exists today about charitable organizations.

It would make sure that information was available across the country about foundations, about other kinds of charitable organizations, and I should amend something I said earlier, Mr. Chairman.

The Foundation Center should be commended for the fact that they are making available in a few cities, New York, Washington, and elsewhere, 990 forms and other kinds of information, but it should be made much more widely available than it has been made, and this Philanthropic Policy Board could see to that.

This group could look at some of the really difficult problems that we have not had a chance to look at. I would like to enumerate these. I mentioned that I think not enough attention has been given to a new kind of tax incentive that would meet all of our requirements for philanthropy, that was equitable, that was not tax avoidance, that did produce more money, that did spread the giving among more people. This is the kind of a group that could be involved in reviewing that kind of policy.

The CHAIRMAN. Do you suggest what that should be, Mr. Peterson?

Mr. PETERSON. What?

The CHAIRMAN. What that tax incentive should be?

Mr. PETERSON. What I did say, Senator, was that every tax expert we have talked to agrees this problem has not received a great deal of attention. Everybody agrees it needs Treasury data, and everybody that I have talked to would be delighted to work on such a project, and some of the people in Treasury have told me that they would love to have an assignment of that sort. I recommend you to ask somebody to do it.

Senator MILLER. Mr. Peterson, on that point could you give us a comment on what Senator Curtis was getting at this morning? Some people from the charitable groups here have at least privately suggested that instead of increasing the optional standard deduction from $1,000 to $1,200 or $1,400, that we keep it at $1,000 but in addition to that then allow them to add on their charitable contributions.

Mr. PETERSON. That is one of the ideas that we have discussed. I am obviously not a tax technican but I will tell another idea that has been proposed to us that we have simply not had the time to look at seriously.

The theory of the idea is the following, Senator Miller. There is some feeling that there is some level of giving that will take place in the country without a great deal of incentive. The feeling is, for example, that much of the money you and I and others give, to churches in particular, for example, and various kinds of Boy Scouts and activities of that sort, we would give without the benefit of significant incentive.

If one of our objectives is to get the highest level of giving at the lowest cost to government, one of the tax experts we talked to thought that one approach that might be thought of might be actually to set a low level deduction, much in the way that we set medical deductions, but to set that at a very low number. Above that number, in order to

give more and more people an incentive to give, you get quite generous in the kind of an incentive you could give. The feeling is that you would get into society a substantial amount of the money you are already getting, but that you would increase the level of giving, which we as a group think is important.

There are some other questions, Senator, that we think such a group should look at. I have said very little about the role of States in charitable organizations. We find there is quite a quagmire of confusion about this. I have already pointed out to you that there is little regulation of charitable organizations in general and in particular of foundations at State levels.

I am not a lawyer, but I am told by the best lawyers we have that there is an enormous variation between one State and the next with regard to laws dealing with charitable institutions. This presents great problems in regulation and suggests uniform codes.

I mentioned earlier that we recommended that you should consider giving the Federal courts equity jurisdiction to be able to move into some of these cases where there are abuses and enjoin them in certain kinds of grants. This is a kind of problem that I think a group like this could look at because it would require a national cooperative kind of effort.

We would like to see a group like this look at basic tax law definitions, which define the areas that are entitled to tax deduction. One of the things, for example, that such a group might do is annually look at the Internal Revenue rulings which, after all, are the place where decisions are made as to whether some activity or organization is charitable or whether it is not charitable for tax purposes.

We think a group like this, much like our group, but which is devoted to this over a period of time, might be able to make a real contribution to you in the whole arena of philanthropy and charitable organizations.

Another problem that we have discovered as we have looked at charitable institutions, is the great confusion about what the role and responsibility of the trustees is. One of the things that worries us a bit about some of these penalties that are being talked about is we have not yet really defined very well for many of our charitable organizations what the responsibilities of trustees are.

I think you will agree with me that in the case of business institutions there is a clearer understanding of what the responsibilities are. We find a fair amount of cloudiness in charitable institutions in this regard.

What I think is really important is for this philanthropic policy board to nurture the private philanthropic sector, which is one of the things that makes this country what it is. This whole philanthropic sector has, in our view, been inadequately represented, and I think this whole tax and legislative situation that we are now experiencing makes this clear. And we would urge you to consider setting up a group, largely of private citizens, but with total access to Government information, to advise perhaps on an annual basis their recommendations on many of the problems that we are now talking about today.

Let me just summarize very briefly if I may, Senator, and we can move on. The first thing I have tried to say I think is that everywhere

we look, the needs of charitable organizations are going up dramatically, and we would like to urge you to reaffirm to the country and reaffirm through your tax policy that what you really want is to encourage people to give more of their money and themselves.

We would urge you to look at the current House bill and ask yourselves what the effect of this bill is on charitable giving. I have verified that very few estimates now exist on that effect. I think it is terribly important that you determine as best you can what the effects are, because I do not think there are many people who really want to see these terrific charitable organizations have even more serious problems a year from now than they do now.

On the question of tax equity, with regard to charitable giving, I would like to urge you gentlemen to consider the possibility of defining very specifically those cases where people make money off of charity, and specifically preclude those from happening; over-evaluation of property, giving farm products such as wheat and all of the various other things that you are aware of. I think you can do that without discouraging charity in general, which I think most people would not want to do.

As far as foundations are concerned, I think this experience has taught us a great deal. I think it has said to us that there are a lot of misconceptions that exist about foundations, and that by and large most of what they do, most of the money that they give, is to purposes that the vast majority of the country thinks are desirable.

We think the abuses that have been talked about can be easily handled through a much more intensified auditing program. We think it is possible to identify the grantmaking abuses, and if you will agree with us on the setting up of equity jurisdiction in the courts, I think, Senator, you may have been out when I suggested that for certain kinds of abuses, for example, grants that are in certain sensitive areas, it is not enough to penalize somebody for that. We would like to see it instantly disclosed and prevented, and the only way you can prevent it is to have equity jurisdiction in the courts so that it can be enjoined. These questions are so delicate, they require a judicial appraisal of the circumstances, not just one of two circumstances. You and I know trying to define what is meant by educational and what is means by political, for example, is not something that you can do easily. This is something that requires, in my view, a judicial process in order to make a balanced judgment.

If you will get very tough and specific on abuses, if you will clarify the kinds of grantmaking abuses in this noncharitable area that you are concerned about, then we would like to see you adopt a policy, if you do those things, of encouraging the setting up of foundations.

Now, the current House bill provisions I think will have a highly destructive effect on new foundations. First, the practical elimination of appreciated property as a contribution, the provisions on control stock will in my opinion have an enormously damaging effect.

You might wonder why you have not heard a lot of testimony about that. I think there is an understandable reason. I think the testimony you have heard tends to come from existing foundations. The kind of concerns that a Commission like ours has is the total and the longer term picture, the new ones as well as the old ones and we are convinced those effects could be very serious indeed.

Now, with regard to foundations, once you have adequate disclosure, and I cannot overemphasize how public reports, and in some cases instant disclosure will have quite a positive effect, then we would like to focus your attention to the very important question of how much money gets paid out to charities. I think, gentlemen, if you could be satisfied that a good deal of money was coming out, and that it was being spent on purposes that most Americans thought were desirable purposes, that you would probably want to encourage the setting up of foundations, and that all of these things have to be looked at in our opinion as an overall package.

Thank you very much.

The CHAIRMAN. Thank you very much for all the hard work you have done on this thing, Mr. Peterson. I know you have worked diligently to bring us information, needed information. I did want to ask you several questions to the extent that you might have the information.

It occurred to me that to the extent that a foundation deposits money in a bank and that bank in turn loans money to people, it is not likely you would come across that in the study you are making. Did you try to get at that?

Mr. PETERSON. We did. Senator, at the present time foundations are required to report certain kinds of transactions. I reported earlier on the level of those various kinds of transactions.

The CHAIRMAN. Let us say if a foundation keeps its money in the First National Bank, and the First National Bank in turn, not as a condition of the loan but they just find it good business, seeing that this man has the power to withdraw that money from that bank if he wants to, he would like to have them make a loan to his son-in-law, is that something that you would be likely to come across in the study you made?

Mr. PETERSON. We did find this much. Under the current regulations, you are to report whether you did or did not borrow money directly from the foundation. That happened in about 1 and a half percent of the cases where there was some kind of transaction of that sort. The indirect thing you are talking about we would not have uncovered.

The CHAIRMAN. That is what I was thinking. If his son or Aunt Sue or somebody borrowed the money, it would seem to me you would not come across that?

Mr. PETERSON. That is true though, isn't it, Senator, of a lot of situations other than foundations? For example, I suppose it could be argued that banks would consider some of these other relationships in many of the loans they make.

The CHAIRMAN. Oh, yes, I understand that. Now, in a similar vein, did you attempt to uncover the situations where a person on behalf of a foundation makes a large grant to a university and the university gives a scholarship to his son or one of his relatives?

Mr. PETERSON. Yes, we mentioned that Arthur Andersen & Co. reporting to us possible abuses; that one of them that was reported by several of the tax accountants anonymously, did cover the situation where in particular religious institutions, I do not mean to pick on a religious institution, which also has a school, there can be occasions where a grant to the religious institution is really to some extent

at least for the educating of some individual. That is true incidentally of private gifts as well as foundation gifts obviously.

What we would suggest to you, and that is one of the abuses we mentioned, is full disclosure of any kind of gift where there are any specific individuals who are to receive any kind of benefits from that gift to that organization. It happens infrequently I am sure, but it has happened, yes.

The CHAIRMAN. I am sure this is an infrequent thing, but someone told me of a situation where two men had a foundation, and Mr. X gives Mr. Y's son a scholarship to go to college and Mr. Y gives Mr. X's son a scholarship. I would think that you would be unlikely to come across that unless you had the whole thing computerized by tax number?

Mr. PETERSON. There is, Senator, a provision in the House bill that I think most of us would be sympathetic to, and that is the notion that where there are grants to individuals of the type you are describing, there should be some kind of systematic selection system that is used for the picking of the scholarship grantees, and that is the case you are talking about.

The CHAIRMAN. You are recommending that. In a like vein, when you are asking these CPA's what their reaction is to the foundation situation, would it not be true that these certified public accountants would owe a duty to their clients, to more or less protect their clients interests and speak favorably of them and their activities, insofar as they could speak a good word for them? Wouldn't those be the kind of people who would like to say something nice about their client rather than wanting to criticize them?

Mr. PETERSON. The way we tried to minimize that, though it obviously can happen, is the following. No one signed these questionnaires. There is no way of knowing who they came from, and they were never identified with an individual of any kind. The questionnaires went back not to us but to Arthur Andersen, and it is as good a job as we thought we could do.

Frankly, one of the reasons we recommended 100 percent auditing and I think you would agree with me there is only one way to get at the bottom of that kind of concern and that is people really having power to go in and look at the records. No private group in the world has that power.

The CHAIRMAN. You are recommending that?

Mr. PETERSON. We are recommending 100 percent auditing over a 3-year period, yes.

The CHAIRMAN. Senator Anderson?

Senator ANDERSON. I have heard of the Welter Foundation of Texas where the Welter family was given some land. Of course, there is very large amounts of crude oil in Texas and the result was that they had to have a charitable use for the money they made.

Mr. PETERSON. Senator, one way I think of handling problems of that sort is we would recommend that any significant contribution of appreciated property to a foundation be appraised independently and promptly, and to the satisfaction of the IRS, of value received for that contribution. I would think that this might be a way of getting around some of these problems where assets are put into foundations for which a deduction is given, but which are not the real

value of that contribution. Thus, we would specifically suggest that all such appreciated property contributions over some, you know, de minimis amount, be appraised independently. Otherwise when you have got the same person on both ends of the transaction, there is always a question as to whether that is really a fair value of the thing that was contributed. The IRS, I am told, has done this very successfully in the case of significant pieces of art, and I would think that people as able as they are could figure out a way of evaluating property that is contributed to a foundation and I would urge them to do it.

Senator MILLER. First, Mr. Peterson, let me commend you and your colleagues for the tremendous job you have done. I am sure that everyone that has an opportunity to look at this report will derive a great amount of benefit from it.

I am troubled by some aspects of the report, some of the conclusions. I agree that we ought to delegate responsibility to the Treasury for a great amount of this, but let me ask you a couple of questions.

The thrust of your remarks certainly in response to some questions, was that we want to encourage more foundations to be formed. Well, now, suppose there is an individual who is all ready to form a foundation, and he is going to form it by donating to it a good chunk of stock in his private corporation, and he checks with his tax adviser and his tax adviser and his financial advisers tell him that this stock has been earning at a rate of 4 percent a year for the last 4 or 5 years?

Mr. PETERSON. Are you referring to the dividend, Senator?

Senator MILLER. Yes, and that it is a prudent dividend policy, in view of the needs to plow back in a certain amount of the earnings for updating plant and equipment. Now he is all of a sudden faced with the proposition that if he donates that stock to the foundation, the foundation is stuck with let's say a 7-percent payout rule, that the next thing they are going to have to do within 6 months or a year is sell the stock. I assure you, and you know that that foundation will not be founded. And I think to that extent we are going to be discouraging the formation of foundations.

Another thing that bothers me is that I am not sure that the Commission gave a statement on this as to whether they would make these new rules apply prospectively or retroactively, and if they go retroactive, then what about the foundation which was set up many years ago, which has been paying out dividends. The company which it may control has had only a prudent policy. It sounds pretty harsh to me to turn around and say well, we are sorry, you have been doing a good job with what you have got, but you are going to have to get rid of this stock, sell it to some conglomerate organization, and the next thing you know put it into a mutual fund of some kind.

Do you have any thoughts on whether this should be prospective or retroactive?

Mr. PETERSON. Well, of course, any payout requirement, and I think the technical people on the staff would agree with me that any payout requirement including the one in the House bill will require some changes in the original agreements, where certain kinds of disposition was prohibited, and I think you would agree if the number were 6, 4, or 2 percent, or whatever it was it might require that kind of a retroactive charge.

I think, Senator, to be fair to my fellow Commissioners, it isn't that we weren't aware of the fact that this may have the effect of some divestiture on company control situations. I am very much aware of that. On the other hand, it seems to us that if you don't set an objective payout, and treat people equally, who after all did receive originally the same deduction for that contribution, you then find yourself, faced with other kinds of alternatives, such as arbitrary divestments, arbitrary rules, which are not based on performance at all, and which in my view would have a devastating effect. So the balance that we have to go through here, Senator, was the balance of trying to be fair and set an objective standard, not being arbitrary, trying to encourage the Treasury Department and the IRS to have some flexibility in, for example, giving periods of time to divest themselves of the stock, coming up with certain agreements as to how the stock could be divested, giving them time originally to recapitalize it. We would be for all kinds of flexibility, I think, of that kind.

Senator MILLER. Maybe you and I are hung up on this one. I agree with much of what you have said. As I understand it you want to have the Secretary of the Treasury promulgate a single rate, but what I would like to have him do is to promulgate several rates, based upon an average, for example, within specialized types of industries or investments, but they would be arbitrary.

If for example, you are a foundation with your investments in an electronic company, and the average for the electronics industry is an 8-percent payout, but you are only paying out 5, you are going to have to live with that. But to mix all of these things into one ball of wax and come up with one percentage rate bothers me very much.

I would like to just make this point. You are valid in your proposition that the donors of these various foundations were treated alike in their tax exemption.

Mr. PETERSON. Tax deduction, yes.

Senator MILLER. In their tax deductions, but I don't think it follows that the foundations are being treated alike, because they are all exempt from income, because this foundation, which has $1 million tied up in a low pay is getting exemption on a relatively small amount of income, whereas this foundation which is tied up in high pay is getting a high exemption.

I think that is what we have to look at too and that gets you back to the payout but I agree with you we need some kind of a standard, preferably set by Treasury, and I would like to have the flexibility built in in the form of several rates rather than just one.

Mr. PETERSON. But you see, Senator, we have taken a lot of testimony from a wide variety of people on our Commission. You remember I started my discussion by saying one of the things that does trouble people about the foundation setup is that there is some of this having their "cake," as it were, and eating it, and there is an important aspect of that.

Now, if you don't use an objective standard of some sort, what I guess concerns this Commission is that you then are saying, I think, that these funds are not being invested in what is on the best interests of the foundation. They are being invested or not invested as the case may be for a variety of other reasons that are not really in the long-term interest of that foundation.

Put it this way. If that foundation were independent, if it were concerned with its own interests as it were, I am sure we would agree that it would invest the money wherever it thought the money should be invested.

Senator MILLER. Then you would exempt these community foundations.

Mr. PETERSON. What?

Senator MILLER. You would exempt these community foundations, then.

Mr. PETERSON. Why is that, sir?

Senator MILLER. I understood when you were discussing the payout or statistics regarding some of the community foundations this morning I understood they are in the nature of the independent public type.

Mr. PETERSON. Yes.

Senator MILLER. So you would probably exempt them from the payout requirement.

Mr. PETERSON. No, we would include everyone in the payout requirement. We are trying to come up with something we think treats everyone alike. No, we would include everyone, Senator. I simply said that one alternative to the divestiture situation, the very understandable situation that you describe, where a company has a low-yield situation is to put that money or that foundation into a community foundation, maintaining its identity, which is possible in these community foundations; and the community foundation in turn could make its payouts from other funds that they have, and they have, you know, lots of funds.

Senator MILLER. Some of them do, some of them don't but I see harshness. I am thinking now in terms of a foundation out in Colorado that owns the Broadmoor. As I understand it, if they were going to realize, if they had to liquidate, let us say, let's say it has a low payout, if they are going to realize the money that they probably ought to be able to realize, I can see it taking 5 years very easily and maybe 10.

Mr. PETERSON. Yes.

Senator MILLER. To sell off the golf course, the hotel, the railroad and other parcels out there, and yet I understand from you, you thought maybe 6 months or possibly a year.

Mr. PETERSON. No. What I would be quite happy to do, Senator, in a case like that, and that was the first alternative I presented, if there were a case where there was great hardship, where you couldn't sell something off in pieces. I can appreciate some good reasons why this might be. I think it would be quite simple and I would be for it, to state the general principles that the Treasury Department should have the flexibility to make what you might call long-term arrangements with somebody, where for example there would be a very low payout accepted for 10 years or something of that sort. At that time there would be an agreement that within that period the asset would be sold, 8 years or whatever the number is, and at that point charity would get paid a compounded payout. I think there should be that kind of flexibility.

Senator MILLER. I think you have a good point there. My problem is to what extent can we delegate all of that discretion to Treasury without setting up some guidelines that are specific enough so that we are not caught on an unconstitutional delegation of power.

Mr. Peterson. Right, and we think the principle, at least our lawyers felt the principle that you could delegate would be to say the principle that all foundations are treated alike with regard to what the payout requirement is, and if there are special circumstances that make it extremely destructive to pay it out immediately, that the principle is that on a compounded basis at the time when the dissolution does take place, charity is made whole for that period of time that there was a lower payout.

Senator Miller. Let me ask you one last question. Your approach when it is finally all jelled out, with certain exemptions and flexibilities, is to arrive at 1 percent, maybe adjusted over 2 or 3 years, but you start out say with 7 percent.

The approach I suggest is that Treasury would set up several percentages based upon the type of investment that would be in certain, let's say, stocks, certain categories, railroads, utilities and the like, and if the foundation had its portfolio tied up in that particular type of stock, it would have to meet the average for that stock, and if it was below average, too bad, it is going to have to meet it.

Now to that extent, we would get more money in, wouldn't we?

Mr. Peterson. Yes.

Senator Miller. Probably wouldn't get in as much as you are advocating, but I think that that is how close you and I are on this, and I suggest to you that before we go the full route, I can see tremendous problems. I can see a problem, for example, where all the foundations may ultimately have to end up with two or three categories of investment. I am not so sure that that investment is available for all of our foundations. I don't know whether we have enough study in depth to know that it is. They may have to be content to get into Blue Chip stocks or something else instead of into some of these pools or funds that you are talking about.

Mr. Peterson. Quite frankly, I would assume that the Secretary of the Treasury in having rule-making proceedings here would look at the available securities in America, and I would be surprised if he would come out with a recommendation which said that there must be an investment in a certain kind of security. My guess is that that would be a serious error if he did that.

Senator Miller. No, he wouldn't say that, but because of the percentage that he puts there, he might—suppose he made it nine instead of seven, you might find that your fund managers are looking around and they only have a very limited area.

Mr. Peterson. I would hope he would not set it at a level that a reasonable man wouldn't say is what an independent fund manager who does have to consider not just growth, obviously, but he has got to consider the security of what he has. I would be inclined toward a kind of a standard that might be something like a balanced fund situation where there is, as I am sure you know, a fair amount of debt in those 20, 30, 40 percent. He could look at what bank trusts are doing, who have this very same problem of how do you balance security with the long-term growth. If he were to set that number on something that was let's say total equity or something of that sort, it is certainly not the kind of number we have in mind. If it were that kind of number our payout requirement you see has been 15 percent compounded for

the last 10 years, if you simply took the general growth funds that I mentioned. We don't choose a number anything like that.

Incidentally, the other reason for not choosing that, of course, is what goes up can come down, and I don't think a prudent man who has that kind of long-term responsibility would put all his money in one or the other.

We happen to have had an era in which equity stocks have been performing extremely well. There is nothing which says this is going to go on forever, and I would assume he would come up with a very balanced notion of a guideline. I would hope he would.

Senator MILLER. I don't suppose you have talked with any of the Treasury people about this, have you, as to whether or not they could implement this; how much of a financial advisory profit-sharing funds. They tell me that in the past 10 years there has been a revolution with regard to the definition of what a prudent man would do, and that these days a prudent man would most emphatically not put all his money into low yield debt instruments.

In fact, the evidence is overwhelming that if he had, he would have been earning much, much less money than if he had some investments in equity, and I think you are absolutely right. There has been a very significant change, and that is why we recommend to the total return concept, not just income yield in our formula.

Senator MILLER. Thank you again. I appreciate your responses, and especially the great amount of time, patience and very thorough explanation you gave the committee.

Mr. PETERSON. Thank you very much.

Senator FANNIN. Mr. Peterson, I too want to commend you for your performance. When we talk about the performance factor, we would certainly give you a high grade in your performance here today and for the work that you and your Commission has been doing preparing this information.

In your testimony you referred to distinctive characteristics of foundations. Well, we have heard from a great number of foundations and I am thinking back concerning some of the testimony that has been given to us, and in trying to apply this to the total picture that you have very capably given to us, and I just wonder when you answered the question from Senator Miller staff they would have to have in order to implement this?

Mr. PETERSON. I can tell you what the opinions are of the few people that we have talked to. The opinions are that there are probably eight or 10 people in the United States, a fair number of whom we have talked to, incidentally, in the course of deciding what a reasonable return is, who the Secretary of the Treasury I am sure could call on. The University of Chicago, for example, my alma mater has something called the Institute for Research in Security Prices, headed by Dr. James Lorrie. They have put every return of every stock in the last 40 years on a computer, with a big grant they got from Merrill Lynch. They can tell you what the return has been on almost any kind of an equity you can think of. I think reasonable men could sit around a table and say what is the balance now of investments that you as a prudent independent, and the word "independent" is important here, man would invest those moneys in. And I doubt that it would be all equity, but I think you would agree with me I also doubt that it would

be all debt, because the world has changed a great deal since the days of high yield and no capital return.

Senator MILLER. So we have now gone almost from a change of the prudent-man rule to the computer-man rule.

Mr. PETERSON. I would say this, Senator Miller. I have talked to the heads of the trust departments of many large banks in this country. I have talked to the heads of pension and about community foundations, I am a little confused, because you are not talking about the conduit foundations, in that respect, are you?

I will be quite honest with you, Senator. I am not sure I am an expert on foundations now, but I know I wasn't 6 months ago. I knew very little about community foundations. We have one in Chicago called the Community Trust. There is a very important one in Cleveland.

This is the following kind of situation. There are apparently many people who want to give money. They want to give it through the foundation route, but they do not feel they have the expertise, the staff and so forth to be able to evaluate it, where to put this money.

What the community foundation does, and why one of our recommendations might be to suggest that some who feel this way might merge themselves into community foundations, that it gives these donors a certain amount of expertise and staff and so forth which they don't have themselves, so it is kind of like a community fund. It is a group of foundations that are under one overall umbrella.

Senator FANNIN. We have so many, as you have referred to in your testimony, the operational foundation. I think Williamsburg was used as an example.

Mr. PETERSON. Right.

Senator FANNIN. You are not classifying those in the category which the information that you have given to us today would refer to.

Mr. PETERSON. No. There is an additional reason why I haven't, incidentally. I am trying assiduously to be as independent and objective and credible as I can be. After I took this job I found I was a trustee of two operating foundations, Brookings and National Educational Television, and under the circumstances I thought it might be best that I not talk about the problem least my appearance here be misinterpreted.

Senator FANNIN. I agree, too, with your premise that you were thinking of recipients, too, I mean grant making, but also you referred continuously to the essential part of your overall testimony being in connection with the recipients.

Mr. PETERSON. That is right.

Senator FANNIN. Because of the necessity of continuity of contributions, if we are going to maintain the level of our educational institutions to continue on with what we have been doing over the years.

We also have other types of foundations. We have a problem, I have also considered when you refer to self-dealing matters, that is personna non grata. And then we had testimony given to us where some of the large or at least I know of one large corporation, one large manufacturing concern under study, that is owned by a foundation, and it is a self-dealing program, and the information given was that this would require them to practically dissolve this complete organization

to accomplish what is in the House bill as far as the 20-percent requirement is concerned.

Now, I am not sure that I understand your exact recommendation on the divestiture.

Mr. PETERSON. My recommendation, Senator, is the following: I think a 5-year provision or a 10-year provision is extremely harsh, and will have the effect of greatly reducing the contributions to charity through foundations which we strongly believe is a fine institution.

On the other hand, I hope you would also agree that it is a mistake if one doesn't put some kind of a payout performance requirement on those foundations. Let me be a little extreme to illustrate my point; if you don't put a performance requirement on them to pay out to charity what is a reasonable amount, then I think we could easily see the situation, couldn't we, where a foundation could be set up, assets could be locked up into this founadtion, and 100 years from now we would still be having a discussion about the extent to which charity benefited. We might still be hearing testimony to the effect that just wait a while longer and charity is going to benefit.

Our thinking has been, rather than put a harsh and fixed period of time on divestment, put a reasonable performance test on it, that is the amount that is paid out. We think that will make the divestment effect far more gradual than what is in the House bill at the present time.

Senator FANNIN. I agree performance is a factor and is important and we must think about it if we are going to have these funds available for contributions. At the same time, we do have other things to think about, where a complete community is dependent upon that company continuing their operations in that particular area. We have one in particular where the officials have stated that if they must divest down to 20 percent, that their company will be picked up by one of the large companies of the Nation, and that they will soon be moved away from that community, and this is a consideration in some respects.

Now they may be isolated but I am trying to rather take the overall total picture, to also consider some of the detrimental effects that might happen if we are not careful in properly writing this legislation.

Mr. PETERSON. I wonder if we could talk about the general problem you are describing, because it is one that not only affects companies that have foundations, that have control stock, but many companies that don't, and that is really kind of a widespread concern in the country about raids of various types on the company, by conglomerates and so forth.

I think I have two kinds of answers to the very good question I think you are asking. One of them is that if as a matter of national policy there is general concern about the use of certain kinds of procedures and tactics to take over other companies, then it might be that that problem should be attacked directly, so that all companies who might be entitled to be protected from raiding tactics of various kinds would be protected.

For example, I know very few people that are running companies like I am, who want to be raided, and one of the interesting policy questions you have here is inasmuch as the deduction has been given to such company controlled foundations and, in a sense, the public, and

the government has given the deduction, what is its basis for the difference in treatment, and how do you avoid the kind of abuse I am talking about of very low payouts to charity.

Senator FANNIN. Yes, I realize that we do have problems here that would affect general operations, and I also know that we can't pass legislation just for the exceptions, but I don't know how many companies are involved or how many foundations are involved in what I am talking about, but I do know that we have had testimony and I am concerned about the effect it would have on those companies, although I realize that that can't be the controlling factor.

I certainly express my appreciation to you, Mr. Peterson, for the way that you have handled the questions and also for this very all-inclusive report.

Mr. PETERSON. Thank you.

Senator MILLER. Could I come back, Mr. Peterson, to this matter of private foundations? Earlier today I had the impression that we were talking about the grant-type foundation.

Mr. PETERSON. Yes.

Senator MILLER. As distinguished from the——

Mr. PETERSON. Operating.

Senator MILLER. The operating type like Williamsburg.

Mr. PETERSON. That is correct.

Senator MILLER. Then I started thinking about the United Givers fund. That is a grant fund, is it not? I don't know that the UGF in Sioux Ciy, Iowa, where I come from is an operating foundation.

Mr. PETERSON. One of the criteria you used for defining what a private foundation is the source of its support. There is the notion that if the sources of support are public in nature, that is they come from a wide variety of sources, that in itself gives you a good deal of protection. I believe, am I not right on this, I am not an expert on this point, that it is that the Givers fund in effect treated as a public charity?

Senator MILLER. That was my understanding, but then what caused me concern is when you started analyzing the community foundations which I gathered were of that nature, and yet you stated that you wanted to cover them all the same.

To make it clear on this point, are you suggesting that the payout requirement be uniform for all of these, or are you suggesting that it only be for the privately supported grant type foundation excluding the publicly supported foundation?

Mr. PETERSON. The situation, Senator, is the following: I don't know of any exceptions to this. There may be one. The vast majority, the kind of United Givers situation that you are describing has a high element of a conduit operation in it, where a lot of the money flows and the payout would be probably much higher, much like many company foundations, probably 30, 40 or 50 percent payout and it is really not even a factor to them.

Frankly, I am not an expert on United Givers. I really haven't thought about it as much as I should.

Senator MILLER. I do see a problem beyond that though, that where you may have a foundation that received 80 percent of its donations from the general public, with pretty much the general public having

to do with who is going to be the foundation's trustees and all of that.

Mr. PETERSON. Yes.

Senator MILLER. Like the community type foundations, I can get much less concerned about their being an adequate payout in that situation that I can where one person sets up a private foundation, and I am wondering if we could simplify our problem by concentrating on the purely privately supported or nearly privately supported grant type foundation.

Mr. PETERSON. I have been thinking since you brought up the example, I am sorry I didn't know about the example in advance, of a situation where a local community, for example, one could demonstrate as a reasonable man that there might be very serious effects. You will remember one of the possibilities I talked about is merging such an institution with another kind of foundation. If, for example, the broader institution had a lot of public support from a wide variety of sources then it seems to me that in that case it could either be considered a publicly supported activity and not affected, or the payout could easily come from its conduit aspect that is vastly in excess of the kind of payout we are talking about.

Senator MILLER. In any event, your whole Commission's thrust is concentrated on the privately supported private grant type foundation.

Mr. PETERSON. Yes, on the grantmaking foundation. Frankly, the number of publicly supported, of course, I don't know what we precisely mean by "public," but most of the community foundations that I mentioned are really a collection as I understand it of private trusts and bequests and so forth, who kind of want the feeling of public involvement in the giving. It is the kind of thing, for example, Senator, where if a person wants to be sure that a local community is taken care of, the case you are talking about, he can set up a charter that says "This is what I want my money to be used for, this is what I don't want it to be used for," and he can be reasonably assured because of its public nature, where the mayor picks one man or the bar association or somebody like that, that the local interests of the community are adequately represented. And if he, for example, is devoted to the city of Des Moines or Chicago, and I think the Chicago Community Trust has a good deal of very local charitable giving, I can get that information for you, but I think most community trusts are almost entirely oriented to local problems, almost entirely to community problems.

Senator MILLER. If they are, then why should we get to worrying about them? Why not leave them alone, at least for the time being, and concentrate on the big problems that you have been covering during most of your testimony?

Mr. PETERSON. I think if one can be satisfied there is a lot of public support going into them and so forth, one might easily consider such a possibility.

Senator MILLER. Thank you again.

The committee will be adjourned.

(Mr. Peterson's prepared statement follows:)

STATEMENT OF PETER G. PETERSON, CHAIRMAN, COMMISSION ON FOUNDATIONS AND PRIVATE PHILANTHROPY

SECTION I. BACKGROUND OF COMMISSION

My name is Peter G. Peterson. I am chairman and president of Bell & Howell Company, Chicago. I am here today in my capacity as chairman of the Com-

mission on Foundations and Private Philanthropy. This is a group of private citizens who are making what we hope and trust is an objective study of foundations, of these important, these complex, these poorly understood, and—in many ways—*uniquely American institutions.*

Permit me to outline briefly the origin of this group. I was invited to head this commission in the spring of this year, by John D. Rockefeller 3rd, representing several major foundations, which in turn were stimulated by a proposal for such a citizens commission by Alan Pifer, president of the Carnegie Corporation, and, I am told, by the chairman of this Senate Committee among others. The reasons for these foundations' choice of a chairman have mystified me to this day, and perhaps at this point mystifies some of the foundations as well.

I, in turn, accepted this assignment on the following conditions:

1. That leaders in the legislative and executive branches would be consulted as to the potential value of such a commission. The matter was discussed with the Chairman of this committee and the Chairman of the Ways and Means Committee. Both were gracious enough to say such an inquiry might be useful. They of course bear no responsibility for our results. I should also say that Messrs. Tom Vail and Joseph Ingolia of the Senate Finance Committee staff and Dr. Larry Woodworth of the Joint Committee on Internal Revenue have been very helpful in posing relevant questions.

I should mention appreciatively the Under Secretary of the Treasury, the Assistant Secretary of Treasury for Taxation, and the Director of Internal Revenue and their staffs, all of whom gave our various studies the benefit of their cooperation and obvious resources.

2. I also agreed to accept this assignment only if I could assure myself and others of the *objectivity* of such a commission and its staff, by selecting it myself with careful attention to the background of each person.

For example, I felt it necessary to withdraw invitations in a number of cases where I found that certain persons, however outstanding, had affiliations with foundations that might make the objectivity of their judgments about foundations subject to question.

In my own case, I have no foundation of my own, though Bell & Howell does have a company foundation. I am not on the board of any foundation, as I understood the term at the time I accepted this assignment. Upon reading the new definitions in the House Bill, I found that—as a trustee of the Brookings Institution and the National Educational Television—I am considered a foundation trustee and I leave it to you to decide how much prejudice to allow for. I do not propose in my testimony to go into any of the particular problems of those organizations with repect to the pending legislation.

I felt that this need for independence extended to the financing of our effort as well. We are raising our own money from companies, labor unions, and individuals and have not accepted funds from foundations. I think it is possible that some of our recommendations will not be popular with foundations and I would not have wanted foundation contributors to feel we were ungrateful or unfriendly recipients of their support.

I have attached a list of Commission members and staff to this statement. I believe you will agree that they represent a variety of backgrounds.

I know you will also agree that foundations do not lack for critics and this Commission has wanted to be sure it noted these criticisms—all of which you have probably heard before. Some of these allegations as they have been reported to us are:

"Many, or most foundations are nothing more than tax dodges for millionaires."

"Foundations are heavily involved in politics and not charity. Why should these activities be fostered at public expense?"

"Foundations often use their money to further extreme ideologies—left and right."

"Many foudations represent great concentration of in-perpetuity power and money controlled by an 'Ivy League' self-appointed establishment."

"Foundations spend a great deal of money internationally and ignore the needs of our own society."

"Foundations squander money, that would otherwise go to charity, on high salaries and fancy overhead expenses."

"Foundations hoard money as though it were their own when it belongs to the public and should be spent on charity."

We quickly found that many of these observations, however hostile or entertaining, depending upon one's point of view, had one thing in common . . . very

little *evidence* by which they could be supported *or* refuted. Early in the life of this Commission on April 14, 1969, we developed a work outline of the Commission's study, and I quote: "It is anticipated that the primary function of the Commission will be to formulate judgments on the principal policy questions which are raised by the role of foundations in our society . . . the Commission does not expect to engage in any extensive fact-gathering activities. Very extensive data about foundations and their activities are available from both public and private sources."

No commission ever started its inquiries upon a more erroneous assumption.

For example, when we asked how *frequently* each kind of foundation abuse occurred, we were told either that there were no such studies, or treated to an anecdote or two with no clear notion of whether the anecdote was an exception or expresses a persistent pattern.

Faced with a vacuum of information, we launched several studies of foundation abuses. For example, Arthur Anderson, a leading accounting firm, surveyed 200 tax accountants across America anonymously in an attempt to estimate the frequency and nature of tax abuse by foundations. The National Opinion Research Center is serving as an outside research consultant, and Market Facts, Inc. is conducting a survey among foundations of all sizes and types, randomly selected from the Internal Revenue Service files with their complete cooperation. The so-called 990A forms which foundations must file annually were analyzed for evidence of various kinds of self-dealing transactions. May I say, parenthetically, that while the 990A form can, in our view, be substantially improved, it does contain valuable information. We find it distinctly ironic that, in view of widespread allegations about foundations and the equally widespread ignorance, the 990A form apparently remains one of the less utilized sources of information in the government storehouse.

Out of these studies of abuses have also come recommendations for your consideration that deal with 1) additional, potential *abuses* that we believe should be covered in legislation; 2) much more intensive IRS auditing of foundations, and 3) concrete suggestions for some different concepts of public disclosure and public reporting that should keep you and the public much better informed on the level of any such abuses in the future.

On the question of how much foundation money goes to quasi-political purposes, and how much to generally acceptable charitable purposes, we could find either no estimates at all or what were frankly self-serving guesses. I will show you today our preliminary findings on the numbers of foundations making, and the amounts of money spent for, various kinds of sensitive grants. I believe we would all agree that the kind of legislative action that is appropriate depends at least partly on the *incidence* of various kinds of grants—if you knew that questionable grants account for 1% of the total, you might feel quite differently than if you found they were 30%, 40%, or more of the grants, as some have apparently assumed.

Once again, I will offer today some practical recommendations on what we believe to be appropriate new kinds of legislative action for the handling of sensitive grants that stand on the borderline between charity and politics.

On the allegation of foundation hoarding of money and low payout of funds to charity, we will show you some data on the rate of return in 1968 on foundation assets as well as the payout to charity. You will see how this and other evidence has led us to recommend that you consider legislating a higher payout requirement for foundations.

Reliable data of the most fundamental nature is not obtainable. For example, you have heard testimony that there are approximately 22,000 foundations in the United States, with assets of 20.5 billion dollars. Confusion abounds as to the definition of a foundation which at least partially explains why others say there are 45,000 foundations. I must also remind you that the assets reported on the 990A form may often be carried at cost rather than market value. A prime example is the Irvine Foundation which recently testified before this Committee.

Its assets have been listed at 6 million dollars. Yet, testimony before this Committee clearly establishes that the value of the assets *at a minimum* is substantially in excess of 100 million dollars and our Commission has seen estimates that approach one billion dollars.

The loss, or perhaps the absence, of confidence in foundations may be a reaction to fear of the unknown—in terms of assets, or activities, or both.

To move on, I would not be so fatuous as to suggest that our Commission, with its limited resources of time and staff, has answers to all these allegations or questions, or even all the answers to any one of them.

Perhaps you will agree, however, that we do have evidence that might make some of our recommendations, and perhaps some of your ultimate decisions, more firmly based on fact than the hearsay and anecdotal approach that seems to characterize the situation today.

What I will present to you is in the nature of a preview of a final report which is and always has been scheduled for completion prior to year-end. Some of our studies are only partly completed and where that is true I will present only preliminary findings. Also, all my fellow Commission members were not able to attend our most recent meeting, and what I say today must be considered as my view of the consensus of our deliberations, and not as a final report.

Before presenting you with our findings and recommendations on foundations, I feel we must look at private philanthropy a good deal more broadly.

Unless we assess the present and future needs of charitable organizations in our society—which are the recipients, after all, of most foundation grants—we cannot intelligently assess the roles of foundations, and indeed private philanthropy as a whole.

Foundation funds are the river that has irrigated many important crops. Prudence dictates that before we change the course of this stream, we calculate the effect on our resources.

SECTION II. THE FINANCIAL NEEDS OF AMERICA'S CHARITABLE ORGANIZATIONS

We are undertaking the hazardous and admittedly conjectural task of projecting the national needs in 1975 for each of the major charitable and social sectors of our society . . . health and medicine, education, religion, welfare, the arts, and so forth.

Then, we propose to estimate the amounts of support that might be expected from various sources if current trends continue.

From this, we expect to come up with a kind of "giving-gap"—the projected deficit in our social accounts.

You, I understand, have seen similar projections in the area of Medicare and Medicaid and have undoubtedly been as sobered as we have been by the projections of the experts. Quite frankly, we have been so taken aback by the dollar needs, and by deficits projected in tens of billions of dollars, that we are rechecking our own assessment of these needs . . . though we are quite prepared now to believe the melancholy extrapolation that this society is going to need to find tens of billions of dollars more by 1975. And if by then, our economy reaches its current cosmic projection of over 1.3 trillion dollars, I think it is not too hopeful to say that our society will somehow energize itself to find the money it really needs to attain our minimum standards of social health—or at least to cope realistically with our major social illnesses.

How else might we assess the needs of charitable organizations in 1975? We have approached this question in two other ways, less quantitative perhaps, but nevertheless essential to a balanced understanding.

First, more than 750 distinguished citizens across the country have answered an extensive questionnaire.

Who are these distinguished citizens? They are persons whom we expected to be knowledgeable about charitable endeavors in our society. They are citizens who, we expect, are going to continue to assume heavy responsibility for the various private sectors of our society.

They are, for example, scientists—both Nobel Prize Laureates and operating heads of scientific institutions. There are medical people . . . both leaders of medical organizations and medical educational institutions. There are businessmen—chosen from the ranks of chairmen and presidents of America's leading companies. There are labor leaders—both at national and local levels. There are religious leaders and scholars. There are representatives from the arts. This group, then is a kind of "Who's Who" of the knowledgeable citizens who also take a good deal of the responsibility for the operation of our private charitable organizations.

First, we asked them to tell us about which of the charitable sectors of our society they felt most knowledgeable. Then we asked for their best estimate of the trend of financial needs of their special field of philanthropy.

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

OVER THE NEXT 5 to 10 YEARS, WHAT WOULD YOU EXPECT TO BE THE TREND IN FINANCIAL NEEDS OF CHARITABLE ORGANIZATIONS IN THE PARTICULAR FIELD OR AREA OF SOCIETY IN WHICH YOU FEEL MOST KNOWLEDGEABLE ABOUT PHILANTHROPY?

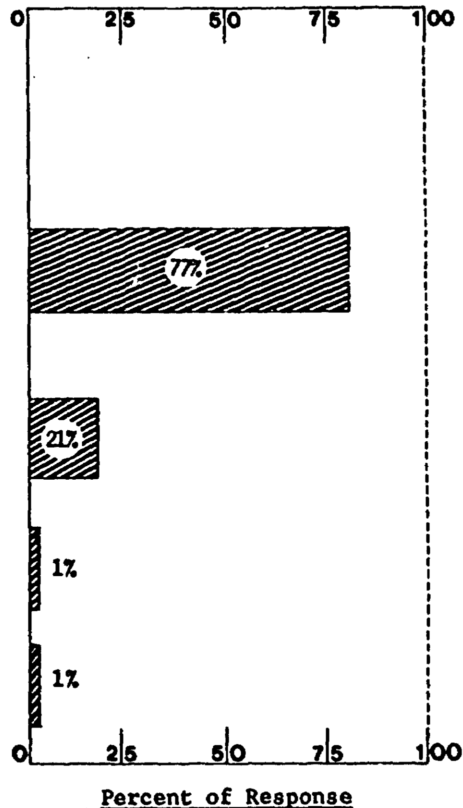
Predicted Trend of Financial Needs in Next 5-10 Years

"to go up rapidly over this period, significantly more rapidly than gross national product, for example."

"to go up but at a relatively modest rate - about like the gross national product."

"to stay the same as they are now."

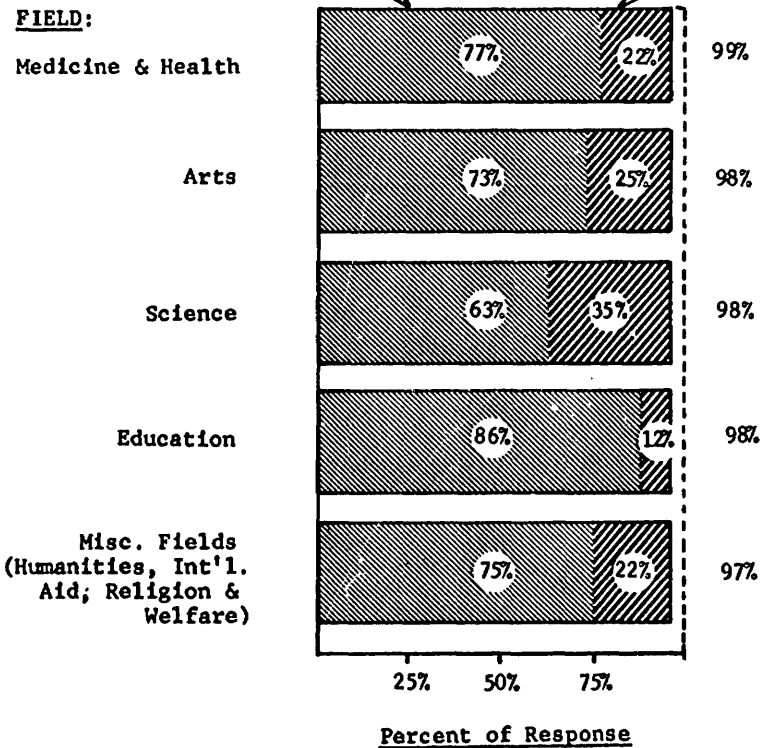
"to go down over this period."



You will notice in the following table that the substantial majority in *every* field felt that needs would go up rapidly over this period, significantly more than the gross national product. However, there are some differences: a striking 86% of those distinguished citizens involved in education saw the future needs this way, whereas significantly fewer, or 63%, of those in science felt this way . . . perhaps chastened by some of the recent cutbacks in grants to science.

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

IN THE FIELD IN WHICH YOU FEEL MOST KNOWLEDGEABLE, WHAT DO YOU EXPECT THE TRENDS OF FINANCIAL NEEDS WILL BE DURING THE NEXT 5-10 YEARS



Another approach, of course, is to go to the charitable organizations themselves and get their projections. By now, over fifty Chicago charitable organizations of all types—hospitals, universities, symphonies, museums, welfare agencies—have submitted themselves generously and charitably, to very intensive 2 to 3 hour interviews plus an in-depth look at their financial and cost records.

It will not surprise you to know we found none of these organizations who expected charitable needs to go down or even stay flat, and it may not surprise you that they thought they would have financial problems in the future . . . after all, we all have money problems and perhaps the fund raising instinct of charitable organizations is so well developed that it is hard to pass by an opportunity to say so.

Even allowing for this all too human tendency, our Commission is impressed by the degree to which these organizations feel they are facing urgent problems. For example, when asked:

"Looking ahead to your 1975 financial situation, which of the following statements reflects your feelings about the situation:

"To be sure, costs are rising and charitable needs are growing, but I'm also confident that outside revenues and contributions will also go up fast enough to meet our needs	17%
"I'm quite concerned about rising costs and increasing charitable needs. I'm not at all sure that outside funds will be adequate to meet these needs and some cutbacks will probably be necessary to make ends meet	26%
"I believe that by 1975 our organization will be facing a real budget crisis unless some major new sources of funds are developed."	57%

Because we, and particularly you, are aware of the rapidly growing government investment in these charitable sectors, we wanted to determine what impact a drop of 25% in private giving would make. Over 82% of these Chicago charitable organizations reported that they would either "cease to exist" or "face a very serious budget problem."

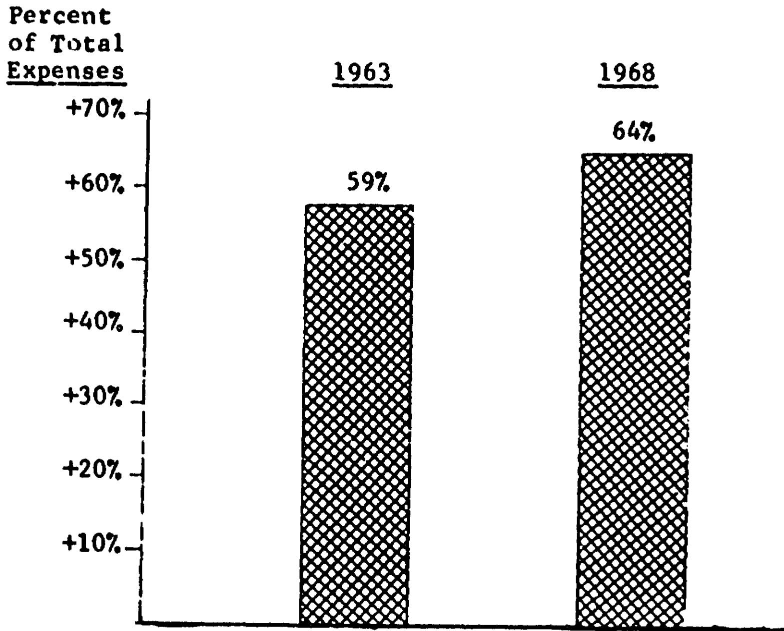
How can this be, one might ask, in view of the rapidly increasing government expenditures in these same areas?

We are now in the process of putting together the answer to this question, but already some things are clear.

First, as a businessman, I am struck by how much this business of charity is a *personal service*, a *people business*. Even without considering the substantial value of the volunteer inputs, notice both the level and the relative increase in the importance of this people expense. Obviously, the budgets of charitable organizations show a much higher percentage of people-related expenses—two to three times higher than many manufacturing companies where the people expense in the last census of manufacturing firms was about 24%.

THE INCREASING COST OF PEOPLE

PERSONNEL EXPENSES*AS A PERCENT OF TOTAL EXPENSES
FOR SELECTED CHICAGO
CHARITABLE ORGANIZATIONS: 1963 - 1968



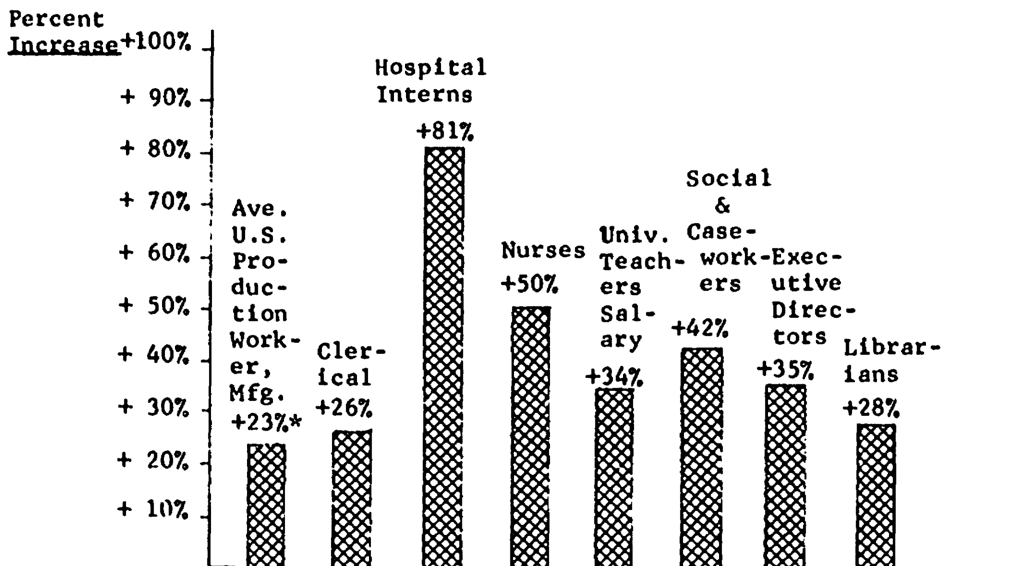
*Does not put any value on volunteer labor.

Why then, we asked, can one item increase so much not only in absolute terms but also increase 5 percentage points of the budget in only five years?

As we searched for the answers, one stands out above all others. The salaries being paid many employees of charitable organizations are apparently rising much faster than for the manufacturing segment of our labor force.

SALARY INCREASES FOR EMPLOYEES OF CHARITABLE ORGANIZATIONS
1963 - 1968

SELECTED COMPARATIVE SALARY INCREASES 1963-1968
(As Reported by Chicago Charitable Organizations)



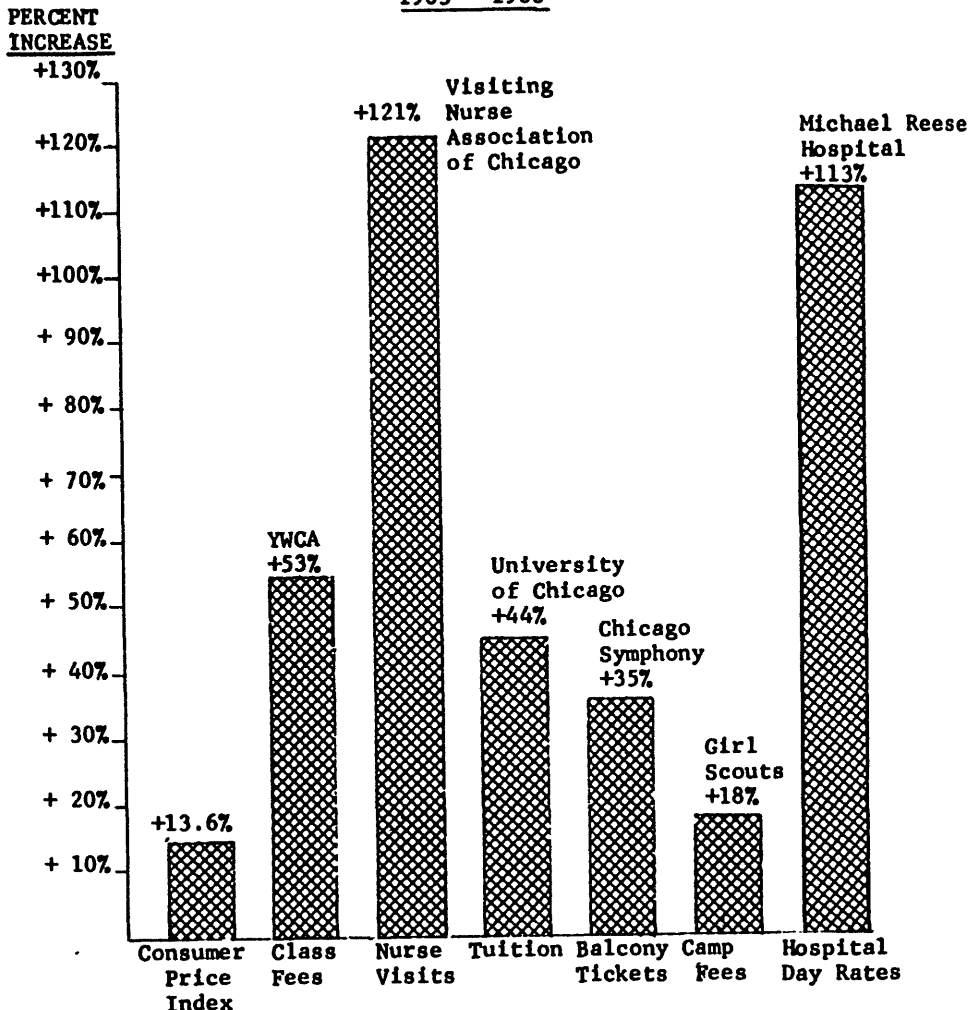
*Source: U.S. Dept. of Commerce and Commission Survey of Chicago Philanthropic Organizations

The reason for these increases is, as in all things of this sort, a question of supply and demand. Lest anyone conclude from this last chart that these classes of charitable employees are being paid bountiful salaries, let me hasten to say that for the most part they are catching up from what most fair people would call unreasonably, or perhaps unconscionably, low levels. It is strong evidence of the need to train more skilled people to serve these charitable organizations.

You might ask, as we did, why don't some of these charitable organizations simply charge the public more for their services? Why should the government and private philanthropy foot the bill?

An answer that emerges clearly from our Chicago study is that many of these organizations who can charge the public more have been doing just that . . . with what we might have considered a good deal of boldness, certainly in comparison with rise of prices in general.

CHICAGO PHILANTHROPIC STUDY
PRELIMINARY--OCTOBER 1969



And in spite of what appear to us to be sincere efforts to alleviate their financial problems, we were distressed to see some of Chicago's most honored charitable organizations suffering with operating deficits—the YMCA, Art Institute, Salvation Army, the Chicago Symphony (like most major symphonies in this country, which is now in what might well be called a desperate fund-raising drive to save the orchestra), and the University of Chicago which after an exhaustive and, as a Trustee, I must say depressing study a few years ago, predicted an annual operating deficit of some twenty-five million dollars in 1975.

The skeptic might take this a step further. Granted, he might say, they aren't paying higher salaries than they need to pay. Granted that real efforts are being made to raise money from the public, why don't these charitable organizations improve their *productivity?*

Even the question of productivity raises the blood pressure of professionals in the field who quickly point out that you can measure the output of a steel plant or a photographic firm, but you will have a great deal of trouble even defining what you mean by the output of a hospital, or a welfare worker.

But even if we ignore these formidable problems that are far too deep to be either discussed or solved here, our Chicago evidence suggests that in many cases it is simply taking *more* people in charitable organizations to serve a typical recipient—whether he be a hospital patient "enjoying" the benefits of rapidly

advancing technology and skills, a graduate student being exposed to a rapidly proliferating curriculum, or a welfare case, previously ignored as intractable and unemployable, now being given intensive training and individualized help.

The changes in the quality and nature of the work being done by charitable organizations have in a significant number of cases raised *unit cost* to provide a person with charitable services from 50% to 100% during the last five year period when the consumer price index sent up less than 14%.

There are inefficiencies, to be sure, and in the past I think it is fair to say that these expenses have not received systematic, intensive attention in many charitable organizations. There can be no question now that the pressure is increasingly on the charitable organizations to increase the efficiencies of the clerical, the paper work, and all the indirect expenses that seem to plague all organizations.

But having said this, I believe any fair person who is trying to project the honest facts about the present and future needs of charitable organizations in America will come to the conclusion that the public policy of this country must take into account the unpleasant but important reality that the needs of America's vital charitable organizations are rising rapidly and, without important *new* sources of funds measured in many billions of dollars, will face what can be fairly called the *charitable crisis of the 70s.*

Choice of a public policy aimed at meeting the needs of America's charitable organizations

This country, collectively and individually, can meet the growing budget crisis of charitable organizations in a number of ways. To simplify greatly the policy alternatives—we have said there are three very broad policies the country adopt:

Policy alternative No. 1: Permit a significant number of charitable organizations to decline or die by not providing major new funds through either private or government sources.

We see no evidence that any responsible segment of our society, and certainly not this commission or the Senate Finance Committee, I'm sure, has any such goal. There is no desire to see these charitable organizations, one of our country's most humane and enduring trademarks, do anything but flourish at a time when any sensitive and decent citizen cannot help but be apprehensive about the future of our society.

Policy alternative No. 2: Decide that these problems are truly public problems and decide on a national policy to take them over at the government level through tax dollars and give reduced incentives to private philanthropy.

To a degree that has surprised many on our commission, a number of European societies have already moved significantly in the direction of this State supporting all major segments of education including higher education and even the arts.

Policy alternative No. 3: Encourage the private sector to give to a greater extent and take as large a role in the solution of these problems as is possible or practical.

All of us know that the government has played a much more important role in supporting charitable sectors of our society with each passing year . . . whether it be education at all levels, science, medicine, welfare, and indeed to some extent, the arts.

As a Commission with diverse backgrounds—some with government experience, some with none. Some with business, private enterprise backgrounds, other with government or academic histories. Some with Republican orientations, others with extensive traditions as Democrats. It is surprising and in some ways very reassuring that such remarkable unanimity emerges.

1. First, we recognize that the world has changed profoundly and the scale of our problems has changed with it. The federal government should play a major role in the support of these charitable organizations.

No one on the Commission seemed to suffer any fantasies that the private sector could by itself muster up the multi-billions that will be needed to meet the social problems of the 70s.

2. With equal unanimity, this Commission urges that the top national policy be the strongest kind of reaffirmation of the independent and complementary role that is to be played by the individuals and by the private sector; that this reaffirmation should be expressed in the kind of tax bill that passes.

I hope to be able to demonstrate that the House-passed tax bill is interpreted by this Commission and the distinguished citizen and leadership segments of

this society as distinctly anti-philanthropic—and that this is expressed in what is said and not said, about the importance of private philanthropy in this society and very important, in what has been done, and not done, to the tax incentives to private giving.

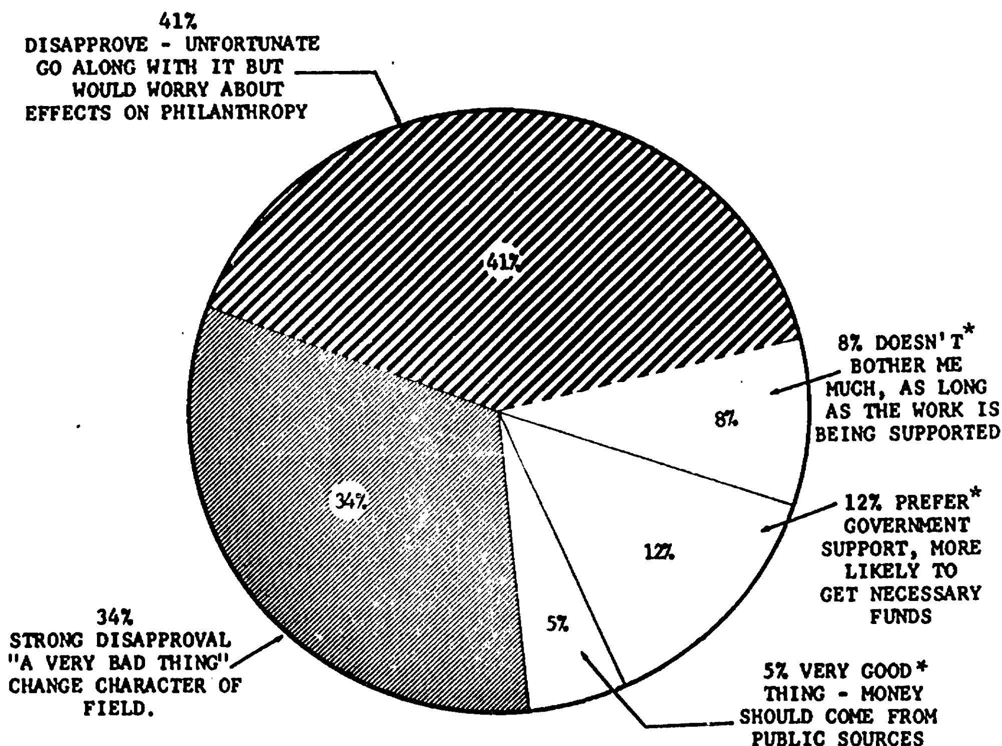
First, before we review the tax reform bill with respect to philanthropy, let us see what the Distinguished Citizen Study told us about what they felt the national tax policy should be.

We put it to the distinguished citizens in several ways. First, how would they feel if the government's support of private organizations increased to the point where the government would predominate at the expense of diminishing private involvement and support.

Even though many who participated in our study have worked in fields such as science and medicine that have been and are the grateful beneficiaries of impressive government generosity, their desire to preserve and encourage the private sector is striking. As against this view, we think it is even more striking to see how these same citizens view the House Bill in its anti-philanthropic effects.

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

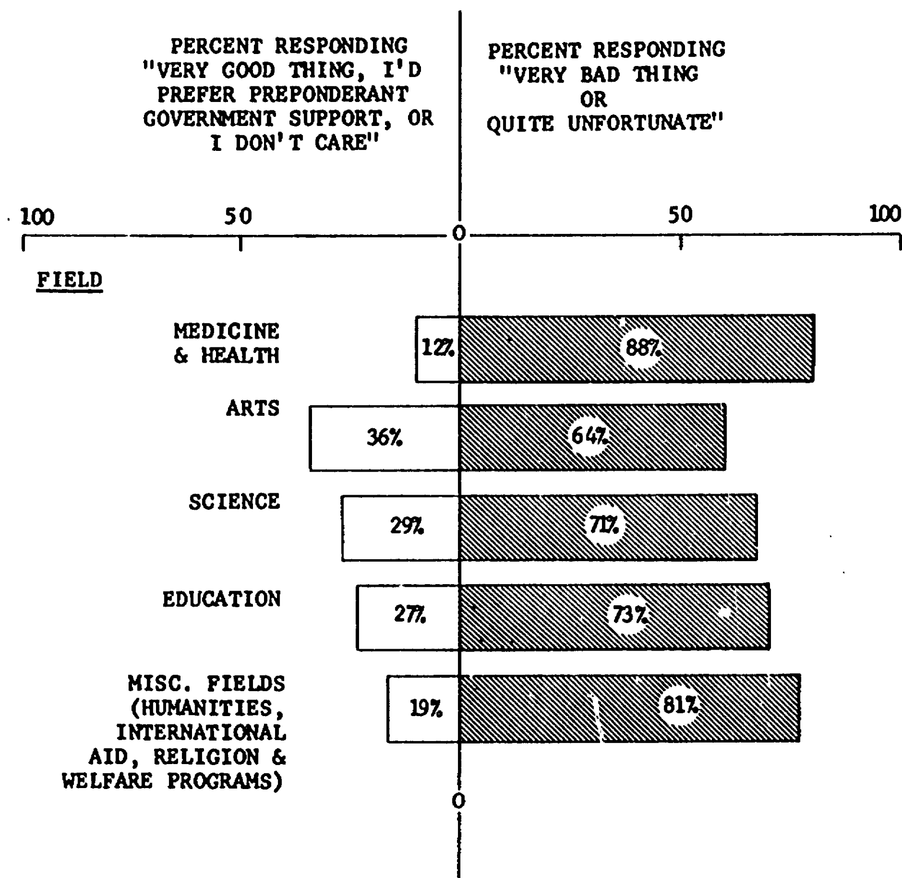
ATTITUDE TOWARDS PREPONDERANT GOVERNMENT SUPPORT OF CHARITABLE ORGANIZATIONS AT THE EXPENSE OF A LESSER ROLE FOR PRIVATE PHILANTHROPIC SECTOR.



*Of those citizens who said that preponderant support will have to come from the government at the expense of a lesser role for private philanthropy, 71% said that even though it may be desirable to maintain the importance of private contributions, it is inevitable that government will dominate...the sheer massiveness of the financial needs in the future preclude a preponderant role for private philanthropy.

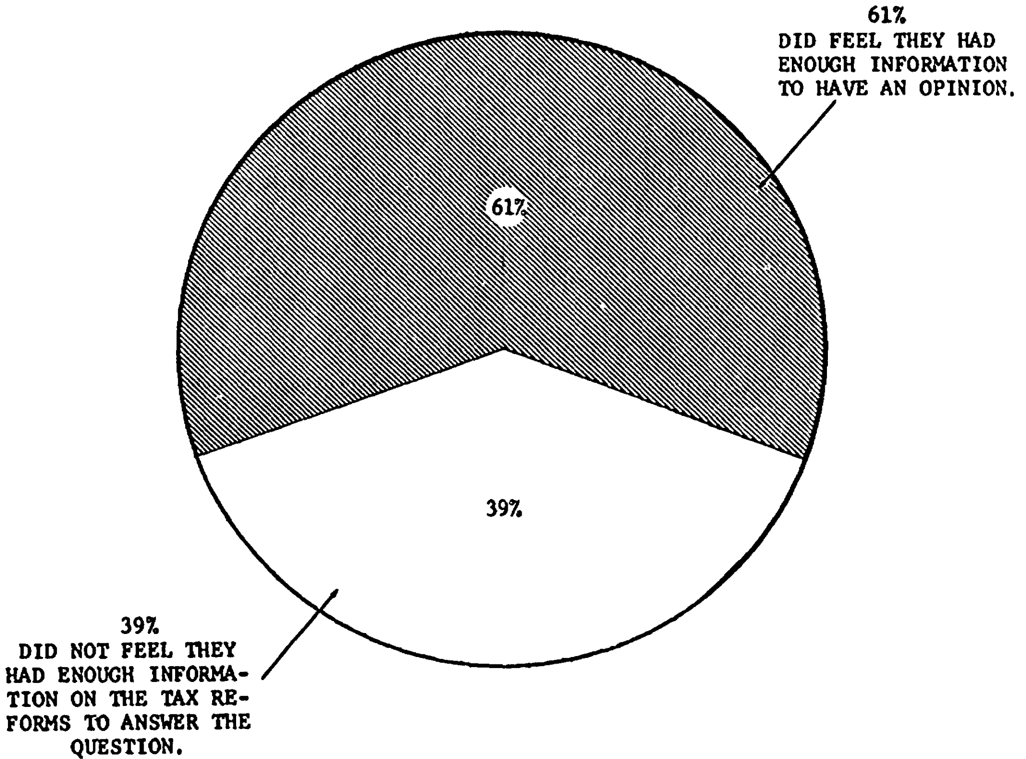
DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

ATTITUDE TOWARDS PREPONDERANT GOVERNMENT SUPPORT OF CHARITABLE ORGANIZATIONS AT THE EXPENSE OF A LESSER ROLE FOR PRIVATE PHILANTHROPIC SECTOR - ANALYSIS OF RESPONSE ACCORDING TO FIELD OF SPECIALTY



DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

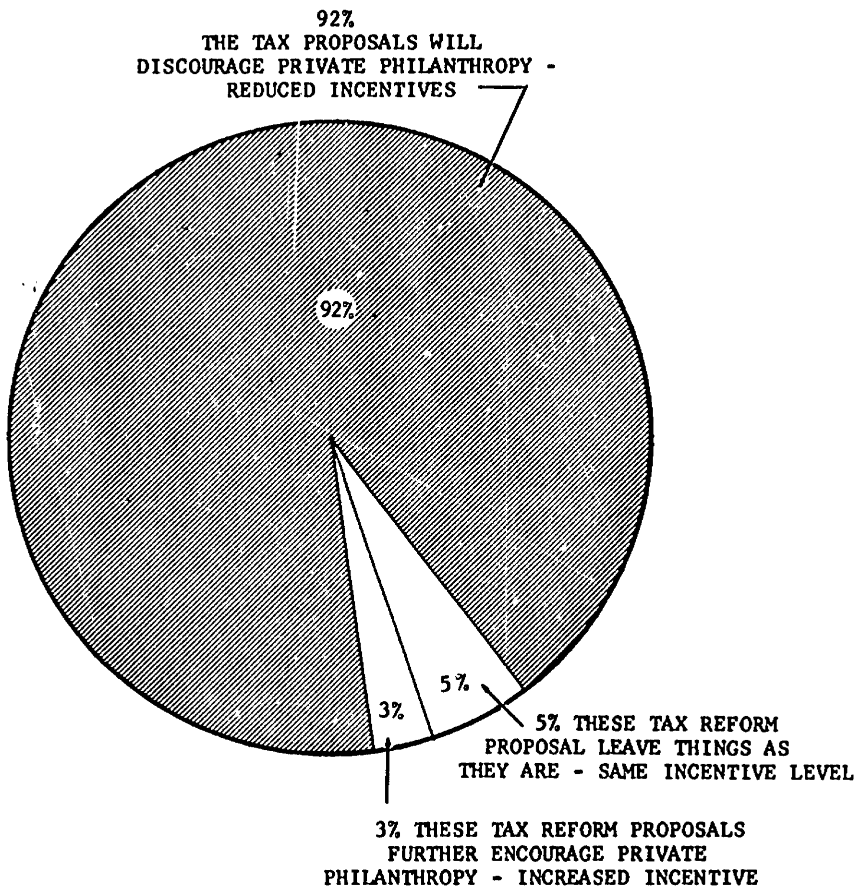
"FROM WHAT YOU KNOW, WHAT DO YOU BELIEVE THE TOTAL IMPACT OF THESE HOUSE TAX REFORM PROPOSALS TO BE?" *



* These questionnaires were completed in August and the House Bill was reported in July.

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

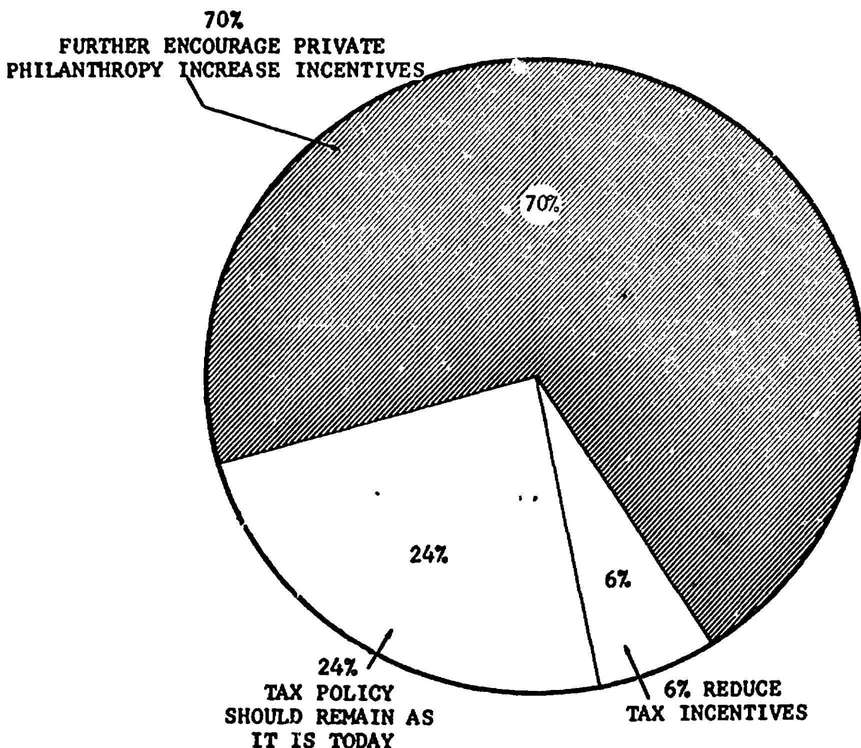
WHAT DO YOU BELIEVE THE TOTAL IMPACT OF THE HOUSE TAX REFORM PROPOSALS WILL BE ... (AMONG THOSE WHO FELT THEY HAD ENOUGH INFORMATION TO HAVE AN OPINION).



It is then quite consistent for the leaders in our survey to tell us that they believe *additional* private incentives are one appropriate route to meet the growing financial crisis of charitable organizations.

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

"ASSUMING GROWING NEEDS OF CHARITABLE ORGANIZATIONS AND GROWING GOVERNMENT EXPENDITURES, WHAT SHOULD BE THE PUBLIC POLICY TOWARD PRIVATE PHILANTHROPY? SHOULD GOVERNMENTAL INCENTIVES BE DESIGNED TO STIMULATE MORE PRIVATE GIVING ABOVE AND BEYOND ITS CURRENT LEVEL: SHOULD CURRENT TAX INCENTIVES BE LEFT AS THEY ARE: SHOULD SOME DIS-INCENTIVES TO PRIVATE GIVING BE INSTITUTED?"



The Commission agrees emphatically that a basic tax policy of further private incentives is the best one for this country—confronted as we are by limited dollar resources and rapidly accelerating demands on many fronts. The Commission would add that the productivity of the multi-billion dollar resources of the existing foundations should also be re-appraised to determine whether society might not get a larger return to charity on this very large investment. I will have more to say about this later.

The human and social values of the private sector's deep involvement and support of charitable organizations do not need restatement here. Your more specific interest now is how to get the highest social return per dollar spent—whether in direct government support, or through tax incentives.

We hope to develop a clearer notion of the dollar-multiplier effect of the private charitable dollar as opposed to a government dollar for the same purposes.

First, the "cost" to the government of a charity dollar is obviously less than the cost at a dollar of direct government expenditure. Where the private donor is in the 70% tax bracket the government saves 30%. When the donor is in a lower tax bracket the saving to the government is proportionately greater.

Second, there is the question of cost and efficiency—whether the private sector does the job more efficiently with less administrative expense to the government.

We are gathering evidence on one aspect of this cost-efficiency factor—the value of the volunteer labor. For three-fourths of the Chicago charitable organizations studied so far, the number of volunteer workers exceeded the

paid employees. And if we place a $3 per hour value on the volunteer labor, we find an impressive list of charitable organizations where the dollar value of the volunteer labor exceeds the total dollar payroll. For example, this is true of the Chicago YWCA, Red Cross, United Cerebral Palsy and Girl Scouts.

This expeirence is confirmed by available national statistics that project some 55 to 60 million Americans engaged in full-time or part-time volunteer activity for nonprofit institutions during the year. From the business sector alone, Fortune Magazine recently estimated the value of volunteer services at five billion dollars annually.

We do not yet have an answer to the other aspect of the question—what happens to this level of volunteer activity when the charitable institution becomes either state-supported or operated? In Chicago, we are trying to find out by comparing volunteer activity in Illinois or Cook County operated hospitals versus private hospitals, in Illinois operated welfare organizations as compared with private welfare agencies.

If this energetic and involved segment of the American public should sense that national policy is shifting away from strong encouragement of private philanthropy, I would hazard a guess that some, perhaps many, may conclude that they are not genuinely wanted, and reduce their personal efforts.

Thus, both for deeply philosophical reasons that have to do with the kind of society we really want, and for equally impressive pragmatic, dollar-and-cents reasons that have to do with getting this vital social work done at lowest cost, this Commission would urge you to reaffirm in attitude and action the strongest reassurance to the public that you share the view that however big and complex our social needs are, you want the private sector to contribute more of itself and of its money to a compassionate and effective solution of the massive and growing problems of the seventies.

III. THE HOUSE BILL AND ITS IMPACT ON PHILANTHROPY

The attitude of many dealing with these issues is something to this effect: "There is no intention to hurt charitable organizations. All that is being done is to close loopholes, to broaden the tax base and to eliminate special preference so that the very rich cannot get away with paying a pittance in taxes."

In short, this justification says that whatever is being done is in the name of tax equity—and certainly the vast majority of us think it both sensible and decent that we try to preserve the integrity of the tax system so that all who can share in the cost of governmental activity do so. The question, of course, is: What are the specific inequities we should correct? And what are the costs to society of the proposed corrections?

I was describing some of the negative effects on philanthropy to a physician friend recently, who said: "That sounds like what we call an *iatrogenic* disease." He explained that the word "iatrogenic" derives from the Greek word "iatro," meaning doctor—and it refers to unintended diseases or side effects that are caused by the medical treatment itself. We appear to have a similar problem here. Those of you who have the responsibility to decide tax policy must look at our entire body politic and balance the effects of treating afflictions of a part of the body with the effect upon the system as a whole.

The current tax bill represents a very understandable attempt to treat some defects in the equity of our tax structure. The effort is supported by the mood of the country to have every taxpayer pull his full weight.

I would raise the question of whether sufficient attention has been given to the *encouragement* of private charity. Were careful assessments made of the side effects of the bill?

Even today, our Commission has been deplorably unable to obtain a detailed assessment, provision by provision, of the probable effects of the House bill on charitable giving. Please do not misinterpret my statement. We have had splendid coöperation in every sense from the staffs of legislative committees and from the Treasury Department.

With the frightful press of time during this last six hectic months of tax reform, I believe these estimates have not yet been made. The public interest would be richly served by a full analysis of the likely dollar effects of each provision affecting charitable giving, and upon the overall consequences of the Bill as a whole.

If these estimates are to be reliable, they require full access to data on revenue and charitable giving that are available only in the Treasury Department.

Our Commission has conducted its own research among large charitable donors whose names we obtained from charitable institutions throughout the country. In total, 85 such philanthropists cooperated with the Commission in estimating the effects of the House bill on their future attitudes and actions.

Development directors of major charitable institutions tell us that these kinds of donors are not only enormously important for the gifts they make, but for the leadership role these gifts play in providing the initial impetus to fund raising efforts.

You will see in the attached chart that it is no overstatement to call them *large* donors—their median annual giving over the last five years in $375,000.

Descriptive characteristics, 85 large donors in Commission study

Average median annual donation to charity—in last 5 years	$375,000
Donors having foundations	74%
Donors who in recent years have reached 30% ceiling on charitable gifts	82%
Donors qualifying for, or who have qualified for, the unlimited deduction	13%
Donors who said that they were familiar with the house tax reform bill	92%
Have discussed the house bill implications with their tax or financial advisors	78%
Currently giving through a family foundation	69%
Planning further contributions to a foundation, or setting up a new foundation	63%
Owns over 20% of the stock of a company	54%
Donor or his family has a foundation that owns over 20% of the stock of a company	16%

The *form* of the gifts that large donors make is obviously of prime importance in view of the treatment of gifts of appreciated property in the House bill.

Form of giving by large donors

"Over the past 5 years or so, what was the approximate distribution of your charitable giving as between these *various kinds of gifts?*"

	Percent
Appreciated property:	
Outright gifts of appreciated tangible personal property	1
Bargain sales	5
Outright gifts of all other appreciated property (stock, property, bonds, etc.)	61
Subtotal	67
Cash or unappreciated property	[1] 25
Future interests, trusts, etc	8
Total	100

[1] Some of the donors answered this question in terms of their foundations' giving rather than their own direct philanthropy. This has the effect of overstating the percentage shown for "Cash or Unappreciated Property."

To give you some clues to the particular interests of these large donors, this chart indicates their dominant concern for higher education. Relatively small amounts go to churches and religion—only 5% compared to almost 45%-50% of all private giving.

Estimated current distribution of giving of large donors studied

	Percent
Higher education	45
Welfare, social and community service	12
Hospitals and health care institutions	10
Other cultural institutions, music, humanities	10
Education (other than higher)	7
Art museums	6
Church and religious affiliates	5
Other miscellaneous (conservation, etc.)	5
Total estimated giving by large donors studied	100

Many have wondered precisely what effect tax incentives have on charitable giving. Members of the staff of this Committee expressed an interest in the extent to which charitable giving would be reduced with no incentives at all.

Here is what the big donors tell us in answer to the following question:

"For the moment, let us assume that there *were no tax benefits at all* for charitable giving—in other words, let us assume you had to make all your charitable contributions out of your *after*-tax income.

"What effect would this have on your charitable contributions?"

Only 4% affirmed it would have no effect on their giving. The remaining 96% indicated it would reduce their giving—and the median reduction was 75%.

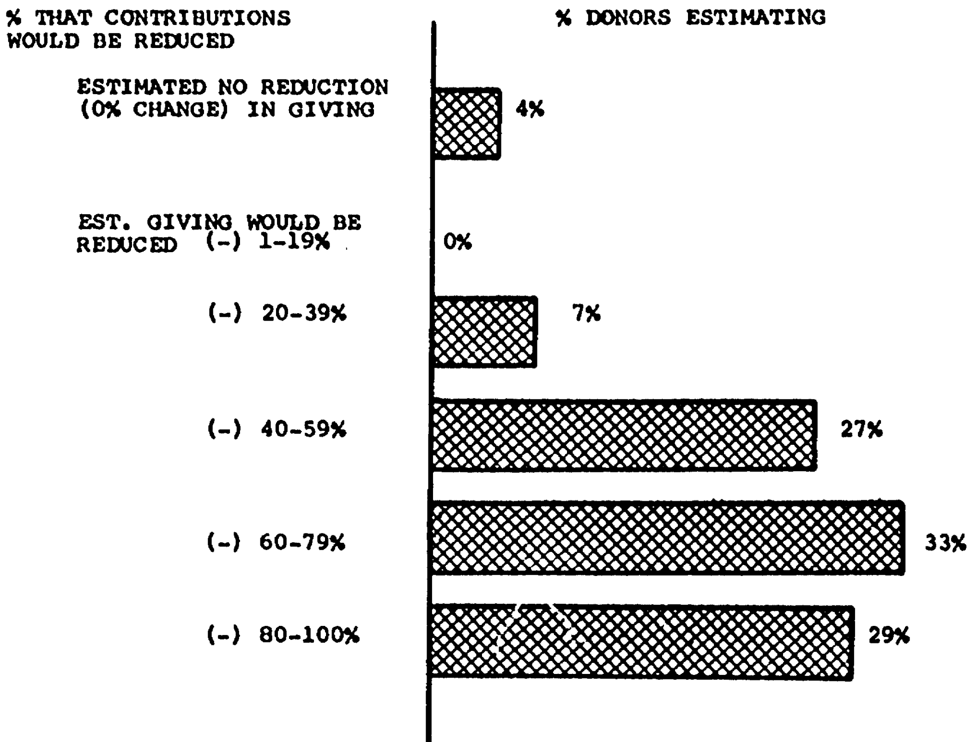
Estimated effect on charitable giving if no tax incentives

"For the moment, let us assume that there *were no tax benefits at all* for charitable giving—in other words, let us assume you had to make all your charitable contributions out of your *after*-tax income.

"What effect would this have on your charitable contributions?"

Minus 75 percent estimated average (median) reduction in charitable contributions.

ESTIMATED EFFECT ON CHARITABLE GIVING IF NO TAX INCENTIVE



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My own hunch is that this response may be something of an overreaction to the proposed changes in the tax bill. It is apparent that the amount of charitable giving depends on a mixture of at least two elements besides tax incentives: philanthropic interests and social pressures. While some moral purists might decry this mixture of motives—a point to which I will come back later—it is enough to observe first, that the recognition of mixed motives has been inherent in our tax laws for over fifty years; and, second, that tax incentives are a highly significant factor.

Any conclusion about motivations for giving is clearly conjecture. We went on to a more objective question—the actual determination of the effect of the House Bill on the big donors' taxes (which quite a number apparently had their tax accountants recompute).

Estimated effect of House bill on 1968 taxes of large private donors

"First, we want to know what would have happened to the *taxes you would have paid* if your level of *charitable contributions* were the *same type* and at the *same level as in 1968*, but the *new tax reform provisions* were in effect."

Plus 25 percent the estimated average (median) increase in 1968 taxes.

Comment: Over 90% of the donors responding stated that their taxes would have increased.

We moved from here to a question of principal interest to us—the effect of this tax bill on charitable giving. This is necessarily a hypothetical question but the attitude expressed in the following numbers if indeed a disturbing one for anyone concerned with the need for substantially increased giving.

Estimated effect of House bill on charitable giving by large donors

"Second, having some feel of the effect of this on your taxes paid, we would like your opinion on what effect these tax reforms, in turn, would have on *your level of charitable giving.*"

Minus 50 percent estimated average (median) reduction in charitable gifts by large private donors, had House bill been in effect.

Given any effect of this magnitude, it becomes essential to determine which provisions of the Bill play the largest role. Therefore, we asked those same donors to indicate the comparative effect of the various provisions upon their charitable contributions. While the complexity of the computations makes it difficult to assign precise effects to each provision, it seems clear that the provision having the largest negative effect on contributions was the *allocation of deductions* feature whereby deductions, including charitable contributions, will be allocated between taxable and non-taxable income. Next in negative impact on charitable giving is the *limit on tax preference* provision, with gifts of appreciated property being included as a tax preference.

Opinions of large donors studied concerning which one (of several) House bill provisions would cause the greatest reduction in their charitable giving

Percent of donors who thought provision(s) would have greatest negative impact on giving:

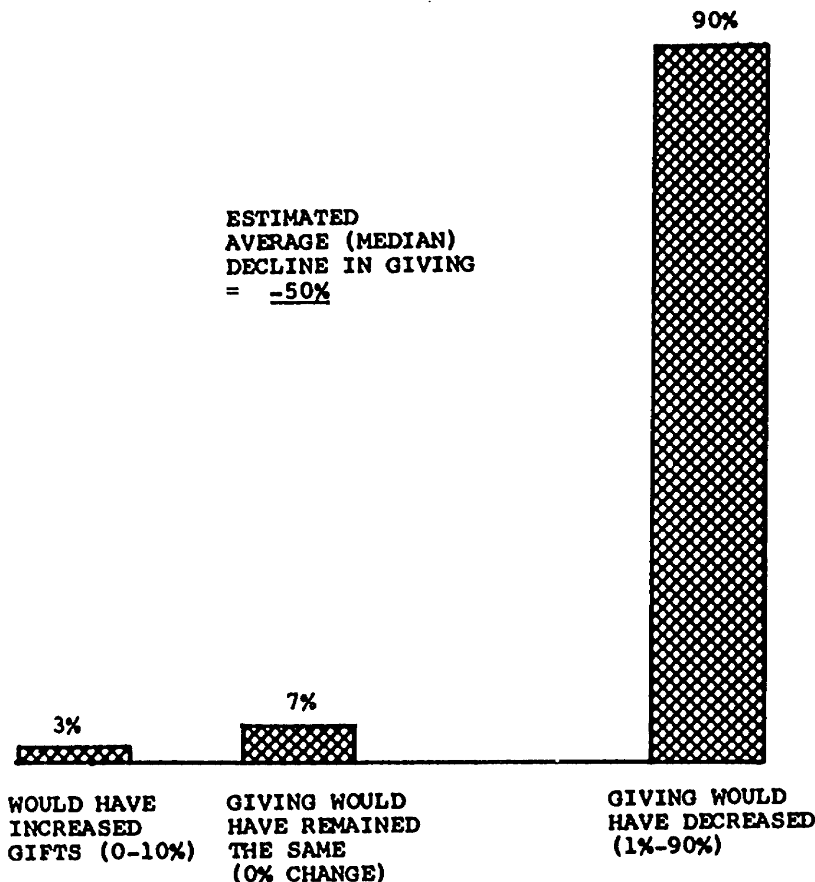
Allocation of deductions provision	58
Limit on tax preference provision	24
Total	[1] 82
Charitable trust restrictions	8
"Bargain sale" provision	2
Specific foundation provisions	8
Removal of deductability of tangible personal property	0
Total of large donors studied	100

[1] Since many donors expected that these two provisions would have to be evaluated simultaneously, it was difficult for them to say precisely which of them would have the greatest single effect. However, most estimated the "Allocation of Deductions" provision would have the greatest negative effect on contributions.

The House bill would increase to 50% the present 30% limitation on charitable giving. It is perhaps the one provision of the House bill designed to strengthen the incentive effect of charitable deduction for the taxpayers generally.

I am sorry to report that not one large donor in our study believed that this new 50% provision provides an incentive to increase his total contributions, when taking the total reform bill into account. The allocation of deductions and

ESTIMATED EFFECT OF HOUSE BILL
ON CHARITABLE GIVING BY LARGE DONORS



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limited tax preference provisions apparently minimize the benefit of this provision.

Perhaps an additional word on the *complexity* of the House tax bill is in order. A number of the large donors emphasized this point by referring to the "necessity of solving simultaneous equations" and "requiring your own computer." Complexity is troublesome because of its effect on decision-making in charitable giving. The vast majority of charitable gifts cost the donor something, and it is usually a bid traumatic for him to make the final decision to give. Thus, people who raise money for charity worry about additional barriers to the already difficult decision to give.

Fund-raising experts say that *simplicity* is an important stimulant to giving. . . . so that the donor clearly understands the specific effect upon him. Under the House bill, the donor will often not know until late in the year what the amount and distribution of various kinds of his income will be. Therefore, he is

likely to delay giving; to "think about it a little more," to say "let's see how things turn out later in the year." Those who raise money for charity decry any additions to the already formidable store of excuses for not giving. They know from experience that a gift delayed is often a gift denied.

While we believe the times most emphatically do not call for disincentives to charitable giving, this Commission is certainly anxious to remedy tax inequities that relate to charitable giving. Particularly we find ourselves concerned about the situation in which the donor ends up better off by giving something to charity rather than selling it. The concept of "making money off charity" is not an attractive one.

Tax experts point out a number of ways in which this can happen and we would suggest specific legislative treatment to deal with each of the following:

1. It is clear that *inflated valuation of property* can have such an effect. We believe that the requirement of objective appraisal procedures, and prompt verification of the value of contributions of appreciated property, would significantly reduce this inequity.

2. I am told that contributions of property which the donor has already fully depreciated or where the sale would produce ordinary income rather than capital gains, can improve the after-tax position of the donor. Such effects can and should be dealt with in legislation.

3. We can see this "money-making effect" where the gift is in the form of high-markup products whose direct cost as a percentage of market value is less than the income tax rate—such as drugs, certain kinds of machinery, etc.

We would not want to encourage philanthropic giving at the expense of the basic integrity of the tax system and at an excessive cost to federal revenues. We would urge you to take action to control the above inequities.

Up to now, I have covered our deep concern over 1) the effects of the House bill on charitable giving, and have suggested that you get data on the effect of specific provisions on charitable giving. 2) Also, I have suggested that you limit those kinds of charitable gifts that result in the inequity of a high tax cost to the government and a net dollar benefit to the donor.

We have one longer term, and we believe important, tax policy recommendation dealing with private philanthropy. Let me be presumptuous and assume you accept our basic premise that the charitable crisis of the seventies requires significantly more funds, and that the private sector should be encouraged to give more.

What kind of new tax incentives for charitable giving would achieve this objective?

We would like to suggest the criteria for such a new tax incentive. It would:

1. Produce *significantly* more money for charity . . . in the range of several billion dollars.

2. Be compatible with tax equity, and prevention of tax avoidance.

3. Spread the giving among more people; *democratize* philanthropy more, and be less "elitist." It is obvious that only the very wealthy can make the really large gifts and if we are to increase the total flow of funds, they too must be further encouraged. However, we believe a better tax incentive system would give *more* people an incentive to participate in philanthropic giving, and therefore to participate in the decisions on how to allocate these funds.

4. So at relatively low cost to federal revenues, consistent with the above guidelines.

Our Commission has reviewed this objective with perhaps a dozen of America's foremost tax economists and tax lawyers, both *in and out* of government. Their views can be briefly summarized:

1. The area of really new and effective tax-incentive approaches to private giving has received remarkably little attention over recent years. It is certain that the need for such incentives was not a serious concern in the development of the current legislation.

2. The little publicly available data on charitable giving and the effects of various incentives is either primitive or out of date. The development of new incentives requires detailed revenue cost and charitable giving data that only the Treasury Department has.

3. Every expert the Commission has talked to agrees that current incentives have serious defects, and that the assignment to define new approaches that meet the criteria I mentioned earlier is indeed a worthy one that would challenge the best economists and tax experts in the country. They also agree that this is a highly complex and difficult task. There are no "quick and easy" solutions.

It is the recommendation of this Commission that a group of the best informed experts in the country be assembled and charged with the responsibility to recom-

mend to Congress and the Administration new incentive approaches to philanthropic giving. Their recommendation should, if possible, be ready for your consideration in 1970.

IV. FOUNDATIONS—THEIR NATURE AND THEIR ROLE

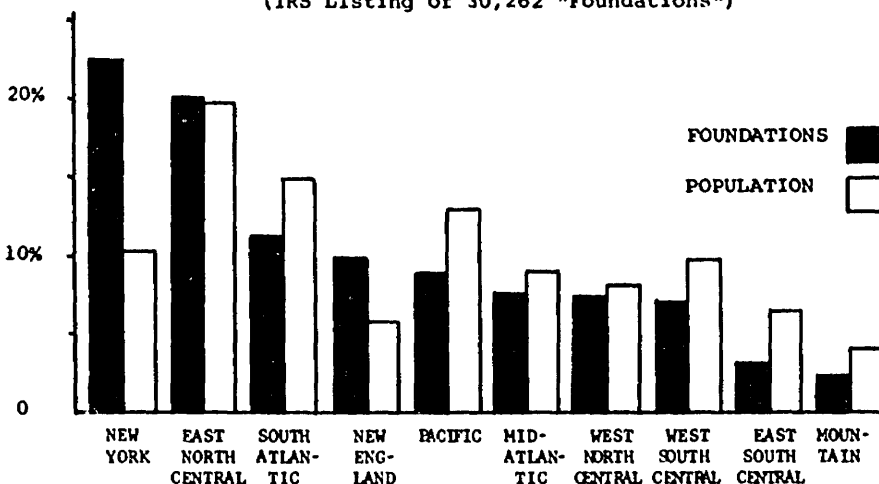
The principal focus of our Commission's work has been on foundations. We have, of course, looked beyond foundations into the much broader field of philanthropy because foundations are an integral part of philanthropy and because many proposals affecting foundations have an impact on philanthropy generally. To place foundations into perspective within the philanthropic field, it may be noted that annual foundation giving is approximately one-tenth of total private giving.

As you well know, there is no accepted definition of foundations. For the purpose of our study we have defined foundations as organizations whose principal activity is grant-making, thus excluding operating organizations. We have also excluded from our definition organizations whose funds come from public subscriptions, and so-called "feeder" organizations whose grants go solely to a single organization.

Foundations are found in every state of the Union although a disproportionate number appear to be located in the Eastern part of the country.

FOUNDATIONS BY REGION VS. POPULATION BY REGION

(IRS Listing of 30,262 "Foundations")



NEW YORK: F=22.36%; P=9.11%

EAST NORTH CENTRAL: F=20.14%; P=19.64%
Illinois, Indiana, Michigan, Ohio, Wisconsin

SOUTH ATLANTIC: F=11.14%; P=14.99%
Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia, West Virginia

NEW ENGLAND: F=9.87%; P=5.71%
Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont

PACIFIC: F=8.88%; P=12.95%
Alaska, California, Hawaii, Oregon, Washington

MIDDLE ATLANTIC: F=7.84%; P=9.38%
New Jersey, Pennsylvania

WEST NORTH CENTRAL: F=7.50%; P=8.04%
Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota

WEST SOUTH CENTRAL: F=7.04%; P=9.66%
Arkansas, Louisiana, Oklahoma, Texas

EAST SOUTH CENTRAL: F=2.89%; P=6.50%
Alabama, Kentucky, Mississippi, Tennessee

MOUNTAIN: F=2.34%; P=4.02%
Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, Wyoming

F = Foundations' per cent of total

P = Population's per cent of total

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In arriving at this geographical distribution we have used the 1968 listing of foundations which was compiled by the Internal Revenue Service. This list contains 30,262 foundations.

We have undertaken a survey of a sample of grant-making foundations, to determine where their grants go, the form of their contributions, their method of operation and other basic information about the operation of a cross-section of foundations. In many respects this survey represents one of the first systematic attempts to gather comprehensive data on foundations. Because so little is known, there are few guidelines for designing a sample of these institutions. It is difficult, for example, to achieve a precise sample when there is no adequate data on numbers, assets, or amount of grants.

The final report of the Commission will include data for some 350 foundations distributed across the various categories of foundations. At this time we have completed information from 163, about half of the total sample. For example, we plan to get completed interviews from as many of the top 26 foundations as possible. We have now completed 14 of those interviews.

Nevertheless, even these preliminary findings show some strong trends.

In our study we have divided foundations into four categories by assets size: over 100 million; 10–100 million; 1–10 million and under 1 million. We have treated company foundations and community foundations separately. It is significant to note that the 26 largest foundations hold over 10 billion dollars in assets and account for roughly 479 million dollars in grants per year. These large foundations, of which Ford, Rockefeller and Carnegie are familiar examples, usually operate on a national or even international scale although some, such as Duke and Mott, operate on a regional basis. Most of the small foundations, which are generally closely identified with the donor, operate on a regional or local basis:

GEOGRAPHICAL FOCUS OF FOUNDATION ACTIVITIES

[In percent]

	Type of foundation						
	Under $1,000,000 in assets	$1,000,000 to $10,000,000 in assets	$10,000,000 to $100,000,000 in assets	Over $100,000,000 in assets	Company foundations	Community foundations	All foundations
Regional or local	59	77	39	28	43	100	61
1 or more towns, cities, counties, or metropolitan areas	42	51	31	7	27	81	43
State	9	11	0	7	12	6	9
Region	9	14	8	14	4	13	9
National	22	9	23	29	39	0	21
National and international	9	6	31	43	4	0	9
International only	7	0	0	0	0	0	6
Other	3	9	8	0	15	0	3
Total[1]	100	100	100	100	100	100	100

[1] Percentages may not add to 100 percent because of rounding.

Source: Preliminary Oct. 20, 1969, foundation survey.

Community foundations, of which the Cleveland Foundation, the Permanent Charities Fund of Boston and the Chicago Community Trust are examples, differ from other foundations in several significant respects. Their endowment assets represent the pooling of gifts and bequests from a number of donors within the community and their trustees are usually appointed by various community leaders. For example, there may be one trustee nominated by the Mayor, one by the head of the local bar association, a third by the president of a university, and so forth. Their grants are devoted, almost entirely, to one metropolitan area.

A final category is the company foundation. These are usually closely tied to the corporation which sets them up, with company officers serving as trustees of the foundation. Such foundations often are simply a convenient alternative method for channeling corporate giving or a means of evening out corporate earnings by contributing more in good years and reducing contributions when earnings fall off. Some company foundations are so-called conduits, where annual grants are roughly equal to the annual contributions received from the corpora-

tion. These conduit type foundations have little or no endowment. There are, however, a number of company foundations which have substantial endowments.

While classification of foundations by size is helpful in obtaining a picture of the foundation field, we have concluded that there is no practical basis for classifying foundations for purposes of governmental regulation. Neither distinctions in size, purpose, or such factors as the presence or absence of a professional staff or of independent trustees provides a sound basis for differences in legal treatment. Contributions to all types of foundations receive the same tax benefits from the government. We can see no reasons why all foundations should be subject to such regulations as pay-out requirements, prohibitions on self-dealing, and prohibitions against involvement in elective politics. Public disclosure obligations should apply to all.

A. Reasons for establishing foundations

The reasons why a donor establishes a foundation—instead of giving directly to operating charities—are highly varied. There undoubtedly is a mixture of "pure" philanthropic motivations and of personal motives, including tax advantages. The existence of mixed motives is, of course, inherent in the use of tax incentives to encourage philanthropy. While no quantitative assessment is possible, it is clear that more funds have gone to charity in general, and to foundations in particular, than would have been the case without the tax inducements which have been granted to foundations and foundation donors.

First, the use of a foundation makes possible certain types of grants which would not be tax deductible when made by an individual donor. A foundation may make grants to individuals and it can also make foreign grants while an individual can obtain a tax deduction only for his contributions to tax-exempt organizations in the United States. However, a study of the grant making activity of foundations does not suggest that grants to individuals or to international organizations are of major importance.

Most grants are to tax-exempt organizations in the United States—74 percent to 30 percent charitable organizations. Only about 7 percent of all foundation grants go to recipients for which an individual would not receive a tax deduction for the same grant.

Second, foundations may also provide various elements of administrative convenience. Thus, it may be simpler for an individual with appreciated property to transfer that property to a foundation, and then make a number of donations from the foundation. This is likely to be simpler than to transfer such assets directly to a large number of recipient organizations.

Third, use of a foundation may also serve to insulate the donor from direct appeals from contributors. This point may well be one of the reasons why corporations organize foundations. It enables the top management of the corporation to some extent to avoid personal solicitation by channeling requests to the company foundations.

Fourth, foundations are also useful as a means of "evening out" gifts between different years. Thus a company or an individual may put more money into a foundation in a good year than in a poor year and still maintain the same level of support to various charitable organizations. Foundations can also be used for the opposite reasons: accumulating several years' contributions in order to make a large grant at a later date.

Fifth, an individual may, with tax-deductible dollars, hire a professional staff in order to systematize and develop expertise in giving. However, it appears that professional staffing is largely limited to the largest foundations, and even there the staffs are often surprisingly small. We are now estimating our total full-time personnel count of all foundations for our final report, but it would now appear to number in the very low thousands.

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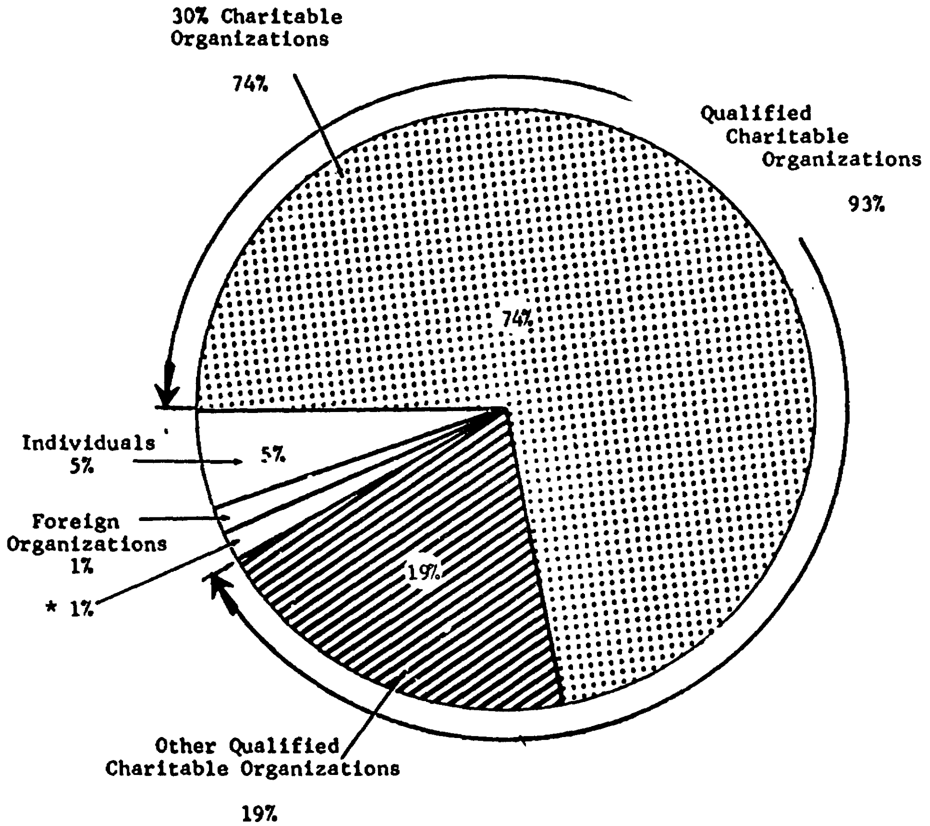
Foundation Study
Preliminary October, 1969

RELATIVE IMPORTANCE OF VARIOUS CLASSES
OF RECIPIENTS OF FOUNDATION GRANTS - IN DOLLARS



* Other tax-emempt, non-profit, or profit organizations less than 1%.

PERCENT OF FOUNDATIONS WITH PAID OFFICERS AND PROFESSIONAL HELP

[In percent]

	Type of foundation						
	Under $1,000,000 in assets	$1,000,000 to $10,000,000 in assets	$10,000,000 to $100,000,000 in assets	Over $100,000,000 in assets, total	Company foundations	Community foundations	All foundation
No professional staff	87	41	25	0	92	69	84
Part-time professional staff	10	41	42	7	0	6	11
1	3	29	25	0	0	0	5
2 to 5	5	12	17	0	0	6	5
6 to 10	0	0	0	0	0	0	(1)
Over 10	2	0	0	7	0	0	2
Full-time professional staff[2]	3	21	42	93	8	25	5
1	3	12	17	0	8	19	4
2 to 5	0	3	17	28	0	0	1
6 to 10	0	6	0	14	0	0	(1)
Over 10	0	0	8	50	0	6	(1)

[1] Less than ½ of 1 percent.
[2] These figures are not additive to 100 percent because some foundations have both part- and full-time employees.

Sixth, very personal considerations are also sometimes mentioned as a reason for setting up foundations. The foundation provides an opportunity for perpetuating the owner's name and his charitable interests after his death, and perhaps giving him a certain status and distinction while alive.

In all likelihood the most attractive feature of the use of a foundation is that it enables the donor, at least in some measure, "to have his cake and eat it too." He obtains a tax deduction at the time he makes a donation to the foundation; yet he can still exercise a substantial measure of control over the assets which he has donated to the foundation. This point is, of course, of particular importance when the asset contributed to the foundation is stock in family-controlled or otherwise closely-held business. Placing such stock in a foundation allows the donor to maintain his control over the business in a manner which probably could not be achieved if the stock was given to a charitable institution not under the control of the donor.

A related factor is that a grant to the foundation leaves the donor with continuing control over the charitable distributions which the foundation will make. If the funds were given to a university, the donor can specify at the time of his gift the purpose for which the money can be used. Thereafter, however, the money passes beyond his control.

In sum, it is clear that a wide variety of reasons may motivate the establishment of foundations. We believe, however, that the ability to obtain a tax deduction and still maintain an element of control over the asset which is contributed, is likely to be the most important factor. This is suggested by the way in which foundations get their money.

PERCENTAGE OF CONTRIBUTIONS TO FOUNDATIONS IN VARIOUS FORMS

Form of contributions	Type of foundation								All foundations	
	Under $1,000,000 in assets	$1,000,000 to $10,000,000 in assets	$10,000,000 to $100,000,000 in assets	Over $100,000,000 in assets			Company foundations	Community foundations	Total	Excluding Ford
				Total	Excluding Ford	Ford				
Appreciated property:										
Tangible:										
Personal property		2	(1)	(1)	(1)	1			(1)	(1)
Real estate	7	6	1	3	3	3	8	2	3	3
Intangible (stocks, bonds, etc.)	58	53	78	88	86	91	72	65	76	74
Stocks of company in which donor or family owned controlling interest (20 percent or more)	18	21	75	62	48	90	13		53	47
Other intangible property	40	32	3	26	38	1	59	65	23	27
Cash or unappreciated property	29	29	18	9	11	6	20	32	17	19
Partial interest in property (other than trust)			2						1	1
Charitable trust income or remainder	7	10	1						3	3

[1] Less than ½ of 1 percent.

As the attached chart shows, more than three-fourths of the assets of foundations were contributed in the form of appreciated intangible property. And more than *half was stock of a company in which the donor and his family had an interest in excess of 20%.*

Most foundations in terms of numbers have not received control stock in a corporation. Our data show that only 8% of foundations have ever owned more than 20% of the stock of a company, and only 4% now do. But over half of the *large* foundations in our study with assets over 10 million dollars have owned such control stock, and this, of course, explains why such a large portion of total contributions is in these forms.

OWNERSHIP OF CONTROL STOCK

Foundation type	Percent of foundations—	
	Ever owning 20 percent of stock in a company	Now owning 20 percent of the stock in a company
Under $1,000,000 in assets	7	4
$1,000,000 to $10,000,000	11	6
$10,000,000 to $100,000,000	54	39
Over $100,000,000	57	36
Community	13	7
Company	17	13
All foundations	8	4

It is apparent that the privilege of contributing control stock and other appreciated property is of paramount importance in the creation of new foundations of significant size. And both of these forms of contribution to foundations are severely limited in the House bill.

B. *Distinctive characteristics of foundations*

Recognizing that great variety exists within the foundation field, what characteristics make foundations distinctive? We believe that there are two factors which most clearly distinguish foundations from other institutions from other institutions in our society.

First, and most important is the fact that foundations have funds which are not committed to their own on-going activities. Practically every other organization in our society, whether it be a government agency, a corporation of a university, is likely to have its future activities dictated in part by the momentum of its on-going programs. The budget pressures of existing programs generally make it very difficult to find funds for different kinds of programs. The most distinctive thing about foundations is that they have substantial amounts of "free" money which their trustees can spend next year for purposes quite different from those pursued in the present year. This gives foundations a degree of flexibility, unmatched by any other institution in our society. This potential for doing new things is of very great importance to a society confronted by an era of great change.

Second, foundations with endowments are not required to raise new funds. This frees them from an element of external control which most other institutions must face. Government agencies must satisfy Congressional authorization and appropriations committees, as well as the Budget Bureau. Corporations must satisfy both their customers and their investors. Universities must satisfy a variety of existing and potential sources of funds. The absence of such external controls is also of great importance in giving foundations a potential for flexibility far greater than that possessed by other institutions.

Both the freedom from internal compulsions and from external financial controls are, of course, of great value to foundations. However, they also represent a real risk. Foundations are not subject to the discipline which institutions with budgetary pressures inevitably have. This manifests itself in a variety of ways. First, foundations have not been under pressure to maximize the return on their investments. Second, they have been free, within relatively broad legal limits, to decide whether to spend money currently or to let their assets appreciate for future years. Third, they have not been under the same pressure to control costs and expenses as are other organizations, particularly those which must compete in the market place.

In sum, the distinctive characteristics of foundations give them a great potential for doing important work. However, they also create a considerable potential for abuse or for inadequate performance.

O. *Assessment of foundations*

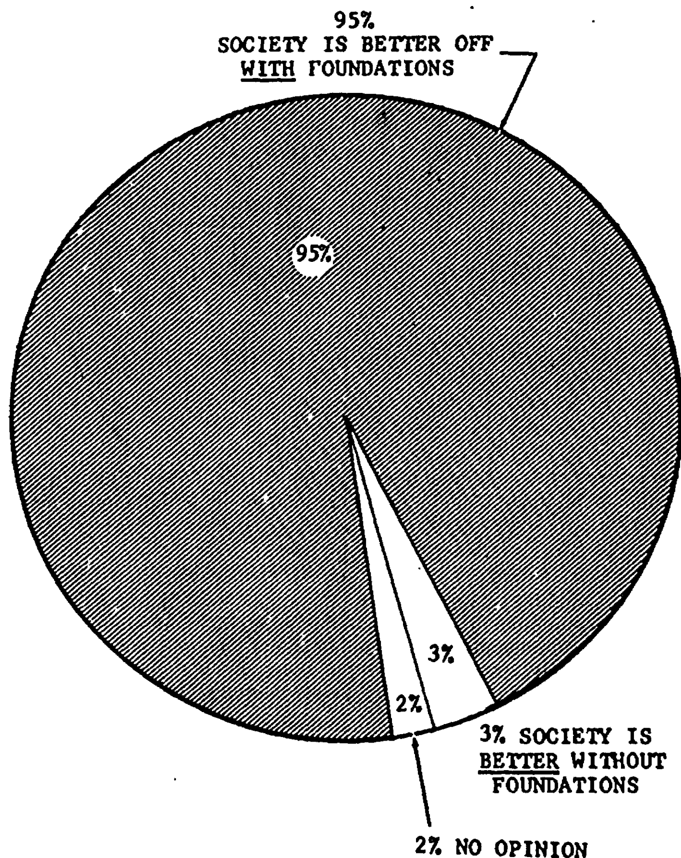
On balance, do the advantages of foundations outweigh the dangers? In approaching this question we have attempted to review both the accomplishments and shortcomings of foundations. Any evaluation of foundations accomplishments is, of course, enormously difficult. No "cost-benefit" analysis, comparing the loss of tax income with the social benefits produced by foundations, is possible. There are no meaningful yardsticks to "measure" foundation performance. Would similar results have occurred if funds went directly from Donor to recipient or if the project had been funded by government? Even the significance of a particular grant is invariably difficult to assess. This is inherent in the fact that foundations are grant-making institutions: How can one accurately apportion the relative degree of credit (or of blame) for a foundation-financed program between the foundation which provided the money and the recipient who did the work? For

In our survey of distinguished citizens we sought their opinion on whether society is better off with foundations:

An overwhelming 95 percent responded that they believed that we were better off.

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

"IN YOUR VIEW, IS OUR SOCIETY BETTER OFF WITH FOUNDATIONS, OR WOULD IT BE BETTER OFF IF THEY DID NOT EXIST AND ALL PRIVATE CHARITY WENT DIRECTLY FROM THE GIVER TO THE RECIPIENT?"



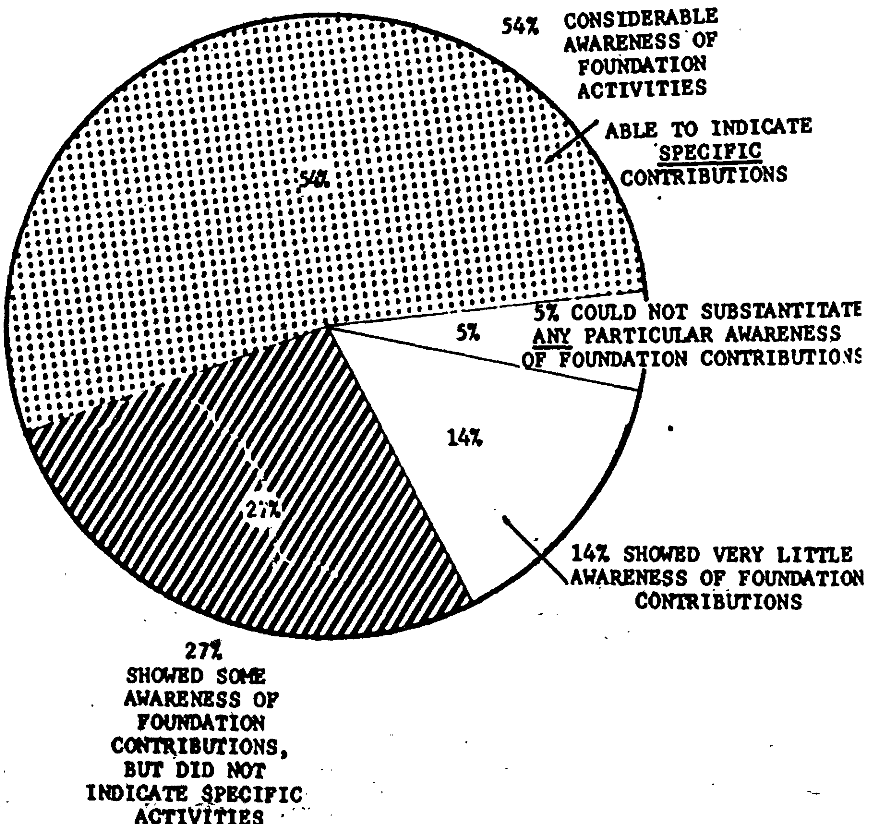
example, the fact that a foundation has assisted a long list of Nobel Prize winners may mean that the foundation has made some very productive grants. It could also mean that the foundations has been quite unimaginative and limited its grants to big names who could readily have received help from other sources.

Recognizing that no present assessment of the "value" of foundations can be made, we are nonetheless convinced that a favorable judgment on their role in American life is justified. This conclusion is based on the fact that foundations have been closely associated with a large number of highly-significant projects, many of which might not have been performed without foundation support. We believe this judgment is shared by leading authorities in all of the principal areas of activity in which foundations have worked, including education, medicine, science and technology, the humanities and the arts, civil rights, welfare and others.

Next we asked these individuals if they were aware of significant developments, achievements or innovations in their field in which foundations made a contribution. A total of eighty-one percent were able to indicate contributions.

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

"ARE YOU AWARE OF ANY SIGNIFICANT DEVELOPMENTS, ACHIEVEMENTS OR INNOVATIONS IN YOUR FIELD OR AREA OF SOCIETY IN WHICH FOUNDATIONS MADE A CONTRIBUTION?"



We also asked for opinions as to the overall impact of foundations on fields of philanthropy and found that 85 percent reported that foundations had played a significant or positive role.

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

WHICH STATEMENT COMES CLOSEST TO EXPRESSING YOUR VIEW OF THE ROLE OF FOUNDATIONS IN THE AREA OF SOCIETY YOU FEEL MOST KNOWLEDGEABLE?

OVERALL IMPACT:

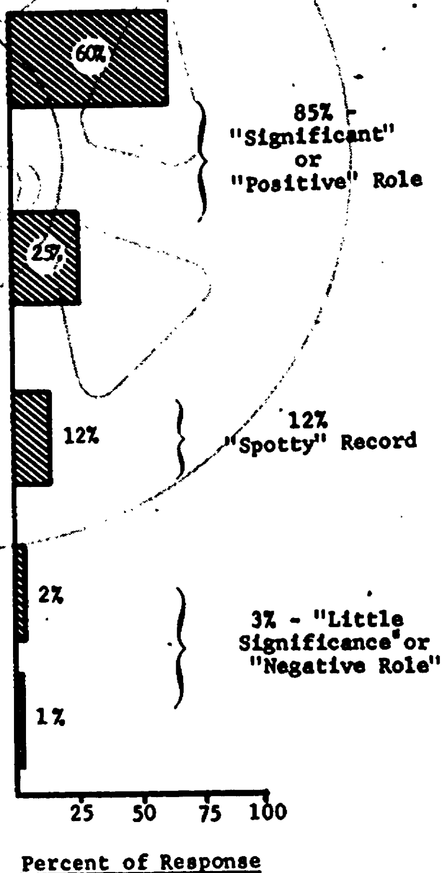
Foundations have played a very significant role in this field - without them, some of the significant developments perhaps would not have taken place at all, or at least would ~~not~~ have been delayed.

On balance, foundations have played a positive role - they have tended to support worthwhile projects - but on the whole they have been worthwhile.

My overall reaction to the contribution of foundations is a mixed one - the record is a "spotty" one, good some of the time, but insignificant, non-existent and even negative at other times.

Foundations have contributed very little of significance in this field.

Foundations have played a negative role in this field - I believe the field would have been better off without them.



In our final report we will examine some of the achievements of foundations, drawing on the expertise of members of our Commission and on various studies which we have sponsored. I do not think it would be helpful at this time to attempt to elaborate at length on examples of particular foundation achievements, especially since your Committee has already heard from foundation representatives and recipients on this subject.

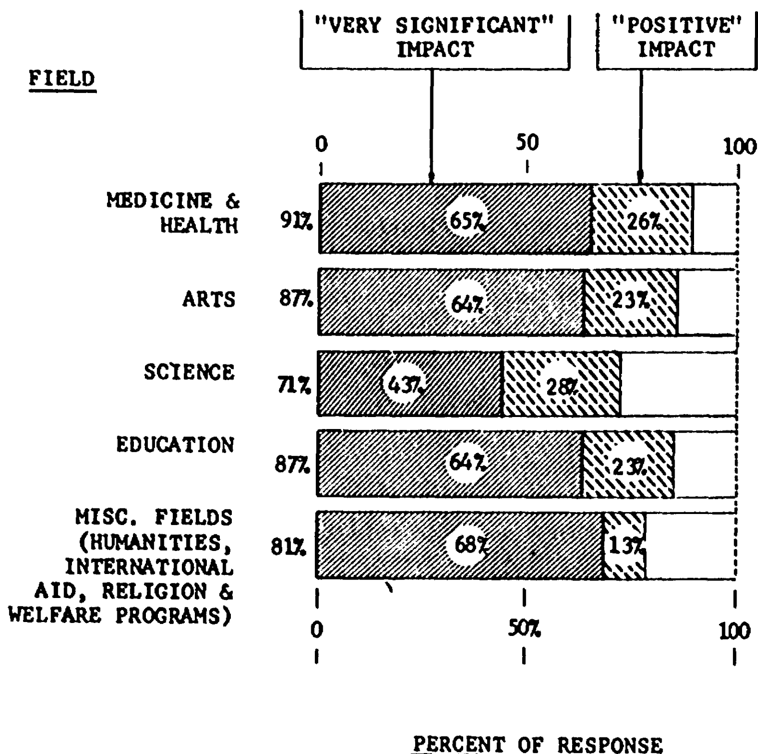
It is our overall judgment that foundations have demonstrated some unique capability to support useful work which other organizations, individual donors, and government were unable to or unlikely to sponsor. And we believe foundations have the potential to make more important contributions in the future.

It is apparent to us that the record of foundations includes significant abuses and shortcomings, as well as great accomplishments. We believe that both the defenders and the detractors of foundations are mistaken when they endeavor

Finally, we segregated the "significant" or "positive" role" responses by field of philanthropy best known to the respondent. Note the somewhat less favorable response from the scientific community, where governmental funds which have played a dominant role in recent years for scientific research and development.

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

THE OVERALL IMPACT OF FOUNDATIONS ON FIELDS OF PHILANTHROPY:
"VERY SIGNIFICANT" OR "POSITIVE ROLE" RESPONSES:
ANALYSIS OF RESPONSE ACCORDING TO FIELD OF SPECIALTY



to draw up some kind of equation between accomplishments and abuses. Visualize trying to apply such a test to government or to a particular administration. Such a task is both impossible and irrelevant.

Foundation accomplishments do not excuse the abuses; nor do the abuses justify the hamstringing of foundations. As our specific recommendations will indicate, the abuses *can* be dealt with effectively without reducing the potential for accomplishments.

Foundations and government

One justification for the grant of a tax incentive is that it encourages work of great public interest which government institutions either are not performing

or cannot perform. This has traditionally been true in the field of education, in scientific research, and in many other areas of foundation activity. Over the last 30 years the vast expansion in the role of government has radically changed the basic relationship between foundations and government. In all of the traditional areas of foundation activity, including health, education, welfare and scientific research, government expenditures—federal, state and local—are now far higher than foundation spending. This is true even in newer areas such as civil rights, the population problem, and environmental protection. Perhaps only in the religious field and in the arts are the foundations spending larger sums than government agencies.

The rationale for foundations can no longer be that they are working in fields in which the government is not active. The basic question which must be answered is whether, notwithstanding governmental responsibilities, foundations are capable of making a useful contribution. This is a question to which our Commission has devoted very substantial time and on which we have obtained the thoughts of many knowledgeable people.

We believe that foundations have significant advantages over government agencies in several important respects:

1. It is much easier for a foundation to carry on a controversial experiment than it is for a government agency. The system of checks and balances under which government programs are conceived and executed makes it extremely difficult to tolerate failures. It also makes it very difficult to operate on a small scale. Political administrations are often not around long enough to wait for the five or more years it make take to know whether a given approach works. This introduces a two-fold bias. An experimental program which looks as though it may produce negative results may well be killed too early. A program which looks promising may well be given broad application prematurely.

Many knowledgeable observers suggest, for example, that one of the major problems with such anti-poverty programs as Community Action has been that experimental approaches were proliferated too widely too early, with inadequate evaluation of results. Similar criticism has been leveled at the Model Cities Program.

Foundations are considerably freer than government to experiment. It is possible for a foundation to sponsor a project in one community without being exposed to pressure to duplicate the experiment in every other Congressional District. Similarly, the flexibility of a foundation as a grant-making institution makes it possible to write off an unsuccessful experiment without the dangers this would involve in a government program.

2. Government programs are difficult to launch in sensitive areas which are likely to arouse controversy. The objections of a vocal minority can often stop a government program. The fact that foundations are relatively freer from public pressure allows them to be considerably more venturesome.

Foundation work in the birth control field provides an excellent example. A growing national acceptance fostered by work supported by foundation funds made it much easier for government to enter this field.

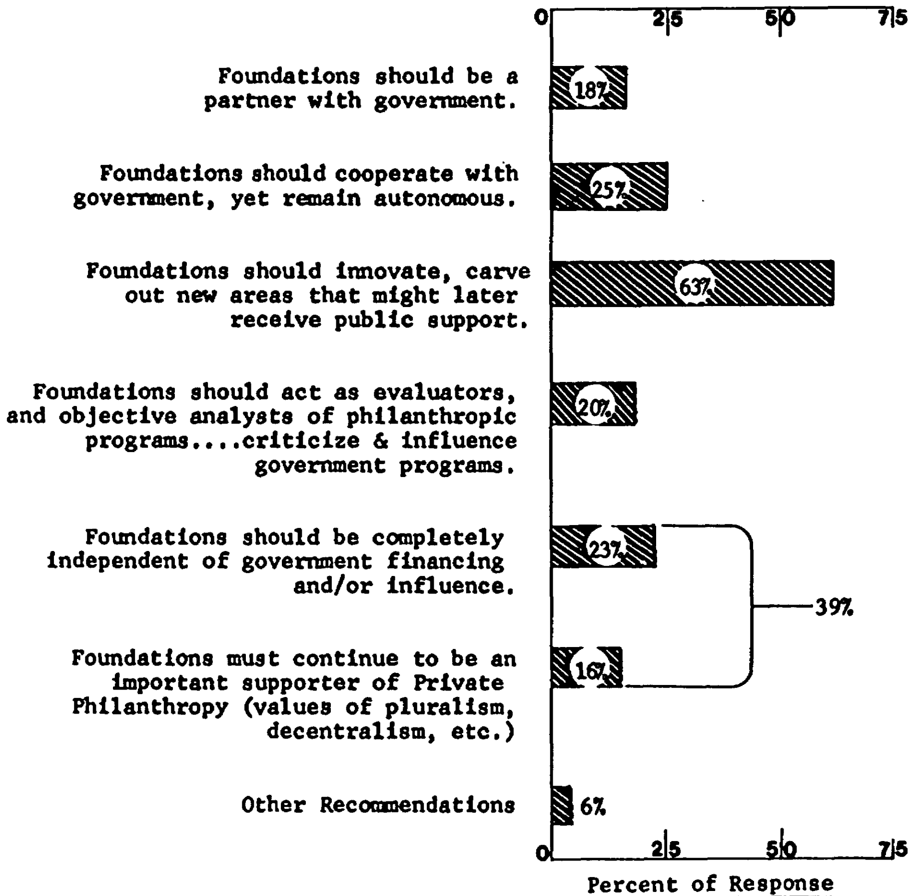
The national assessment program in education provides another example. The hostility to federal intervention in the operation of local schools made it impossible for the federal government to undertake a program which would involve the measurement of the levels of achievement in different schools systems throughout the country. It was, however, possible to launch such a program with foundations. Once under way it has become possible for the government to get aboard.

3. The need for government action to meet requirements for a broad consensus makes it much harder for the government to proceed in areas where only a minority has a significant interest. Government support of the arts, of the humanities, provide early examples. Perhaps the growth of educational television illustrates this pattern. In the early days of educational television it is unlikely that much enthusiasm could have been generated for government support. Nurtured by Ford Foundation support almost exclusively, then studied by the Carnegie Commission under the leadership of James Killian; we saw the concept of public educational television born in the form of the Public Broadcasting Corporation. In each of these areas the foundations have filled a need which was not being met by government.

4. Government programs rarely cover a field uniformly. Thus foundations can generally pick niches where special needs or opportunities exist. Thus, for example, while much government money is available for manpower training, founda-

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969

ATTITUDES REGARDING THE PROPER ROLES OF
OF FOUNDATIONS AS THEY RELATE TO GOVERNMENT ACTIVITIES.



tion funds were able to recognize the need for programs designed to up-grade existing employees at a time when government funding was directed primarily to low-level entry jobs.

5. The greater flexibility of foundation procedures makes it possible to respond much more quickly to unusual situations than government agencies can. This has been proven time and again in areas such as the safeguarding of recreational lands for National Parks.

6. Foundation-financed programs may often be acceptable where government-financed programs would be unwelcome. For example, studies of student unrest in the colleges can be more readily conducted with foundation funds than with government money. Similarly, international programs in some non-aligned countries may well have an acceptance which government programs do not have.

7. Studies of public policy issues in which the government has a direct interest are much more difficult to carry on with government funds. It is far easier to assure the objectivity of such studies when the funding comes from a foundation. Currently, for example, until the Brooking Institution launched its pioneer-

ing efforts to appraise defense policy, there was not a single, independent institution reviewing military policy and premises—at a time when much of the public probably welcomes another view. We believe that this is a point of very substantial importance. With the increasing complexity of governmental programs, objective studies of governmental programs at a federal, state and local level are essential.

All in all, we are persuaded that a complex society like ours benefits when an independent and sophisticated private sector institution can pioneer, espond, complement, fill the niches, and even criticize and evaluate government programs.

V. REGULATIONS OF FOUNDATIONS

While we conclude that foundations are institutions that have vital and in some ways unique roles to play in our society, we also conclude that certain abuses and dangers exist that deserve serious attention.

Precisely because foundations are private sector organizations, it is important they be given a great deal of freedom to make their distinctive contribtuion in their own way. On the other hand, precisely because foundations have been granted substantial tax deductions, the public has a distinct interest in knowing that charity receives a proper return on the investment society has made. Like any capital investment—and a foundation is ultimately a form of capitalized philanthropy—it is essential to look at both the short term—what are foundations doing for charity currently—and long term—what are foundations going to do for charity in the years ahead.

What kind of actions are needed to assure that foundations provide society with an adequate social return on the capital invested in them?

First, of course, we need to be concerned about various kinds of financial abuses that benefit the donor at the expense of the foundation and therefore of charity. This may be attributable, in some measure, to the donor's misconception that it is "his" foundation and therefore "his" money.

As an aside, let me note that the use of the term "private foundation" in the House bill is unfortunate. We believe the emphasis should be on the public, rather than on the private, character of foundations. Substituting the term "*philanthropic* foundation" might help to emphasize that foundations are there to benefit charity, not private individuals.

Second, there are what we might call grant-making abuses that result from spending foundation money for purposes that are not properly charitable.

Third, and perhaps most serious, are problems which adversely affect the amounts paid out to charity. This may be due either to poor investment management or to decisions to save foundation earnings for future uses.

Self-dealing problems

Let us start with the financial abuses—the so-called self-dealing problems that give rise to a good deal of the "tax dodge" criticism.

What is the incidence of these abuses? Are they so frequent as to cause one to doubt whether the institution of foundations is worth saving, or are financial abuses at a level which represents an irritant which must be cured but not a cause for severely restricting foundations?

The problem this question presents to a non-governmental commission such as ours is an obvious one. We have no subpoena powers, nor the authority to audit. Thus, we had to try some indirect approaches. I use the word indirect to suggest that it obviously isn't as simple as asking the given foundation whether it engages in financial abuses.

Our first approach was to estimate the extent of transactions between the donor and the foundation that give rise to the possibility for abuse. Foundations are required on their tax return (Form 990-A) to answer certain questions relating to self-dealing transactions. We decided to tabulate some 500 of these forms. The answers are shown below and suggest that a relatively small fraction of the foundations seem to have transactions between the donor and the foundation.

All this indicates of course is the potential for abuse and we searched for ways of getting at least an indication of the extent to which this potential was realized.

It occurred to our staff that tax accountants are perhaps better informed than anyone else and might be a source of information.

SAMPLE OF IRS 990-A FORMS
PRELIMINARY--OCTOBER 1969

EXTENT OF SELF-DEALING TRANSACTIONS* REPORTED ON FORM 990-A

BORROWING INCOME OR CORPUS	1.5%
RECEIVING COMPENSATION FOR SERVICE	2.5%
USING SERVICES OR ASSETS	.5%
PURCHASING SECURITIES OR OTHER PROPERTY	3.5%
SELLING SERVICES OR PROPERTY	5.5%
RECEIVING INCOME OR CORPUS IN ANY OTHER TRANSACTION	1.1%
NUMBER OF FORM 990-A's EXAMINED	492

* It must be emphasized that the current law does not prohibit self-dealing transactions but rather imposes an arms-length or reasonable standard. Thus, while these transactions are potential self-dealing abuses, it should not be assumed they are violations.

Arthur Andersen, a leading accounting firm, promised complete anonymity to some two hundred accountants across the country (they did not sign the questionnaires) if they would indicate their own experience with foundation abuses.

The answers of the accountants speak for themselves. They indicate that a very substantial majority feel that self-dealing abuses are rare. At the same time 5% to 10% believe these abuses to be quite common.

FOUNDATION ABUSES: ARTHUR ANDERSEN STUDY C.P.A. FIRMS

A. "There are loose financial self dealings between small foundations and the donor or friends which work to the advantage of the donor or friends."

	Percent
Very infrequent	69
Not common	22
Fairly common	7
Very common	2
Total	100

B. "There is loose record-keeping by small foundations which make it difficult to know whether personal advantage is being taken by the donor or his friends."

	Percent
Very infrequent	68
Not common	24
Fairly common	5
Very common	3
Total	100

C. "There are high operating expenses relative to the assets or income of the foundations."

	Percent
Very infrequent	72
Not common	22
Fairly common	4
Very common	2
Total	100

Clearly any tax abuse is bothersome, but when it reaches a level above the extreme exception—then something drastic should be done. Our reading of these findings is that while it is quite unwarranted to suggest "foundations are nothing but tax dodges" there is enough potential for abuse to warrant vigorous action. We strongly support legislation that prohibits self-dealing.

A study of abuses would be superficial if it assumed that the currently acknowledged abuses are the only ones to be concerned about. Through a wide variety of sources we have identified some additional abuses that we believe are worth your specific attention. Permit me to illustrate some of these.

1. Company foundations have been largely ignored in much of the anxiety over foundation abuses. They should not be. We believe these are situations in which company foundations seem to be making grants that are more appropriately business expenses. The privilege of tax exemption on income is, of course, extended to foundation income but *not* company income. It is thus improper to use foundation funds for what are properly business expenses.

Two illustrations will suffice. *First*, grants of a foundation for research in the industry in which the company operates has significant potential for special benefits to the company. How should the *public* be made aware of and benefit from such research? How do competitors gain access to this research? *Second*, company foundation grants to customers or suppliers of the company present some complex issues which deserve careful scrutiny.

2. Serious abuses may result from the over-valuation of property contributed by a donor to his foundation. Although over-valuation problems can also arise in connection with contributions to other charitable organizations, the potential for abuse may be somewhat more acute in the case of foundations, where the donor is in effect on both sides of the transaction. The risk of self-dealing abuse is aggravated by the infrequent level of government auditing; the passage of time after a transaction has taken place complicates the problem of determining a fair valuation.

We would recommend that significant contributions of property to foundations be validated by independent appraisals at the time of the contribution.

3. Substantial overlap in stock ownership between donors and foundations appears to be fairly common. This raises some rather interesting questions of how one can be sure that the foundations' interest in maximizing the return

from portfolio protected. One need not be unduly imaginative to visualize a case in which the donor has the foundation buy stock in a company in which he also owns stock, in order to inflate the price artificially so that he can profit; or, alternatively, sell his stock in a market downturn before the foundation stock is sold.

Disclosure requirements specifically directed to such transactions would probably help reduce their incidence.

4. We have also heard about cases in which the foundation conditions a grant to a charitable organization by specifying that an individual related to the donor should receive benefits, such as free tuition in a religious school. Once again, improved disclosure on all grants where individuals are specified, could be helpful in discouraging such practices.

5. We have seen a few cases where excessive administrative expenses resulted in a diversion of funds from charity.

The Commission favors a legislative prohibition on payment of excessive or unnecessary expenditures. Such expenditures should be limited to the same kind of "ordinary and necessary" rule of reason that is used in the deductibility of business expenses.

Increased IRS auditing

Once the abuses to be corrected have been identified, it is obviously necessary to make sure that the legislative intent is carried out. We believe that the most effective weapon both for determining the level of abuses and minimizing them in the future is an intensive auditing program. That the audit program has not been adequate, at either the federal or the state level, is obvious from the following chart from our foundation survey.

GOVERNMENT AUDITING OF FOUNDATIONS

"To the best of your knowledge, has the foundation been audited in the past ten years by state officials or the Federal Internal Revenue Service?"

Percent of foundations reporting

Yes, had been audited	34
State audits	8
IRS audits	29

We understand the serious budgetary pressures of the Internal Revenue Service and the fact that high priority is placed on audits that increase tax revenues. Thus it is not surprising to discover such a low level of audits. How law is perhaps best illustrated by reminding you that the Ford Foundation, largest of all foundations by a 4-fold margin, is only now undergoing the second IRS audit in its history.

The crisis in confidence confronting foundations merits intensive action. It is not only irrational but it is unfair both to foundations and to the public interest to permit allegations of tax dodging to persist without using the available regulatory tool to correct abuses.

Our Commission recommends that *all* foundations be audited at least once in the next three years. We recognize that this will involve a substantial step-up in IRS auditing activity. However, we believe that only an effort on such a scale will be adequate to assure the public that the privilege of setting up a foundation is not being abused. The results of such a three-year program should also provide sufficient data to enable Congress to make informed decisions regarding the proper level of future surveillance.

We recognize that the cost of an increased audit program is substantial and we propose that this cost be paid by a special user charge payable by the foundations. Such a charge should reasonably reflect the actual cost increase of this special regulatory effort, and would be limited to the three-year period. The Commission believes the user fees should be paid into an earmarked fund in which the costs of this auditing program are carefully cost-justified at least annually. This cost is likely to be substantially less than the 7½% tax on investment income proposed by the House and perhaps even the 2% tax recommended by the Treasury.

As a matter of principle, we question the desirability of charging philanthropic institutions for the cost of IRS supervision when the cost of supervising corporations as well as charitable institutions is borne by the regular administra-

tive budget and is not made a special charge. We would suggest, therefore, that the precedent of the user charge be limited to the special three-year audit program we are recommending.

State regulation

Some students of the problem of regulation have urged that the states be given a larger role in policing foundation activities. They contend that the states have an incentive to supervise foundations because of their interest in the collection of estate, income and other taxes.

This contention seems refuted by the evidence that in the last ten years only 8 percent of the foundations in our survey have been audited by state agencies. New York State has shown a deep interest in foundations and their activities, but most states have neglected the problem, a condition reflecting their lack of staff and resources for the task.

Another defect in proposals to refer the regulatory problem to the states is the lack of uniform state laws in a field where uniformity is clearly desirable. We shall discuss this need at greater length in our final report, but for the time being it seems conclusive that until the states agree on standards of auditing and related subjects, and work out a complementary system of regulation, it would be imprudent to rely on state agencies to do the job. The public concern is too urgent to be dismissed by a shift of responsibility that in most states would be tantamount to no regulation at all.

Self-regulation

Self-regulation by the foundations themselves has also been advanced as a solution to the abuses which have been exposed. Over the long term, an organization from the foundation field may indeed play such a role. But we are concerned with the large number of foundations unaffiliated with existing foundation organizations and among whom may well be some of the most likely offenders.

Responsible foundation groups are now beginning a commendable effort to police the field, but the lack of sanctions limits the effectiveness of their efforts to meet the current urgency. Perhaps in the future, when government measures have curbed the less scrupulous and there is fuller membership in a central organization, self-regulation can play a larger role.

There is, of course, an important distinction between formal disclosure and adequate public communication. Events of the past year have demonstrated the existence of a communications gap between foundations and a number of their constituencies.

There is no reason why policy makers, such as your committee, should not have answers to the many questions that today remain unanswered. What are the assets of the foundations? How are these assets being managed? What return do they bring? For what purpose are grants being made? What is the degree of foundation involvement in various areas of our society?

Our Commission believes the best interests of foundations and the public would be served if some new approaches to disclosure were adopted.

Perhaps the first step of such a program is to modify the annual reporting form in fundamental ways so as to provide some of the following kinds of information and benefits:

1. *Uniform Accounting Standards.*—There are enormous variations in the meaning and interpretation of such terms as value of assets (cost or market), grants (amounts actually paid or amounts authorized for payment), administrative expenses (with or without investment management fees), etc.

2. *Purposes of Grants.*—The 990–A form does not include adequate information about the purposes of the grants. Both for purposes of statistical analysis and for prospective recipients more information would be useful.

3. *Investment Activities.*—In this area, too, the 990–A form is inadequate. More detailed information will be helpful as a means of preventing and policing abuses, and measuring investment return.

In addition to annual disclosure we believe there are occasions for special reports, on a more immediate basis, in connection with potentially controversial activities. In particular, we urge that prompt disclosure to government agencies be made in connection with any foundation program which involves payments to government employees. We also believe that any policy studies which involve more than occasional contacts with members of Congress and their staffs should require registration under the Federal Lobbying Act.

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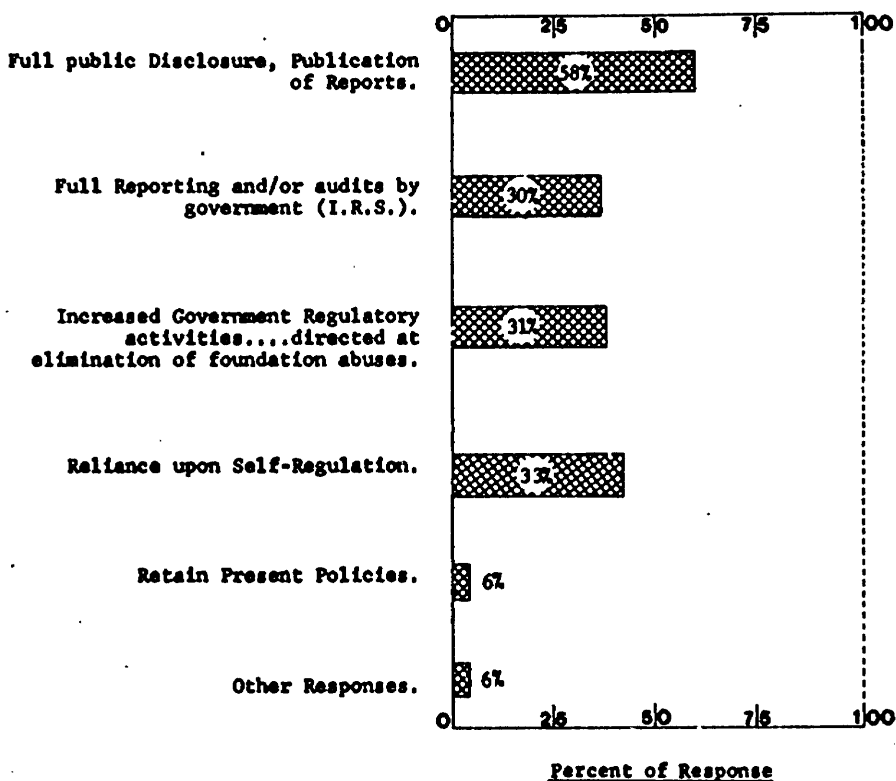
Public Disclosure

It is interesting to note that our distinguished citizen group when asked what methods of regulating foundations were desirable, frequently mentioned more extensive public disclosure. That view is endorsed by our Commission.

DISTINGUISHED CITIZENS STUDY
PRELIMINARY DATA
OCTOBER, 1969



Requiring individual foundations to furnish more detailed reports is not by itself sufficient to overcome the information gap. We recommend two other steps: *First*, there should be an annual statistical report to Congress and the public on the activities of foundations. This country has too large a financial stake—at this point *unknown* billions—not to be better informed on the return from this investment. *Second*, we recommend that the accessibility of reports about foundations be improved. We commend the program of the Foundation Center in New York to provide access to such information. Similar efforts should be encouraged in other parts of the country.

The public disclosure procedures we are urging would serve five purposes:

1. They would help to re-establish public confidence in foundations.
2. They would provide information to help Congress and the Executive Branch to reach wise policy decisions about foundations.

3. They would make it easier for prospective recipients of grants to determine which foundations are interested in particular fields or work.

4. They should significantly reduce questionable practices. We need only to look to the field of securities regulations to see what a profound difference public disclosure can have.

5. Greater disclosure, if coupled with equity jurisdiction in the Federal courts, may make it possible to enjoin improper activities at an early stage.

Sanctions of violations

There are serious shortcomings both in the existing penalties for violations of the legal rules applicable to foundations, and in the new sanctions proposed in the House bill. The principal existing sanction—loss of tax exemption—is so drastic as to be useless except in the most extreme cases. The provision of the House bill for a graduated system of "taxes" for various forms of violation has other shortcomings. We recognize that this is a highly technical subject and I am not in a position to make detailed recommendations. Let me outline, however, the general principles which we believe a satisfactory system of sanctions should embody:

First, the objective of the system of sanctions should be to make charity whole, not to increase the collection of taxes. As a general rule, penalties should not be levied against the assets of the foundations, but rather against the persons responsible for the violation. An individual who has enriched himself at the expense of the foundation, should be required to make the foundation whole.

Second, fines should only be levied where the prohibited conduct can be defined in an unambiguous manner. In particular, fines should not be imposed in areas where there are difficult questions of judgment, as may arise in connection with certain investment-policy and grant-making decisions.

Third, provision should be made for promptly enjoining improper activities rather than penalizing them after they have occurred. We are attracted by the possibility of providing equity jurisdiction in the Federal courts. This can be readily provided by Congressional action; we see no constitutional problem. This is a subject which our Commission has under study.

We believe that Federal equity jurisdiction would provide a very useful additional tool for the regulation of foundations. Action in the Federal courts could be initiated by the U.S. Attorney General. Such actions could be brought at the request of the Internal Revenue Service. An action for an injunction would be particularly appropriate in preventing questionable activities in the political or legislative area where legal remedies such as fines could be too little or too late.

The successful development of equitable remedies might well be a much more effective way to deal with controversial and difficult cases than would be possible through present administrative procedures. Particularly where sensitive issues are raised such as drawing the line between proper educational activities and improper political activities, we believe that the courts are uniquely qualified to provide prompt and effective relief.

Fourth, sanctions should be geared to the seriousness of the violation, and whether it is willful or inadvertent. For minor or technical violations, a warning with an opportunity to make corrections may be sufficient. In other cases monetary penalites will be necessary. Such penalties should not be automatically measured by the amount involved in the improper transaction.

Penalties should increase in the event of repeated violations. The level of fines should not be so severe as to discourage individuals from becoming trustees and officers of foundations. We believe that the penalties contained in the House bill, particularly in connection with grant-making and investment activities would have a chilling effect. The difficulties which corporations have been encountering in obtaining the services of outside directors, notwithstanding the availability of directors' liability insurance, makes it clear that this can be a very real problem.

Grant-making activities of foundations

It is commonly assumed by many persons, in view of recent publicity, that foundations devote a large percentage of their funds to political, controversial or quasi-charitable activities. When we sought to investigate these assumptions we found that very little was actually known about how foundations spent their money.

As I noted previously, 93 percent of the grants of all foundations are made to qualified charitable organizations—74 percent to 80 percent organizations. This distribution percentage remains relatively constant for each type of foundation.

DISTRIBUTION OF 1968 FOUNDATION GRANTS BY TYPE OF RECIPIENTS

[In percent]

Percent of total grants allocated to—	Type of foundation: Under $1,000,000 in assets	$1,000,000 to $10,000,000 in assets	$10,000,000 to $100,000,000 in assets	Over $100,000,000 in assets, total	Company foundations	Community foundations	All foundations
30 percent charitable organizations	82	67	74	71	71	54	74
Other qualified charitable organizations	12	24	25	16	27	21	19
Total, qualified charitable organizations	95	91	99	87	98	75	93
Other tax-exempt or nonprofit organizations		(1)				[2] 12	(1)
Foreign organizations	(1)	1	(1)	5	(1)		1
Individuals	5	8	(1)	9	1	[2] 13	5
Grand total	100	100	100	100	100	100	100

[1] Less than ½ of 1 percent.
[2] Community foundations in some cases appear to have included noncharitable bequests with grants.

Note.—Percentages may not add to 100 because of rounding.

We also sought detailed information on the purpose of foundation grants in the year 1968. We asked foundations to distribute their grants among the following purposes:

Educational (Educational research, elementary, secondary, higher, and adult education programs [except manpower or vocational training]).

Health and medicine (medical research, treatment, and education [includes hospitals, clinics, public health education and services, such as birth control clinics, etc.]).

General welfare (support of Community Chest, United Fund, Welfare Council and similar general welfare agencies).

Community action or services (organizing or supporting designated groups [including, for example youth groups, such as "gangs"], neighborhoods, or regions, planning for community improvement, and provision of community facilities not elsewhere classified).

Cultural organizations and facilities (libraries, art galleries, museums, symphonies, theater, educational television).

Religion (support of a church, synagogue, or other religious organization primarily for religious instruction, practice or other predominantly religious purpose).

Science and technology (all non-medical research and development in the physical and natural sciences and technological applications of scientific knowledge).

Arts and humanities (support of artistic endeavors—writing, fine arts, music, and research and publication in the humanities).

Social sciences (all social science research and publication not elsewhere classified).

Manpower training and employment (research on manpower problems, vocational and job training and related programs).

Community, ethnic or inter-racial relations (improvement of inter-group understanding and relations).

Individual and family services and support (provision of food, clothing, and other necessities, and services [except medical or educational services] for the needy).

Recreational and conservation (provision of recreation facilities and programs, parks, conservation of natural resources, wildlife preservation).

Housing (design, construction, or provision of housing, and improvement of housing conditions or access to housing for designated groups).

Projects directly related to the political process (Voter registration, voter education, schools for political candidates, etc.).

I should tell you that the Ford Foundation has generously agreed to permit us to present some of its grant-making activities separately in view of their importance.

The data show that more than 50 percent of all grants were for education, health, and medicine.

PURPOSES OF FOUNDATION GRANTS

[PERCENT OF FOUNDATION GRANTS]

Purpose	Percent
Educational	36
Health and medicine	25
General Welfare	7
Community action or services	7
Cultural organizations and facilities	6
Religion	3
Sicence and technology	3
Arts and humanities	3
Social sciences	2
Manpower training and employment	2
Community, ethnic or interracial relations	2
Individual and family services and support	1
Recreational and conservation	1
Housing	1
Projects directly related to the political process	(*)
Other	1

*Less than one-half of 1 percent.

PURPOSE OF FOUNDATION GRANTS 1968

[In percent]

Percent of foundation grant dollars for—	Type of foundation: Under $1,000,000 in assets	$1,000,000 to $10,000,000 in assets	$10,000,000 to $100,000,000 in assets	Over $100,000,000 in assets: Total	Excluding Ford	Ford	Company foundations	Community foundations
Education	10	53	20	43	45	37	49	12
Health and medicine	46	14	34	20	25	9	6	13
General welfare	27	4	11	1	2	0	17	3
Community action	3	5	13	6	6	5	4	23
Cultural	1	9	4	7	5	12	5	20
Religion	9	3	4	1	2	0		(1)
Science and technology	(1)		8	2	3	1	(1)	(1)
Arts and humanities	1	1		4	(1)	10		8
Social sciences		(1)		5	3	9		
Manpower		2	2	3	2	4		1
Community relations	2			2	1	3	2	8
Individual and family services	1	3	1	1	1	0	1	3
Recreation and conservation	(1)	1	1	1	(1)	3	(1)	(1)
Housing		3		2	1	3		1
Political process				1	1	1	(1)	(1)
Other				2	2	3	14	5
Total	100	100	100	100	100	100	100	100

[1] Less than ½ of 1 percent.

Note—Percentages may not add up to 100 because of rounding.

We have also calculated the percentage of foundations by type which make grants *only* to qualified charitable organizations. As shown on this chart 81 percent of all foundations limit their grants to this type of recipient.

Percentage of foundations by type making grants only to qualified charitable organizations

Under $1 million in assets	82
$1 million to $10 million in assets	63
$10 million to $100 million in assets	85
Over $100 million in assets	64
Company foundations	81
Community foundations	56
All foundations	81

We had heard that foundations are mainly interested in making innovative grants and thus we asked each foundation in our survey "Has the foundation made any grants or gifts in the past three years which you consider innovative, experimental or out-of-the ordinary?" *Only 12 percent* answered "yes" to this question.

We also asked "Have any of the projects supported by your foundation's grants or gifts in the past three years been considered controversial or particularly unpopular?" *Less than 1 percent* answered "yes".

We sought to test these answers by asking whether or not each foundation had made grants in the past three years for various specific activities which could be considered controversial. The minuscule percentage of foundation grant dollars devoted to each is reflected by the following chart:

Percentage of foundation grants in the last 3 years for specified sensitive or controversial activities

Voter registration and education	0.2
Schools for political candidates	(*)
Student organizations	0.2
Public policy studies	1.9
Community or neighborhood organizing	1.8
Grants to Government employees	(*)
Birth control	1.2
Sex education	(*)
Grants connected with a specific election	0.1

*Less than 0.1 percent.

Finally, we specifically investigated the reported grants to individuals (5% of total foundation grants) to determine the purpose for which each grant was made. Over 90 percent of these grants were either scholarships, fellowships or research grants.

Purposes of grants to individuals

Grants to individuals are 5% of total foundation grants

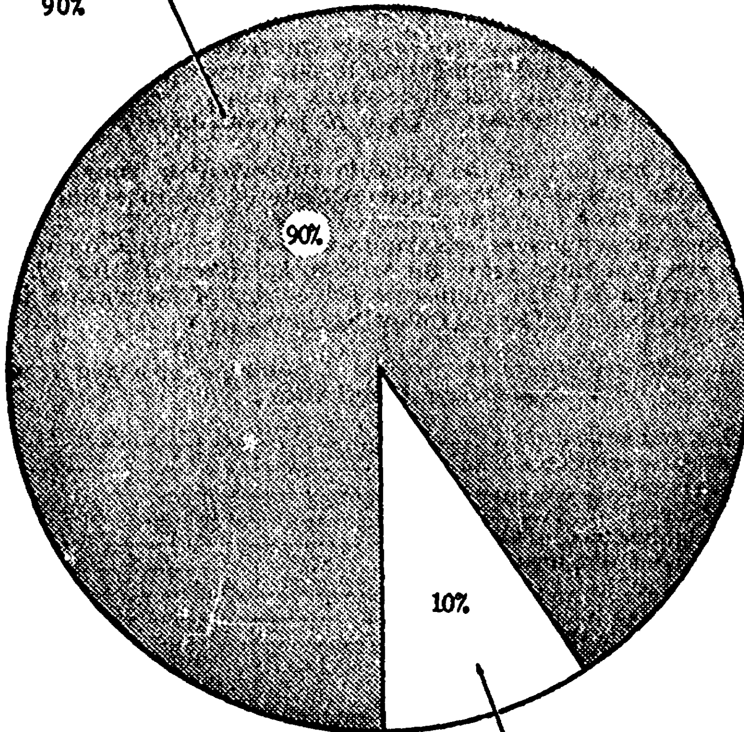
Percent of grants to individuals

Scholarships and fellowships	87
Research	5
Support of creative work	2
Travel and study:	
Ford Foundation	3
Others	2
Awards and encouragement for professionals and students	1
Direct aid to indigent persons	½
Religious missionary work	½
Total	100

After considering all of this data we have reached the conclusion that the grants of foundations which have received the most publicity and which have caused concern in many quarters are but a small fraction of the total annual grants made by foundations.

Foundations Study
Preliminary October, 1969

FOUNDATION GRANTS



* These grant amounts appear to have gone primarily to recipients in the United States.

Since their grant-making activities are the basic reason for the existence of foundations, it is appropriate that this subject should have occupied more time than any other in our Commission's deliberations. We have listened to presentations by representatives of foundations and by distinguished citizens with governmental and other experience relevant to foundation grant-making.

Unquestionably, the most sensitive area of grants is that in which the purpose may involve contact with government at some point through interaction with welfare programs, through possible influence on voters, or on possible

legislative or administrative action. The subject presents complex problems, requiring a balancing of conflicting considerations.

Studies of Public Issues and the Legislative Process.—We reached the basic premise that it is impossible to draw any line of demarcation between the foundations' fields of interest and those of government. Federal, state and local governments are active in practically every significant area of foundation interest, and usually on a much larger scale. This is true both of the conventional fields of philanthropy—health, education, welfare, science and technology—but also in newer areas such as urban problems, civil rights and population studies.

Far from deploring this intertwining and interaction of private and governmental programs, we consider this a healthy feature of American society. Interchanges between the private and public sector in the formulation of policy is an essential part of the democratic system. In the infinitely complex problems facing government today it becomes at once more important to have private participation in decision-making, and more difficult to make significant private contributions.

The work of our own Commission will serve as an illustration of the difficulties I describe. We have, up to this point, operated without foundation financing. I can testify from personal experience how difficult it is to raise funds from other sources. We quickly discovered that private individuals cannot deal adequately with even a relatively limited subject except after extensive study and far-ranging fact-gathering. This is not only time consuming, but can be very costly, even though the members of the Commission serve without compensation. Our experience is far from unique, and leads us inexorably to the conclusion that foundation funds are much the best source for financing private efforts to study significant policy issues. Any legal restriction on the use of such funds for studies of public issues must inevitably impair private contributions to decisions on public policy.

In view of the desirability of such contributions, we do not think distinctions should be made between *legislative* decision-making and *executive* decision-making. One of the members of our Commission, who has had extensive Congressional experience, feels strongly that the massive scale of the executive branch contributions to the legislative process makes it particularly useful that there be well-conceived private contributions to Congressional deliberations. Furthermore, we think there is no practical or logical basis for distinguishing between public issues which may become the subject of legislative or administrative action and those which will not. Almost any significant public issue may become the subject of legislative attention. The purest research on cancer may eventually bring restrictions on tobacco advertising, or a study of highway safety result in automotive design regulations.

The higher the quality of the research, the more likely the results are to influence governmental action, as witness Professor Einstein's famous equation. For this reason we consider it unwise and undesirable to attempt to shield legislators and their staffs from contact with private groups engaged in studies which are of legislative interest, as the House bill seeks to do. If the only pressures on legislators came from the foundations, perhaps you could elect to lead a trouble-free life, but as a practical matter an informed voice ought to be more welcome than a merely self-seeking one.

Let me add, and here again I am speaking from personal experience, the exchange of ideas between private individuals and members of Congress and their staffs is mutually beneficial. On most major matters of public interest, members of Congress and their staff are among the foremost experts. The work of our Commission has benefited greatly from our communications with the members and the staffs of this Committee and those of the House Ways and Means Committee.

The provision in the House bill permitting foundations to make available the results of "non-partisan analysis and research" is, in our opinion, far too limited an exception to the restriction on communication affecting legislation. The word "non-partisan" is highly ambiguous. If it means free from any possible impact on party politics, the exemption would be practically meaningless, for any significant public issue can become a matter of partisan controversy. If "non-partisan" means that no conclusion may be drawn it would cancel the purpose for which most studies are undertaken. Could we have interested the 15 members of our Commission, for example, to spend much of their valuable time in earnest study of an urgent public problem if they could not come to any conclusions?

While we feel strongly that there should be no impediment on foundation-financed studies, even though they may have an impact on the formulation of legislation, we recognize that this is an area of genuine sensitivity. The solution, we believe, lies in prompt and full disclosure rather than in prohibitions. We believe there should be advance disclosure of any foundation-financed study if such study involves any substantial number of contracts with members of Congress or their staffs. In addition, any foundation grant which involves compensation to government employees should be disclosed before such payments are made. With respect to executive branch employees, prior notice should be given to the head of the department employing the particular individual. Where legislative employees are involved, notice might go to the Clerk of the Senate or of the House.

Lest there be any misunderstanding, let me emphasize that foundation involvement should be limited to legitimate studies of public issues. The privilege to engage in educational activities which may have an impact on legislation must not be abused. It clearly does not provide a license to carry on pure and lobbying activities.

Elective Politics.—Our Commission fully endorses the prohibitions on foundation involvement in elective politcs. Tax-exempt funds should not be used in election campaigns, whether to support the election of candidates or to influence the vote on measures in referendums. The policy considerations in this area are well settled and do not need further elaboration.

"Grass Roots" Campaigns.—We agree that foundation funds should not be used for "grass roots" campaigns designed to bring pressure on legislators. The only proper role of foundations in the political process is an educational one. Where the objective is political pressure rather than dissemination of ideas, foundation involvement becomes improper. We recognize, of course, that this principle is more easily stated than applied in practice. However, the fact that there may be some difficult borderline case is no reason for ignoring the underlying principle. We would encourage foundations to seek advance rulings before venturing into questionable areas. This should not be a legislative requirement.

Definition of Propaganda.—Starting from the premise that the legitimate functions of foundations in the political process is an educational one, we agree that the use of foundation funds for propaganda purposes should be barred. However, we would urge a redefinition of what constitutes propaganda. Truth may be used as propaganda as in the public exhortations to send your child to the dentist. The test should not be whether "both sides" are presented in an impartial manner, or whether conclusions are drawn, but whether the material being distributed is educational in character. We recommend that this test be applied in a conservative manner. The line between "propaganda" and "education" should not provide a basis for censorship of ideas. Only in very clear-cut cases, such as hate material, which no reasonable man could consider as eductional, should the restriction on propaganda be invoked.

Payout requirement

We start out with the simple proposition that every institution should be judged according to how well it achieves its basic purpose. Thus, a business corporation is measured by its growth in sales and profits; a foundation, by what it contributes to charity.

Foundations represent a huge capital investment in philanthropy—unknown billions, but probably somewhere between 20 and 30 billion dollars.

This capitalized philanthropy has been jointly funded by the donor and by society at large through a tax deduction. Thus, the public has every reason to be interested in a satisfactory return on this capital investment. If indeed the value of foundations is, say, 25 billion dollars—every percentage point improvement in return represents 250 million dollars more annually to charity. As one watches the tortuous process you must be going through to add 250 million dollars of additional tax revenues, this is not a moot point. And when you consider that the current evidence suggests that foundation rates of return might reasonably be expected to increase not one but several percentage points—it becomes worth serious scrutiny.

What is the total rate of return on foundations—total return being the virtually universal measuring stick used by mutual funds, profit sharing funds, pension funds, and endowment funds? It includes the interest, dividends, the realized and unrealized capital gains and does not differentiate between various kinds of income on the very rational thesis that for tax-exempt organizations

(of all institutions) it makes no difference because no tax is paid on *any* income—whether dividends, capital gains, interest, etc.

What is a reasonable total return? As you might expect, funds that have higher percentages of equity stock have done better over the last 40 years whereas balanced funds with more debt instruments have not generally done as well.

Over the last ten years, here is the total return as presented in a study entitled "Managing Educational Endowments"—

1959–69 annual average, in percent

21 balanced funds	9.2
10 large general growth funds	14.6

In 1968 we are told that an average performance of mutual funds was 15.3% return for a so-called common stock mutual fund, and 14.9% return for a balanced fund.

How has the total return been on the foundation assets?

To estimate this, however imperfectly, we asked the Arthur Anderson Company to compute the total return on a sample of 990A forms for various sizes of foundations.

We say imperfect estimates because we were not able to verify in all cases whether the market value was shown, but it is at least as good an estimate as we can make. Shown below is the *median* return (to help offset any major swings caused by any disproportionate effect of those not showing market values).

990A foundation forms 1968 total investment return (median), in percent

Asset size:	
1 to 10 million	6.1
10 to 100 million	7.7
100 million and over	8.0
Community foundations	5.9
Company foundations	6.0

It might be said that one year is not an adequate period (though it does seem significant that in every category the return is substantially lower than balanced funds' performance of nearly 15% in 1968).

It might be said that our data are not as accurate as they could be because of possible confusions in reporting. (Here we would agree, but we were hopeful the median calculation would help minimize any such effects.)

In the case of 14 selected large foundations, we were able to confirm the accuracy of the total return data and here again for this one year, 1968, see a return of 8% for this foundation group vs. the 15% figure for balanced funds.

The Commission discussed this question of investment returns with a number of investment experts and found a good deal of confirmation—or perhaps suspicion would be a more accurate word—that returns on foundation investments were significantly lower.

For example, I quote from an article in the *Institutional Investor* of November, 1968, entitled "Foundations: The Quiet $20 Billion"—

"Is there a place as yet untouched by the revolution in money management? Where the winds of performance are not felt, where the opportuning cries of ambitious brokers are not heard, a last redoubt so quiet the clocks can be heard ticking?

"There is such a place, and it is called foundationland. There, tax-exempt, is twenty billion dollars, one of the bigger pools of capital in capitalism and it is still run the way money used to be. The way it used to be, that is for Widows and Orphans, before currency began to depreciate. In foundationland the verities are Preservation of Capital and Yield, verities the current generation shies from. In foundationland, the managers do not often buy their stocks, because they already have them—they were given them many years ago, and now they sit, quietly watching."

This article refers to stock turnover rate for foundations from an SEC study—in the range of 1% to 2% a year—which investment experts tell us is extraordinarily low (by a factor of 10 or more) compared to a variety of other funds.

What this means, of course, is that foundations are apparently much more likely, as the article says, to "sit, quietly watching."

One can only speculate as to the reasons for this low turnover. Among reasons we have given are that a good deal of the stock is often control stock in a company and it has not been considered appropriate to trade these securities. Others point out that the effective investment of funds has not been considered a high priority objective.

In some cases the legal instruments setting up the foundation prohibit the sale of the securities donated to the foundation.

This Commission has received expert advice from some nationally recognized experts, but we would certainly not claim we have the resources or the authority to review the investment performance of foundations in greater detail over longer periods.

Approaching this from several different standpoints, we arrive at the same point; namely, that the investment performance of foundations is sub-par, perhaps significantly, and the cost of this to society could easily amount to hundreds of millions and perhaps over a billion dollars annually.

We would welcome additional studies of foundation investment returns and indeed would hope that new foundation annual reporting forms would put a good deal more stress both on computing this return and providing the opportunity for more detailed analysis of the investment patterns.

Payout to charity

We now look at another measure of society's return on this capitalized investment in philanthropy . . the payout to charity in 1968 expressed as a percent of the reported assets . . .

Median payout as a percent of assets (grants, administrative expenses, etc.)

Reported assets:	
Foundations, 1 to 10 million	4.8
Foundations, 10 to 100 million	4.9
Foundations—100 million and over	5.7
Community foundations	5.2
Company foundations (significant number of conduit foundations)	22.5

What this tells, of course, is that on the average, about half the foundations studied paid out less than 5% and further analysis shows that about one-third paid out less than 4% of assets. I should remind you that, to the extent we have foundations reporting their assets to us on a basis of cost rather than market value, even this payout figure is overstated.

The very substantial majority of the Commission believes that (1) our society should receive significant current benefit to charity, and (2) the foundation in turn should be encouraged to make reasonable and productive investments so as to earn over the long term amounts that are comparable to what a veriety of professionally managed portfolios earn over this period of time.

Over the last 40 years the average rate of inflation has been 1.6% and closer to 2% over the last 10 years or so. Thus, if the objective were that one should permit a reasonable investor to earn enough to maintain the purchasing power of his assets—then one could require an annual payout to charity of from 6% to 8%.

The precise number should depend on reasonable total investment return which we would leave to the determination of the Secretary of the Treasury to re-set every few years after appropriate consultation and review of the performance of relevant types of investment portfolios, balanced funds, pensions, etc. The Secretary's determination would be made in a formal "rule-making" procedure in which all affected parties would have an opportunity to comment.

The payout number also depends on how one balances the priorities between the future and the present. Those who view the problems facing charitable organizations as especially urgent would lean in the direction of a higher annual payout. Those who lean toward the longer range future would pick a lower figure in the range.

I would think, however, that virtually all of the Commission agrees that foundation investment returns deserve a great deal of improvement and emphasis

Speaking only for myself, I would probably opt for a figure in the upper end of the 6% to 8% range because I believe the needs over the near term foreseeable future are demonstrably accelerating.

We see a high payout requirement having a number of advantages to society and, we believe, to foundations as well:

1. It results in substantial benefits to charity at a time in our lives when every reasonable projection says more and more money will be desperately needed to maintain the viability and thrust of the private sector's role.

2. Such a payout will provide an incentive to foundations to improve their rate of return and this in itself could mean benefits to charity compounded at hundreds of millions of dollars a year or more.

3. The disposition of control stock is an extraordinarily important question—as our review of the sources of major contributions of existing foundations have made very clear.

The House Bill takes the view that the disposition of this control stock over 5 years, and in some cases 10, is required. Considering the motives of large donors in giving in the first place, this will not only present some serious problems to them but could well discourage philanthropic giving unduly, and perhaps decisively.

We believe the public interest is best served when we concern ourselves with the consequences and *performance* of foundation activity rather than to assess the motives of those who establish or operate these organizations.

Men's motives are always mixed; charity is not without its variety; generosity is not without its own kind of pride, and except for saints, we all perform our best and worst actions for a mixture of reasons.

If the foundation provides an adequate return to charity, if abuses have been adequately controlled, if non-charitable grants are stopped, then it seems to us a bit fruitless to speculate upon the mixed motivations of foundation donors.

4. For this same reason, we strongly oppose the restrictions on appreciated property gifts to foundations as unnecessarily punitive, self-defeating and potentially disastrous to the all important birth rate of new foundations to meet the charitable crisis of the seventies and beyond.

Our survey of large donors indicates that 63% would not want to or wanted to set up a foundation at all if the restrictions on the contribution of appreciated property were in effect. Another 25% would contribute less to a foundation. The large donors view this as the provision with the greatest negative effect on their contribution to foundations.

We would like to know what the impact of each of these provisions would be on you:

ESTIMATED EFFECT ON FOUNDATIONS

[In percent]

	Lead me not to want or have wanted to set up a foundation at all	Lead me to give or to have given less to a foundation	Have no effect on my giving to a foundation
Provisions:			
Tax on appreciated property given to a foundation	63	25	12
7.5 percent tax on foundation income	28	23	49
Distribute at least 5 percent of assets	24	13	63

These severe House Bill restrictions on required divestment of control stock and on appreciated property contributions appear to us to be largely punitive in their effects and may achieve a pound of harm for every ounce of good they do.

A high payout requirement will present some problems to which flexible answers should be provided, *as long as the fundamental requirement is met of a high payout to charity.*

Relevance to Perpetuity Problem—We also believe that a high payout requirement provides a partial, and we think sufficient, answer to the concerns which have been expressed about perpetual existence of foundations. A high payout requirement means that foundations will have perpetual life only as long as they continue to make substantial contributions to charity. If a foundation's endowment is not sufficiently productive to meet the payout requirement, the foundation will gradually be phased out of existence. Thus perpetual life becomes a justified reward for continuing productvity, and not an automatic privilege which is granted without being earned.

If the foundation will not invest its funds productively for the long term benefit of charity and if continued donor contributions or outside support are not forthcoming, then it may well be the case that the foundation has not earned the privilege of perpetuity.

The Commission has considered proposals that the life of foundations should be limited to a fixed term. These proposals reflect concern about self-perpetuating dynasties and the distrust of institutions without a clearly defined constituency or public accountability.

It is our tentative conclusion that the arguments for limited life are not sufficiently persuasive to make such a drastic step appropriate. A fixed term provides a bad precedent for other charitable organizations and does not discriminate between organizations which deserve to continue and those who do not. As noted in our discussion of the payout requirement the right to perpetual life should be earned, and should not be an automatic privilege. Only foundations which continue to make satisfactory contributions to charity should be entitled to perpetual existence.

We suspect that limited life may well have a discouraging effect on the birth rate of new foundations. The ability to create an institution bearing the donor's name and having perpetual life may be a very significant psychological incentive for the creation of foundations.

The evidence with respect to the bad effect of continued existence of foundations is largely conjectural. Particularly with the larger foundations, there appears to be some evidence to support the view that the institutions may improve with age. A number of foundations which started out under close control of an individual donor or his family have over time become completely independent of such control. There is also some question abou the effectiveness of a limited life organization during its final years.

In sum, we believe that a very high burden of proof should be met before a mandatory death sentence should be decreed. The arguments against perpetual existence do not meet this burden of proof.

Specific Suggestions.—Our studies of the payout requirement have suggested a number of specific improvements in the provision contained in the House bill:

(a) The payout requirement should be expressed solely as a percentage of assets and should not be measured by earned "income." In measuring a foundation's investment performance, it is inappropriate to distinguish between ordinary income and capital gains, or between realized and unrealized gains. Introducing distinctions between different types of income may result in distortions of foundation investment management in order to maximize one type of income at the expense of another.

(b) The required payout should be based on a two- or three-year moving average of asset values. This would avoid fluctuations reflecting short-term changes in asset values. A longer averaging period might be appropriate for new foundations and for those receiving substantial new contributions.

(c) Foundations should be exempted from the payout requirement to permit accumulation of several years' income for specific large scale projects. Such accumulation should not be made without prior notice to the Internal Revenue Service. We believe that prior notice to IRS and an opportunity to disapprove is more appropriate than advance approval.

(d) All proper foundation expenditures should be included in determining whether the payout requirement has been met. For this purpose both grants and direct expenditures, including the costs of investment management taxes or user fees and other reasonable and necessary administration expenses, should be included.

Establishment and Revision of Payout Percentage.—We question the desirability of including a specific payout percentage in the law. We recommend instead that the law define the criteria by which the percentage should be determined and give the Secretary of the Treasury the authority to establish the percentage, and to make revisions from time to time.

Problems of Diversification.—A high payout requirement will encourage foundations to dispose of unproductive assets and to make new investments. It may be desirable to provide a reasonable transition period to afford foundations adequate time to diversify their portfolios.

More difficult problems are raised where a foundation's assets are in the form of closely held stock or are not readily marketable for other reasons. Such problems are not insuperable. Without going into technical detail, we might suggest some steps which should be considered:

(a) Provision for sales by the foundation back to the donor of assets which are not readily marketable. Such sales should be made at an independently appraised price, and should be exempt from the self-dealing prohibitions.

(b) Recapitalization of a closely-held business to provide the foundation with a higher yield security in order to enable it to meet the payout requirements.

(c) Internal Revenue Service administrative authority to provide additional time in situations of unusual difficulty. The granting of additional time would be coupled with a requirement to make up the deficiency, after the appropriate reinvestments have been made.

Philanthropic Policy Board

We recommend the formation of a Philanthropic Policy Board to provide at the highest possible level informed and balanced policy judgments on major issues affecting philanthropy. The Board should be quasi-governmental in character, with full access to governmental data and with power to obtain data from private sources.

The Board should be composed of ten to fifteen top level private citizens and government officials. We suggest that the majority of the members be from the private sector. The Board might include individuals from the Senate and the House of Representatives, from the Executive Branch, from state regulatory agencies concerned with philanthropy, and from a variety of philanthropic organizations. Both the chairman and several other members should come from the public at large.

It may be appropriate to provide the Board with a federal charter and to provide for Presidential appointment and Senate confirmation of its members. The members should be appointed for fixed terms, perhaps for four years. The Board would meet on a periodic basis, perhaps four to ten times per year. It should have a small full-time staff and should also be authorized to arrange for studies by individual consultants and organizations. Its funding might come from both private and public sources.

Among the functions to be performed by the Board are:

1. Annual report to the Congress and to the President on the state of philanthropy. The purpose of such a report would be to provide a basis for proper formulation of laws and public policies.
2. Compilation of adequate statistical and other information about the entire field of philanthropy.
3. Establishment at several locations around the country of repositories of information about foundations and other philanthropic institutions. For example, the information about foundations should be organized in a manner to enable prospective grantees to determine which foundations may be active in his field of interest. A second purpose would be to provide for an interchange of information between foundations in order to reduce useless over-lapping of programs among foundations.
4. Policy studies of various problem areas affecting philanthropy. Such studies might be undertaken on the Board's own initiative or at the request of congressional committees or governmental agencies. It should make such public recommendations as it may deem appropriate.
5. Periodic assessments of government supervision of foundations and of other governmental programs which have an impact on philanthropy.

The recommendation for the establishment of the Board stems from the experience of our Commission. In particular it reflects our concern about the lack of adequate information regarding the philanthropic sector and its needs and the great difficulty of making accurate assessments of the effects of government policies on philanthropy.

The work of our Commission has also uncovered a number of very difficult issues on which the Commission will not be able to make any firm recommendations. These might well be useful subjects for studies by the Board:

First, the Board might encourage and review the development of a new tax incentive structure which will provide adequate incentives for increased contributions to philanthropy, without unreasonable costs to the Treasury and consistent with considerations of tax equity. I have already commented on the importance of such a study. This is a highly complex subject requiring the talents of tax specialists, economists and statisticians among others.

Second, a number of complex questions are raised by the role of the government in supervising foundations and philanthropy, including the proper method of meshing the responsibilities of the federal government with those of the states; the encouragement of uniform state laws dealing with charitable organizations and foundations; the proper balance between administrative regulations and judicial remedies; the reconciliation of the government's interest in encouraging philanthropy and in regulating possible abuses.

Third, the Board might undertake a basic policy review of the tax law definitions which define the areas of activity entitled to tax deductions and exemptions. Such a review might deal both with the adequacy of the existing statutory definitions and with the policy principles which should guide the Internal Revenue Service administrative rulings defining the borderline between charitable and non-charitable activities. Such a study should deal with the activities of all charitable organizations and not merely with foundations.

Fourth, an examination of the role and responsibilities of trustees of charitable organizations would be useful. There is much confusion now in the minds of trustees of many charitable institutions as to their appropriate responsibilities.

We believe that the foregoing examples illustrate the many important tasks which the Philanthropic Policy Board will be able to perform.

More important than its task is its mission . . . to preserve, to nurture and to relate the role of the philanthropic sector to the society as a whole.

VI. SUMMARY OF COMMISSION RECOMMENDATIONS

Our recommendations are directed to three basic objectives:

First, we want to stimulate a significant increase in the funds actively devoted to philanthropy. We have spelled out why we believe charitable needs will continue to rise rapidly in the seventies, and why we strongly reaffirm the further encouragement of private philanthropy.

Second, we want to assure that foundation funds are devoted to legitimate charitable purposes, without diversion either for private gain or for activities which are not properly charitable. This is essential not only because of the pressing needs of charity, but also to assure public confidence in foundations.

Third, we want to increase diversity in the private sector and to encourage foundations to be active in areas where increased private sector involvement is important and where foundations can make distinctive contributions.

Based on these objectives we have arrived at the following recommendations:

1. High Payout Requirement

Foundations should be required to make substantial annual distributions to charity to help meet rapidly accelerating charitable needs. Our data on the performance of university endowments, mutual funds and other professionally-managed investments suggests that a payout in the 6% to 8% range is fair and reasonable under present conditions. Any payout percentages should, of course, be reviewed periodically to take account of changes in economic conditions.

Perhaps more important than the particular percentage are the assumptions on which it should be based. We believe that the payout requirement for foundations should be high enough to encourage them to invest their funds productively. The percentage should not be so high as to amount to a delayed death sentence. A foundation with a well-managed investment portfolio should be able to maintain its size and to stay abreast of changes in the value of the dollar. However, the current needs of our society for philanthropic funds are so great that we consider it inappropriate to permit foundations to grow in size, without making an adequate current contribution to philanthropy. A payout percentage which will permit a well-managed foundation portfolio to maintain its size, while making a productive contribution to charity, represents an equitable balance between the pressure of society's current needs and the interests of future generations.

While accurate forecasts are impossible to make, a payout requirement in the 6% to 8% range might increase foundation grants significantly, perhaps in excess of $500 million per year. That, however, is not the only reason why we recommend a high payout. Another important reason is the peculiar nature of foundations as grant-making institutions. Foundations are unique in our society in having assets which are not fully committed to on-going activities. This is one of their great strengths, and makes them capable of doing things which other institutions cannot do. However, it also means that foundations are not under the same budgetary pressures as other organizations. From the limited data available to us we feel that foundation investment performance has in the past been quite unimpressive and that very substantial improvements are possible.

Another reason why we favor a high payout requirement is that the donor to a foundation receives a tax deduction at the time of his donation. Considering the pressing needs for charitable funds, we believe that funds for which a charitable deduction has been received should be devoted to charity on a prompt and productive basis.

Relevance to Perpetuity Problem.—We also believe that a high payout requirement provides a partial, and we think sufficient, answer to the concerns which have been expressed about perpetual existence of foundations. A high payout requirement means that foundations can have perpetual life only as long as they continue to make substantial contributions to charity. If a foundation's endowment is not sufficiently productive to meet the payout requirement, the foundation will gradually be phased out of existence. Thus, perpetual life becomes a justified reward for continuing productivity, and not an automatic privilege which is granted without being earned.

Relevance to Corporate Control Problem.—A high payout requirement will also serve to answer at least some of the concerns which have been expressed with respect to foundation ownership of sizable blocks of stock in business corporations. One concern is that such blocks may be given to foundations for reasons, such as protecting the donor's control of the corporation, which have nothing to do with their desirability from an investment standpoint. We believe that the concerns about foundation holdings of large blocks would be substantially reduced when such holdings make a productive contribution to charity. A high payout requirement coupled with prohibitions on self-dealing, greater disclosure and improved government supervision, provides a better solution than an arbitrary limit on percentage of ownership.

Specific Suggestions.—Our studies of the payout requirement have suggested a number of specific improvements in the provision contained in the House bill:

(a) The payout requirement should be expressed solely as a percentage of assets and should not be measured by earned "income." In measuring a foundation's investment performance, it is inappropriate to distinguish between ordinary income and capital gains, or between realized and unrealized gains. Introducing distinctions between different types of income may result in distortions of foundation investment management in order to maximize one type of income at the expense of another.

(b) The required payout should be based on a two- or three-year moving average of asset values. This would avoid fluctuations reflecting short-term changes in asset values. A longer averaging period might be appropriate for new foundations and for those receiving substantial new contributions.

(c) Foundations should be exempted from the payout requirement to permit accumulation of several years' income for specific large scale projects. Such accumulation should not be made without prior notice to the Internal Revenue Service. We believe that prior notice and an opportunity to disapprove is more appropriate than requiring advance approval by IRS.

(d) All proper foundation expenditures should be included in determining whether the payout requirement has been met. For this purpose both grants and direct expenditures, including the costs of investment management, taxes or user fees, and other reasonable and necessary administrative expenses, should be included.

Establishment and Revision of Payout Percentage.—We question the desirability of including a specific payout percentage in the law. We recommend instead that the law define the criteria by which the percentage should be determined and give the Secretary of the Treasury the authority to establish the percentage, and to make revisions from time to time. The Secretary's determination should be made in a formal "rule-making" procedure, in which the foundations and other affected parties would have an opportunity to comment.

Problems of Diversification.—A high payout requirement may make it necessary for some foundations to dispose of unproductive assets and to make new investments. It may be desirable to provide a reasonable transition period to afford foundations adequate time to diversify their portfolios.

Where a foundation's unproductive assets are in the form of closely held stock or are not readily marketable for other reasons, diversification will present some problems. However, such problems are not insuperable. Without going into technical detail, we might suggest some steps which should be considered:

(a) Sales back to the donor of assets which are not readily marketable. Such sales should be made at an independently appraised price, and should be exempt from the self-dealing prohibitions.

(b) Recapitalization of a closely-held business to provide the foundation with a higher yield security in order to enable it to meet the payout requirement.

(c) Internal Revenue Service administrative authority to provide additional time in situations of unusual difficulty. The granting of additional time should be

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coupled with a requirement to make up the deficiency, after the appropriate reinvestments have meen made.

2. Increased Foundation Reporting and Disclosure

Foundations should be required to increase substantially the amount of information which they make public. This recommendation reflects one of the major problems which our own Commission encountered in its work: the lack of adequate information about foundations. Fewer than 200 out of perhaps 30,000 foundations distribute annual reports. The tax return required by the Internal Revenue Service, while technically a public document, is difficult and expensive to obtain. It is in many respects inadequate and unsatisfactory as a public accounting of foundation activities.

We believe that increased disclosure is important for a number of reasons.

First, it should help to re-establish public confidence in foundations. We believe that one element underlying the public concern is a feeling of unease about activities behind the scenes, a suspicion nourished by the fact that relatively little is known about foundations. Greater availability of information should serve to alleviate such concerns.

Second, additional information will help both Congress and the Executive Branch to reach proper policy decisions about foundation activities. One of the most difficult, and most costly, efforts of this commission has been to obtain more information in order to reach conclusions based on facts, rather than conjectures.

Third, increased disclosure is likely to have a desirable prophylactic effect on questionable practices. Those of us with experience in the corporate world are well aware that the public disclosure requirements of the securities laws have had a favorable effect on the standards of the business community.

Fourth, increased disclosure, coupled with equity jurisdiction in the federal courts, might make it possible to enjoin improper foundation activities at an early stage.

Fifth, more adequate foundation reporting should make it easier for prospective recipients to determine which foundations are interested in particular fields of work.

The Commission has had a task force at work on foundation reporting practices. Based on the work of this task force, we believe that we will be able to recommend major revisions in foundation reporting practices. They will deal with the need for uniform accounting standards, for more meaningful description of grant-making activities, and will provide a better basis for policing of abuses.

We expect that our report will also cover methods of making the information disclosed more accessible, and for summarizing and otherwise organizing information about foundations in a manner which will facilitate the formulation of public policy.

3. Prohibitions Against Self-Dealing

We endorse the prohibitions against self-dealing contained in the House bill. In our view, strict self-dealing prohibitions are essential both in order to restore public confidence in foundations and to assure that funds which have been dedicated to philanthropy will not be diverted to non-philanthropic purposes. A fundamental premise which cannot be over-emphasized is that a foundation's assets are irrevocably committed to charity and that the diversion of a foundation's assets for the private financial benefit of the donor, or of the managers of the foundation. cannot be tolerated. Our studies of the prevalence of self-dealing practices suggest that there is sufficient justification for the enactment of the strict self-dealing prohibitions contained in the House bill.

The use of the term "*private* foundation" in the House bill is unfortunate. We believe the emphasis should be on the public, rather than on the private, character of foundations. Substituting the term "*philanthropic* foundation" might help to emphasize that foundations are there to benefit charity, not private individuals.

4. Increased Internal Revenue Service Audits

Again with the objective of restoring public confidence in foundations, we urge that there be a substantial increase in Internal Revenue Service audits of foundations. We recommend that *all* foundations be audited at least once within the next three years. We recognize that this will involve a substantial step-up in IRS auditing activity. However, we believe that only an effort on this scale will be adequate to assure the public that the privilege of setting up a foundation is not being abused. The result of such a three-year program should also provide suffi-

cient data to enable Congress to make realistic decisions regarding the proper level of future surveillance.

We recognize that the cost of an increased audit program is substantial and we propose that this cost be paid by a special user charge payable by the foundations. Such a charge should reasonably reflect the actual cost increase of this special regulatory effort, and should be limited to the three-year period. This cost is likely to be substantially less than the 7½% tax on investment income proposed by the House or the 2% tax recommended by the Treasury.

As a matter of principle, we question the desirability of charging philanthropic institutions for the cost of IRS supervision when the cost of supervising corporations and other institutions is borne by the regular administrative budget, and is not made a special charge. We would suggest, therefore, that the precedent of the user charge be limited to the special three-year audit program we are recommending. We do not believe that either state regulation or self-regulation by the foundations provides an adequate alternative to increased IRS supervision under current conditions.

5. Sanctions for Violations

There are serious shortcomings both in the existing sanctions for violations of the legal rules applicable to foundations, and in the new sanctions proposed in the House bill. The principal existing penalty—loss of tax exemption—is so drastic as to be useless except in the most extreme cases. The provision of the House bill for a graduated system of "taxes" for various forms of violation has other shortcomings. We recognize that this is a technical subject and I am not in a position to make detailed recommendations. Let me outline, however, the general principles which we believe a satisfactory system of sanctions should embody:

First, the objectives of the system of sanctions should be made to make charity whole, not to increase the collection of taxes. As a general rule, penalties should not be levied against the assets of the foundations, but rather against the individuals responsible for the violation. An individual who has enriched himself at the expense of the foundation, should be required to make the foundation whole.

Second, fines should only be levied where the prohibited conduct can be defined in an unambiguous manner. In particular, fines should not be imposed in areas where there are difficult questions of judgment, as may arise in connection with certain investment policy and grant-making decisions.

Third, provision should be made for promptly enjoining improper activities rather than penalizing them after they have occurred. We are attracted by the possibility of providing equity jurisdiction in the federal courts. This can be provided by Congressional action; we see no constitutional problem. This is a subject which our Commission has under study.

Fourth, sanctions should be geared to the seriousness of the violation, and whether it is willful or inadvertent. For minor or technical violations, a warning with an opportunity to make corrections may be sufficient. In other cases monetary penalty will be necessary. Such penalties should be imposed in the form of fines, not as excise taxes and they should not be automatically measured by the amount involved in the improper transaction. Penalties should increase in the event of repeated violations. In setting the level of fines, one should not discourage individuals from becoming trustees and officers of foundations.

6. Tax Incentives

We are concerned about the widening gap between charitable needs and charitable resources. This problem is so serious that we strongly urge that there be a careful examination of the effect on philanthropy of the House bill. In particular, we believe that the bill has major, if unintended, anti-philantropic effects. The most serious effects result from the allocation of deductions provisions and the limit on tax preferences. What is needed is a full analysis of the likely dollar effects of each provision affecting charitable giving and an assessment of the effect of the bill as a whole. In such an assessment it is important to keep in mind that complexity itself operates as a disincentive for philanthropic giving.

Specific attention sould be given to those provisions of present law which allow a donor to make money by contributing to charity. Of special importance is the need to insure that charitable contributions are not overvalued.

In view of the need for greatly increased private contributions to meet ever expanding needs, we believe that a panel of experts should be immediately

assembled to recommend new and equitable tax incentives to increase philanthropic giving.

7. Grant-Making Activities—Foundations and Government

Our Commission has devoted much of its time to the grant-making activities of foundations. We have listened to presentations by representatives of foundations and by distinguished citizens with governmental and other experience relevant to foundation grant-making activities. In the Commission's own deliberations, this subject has occupied more time than any other. Unquestionably, the most sensitive area of grants are those involving interaction with government programs. This is a complex subject to requiring a balancing of conflicting considerations.

Studies of Public Issues and the Legislative Process.—We reached the basic premise that it is impossible to draw any line of demarcation between the foundations' fields of interest and those of governments. Practically every area of significant foundation activity is one in which federal, state and local governments are also active, generally on a much larger scale. This is true both of the conventional fields of philanthropy—health, education, welfare, science and technology, and such newer areas as urban problems, civil rights, the environment and population control. The interests of foundations and of government agencies are so intertwined that it is unrealistic to expect that foundation programs should not have direct impact on government programs.

Far from deploring intertwining of the private and the public sector, we consider this one of the healthy features of American society. Interchanges between the private sector and the public sector in the development and formulation of public policy is an essential part of the democratic process. The larger and more complex that government becomes, the greater the need for private inputs into the decision-making process. The complexity of the problems, however, makes it much more difficult for the private sector to make meaningful contributions. As the work of our own Commission illustrates, private individuals cannot deal adequately with even a relatively limited subject, except after extensive study and analysis, including substantial fact gathering. This is not only time consuming but can be quite costly even where the members of the Commission serve without compensation.

Our Commission has, up to this point, operated without foundation funds. I can testify from personal experience how difficult it is to raise funds for a study from other sources. Our experience is far from unique, and it is fair to say that foundations are much the best source for funding private efforts to study significant policy issues. Any legal restriction on the availability of foundation funds for studies of public issues cannot help but impair private contributions to the decision-making process.

In considering the desirability for private contributions to the decision-making process, we do not think that distinctions should be made between *legislative* decision-making and *executive* decision-making. One of the members of our Commission, who has had extensive Congressional experience feels strongly that the huge scale of the executive branch input into the legislative process makes it particularly useful that there be well-conceived and well-organized private contributions to Congressional deliberations. Furthermore, we think there is no practical or logical basis for distinguishing between public issues which may become the subject of legislative action and those which will not. Almost any significant public interest is likely to become the subject of legislative attention, a point I need hardly dwell upon before this audience.

For these reasons we strongly question the provisions in the House bill which seek to curb foundation contacts with members of legislative bodies or other persons who may participate in the formulation of legislation. We consider it both unnecessary and undesirable to shield legislators or their staff from contacts with private groups which are engaged in studies of issues which are of legislative interest.

Let me add, and here I am once again speaking from personal experience, the exchanges of ideas between private individuals and members of Congress and their staff is, of course, a mutually beneficial two-way street. On most major issues of public interest, members of Congress and their staff are among the foremost experts who should be consulted by anyone engaged in a serious study.

We believe that the provision in the House bill permitting foundations to make available the results of "non-partisan analysis and research" is far too limited an exception from the prohibition on legislation communications. In

particular the word "non-partisan" is highly ambiguous. If it means free from any impact on partisan politics, the exemption would be practically meaningless, because any significant public question can become a partisan issue. If "non-partisan" means that no final conclusion can be drawn, it would remove the underlying purpose for which most studies are undertaken.

While we feel strongly that there should be no impediment on foundation-financed studies, even though they may have an impact on legislation, and may involve contacts with legislators and other persons who may participate in the formulation of legislation, we recognize that this is an area of genuine sensitivity. The solution, we believe, lies in prompt and full disclosure rather than in prohibitions. We believe there should be advance disclosure of any foundation-financed study if such study involves any substantial number of contacts with members of Congress or their staffs. In addition, any foundation grant which involves compensation to government employees should be disclosed before such payments are made. With respect to executive branch employees, prior notice should be given to the head of the department employing the particular individual. Where legislative employees are involved, notice might go to the Clerk of the Senate or of the House.

Lest there be any misunderstanding let me emphasize that foundation involvement should be limited to legitimate studies of public issues. The privilege to engage in educational activities which may have an impact on legislation must not be abused. It clearly does not provide a license to carry on pure and simple lobbying activities.

Elective Politics.—Our Commission fully endorses the prohibitions on foundation involvement in elective politics. Tax-exempt funds should not be used in election campaigns, whether to support the election of candidates or the passage of measures voted on in referendums. The policy considerations in this area are well settled and do not need further elaboration.

Grass Roots Campaigns.—We also agree that foundation funds should not be used for grass roots campaigns designed to bring pressure on legislators. We believe that the only proper role of foundations in the political process is an educational one. Where the objective is political pressure rather than dissemination of ideas, foundation involvement becomes improper. We recognize, of course, that this principle is more easily stated than it is applied in practice. However, the fact that there may be some difficult borderline case is no reason for ignoring the underlying principle. We would encourage foundations to seek advance rulings before venturing into questionable areas. This should not be a legislative requirement.

Definition of Propaganda.—Starting from the premise that the legitimate functions of foundations in the political process is an educational one, we agree that the use of foundation funds for propaganda purposes should be barred. However, we would urge a redefinition of what constitutes propaganda. The test should not be whether "both sides" are presented in an impartial manner, or whether conclusions are drawn, but whether the material being distributed is educational in character. We recommend that this test be applied in a conservative manner. The line between "propaganda" and "education" should not provide a basis for a censorship of ideas. Only in very clear-cut cases, such as hate material, which no reasonable man could consider as educational, should the restriction on propaganda be invoked.

8. The Birth Rate of Foundations: Appreciated Property and Control Stock

It is important that there be adequate incentives for the formation of new foundations. This will not only increase total philanthropic assets, but should improve the degree of diversity within the foundation field. In particular, it should result in a better national distribution of foundations. While the popular conception of foundations as part of an "Eastern establishment" is exaggerated, it is true that there is a substantial concentration of foundations in the Northeast. This undoubtedly reflects the time lag between the creation of great fortunes and the time when they find their way into foundations. Thus the prevalence of foundations in the Northeast reflects the economic predominance of the Northeast in the latter part of the 19th and the early part of the 20th century. The much wider national distribution of centers of wealth in the last three decades is only gradually being reflected in the creation of foundations in other parts of the country.

We believe that the formation of new foundations would be significantly reduced by two changes in tax incentives contained in the House bill. I am referring

to the provision limiting the deductibility of gifts to foundations of appreciated property, and the provision limiting the percentage of stock in any corporation held by a foundation. Our studies indicate that the full deductibility of gifts of appreciated property has been a very important incentive for gifts to philanthropy. Of all the changes proposed in the House bill, this would have the most significant adverse effect on large givers, the people most likely to set up new foundations.

The concern about the effects of the prohibition on foundation ownership of controlling blocks of stock ties in closely with the concern regarding the appreciated property deduction. The history of foundations, particularly of the larger foundations, indicates that they were generally started with gifts of stock, usually controlling blocks, of a business which the donor had developed during his life time. Such blocks obviously will have a very high appreciation in value over the original cost to the donor. Thus, from the standpoint of incentives for the formation of new foundations, the appreciated property deduction and the right to donate controlling blocks are likely to go together. Both are important to the formation of new foundations.

As indicated above, we believe that the concerns which have been expressed about the dangers of foundation ownership of controlling blocks can largely be met by a combination of a high pay-out requirement, strict limitations on self-dealing, and increased disclosure. With these protective features in place, and considering the effect on the birth rate of new foundations, we believe that the balance favors permitting foundation ownership of controlling blocks.

9. Perpetual Existence

The Commission has considered proposals that the life of foundations should be limited to a fixed term. These proposals reflect concern about self-perpetuating dynasties and distrust of institutions without clearly defined constituencies or public accountability.

It is our tentative conclusion that the arguments for limited life are not sufficiently persuasive to make such a drastic step appropriate. A fixed term provides a bad precedent for other charitable organizations and does not discriminate between organizations which deserve to continue and those who do not.

As noted in our discussion of the pay-out requirement, the right to perpetual life should be earned, and should not be an automatic privilege. Only foundations which continue to make satisfactory contributions to charity should be entitled to perpetual existence.

We suspect that limited life may well have a discouraging effect on the birth rate of new foundations. The ability to create an institution bearing the donor's name and having perpetual life may be a very significant psychological incentive for the creation of foundations.

The evidence with respect to the bad effect of continued existence of foundations is largely conjectural. Particularly with the larger foundations, there appears to be some evidence to support the view that the institutions may improve with age. A number of foundations which started out under close control of an individual donor or his family have over time become completely independent of such control. There is also some question about the effectiveness of a limited life organization during its final years.

In sum, we believe that a very high burden of proof should be met before a mandatory death sentence should be decreed. The arguments against perpetual existence do not meet this burden of proof.

10. Philanthropic Policy Board

We recommend the formation of a Philanthropic Policy Board to provide at the highest possible level informed and balanced policy judgments on major issues affecting philanthropy. The Board should be quasi-governmental in character, with full access to governmental data and with power to obtain data from private sources.

The Board should be composed of ten to fifteen top level private citizens and government officials. We suggest that the majority of the members be from the private sector. The Board might include individuals from the Senate and the House of Representatives, from the Executive Branch, from state regulatory agencies concerned with philanthropy, and from a variety of philanthropic organizations. Both the chairman and several other members should come from the public at large.

It may be appropriate to provide the Board with a federal charter and to provide for Presidential appointment and Senate confirmation of its members. The

members should be appointed for fixed terms, perhaps for four years. The Board would meet on a periodic basis, perhaps four to ten times per year. It should have a small full-time staff and should also be authorized to arrange for studies by individual consultants and organizations. Its funding might come from both private and public sources.

Among the functions to be performed by the Board are:

1. Annual report to the Congress and to the President on the state of philanthropy. The purpose of such a report would be to provide a basis for proper formulation of laws and public policies.
2. Compilation of adequate statistical and other information about the entire field of philanthropy.
3. Establishment at several locations around the country of repositories of information about foundations and other philanthropic institutions. For example, the information about foundations should be organized in a manner to enable prospective grantees to determine which foundations may be active in his field of interest. A second purpose would be to provide for an interchange of information between foundations in order to reduce useless over-lapping of programs among foundations.
4. Policy studies of various problem areas affecting philanthropy. Such studies might be undertaken on the Board's own initiative or at the request of congressional committees or governmental agencies. It should make such public recommendations as it may deem appropriate.
5. Periodic assessments of government supervision of foundations and of other governmental programs which have an impact on philanthropy.

The recommendation for the establishment of the Board stems from the experience of our Commission. In particular it reflects our concern about the lack of adequate information regarding the philanthropic sector and its needs and the great difficulty of making accurate assessments of the effects of government policies on philanthropy.

The work of our Commission has also uncovered a number of very difficult issues on which the Commission will not be able to make any firm recommendations. These might well be useful subjects for studies by the Board:

First, the Board might encourage and review the development of a new tax incentive structure which will provide adequate incentives for increased contributions to philanthropy, without unreasonable costs to the Treasury and consistent with considerations of tax equity. I have already commented on the importance of such a study. This is a highly complex subject requiring the talents of tax specialists, economists and statisticians among others.

Second, a number of complex questions are raised by the role of the government in supervising foundations and philanthropy, including the proper method of meshing the responsibilities of the federal government with those of the states; the encouragement of uniform state laws dealing with charitable organizations and foundations; the proper balance between administrative regulations and judicial remedies; the reconciliation of the government's interest in encouraging philanthropy and in regulating possible abuses.

Third, the Board might undertake a basic policy review of the tax law definitions which define the areas of activity entitled to tax deductions and exemptions. Such a review might deal both with the adequacy of the existing statutory definitions and with the policy principles which should guide the Internal Revenue Service administrative rulings defining the borderline between charitable and non-charitable activities. Such a study should deal with the activities of all charitable organizations and not merely with foundations.

Fourth, an examination of the role and responsibilities of trustees of charitable organizations would be useful. There is much confusion now in the minds of trustees of many charitable institutions as to their appropriate responsibilities.

We believe that the foregoing examples illustrate the many important tasks which the Philanthropic Policy Board will be able to perform.

More important than its task is its mission . . . to preserve, to nurture and to relate the role of the philanthropic sector to the society as a whole.

J. Paul Austin, President and Chief Executive Officer, The Coca-Cola Company, Atlanta, Georgia.

Prof. Daniel Bell, Department of Sociology, Columbia University, New York, N.Y.; Chairman, Commission on Year 2000 of American Academy of Arts and Sciences.

Daniel Bryant, Chairman and Chief Executive Officer, Bekins Moving & Storage Co., Los Angeles, Calif.; Past President, Los Angeles Chamber of Commerce, and Los Angeles Merchants & Manufacturers Association.

James Chambers, President, Times Herald Printing Co., Publisher, Dallas Times Herald, Dallas, Texas.

Sheldon S. Cohen, Cohen & Uretz, Washington, D.C.; Commissioner of Internal Revenue, 1965–69.

Thomas B. Curtis, Vice President and General Counsel, Encyclopaedia Britannica, Chicago, Ill.; Member, U.S. House of Representatives, 1950–69; Member, Ways and Means Committee, Joint Economic Committee.

Paul Freund, The Carl M. Loeb University Professor, Harvard University, Cambridge, Mass.: President, American Academy of Arts and Sciences 1964–67.

Martin Friedman, Director, Walker Art Center, Minneapolis, Minnesota; Commissioner, Smithsonian Commission, National Collection of Fine Arts.

Mrs. Patricia Roberts Harris, Professor of Law, Howard University, Washington, D.C.; U.S. Ambassador to Luxembourg, 1965–67.

Hon. A. Leon Higginbotham, Jr., Judge, U.S. District Court for Eastern District of Pennsylvania, Philadelphia, Pennsylvania.

Lane Kirkland, Secretary-Treasurer, AFL–CIO, Washington, D.C.; President of Institute of Collective Bargaining and Group Relations.

Dr. Philip Lee, Chancellor, University of California, School of Medicine, San Francisco, California; Former Assistant Secretary, Department of Health, Education, and Welfare.

Edward Levi, President, University of Chicago, Chicago, Illinois.

Dr. Franklin Long, Vice President for Research and Advanced Studies, Cornell University, Ithaca, New York.

A. S. Mike Monroney, Consultant, Washington, D.C.; Member, U.S. House of Representatives, 1938–50; U.S. Senator, Oklahoma, 1950–69.

Key staff members include:

Director, Everett L. Hollis, Partner, Chicago law firm of Mayer, Friedlich, Spiess, Tierney, Brown & Platt.

Walter J. Blum, Professor of Law, University of Chicago, and noted tax expert.

Fritz Heimann, Associate Corporate Counsel, General Electric Company, New York.

William A. Wineberg, Jr., Associate, Mayer, Friedlich, Spiess, Tierney, Brown & Platt.

John Labovitz, Editor in Chief, University of Chicago Law Review, 1968–69.

(Whereupon, at 4:10 p.m., the committee was adjourned.)

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