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# TAX REFORM ACT OF 1969

# H.R. 13270

## PART A—TESTIMONY TO BE RECEIVED TUESDAY, OCTOBER 7, 1969

## PART B—ADDITIONAL STATEMENTS

(Topic: Foundations)

COMMITTEE ON FINANCE
UNITED STATES SENATE
RUSSELL B. LONG, *Chairman*

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Senate Committee on Finance

Hearings on the Tax Reform Act of 1969
(H.R. 13270)

September 10, 1969

JOINT STATEMENT PRESENTED ON BEHALF OF ADVANCED-STUDY AND RESEARCH INSTITUTIONS WITH RESPECT TO THE PROVISIONS OF H.R. 13270 AFFECTING PRIVATE FOUNDATIONS

Witnesses:

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.

Caryl P. Haskins, President, Carnegie Institution of Washington.

## Summary of Principal Points in Joint Statement submitted on behalf of Advanced-Study Institutions

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 that they are eligible to receive qualifying distributions from private foundations.

6. To ensure that these institutions, which 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.

## 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 organisationally 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 organisations 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, th a description of the role of advanced training and research organisations 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 than specialized vocational training. These range in size and character from small private junior colleges to great state universities. They include private 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 educationl (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 typically 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 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. 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 organisationally 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 recognised, 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 organisational 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 important 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



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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 Einrtein'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 1911 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 forth 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 organizations 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. <u>Problems created by the proposed legislation</u>.

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. <u>The definitions</u>.

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 <u>not</u> 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/]

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.

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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.

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.

B. The tax.

The first problem, of course, would be the financial burden imposed by the proposed 7 1/2% 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.[1/] 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

1/ 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 pre-determined subjects.

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 foundations, and from the Bill's proposed restrictions, discussed below, on the ability of private foundations to make grants to these institutions out of income. Furthermore, the grant-making private foundations themselves will be subject to the 7 1/2% 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 7 1/2% 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.

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 grants 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 7 1/2% 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 the 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 not engage to any extent in

direct lobbying or "grass roots" campaigns with respect to pending legislation (other than appearances or communications respecting legislation that directly affects the institutions themselves).[1/] 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 clarifying 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.

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1/ Cf., Treas. Reg. § 1.162-20(b)(2).

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 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, the 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 freedowm 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



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representative example of its activities. These are resources and activities--physical in part but primarily human--which we believe this country cannot affort to dissipate. Taxing their income by 7-1/2 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 definition 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 a faculty, body of scholars or professional staff engaged directly in objective, non-partisan 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 of "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 seems 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 exampt 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 grant-maker 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.

September 25, 1969

Advanced-Study Group

THE TAX REFORM ACT OF 1969
(H.R. 13270)

Memorandum 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.

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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.

Calendar No. _______

91st CONGRESS
1st Session

H.R. 13270

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) 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."

September 25, 1969

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. An 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 particular 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 $5000 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.



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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.

Senate Committee on Finance

Hearings on the Tax Reform Act of 1969
(H.R. 13270)

September 10, 1969

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

to supplement their
Joint Statement
presented on behalf of
Advanced-Study Institutions

Brief Summary of
Statement by Kermit Gordon
President of the Brookings Institution
on H. R. 13270
before the Senate Committee on Finance
September 10, 1969

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 7 1/2 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 could 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 by Kermit Gordon
President of the Brookings Institution
on H. R. 13270
before the Senate Committee on Finance
September 10, 1969

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 years old. Its origins date back to the first of its predecessor organizations – the Institute for Government 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 operations 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 benefitted 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 activities 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 enable them to do research in Washington for their doctoral dissertations. 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 policies 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 Douglas 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, 29 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 is not a large contribution to an organization with a $5 million budget. We request that the Committee substitute a percentage limitation in place of this 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 auspices 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 7 1/2 percent tax on net investment income, as would the private foundations on which we depend for support.

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 disbursements 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 7 1/2 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 crédit and the deduction of operating and administrative expenses. Far from being a "modest" or "token" tax, the 7 1/2 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 corporation 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 7 1/2 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 7 1/2 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 an 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 writing 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 occurrence 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 subsequently 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 foundation 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 responsibility 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 interfere 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.



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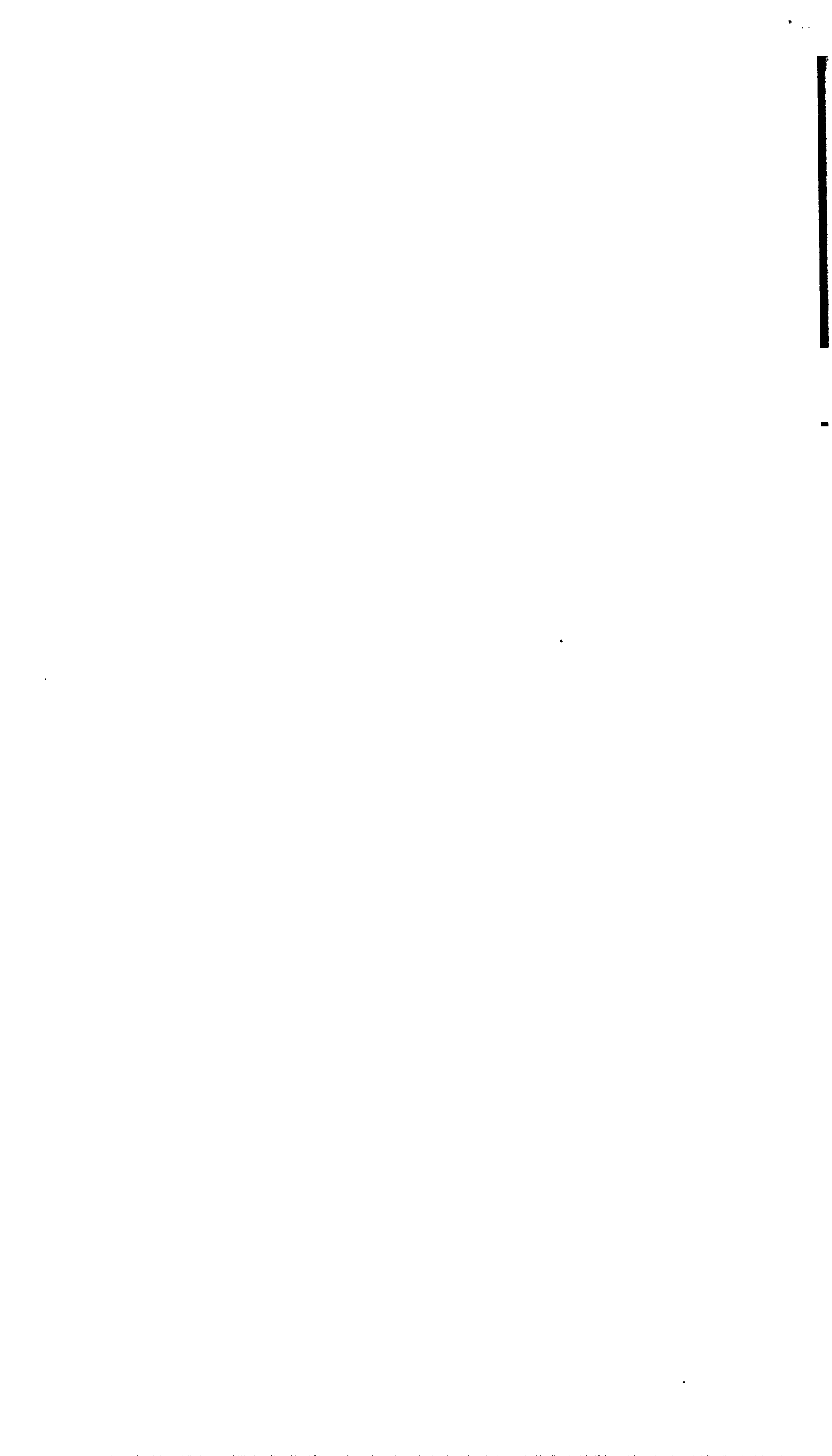

WRITTEN STATEMENT ON BEHALF OF
CARNEGIE INSTITUTION OF WASHINGTON
BY CARYL P. HASKINS, PRESIDENT
TO THE COMMITTEE ON FINANCE, UNITED STATES SENATE
ON H. R. 13270

September 10, 1969

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 cooperate 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 400 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 per cent 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 7-1/2 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 con-

tribution 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" excepted 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 an opportunity to understand us by working with us.

Respectfully submitted,

Caryl P. Haskins
President, Carnegie Institution of Washington

# *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 corporate 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 at 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 corporation 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 liability 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 by 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

202 Junipero Serra Boulevard • Stanford, California 94305 Telephone (415) 321-2052

September 5, 1969

The Honorable 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 purpose. 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 interests 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.



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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 one 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 behavioral 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.

* This list is made a part of the official files of the Committee.

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 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 <u>is</u> a postdoctoral educational institution, contributing to the understanding of advanced scholars, and through them modifying the course of training in our universities.

(The full text of Dr. Hilgard's letter will be found in the appendix.)

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 curricula 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 thought 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

OMW:g

Enclosures

CENTER FOR ADVANCED STUDY IN THE BEHAVIORAL SCIENCES

202 Junipero Serra Boulevard
Stanford, California 94305
(415-321-2052)

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 |
|---|---|---|
| Anthropology | 81 | 12 |
| Biology | 18 | 3 |
| Economics | 53 | 8 |
| Education | 20 | 3 |
| History | 58 | 8 |
| Humanities | 26 | 4 |
| Law | 25 | 4 |
| Linguistics | 26 | 4 |
| Mathematics-Statistics | 14 | 2 |
| Miscellaneous | 7 | 1 |
| Philosophy | 34 | 5 |
| Political Science | 73 | 11 |
| Psychiatry | 29 | 4 |
| Psychology | 127 | 19 |
| Sociology | 81 | 12 |
| Total | 672 | 100 |

CENTER FOR ADVANCED STUDY IN THE BEHAVIORAL SCIENCES

DISTRIBUTION OF FELLOWS BY STATE AND COUNTRY

1954-55 to 1968-69

| COUNTRY | NO. OF INSTITUTIONS | NO. OF FELLOWS |
|---|---|---|
| United States | | |
| Arizona | 1 | 1 |
| California | 14 | 105 |
| Colorado | 1 | 1 |
| Connecticut | 3 | 39 |
| Georgia | 1 | 1 |
| Illinois | 4 | 69 |
| Indiana | 2 | 7 |
| Iowa | 3 | 6 |
| Kansas | 3 | 3 |
| Louisiana | 1 | 2 |
| Maine | 1 | 1 |
| Maryland | 2 | 6 |
| Massachusetts | 6 | 76 |
| Michigan | 4 | 42 |
| Minnesota | 1 | 10 |
| Missouri | 2 | 6 |
| Nebraska | 1 | 1 |
| New Hampshire | 1 | 4 |
| New Jersey | 3 | 18 |
| New York | 15 | 75 |
| North Carolina | 2 | 11 |
| Ohio | 2 | 4 |
| Oklahoma | 1 | 1 |
| Oregon | 4 | 9 |
| Pennsylvania | 7 | 22 |
| Rhode Island | 1 | 1 |
| Tennessee | 2 | 2 |
| Texas | 2 | 7 |
| Vermont | 1 | 1 |

Distribution of Fellows by State and Country 

| COUNTRY | | NO. OF INSTITUTIONS | NO. OF FELLOWS |
|---|---|---|---|
| United States (cont.) | | | |
| Virginia | | 1 | 3 |
| Washington | | 1 | 4 |
| Washington, D.C. | | 5 | 10 |
| Wisconsin | | 2 | 14 |
| | Sub-Total | 100 | 562 |
| Austria | | 1 | 1 |
| France | | 4 | 5 |
| Germany | | 5 | 5 |
| India | | 4 | 4 |
| Indonesia | | 1 | 1 |
| Israel | | 1 | 4 |
| Italy | | 2 | 2 |
| Japan | | 4 | 4 |
| Mexico | | 1 | 1 |
| Netherlands | | 4 | 6 |
| Norway | | 4 | 5 |
| Poland | | 3 | 4 |
| Portugal | | 1 | 1 |
| Romania | | 1 | 1 |
| South Africa | | 1 | 1 |
| Sweden | | 2 | 4 |
| United Kingdom | | | |
| Australia | | 4 | 4 |
| Canada | | 5 | 7 |
| England | | 11 | 46 |
| Scotland | | 3 | 3 |
| Yugoslavia | | 1 | 1 |
| | Sub-Total | 63 | 110 |
| | GRAND TOTALS | 163 | 672 |

BEHAVIORAL AND SOCIAL SCIENCES SURVEY COMMITTEE
*under the auspices of*
NATIONAL RESEARCH COUNCIL SOCIAL SCIENCE RESEARCH COUNCIL
1755 MASSACHUSETTS AVENUE, N.W. WASHINGTON, D.C. [illegible] [illegible]

August 18, 1969

Dr. O. Meredith Wilson
Director
Center for Advanced Study in the
Behavioral Sciences
202 Junipero Serra Boulevard
Stanford, California 94305

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, linguistics, 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.

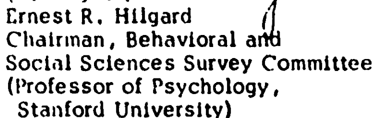
The result was that we came up with 76 members of our committees and panels, responsible for the reports soon to appear. The "statistic" to which I refer is that a recent check shows that 33 of these 76, or 43 percent, had been Fellows at the Center for Advanced Study in the Behavioral Sciences. There 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 them to accept appointment in serving their professions and society at large through non-remunerated 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. Those 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
(Professor of Psychology,
Stanford University)

Statement submitted to the Senate Finance Committee in behalf of the Institute for Advanced Study, Princeton, New Jersey, with respect to the Hearings on S ____________ (H.R. 13270) September 10, 1969 by Carl Kaysen, Director.

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, mediaeval 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 limitations of the

institution, and the desire to preserve a community small enough to be a true community, limit the number of members admissible.

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 Neumann 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 government 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 universities 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 mediaeval 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.

SUMMARY

Statement of Brooks Hays, Chairman
Southern Committee on Political Ethics
Before the
Senate Finance Committee
October 7, 1969

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 Unites 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 of Brooks Hays, Chairman
Southern Committee on Political Ethics
Before the
Senate Finance Committee
October 7, 1969

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 of 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 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.



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September 8, 1969

Summary of Statement of The James Irvine Foundation Regarding Section 101 of H.R 13270 Submitted to The Senate Finance Committee on September 8, 1969

1. The James Irvine Foundation is the trustee of a charitable trust which owns 54.55% of the stock of The Irvine Company of Orange County, California, by virtue of a gift from Mr. James Irvine.

2. The stock had a value of $5.6 million when it became absolute and has produced income of more than $10 million which has been distributed on a current basis to the universities, colleges, hospitals, youth organizations and similar charities in the community served by the Foundation.

3. The Foundation respectfully urges 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 foundations and operate as a powerful deterrent to the making of substantial gifts of corporate stock to charity in the future.

4. If the Committee should, nevertheless, conclude that the divestiture proposal should be adopted, then

(a) An exception should be made for foundations in existence on May 26, 1969, with respect to all business interests acquired before that date;

(b) An exception should also be made with respect to business interests which foundations are directed to retain by the terms of governing instruments which were irrevocable on May 26, 1969; and

(c) Provision should be made for an unrestricted ten-year period for the disposition of stockholdings in excess of the prohibited amount, with authority in the Secretary of the Treasury to extend the period in cases of hardship.

5. The minimum investment return proposal which would require foundations to distribute out of capital each

year the amount by which their annual net income is less than 5 percent of the market value of their assets should be modified to except therefrom:

(a) Existing trusts established by instruments which do not permit distributions out of capital;

(b) The value of investments which the trustees have no power to change;

(c) For a transition period of ten years, the value of investments now held by foundations which do not produce income equal to the minimum investment return rate; and

(d) For a reasonable period the value of unproductive assets acquired by means other than purchase.

6. The minimum investment return rate should be based upon the estate or income tax savings on the bequest or gift to charity and the income tax savings on realized capital gains. It should not be applied to unrealized appreciation in the value of assets on which no tax saving has been realized.

STATEMENT

of

THE JAMES IRVINE FOUNDATION*

Regarding

Provisions of Section 101 of H.R. 13270

Submitted

to

The Committee on Finance

United States Senate

on

September 8, 1969

The James Irvine Foundation
111 Sutter Street
Suite 1724
San Francisco, California 94104

* Presented by Howard J. Privett.

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 <u>inter vivos</u> 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, <u>inter alia</u>:

> "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 $109,000 per share in 1962 and 13 1/2 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 is 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 of 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 seeks 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



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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 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 observations 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

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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.

almost all of The Irvine Company's stock not owned by the Foundation is owned by descendants 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 losses 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.

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 previously 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.

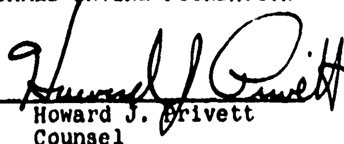
5. If a minimum investment return distribution is to be required, the 5% rate should in all fairness be based on the tax benefits conferred (estate or income tax saving on the bequest or gift to charity plus income tax saving on realized capital gains). It should not be applied to the unrealized appreciation 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,

THE JAMES IRVINE FOUNDATION



By Howard J. Privett
Counsel

# ANALYSIS AND CRITICISM OF THE TREASURY PROPOSAL TO LIMIT STOCK OWNERSHIP BY PRIVATE FOUNDATIONS

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 per cent 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 per cent 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

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* Member of the California Bar.

[1] STAFF OF SENATE COMM. ON FINANCE, 89TH CONG., 1ST SESS., 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.

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 per cent 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 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

[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.
[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).

Means Committee that it consider denying a tax exemption if a foundation invested more than five or ten per cent 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 foundations 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 it 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 corpora-

[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).



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tion 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 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

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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.

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 Businesses

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]

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[11] 380 U.S. 563 (1965). In this case the United States 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 Dairy, 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, 13 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.

to an operating subsidiary, 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 basis. 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

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15 See Kolkey v. Commissioner, 254 F.2d [illegible] (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 ed. 1956).

20 Fremont-Smith, *Government Supervision and Accountability of Foundations*,

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 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

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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).

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 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 per cent or more of the stock of a corporation received dividends over a ten-year period equal to forty-two per cent of the market value of their corporate holdings. This was substantially in excess of a twenty-nine per cent 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

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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].

[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).

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 if 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.

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[25] N.Y. Gen. Corp. Law § 34.
[26] Ontario Stat. ch. 13, § 2 (1959).

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 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 per cent 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 activities would be severely affected by the proposal. One is Duke Endowment which owns fifty-seven per cent 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 per cent of the Class A voting

[27] II Statements 500.

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 per cent 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 per cent of the S. S. Kresge Company voting stock), John A. Hartford Foundation (owner of thirty-four per cent of the Great Atlantic & Pacific Tea Company, Inc. voting stock), Samuel H. Kress Foundation (owner of forty-two per cent of the S. H. Kress & Company voting stock), Wenner-Gren Foundation for Anthropological Research (owner of twenty-four per cent of Electrolux Corporation voting stock), the Pew Memorial Trust (owner of twenty-one per cent of Sun Oil Company voting stock), and The Danforth Foundation (owner of twenty-three per cent 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.

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[28] I STATEMENTS 284.
[29] I STATEMENTS 357.

October 3, 1969

Supplement to Statement of
The James Irvine Foundation
Submitted to the Committee on Finance
United States Senate
on
September 8, 1969

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 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 claims 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. Smith 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 <u>inter alia</u>:

> "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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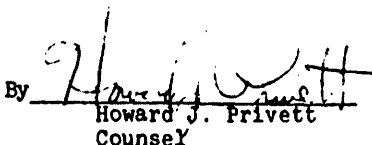
> * * *
>
> "There never was a greater miscarriage of justice than the decisions of the courts in this litigation.
>
> "However, the record that was made in the federal courts in Mrs. Smith's case

> 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."

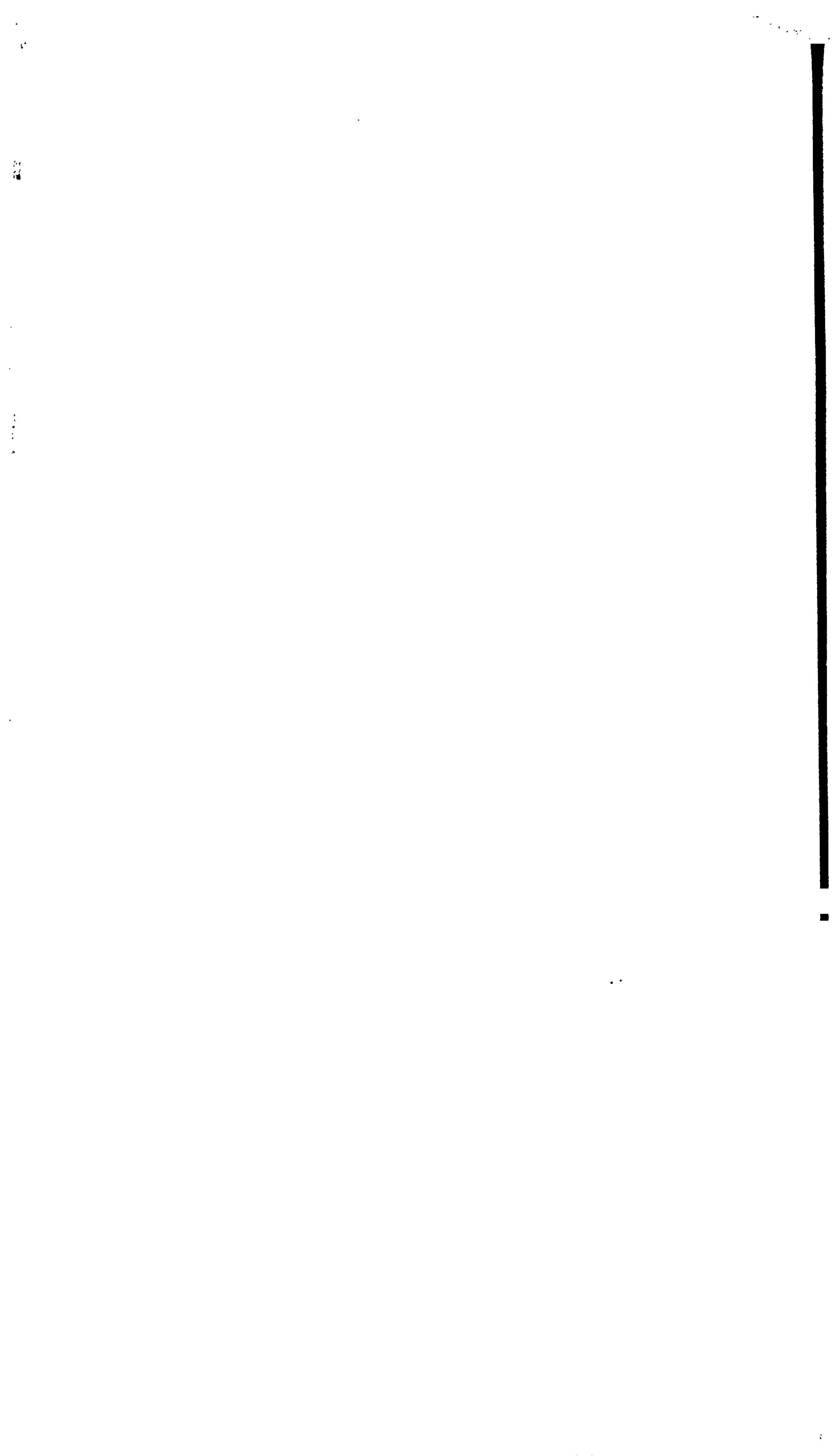
We believe it is clear from the foregoing that Mrs. Smith's charges against the Foundation are without substance in fact or in law and that her submittals to your Committee and to the Committee on Ways and Means are calculated not to serve the public interest but to benefit her private interests at the expense of the charitable beneficiaries of Mr. Irvine's trust.

Respectfully submitted,

THE JAMES IRVINE FOUNDATION



By Howard J. Privett
Counsel



TO THE HONORABLE RUSSELL B. LONG, CHAIRMAN, AND THE HONORABLE MEMBERS OF THE COMMITTEE ON FINANCE, UNITED STATES SENATE

SUMMARY OF THE PRINCIPAL POINTS PRESENTED TO THE COMMITTEE ON FINANCE, UNITED STATES SENATE, IN THE ATTACHED STATEMENT OF JOAN IRVINE SMITH WITH REFERENCE TO THE JAMES IRVINE FOUNDATION.

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 Irvine 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 of 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 841 1/2 shares and The James Irvine Foundation holds, as trustee, 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

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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, 13 1/2 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

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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.

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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

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held in corporations whose business is unrelated to the charitable activities of foundations; the income tax of 7 1/2% 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 7 1/2% 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.

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TO THE HONORABLE RUSSELL B. LONG, CHAIRMAN, AND THE HONORABLE MEMBERS OF THE COMMITTEE ON FINANCE, UNITED STATES SENATE.

STATEMENT OF JOAN IRVINE SMITH TO THE COMMITTEE ON FINANCE, UNITED STATES SENATE

RE: THE JAMES IRVINE FOUNDATION

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 my 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 acquainted 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 841 1/2 shares. Approximately 202 1/2 shares of Irvine stock are owned by other members of the Irvine family. On November 6, 1968, The Irvine Company purchased 13 1/2 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 COMPANY.

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 Irvine 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 1/2 undivided interest with The Irvine Company owning the other 1/2 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 funds 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 1/2 interest and in the name of The Irvine Company as to the remaining 1/2 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 COMPANY 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 lawfirm 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 were 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 University 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 COMPANY 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





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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 utilities 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 do 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 transaction 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 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 Supervisors 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 49,253 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 39,000 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 49,253 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 agricultural 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 49,253 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 COMPANY.

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 likelihood 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 and 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 1/3 of the stock therein and The Irvine Company would loan the employees 90% of the money they would need to buy this 1/3 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 give away 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 COMPANY 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 13 1/2 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 Irvine 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



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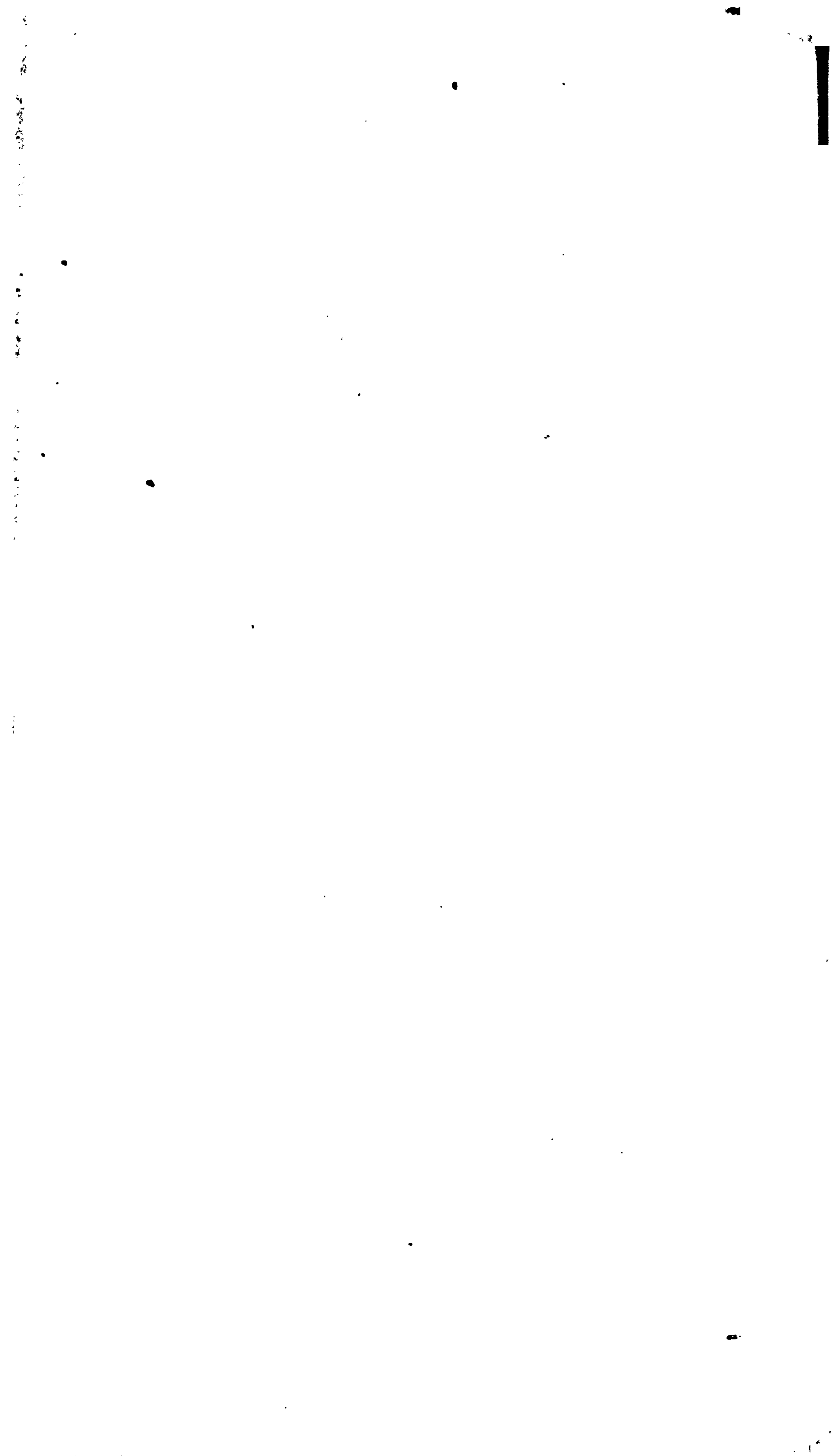
Tax Reform Act of 1969 - H.R. 13270 provides that all tax exempt private foundations, including The James Irvine Foundation, commencing with the year 1970, will be required to pay an income tax of 7 1/2% based on the value of the investment assets held by the Foundation. In my opinion, this income tax of 7 1/2% 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

UNITED STATES SENATE, ON OCTOBER 7, 1969

Re: The Incompetent and Self-Dealing Management Polices of THE JAMES IRVINE FOUNDATION Through Its 53% Stock Control of The Irvine Company.



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. NcLaren 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 13-1/2 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 1-1/4 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 (13-1/2 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 thingon 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 [illegible]

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 more money than that, whether it is a good thing to continue to have this much of your total corpus tied up in the 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].

Mr. Mills : 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 (myself) 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 (myself) 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 would 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.

Mr. Mills : 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.

Mr. Mills : 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 interlocking 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 3?

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. Schneebeli, 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 [Agricultural 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 [myself].

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 me. 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.



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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 49,2[illegible] 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 constitutes 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 man-

agement 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 thé 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.



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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 27-1/2% 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 Irvine 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

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Company, has an income on this stock through dividends amounting to approximately $1,000,000 per year. The value of these 459 shares of Irvine stock will be determined annually by the appraisal of the United States Treasury Department; and, assuming that the first valuation 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:

"Honorable Harry F. Byrd
Chairman, Committee on Finance
United States Senate
Washington, D. C.

Honorable 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 the 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; occasionally, 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 [illegible] 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, approximately 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 publication 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 tax-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 Deptember 4, 1969, with the exception of the 7-1/2% income tax provision contained in the Bill, and which provision the Nixon Administration recommended be reduced from 7-1/2 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 Privott 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. Congressmann Utt has continuously since 1952 represented the Congressional District in California in which the Irvine Ranch is located and where The James Irvine 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 13-1/2 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 no?

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'e 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.

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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 Jcaquin 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."

## A SUMMARY OF LILLY ENDOWMENT POSITIONS ON PROVISIONS OF H.R. 13270 AFFECTING PRIVATE FOUNDATIONS

Lilly Endowment is in agreement with those provisions of H.R. 13270, the "Tax Reform Act of 1969," which are intended to correct abuses by some private foundations of their tax-exempt privileges. We feel, however, that certain provisions of this bill 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.

### DISTRIBUTION OF INCOME

The House bill would require a foundation to distribute annually an amount equal to at least 5 percent of the market value of its assets . . .

A minimum-investment-return requirement should not exceed the return which a foundation could expect over a period of time from a diversified portfolio containing common stocks. As demonstrated in attachments A and B, the income from such investments seldom reaches 5 percent.

We suggest that 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. Furthermore, we suggest that 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.

STOCK OWNERSHIP LIMITATION

The House bill would limit to 20 percent the holdings of a foundation in an incorporated business enterprise when combined with the holdings of "disqualified persons". . .

The prohibition against more than a 20-percent stock ownership 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 a long record of continuous dividend payments and which has an increasing number of outside investors now totaling more than 15,000.

. . . Instead, we suggest that the basic recommendation made by the Treasury Department in its report to Congress in April, 1969, be adopted--that the voting stock of any one corporation held by a foundation should be limited to 20 percent and when combined with holdings of disqualified persons should be limited to 35 percent.

"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 present definition, we believe, might be interpreted to include stockholdings of deceased donors and, thereby, 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

The House bill 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 would divert this income from charity.

Instead, we suggest that 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.

--Lilly Endowment, Inc.

September 2, 1969

FOR RELEASE
UPON DELIVERY

STATEMENT OF BYRON P. HOLLETT
MEMBER, BOARD OF DIRECTORS
LILLY ENDOWMENT, INC.

before

COMMITTEE ON FINANCE
UNITED STATES SENATE

Scheduled for delivery
Tuesday, September 9, 1969

My name is Byron P. Hollett*. 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.** 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

*For biographical sketch, see attachment A.

**For additional information on the Endowment, see the enclosed copy of its report for 1968.

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.

## 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 distributed 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 Million, at Dates Received, Compared with Investment Thereof in Five Alternative Programs

| | (Millions) | |
|---|---|---|
| | 1937-1968 | In 1968 |
| Donated Stock | $81 | $6.8 |
| Moody's Industrial Stocks | 72 | 5.4 |
| Dow-Jones Industrial Stocks | 68 | 4.8 |
| Massachusetts Investors Trust* | 61 | 4.3 |
| State Street Investment Corporation* | 45 | 3.4 |
| Government Bonds held to maturity | 15 | 1.2 |

Computations made by Ernst & Ernst, Certified Public Accountants

*Assumes capital gain distributions accepted in additional shares.

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.

"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



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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.

# # #

ATTACHMENT A

## BYRON P. HOLLETT

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. Hollett was associated in the practice of law with his father's firm, Hollett & Lafuze. Since 1951 he has been a partner in the Indianapolis law firm of Baker & Daniels.

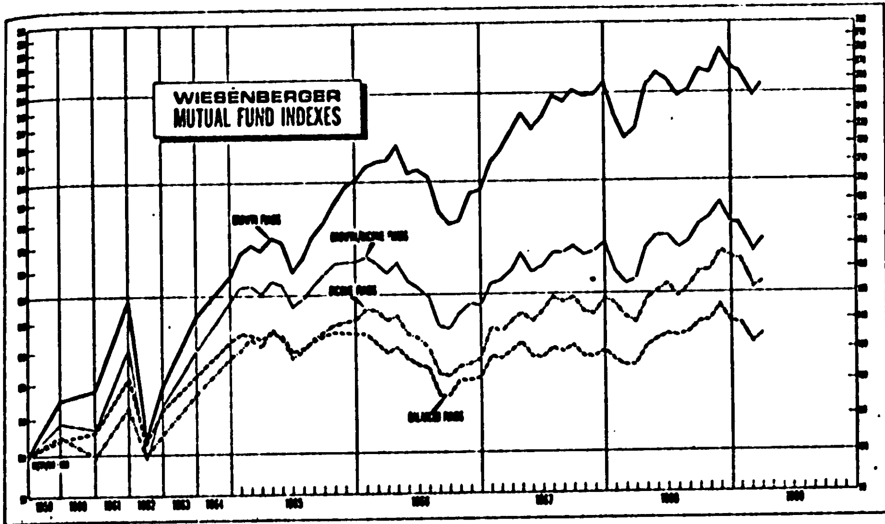
In addition to being a member of the board of directors of Lilly Endowment, Inc., Mr. Hollett is a director of the American Fletcher National Bank and Trust Company and the United Fund of Greater Indianapolis. He is also a member of the board of governors of the James Whitcomb Riley Hospital for Children, a trustee of Wabash College, and Chancellor of the Episcopal Diocese of Indianapolis.

# # #

# WIESENBERGER MUTUAL FUND INDEXES ATTACHMENT B

The Indexes below provide a convenient picture of comparative short-term and long-term price changes in certain types of mutual funds. They are not, however, indexes of average management performance for the various groups and should not be considered as such.

The four index classifications correspond with the categories described in Chapter VIII, and each index is based on the price movements of five large mutual funds.




| | GROWTH FUNDS | | GROWTH-INCOME FUNDS | | BALANCED FUNDS | | INCOME FUNDS | |
|---|---|---|---|---|---|---|---|---|
| | Index | Average Yield | Index | Average Yield | Index | Average Yield | Index | Average Yield |
| December 31, 1958 | 100.00 | 1.6% | 100.00 | 2.6% | 100.00 | 2.9% | 100.00 | 4.6% |
| December 31, 1959 | 114.39 | 1.4 | 108.58 | 2.4 | 103.24 | 2.9 | 104.34 | 4.4 |
| December 31, 1960 | 117.79 | 1.6 | 106.25 | 2.6 | 105.29 | 3.0 | 99.72 | 4.8 |
| December 31, 1961 | 148.27 | 0.9 | 130.78 | 2.1 | 121.31 | 2.7 | 112.21 | 4.2 |
| June 29, 1962 | 103.06 | 1.3 | 98.70 | 2.8 | 102.27 | 3.2 | 99.31 | 4.9 |
| December 31, 1962 | 118.87 | 1.4 | 112.95 | 2.6 | 112.21 | 3.0 | 104.51 | 4.8 |
| December 31, 1963 | 141.62 | 1.3 | 130.18 | 2.3 | 121.89 | 2.8 | 115.97 | 4.1 |
| December 31, 1964 | 157.04 | 1.4 | 147.43 | 2.3 | 132.41 | 2.8 | 127.24 | 3.9 |
| December 31, 1965 | 200.62 | 1.3 | 162.19 | 2.3 | 134.92 | 2.9 | 140.33 | 3.7 |
| December 30, 1966 | 194.66 | 1.5 | 145.16 | 2.8 | 120.88 | 3.4 | 126.51 | 4.3 |
| January 31, 1967 | 209.33 | 1.4 | 153.44 | 2.6 | 127.24 | 3.3 | 136.74 | 4.0 |
| February 28, 1967 | 215.81 | 1.4 | 154.65 | 2.6 | 126.74 | 3.3 | 135.22 | 4.1 |
| March 31, 1967 | 226.46 | 1.3 | 159.56 | 2.6 | 129.43 | 3.2 | 139.82 | 3.9 |
| April 28, 1967 | 236.48 | 1.3 | 165.18 | 2.5 | 131.70 | 3.2 | 142.08 | 4.0 |
| May 31, 1967 | 228.33 | 1.4 | 158.26 | 2.6 | 126.99 | 3.3 | 139.17 | 4.1 |
| June 30, 1967 | 234.28 | 1.3 | 160.51 | 2.6 | 126.83 | 3.3 | 142.91 | 4.0 |
| July 31, 1967 | 247.74 | 1.2 | 165.67 | 2.5 | 129.99 | 3.2 | 148.08 | 3.9 |
| August 31, 1967 | 244.27 | 1.3 | 165.61 | 2.5 | 129.13 | 3.3 | 146.42 | 4.0 |
| September 29, 1967 | 251.28 | 1.2 | 168.91 | 2.5 | 130.94 | 3.2 | 148.64 | 3.9 |
| October 31, 1967 | 248.02 | 1.3 | 164.97 | 2.6 | 127.34 | 3.3 | 142.91 | 4.1 |
| November 30, 1967 | 248.70 | 1.3 | 166.15 | 2.5 | 126.99 | 3.3 | 141.72 | 4.1 |
| December 29, 1967 | 256.51 | 1.2 | 170.25 | 2.4 | 129.15 | 3.3 | 147.47 | 4.0 |
| January 31, 1968 | 235.23 | 1.3 | 159.14 | 2.6 | 125.85 | 3.4 | 145.74 | 4.0 |
| February 29, 1968 | 222.80 | 1.4 | 153.31 | 2.7 | 123.80 | 3.4 | 140.77 | 4.1 |
| March 29, 1968 | 228.12 | 1.4 | 155.03 | 2.7 | 123.80 | 3.5 | 138.93 | 4.2 |
| April 30, 1968 | 253.51 | 1.3 | 168.91 | 2.5 | 130.41 | 3.3 | 147.45 | 4.0 |
| May 31, 1968 | 262.48 | 1.3 | 172.86 | 2.4 | 132.22 | 3.2 | 150.46 | 4.0 |
| June 28, 1968 | 258.87 | 1.3 | 172.88 | 2.4 | 133.99 | 3.2 | 153.11 | 3.9 |
| July 31, 1968 | 248.08 | 1.3 | 168.41 | 2.5 | 133.50 | 3.2 | 149.03 | 4.0 |
| August 30, 1968 | 251.63 | 1.3 | 170.83 | 2.4 | 134.59 | 3.2 | 151.97 | 3.9 |
| September 30, 1968 | 265.20 | 1.3 | 178.23 | 2.4 | 138.45 | 3.1 | 158.37 | 3.8 |
| October 31, 1968 | 263.22 | 1.3 | 181.20 | 2.4 | 139.74 | 3.1 | 158.37 | 3.8 |
| November 29, 1968 | 279.37 | 1.3 | 188.51 | 2.2 | 144.20 | 3.1 | 166.21 | 3.7 |
| December 29, 1968 | 265.98 | 1.4 | 179.22 | 2.1 | 138.73 | 3.3 | 163.46 | 3.7 |
| January 31, 1969 | 263.02 | 1.4 | 178.80 | 2.2 | 138.08 | 3.3 | 162.38 | 3.8 |
| February 28, 1969 | 249.48 | 1.4 | 167.60 | 2.2 | 132.59 | 3.4 | 152.94 | 4.0 |
| March 31, 1969 | 256.67 | 1.4 | 172.88 | 2.2 | 135.25 | 3.3 | 153.80 | 3.9 |

ATTACHMENT C-1

MERRILL LYNCH,
PIERCE,
FENNER & SMITH INC

SECURITIES RESEARCH DIVISION

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.

| Industry Group | Yield | P/E Ratio |
|---|---|---|
| 540 Stock Composite | 3.5% | 13.3 |
| Aerospace Mfg. | 4.2 | 10.7 |
| Agricultural Machinery | 5.3 | 11.8 |
| Air Conditioning | 1.6 | 21.6 |
| Airlines | 2.5 | 17.2 |
| Aluminum | 3.3 | 10.8 |
| Apparel Mfg. | 2.7 | 13.6 |
| Appliances, Housewares | 3.2 | 13.5 |
| Auto Equipment | 4.6 | 11.1 |
| Auto Finance | 5.4 | 10.5 |
| Automobiles | 4.2 | 9.4 |
| Banks - New York City | 4.3 | 10.8 |
| Banks - Outside N.Y.C. | 3.7 | 10.6 |
| Beer | 2.7 | 19.0 |
| Beet Sugar | 5.7 | 9.5 |
| Biscuits | 3.7 | 17.5 |
| Bread Baking | 4.0 | 10.0 |
| Canning | 2.7 | 15.7 |
| Cement | 4.1 | 13.3 |
| Chemicals | 4.4 | 12.9 |
| Cigarettes | 5.6 | 10.1 |
| Coal | 1.0 | 17.3 |
| Construction Machinery | 4.8 | 11.0 |
| Consumer Electronics | 2.6 | 14.0 |
| Containers - Glass | 2.0 | 13.9 |
| Containers - Metal | 2.3% | 13.4 |
| Containers - Paper | 2.7 | 9.5 |
| Copper | 5.6 | 7.0 |
| Cosmetics | 1.6 | 20.7 |
| Dairy Products | 3.7 | 14.3 |
| Department Stores | 2.9 | 15.6 |
| Discount Chains | 1.1 | 13.4 |
| Drugs | 2.1 | 23.5 |
| Electrical Equipment | 2.7 | 16.7 |
| Electronics | 0.8 | 23.1 |
| Food Chains | 3.2 | 12.8 |
| Gold | 1.5 | 25.0 |
| Home Furnishings | 2.1 | 16.6 |
| Industrial - Composite | 3.2 | 13.9 |
| Insurance - Fire & Casualty | 4.4 | 15.3 |
| Insurance - Life | 2.1 | 12.2 |
| Lead and Zinc | 4.4 | 15.4 |
| Liquor | 3.1 | 16.3 |
| Machine Tools | 4.0 | 10.6 |
| Machinery - Heavy | 4.7 | 10.1 |
| Meat Packing | 2.9 | 12.5 |
| Metal Fabricating | 6.0 | 13.4 |
| Movie Producers | 2.8 | 23.5 |
| Office Equipment | 1.1 | 29.0 |
| Oil Field Equipment | 3.1 | 14.1 |

ATTACHMENT C-2

| Industry Group | Yield | P/E Ratio |
|---|---|---|
| Packaged Foods | 3.3% | 16.5 |
| Paint | 4.7 | 13.0 |
| Paper - Composite | 3.5 | 12.5 |
| Paper - Diversified Producers | 3.8 | 13.7 |
| Paper Makers | 3.5 | 14.4 |
| Petroleum | 3.4 | 12.6 |
| Plumbing & Heating | 3.3 | 13.4 |
| Printing & Publishing | 2.9 | 15.7 |
| Railroad Car Leasing Cos. | 4.7 | 12.4 |
| Railroads - Composite | 5.1 | 9.3 |
| Railroads - Coal | 6.6 | 9.5 |
| Railroads - Eastern | 5.5 | 11.6 |
| Railroads - Southern | 5.2 | 9.5 |
| Railroads - Western | 4.7 | 9.0 |
| Recreation | 2.1 | 14.8 |
| Roofing & Wallboard | 3.2 | 15.3 |
| Rubber | 3.9 | 10.7 |
| Shoe Chains | 3.0 | 13.0 |
| Shoe Manufacturing | 3.8 | 11.1 |

| Industry Group | Yield | P/E Ratio |
|---|---|---|
| Small Loans | 4.4% | 11.1 |
| Snuff | 5.2 | 10.1 |
| Soap Detergents, Toiletries | 2.4 | 18.4 |
| Soft Drinks | 2.2 | 24.5 |
| Steel | 4.9 | 8.2 |
| Textiles | 5.4 | 11.0 |
| Utilities: | | |
| Composite | 5.2 | 12.4 |
| Electric | 5.1 | 13.1 |
| Gas Distributors | 6.0 | 11.7 |
| Holding Cos. | 4.8 | 14.2 |
| Integrated Gas Cos. | 6.1 | 11.0 |
| Natural Gas Pipelines | 5.1 | 10.7 |
| Communications | 4.7 | 14.1 |
| Variety Chains | 3.8 | 12.0 |
| Vending | 1.8 | 15.0 |
| Dow-Jones Industrials | 4.2 | 12.9 |

SECURITIES RESEARCH DIVISION

BEFORE THE COMMITTEE ON FINANCE

OF THE

UNITED STATES SENATE

Statement of Ross L. Malone, President
American Bar Foundation, concerning
H.R. 13270

<u>SUMMARY OF PRINCIPAL POINTS</u>

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.

BEFORE THE COMMITTEE ON FINANCE

OF THE

UNITED STATES SENATE

Statement by Ross L. Malone, President, American Bar Foundation, concerning H.R. 13270

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 collaboration 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. Ruehausen, 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.



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BEFORE THE COMMITTEE ON FINANCE

OF THE

UNITED STATES SENATE

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

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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 of 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 support. 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:

| Line Number | Text |
|---|---|
| 17 | "(vi) an organization referred to in sub- |
| 18 | section (c)(2) which normally receives a sub- |
| 19 | stantial part of its support (exclusive of income |

20 received in the exercise or performance by such
21 organization of its charitable, educational, or
22 other purpose or function constituting the basis
23 for its exemption under section 501(a)) from
24 a governmental unit referred to in subsection
1 (c)(1) or from direct or indirect contributions
2 from the general public,
3 shall be allowed to the extent that the aggregate of
4 such contributions does not exceed 30 percent of the
5 taxpayer's contribution base."

It is respectfully requested that this language be amended to read:

Line Number Text

17 "(vi) an organization referred to in sub-
18 section (c)(2) which normally receives a sub-
19 stantial part of its support (exclusive of income
20 received in the exercise or performance by such
21 organization of its charitable, educational, or
22 other purpose or function constituting the basis
23 for its exemption under section 501(a)) from
24 a governmental unit referred to in subsection
(c)(1) or from direct or indirect
contributions from the general public
<u>or from an organization having a sub-
stantial number of members,</u>
shall be allowed to the extent that the
aggregate of such contributions does not
exceed 30 percent of the taxpayer's contri-
bution 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:

| Line Number | Text |
|---|---|
| 11 | "(2) SUBSTANTIAL CONTRIBUTOR.-For purposes |
| 12 | of paragraph (1), the term 'substantial contributor' |
| 13 | means— |
| 14 | "(A) any person who (by himself or with his |
| 15 | spouse) contributed more than $5,000 to the private |
| 16 | foundation in any one calendar year (or bequeathed |
| 17 | more than $5,000 to the private foundation), and |
| 18 | "(B) any person who (by himself or with his |
| 19 | spouse) contributed or bequeathed the greatest |
| 20 | amount to the foundation in any one calendar year. |
| 21 | In the case of a trust, such term also includes the creator |
| 22 | of such a trust." |

It is respectfully requested that this language be amended to read:

| Line Number | Text |
|---|---|
| 11 | "(2) SUBSTANTIAL CONTRIBUTOR.-For purposes |
| 12 | of paragraph (1), the term 'substantial contributor' |
| 13 | means— |
| 14 | "(A) any person who (by himself or with his |
| 15 | spouse) contributed more than $5,000 to the private |
| 16 | foundation in any one calendar year (or bequeathed |
| 17 | more than $5,000 to the private foundation), and |
| 18 | "(B) any person who (by himself or with his |
| 19 | spouse) contributed or bequeathed the greatest |
| 20 | amount to the foundation in any one calendar year. |
| 21 | 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, | | | | | | |
|---|---|---|---|---|---|---|---|
| **REVENUES FOR ALL FUNDS** | 1965 | 1966 | 1967 | 1968 | 1969 | 5 Year Average | Per Cent of Total |
| 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 | 74,225 | 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 |
| Benficiary 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) | |

Schedule 1

## AMERICAN BAR FOUNDATION

Summary of Contributions, Gifts and Grants
Fiscal Years Ended June 30, 1965 to 1969

| | Fiscal Year Ended June 30, | | | | | | |
|---|---|---|---|---|---|---|---|
| | 1965 | 1966 | 1967 | 1968 | 1969 | 5 Year Average | Per Cent 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 Fdn. | 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 Company | 4,733 | -0- | -0- | -0- | -0- | 947 | .13 |
| (1) Various Law Firms and Contributors | 29,023 | 1,000 | -0- | -0- | 1,000 | 6,205 | .85 |
| (1) Value of Book Contributed to Cromwell Library by Publishers | -0- | -0- | -0- | 13,786 | -0- | 2,757 | .38 |
| | $ 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

| | June 30, 1967 | June 30, 1968 | Average | Per Cent to Total |
|---|---|---|---|---|
| ersonnel (1) | $ 454,413 | $ 594,065 | $ 524,239 | 57.43 |
| ringe Benefits and Taxes | 37,543 | 46,416 | 41,980 | 4.60 |
| ravel | 47,537 | 71,154 | 59,345 | 6.50 |
| ublications | 53,810 | 92,316 | 73,063 | 8.00 |
| ther Printing and Duplicating | 10,962 | 28,791 | 19,878 | 2.18 |
| ommunications | 25,139 | 39,871 | 32,505 | 3.56 |
| quipment and Furnishings | 13,432 | 18,900 | 16,166 | 1.77 |
| ooks, Subscriptions, Microfilming | 22,323 | 21,962 | 22,142 | 2.43 |
| uilding Fund - Depreciation | 75,601 | 78,340 | 76,970 | 8.43 |
| utside Professional Services | -0- | 57,746 | 28,873 | 3.16 |
| undries | 15,039 | 20,440 | 17,739 | 1.94 |
| | $ 755,799 | $ 1,070,001 | $ 912,900 | 100.00 |

(1) This figure includes salaries for approximately 50 professional, non-professional and clerical employees, as well as some individual grants for research. See the annual report.

OTE: 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.

Summary of Testimony of
The Association of American Universities
before the Senate Finance Committee, October 7, 1969

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 ensure that the foundations operate within the law.
   - This fee to substitute for the 7.5 percent tax on investment income in the House bill.
   - 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 per 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 so seriously impair the capacity of universities to serve the Nation.

Testimony on behalf of

The Association of American Universities

on the

Private Foundation and Related Provisions of the

Tax Reform Act of 1969

Presented by

Lincoln Gordon, President

The Johns Hopkins University

before the

Senate Committee on Finance

October 7, 1969



33-758 O - 69 -- No. 18 -- 19

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 is only 7 percent of the annual operating revenues, and for all public universities .6%.)[1] They are 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.

[1] Financial Statistics of Institutions of Higher Education. Current Funds Revenues and Expenditures. 1965-66. National Center for Educational Statistics.

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 desperate 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 of 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.[1/] 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 students 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 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

1/Carnegie Commission on Higher Education. Quality and Equality: New Levels of Federal Responsibility for Higher Education. December 1968, p. 8.

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 861 institutions.[1] 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 weel 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.

[1] Voluntary Support of Higher Education, 1967-68. Council for Financial Aid to Education.

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 governmental 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.[1/] 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

[1/] 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.

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 operation 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 change 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

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 hold 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. Hills : 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. Hills : I don't know, if this Company [Irvine Company] can't make any more 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].

Mr. Hills : 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 (myself) 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 (myself) 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 would 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 reccommends that we require you to do that without imposing any hardship on you.

Mr. Mills : 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.

Mr. Mills : 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

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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 3?

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. Schneebeli, 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 [Agricultural 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 [myself].

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 me. 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.



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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 49,233 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 constitutes 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 man-

agement 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 27-1/2% 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 Irvine 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 Irvine stock will be determined annually by the appraisal of the United States Treasury Department; and, assuming that the first valuation 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:

"Honorable Harry F. Byrd
Chairman, Committee on Finance
United States Senate
Washington, D. C.

Honorable 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 the 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; occasionally, 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, approximately 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 publication 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 tax-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 Deptember 4, 1969, with the exception of the 7-1/2% income tax provision contained in the Bill, and which provision the Nixon Administration recommended be reduced from 7-1/2 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. Congressmann Utt has continuously since 1952 represented the Congressional District in California in which the Irvine Ranch is located and where The James Irvine 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 13-1/2 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 those 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 Cloverdon Co. still writes that insurance, does it no?

Mrs. Smith: What?

Mr. Utt : Tom Cloverdon.

Mrs. Smith: Yes, Cloverdon & 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.



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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 Jcaquin 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."

## A SUMMARY OF LILLY ENDOWMENT POSITIONS ON PROVISIONS OF H.R. 13270 AFFECTING PRIVATE FOUNDATIONS

Lilly Endowment is in agreement with those provisions of H.R. 13270, the "Tax Reform Act of 1969," which are intended to correct abuses by some private foundations of their tax-exempt privileges. We feel, however, that certain provisions of this bill 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.

### DISTRIBUTION OF INCOME

The House bill would require a foundation to distribute annually an amount equal to at least 5 percent of the market value of its assets . . .

A minimum-investment-return requirement should not exceed the return which a foundation could expect over a period of time from a diversified portfolio containing common stocks. As demonstrated in attachments A and B, the income from such investments seldom reaches 5 percent.

We suggest that 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. Furthermore, we suggest that 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.

## STOCK OWNERSHIP LIMITATION

> The House bill would limit to 20 percent the holdings of a foundation in an incorporated business enterprise when combined with the holdings of "disqualified persons". . .

The prohibition against more than a 20-percent stock ownership 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 a long record of continuous dividend payments and which has an increasing number of outside investors now totaling more than 15,000.

*Instead,* we suggest that the basic recommendation made by the Treasury Department in its report to Congress in April, 1969, be adopted--that the voting stock of any one corporation held by a foundation should be limited to 20 percent and when combined with holdings of disqualified persons should be limited to 35 percent.

"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 present definition, we believe, might be interpreted to include stockholdings of deceased donors and, thereby, 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

The House bill 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 would divert this income from charity.

Instead, we suggest that 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.

--Lilly Endowment, Inc.

September 2, 1969

FOR RELEASE
UPON DELIVERY

STATEMENT OF BYRON P. HOLLETT
MEMBER, BOARD OF DIRECTORS
LILLY ENDOWMENT, INC.

before

COMMITTEE ON FINANCE
UNITED STATES SENATE

Scheduled for delivery
Tuesday, September 9, 1969

My name is Byron P. Hollett*. 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.** 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

*For biographical sketch, see attachment A.

**For additional information on the Endowment, see the enclosed copy of its report for 1968.

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.

## 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 distributed 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 Million, at Dates Received, Compared with Investment Thereof in Five Alternative Programs

| | (Millions) | |
|---|---|---|
| | 1937-1968 | In 1968 |
| Donated Stock | $81 | $6.8 |
| Moody's Industrial Stocks | 72 | 5.4 |
| Dow-Jones Industrial Stocks | 68 | 4.8 |
| Massachusetts Investors Trust* | 61 | 4.3 |
| State Street Investment Corporation* | 45 | 3.4 |
| Government Bonds held to maturity | 15 | 1.2 |

Computations made by Ernst & Ernst, Certified Public Accountants

*Assumes capital gain distributions accepted in additional shares.

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.

"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



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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.

# # #

ATTACHMENT A

## BYRON P. HOLLETT

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. Hollett was associated in the practice of law with his father's firm, Hollett & 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.

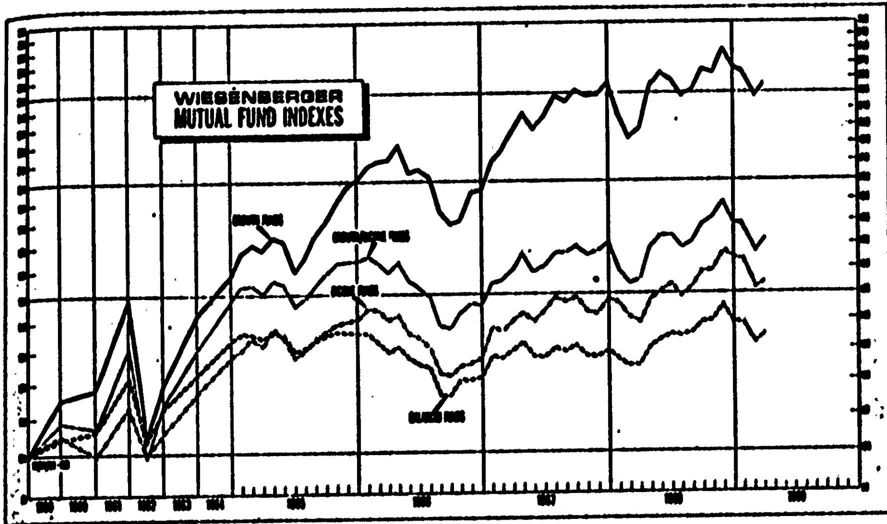
# # #

# WIESENBERGER MUTUAL FUND INDEXES

ATTACHMENT B

The indexes below provide a convenient picture of comparative short-term and long-term price changes in certain types of mutual funds. They are not, however, indexes of average management performance for the various groups and should not be considered as such.

The four index classifications correspond with the categories described in Chapter VIII, and each index is based on the price movements of five large mutual funds.




| | GROWTH FUNDS | | GROWTH-INCOME FUNDS | | BALANCED FUNDS | | INCOME FUNDS | |
|---|---|---|---|---|---|---|---|---|
| | Index | Average Yield | Index | Average Yield | Index | Average Yield | Index | Average Yield |
| December 31, 1958 | 100.00 | 1.6% | 100.00 | 2.6% | 100.00 | 2.9% | 100.00 | 4.6% |
| December 31, 1959 | 114.39 | 1.4 | 108.58 | 2.4 | 103.24 | 2.9 | 104.34 | 4.4 |
| December 31, 1960 | 117.79 | 1.6 | 106.25 | 2.6 | 105.29 | 3.0 | 99.72 | 4.8 |
| December 31, 1961 | 148.27 | 0.9 | 130.78 | 2.1 | 121.31 | 2.7 | 112.21 | 4.2 |
| June 29, 1962 | 103.06 | 1.3 | 98.70 | 2.8 | 102.27 | 3.2 | 99.31 | 4.9 |
| December 31, 1962 | 118.87 | 1.4 | 112.95 | 2.6 | 112.21 | 3.0 | 104.51 | 4.8 |
| December 31, 1963 | 141.62 | 1.3 | 130.18 | 2.3 | 121.89 | 2.8 | 115.97 | 4.1 |
| December 31, 1964 | 157.04 | 1.4 | 147.43 | 2.3 | 132.41 | 2.8 | 127.24 | 3.9 |
| December 31, 1965 | 200.62 | 1.3 | 162.19 | 2.3 | 134.92 | 2.9 | 140.33 | 3.7 |
| December 30, 1966 | 194.66 | 1.5 | 145.16 | 2.8 | 120.88 | 3.4 | 126.51 | 4.3 |
| January 31, 1967 | 209.33 | 1.4 | 153.44 | 2.6 | 127.24 | 3.3 | 136.74 | 4.0 |
| February 28, 1967 | 215.81 | 1.4 | 154.65 | 2.6 | 126.74 | 3.3 | 135.22 | 4.1 |
| March 31, 1967 | 226.46 | 1.3 | 159.56 | 2.6 | 129.43 | 3.2 | 139.82 | 3.9 |
| April 28, 1967 | 236.48 | 1.3 | 165.18 | 2.5 | 131.70 | 3.2 | 142.08 | 4.0 |
| May 31, 1967 | 228.33 | 1.4 | 158.26 | 2.6 | 126.99 | 3.3 | 139.17 | 4.1 |
| June 30, 1967 | 234.28 | 1.3 | 160.51 | 2.6 | 126.83 | 3.3 | 142.91 | 4.0 |
| July 31, 1967 | 247.74 | 1.2 | 165.67 | 2.5 | 129.99 | 3.2 | 148.08 | 3.9 |
| August 31, 1967 | 244.27 | 1.3 | 165.61 | 2.5 | 129.13 | 3.3 | 146.42 | 4.0 |
| September 29, 1967 | 251.28 | 1.2 | 168.91 | 2.5 | 130.94 | 3.2 | 148.64 | 3.9 |
| October 31, 1967 | 248.02 | 1.3 | 164.97 | 2.6 | 127.34 | 3.3 | 142.91 | 4.1 |
| November 30, 1967 | 248.70 | 1.3 | 166.15 | 2.5 | 126.99 | 3.3 | 141.72 | 4.1 |
| December 29, 1967 | 256.51 | 1.2 | 170.25 | 2.4 | 129.15 | 3.3 | 147.47 | 4.0 |
| January 31, 1968 | 235.23 | 1.3 | 159.14 | 2.6 | 125.85 | 3.4 | 145.74 | 4.0 |
| February 29, 1968 | 222.80 | 1.4 | 153.31 | 2.7 | 123.80 | 3.4 | 140.77 | 4.1 |
| March 29, 1968 | 228.12 | 1.4 | 155.03 | 2.7 | 123.80 | 3.5 | 138.93 | 4.2 |
| April 30, 1968 | 253.51 | 1.3 | 168.91 | 2.5 | 130.41 | 3.3 | 147.45 | 4.0 |
| May 31, 1968 | 262.48 | 1.3 | 172.86 | 2.4 | 132.22 | 3.2 | 150.46 | 4.0 |
| June 28, 1968 | 258.87 | 1.3 | 172.88 | 2.4 | 133.99 | 3.2 | 153.11 | 3.9 |
| July 31, 1968 | 248.08 | 1.3 | 168.41 | 2.5 | 133.50 | 3.2 | 149.03 | 4.0 |
| August 30, 1968 | 251.63 | 1.3 | 170.83 | 2.4 | 134.59 | 3.2 | 151.97 | 3.9 |
| September 30, 1968 | 265.20 | 1.3 | 178.23 | 2.4 | 138.45 | 3.1 | 158.37 | 3.8 |
| October 31, 1968 | 263.22 | 1.3 | 181.20 | 2.4 | 139.74 | 3.1 | 158.37 | 3.8 |
| November 29, 1968 | 279.37 | 1.3 | 188.51 | 2.2 | 144.20 | 3.1 | 166.21 | 3.7 |
| December 29, 1968 | 265.98 | 1.4 | 179.22 | 2.1 | 138.73 | 3.3 | 163.46 | 3.7 |
| January 31, 1969 | 263.02 | 1.4 | 178.80 | 2.2 | 138.08 | 3.3 | 162.58 | 3.8 |
| February 28, 1969 | 249.48 | 1.4 | 167.60 | 2.2 | 132.59 | 3.4 | 152.94 | 4.0 |
| March 31, 1969 | 256.67 | 1.4 | 172.88 | 2.2 | 135.25 | 3.3 | 153.80 | 3.9 |

ATTACHMENT C-1

MERRILL LYNCH,
PIERCE,
FENNER & SMITH INC

SECURITIES RESEARCH DIVISION

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.

| Industry Group | Yield | P/E Ratio |
|---|---|---|
| 540 Stock Composite | 3.5% | 13.3 |
| Aerospace Mfg. | 4.2 | 10.7 |
| Agricultural Machinery | 5.3 | 11.8 |
| Air Conditioning | 1.6 | 21.6 |
| Airlines | 2.5 | 17.2 |
| Aluminum | 3.3 | 10.8 |
| Apparel Mfg. | 2.7 | 13.6 |
| Appliances, Housewares | 3.2 | 13.5 |
| Auto Equipment | 4.6 | 11.1 |
| Auto Finance | 5.4 | 10.5 |
| Automobiles | 4.2 | 9.4 |
| Banks - New York City | 4.3 | 10.8 |
| Banks - Outside N.Y.C. | 3.7 | 10.6 |
| Beer | 2.7 | 19.0 |
| Beet Sugar | 5.7 | 9.5 |
| Biscuits | 3.7 | 17.5 |
| Bread Baking | 4.0 | 10.0 |
| Canning | 2.7 | 15.7 |
| Cement | 4.1 | 13.3 |
| Chemicals | 4.4 | 12.9 |
| Cigarettes | 5.6 | 10.1 |
| Coal | 1.0 | 17.3 |
| Construction Machinery | 4.8 | 11.0 |
| Consumer Electronics | 2.6 | 14.0 |
| Containers - Glass | 2.0 | 13.9 |
| Containers - Metal | 2.3% | 13.4 |
| Containers - Paper | 2.7 | 9.5 |
| Copper | 5.6 | 7.0 |
| Cosmetics | 1.6 | 20.7 |
| Dairy Products | 3.7 | 14.3 |
| Department Stores | 2.9 | 15.6 |
| Discount Chains | 1.1 | 13.4 |
| Drugs | 2.1 | 23.5 |
| Electrical Equipment | 2.7 | 16.7 |
| Electronics | 0.8 | 23.1 |
| Food Chains | 3.2 | 12.8 |
| Gold | 1.5 | 25.0 |
| Home Furnishings | 2.1 | 16.6 |
| Industrial - Composite | 3.2 | 13.9 |
| Insurance - Fire & Casualty | 4.4 | 15.3 |
| Insurance - Life | 2.1 | 12.2 |
| Lead and Zinc | 4.4 | 15.4 |
| Liquor | 3.1 | 16.3 |
| Machine Tools | 4.0 | 10.6 |
| Machinery - Heavy | 4.7 | 10.1 |
| Meat Packing | 2.9 | 12.5 |
| Metal Fabricating | 6.0 | 13.4 |
| Movie Producers | 2.8 | 23.5 |
| Office Equipment | 1.1 | 29.0 |
| Oil Field Equipment | 3.1 | 14.1 |

| Industry Group | Yield | P/E Ratio |
|---|---|---|
| Packaged Foods | 3.3% | 16.5 |
| Paint | 4.7 | 13.0 |
| Paper - Composite | 3.5 | 12.5 |
| Paper - Diversified Producers | 3.8 | 13.7 |
| Paper Makers | 3.5 | 14.4 |
| Petroleum | 3.4 | 12.6 |
| Plumbing & Heating | 3.3 | 13.4 |
| Printing & Publishing | 2.9 | 15.7 |
| Railroad Car Leasing Cos. | 4.7 | 12.4 |
| Railroads - Composite | 5.1 | 9.3 |
| Railroads - Coal | 6.6 | 9.5 |
| Railroads - Eastern | 5.5 | 11.6 |
| Railroads - Southern | 5.2 | 9.5 |
| Railroads - Western | 4.7 | 9.0 |
| Recreation | 2.1 | 14.8 |
| Roofing & Wallboard | 3.2 | 15.3 |
| Rubber | 3.9 | 10.7 |
| Shoe Chains | 3.0 | 13.0 |
| Shoe Manufacturing | 3.8 | 11.1 |

| Industry Group | Yield | P/E Ratio |
|---|---|---|
| Small Loans | 4.4% | 11.1 |
| Snuff | 5.2 | 10.1 |
| Soap Detergents, Toiletries | 2.4 | 18.4 |
| Soft Drinks | 2.2 | 24.5 |
| Steel | 4.9 | 8.2 |
| Textiles | 5.4 | 11.0 |
| Utilities: | | |
| Composite | 5.2 | 12.4 |
| Electric | 5.1 | 13.1 |
| Gas Distributors | 6.0 | 11.7 |
| Holding Cos. | 4.8 | 14.2 |
| Integrated Gas Cos. | 6.1 | 11.0 |
| Natural Gas Pipe-lines | 5.1 | 10.7 |
| Communications | 4.7 | 14.1 |
| Variety Chains | 3.8 | 12.0 |
| Vending | 1.8 | 15.0 |
| Dow-Jones Industrials | 4.2 | 12.9 |

SECURITIES RESEARCH DIVISION

BEFORE THE COMMITTEE ON FINANCE

OF THE

UNITED STATES SENATE

Statement of Ross L. Malone, President
American Bar Foundation, concerning
H.R. 13270

SUMMARY OF PRINCIPAL POINTS

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.

BEFORE THE COMMITTEE ON FINANCE

OF THE

UNITED STATES SENATE

Statement by Ross L. Malone, President, American Bar Foundation, concerning H.R. 13270

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 collaboration 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. Ruehausen, 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.



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BEFORE THE COMMITTEE ON FINANCE

OF THE

UNITED STATES SENATE

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" <u>unless</u> 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 of 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 support. 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:

| Line Number | Text |
|---|---|
| 17 | "(vi) an organization referred to in sub- |
| 18 | section (c)(2) which normally receives a sub- |
| 19 | stantial part of its support (exclusive of income |

20 received in the exercise or performance by such
21 organization of its charitable, educational, or
22 other purpose or function constituting the basis
23 for its exemption under section 501(a)) from
24 a governmental unit referred to in subsection
1 (c)(1) or from direct or indirect contributions
2 from the general public,
3 shall be allowed to the extent that the aggregate of
4 such contributions does not exceed 30 percent of the
5 taxpayer's contribution base."

It i., respectfully requested that this language be amended to read:

Line Number — Text

17 "(vi) an organization referred to in sub-
18 section (c)(2) which norma ly receives a sub-
19 stantial part of its support (exclusive of income
20 received in the exercise or performance by such
21 organization of its charitable, educational, or
22 other purpose or function constituting the basis
23 for its exemption under section 501(a))from
24 a governmental unit referred to in subsection
(c)(1) or from direct or indirect
contributions from the general public
<u>or from an organization having a sub-
stantial number of members,</u>
shall be allowed to the extent that the
aggregate of such contributions does not
exceed 30 percent of the taxpayer's contri-
bution 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:

| Line Number | Text |
|---|---|
| 11 | "(2) SUBSTANTIAL CONTRIBUTOR.-For purposes |
| 12 | of paragraph (1), the term 'substantial contributor' |
| 13 | means— |
| 14 | "(A) any person who (by himself or with his |
| 15 | spouse) contributed more than $5,000 to the private |
| 16 | foundation in any one calendar year (or bequeathed |
| 17 | more than $5,000 to the private foundation), and |
| 18 | "(B) any person who (by himself or with his |
| 19 | spouse) contributed or bequeathed the greatest |
| 20 | amount to the foundation in any one calendar year. |
| 21 | In the case of a trust, such term also includes the creator |
| 22 | of such a trust." |

It is respectfully requested that this language be amended to read:

| Line Number | Text |
|---|---|
| 11 | "(2) SUBSTANTIAL CONTRIBUTOR.-For purposes |
| 12 | of paragraph (1), the term 'substantial contributor' |
| 13 | means— |
| 14 | "(A) any person who (by himself or with his |
| 15 | spouse) contributed more than $5,000 to the private |
| 16 | foundation in any one calendar year (or bequeathed |
| 17 | more than $5,000 to the private foundation), and |
| 18 | "(B) any person who (by himself or with his |
| 19 | spouse) contributed or bequeathed the greatest |
| 20 | amount to the foundation in any one calendar year. |
| 21 | In the case of a trust, such term also includes the creator |
| | of such trust, <u>but in the case of a foundation,</u> |
| | <u>such term shall not include a foundation</u> |
| | <u>which is not itself a private foundation</u>." |
| | (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, | | | | | | |
|---|---|---|---|---|---|---|---|
| REVENUES FOR ALL FUNDS | 1965 | 1966 | 1967 | 1968 | 1969 | 5 Year Average | Per Cent of Total |
| 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 | 74,225 | 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 |
| Benficiary 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) | |

Schedule 1

# AMERICAN BAR FOUNDATION

## Summary of Contributions, Gifts and Grants
## Fiscal Years Ended June 30, 1965 to 1969

| | Fiscal Year Ended June 30, | | | | | | |
|---|---|---|---|---|---|---|---|
| | 1965 | 1966 | 1967 | 1968 | 1969 | 5 Year Average | Per Cent 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 Fdn. | 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 Company | 4,733 | -0- | -0- | -0- | -0- | 947 | .13 |
| (1) Various Law Firms and Contributors | 29,023 | 1,000 | -0- | -0- | 1,000 | 6,205 | .85 |
| (1) Value of Book Contributed to Cromwell Library by Publishers | -0- | -0- | -0- | 13,786 | -0- | 2,757 | .38 |
| | $ 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

| | June 30, | | | |
|---|---|---|---|---|
| | 1967 | 1968 | Average | Per Cent to Tota |
| Personnel (1) | $ 454,413 | $ 594,065 | $ 524,239 | 57.4 |
| 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 |
| | $ 755,799 | $ 1,070,001 | $ 912,900 | 100.0 |

(1) This figure includes salaries for approximately 50 professional, non-professional 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.

Summary of Testimony of
The Association of American Universities
before the Senate Finance Committee, October 7, 1969

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 ensure that the foundations operate within the law.
   - This fee to substitute for the 7.5 percent tax on investment income in the House bill.
   - 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 per 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 so seriously impair the capacity of universities to serve the Nation.

Testimony on behalf of

The Association of American Universities

on the

Private Foundation and Related Provisions of the

Tax Reform Act of 1969

Presented by

Lincoln Gordon, President

The Johns Hopkins University

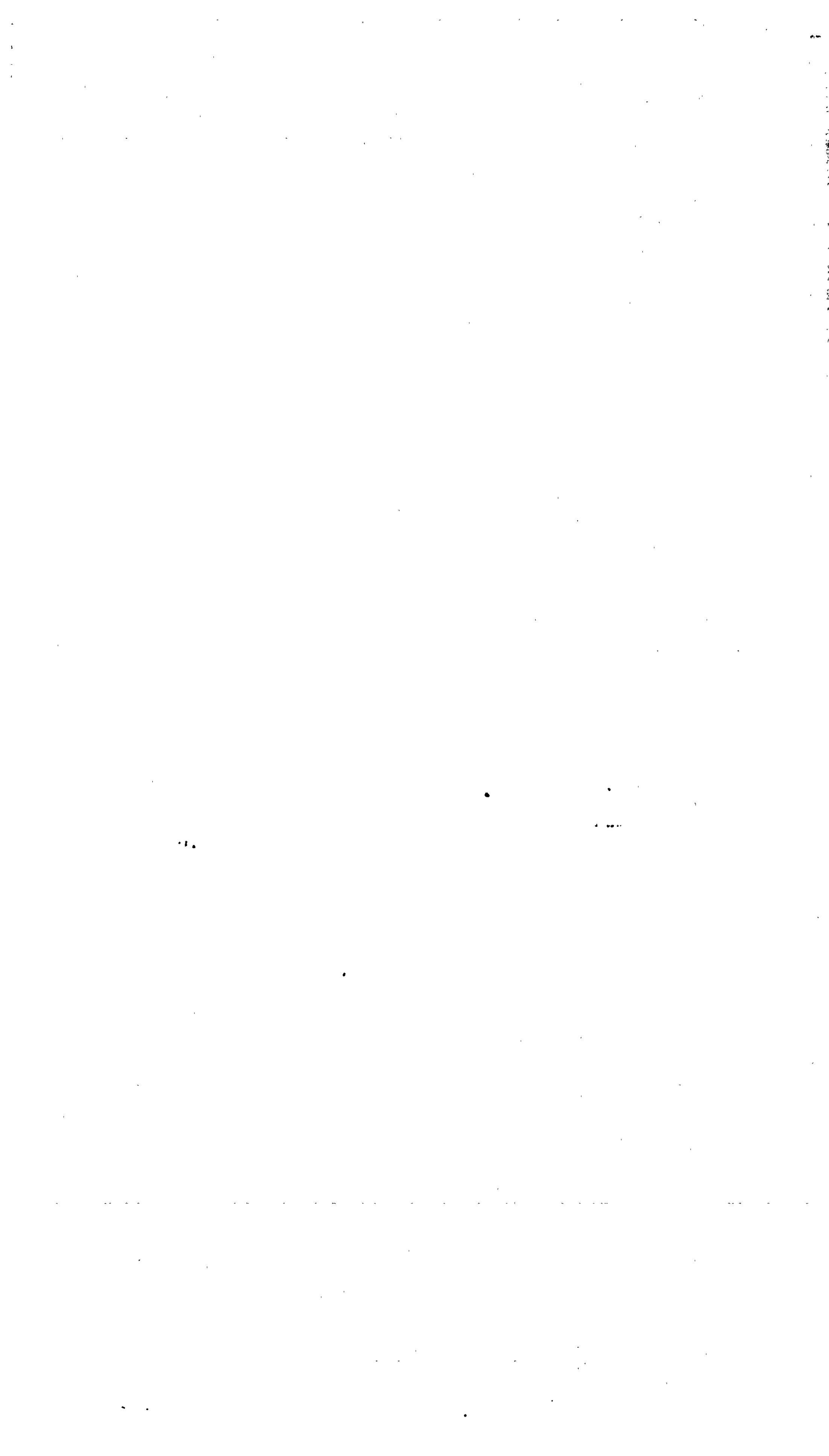
before the

Senate Committee on Finance

October 7, 1969



33-758 O - 69 -- No. 18 -- 19



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 is only 7 percent of the annual operating revenues, and for all public universities .6%.)[1] They are 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.

[1] Financial Statistics of Institutions of Higher Education. Current Funds Revenues and Expenditures. 1965-66. National Center for Educational Statistics.

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 desperate 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 of 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.[1] 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 students 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 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

[1] Carnegie Commission on Higher Education. Quality and Equality: New Levels of Federal Responsibility for Higher Education. December 1968, p. 8.

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 861 institutions.[1/] 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 weel 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.

[1/] Voluntary Support of Higher Education, 1967-68. Council for Financial Aid to Education.

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 governmental 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.[1] 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

[1] 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.

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 operation 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 change 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 looses, 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 emoval 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 nonpartisan 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 saving 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 | 54 |
| 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 |



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Membership List

**ASSOCIATION OF AMERICAN UNIVERSITIES**
**1785 Massachusetts Avenue, N.W.**
**Washington, D. C. 20036**

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

**SUMMARY OF POINTS MADE IN THE ATTACHED STATEMENT SUBMITTED TO SENATE FINANCE COMMITTEE BY JOHN G. SIMON, PROFESSOR OF LAW, YALE UNIVERSITY**

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

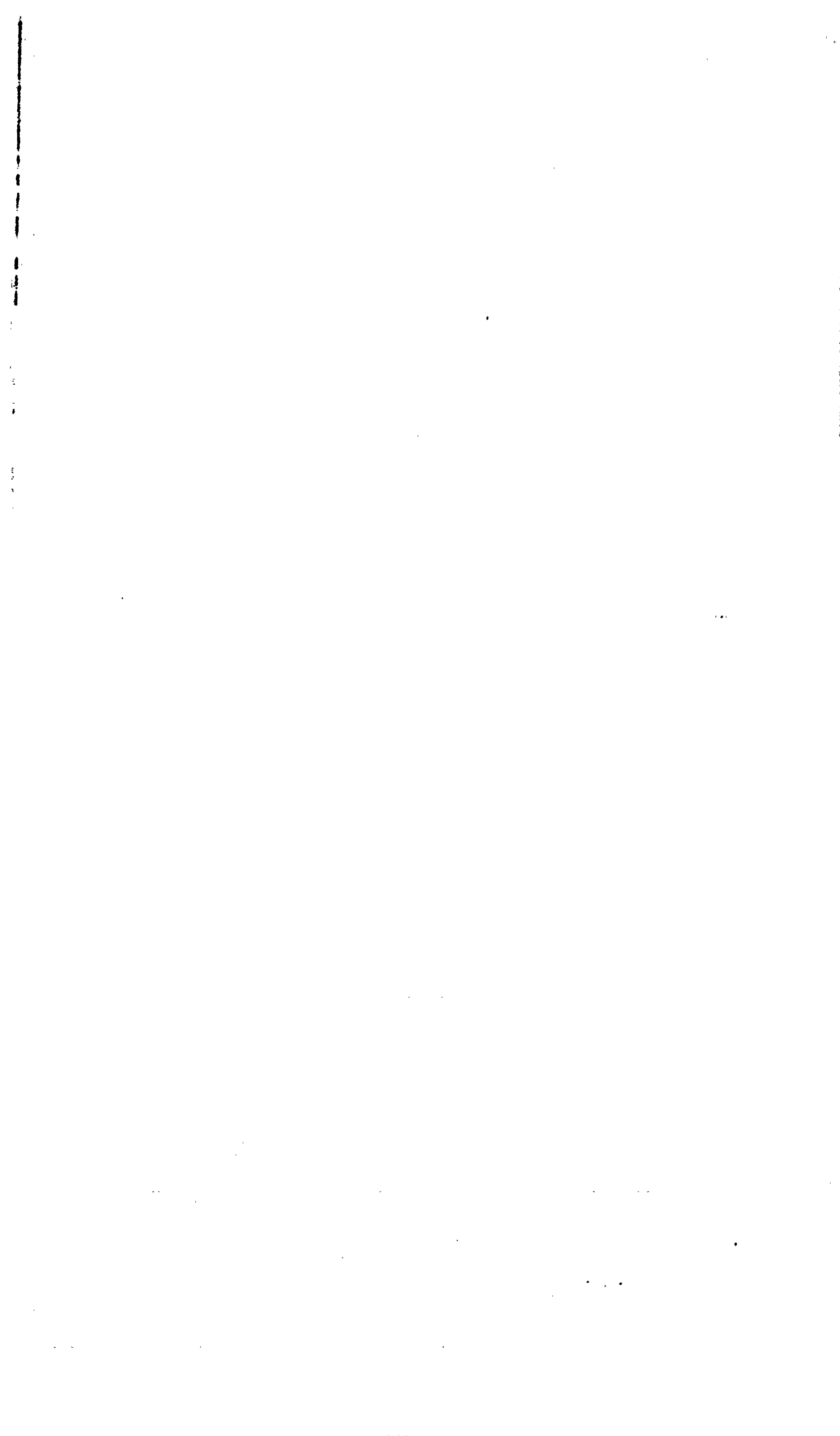
In this section various possible arguments in favor of diverting charitable gifts away from foundations -- (a) quantitative arguments, (b) qualitative arguments, and (c) arguments relating to "power" and "non-accountability" -- are briefly analyzed and are found to lack logical or empirical support. 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.

5. <u>Conclusion</u>

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.



STATEMENT BY JOHN G. SIMON,
PROFESSOR OF LAW, YALE UNIVERSITY
ON ASPECTS OF H. R. 13270
RELATING TO PRIVATE FOUNDATIONS
SUBMITTED TO SENATE FINANCE COMMITTEE
SEPTEMBER 8, 1969

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."

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.* (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 per cent -- owned 10 per cent or more of a stock of a business corporation. And 45 of the 175 foundations -- 26 per cent of them -- owned 20 per cent or more of the stock of a business corporation. In a large number of the cases falling between 10 per cent and 20 per cent, the figure would be over 20 per cent 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.

* 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 Contributions," National Tax Journal, vol. 20, March 1967.

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.* 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 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.

* 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.

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 is 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.*

Here, as in the appreciated property situation, the result may be no gift to charity at all, or the donor may simply give

* 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.

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 foundation 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 <u>non</u>-corporate-controlling foundation may require just as much financial attention as the single predominant investment of a corporate-controlling 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-control 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.*

(Continued on page 10)

* 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 Attorneys 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.



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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.* 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 Arguments in Favor of Diversion

1. One argument is quantitative. 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

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* 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 exisiting law or H.R. 13270, and they do not even have to file an annual information return!

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 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 foundations. 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' percentage 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.

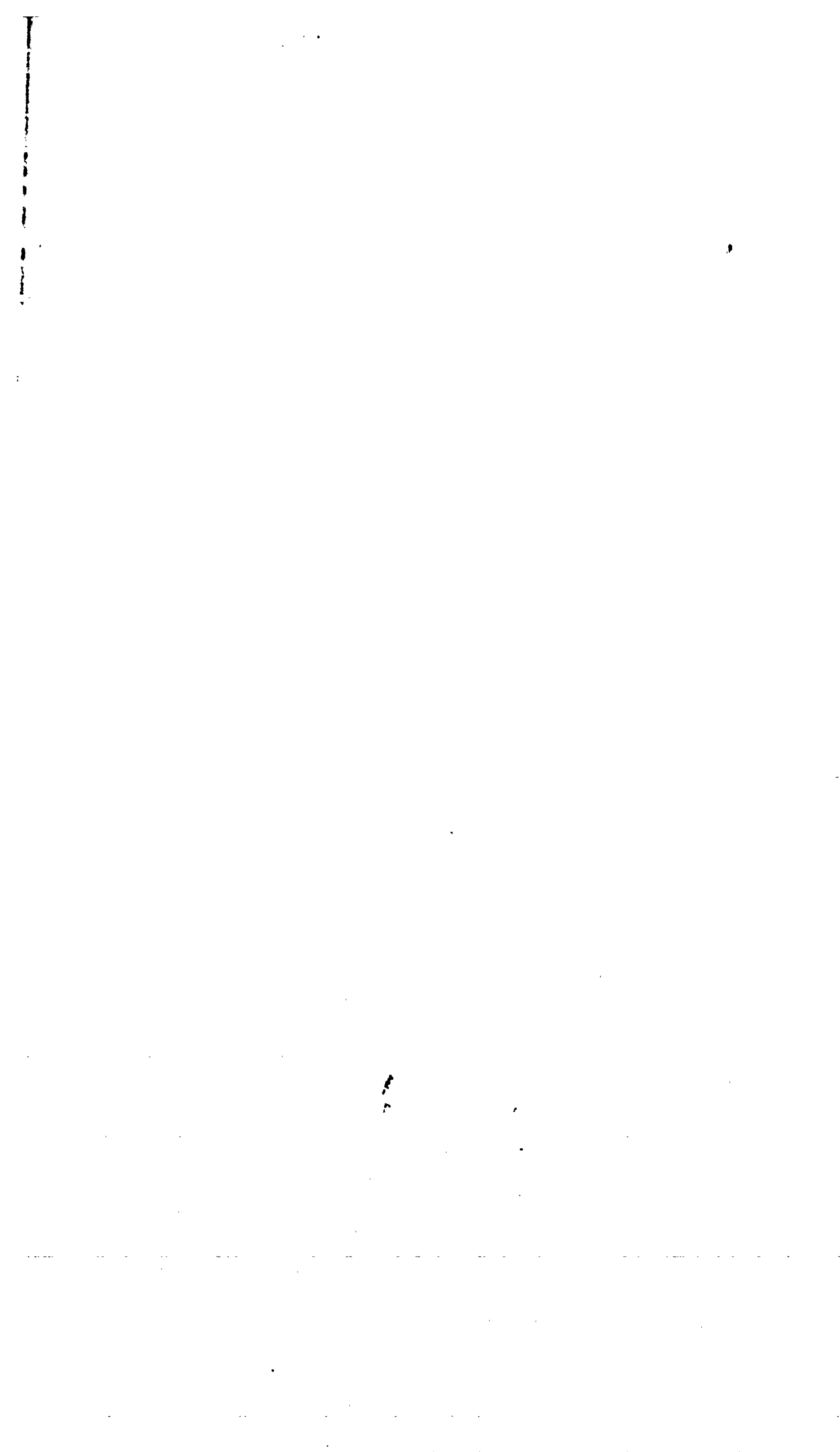
As these two provisions now stand in H.R. 13270, they are likely to inflict serious damage on our system of "private charitable enterprise," for that system, as the President of Yale University has stated,

> "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.



# THE HORMEL FOUNDATION

MEMBERS,
R. F. GRAY, CHAIRMAN
J. G. HUNTTING, VICE CH.
GEO. W. RYAN, SEC.-TREAS
JAMES C. HORMEL - Resigned August 11, 1969
ROBERT F. LICHTY
RAYMOND B. ONDOV
H. B. THOMPSON

AUSTIN, MINNESOTA 55912

August 25, 1969

Committee on Finance
United States Senate
2227 New Senate Office Blg.
Washington, D. C. 20510

SUMMARY OF PRINCIPAL POINTS

Re: Tax Reform Act of 1969
H. R. 13270

Gentlemen:

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. 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 Hormel 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 Hormel 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.

Respectfully submitted,

THE HORMEL FOUNDATION

By: [signature]
R. F. Gray, Chairman

By: [signature]
Raymond B. Ondov, Member

RBO: js

# THE HORMEL FOUNDATION

MEMBERS
R. F. GRAY, CHAIRMAN
J. G. HUNTTING, VICE CH.
GEO. W. RYAN, SEC.-TREAS
JAMES C. HORMEL - Resigned August 11, 1969
ROBERT F. LICHTY
RAYMOND B. ONDOV
M. B. THOMPSON

AUSTIN, MINNESOTA 55912

August 25, 1969

Committee on Finance
United States Senate
2227 New Senate Office Bldg.
Washington, D. C. 20510

Gentlemen:

Re: Tax Reform Act of 1969
H. R. 13270

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



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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.(E)(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 it 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 interest 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 Delaware 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 their community.

6.(b)(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, "Emporical 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:

| | |
|---|---|
| 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 longstanding 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 <u>Subchapter F-Exempt Organizations</u>, 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. <u>Judgment should be based on performance</u>.

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 establish 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.

Respectfully submitted,

THE HORMEL FOUNDATION

By: ______________________
R. F. Gray, Chairman

By: ______________________
Raymond B. Ondov, Member

RBO:js

The Hormel Foundation

Appendix A

(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 A

# THE HORMEL FOUNDATION

## APPENDIX B

MEMORANDUM OF AGREEMENT

BETWEEN

THE HORMEL FOUNDATION

AND

UNIVERSITY OF MINNESOTA

ESTABLISHING

THE HORMEL INSTITUTE

AUSTIN, MINNESOTA

AS A

UNIT OF

THE GRADUATE SCHOOL

UNIVERSITY OF MINNESOTA

NOVEMBER 30, 1942

1.

APPENDIX B

MEMORANDUM OF AGREEMENT

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 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 20th 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 [illegible] 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 the right of ingress and egress.

4.

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 advance the

5.

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 Olmsted 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 to terminate it 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.

| Witnesses: | The Hormel Foundation |
| --- | --- |
| C. D. Bigelow | By S. D. Catherwood, Chairman |
| Helen Morris | By M. F. Dugan, Secretary-Treasurer |
| | Regents of the University of Minnesota |
| Marie Rousseau | By W. C. Coffey, President |
| H. Gertrude Koll | By W. T. Middlebrook, Secretary |

8.

THE HORMEL INSTITUTE

UNIT OF
THE GRADUATE SCHOOL
UNIVERSITY OF MINNESOTA

| | | |
|---|---|---|
| CHAIRMAN | - | BRYCE L. CRAWFORD, JR., DEAN<br>THE GRADUATE SCHOOL<br>UNIVERSITY OF MINNESOTA<br>MINNEAPOLIS, MINNESOTA [illegible] |
| MEMBER | - | SHERWOOD O. BERG, DEAN<br>INSTITUTE OF AGRICULTURE<br>UNIVERSITY OF MINNESOTA<br>ST. PAUL, MINNESOTA [illegible] |
| MEMBER | - | DR. DAVID E. DONALD<br>ASSOC. PROFESSOR, PHYSIOLOGY<br>MAYO GRADUATE SCHOOL OF MEDICINE<br>ROCHESTER, MINNESOTA |
| MEMBER | - | DR. LAVELL HENDERSON<br>HEAD, DEPT. OF BIOCHEMISTRY<br>COLLEGE OF BIOLOGICAL SCIENCES<br>UNIVERSITY OF MINNESOTA<br>ST. PAUL, MINNESOTA |
| MEMBER | - | RAYMOND B. ONDOV<br>ATTORNEY AT LAW<br>MEMBER OF<br>THE HORMEL FOUNDATION<br>AUSTIN, MINNESOTA |

• • • • •

EXECUTIVE DIRECTOR -

DR. W. O. LUNDBERG
PROFESSOR OF BIOCHEMISTRY
THE HORMEL INSTITUTE
AUSTIN, MINNESOTA

MARCH 14, 1959 9.

## APPENDIX C

## THE HORMEL FOUNDATION

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 C



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# THE HORMEL INSTITUTE



UNIVERSITY OF MINNESOTA

Austin, Minnesota

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 * and the Board of Regents of the University.

The activities of The Hormel Institute are supervised by a Board of Directors **. 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

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* 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.

** 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.

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
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 department 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, mocroorganisms 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 and 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. Privett 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 microanalytical 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 recieved from National Institutes of Health in form of 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*
Attorney at Law
Director, Geo. A. Hormel & Co.
New York, New York

Richard D. Arney*
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

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Robert F. Lichty**
President
First National Bank
Austin, Minnesota

## GEO. A. HORMEL & COMPANY

## BOARD OF DIRECTORS

## NOVEMBER 30, 1968

Richard D. Arney*
Executive Vice Pres.
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
Exec.Vice Pres.&Secretary
Geo. A. Hormel & Co.
Austin, Minnesota

James C. Hormel*
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

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Sherwood O. Berg***
Dean, Institute of Agriculture
University of Minnesota
Minneapolis, Minnesota

*Resigned subsequent to November 30, 1968.

**Became a member of The Hormel Foundation on May 26, 1969.

***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 |
| United States 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 F

# GEO. A. HORMEL & COMPANY

## VULNERABILITY TO TAKE-OVER

### 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**

$$\frac{\text{Working Capital}}{\text{Total Assets}} = \frac{40,497,197}{108,484,480} = 37\%$$

**Debt Position - Long-Term Debt as a Percentage of Net Worth**

$$\frac{\text{Long-Term Debt}}{\text{Net Worth}} = \frac{3,006,000}{70,280,170} = 4\%$$

**Price/Earnings Ratio - Annual Earnings Per Share Divided to Per Share Market Price**

$$\frac{\text{Price}}{\text{1968 Earnings Per Share}} = \frac{36}{3.84} = 9.4$$

**Earnings Stability - Percentage Growth in Earnings - Past Three Years**

| Earnings (000's) | 1965 | 1966 | 1967 | 1968 |
|---|---|---|---|---|
| | $4,351 | $3,511 | $8,658 | $9,134 |

Since our earnings have more than doubled, we would have a score of zero on the table on Page 95.

| Summary | Ratio | Score | Danger Zone |
|---|---|---|---|
| Liquidity | 37% | 18 | Yes |
| Debt | 4% | 25 | Yes |
| P/E Ratio | 9.4 to 1 | 35 | Yes |
| Earnings | Double | 0 | No |
| Total Points | | 78 | Yes |

Appendix G

The Hormel Foundation
Appendix II

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 |
|---|---|---|
| 7/21/44 | $ 500.00 | 8/15/44 |
| 7/31/44 | 1500.00 | 8/15/44 |
| 10/30/44 | 1000.00 | 11/16/44 |
| 1/4/45 | 1000.00 | 2/15/45 |
| 1/27/45 | 500.00 | 2/15/45 |
| 1/31/45 | 1500.00 | 2/15/45 |
| 3/26/45 | 1000.00 | 5/16/45 |
| 4/2/45 | 2500.00 | 5/16/45 |
| 4/20/45 | 1000.00 | 5/16/45 |
| 6/29/45 | 1500.00 | 8/18/45 |
| 7/14/45 | 2000.00 | 8/18/45 |

The following borrowings were made from Hormel, Inc.:

| Date of Borrowing | Amount | Paid |
|---|---|---|
| 4/1/49 | $10,000.00 | 8/15/49 |
| 1/3/44 | 600.00 | 2/15/44 |

The Foundation has never borrowed any money except as shown above.

Appendix II

## The Hormel Foundation
## Appendix I

This appendix contains general information relative to Geo. A. Hormel & Company dividend rates, stock dividends and stock splits, etc.

**Dividend Rates**

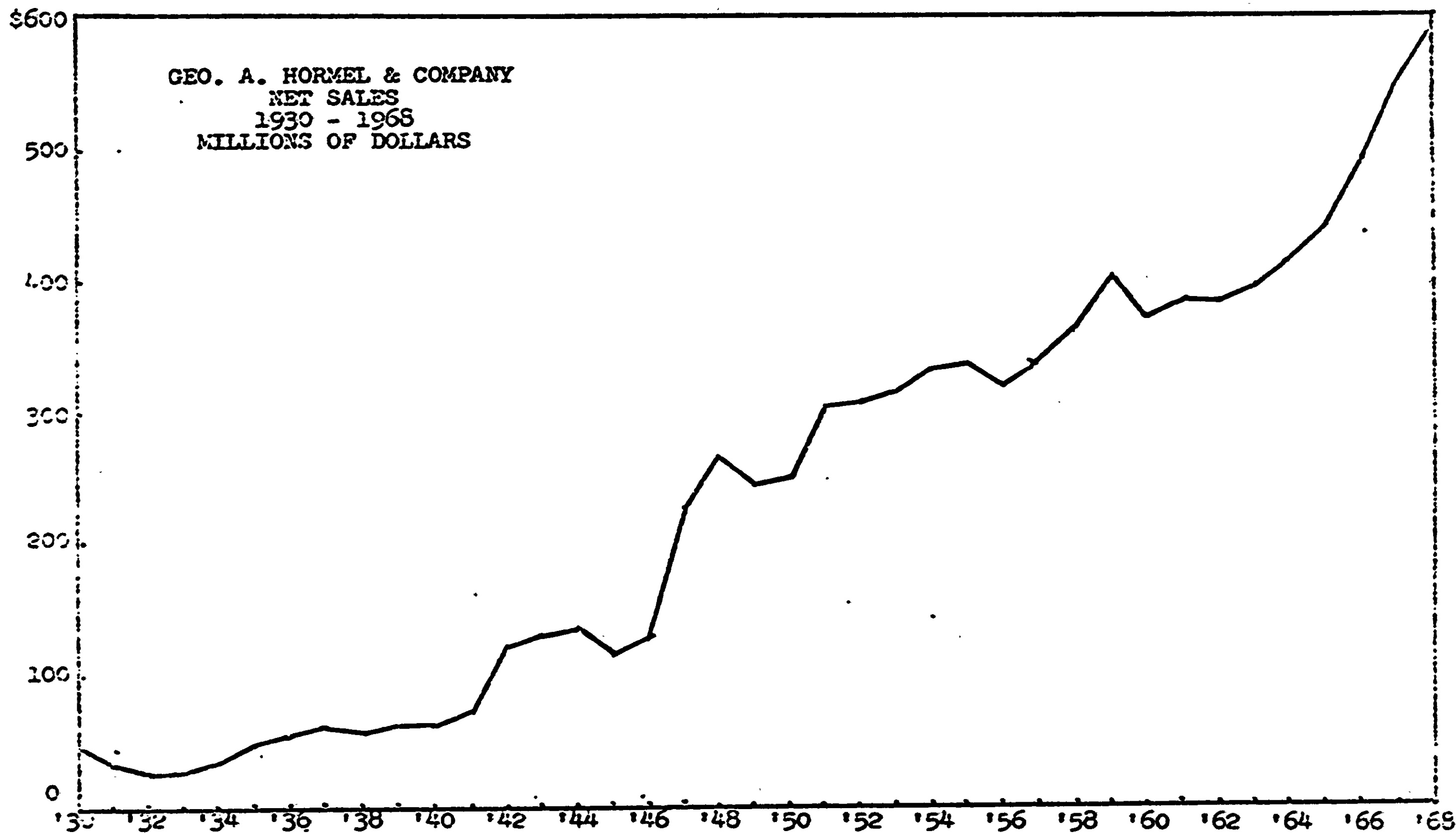
| | | |
|---|---|---|
| February 1928 | | 37 1/2¢ |
| November 1929 | | 50¢ |
| February 1932 | | 25¢ |
| February 1938 | | 37 1/2¢ |
| February 1940 | | 50¢ |
| November 1947 | | 62 1/2¢ |
| February 1960 | | 35¢ |
| December 1964 | Extra | 20¢ |
| May 1967 | | 40¢ |
| May 1967 | Extra | 50¢ |
| February 1968 | | 45¢ |
| May 1968 | | 22 1/2¢ |
| 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 239,253 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



OUTLINE-SUMMARY OF
"TESTIMONY OF CHARLES STEWART MOTT
ON TAXATION OF FOUNDATIONS"

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. THIS 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 AS 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 7-1/2% 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 BUSINESSES 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. POSSIBLY A VOLUNTARY ASSOCIATION 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.

TESTIMONY OF CHARLES STEWART MOTT

ON TAXATION OF FOUNDATIONS

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 weakened 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:



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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 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 service, 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 trouble-shooter, 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 92-1/2% good. For this reason, I do not understand the logic of the proposed 7-1/2% 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 requestsmight 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 necessary 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 piece.

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 I am 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 <u>your</u> 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 govenment 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.

Testimony of
EUGENE T. HACKLER
Representing the
AMERICAN ASSOCIATION OF HOMES FOR THE AGING
315 Park Avenue South, New York, N. Y. 10010
and
EV. LUTHERAN GOOD SAMARITAN SOCIETY
400 West Third Street, Sioux Falls, South Dakota
before the
Senate Finance Committee
Senate of the United States
Washington, D. C.

on the
"TAX REFORM ACT OF 1969"
H. R. 13270
Tax Exempt Organizations

September 10, 1969

## SUMMARY OF POINTS

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 assecs, the evaluation of

(Page 1 of Summary of Points)

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.

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We stand ready to assist this committee at any time where our experience and consultation would seem helpful.

(Page 2 of Summary of Points)

Testimony of
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September 10, 1969

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.



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The Ev. 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 hospitals, 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.

- 2 -

We think the Bill can be improved in the following areas:

I.
LONG TERM CARE INSTITUIONS 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 7 1/2% 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 life-lines 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.

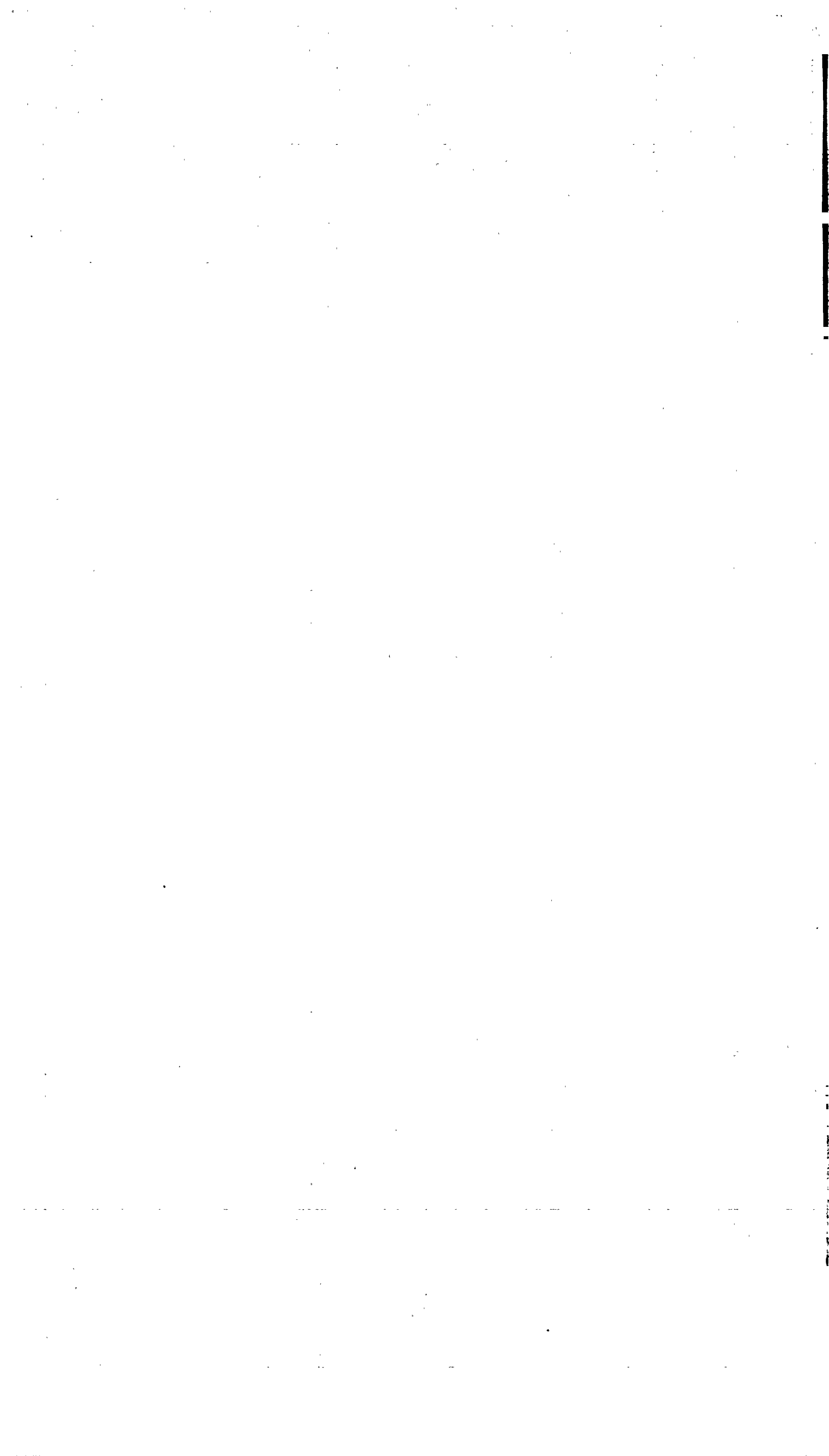
(2) Higher cost to the elderly.
If payment of taxes on investment income or the erosion of our tax exemption develops, then the costs to our residents will increase. This will be the natural result if our institutions are to survive. This will be placing an unusually heavy burden upon our aging population. 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

Statement by Mitchell Rogovin
In Behalf of the
Louis & Henrietta Blaustein Foundation, Inc.
Before The
Senate Finance Committee
On the
Tax Reform Act of 1969
Thursday, September 11, 1969



## SUMMARY OF STATEMENT BY MITCHELL ROGOVIN

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% 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 organizations 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% 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%.

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.

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/

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/

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1/ See, Andrews, Philanthropic Giving, Russell Sage Foundation, p. 30; 5 Encyclopedia Briticannica (1955 Ed.) Charity, p. 250.

2/ See Statements of Miller and Wells, The Role of Foundations in American Life, September 9, 1969.

SOME SPECIFIC CONCERNS

The need for specific legislation to curb the over-reach 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 [1/] or Congressman Patman's hearings on private foundations. [2/] 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

1/Treasury Department Report on Private Foundations, Committee on Ways and Means, 89th Cong., 2d Sess. (1965).

2/ 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).



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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 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. 1/ 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,

1/ ". . . 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).

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

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1/ H. Rpt. No. 91-413 (Part I), 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.

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.

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 stock from private foundations, [1/] 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

1/ A method of divestiture approved by the Bill.

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. 1/ 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

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1/ 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).

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. 1/ 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.

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1/ 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 decreased 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 43 (Jan. 1966), and Herwitz, Stock Redemptions and the Accumulated Earnings Tax, 74 Har. L. Rev. 866 (1961).

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. 1/

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 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

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1/ 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.

market other than the issuing company will have difficulty realizing the full value of such assets. 1/ 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 to the bill are intended to facilitate the policy behind this provision; to change the type of investments held by certain private foundations.

An alternative approach which recognizes that non-voting stock in the hands of a private foundation is

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1/ 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.

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 provisions of section 4943 of the Bill will not apply. 1/

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

1/ 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.

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 foundation 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 2-1/2 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 <u>all</u> 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. 1/ This would demonstrate the foundation's intention to divest and would allow the redeeming corporation to develop an appropriate plan for the redemption.

1/ 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.



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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 the will speak as of the date of the codicil. 1/ 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

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1/ 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 far from clear.

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. 1/

(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. 1/

(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.

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1/ See Appendix A for illustrative draft language.

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," 1/ 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. 2/

This provision of the House Bill draws a line totally lacking in rationality. Under this provision, for example, a

1/ H. Rpt. No. 91-413 (Part I), p. 54, 91st Cong., 1st Sess. (1969).

2/ A tax on unrealized appreciation would be a sharp departure from the philosophy of our federal taxation scheme.

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 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

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).

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 7-1/2 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 philanthropy to their tax rolls once the lead is taken by the federal government.

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. The Revenue Code has never drawn a distinction among charities; making some tax-free and some 92-1/2% 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 [1/] to defray the administrative expenses of examining exempt foundations and

1/ 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.

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.

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 pe cent 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." 1/

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.

1/ H. Rpt. No. 91-413 (Part I), p. 27, 91st Cong., 1st Sess. (1969).

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 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 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 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

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1/ This figure includes the interest factor.

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 acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement. . . ."



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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 [1] 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,

[1] H. Rpt. No. 91-413 (Part I), p. 46, 91st Cong., 1st Sess. (1969).

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'. . . . . ." (underlined 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.

§ 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 ancestors 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, <u>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)</u>, shall be allowed, but in computing such <u>deductions</u> the limitations in section 170(b)(1)(A) and (B) shall apply, and section 170(b)(2) and (5) shall not apply.

(New matter underlined)

§ 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.

(New material underlined)

Add a new subsection to section 303(a) to read as follows:

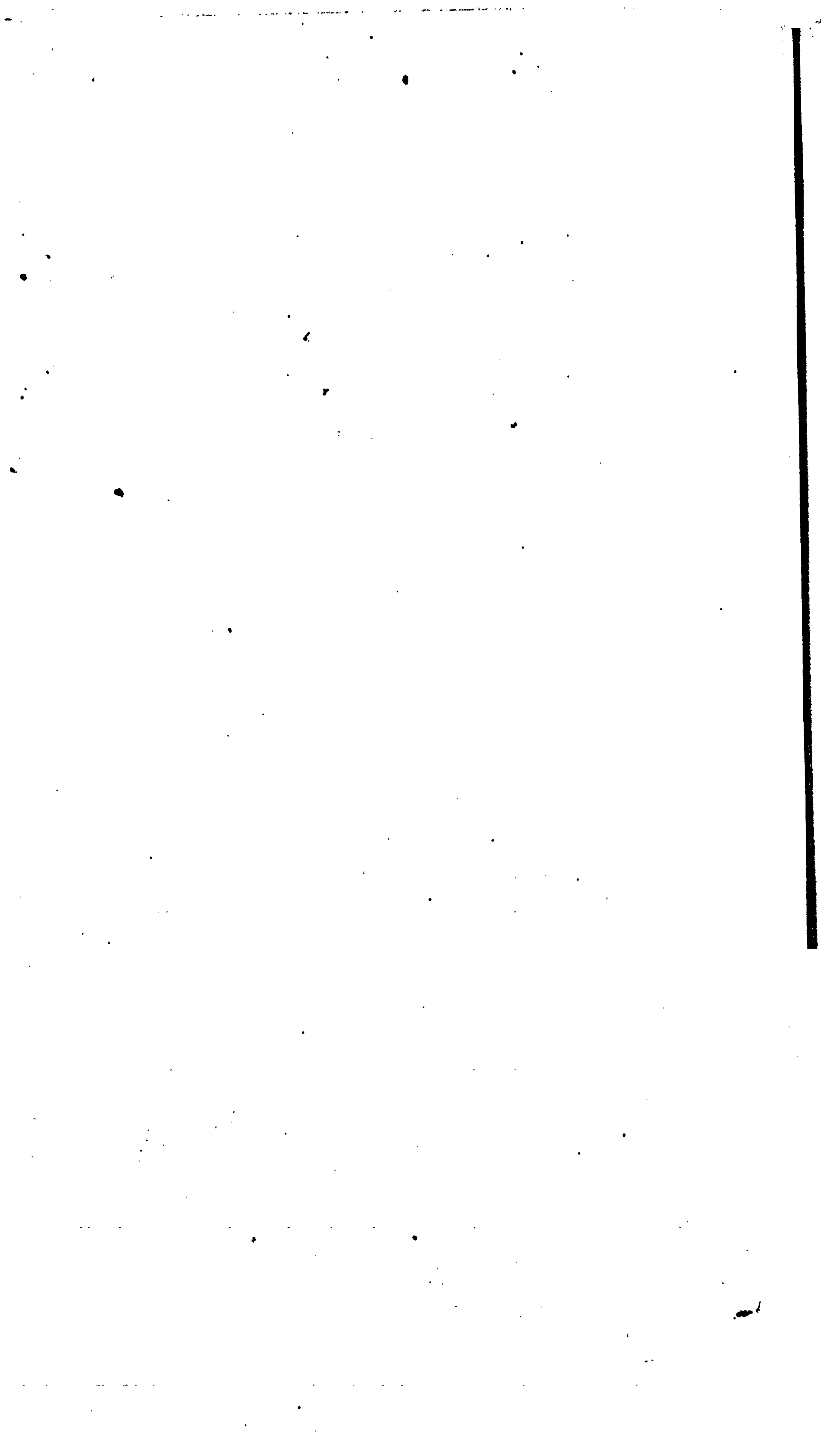
(3) the amount paid out in redemption of stock of closely held business enterprises, as provided in section 4943(e).

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 anti-trust 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)."

# STATEMENT BY THE HONORABLE ELVIS J. STAHR
## PRESIDENT, NATIONAL AUDUBON SOCIETY
## BEFORE THE
## SENATE FINANCE COMMITTEE
## ON
## THE TAX REFORM ACT OF 1969

October 7, 1969



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 scientists 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 getting 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 foundationsare 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 allocation 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 preference 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 (7 1/2% 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



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administrativo costs. However, 7 1/2% 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 an 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 transgression 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.

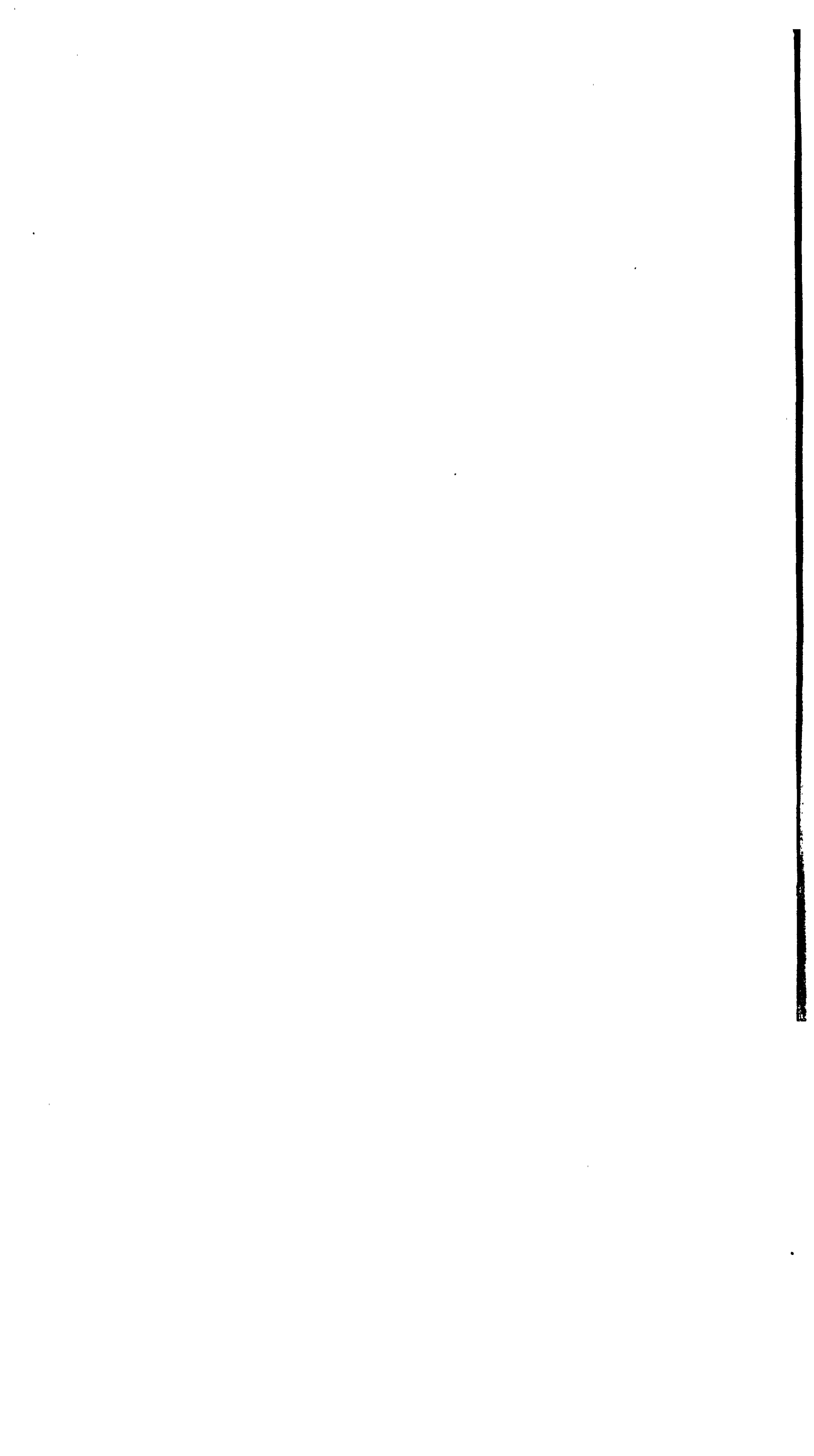
We earnestly hope, and respectfully ask that you give these provisions of the tax reform bill separate and thorough study on their own merits and demerits.

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 perceive 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.

# PART B—ADDITIONAL STATEMENTS



AMERICAN ACADEMY OF ARTS AND SCIENCES

280 NEWTON STREET · BROOKLINE STATION · BOSTON, MASSACHUSETTS 02146 · 522-2400

Statement on H.R. 13270 (The Tax Reform Act of 1969)

Talcott Parsons, President

American Academy of Arts and Sciences

The officers of the American Academy of Arts and Sciences endorse the statement with regard to certain provisions of H.R. 13270 (the Tax Reform Act of 1969) prepared for the Committee on Finance of the United States Senate by the Advanced Study Group.

The American Academy is a scientific and learned society consisting of 2173 elected members representing all of the established fields of science, learning, and scholarship. It was founded in 1780 by John Adams and other leaders prominent in laying the philosophical foundations of the new nation and in framing its laws, governmental structure, and institutions. Since its founding, its purpose has been to support scientific and scholarly research, to promote the communication of scientific and scholarly ideas, and to undertake interdisciplinary studies of those problems in the public interest which belong to no one scientific or scholarly profession, or to no single institution, but which call for careful study, appraisal, and definition.

The Academy's principal activity is to organize studies, research projects, and conferences which bring together nationally recognized scientists, scholars, and representatives from business, government, and public affairs. These activities include a variety of studies in science, the professions, and public affairs: the recent history of physics, the methods of humanistic disciplines, sociological perspectives on poverty, America in the Year 2000, the contemporary university, the social consequences of technological progress, and business in America. The results of these studies are widely circulated to the scholarly and scientific community and to the general public through the journal of the Academy, Daedalus, as well as books and working papers.

The officers of the Academy are concerned because the proposed legislation is broadly written and would inadvertently place a unique and special burden on certain organizations which are a central part of the American system of higher education and which have not been involved in any of the abuses which the legislation is designed to prevent. These are organizations for advanced study and learning, assocations of scientists and scholars, and institutes which bring together various representatives of the learned professions for special studies and research. In point of origin many of these organizations are older than universities; they had a central role in the development and promotion of scientific research and the scholarly disciplines; and they perform functions vital to the continuation of higher education. If the proposed bill is passed some of these organizations simply could not survive, and most would be seriously crippled in their activities and programs. We strongly urge the Committee

on Finance to recognize that these organizations, whose history and current activities identify them as scholarly associations and institutions of advanced learning, are to be regarded as an integral part of our system of higher education and should be exempt from the proposed legislation.

In addition, at a time when many of our colleges and universities are beset by tension and turmoil and their financial and physical resources strained by the innumerable functions that they perform for society in education, research, and public service, it is unwise to impair that sector of the scholarly and scientific community which is sheltered from confrontation and which, because of the broad nature of its public support, places little or no burden on public funds.

We trust that the Committee will make amendments to the tax reform bill to recognize the essential identity between universities and colleges and organizations of advanced research and scholarship.

AMERICAN COUNCIL OF LEARNED SOCIETIES
345 EAST 46TH STREET (AT UNITED NATIONS PLAZA), NEW YORK, N. Y. 10017
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STATEMENT OF FREDERICK BURKHARDT
President, American Council of Learned Societies

to the
Finance Committee
United States Senate

September 8, 1969

Mr. Chairman and members of the Committee:

I should like first to express my thanks to the Committee for affording me an opportunity to present a statement on the Tax Reform Act of 1969.

My name is Frederick Burkhardt and I am President of the American Council of Learned Societies, a federation of thirty-three national learned societies in the humanities and social sciences. A list of these societies is attached to this statement and the work of the Council is described in a brochure which also is attached.

My concern is with the effect which this legislation, if enacted in its present form, would have on learned societies and independent organizations whose function it is to advance research and knowledge, either directly, or indirectly through grants to scholars.

It is clear that the legislation is not intended to hamper the work of such organizations. The Report of the Committee on Ways and Means of the House of Representatives states ". . . there are other organizations

supported by private foundations which your committee concluded should also be permitted to continue to receive grants from other private foundations."

The proposed legislation seeks to accomplish this by its defination of "operating foundations" and, in Section 509(a), by exempting certain types of organizations altogether from the definition of private foundation.

However, learned societies and scholarly organizations, except those that now have 170(b)(1)(B) status, must meet conditions set by definitions framed in terms of their normal sources of support and, although many membership organizations would now qualify for exemption under these terms, and other organizations would qualify as "operating foundations," the definition according to sources of support produces problems and restrictions which should not be placed on these organizations, and in some cases results in scholarly organizations being considered private foundations because their current sources of support do not precisely meet the formulas set forth in the legislation.

Let me give some examples:

Learned Society A, a large national society with over 20,000 members, now receives 40% of its support from membership dues, and has a gross investment income of less than one-third of its total support. It therefore meets the conditions of Sec. 509(a)(2) and is not considered a private foundation. However, this society seeks and receives grants from private foundations to improve instruction and to advance research in its field. It must now restrict its initiative in this important area of its work lest its grants for projects change the proportion of its support so that

it would then become a private foundation, or possibly an operating foundation. In either case it would become subject to the taxation and other rules imposed on foundations by the Act. This dampening of perfectly healthy and sound initiative seems to me to be an undesirable, though unintended, consequence of the legislation in its present form.

Another example: Organization B has about 2,000 members, but its source of support from private foundations and individuals is such that under the present language of the Act it would be considered a private operating foundation. It is at present negotiating a grant with private foundation X for a very important project. If this grant should be made, however, the proportion of support from Foundation X would rise to above 25% of Organization B's total support, and the organization would then presumably become a private foundation itself and thus be disqualified from receiving grants from other private foundations except out of corpus. This again seems an unfortunate and unintended result of defining according to sources of support.

A third and final example:
Association C has no individual, but only institutional, membership. Dues form only a small fraction of its normal support, which comes from several large foundations and some government agencies. Its work consists of fairly large programs of fellowships and grants to individual scholars for post-doctoral research, and related activities designed to encourage research and teaching--such as research conferences, studies, and surveys. The Association's field is an important one, but only a limited number of

foundations and government agencies can be expected to support it. In this situation it is difficult to avoid the 25% limitation and, indeed, in the past one or another foundation has provided more than 25% of its program support in most years. Again we have an artificial and onerous restriction placed upon an organization with highly desirable and effective activities. It must, if the present form of the legislation stands, either reduce its support from one of the present supporting foundations, or risk becoming a private foundation itself if it cannot find additional support sufficient to reduce the percentage provided by the major supporting foundation.

All of the above problems are real instances. All of the organizations concerned are reputable, distinguished scholarly organizations which do excellent work in their respective fields. I am convinced that it is not the intent of this legislation to hamper or restrict such organizations in their work.

It seems to me, therefore, that the text of the legislation should be amended so that Sec. 509(a) is provided with a fifth category of organization exempt from the definition of private foundation, and hence exempt from the taxes and rules established by the Act. This category should include learned societies and organizations engaged in the advancement of research and knowledge, and should be defined in positive functional terms rather than in terms of their sources of support. The category should be defined so that it does not provide a loop-hole for self-dealing foundations or for charlatan organizations. I believe this

can be done and I should be happy to work with the staff of the Committee to provide such a definition if, as I hope, it judges that the points raised in the above paragraph have merit.

For the present I most earnestly urge the Committee to take note of the problem I raise, which, stated simply and baldly, is that as it now stands the Act would seriously hamper and possibly damage the work of a number of excellent scholarly organisations and at best place restrictions upon their initiative and progress--restrictions that are clearly both artificial and undesirable. These organizations ought not to be affected at all by the present Act. They are not foundations in the usual sense of that term. They do not usually have large funds of their own, nor do they accumulate funds for themselves. They are independent, and they render a full public accounting of their activities. They are essential components of the educational process and progress of this country. They should therefore be made clearly exempt from the provisions of this legislation.

The above comments have been restricted to specific aspects of the proposed Act and their consequences for certain scholarly organisations if enacted in their present form.

I should now like to conclude with two comments regarding more general aspects of the Act.

My first observation concerns the principle of taxation of private philanthropic foundations. This seems to me to be in clear contradiction of a long-standing tradition in the United States that exemption from taxation for philanthropic giving is a social good and in the interest



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of the national welfare. Let us preserve that tradition and that principle, which is one in which this country can take great pride, for it has shown the way to the whole world in this area of legislation.

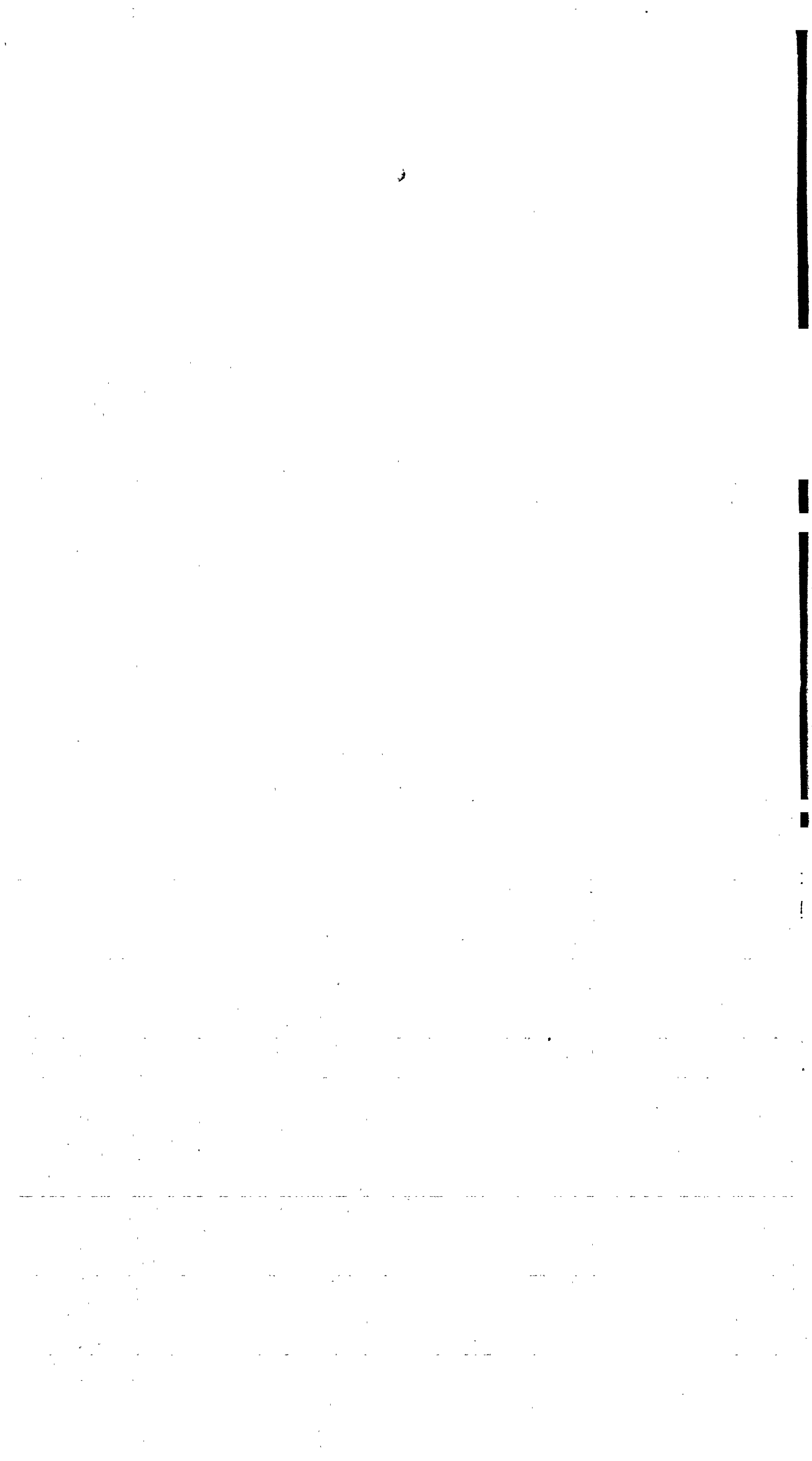
I believe that the objective of eliminating abuses without interfering with the socially desirable activities of the reputable philanthropic foundations can be accomplished by enforcement of the Internal Revenue Code and by insistence on the filing of timely and complete information returns. The cost of administration, to insure that foundations promptly and properly use their funds for charitable purposes, can be covered by registration fees to be paid by the foundations.

Second, there seems to be an unwarranted assumption in the proposed legislation that it is undesirable or bad *per se* that an organization's support comes from a single source or a few sources. Surely, whether they come from one or many sources, the funds can be used for good or ill, and what is important is how they are used for the public benefit.

## AMERICAN COUNCIL OF LEARNED SOCIETIES

### Constituent Members of the Council

| | Date of Founding |
|---|---|
| American Academy of Arts and Sciences | 1780 |
| American Anthropological Association | 1902 |
| American Antiquarian Society | 1812 |
| American Dialect Society | 1889 |
| American Economic Association | 1885 |
| American Folklore Society | 1888 |
| American Historical Association | 1884 |
| American Musicological Society | 1934 |
| American Numismatic Society | 1858 |
| American Oriental Society | 1842 |
| American Philological Association | 1869 |
| American Philosophical Association | 1901 |
| American Philosophical Society | 1743 |
| American Political Science Association | 1903 |
| American Society for Aesthetics | 1942 |
| American Sociological Association | 1905 |
| American Studies Association | 1950 |
| Archaeological Institute of America | 1879 |
| Association for Asian Studies | 1941 |
| Association of American Geographers | 1904 |
| Association of American Law Schools | 1900 |
| Bibliographical Society of America | 1904 |
| College Art Association of America | 1912 |
| Economic History Association | 1940 |
| History of Science Society | 1924 |
| Linguistic Society of America | 1924 |
| Mediaeval Academy of America | 1925 |
| Metaphysical Society of America | 1950 |
| Modern Language Association of America | 1883 |
| Renaissance Society of America | 1954 |
| Society for Ethnomusicology | 1955 |
| Society of Architectural Historians | 1940 |
| Society of Biblical Literature | 1880 |



5 September 1969

Statement by Joseph E. Johnson, President, Carnegie Endowment for International Peace, relating to Title I of HR 13270, submitted for the record to the Senate Finance Committee

I wish to associate myself with the general approach taken by the representatives of the advanced study group.

I share with my colleagues in other foundations and with fair-minded citizens everywhere a deep concern over the abuses perpetrated in the name of philanthropy by certain tax-exempt institutions to the detriment of public confidence in all foundations. All responsible foundation officials welcome these sound provisions of the bill designed to stop self-dealing and other misuses of the tax-exempt privilege.

With respect to other aspects of the proposed legislation on private foundations, however, it is my view that the constructive contributions to the welfare of mankind made over the years by foundations are in danger of being slighted.

The intent of parts of the bill appears to be more punitive than corrective. What shocks me in particular is the implication contained in the proposals regarding grants to individuals, restrictions of activities, and a tax on income--that we have all willfully betrayed the trust in us implied by the granting of tax-exempt status, and have sought to evade the responsibilities defined in our charters and laid down in existing legislation.

The Carnegie Endowment for International Peace was founded 59 years ago. Andrew Carnegie set as its aim "to hasten the abolition of international war." Under the terms of its charter, one of the things the Endowment is enjoined to do is to "promote the advancement and diffusion of knowledge and understanding among the people of the United States." Thus the Endowment has been given an educational

task. Over the years, Endowment Trustees, officers, and staff have sought conscientiously to perform that task by contributing, through various research, publishing, and scholarship programs, to a better public understanding of the causes of war, the nature and effects of war, international law, international organizations, and international relations in general.

I am also disturbed that the Carnegie Endowment should be classified as a "private foundation." Quite apart from the extreme measures to be adopted against "private foundations," such a classification would not accurately reflect the purpose and nature of the Endowment's activities. In its program and other activities, the Endowment is directly concerned with perhaps the most vital public question of the day, if not the century--world peace. The Endowment makes frequent and full public reports on its activities. No rational ground is suggested why the Endowment should be placed in the same category as a family foundation which has no operating program and conducts its activities essentially in private.

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section 509

The bill provides an exception from the classifications of private foundations for foundations supported by the public or by governmental agencies. Yet surely the test should be the nature of the foundation's activities, not the source of its funds. If the proposed definition of private foundations is adopted, the result would be to penalize the Endowment because through Mr. Carnegie's generosity nearly sixty years ago the Carnegie Endowment has not been compelled to seek outside funds.

The proposed legislative measures raise serious questions whether we can continue to pursue our objectives along lines employed by educational institutions. For example, the Endowment now operates a modest program of

travel and maintenance grants, in consultation with an advisory committee of scholars, for young professors in the field of international organizations, as well as two visiting research scholarships in the field of international relations. As an educational institution, the Endowment provides machinery through public announcements, competitions, and advisory committees by which scholars from various disciplines can contribute to broadening and enriching the field of international relations. I believe we have instituted selection processes as fair as those of any university. To require that these procedures be approved in advance by the Secretary of the Treasury or his delegate would add nothing to their fairness, and might restrict their flexibility.

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Far more menacing to our functioning is the proposed restriction on foundation activity in the field of public policy. With a mandate such as ours, Endowment programs, if they are to be effective, must aim at informing a wide range of people involved in the policy-making process on issues related to international affairs. Would it be possible for the Endowment, under this bill, to sponsor international conferences similar to the one on nuclear non-proliferation that we supported and co-sponsored in 1966, or to publish studies, as we have done, on such issues as the United Nations Peace Force (1957), the future of NATO (1967), or the United Nations and Vietnam (1968)? Would we be prohibited from making grants as we did in 1966 to the Brookings Institution for a study on financing the United Nations?

We also have tried in the past to help link various segments of the foreign affairs community. I cite here the example of the Committee on Foreign Affairs Personnel. This Committee, composed of private citizens, was established in 1961 under the auspices of the Carnegie Endowment for International Peace, with

the strong support of the then Secretary of State, Dean Rusk. The chairman was Mr. Rusk's predecessor, the Honorable Christian A. Herter, and the other members represented a broad spectrum of experience in relation to problems of personnel and administration of foreign affairs. The Committee report, Personnel for the New Diplomacy, which contained a series of recommendations on recruiting and training foreign affairs personnel, was presented to Mr. Rusk and simultaneously published by the Endowment in 1962. Should foundations be barred from undertaking this kind of activity?

p. 45 )
lines 11-12)

It may be said that we are seeing specters that do not exist, since the bill specifically allows foundations to make available the results of nonpartisan analysis or research. However, some of our publications do conclude by making recommendations on matters of public policy; and some future Treasury official who disagreed with a particular recommendation might, unless the language of the bill is made more precise, decide that this was "an attempt to affect the opinion of the general public." As to the forbidding of "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, "does this mean that I could not take a part-time or temporary post as an unpaid consultant to an executive department or congressional committee, if the drafting of proposed legislation might be involved? I raise these questions, Mr. Chairman, to show the potential difficulties lurking in these rather ambiguous formulations of the bill.

p. 23 )
lines 19-25)

There is one other specific provision that would affect the Carnegie Endowment for International Peace very directly: that is the paragraph which forbids a foundation to pay or reimburse traveling expenses (including amounts expended for meals and lodging) for certain government officials and members of

the Congress, except for travel within the United States. The Carnegie Endowment, as a part of its regular program activities, supports--and frequently sponsors or co-sponsors--a number of international conferences. To some of these, members of the Congress and high government officials have been invited in the past. While many such persons have found ways to meet their own traveling expenses, some have not. Moreover, not infrequently, the host organization or organizations pay for the lodging and meals of participants for the duration of the conference, and it appears that such payment would be illegal within the language as now drafted. It is difficult to see the reason for discriminating between domestic and international travel as the present bill does. I respectfully urge that the Committee remedy the situation by striking out on page 23 the last word of line 20, all of line 21, and line 22 up to the comma.

Finally, I turn to the proposed tax on foundation income. A foundation such as the Carnegie Endowment, while privately managed, is public in the nature of its activities. The types of institutions that may be affected by its programs can be as specific as a university department or a government bureau, or as broad as an entire profession or great national program. The public character of the Carnegie Endowment derives more importantly from this kind of contribution, which it has made since its founding in 1910, rather than from its tax exemption, which came subsequently. Any tax on foundations--and there is no reason to believe that it would stop at 7-1/2%--would do virtually nothing to correct the abuses that trouble us all. It would merely be passed on to the recipients of foundation grants in terms of reduced awards or outright rejections, and seriously affect their work. A Federal tax, once imposed, might be emulated by states and

municipalities. Since many if not most foundation grants are in areas affecting the public welfare, the net result might be simply an increased public demand for the expenditure of public monies to meet these purposes.

I respectfully suggest that those provisions of Title I of HR 13270 referred to above do not reflect attention to the concerns of legitimate foundations; they promise not only to punish the many for the mistakes of the few, but more significantly to wall off vital elements in our national life from one another at a time when national priorities and international complexities impel us to come together.

# # #

Summary of
Statement of the National Bureau of Economic Research, Inc.
On Proposed Treatment of Tax Exempt Organizations
Submitted by John R. Meyer, President

The National Bureau is a non profit organization formed in 1920 in New York City and dedicated to independent research on social and economic problems and to impartial interpretation of research findings. It is a broadly based organization, being governed by a Board of 51 Directors, more than half of whom are selected by universities and by professional, business and labor organizations. In its work it has the cooperation of a wide range of university scholars, government agencies, and business firms. It is supported in part by grants and grant contracts from foundations, government agencies, and business associations; in part by contributions and subscriptions from companies, labor organizations, libraries and individuals; and in part by investment income.

While we believe the National Bureau is more in the nature of a public institution than a private foundation, there appear to be uncertainties in the rules provided in H.R. 13270 regarding the classification of exempt organizations that might result in the Bureau being treated as a private foundation. If it were so treated, its work would be adversely affected by the imposition of tax on investment income, by the loss of foundation grants to an unqualified distributee, and perhaps by the reluctance of outstanding men to serve as directors in view of tax sanctions that might be imposed on foundation managers.

To qualify as other than a private foundation under H.R. 13270, a tax exempt organization must obtain proportions of its support and income from specified sources. It is not clear, however, how some receipts from foundations, government grant contracts, trade associations and individuals will be construed under the bill, especially in view of limitations on the size of receipts from any one person that may be treated as qualifying support.

The National Bureau urges that the definitional rules be modified so that research and educational institutions in our circumstances will clearly qualify as other than a private foundation under the proposed tax revision.

Statement of the National Bureau of Economic Research, Inc.
On Proposed Treatment of Tax Exempt Organizations
Submitted by John R. Meyer, President

The National Bureau of Economic Research is concerned that tax reforms designed to correct abuses of some exempt organizations be clearly drawn so that the new rules will not adversely affect organizations that are not narrowly controlled and not engaged in abusive activities. We appreciate that this has also been the concern of those formulating the tax reform bill. Between the release of the Committee on Ways and Means' Tentative Decisions in May and the passage of H.R. 13270 by the House of Representatives in August, a number of definitional rules were developed to clarify distinctions between the proposed classes of private foundations, operating foundations, and other exempt organizations. However, there is still considerable uncertainty about the manner in which some of the rules and tests provided by the bill would be interpreted and applied.

We believe the National Bureau should, and probably would, be excluded from the new class of private foundations. The National Bureau is a nonprofit organization dedicated to independent research and impartial interpretation of research findings. In a broad sense it is a public institution and not a private foundation. Formally it is a private membership corporation, and it takes pride in the independence of its operations. Its organization, governing body, and methods of operation are broadly based. In the sense that a business corporation may be said to be publicly rather than closely owned, the National Bureau may be regarded as a publicly directed organization.

We hope that as further attention is given to the proposed rules for private foundations and other organizations, the methods of definition can be modified to remove uncertainties as to where institutions like the National Bureau will fall under the new classification. To assist in the Committee on Finance's consideration of how institutions of our type are to be treated under the tax revision, we would like to indicate the character of the National Bureau's organization and operations and note some points in the proposed tax rules that are of concern to us.

Organization and Operations

The National Bureau was formed in 1920 under the Membership Corporations Law of the State of New York. The members of the corporation are also its directors, who are elected for three-year terms. From its inception the membership has included men of diverse interests, chosen from business, labor, professional associations and universities. The membership is comprised of three classes: 24 directors at large who are elected by the existing membership; directors by university appointment, who are selected by each of 15 universities; and directors by appointment of 10 other organizations, who are selected by their respective organizations.

Under the certificate of incorporation: "The particular objects for which the corporation is formed are to encourage, in the broadest and most liberal manner, investigation, research and discovery, and the application of knowledge to the well-being of mankind; and in particular to conduct, or assist in the making of, exact and impartial investigations in the field of economic, social and industrial science, and to this end to cooperate with Governments, universities, learned societies, and individuals."

The Board of Directors is charged with the responsibility of approving areas of investigation, of ensuring procedures that safeguard the objective and scientific character of the findings, and that help make them authoritative and acceptable to persons of different interests and views. All National Bureau reports prepared by the research staff must be approved by the Directors before publication.

Officers are elected and members of the research staff are appointed by the Board of Directors. Some of the 75 members of the research staff are employed full time at the Bureau's principal offices at 261 Madison Avenue, New York City and at a branch office located in the Yale University Computer Center. Others of the staff teach part time at universities and devote their research time to Bureau projects. Staff members are aided by research assistants, for many of whom the Bureau is a place for training, combined with graduate studies, for careers in government, business or universities. The Bureau also maintains a research fellowship program, designed primarily to further the professional development of outstanding scholars, generally at the post-doctoral level.

Besides the research conducted by its own staff, the National Bureau sponsors two continuing groups that plan and organize research conferences. The Universities-National Bureau Committee for Economic Research is comprised of representatives from 37 universities which offer graduate work in economics and emphasize research, as well as a representative from the National Bureau and a few committee members elected at large. The Conference on Research in Income and Wealth operates as a separate committee of the National Bureau, under the direction of an executive committee elected annually by the membership, with one member appointed by the President of the National Bureau. The members of the Conference, now 133, are from government, universities, and business, but are elected as individuals who are interested in income and wealth research, and not as representatives of institutions.

Nearly 400 staff research reports and conference volumes have been published and made generally available to interested persons in the universities, business and government. The National Bureau has pioneered, and is continuing research, in measuring the national income and wealth, in analyzing income distribution, in describing and diagnosing business cycles, in analyzing relations between wages, productivity and prices, and in studying conditions conducive to economic growth, stability of the price level, and international financial balance. Current studies

place important emphasis on some of the fundamental problems of urban economics, regional development and human resources.

Relationship to Government

While the areas to which the Bureau devotes its research efforts are determined by the Board of Directors, they have been responsive over the years to needs for studies suggested by government agencies. One of the Bureau's early publications in 1923 was Business Cycles and Unemployment, a report of an investigation proposed in 1921 by President Harding's Conference on Unemployment. Leo Wolman's The Planning and Control of Public Works, published in 1930, was the result of a request from the President's Committee on Recent Economic Changes for a study of the possibility of public works as a device of economic stabilization. A sequel to this study, Public Works in Prosperity and Depression by Arthur D. Gayer, was prepared in 1935 for the National Planning Board, Federal Emergency Administration of Public Works. In 1949 the National Bureau published The Statistical Agencies of the Federal Government, a Report to the Commission on Organization of the Executive Branch of the Government prepared by Frederick C. Mills and Clarence D. Long of the Bureau's research staff. As noted in the foreword, the Executive Committee of the National Bureau agreed to accept the invitation of the Commission Chairman, Mr. Hoover, to undertake this study "in view of the high public importance of the Commission's enterprise, the critical role of statistical intelligence in the working of our social economy, and the National Bureau's extensive experience in statistical work."

Similarly, when the U.S. Bureau of the Budget requested in 1959 an objective review of official price statistics, the National Bureau set up a Price Statistics Review Committee under George J. Stigler's chairmanship and in 1960 submitted to the Bureau of the Budget a report, The Price Statistics of the Federal Government, which was also published as a print of the Joint Economic Committee. Among other studies undertaken at the suggestion of government agencies are The National Economic Accounts of the United States, a report requested by the Bureau of the Budget and printed by the Joint Economic Committee in 1957; and Measuring the Nation's Wealth, a report presented by the Conference on Research in Income and Wealth to the Joint Economic Committee in 1964.

The National Bureau has also utilized its conference procedures to investigate problems of common interest to itself and government agencies. For instance, in response to an invitation by the Board of Governors of the Federal Reserve System, the Bureau in 1956 organized a Conference on Consumer Instalment Credit to bring into focus and fruition much of the research in that field being done by scholars of special competence at various institutions. The results were published by the Federal Reserve Board. A Conference on the Measurement and Interpretation of Job Vacancy Statistics was held in 1965 in response to a request by the Secretary

of Labor that the Bureau assist in promoting research on measuring job vacancies. The conference was financially assisted by the Department of Labor and brought together economists and others from government, universities, research institutions, trade unions and business enterprises. The National Bureau published the proceedings.

Pioneering work by the National Bureau has contributed to the development of concepts and measurement methods that have been further refined by government agencies which now publish statistical series periodically, including:

--- estimates of gross national product and national income, by the Department of Commerce;

--- leading indicators for use in forecasting business conditions, by the Department of Commerce;

--- estimates of labor productivity, by the Department of Labor;

--- estimates of the flow of funds, saving and investment, by the Federal Reserve System;

--- statistical series on consumer credit, by the Federal Reserve System;

--- measures of consumer purchase probability for autos and other durables, now used in surveys by the Bureau of the Census.

Financial Support

In its fiscal year ending June 30, 1969 the National Bureau expended $2,070,863 on research and related programs. Its current income was $1,813,258. The deficit of $257,665 was financed by drawing on the principal of sustaining funds.

The work of the National Bureau is supported in part by grants for particular studies from philanthropic foundations, government agencies, and business associations; in part by investment income on capital-sum grants from foundations; and in part from unrestricted or general-support contributions and subscriptions from companies, banks, labor organizations, foundations and individuals. Minor amounts of income are received from the sale of publications and from subscriptions of libraries, faculty members and students.

From its start in 1920 the National Bureau has had yearly financial assistance from business firms and individuals who believed that basic economic research and efforts to improve factual understanding of the operations of the economy were worthy of support. Over the years the number of these supporters has grown to about 300, including labor organizations, trade associations, and foundations. These contributing sbuscribers pay from $100 to $20,000 each per annum and in the aggregate provide one-fifth to one-fourth of the National Bureau annual income. These contributing subscribers, as well as other subscribers, receive all National Bureau reports as they are published.

From time to time other organizations and foundations have contributed unrestricted funds for the general support of the National Bureau's current operations. In recent years current general-support grants have been received from the American Bankers Association, the Richard King Mellon Foundation, the Scherman Foundation, and the Twentieth Century Fund. The International Busines Machines Corporation has also contributed computer time which has been utilized by virtually all National Bureau projects. Dun & Bradstreet, Inc. has contributed computer tapes of data on business firms for general statistical analyses in connection with Bureau studies.

About one-fourth of the National Bureau's current support is derived from interest and dividend income on capital or sustaining-fund grants. Several of the major foundations have assisted the Bureau's work with long-term general-support grants to enable coninuity in research operations and to lessen reliance on year-to-year grants and contributions. The first of these was a $2,000,000 grant from the Rockefeller Foundation in 1952, under which the income could be used but the principal was to be maintained inviolate for ten years, after which both principal and income were available for general purposes. Long-term, general-purpose grants have also been made of $1,250,000 in 1955 and $2,500,000 in 1959 by the Ford Foundation; of $100,000 in 1964 by the Falk Foundation; and of $250,000 in each of 1968 and 1969 by the Alfred P. Sloan Foundation. The National Bureau utilizes the income from these sustaining funds for current operating purposes and draws on the principal to meet current operating deficits.



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The single largest source of National Bureau income is comprised of grants of restricted funds. These are grants or grant contracts from government agencies, foundations, businesses, or trade associations which support particular National Bureau projects or programs according to terms set forth in the grants. For example, the National Science Foundation has awarded a two-year grant of $79,000 to assist in the support of the conference programs of the Universities-National Bureau Committee on Economic Research and the Conference on Income and Wealth. The Public Health Service of the Department of Health, Education and Welfare has awarded a four-year grant of $442,085 to support studies of the economics of health. The Department of Housing and Urban Development has awarded a grant contract to provide $229,260 to assist in financing a study of urban land use as affected by transportation system improvements. In connection with the Institutional Investors Study, the Securities and Exchange Commission has awarded a contract to provide $68,000 for an updating of National Bureau studies of the flow of funds and national balance sheets. The Carnegie Corporation of New York has made a grant of $250,000 for studies of the economics of education. The American Bankers Association has provided a three-year grant of $150,000 for studies of banking structures and performance of services to business and consumers. A common feature of those grants is that they provide current income to the National Bureau only as expenditures are incurred within the grant terms. These include provisions for the type of expenditures on a project that may be borne by the grant or must be borne by general funds of the Bureau. Grant funds not expended according to grant or contract terms within the specified period are either not received or revert to the grantor.

Possible Treatment as a Private Foundation

Despite the diversity of the National Bureau's support and the public character of its operations, it appears that the definitional rules now contained in H.R. 13270 could result in the National Bureau being classified as a private foundation. If this were to occur, the capacity of the National Bureau to perform its nonpartisan and impartial research functions would be seriously impaired.

The imposition of a 7½ percent tax on investment income would reduce funds available for research and educational purposes by about $40,000 a year. Much more serious would be the loss of income and support from foundations on which the National Bureau has relied for many years. As a private foundation, the National Bureau would not be a qualifying distributee for grants from other private foundations. If these grants were discontinued, as they undoubtedly would be under the new tax rules, the National Bureau's current income would be reduced by one-fourth or more, and its current operations, which have been conducted with deficits in recent years, would have to be commensurately curtailed.

The operation of the National Bureau has depended upon the guidance and active participation of distinguished, public-spirited men who have served as members and directors of the corporation without pay. Under the proposed treatment, directors and officers of an organization classified as a private foundation would be subject to severe tax penalties if the organization were found to have violated rule about self-dealing improper

investments, taxable expenditures, or filing of tax returns. Although we would not expect the National Bureau ever to be involved in such violations, we are concerned about the effect the possibility of violation and penalties may have on the willingness of able and outstanding men to serve upon our Board.

If the National Bureau were construed to be a private foundation under the new definitions, it probably could modify its program and seek different methods of financing that would then qualify it for exclusion from the private foundation class. But this would involve disruption and inefficiencies in operations, and would henceforth require continuing concern to tailor operations and to find sources of support in the light of tax considerations rather than concentrating simply on the conduct of a research and educational program.

Clarifying the Classification of Private Foundations

It does not seem to us that an institution organized, operated and supported as the National Bureau has been for nearly 50 years could now reasonably be regarded and treated as a private foundation. The National Bureau has not engaged in the types of activities at which the tax reform proposals are directed. While it has had modest operating surpluses in some years, it has also had substantial deficits in others, and income has not been unreasonably accumulated. The directors, officers and grantors have not engaged in self-dealings or attempts to control business. The organization has not engaged in lobbying or electioneering. Grants to research fellows have been made on the basis of objective appraisals of scholarly qualifications and research potentials.

Yet it is not entirely clear in what classification of tax exempt organizations the National Bureau may fall under the proposed tax revision. The definitions of private foundations and operating foundations in H.R. 13270 are in terms of "support", "gross receipts", and "income", and in proportions thereof. Application of the definitions will depend to a considerable extent upon interpretations of these terms. A number of points in the definitions are of concern to us because of the manner in which they may apply to organizations in our circumstances.

Under the proposed Section 509 of the Internal Revenue Code, organizations would not be classified as private foundations if in general they normally received more than one-third of their support from specified sources and did not receive more than one-third of their support from gross investment income. If the National Bureau's income from sources other than investments is regarded as support for its research operations, then the general rule would appear to exclude the National Bureau from the class of private foundations. However, limitations on the amount of support permitted from any one person could work harshly against organizations in our situation. Among the items eligible to be included in support of an exempt organization are gross receipts from admissions, sales of merchandise, or performance of services, if these are not from an unrelated trade or business activity. However, the amount of eligible receipts in any taxable year from any one person is limited to one percent of the organization's support. If as a first approximation all of the National Bureau's income in its fiscal 1968-69 year were regarded as support, then gross receipts from performance of services in excess of $18,000 from any one person would have been eliminated from the type of support needed to qualify as other than a private foundation. In the application of the one-percent test, the interpretation of the terms "person" and "gross

of this income ineligible for the support needed to qualify for

receipts from performance of services" would be highly important. Is a business corporation, or the Carnegie Corporation of New York, the American Bankers Association, or perhaps even a government agency, to be regarded as a person for purposes of this test? Much of the National Bureau's income is derived from restricted fund grants in support of particular studies. If these portions of income which are received from foundations, corporations, trade associations or government agencies were to be construed as gross receipts from persons for performance of services, the disallowance of the excess over one percent of support in each case would seem to render much exclusion. The remaining receipts from grants, contributions, gross receipts on sales or performance of services might then be less than one-third of total support, and the National Bureau would apparently be classed as a private foundation.

The rule provided by the proposed Section 509 for exclusion of an organization from the private foundation class is also subject to a limitation with respect to disqualified persons. To meet the exclusion test, more than one-third of the organization's support must come from certain sources but these cannot include persons who are disqualified with respect to the organization. It might be assumed that the intent is to rule out support from persons who may be realizing some undue advantages from their support of a tax exempt organization. But the way in which the proposed rules would appear to apply to an organization like the National Bureau could create a large, and perhaps unintended, class of disqualified persons.

A disqualified person, as defined in Section 4946, includes a person who is a substantial contributor to the foundation or an individual who has certain interests in a corporation which is a substantial contributor to the foundation. The term "substantial contributor" means a person who is described in Section 507 (b) (2) as any person who (by himself or with his spouse) contributed more than $5,000 to the private foundation in any one calendar year.

Just how this set of proposed rules would be applied is not entirely clear, but a plausible interpretation might make it difficult for the National Bureau to qualify as other than a private foundation under the rules. Apparently any person who contributes more than $5,000 in a year could be disqualified, including individuals, corporations, and foundations. Whether a government agency such as the National Science Foundation which contributes substantially to the support of certain programs would be regarded as a disqualified person seems more questionable. In any event, it appears that a large proportion of the National Bureau's receipts from grants and from contributing subscriptions might be disqualified, and it would be doubtful whether the remaining qualified support could be one-third of total support.

While the National Bureau obtains its support from a number and diversity of sources, its situation is different from tax exempt organizations which have support from thousands of persons such as community chests, the Boy Scouts or the March of Dimes, or which obtain receipts from thousands of persons for the admission or the performance of services such as museums or symphony orchestras. The manner in which size limitations on grants, contributions or receipts for performance of services are interpreted could make the rules for exclusion from private foundation status of no avail to organizations like the National Bureau.

There are also questions of whether the National Bureau could qualify as an "operating foundation" under the terms set forth in the proposed Section 4942 (j)(3). We would presumably qualify under the first rule provided by Subsection (A) since substantially all of our income (and often more) is expended in the active conduct of research and educational activities. We would presumably not qualify under (B)(i) since substantially more than half of the assets are not devoted directly to such activities; the assets provide investment income and thus indirectly support our research functions. Whether we would qualify under Subsection (B)(ii) would again seem to depend upon interpretation of terms. To qualify, substantially all of the support (other than gross investment income) should normally be received from 5 or more exempt organizations or from the general public. In some years, as noted above, significant portions of the support for National Bureau projects have come from government agencies. Can this support be construed as coming from exempt organizations or the general public? If not, perhaps the National Bureau could not qualify as an operating foundation. Or if support for programs should shift over the years from private foundations to increasing support from the National Science Foundation and other government agencies, would this mean that the National Bureau's status would shift from that of an operating foundation to that of a private foundation?

Would support for research projects received from business corporations or trade associations be deemed to be support from the general public for purposes of Section 4942 (j)(3)(B)(ii)? If not, perhaps the National Bureau could not qualify as an operating foundation on these grounds. A good deal would depend here on the meaning of support and whether the distinction between support and income used in existing Section 170 (b)(1)(A)(vi) would perhaps be deemed to apply under Section 4942.

We urge that due consideration be given the broad character of the structure and operations of institutions like the National Bureau, and that clear distinctions between these types of institutions and private foundations be provided in the proposed tax revision.

# Social Science Research Council

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## SUMMARY

**Statement on Tax Reform Bill (HR 13270)**

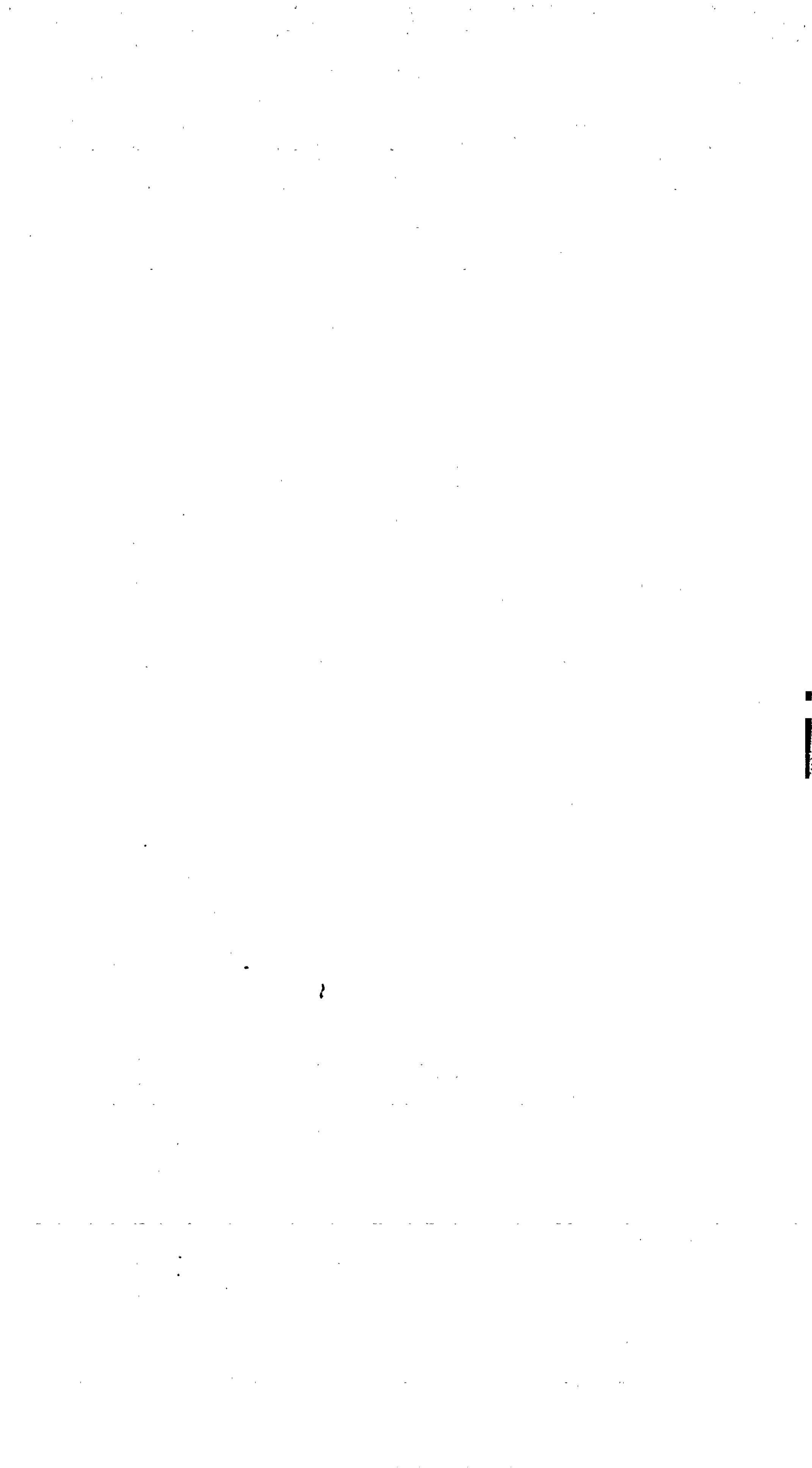
**Committee on Finance, U.S. Senate**

**September 8, 1969**

HR 13270 would seriously damage the programs of the Social Science Research Council by defining it as a private foundation (although it is not one) and thus effectively preventing it from receiving grants from the private foundations (Carnegie, Russell Sage, Ford, Rockefeller, Astor and others) upon which it is dependent.

The Council does not qualify as a private "operating foundation" because (a) it has no real assets and (b) it receives more than 25% of its income from a single source even though it receives income from at least 5 exempt sources.

The major effect of passage of the Bill in its present form would be to force the Council to reduce its programs sharply, possibly cutting out some activities altogether (because they are financed from a single large source) and certainly curtailing other activities (because of the severe reduction in scale necessitated by restricting the Council's income from private foundation grants). The net result would be to force the Council to make program changes which it should not make and which would not be in the best interests of advancing the social sciences.



STATEMENT ON TAX REFORM BILL (HR 13270)

To The

COMMITTEE ON FINANCE, U.S. SENATE

SEPTEMBER 8, 1969

Mr. Chairman, and members of the Committee, my name is Henry W. Riecken, and I am president of the Social Science Research Council. The Council is a private, nonprofit independent organization dedicated to the advancement of the social sciences, principally through improving research. The Council is a voluntary organization of social scientists. The membership of its board of directors and its working committees has included many outstanding members of successive generations of leaders in these disciplines. From its beginning in the 1920's the Council has been a place where social scientists from the United States and Canada--and, increasingly in recent years, from the rest of the world--meet to consult and collaborate, to explore the frontiers of their disciplines and the areas where interdisciplinary endeavors sometimes take root and flourish.

The majority of the Council's board of directors are elected by seven professional associations in the social sciences (in anthropology, economics, history, political science, psychology, sociology, and statistics) but the members serve as individuals, not as agents of these respective associations. The Council is not a federation of professional associations, and the Council's interest in the advancement of social science is not limited to the seven academic disciplines.

For example, the Social Science Research Council and the American Council of Learned Societies jointly sponsor a number of committees that aid research and training of Americans in language and area studies for Latin America, the Middle East, China, Africa, and Eastern Europe.

The two Councils are joined with the American Council on Education and the National Academy of Sciences--National Research Council in the Conference Board of Associated Research Councils which, for two decades, has been responsible for the management of much of the Fulbright-Hays program of educational and scholarly exchanges.

The Social Science Research Council would be very seriously affected by passage of HR 13270.

Under the current provisions of Sections 508 and 509, the Council would be classified as a private foundation and thus be made ineligible to receive qualifying distributions (grants) from private foundations. The Council is not a private foundation. Rather, it is heavily dependent upon private foundations for funds with which to carry out its purposes. These purposes are set forth in the articles of the Council's incorporation which, in 1923, established it as a scholarly association devoted to the advancement of research in the social sciences.

The Council works through a system of committees, composed of leading social scientists who give their time and energy to improving the state of knowledge on some particular topic. These committees hold research conferences and seminars, sponsor research projects and special training institutes. The committees

cover such diverse topics as economic growth and stability; the biological bases of social behavior; learning and the educational process; social factors affecting linguistic behavior; manpower, population and economic change; and a survey of the behavioral and social sciences, as well as the world area study committees already mentioned. Through several of its committees the Council awards fellowships for training young scholars in social science research. The funds for such awards have been provided by the Carnegie Corporation, the Rockefeller Foundation and other private foundations.

In effect the Council functions by joining private foundation funds with professional talent to facilitate scholarly progress in the social sciences. This principal source of the Council's support would be cut off if it were classified as a private foundation.

Furthermore, it seems that the Council could not qualify as an "operating foundation" as defined in Section 4942. It has no real assests such as a building or land that it could "devote directly" to the activities for which it was incorporated. The Council does, of course, devote all of its income to those purposes, and it usually receives most of its income from 5 or more exempt organizations. For example, in 1968-69, it received income from Carnegie Corporation, Ford and Russell Sage Foundations, Rockefeller Brothers Fund, and the Foundation's Fund for Research in Psychiatry.

In this same period, however, it received more than 25% of its income from one Foundation (Ford). While the amounts received

and the sources themselves change from year to year, this pattern of funding has been characteristic of the Council's support for several years.

The reason for this pattern is that the Ford Foundation is able and willing to fund programs which the Council considers important to the development of social science, on a scale which is required by modern scientific methods, whereas other foundations are not. The Ford funds play an indispensable role in the Council's current pattern of activities. The Council cannot carry on its programs with its own funds alone (which, incidentally, came originally from private foundation gifts).

Thus, the definitions offered in this Bill grip the Council like a vise. If it is defined as a private foundation, it must either reduce its programs about 75 percent of their present level (virtually equivalent to going out of business); or reorient its activities so as to obtain substantially all of its funds from the federal government. Such a reorientation would undoubtedly also mean changing the basic nature of its programs, abandoning activities which the Council believes are important.

Alternatively, the Council could try to conform to the definition of an "operating foundation" by reducing the amount of income it receives from its largest source (the opposite alternative to trying to increase support from other private sources is one that we have pursued assiduously for many years and will continue to pursue, but it seems unlikely to be crowned with sufficient success to meet the stipulations of HR 13270).

This would also mean stringent cutbacks in program.

In summary, these provisions of the Bill would strike so severely at the Council, and at many organizations like it, as to be virtually destructive. The difficulty lies in the failure of the proposed legislation to recognize the special nature of a number of scholarly organizations and learned societies. This group of organizations is actually part and parcel of our national system of higher education, related to the universities and colleges and to the professional associations. I take the Social Science Research Council as the example I know best. Its oard of irectors are virtually all university professors who give their time voluntarily to Council affairs. So are almost all the members of its many working committees. The activities of the Council are remarkably similar to what one finds at universities: planning, conduct and appraisal of pure and applied research in the social sciences; offering advanced training in special topics; holding seminars and scientific conferences; preparing and issuing scholarly and technical books and monographs; and, finally, awarding fellowships and research grants on an open competitive basis to qualified students and established scholars.

I respectfully urge the Committee to amend the tax-reform bill so as to recognize the essential continuity and similarity between the independent scholarly research organizations and learned councils on the one hand and the universities on the other. I suggest that the Committee amend Section 509 of the Bill so as to exempt these organizations from the "private foundation" definition as universities are exempt. I do not

here suggest specific language for such an amendment, although I should be happy to offer my ideas to the Committee and its staff or to make myself available for discussion of them.

If the Committee is unable or unwilling to accept such an amendment, I ask that it consider amending the definition of "operating foundation" by adding a third category of organizations, namely: independent scholarly research organizations or learned societies which expend substantially all the support they receive from private foundations within a limited time (perhaps one year or eighteen months) after the year in which the support is received, and for the purposes for which the organization or society was established. Again, I do not here suggest specific language for the proposed amendment but I shall be glad to make my suggestions available to the Committee or its staff at their convenience.

I earnestly hope the Committee will adopt an amendment to achieve the purpose I have urged: to preserve a significant and worthy class of private nonprofit institutions from inadvertent damage by a well-intentioned effort to reform taxation.

Other provisions of the Bill would have less effect upon the Council. Some we can applaud and affirm: the provision against self-dealing, the requirement that grants to individuals be awarded on an objective and nondiscriminatory basis, and the various provisions regarding commercial and business activity.

I would comment on the provision to tax income of private foundations only that it breaches the principle of tax exemption for eleemosynary purposes, especially education and research.

Once this principle is breached, there is no clear way to limit taxation. State and local taxes can easily follow, while the rate of taxation rises. This Bill could open the way to the destruction of one of the noblest social inventions of the western world. No one would quarrel with the worthy purpose of curbing the abuses which some so-called private foundations have committed, but the Bill presently cuts away much that is sound in trying to prune the rotten wood.

Finally, the section of the Bill which prohibits use of foundation funds through grants or projects for propaganda, partisan political activity, lobbying, voter registration drives, electioneering, etc. appears to be both laudable in intent and consistent with the line traditionally drawn between research and analysis on the one hand, and propaganda and influence on the other. But the provisions of this title need to be very carefully drawn so that they do not prevent fair comment on legislation and do not deprive Congress or administrative agencies of expert advice. It seems to me that the present draft would prevent a recipient of a Social Science Research Council grant from providing consultation to a Congressional Committee or an administrative agency if his advice were deemed to have arisen out of study which the grant had supported. Furthermore, the Council's staff and directors will have been given an impossible task of policing the activities of hundreds of grantees in order to be sure that we are not held responsible and subject to fines and penalties that would be crushing for anyone except the very rich.

I have tried to keep this statement brief, but I should

welcome an opportunity to clarify any of the points I have made to explain further the nature and functioning of the Social Science Research Council, and to respond to any questions the members of the Committee may have.

Summary of U. S. Conference of Mayors Statement
to the Senate Finance Committee

Much in the proposed legislation, H.R. 13270, regarding additional regulation of foundations is highly beneficial. Abuses of privileges accorded foundations cannot be condoned. But the U. S. Conference of Mayors believes that, in its present form, the bill contains a certain amount of overkill.

The greater burden of the restrictions in H.R. 13270 falls on recipients of foundation funds, rather than foundations themselves. Many recipient organizations will be greatly affected. Unless the provisions now in the bill are modified by the Senate, it is highly possible that this measure would require or persuade foundations to end their support of dozens of highly regarded and highly successful projects which touch on areas of national, state and local public policy. A vital resource would be lost to the American society.

The proposed measure, in short, would put a chill on foundation ability and willingness to undertake a wide variety of experimental programs which have been of considerable benefit to various groups in this country, cities among them. The effect of this chill may be far greater than the proposed 7.5 percent tax on foundations.

The U. S. Conference of Mayors urges the committee, if it decides that some levy on foundations is required, that it follow the suggestion for a fee or charge to foundations to pay the additional costs that will be incurred by the Internal Revenue Service audits of returns of tax exempt organizations to verify their compliance with the rules.



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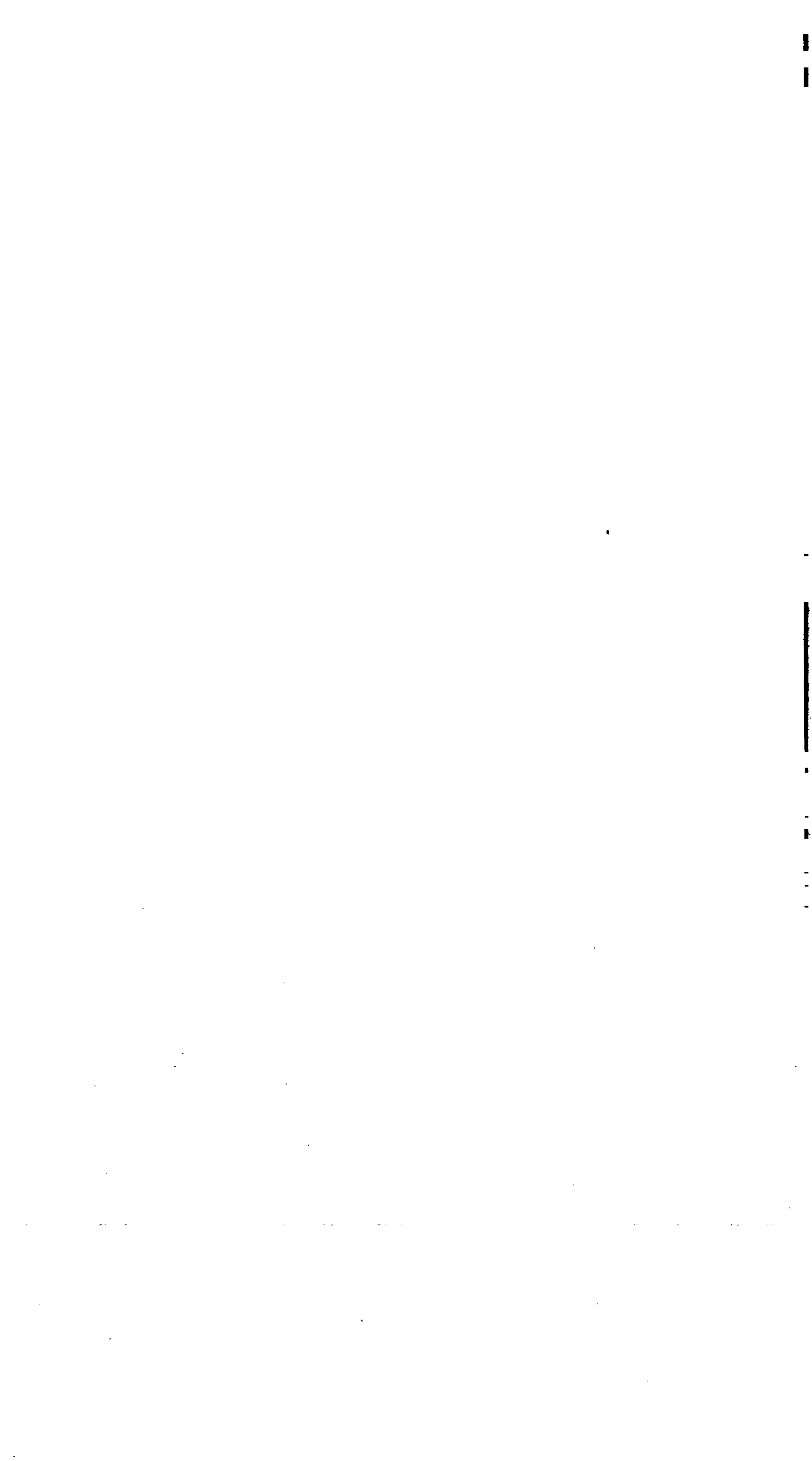


TELEPHONE: 638-6966
(AREA CODE 202)

UNITED STATES CONFERENCE OF MAYORS
1612 K STREET NORTHWEST
WASHINGTON, D. C. 20006

September 10, 1969

The Honorable Russell B. Long
Chairman, Senate Finance Committee
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

The United States Conference of Mayors appreciates this opportunity to submit a statement to the Senate Finance Committee on H. R. 13270 as it relates to revisions in the law governing private foundations.

There is much in the proposed legislation regarding foundations which is highly beneficial. Abuse of the privileges accorded foundations under present law certainly cannot be condoned. And the authors of this bill are to be commended for the inclusion of provisions which would eliminate these abuses.

But it appears to us that, in its present form, the bill contains a certain amount of overkill. The greater burden of the restrictions now written into the measure would fall not on the foundations themselves, but on the recipients of foundation funds. While our studies indicated that the functions of the National League of Cities and the United States Conference of Mayors as recipient of foundation funds will not be substantially affected, many other recipients will.

We think that the potential impact of the bill in its present form on the types of grants foundations would or might be precluded from making ought to be a subject of close study by this Committee. As the Committee knows, the bill would broadly prohibit foundation funds from being used in any manner which might influence legislation, either through contact with a legislative body or through public opinion.

Unless these provisions are modified by the Senate, it is highly possible that this measure would persuade foundations to end their support of dozens of highly-regarded and highly successful projects which touch on areas of national, state, or local public policy. These projects would die because they depend almost entirely on foundation funds. A vital resource for experimentation and innovation would then, we believe, be lost to the American society.

The present language in the bill, in short, carries the potential of putting a chill on foundation willingness to undertake a wide variety of experimental programs which have been of considerable benefit to various groups in this country -- cities among them.

For example, look at the health field. Foundation grants in areas which would be prohibited or highly questionable might include:

--grants for studies in family planning and population control. Nowhere is the problem of family planning and control more necessary than in the cities of America today. We need answers, and the answers can only come from such experimentation.

--sponsorship of professional conferences, attended by public officials, focused on the financial plight of the country's medical schools and the emerging crisis in the nation's system of medical services and medical education. It must be recognized that in terms of urban problems, the cost of services provided by the medical community is one of the highest priority. There is no one on whom the burden falls more heavily for the rising cost of medical services than the residents of the inner city.

In the field of education, the present language of the bill would either prohibit or put in the highly questionable category such programs as grants to public television stations or networks for discussion programs on topics which are, or may soon become, the subject of legislation.

These are random examples. But the fact is that these are activities whose legitimacy the foundations themselves view as jeopardized by the House bill. This view gives some indication of the chill that can settle over the willingness of foundations to fund programs of social significance.

Turning to some other areas of pressing concern to public officials at the local level, the pending legislation might prohibit or seriously curtail such programs as:

--activities of the Conservation Foundation to encourage restoration of clean rivers, reduction of air pollution, and support for regional planning and conservation.

--the program of the National Audubon Society, whose monthly magazine has recently focused extensively on environmental problems raised by the use of DDT and other pesticides.

--support of a program on "law and the social order" sponsored by the American Bar Association, and the American Assembly.

--grants to bar associations to strengthen procedures in juvenile courts or to promote organized legal services for the poor.

--support for the activities of Urban America, Inc., which assist in developing public policies and stimulate action to improve the quality of life in the cities, particularly in the area of housing.

These, we believe the Committee would agree, have been beneficial programs. Yet, as mentioned earlier, each of these would either be prohibited by the bill, or would be put in the highly questionable category.

On top of this, the 7.5 percent tax on foundations which is provided for in the bill would remove millions of dollars annually from the total available for private philanthropy. To the extent that these funds flow into cities and into programs designed to help cities cope with urban problems, this would put increased pressure on already-skimpy city budgets for the funds to deal with these problems.

In addition, the bill in its present form would jeopardize existence of a great many non-profit corporations which depend on foundation funds. It is our belief that this impact would come in two ways: one, through the tax, which would make less foundation money available and, secondly, through a general chill that the bill would cast over all foundations in terms of what programs or organizations they would be willing to fund. Instead of being willing to finance activities of an innovative and experimental character, it seems to us that the effect of the bill will be to make foundations extremely cautious in their funding operations. The effect of this will be felt by people, programs and institutions across the land. Indeed, this chilling effect on foundations from the restrictions now in the bill may be far more extensive than the proposed 7.5 percent tax.

The net impact, we believe, will force a greater reliance than ever before on the ability and willingness of the Federal Government to finance programs for social progress. Either that, or these programs will never be undertaken. In either case, the real loser will be the American taxpayer; either he will bear the burden of increased taxes to pay for social programs now financed by foundations, or he will eventually pay a price for the loss of social programs through an increase in the very problems these programs now seek to cure or alleviate.

We respectfully call to the Committee's attention the views of Rep. Boland of Massachusetts in his floor remarks in the House on August 6 as a comprehensive analysis of some of the potential dangers raised by the provisions of this bill as they relate to restrictions on foundations.

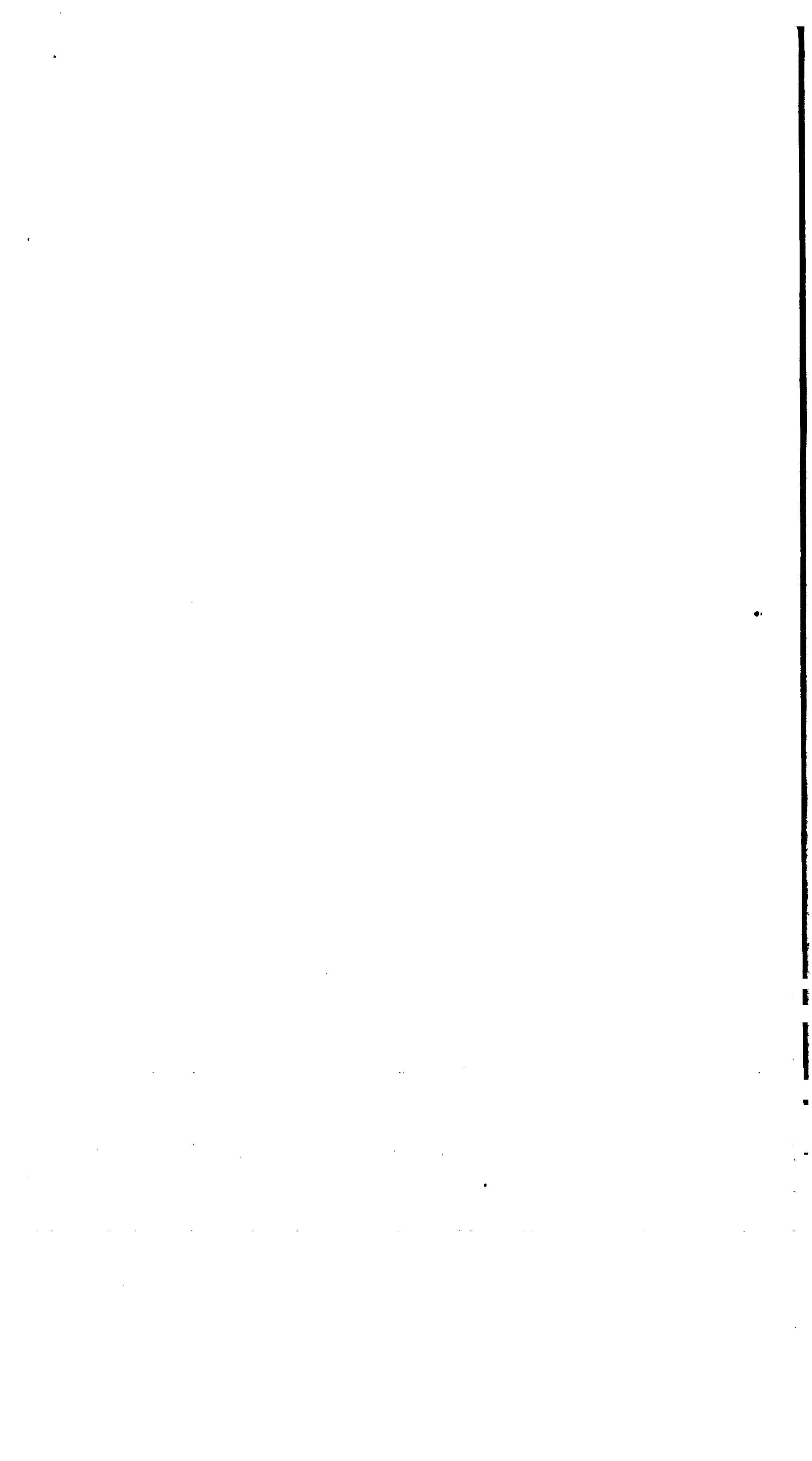
We would urge the Committee, if it decides that some levy on foundations is required, that it follow the suggestion of Reps. Bush and Morton of the House Ways and Means Committee for a fee or charge to foundations to pay the additional costs that will be incurred by the Internal Revenue Service audits of returns of tax exempt organizations to verify their compliance with the rules. It seems to us that this makes sense, and that what the present bill seeks to accomplish by placing added restrictions on foundations could be as well accomplished by more vigorous enforcement of present rules by the IRS.

The U. S. Conference of Mayors thanks the Committee for this opportunity to present its views.

Sincerely,

Jack D. Maltester
President
U. S. Conference of Mayors

9/10/69



STATEMENT BY MORRIS B. ABRAM, PRESIDENT OF THE FIELD FOUNDATION, INC., TO THE COMMITTEE ON FINANCE OF THE UNITED STATES SENATE

Summary of Principal Points

1. The proposed tax on foundation income is an unwarranted invasion of the resources of private charitable initiative.

2. The provisions requiring a foundation to make minimum distributions annually are sound in principle and indeed might be strengthened. However, the provisions which define the type of distribution which will qualify require revision. The definition of operating foundation should be expanded, and grants to foreign operating foundations should be treated as qualifying distributions.

3. The provisions which tax expenditures to influence legislation or the outcome of an election are not responsive to any important problem that cannot be adequately handled under existing law, and have the substantial negative result of discouraging the study of important problems.

4. The restrictions on voter registration programs do not draw a proper distinction between legitimate and illegitimate voter registration activities, and should be either deleted or substantially modified.

STATEMENT BY MORRIS B. ABRAM, PRESIDENT OF THE FIELD FOUNDATION, INC., TO THE COMMITTEE ON FINANCE OF THE UNITED STATES SENATE

This statement will discuss the provisions of the Tax Reform Bill of 1969, H.R. 13270, that curtail the activities of private foundations. My statement will not be concerned with those provisions of the Bill that are designed to preclude financial manipulation and abuse, such as the sections relating to self-dealing, "Clay Brown" type transactions, and the like, since I am in agreement with the general objective of those sections, and am confident that whatever technical problems remain in those provisions will be satisfactorily disposed of. What I wish to discuss in this statement are the provisions of the Bill which, in my judgment, will adversely affect the ability of an important part of the private sector to conduct programs of important value.

1. Tax on Foundation Income. The proposal to levy a tax upon the investment income of foundations is, in my judgment, an unwise invasion of the capacity of private charitable initiative to do needed work. The effect of the tax is to take approximately 1/13th of the foundation income available for projects selected by private charitable enterprise and initiative, and to instead have those funds administered by government. While foundation trustees and government administrators alike

can make errors of judgment, it is my belief that the decisions made by private charitable initiative with respect to the application of foundation income will result in wiser and more efficient use of such income than if the income is, by taxation, transferred to government for disposition by legislators and bureaucrats.

As experiences with foreign aid, defense procurement, government-run poverty programs, and almost any other substantial government program show, government is simply not an efficient mechanism for putting money to good use, and should be resorted to only when there is no other available means of putting the desired funds to the desired use. In the present case, the private sector has, to the extent of the income generated by its resources, the capacity to put that income to good use, and will do so better, in my opinion, than government.

In concluding that the foundation tax is an unwise transfer of funds from private charitable initiative to government, I have considered the argument that the tax will pay for the policing of foundations by the Internal Revenue Service. I do not believe that this was regarded as a strong argument in support of the tax, in light of the fact that it is, as I understand it, far more than the cost of contemplated audits. Apart from the question of the magnitude of the tax, however, it seems to me that a tax on the funds that honest and responsible

foundations would otherwise devote to scholarships, medical research, and the like, is not a very sensible source of funds for policing violations of law by other foundations, any more than it would be a sensible source of funds for combating organized crime or policing any other problem area.

2. Distribution of Income. The provisions of the House Bill requiring qualifying charitable distribution of a foundation's entire income and, in any event, of an amount equal to a minimum return on the value of its assets, are integrally related to the question of whether a tax should be imposed upon foundation income. To the extent that foundations do not actively use their income for active philanthropic purposes, they would not be justifying their exemption from income tax or the tax benefits conferred upon their donors, and should be subjected to far more than the 7-1/2% tax proposed for foundations generally. Thus, I am strongly in accord with the general principle that foundations should be required to devote their income to active charitable endeavors promptly, and that the amount devoted to charity must, in any event, represent a specified rate of return upon the value of the foundation's investment assets. Moreover, I would favor increasing the required rate of distribution from 5% of such value to perhaps as much as 10% of value. The resulting invasion of corpus is not objectionable in my view because I do not believe that foundations

should exist in perpetuity. On the other hand, where foundations comply with applicable distribution requirements, and expend all their income for active philanthropic purposes, no justification for imposing a tax on the foundation's income remains.

While I agree with the general principle underlying the foregoing distribution requirement, I believe that the types of distributions which qualify toward meeting that requirement are too narrowly described. The decision of the House Bill not to treat grants to foreign operating foundations as qualifying distributions is a piece of xenophobia unworthy of a great nation. The definition of "operating foundation", grants to which are qualifying distributions, also needs reconsideration.

The definition of operating foundation requires that the organization, in addition to spending substantially all of its income, either devote substantially more than half of its assets directly to charitable activities or functionally related activities, or derive substantially all of its support, other than gross investment income, from five or more unrelated exempt organizations or from the general public, and not more than 25% of support from any one such organization. The "support" portion of this definition is in my judgment unrealistically restrictive, and unless revised would fail to accord operating foundation status to many valuable programs. The "assets" portion of the definition is not unduly restrictive if, as I

assume is the case, contributions received by the foundation and kept in bank accounts or invested in Treasury bills and the like pending use in the near future are treated as assets devoted directly to charitable activities. If this construction of the definition were not adopted, however, the number of unendowed foundations with valuable expertise and programs that could qualify as "operating foundations" would be extraordinarily restricted. In light of the importance of this point of construction, it seems to me that the language of the Bill should be clarified.

3. Influencing Legislation or Elections. The House Bill imposes a tax on foundations and their knowing managers upon amounts spent "to carry out propaganda, or otherwise attempt to influence legislation," or "to influence the outcome of any public election," other than through "making available the results of nonpartisan analysis or research." This provision of the Bill is directed at an unimportant problem, and is of trivial benefit in its affirmative impact. However, because of the imprecision of its language, it has the substantial negative impact of deterring foundations and their trustees from undertaking important work in areas of social concern.

The number of serious current problems studied in foundation-financed research and whose solution may be a matter of legislative or electoral concern is vast. The advocacy of a particular position or viewpoint is almost inevitable in such

research, and such advocacy is permitted under existing regulations so long as a sufficiently full and fair exposition of the pertinent facts is provided to permit an individual or the public to form an independent opinion or conclusion. (Reg. § 1.501(c)(3)-1(d)(3)(i)). The language of the House Bill, in contrast, leaves the foundation and its trustees exposed to the risk that such research or analysis, in expressing such a point of view, will be deemed "partisan." In light of the heavy penalties imposed on the foundation and its trustees for such violations, the House Bill provisions inevitably would discourage creative work on subjects which are of importance but which are controversial. The result will be a diminution in the extent of efforts devoted to solving some of our most difficult problems at a time when we can ill afford it.

For the reasons stated, the provisions referred to above do substantial harm. On the other hand, I do not believe that there is any basis for concluding that vigorous enforcement of existing law will be inadequate to prevent any serious abuse in this area. While existing law permits a de minimis involvement in influencing legislation, I do not believe the leeway thus permitted has resulted in abuses requiring a remedy which would have effects as adverse as the proposed House Bill provisions on the subject.

4. Voter Registration. The House Committee Report states that the Committee "has sought to steer an appropriate course between the need for wider registration and the dangers of nonresponsible dispensing of tax deductible and tax exempt funds for these activities." However, the Bill in fact gives short shrift to the need for wider registration. In order to avoid the Bill's general prohibition against foundation-financed voter registration programs, a program must meet, among others, two highly restrictive tests set forth in proposed Code section 4945(d): it must be conducted by an organization "the principal activity of which is nonpartisan political activity in 5 or more States," and substantially all of the organization's support must normally be received from five or more unrelated exempt organizations, with not more than 25% of such support from any one such organization, or from the general public.

The registration of citizens in order that they may vote is a vital part of our democratic system, and the proposal of the House Bill to curtail drastically foundation-financed voter registration activity is therefore seriously objectionable. Enforcement of the requirement of existing law that voter registration programs be nonpartisan would, in my opinion, be sufficient to prevent abuse in connection with voter registration activities. At a time when persons with deeply felt grievances are raising questions as to whether they should continue to work within our political system or should seek



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change by other means, the introduction of a new legislative restriction on the ability to work within the established democratic process cannot in my opinion be justified.

Moreover, even if further legislation were deemed necessary to prohibit partisan voter registration efforts, the House Bill prohibition goes far beyond that limited objective. The exception to the prohibition set forth in proposed Code section 4945(d) appears intended to distinguish between ad hoc voter registration programs which may be specifically related to a particular electoral situation, and nonpartisan programs which are regularly conducted in numerous communities throughout several states without regard to particular candidacies or elections, but rather on the basis of the presence of an unduly low proportion of registration among citizens. If this is the intent, however, the provisions of section 4945(d) are unduly restrictive.

Thus, the requirement that the organization be engaged principally in "political" activity is highly restrictive and serves no useful purpose at all. Indeed, the fact that the organization is primarily engaged in other bona fide charitable and educational activities is probably as good, if not a better, protection against partisanship than the requirement of the present Bill that the principal activity be "political." To fairly distinguish between responsibly conducted, nonpartisan voter registration programs, having a broad geographic scope,

and ad hoc program undertaken for particular partisan ends, it would be sufficient, in our opinion, to require simply that the organization maintain a program for the regular conduct of nonpartisan voter registration activities in five or more States.

In addition to an unnecessary requirement that the organization be principally political, section 4945(d) contains unnecessarily burdensome source of support limitations. As a practical matter, the requirement that no more than 25% of support come from a single organization is likely to curtail seriously the availability of foundation financing for broad-based, legitimate nonpartisan voter registration activities. The requirement of participation by at least five foundations is less onerous but may nevertheless present a serious problem for new efforts which are just being organized. So long as the requirements relating to regular, broad-based activity and nonpartisanship are met, I do not believe that any useful purpose is served by such rigorous source of support limitations. It would seem sufficient to protect the integrity of section 4945(d) that the organization not be organized by or controlled by any private foundation not meeting the requirements of section 4945(d).

Morris B. Abram

September 5, 1969.

did not have at least one grant amounting to more than a fourth of its total support. Moreover, we believe that this is appropriate and has not impaired our independence or objectivity in carrying out our programs. We, therefore, suggest two alternatives. First, that the definition of "private foundation" be modified to exclude organizations such as ours, thus making it simply a charitable organization, as organizations "testing for public safety" are. Second, that the definition of "operating foundation" be modified to include us unambiguously. The accompanying specific suggestions have been drawn up with the assistance of our legal counsel and would accomplish these purposes.

Respectfully submitted,

H. Rosenhaupt

H. Rosenhaupt
President

HR/bk

TESTIMONY SUBMITTED BY THE WOODROW WILSON NATIONAL FELLOWSHIP FOUNDATION TO THE FINANCE COMMITTEE OF THE UNITED STATES SENATE IN ITS HEARINGS ON THE TAX REFORM ACT OF 1969

DETAILED SUGGESTIONS

1) Amend Section 509(a) [Bill Section 101(a)] by striking the word "and" following the semi-colon in Section 509(a)(3)(C) and the period in Section 509(a)(4) and adding

"; and

(5) an organization whose principal activity since December 31, 1960, has been either the granting of scholarships or fellowships in ten states or more, or the selecting of candidates for scholarship or fellowship awards in ten states or more, provided, however, that an organization shall not qualify under this subsection unless during each year since December 31, 1960, it has been responsible for the granting of at least 100 such awards or the selecting of at least 100 such candidates."

Comments: Since the Congress has seen fit in Section 509(a)(4) to exclude from the category of private foundations organizations engaged in "testing for public safety" we propose that organizations such as ours, which are engaged on a national scale in selection of persons for scholarships and fellowships be similarly excluded. The above language could also be incorporated in the operating foundation section establishing it as a separate type of operating foundation.

2a) Amend Section 4942(j)(3)(B)(ii) by striking everything following "from" (on line 10) and substituting

"one or more exempt organizations which are not described in Section 4946(a)(1)(H) with respect to the recipient foundation, or from the general public."

2b) Amend Section 4942(j)(3)(B) by striking the period following "organization" (on line 16) in Section 4942(j)(3)(B)(ii) and adding

", or

(iii) which does not make a substantial portion of its grants to other exempt organizations and actively pursues the purposes for which it is organized and operated."

**STATEMENT OF SHELDON H. ELSEN,
CHAIRMAN OF THE COMMITTEE ON
FEDERAL LEGISLATION, ASSOCIATION
OF THE BAR OF THE CITY OF NEW YORK.**

On behalf of the Association of the Bar of the City of New York we want to bring to your attention certain problems which we see in those provisions of the Tax Reform Act of 1969 (H. R. 13270) which relate to private foundations. We believe that the bill is too vague and so restrictive of private foundations as to effectively hobble the foundation's social utility. It is the Association's view that, conceding past abuses of foundations by some, these are capable of legislative remedy, while leaving essentially intact the foundation's ability to function in a constructive manner. Those provisions in the bill which relate to foundation programs should not be enacted into law.

We believe that private foundations have made an enormous and salutary contribution to many phases of American life. The bill appears to be directed at abuses by those using the private foundation as a manipulative or tax avoidance device, including self dealing. We do not direct our remarks to those aspects of the bill, however, or to such relatively technical questions as those involved in the income distribution requirements. Nor is the Association so well qualified as some other organizations

to discuss with you the impact which the 7 1/2 % tax on investment income would have on proper and desirable charitable activities, through limitations of the funds available for grants. What does seem clear, however, is that many valuable social, scientific and cultural activities will be severely impaired by the proposed restrictions on foundation programs, and it is against these restrictions that we wish to speak.

Section 4945 provides penalties against private foundations which make grants "(1) to carry out propaganda, or otherwise attempt to influence legislation," §4945(b)(1). The bill further defines the prohibited activities to include:

> "(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", §4945(c).

A private foundation which makes such payments is taxed 100% of the amount so paid, and foundation managers who knowingly agree to such expenditures are personally liable for 50% of such amounts, jointly and severally.

If the bill's aim is against lobbying, it uses a steamroller to crush an ant. What is most serious is that an enormous number of valuable social projects are likely to be crushed at the same time. Almost any project which is alert to the needs of the day can be said to be attempting to affect public opinion, with the possibility that legislation may eventually be influenced. What is partisan or nonpartisan cannot be readily determined; nor is it desirable that reformers or others with a point of view should be deprived of foundation support. The term propaganda, moreover, can be applied to any use of facts or opinions to influence institutional change. The very vagueness of the bill's language, coupled with the in terrorem effect of severe penalties, both against the foundations and individuals running them, is likely to dry up foundation support for innovative activity. Nor is there any reason for creating a double standard for the lobbying activities of private foundations and other tax exempt organizations. We believe that the nation will be much the poorer if this provision is enacted.

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"other than through making available the results of nonpartisan analysis or research", §4945(c).

A private foundation which makes such payments is taxed 100% of the amount so paid, and foundation managers who knowingly agree to such expenditures are personally liable for 50% of such amounts, jointly and severally.

If the bill's aim is against lobbying, it uses a steamroller to crush an ant. What is most serious is that an enormous number of valuable social projects are likely to be crushed at the same time. Almost any project which is alert to the needs of the day can be said to be attempting to affect public opinion, with the possibility that legislation may eventually be influenced. What is partisan or nonpartisan cannot be readily determined; nor is it desirable that reformers or others with a point of view should be deprived of foundation support. The term propaganda, moreover, can be applied to any use of facts or opinions to influence institutional change. The very vagueness of the bill's language, coupled with the in terrorem effect of severe penalties, both against the foundations and individuals running them, is likely to dry up foundation support for innovative activity. Nor is there any reason for creating a double standard for the lobbying activities of private foundations and other tax exempt organizations. We believe that the nation will be much the poorer if this provision is enacted.

The bill also provides similar penalties for funds paid "(3) as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of subsection (e)," §4945(b)(3). Subsection 4945(e) provides:

> "(e) INDIVIDUAL GRANTS. - Subsection (b)(3) shall not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary or his delegate, if it is demonstrated to the satisfaction of the Secretary or his delegate that it constitutes a scholarship or fellowship grant at an educational institution described in section 170(b)(1)(B)(ii) or that the purpose of the grant is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, or other similar capacity, skill, or talent."

It is not clear whether this provision is intended to require that general procedures be approved in advance by the Internal Revenue Service or each individual grant. If the former, the provision may be workable but its meaning should be defined with greater clarity. If this provision means that individual grants must be cleared in advance,

one questions the wisdom of such an advance approval procedure, with its added cost and delays, which may seriously impede desirable foundation activity. Nor would Internal Revenue agents appear to be persons who would be appropriately vested with any discretion in deciding on individual grants. It would seem that bad faith awards can be policed under existing law. Nor is it clear what the word "nondiscriminatory" means in this context.

Proposed new section 4942 would tax private foundations failing to make so-called qualifying distributions of income. Qualifying distributions are defined in section 4942(g) and include distributions to "public" charities, direct expenditures for charitable activities, and amounts spent to acquire assets to be used for charitable purposes. The term "qualifying distribution" also includes a distribution to an "operating foundation" defined in section 4942(j)(3).

The tax on the failure to distribute income ostensibly is a substitute for the existing rules relating to unreasonable accumulations, but perhaps what is really intended is to curtail the growth in the size of foundations. Provision is made in the bill for "certain set asides" but whether this will prove administratively workable is subject

to question. Program planning and flexibility will undoubtedly be adversely affected by the approach taken in section 4942.

The definition of operating foundation found in section 4942(j)(3) is intended to cover organizations that carry out specialized programs and which spend substantially all their income each year. The Committee report indicates that certain museums, horticultural and recreational areas are provided for through the "asset test" set forth in section 4942(j)(3)(B)(i). However, it is not clear what is meant by "assets". Perhaps the term includes current contributions, but there is a definite ambiguity in this regard.

The definition of operating foundation is also intended to include so-called special purpose foundations, including "learned societies, associations of libraries and organizations which have developed an expertise" in certain substantive areas. (See Committee Report, page 42.) It is clear, however, that the definition, as drafted, will exclude a number of highly worthwhile organizations which might be considered as meeting the description set forth in the Committee Report. For example, the support test found in section 4942(j)(3)(B)(ii) requires that substantially all (85%) of the organization's support (other than investment income) must normally be received from 5 or more

independent exempt organizations, or from the general public, and not more than 25% of the support may be received from any one such exempt organization. Under this test, an organization which receives more than 15% and less than 33 1/3% of its support from a governmental unit could not qualify as an operating foundation, unless the term "general public" were expanded to include governmental units. Under existing law, the terms "governmental unit" and "general public" are separately defined.

Some organizations that might properly be considered as operating foundations are supported by grants from large individual contributors who could not be considered members of the general public. The receipt of substantial contributions from individuals prevents such organizations from meeting the support test and, of course, if the support test is not met, such organizations cannot expect to receive contributions from large private foundations such as The Ford Foundation or The Rockefeller Foundation because such contributions would not be considered qualifying distributions. In short, the effect of defining operating foundation in terms of support sources goes far beyond what was intended and undoubtedly will exclude a number of very worthwhile organizations from the definition. This, in turn, will reduce very substantially the support such organizations receive from private foundations and will bring about a curtailment of valuable programs.

Section 4945(b)(4) in effect prohibits a grant from one private foundation to another private foundation unless the granting foundation exercises "expenditure responsibility". This term is defined as follows:

> "(f) EXPENDITURE RESPONSIBILITY. - The expenditure responsibility referred to in subsection (b)(4) 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 the Secretary or his delegate."

These requirements clearly are unduly onerous. In particular, the requirement that the granting foundation verify the accuracy of the grantee's reports perhaps requires the grantor to audit in detail every single expenditure made by the grantee.

These penalties apply, finally, against amounts paid: "(2) to influence the outcome of any public election (including voter registration drives carried on by or for such foundation)," §4945(b)(2). There are exemptions for an organization:

"(1) which is exempt from taxation under section 501(c)(3),

"(2) the principal activity of which is nonpartisan political activity in 5 or more States,

"(3) 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,

"(4) substantially all of the support (other than gross investment income as defined in section 506(b)(2)) of which is normally received from 5 or more exempt organizations which are not described in section 4946(a)(1)(H) with respect to each other or the recipient foundation, or from the general public, and not more than 25 percent of the support of which is normally received from any one such exempt organization, and

"(5) contributions to which for voter registration drives are not subject to conditions that they may be used only in specified States, possessions of the United States, or political subdivisions or other areas of any of the foregoing, or the District of Columbia."

§4945(d).



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We believe that voter registration normally should be encouraged; registration is necessary to identify voters and prevent frauds, but it should operate as little as possible to deny a vote to otherwise qualified citizens. Thus programs which aid registration encourage participation in our system of representative government, and thus perform an important public and charitable function.

We recognize the possibility of abuse if foundation funds are used for the primary purpose of registering individuals who are deemed more likely to vote for particular candidates or issues. It is not clear how much partisan activity of this sort there has been, but in striking a balance we believe that legislation should resolve doubts in favor of encouraging registration, even at the risk of permitting some partisan activity, if need be. We believe that legislation could be narrowly drafted so as to strike at partisan abuse without endangering other registration activity, but until such more narrowly drafted restrictions are prepared we would favor the elimination of all restrictions in the voter registration area.

Insofar as the present bill does attempt to draw distinctions between partisan and nonpartisan voter registration activity, it still requires substantial reworking.

For example, §4945(d) provides that penalties shall not be applied where a foundation-financed voter registration program is conducted by an organization "the principal activity of which is nonpartisan political activity in 5 or more States". This provision seems to be an attempt to ensure that the program be of the broad-based, nonpartisan type. However, this basic limitation is accompanied by the seemingly unnecessary requirement that nonpartisan political activity must be the principal activity of the organization. It would seem that the fact that the organization is primarily engaged in other bona fide charitable and educational activities is probably as good, if not a better, protection against partisanship than the requirement of the present bill that the principal activity be "political". The 5 States requirement, moreover, would seem to be starting at the wrong end; we would favor a restriction which would be triggered on a finding that the expenditures were primarily designed to favor a particular candidate or party.

Another provision of proposed §4945(d) which seems unduly to curtail legitimate voter registration activities is the requirement of subsection (d)(4) that substantially all of the organization's support must normally be received from five or more unrelated exempt organizations, and that

not more than 25% of such support normally be received from any one such organization. As a practical matter, the requirement that no more than 25% of support come from a single organization is likely to curtail seriously the availability of foundation financing for broad-based, legitimate nonpartisan voter registration activities.

These are examples of problems in the present draft. As we have said we prefer that the problem of partisan activity be approached on a much narrower scale, so as to make sure that legitimate voter registration support is in no way endangered.

In conclusion then we believe that the entire set of limitations on program activities by private foundations should be deleted from the present bill. We are not opposed to carefully worked out and narrowly drawn legislation which may clarify any deficiencies in existing law to restrict clearly shown abuses, without endangering the much more important and socially valuable work which private foundations have supported in the past. The present bill is not so drawn, however, and its effect is likely to be so damaging to innovative and useful programs that we favor rejection of §4945 on taxable expenditures and the modification of §4942 to obviate the problems discussed above in connection with operating foundations. We do not take a position at this time on other sections of the bill.

Statement by Henry Strong
On Behalf of the Hattie M. Strong Foundation
Before the Committee on Finance
of the United States Senate
In Opposition to Certain Provisions
of H. R. 13270 Relating to Private Foundations

My name is Henry Strong. I reside at 5039 Overlook Road, N. W., Washington, D. C. I am filing this Statement in my capacity as President of the Hattie M. Strong Foundation, hereinafter sometimes referred to as the "Strong Foundation", with offices at 1625 Eye Street, N. W., Washington, D. C.

The Strong Foundation was incorporated in the District of Columbia on October 6, 1928, for the purpose of "the promotion of the welfare of society by assisting such religious, educational, charitable and philanthropic work or organizations as may be deemed worthy, and particularly, so far as practicable, to supply funds to young men and women of promise with which they may obtain adequate academic, technical and professional education." The incorporators were Hattie M. Strong, her son L. Corrin Strong and his wife, Alice T. Strong. Mr. Strong was President of the Foundation from its incorporation until his death in 1966. I was elected President in 1967. A list of the officers and past and present Trustees of the Foundation is attached. At present six of the eleven members of the Board of Trustees are unrelated to the Strong family. No Trustee has received or is receiving compensation for serving on the Board. There are four paid professional staff members.

Hattie M. Strong was the principal donor, contributing an initial block of 3,000 shares of Eastman Kodak stock worth $540,000 on October 1, 1928. She and her son, L. Corrin Strong, made additional lifetime and testamentary gifts to the Foundation totalling $544,663. Unsolicited gifts totalling $6,064.82 have been received from former beneficiaries of the Foundation's student loan program. The total amount donated to the Foundation from all sources is $1,090,727.82. Starting with this seed money, the Foundation has made loans totalling $3,035,697.11 to needy students and has distributed $2,205,413.06 in charitable grants. Its current investment portfolio is valued at approximately $12,000,000 as of August 31, 1969.

The Foundation's basic program is the administration of interest-free loans to American college students studying in the United States or abroad and to vocational school students in the Washington, D. C., area. Starting with 73 loans in 1928, the program has served a total of 3,222 students, of whom 970 are currently on the books in the amount of $1,137,400.20. Since 1928, only $119,326.00, or approximately 3.9% of the total amount loaned, has been written off as bad debts. Because of the general shortage of scholarship and student loan funding from public and commercial sources, the Foundation's college loan program is being expanded, and it is expected that approximately 200 new loans will be made for the coming academic year. All income of the Strong Foundation plus a portion of its principal is expended annually in support of the loan program and in the form of grants. Distributions for those purposes are budgeted annually at 4% of investment assets.

The Strong Foundation is proud of its pioneering work in the field of education assistance. Through successful management of its resources and dedication to its founder's aim of helping young men and women of promise to attain adequate academic, technical and professional education, it has enriched the lives of thousands of deserving students. I believe that the record of our Foundation demonstrates the type of significant and expanding contribution to society which can be and is being made by the vast majority of foundations.

I thoroughly endorse appropriate legislation and supervision to prevent abuse of tax-exempt status by any foundation guilty of such practices. However, I believe that the repressive tone of certain portions of H. R. 13270 does a great disservice to the overwhelming majority of individuals engaged in foundation work who are dedicated to public service. A number of the proposed taxes, restrictions and penalties will, if enacted into law, make it extremely difficult for foundations to perform their eleemosynary services and to attract and retain responsible and qualified staff ar board members.

I understand that most of the specific provisions of the Act to which the Strong Foundation has objections and which pertain to foundations generally will be discussed in detail by witnesses appearing before the Committee in coordination with the Council on Foundations, Inc. To avoid unnecessary repetition, I will allude only briefly to them in this statement. The Strong Foundation has, however, encountered difficulty with certain portions of the Act as they relate to our student loan program and I will deal with them in more detail.

SEC. 506. TAX ON PRIVATE FOUNDATION INVESTMENT INCOME

I am opposed to this tax as a matter of principle. The burden will in most cases inevitably be borne by foundation beneficiaries in the form of reduced distributions to charitable purposes. I see neither logic nor justice in thus singling out private foundations. I urge the Committee to eliminate this punitive feature of H. R. 13270.

SEC. 4942 TAXES ON FAILURE TO DISTRIBUTE INCOME

(e) Minimum Investment Return

The 5% figure for Minimum Investment Return is too high, particularly when expressed as a minimum requirement. The Strong Foundation considers that a 4% distribution constitutes a reasonable average annual figure for maintenance of existing program levels in the face of steadily rising operating expenses and costs of education -- two areas of vital concern to our Foundation.

(g) Qualifying Distributions Defined

Expenses of administering legitimate charitable programs should be included as a "qualifying distribution". Such operating expenditures are necessarily made in furtherance of the charitable purposes for which Sec. 501 (c) (3) exemption was granted. Our experience with student loans has clearly demonstrated that a continuing personalized relationship with each loan recipient is essential to the success of such programs, particularly in establishing fair and equitable repayment schedules, and virtually all of the administrative expenses of the Strong Foundation derive from the operation of this program. The failure to include administrative expenses as a "qualifying distribution" would appear

to penalize the more active and conscientious foundations and to encourage passivity and/or inadequate staffing and administrative control of programs. (An alternative solution would result if administrative expenses were made deductible in computing both "adjusted net income" and "minimum investment return".)

It is not clear whether dedication of investment income to the Strong Foundation's steadily expanding student loan program would be deemed a qualifying distribution under the provisions of either subsection (g) (1) (A) or (B). In accounting terms this would amount to transfer of income to capital and not "paid out". The revolving student loan fund is, however, capital which is used directly in carrying out the Strong Foundation's exempt purposes. Moreover, since our student loans are interest free, the revolving fund produces no income and in fact suffers a continuing repayment loss. This type of transaction should be specifically cited as a qualifying distribution under the terms of this definition.

SEC. 4945 TAXES ON TAXABLE EXPENDITURES

(b) Taxable Expenditures

There is no mention in H.R. 13270 of the type of interest free student loan program which the Strong Foundation administers. Although I assume that a fully repayable student loan under our loan program would not be considered an "individual grant" subject to the provisions of subsection (b) (3), I urge the Committee to clarify any doubt in that regard by expressly excluding such loans.

(e) Individual Grants

The Strong Foundation does occasionally convert an outstanding loan to a scholarship grant in severe hardship cases and has made a few individual study grants. I believe that the present procedures for accomplishing this would meet the requirements contemplated by this subsection. I am concerned, however, that the necessity for advance approval of procedures by the Secretary is susceptible to overly rigid interpretation and bureaucratic delays which could seriously impede, if not destroy, the ability to respond quickly and flexibly to changing community needs and cases of individual hardship. In my opinion, sanctions against violation of objective and nondiscriminatory criteria for making individual grants, established by the Secretary, should be substituted for the requirements of administrative prior approval.

(f) Expenditure Responsibility

All responsible foundations bear the obligation to ensure to the best of their ability that funds they distribute are used for the eleemosynary purposes intended. However, I believe that the provisions of this subsection place an undue policing burden on grant-making foundations. They would require greatly increased staff, with resultant decline in funds available for charitable purposes, and/or an unrealistic and probably unacceptable degree of direct foundation involvement in the operations of those recipient organizations administering active charitable programs. The practical effect of this requirement would be to inhibit grants by a private foundation even to an organization qualifying as an "operating foundation".

CONCLUSION

I greatly appreciate this opportunity to present the views of the Strong Foundation on this important and far-reaching legislation. I respectfully request that the Committee on Finances act favorably on the amendments to H. R. 13270 which have been requested in my statement. It is hoped that the tax reform provisions dealing with private foundations, as finally enacted, will not unduly hamper or restrict the important public service being rendered by legitimate foundations.

Respectfully submitted,

Henry Strong
President, Hattie M. Strong Foundation

September 5, 1969

Attachment A

HATTIE M. STRONG FOUNDATION OFFICERS

Henry Strong, President
5039 Overlook Rd., N. W.
Washington, D. C. 20016

Trowbridge Strong, Vice President
401 Woodbine Ave.
Norberth, Pa.

Cecilia E. Bowers, Secretary
930 Washington Building
Arlington Towers
Arlington, Va. 22209

Barbara B. Cantrell, Treasurer
7400 Oriole Ave.
Springfield, Va. 22150

Thelma L. Eichman, Asst. Treasurer
4219 Longfellow St.
Hyattsville, Md. 20781

Attachment B

## HATTIE M. STRONG FOUNDATION BOARD OF TRUSTEES


Mrs. L. Corrin Strong<br>
Whitehall Rd., R. D. #2<br>
Annapolis, Md. 21401

Mrs. C. E. Bowers<br>
930 Washington Building<br>
Arlington Towers<br>
Arlington, Va. 22209

Richard S. T. Marsh<br>
701 Folger Bldg.<br>
725 15th St. N. W.<br>
Washington, D. C. 20005

C. Peter Strong<br>
127 E. 73rd St.<br>
New York, N. Y.

Henry Strong<br>
5039 Overlook Rd. N. W.<br>
Washington, D. C. 20016

Robert W. Wilson<br>
929 E St. N. W.<br>
Washington, D. C.

A. B. Trowbridge, Jr.<br>
4111 Fairfax Road<br>
McLean, Va.

John N. Andrews<br>
2000 N. Adams St.<br>
Arlington, Va. 22200

Trowbridge Strong<br>
401 Woodbine Ave.<br>
Norberth, Pa.

Lew G. Coit<br>
3930 Connecticut Ave., N. W.<br>
Washington, D. C.

Dr. Bennetta B. Washington<br>
1200 19th St. N. W. #710<br>
Washington, D. C.

Attachment C

FORMER TRUSTEES OF THE HATTIE M. STRONG FOUNDATION

Paul Achilles, October 1928 - May 1938

Hattie M. Strong, October 1928 - June 1950

L. Corrin Strong, October 1928 - September 1966

A. B. Trowbridge, October 1928 - December 1940

Wilson M. Compton, December 1937 - March 1967

Bruce Baird, May 1945 - December 1960

J. Edgar Hoover, May 1945 - January 1953

Justice Harold H. Burton, October 1946 - October 1964

Mrs. Harlan F. Stone, October 1946 - November 1958

STATEMENT OF PETER L. SZANTON, PRESIDENT
THE NEW YORK CITY-RAND INSTITUTE
SUBMITTED ON BEHALF OF THE INSTITUTE TO
THE SENATE COMMITTEE ON FINANCE

September 8, 1969

As President of the recently established New York City-Rand Institute, I am submitting this written statement to express my concern about the potential effect which H.R. 13270, the tax reform bill which your Committee is now considering, might have upon organizations such as ours which are devoted exclusively to research and analysis of urban problems. This letter is prompted by what I believe to be an unintended but possible result of the enactment of legislation similar to that passed by the House of Representatives -- serious obstacles to the efforts of private non-profit organizations like the Institute to raise the support needed to continue their work on problems too long neglected in some of our major metropolitan areas.

The Institute is a non-profit corporation formed, in the language of its Certificate of Incorporation, "Primarily to conduct programs of scientific research and study, and provide reports and recommendations, relevant to the operations, planning or administration of the City of New York"; and secondarily to conduct similar activities for other levels or agencies of government. The Institute is composed of approximately 50 scientists and researchers, together with supporting personnel. Under contract with various agencies of the government of the City of New York, it is now actively engaged in attempting to identify and recommend to responsible City officials, effective and feasible solutions to current problems in the fields of health, housing, fire protection, police services, welfare, corrections, water pollution, and economic development. New York City itself is supporting this work at the rate of approximately $2.5 million annually, the Rand Corporation is contributing approximately $150,000 annually, and foundation support is providing an additional $300,000 annually.

The problems for such an organization would not be created by proposed restrictions on matters such as self-dealing or business investments. Nor would they result from an attempt to encourage distribution of income and devotion of assets to charitable purposes. Instead, the principal adverse effects could result from the classifications embodied in the bill which might restrict the availability of financial support. For example, if our Institute were classified as a "private foundation" under Section 509 but not as an "operating foundation" under Section 4942, it might be very difficult to raise the additional support needed to enable the Institute to carry out the purposes for which it was organized, since other foundations could not make "qualifying distributions" to the Institute and hence might be reluctant to make any distributions at all.

I believe that the work of organizations such as ours to find new answers to critical domestic problems in the field of urban affairs should be encouraged by the Congress, not jeopardized. I believe further that this can be accomplished in the context of H.R. 13270 and consistent with its purposes.

As indicated in the House Ways and Means Committee report, Section 4942 of the House bill is designed in part to prevent "grant-making" foundations from distributing their income to one another without the income being used for charitable purposes (p. 42). These distribution requirements were not intended, however, to apply to distributions from "grant-making" to "operating" foundations, such as museums, libraries, learned societies and organizations which have developed "expertise in certain substantive areas and which provide for the independent granting of funds and direction of research in those specialized substantive areas" (pp. 26, 42). The latter group of organizations were included as "operating foundations," according to the Committee report, because they "have developed an expertise which permits them to make effective use of the money through grant programs or otherwise" (p. 26).

The definition of "operating foundations" in the bill itself (Section 4942(j)(3)), is not well designed to

effectuate that intention, primarily because it embodies rigid fiscal criteria which may not, in many cases, have any relevance to the purposes or performance of the organizations affected. For example, it seems clear that our Institute is an "operating" foundation as described in the House Committee report -- it is an "operating" (as distinguished from "grant-making") organization; it has developed expertise in urban research and analysis; and, we believe, it can make effective use of distributions from other foundations in directing research and analysis in the area of its substantive expertise. Moreover, substantially all of its income is expended directly for its specialized purposes. (See p. 42 of House Ways and Means Committee Report.) Yet, the Institute may still fail to meet the rigid criteria of Section 4942(j)(3):

-- The Institute does expend substantially all of its income directly for the active conduct of the activities for which it was organized. But it may not at some future date meet the additional requirement either that substantially more than half of its assets be devoted directly to such activities, or that substantially all of its support be received from five or more exempt organizations not "disqualified" under the bill (but not more than 25% from any one such organization).

To point up the dilemma, which also must confront many organizations like ours, one might review the Institute's future plans in light of those two requirements. As a center for urban research and analysis, our primary assets are people -- professional engineers, mathematicians, economists, physicians, architects, sociologists and others, all of whom are devoted exclusively and directly to our chartered purpose. But personnel are not normally considered as assets in an accounting sense and hence we must look to other assets for satisfaction of the criteria in Section 4942(j)(3)(B)(i). Because of the nature of the Institute's work, we do not presently anticipate a significant investment in land or equipment. We do hope to obtain some permanent form of financial support, beyond yearly contracts with the City of New York, which will provide permanence and continuity to our



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work. But should the Institute succeed in obtaining such support, it might then fail to qualify as an operating foundation -- initially because the support might come from less than five organizations, and ultimately because (to the extent that they exceeded immediate operational needs) such resources would probably be invested to provide additional income while awaiting requirements for their expenditure and to insure some continuity for the Institute.

It is our hope that your Committee will agree that the impact of any tax reform legislation which may be enacted should be determined primarily by the nature and purposes of organizations like ours, rather than by inflexible fiscal standards which may permit adverse results unintended by the Congress. Accordingly, we would urge the Committee to consider the possibility of amending Section 4942(j)(3) to carry out the purposes expressed in the House Committee report by assuring that organizations like the Institute are not arbitrarily excluded from the category of "operating foundations" by the adoption of rigid economic criteria.

Alternatively, the Committee might, in light of the vital importance of research and analysis directed to the solution of urban problems, consider the possibility of excluding from the category of "private foundations" defined in Section 509, non-profit organizations which are organized and operated primarily for such research and analysis. This might be done in the same manner in which organizations devoted to "testing for the public safety" are now exempted by Section 509(a)(4).

To demonstrate the importance of not jeopardizing the continuing support of organizations such as ours, I would like briefly to review the background of the Institute, its activities, and its plans for the future.

The New York City-Rand Institute dates back to the Fall of 1967 when the City of New York and The Rand Corporation began exploring the possibility of focusing the analytical and research skills which Rand had developed primarily in the field of national security upon the complex problems facing a

major metropolitan area like New York. This resulted in formal contracts with the City, under which Rand staff members began working directly with City officials in attempting to solve major problems of fire protection, health services, crime control, housing and redevelopment, and to improve the effectiveness of City government operations in those fields.

Because of the initial success of this undertaking, and because it was clear that the complex and fundamental problems underlying the difficulties of the City could be adequately understood and attacked only through a sustained effort, it became apparent that a permanent organization for the analysis of urban problems should be established. The result was the formation in April of this year of The New York City-Rand Institute. The Institute is administered and staffed by personnel from The Rand Corporation and governed by a Board of Trustees jointly selected by the City and Rand. A listing of the Trustees is attached. In addition to continuing work on the problems outlined above, the Institute has undertaken studies of welfare, water pollution and economic development, and expects in the near future to initiate research in other areas, such as air pollution, transportation, and education.

In every field of inquiry, Institute personnel are called upon to define the problems facing the City, to assess the effectiveness of present efforts to deal with them, and to recommend to the responsible City officials alternative courses of action.

It may be helpful to detail some of the types of work the Institute is engaged in:

o <u>The application of new technologies</u>. In the course of analyzing fire protection in the City, a chemical engineer on the Institute's staff proposed experiments with the addition of minute quantities of long-chain polymers to water streams in fire hoses. Carried out by the Institute, the Fire Department, and a commercial producer of the polymers, the experiments showed that the additive dramatically reduced friction in the hoses, and as a result increased by 50 to 80% the amount of water discharged by the hoses and the distance the

stream would travel on leaving the nozzle -- without any increase in pumping pressure. The New York City Fire Department is now in the process of putting this result into operational use, and the Institute is attempting to respond to dozens of inquiries from other fire departments across the country.

A second technical study explored the use of devices which measure changes in the ionization of the atmosphere to detect not only fires but also smoke and smoldering conditions. It concluded that because of rapid recent improvements in this technology it may be feasible in the near future to install, throughout cities, devices capable of detecting fires at a very early stage and automatically sounding alarms both at the site and in fire department dispatching centers.

Other technical studies have advised agencies of the City government of the potential value of equipment which could automatically keep track of the location of all City ambulances, police cars and fire engines, and have set out a detailed method of evaluating a broad variety of devices which might reduce crime in high-rise housing.

o <u>The design of new procedures</u>. For the Housing and Development Administration new information systems have been designed and procedures recommended, which should enable the City to help arrest the process of deterioration in the existing housing stock by making it possible to determine whether particular problem buildings should be dealt with through building code enforcement, technical or financial assistance to the landlord, take-over by the City, or other measures.

For the Police Department a method of determining how additional patrolmen should be allocated to the various precincts in the City was designed. This system, operated on a computer, is capable of taking into account a wide variety of characteristics of individual neighborhoods -- population density, crime rate, number of street miles, arrest rates, and other factors -- in determining whether additional men should be assigned and in predicting some of the probable effects of such assignments.

The Institute has also recommended to the Police Department procedures which give promise of significantly increasing the ability of the Department to attract and retain members of minority groups.

o The proposal of new operating policies. In their initial work for the Police Department, Institute researchers described with new precision a problem long familiar to professional police administrators: the fact that at some times -- such as Friday nights -- requirements for police assistance might exceed the requirements of other times -- such as Tuesday mornings -- by as much as 500 or 600%, but that the number of men available during such peak periods was normally only 30 or 40% greater than at other times. The Institute recommended a variety of possible solutions to this problem, and is partially responsible for the City's decision to institute a so-called "fourth platoon" -- a major reallocation of police manpower which more than doubles the number of men available during evening hours.

The Institute has recommended to the Community Mental Health Department in New York policies which appear likely to improve the ability of mental health centers to effectively serve the particular populations in their own areas. And it is providing the Fire Department with a mathematical model capable of predicting the probable incidence of false and genuine alarms with sufficient accuracy to allow the Department to pre-deploy and re-deploy equipment on the basis of anticipated requirements.

o The development of new management methods. Together with each of the operating agencies of the City with which it has been working, Institute researchers are developing and refining those agencies' Planning Programming and Budgeting Systems. This work has involved assisting the agencies to specify their objectives, to identify the ways in which their budgets are allocated in terms of those objectives rather than in terms of conventional accounting categories, and to evaluate both the cost and the probable effectiveness of alternative policies and allocations. In this way the Institute has been assisting not

only in the analysis of particular issues, but in the improvement of the process by which many agencies of the City government routinely make decisions. Inquiries from a large number of other State and local jurisdictions for assistance of this kind have been made to the Institute.

In a variety of ways, then, the Institute is attempting to bring advanced scientific and analytic techniques to bear on problems of urban life and local government. Many of its more fundamental studies are long-range in nature and have not yet produced firm or usable conclusions. Much of its other work, however, has found immediate application, as it was designed to do. The City government's belief in the value of this work can be seen in the fact that, despite severe budgetary problems, New York is continuing to invest roughly $2.5 million annually in the continuation of this effort.

But while these City expenditures are significant -- indeed, they are unprecedented in American municipal history -- they cannot fully support the work which needs doing. The Institute, like other such organizations, must look to private sources to supplement the City's contributions. We believe, therefore, that one of the most significant questions now before the Senate Finance Committee is whether organizations like the Institute will be able to receive the additional support they need or whether they will be faced by legislation which could dry up their potential sources of support.

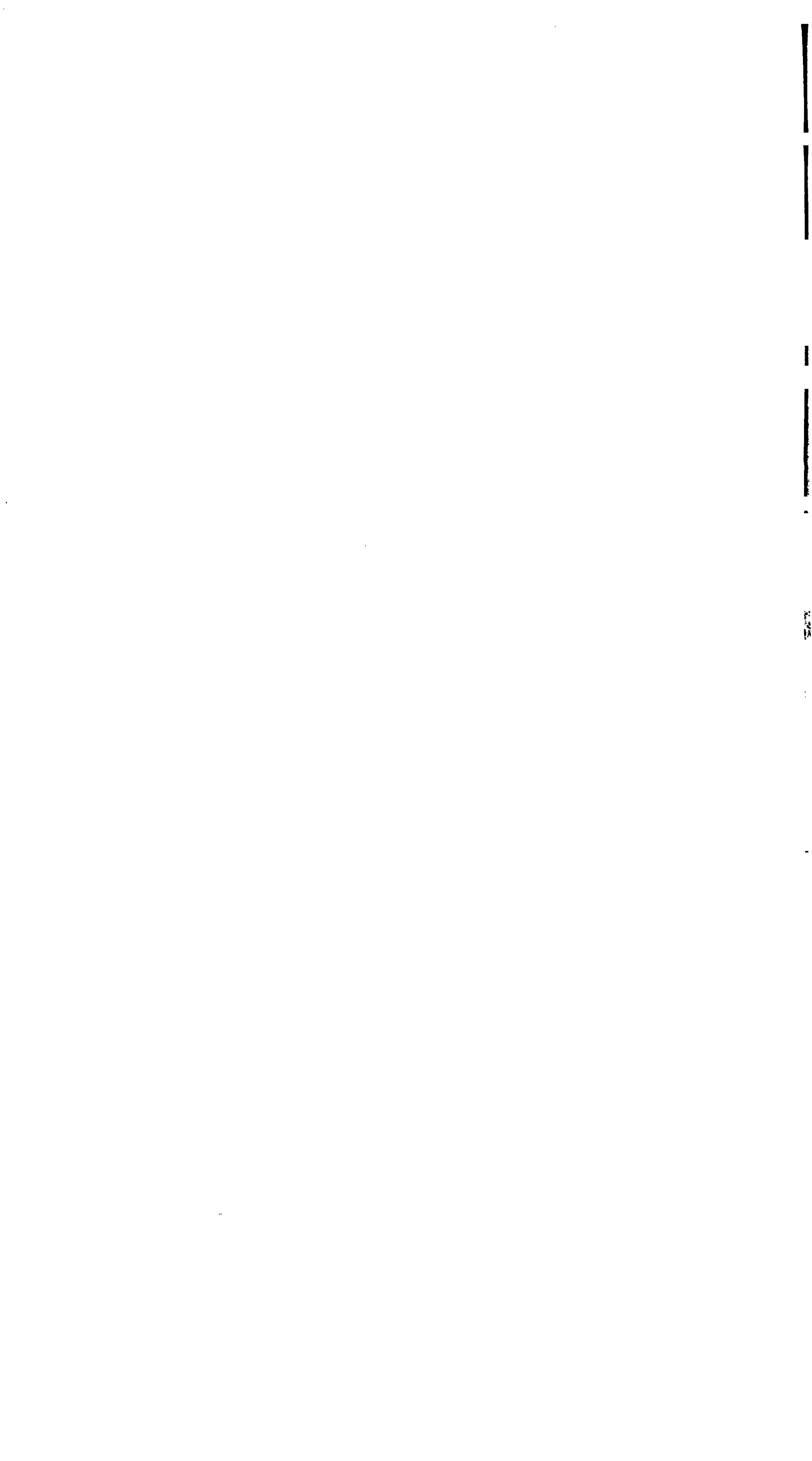
We are also troubled by the uncertainties which appear to be inherent in the language of Section 4945(b) and (c). Presumably all of the activities of the Institute which might be affected by Section 4945 are covered in the exclusion which permits "making available the results of non-partisan analysis or research." However, the vagueness of Section 4945(c) as to influencing legislation through "an attempt to affect the opinion of the general public or any segment thereof" or "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" is of some concern. Under some possible interpretations, this might interfere with the essential close working relations between the Institute and

public officials interested in the work of the Institute. It might also conceivably interfere with the ability of the Institute to respond to public inquiry concerning the results of its studies.

We would hope that, in light of the importance of the work being performed by the Institute and other similar organizations, these matters could receive the attention of your Committee. And we would hope that any legislation which might be enacted could be focused upon our purposes and our activities, rather than upon inflexible fiscal criteria which might impair our effectiveness.

The Institute would be pleased to assist your Committee and its staff should any further information concerning its purposes or activities be needed.

Attachment
Listing of Board of Trustees



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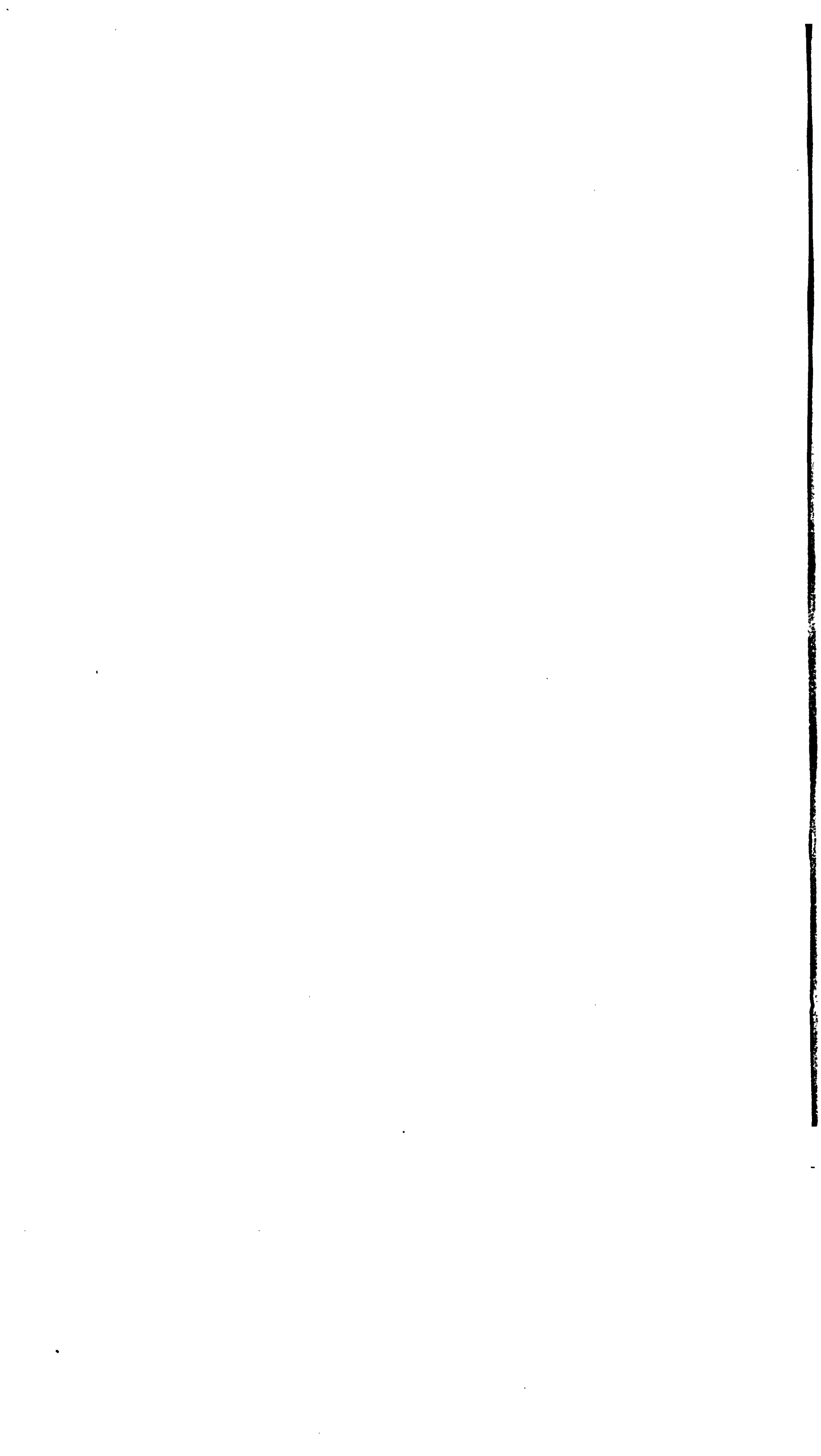

THE AMERICAN SOCIETY OF INTERNATIONAL LAW
2223 MASSACHUSETTS AVENUE, N.W.
WASHINGTON, D.C. 20008
265-4313
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## STATEMENT OF STEPHEN M. SCHWEBEL, EXECUTIVE VICE PRESIDENT, AMERICAN SOCIETY OF INTERNATIONAL LAW, SUBMITTED TO THE COMMITTEE ON FINANCE, UNITED STATES SENATE, ON THE TAX REFORM ACT OF 1969, H.R. 13270

The American Society of International Law, a professional and scholarly society whose purpose is "to foster the study of international law and to promote the establishment and maintenance of international relations on the basis of law and justice", was formed in 1906 and incorporated by Act of Congress in 1950. It is an organization open to public membership which has about 4,700 members in the United States and abroad. It receives its income from membership dues, the sale of publications concerned with international law -- most notably, the American Journal of International Law -- and from foundation grants. Grants by leading American foundations comprise a major part of the Society's resources.

The Tax Reform Act of 1969, as passed by the House of Representatives, places constrictions on foundation financing of education and research. In the Society's view, at least some of these restrictions are not desirable. H.R. 13270, if enacted in the form passed by the House, would present the Society with the following problems:

(1) It is difficult to ascertain under Section 509

whether or not the Society is a "private foundation."

(2) If the Society were to be treated as a private foundation, it would be obliged to conform to a set of legal rules designed to regulate foundations -- organizations whose purpose is to distribute money -- rather than professional societies.

(3) The 7.1/2% tax on investment income of foundations will reduce the amount of funds foundations have available for distribution to organizations such as the Society.

These problems will be discussed in turn.

The Definition of "Private Foundation" in Section 509

The Supplemental Report of the House Committee on Ways and Means on H.R. 13270 (House Report 91-413 [Part 2] at page 6) states that the intention of the Act is to exclude professional societies from the definition of "private foundation" in Section 509. That expression of intention is most welcome. It is the Society's hope that the language of the Act itself will express that intention. As it stands, however, the American Society of International Law finds itself on the borderline of the requirements that Section 509 lays down if an organization is not to be classified as a "private foundation."

Subsection (2)(B) of Section 509 does not pose an immediate problem for the Society, since only some five per cent of the

Society's income comes from its investments. But Subsection (2)(A) does pose a problem. Approximately one-third of the Society's support comes from membership dues, contributions, and subscriptions to publications. Over sixty per cent of the Society's support comes from foundations. The Ford Foundation alone provides about 45% of the Society's support at the present time. The Society also receives substantial support from the Carnegie Corporation of New York, the Henry Luce Foundation, Inc., and the Andrew W. Mellon Foundation.

Subsection (2)(A) of Section 509 does not make clear whether the words "gifts", "grants", and "contributions" include grants made by private foundations and whether there is any limit on the amount that may be contributed by any one foundation. The issue is important to the Society because not only large grants, but dues and small contributions in many cases come not from individuals, but from corporations, corporate foundations, family foundations, and other private foundations. If all membership fees, contributions, gifts and grants from private foundations should be excluded from the reach of Subsection (2)(A), the Society's income from sources listed in Subsection (2)(A) might fall at the present time below the one-third required to exclude it from the definition of a private foundation and, if this were not so now, that income might well fall below that requirement in the future. It may be asked whether the cross reference to Section 4946 and the cross

reference in the definition of "substantial contributor" in that section to Section 507(b)(2) mean that grants from foundations may be included within the calculation of one-third "public support" as long as the foundation does not contribute more than $5,000 and is not the largest contributor during any one year. We trust that the answer to that question is "yes". However, in that event, and for the purpose of the definition of "public support", the Society would submit that the figure of $5,000 in Section 507(b)(2) is too low. More fundamentally, it finds the requirement of Subsection (2)(A) that an organization receive more than one-third of its support from gifts, grants, contributions and membership fees, if it is not to be classed as a "private foundation," too high. The Society would certainly retain its character as a professional and learned Society even if, in a given year, it should receive less than one-third of its income from gifts, grants, contributions or membership fees, by reason, for example, of a growth in foundation support for its research work. Why, in that event, should it be classed as what it certainly is not, a private foundation?

The Society respectfully suggests that the requirement of receipt of more than one-third of an organization's income from gifts, grants, contributions, or membership fees -- excluding foundation grants of more than $5,000 -- to avoid classification as a private foundation be changed to more than twenty per cent. Alternatively, it is suggested that it might well be preferable

for the Act to embody a definition of a private foundation which states what it is, rather than what it is not, and which, by its terms, clearly excludes learned and professional societies whose principal function is not to disburse funds.

One method clearly to exclude learned and professional societies from the definition of "private foundation" would be to amend Section 170(b)(1)(B) expressly to include learned and professional societies, scholarly research organizations, and educational support organizations among the classes of organizations listed in that sub-paragraph that may benefit from the "30 per cent rule" regarding charitable contributions. This would assure that these organizations are excluded from the definition of "private foundation" in Section 509, since that section now expressly excludes 170(b)(1)(B) organizations. It would have the further virtue of rightly placing learned and professional societies and scholarly research organizations in the tax status accorded universities.

Problems Posed by the Application to a Professional Society of Regulations Designed to Govern Private Foundations

If, arguendo, the American Society of International Law were classified pursuant to Section 509 as a "private foundation," it would be presented with the task of conforming to requirements that are designed for organizations whose primary purpose is the making of grants for charitable purposes. Section 4942, for

example, contains requirements that foundations distribute their income. That section also provides that grants from one private foundation to another are not "qualifying distributions" and would have to be paid out of principal rather than income. If the Society were treated as a private foundation, it accordingly would be in an unattractive position to seek grants from foundations. This would seriously cripple the Society's program. "Operating foundations" are rightly excluded from these rules.

The Society would seem to qualify for an operating foundation under Subsection (j)(3)(B)(i) of Section 4942, although the meaning of that subsection is not exactly clear. We should like to note that more than 25 per cent of its support is received from the Ford Foundation. The Society respectfully suggests, in this latter regard, that the requirement of the immediately following Subsection (j)(3)(B)(ii) that not more than 25 per cent of an organization's support be received from any one exempt organization be changed to 50 per cent. Classification of the Society as an operating foundation would somewhat ease, though not solve, problems the Act in its current form is likely to pose.

Assuming that the Society were treated as a "private foundation," or as an "operating foundation," it would also have

to comply with the "self-dealing" and "taxable expenditure" requirements of Sections 4941 and 4945. In general, the Society already substantially conforms to these requirements. We should note, however, in connection with those sections, that government officials play an active role in the Society. Over 15 per cent of the Society's members are officials of government agencies or international organizations. Government officials serve on the Executive Council of the Society and participate actively in its study groups. They, like other members, contribute to and benefit from the professional exchange of views that takes place through publications, public meetings, and private study groups. We trust that such participation would not be construed as giving rise to "taxable expenditures" on the Society's part. We are reassured in this regard by the important reference in Section 4945 to "non-partisan analysis or research."

The Society publishes non-partisan, scholarly studies that it sponsors. Through meetings and publications, it provides a forum for the expression of many points of view. We trust that the legislative history of Section 4945 of H.R. 13270 will make clear that an organization that sponsors scholarly books and publishes a scholarly journal whose contents seek to influence the opinion of their readers, and which sponsors public meetings at which controversial subjects are debated and private meetings at which problems of the public interest are discussed,



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is not thereby "attempting to influence legislation" within the meaning of Section 4945, even if government officials are among the readers, the debaters, the auditors, and the discussants.

The Society has a long-standing, general policy not to take official positions, as a Society, on matters of public controversy. However, on rare occasion the Society has taken a position, for example, on a treaty pending before the Senate, and has made its views known to the Secretary of State and other Executive Branch officials, and to Congressional Committees. If treaties are treated as legislation within the meaning of the Act, it would appear that some of these actions might be "taxable expenditures" under the present provisions of Section 4945, even though that Section is designed to apply to organizations which lack a membership or constituency. Question may be raised as to the desirability of such provisions if they are not to exclude membership organizations.

If the Society were to be classified as a private or operating foundation, it would be subject to the 7.1/2 per cent tax on investment income which the Act prescribes. If the Society were required to pay a tax on its modest investment income, it believes that neither its interest nor the public interest would be served.

If the Society were to be classified as a private foundation, it would also be subject to Section 170(e)(1) and (3), as this section would be amended for the purpose of discouraging

the donation of appreciated property to private foundations. That provision could materially prejudice the Society's interests (unless the Society were treated as an operating foundation). For example, the headquarters it now occupies on Sheridan Circle came into the Society's possession as the result of a gift of appreciated property. This, and the considerations noted above, emphasize the desirability of the Act's making clear that a professional, learned membership society like the American Society of International Law is not a foundation within the meaning of the Act.

The 7.1/2% Tax on Investment Income

Whether or not the Society itself is classified as a private foundation, it is greatly concerned about the imposition of a 7.1/2 per cent tax on investment income of foundations. Such a tax will reduce the amount of funds available for distribution to organizations such as the Society, and to many other kinds of institutions which greatly enrich the national life and life abroad.

In the Society's experience, foundations are the most important source of income, for general support and for support of special projects which otherwise could not be implemented. Foundation support has been vital in the stimulation and realization of research and other scholarly and professional activity of high importance to the national interest. To reduce the amount of funds of foundations available for grants is to put a

brake on innovation and to prejudice the contribution which non-governmental organizations make to American life. American society has been characterized by an extraordinary vitality of citizens' organizations, of the "private sector," not only in universities and churches but in a host of other organizations which promote the public welfare. That vitality is part of the strength of American life, and should be nurtured, not impaired by the law.

In the Society's case, grants from foundations have permitted the Society to embark upon and operate a research program, expand its program of regional meetings throughout the United States, organize conferences for teachers, stimulate inquiry into the work of official legal advisers of foreign ministries and international organizations, and strengthen the activities of student organizations. These activities have greatly enriched the Society's program and have, in large part, been responsible for a notable increase in the Society's membership, influence and effectiveness. As a result of foundation grants and the expansion of membership, the Society's contribution to the educational needs of its professional membership and its service to the public greatly exceeds what it would be today if it had simply continued to publish a professional journal and convene an annual meeting, which were its principal activities prior to receipt of major foundation grants. Funds provided by foundation grants during the past eight years have enabled the American Society of

International Law to make what it believes is a significant contribution to the public good. We do not believe that contribution, or the work of thousands of other beneficiaries of foundation support, should be cut back 7.1/2 per cent. We accordingly respectfully recommend that the provision for a tax on the income of foundations be deleted from the Act.

Conclusions

The American Society of International Law respectfully recommends that the Tax Reform Act of 1969, as passed by the House of Representatives, be amended in the following ways:

1. The Internal Revenue Code should define "private foundation" in a manner that will clearly ensure that professional membership societies are excluded from the definition. This can be accomplished by amending Section 170(b)(1)(B) expressly to include learned and professional societies and scholarly research organizations among the classes of organizations listed in that sub-paragraph.

2. The definition of "substantial contributor" in Section 507(b)(2) should be liberalized to permit donors to make contributions in excess of $5,000 without thereby being classed as "substantial contributors."

3. The definition of "operating foundation" in Section 4942(j)(3)(B)(ii) should be amended to permit an operating foundation to receive as much as fifty per cent of its support from one foundation.

4. The legislative history of Section 4945(c) should make clear that the words "non-partisan analysis or research" are to be construed liberally.

5. Section 506, which imposes a tax on the investment income of foundations, should be deleted.

TRUSTEES
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EDWARD C. [illegible],
EXECUTIVE DIRECTOR

# GRAND RAPIDS FOUNDATION

780 OLD KENT BUILDING
GRAND RAPIDS, MICHIGAN 49502

September 3, 1969

Hon. Russell B. Long, Chairman
Committee on Finance
United States Senate
2227 New Senate Office Building
Washington, D. C.

Dear Senator Long:

Grand Rapids Foundation is an organization which meets the description of <u>Example (1)</u> of Reg. ¶1.170-2(b)(5)(iii)(c)(5). Its constituent supporting trusts are held by local financial institutions. The Foundation's impartial distribution committee has no power to invest, loan or encroach upon the principal of its constituent supporting trusts, but only to distribute the income.

For several years Grand Rapids Foundation has made loans to scholars in the postgraduate and professional fields of study. Approximately 15% of the Foundation's distributable funds have been devoted to this program in recent years. Graduates who return to the community and engage in public service professions, chief of which is teaching in the elementary and secondary schools of the community and in its four local colleges, are given credit for 20% of their loans for each year of completed public service. In consequence, a substantial part of the scholarship loans ultimately becomes grants through these credits. The remaining note balances are repaid and returned to the income and disbursing fund of the Foundation.

A substantial number of teachers, governmental employees and social workers, as well as private professional people such as doctors, lawyers and engineers, have benefited from this loan program.

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It has significantly added to the resources of the community in terms of skilled public servants and private professionals.

Section 4945 of H.R. 13270 imposes a tax of 100% of taxable expenditures made by private foundations and in subparagraph (b) defines "taxable expenditure" to include "a grant to an individual for travel, study or other similar purposes by such individual unless such grant satisfies the requirements of subsection (e)".

Section 4942 imposes a tax on the undistributed income of a private foundation and in subsection (g) defines "qualifying distribution" as "any amount paid out to accomplish one or more purposes described in Section 170(c)(2)(B)".

Both these references require an outright distribution or grant, as contrasted with a loan, and would seem to classify all loans as "taxable expenditures" and exclude them from consideration as "qualifying distributions".

It would seem that by retaining the other restrictions on qualifying distributions and taxable expenditures the public interest would best be served if Congress permits foundations to loan portions of their distributable income in appropriate circumstances. On behalf of the Grand Rapids Foundation, we earnestly suggest that the language of Sections 4942 and 4945 of H.B. 13270 be broadened to permit the making of loans as well as grants out of income under the limitations and procedures set forth in the bill.

Yours very truly,

GRAND RAPIDS FOUNDATION

Executive Director

ECM:ds

STATEMENT OF LEWIS I. MADDOCKS
for the
COUNCIL FOR CHRISTIAN SOCIAL ACTION
UNITED CHURCH OF CHRIST
Oct. 6, 1969

I am Dr. Lewis I. Maddocks, Executive Director of the Council for Christian Social Action of the United Church of Christ. Our national office is at 289 Park Avenue South, New York, N.Y. 10010 and our Washington office is at 110 Maryland Ave. N.E., Washington, D. C. 20002.

The United Church of Christ was formed in 1957 by the merger of the Congregational Christian Churches and the Evangelical and Reformed Church. It has about 7,000 local churches with slightly over two million members. The Council for Christian Social Action is an official agency within that denomination, with the responsibility of making "the implications of the Gospel effective in society." It has 27 members, chosen by the Church.

The Council has previously submitted to the House Ways and Means Committee and also to the Synod of the United Church its recommendations on tax reform. At its last semi-annual meeting, September 19-21, 1969, the Council received reports on the current legislative situation involing tax reform, including provisions in the House Bill limiting the operations of foundations. Council members expressed concern over various provisions that seemed unduly restrictive and perhaps punitive. As a result, the Council unanimously adopted the statement set forth below.


Summary

1) The new prohibitions against foundations issuing "propaganda" or attempting to "influence" elections are unwise and should be deleted.

2) The limitations on voter registration drives are unwise and should be deleted.

3) The proposed requirements that operating foundations must have broad bases for financial support are unwise and should be deleted.


The statement itself follows:

TAX RESTRICTIONS ON FOUNDATIONS
Adopted by the Council for Christian Social Action
September 20, 1969

In our statement on tax reform of last February, and the

General Synod pronouncement of July 1, the following paragraph was included:

> Property contributed to spurious, tax-haven foundations which do not significantly serve social purposes should no longer confer the benefits of tax deduction on the individuals who created them.

The tax bill passed by the House of Representatives contains significant and adequate provisions to meet this problem but, in our opinion, becomes punitive in certain additional restrictions on the operations of foundations, as follows:

1) The prohibition of expenditures "to carry out propaganda, or otherwise attempt to influence legislation" and/or "to influence the outcome of any public election" strikes us as both vague and dangerous. Almost any statement of fact and analysis on a social issue would have some "influence" on any related election and what is "propaganda" usually depends on whether one favors or opposes the statement. We believe it far better to let the market place of ideas and discussion remain free and to continue the legislative limitations already prevailing.

2) The House Act also specifically prohibits expenditures for voter registration drives unless they are by an organization "the principal activity of which is nonpartisan political activity in 5 or more States" and not geographically limited as to use. Registration drives are more effective if they are tied to impending elections and these come at different times in different areas. We realize that many registration drives are intended by their sponsors to affect election results but we feel it better for them to be free to urge registration, perhaps with competing motivations, as long as the drive itself is nonpartisan.

3) The House also proposes to regulate operating foundations with various limitations, such as the requirement that they must get their funds from at least five independent exempt organizations and the general public and that not more than 25% can come from any one organization. This would prohibit a wealthy donor from carrying the burden for any one activity. We believe it better to encourage donors to contribute to any public program that happens to interest them.

We recommend that the abuses of the foundations be dealt with in such a manner as not to restrict their legitimate functions unduly.

**UNITED STATES SENATE**

**COMMITTEE ON FINANCE**

**STATEMENT SUBMITTED BY FELIX J. CHMIEL**
**VICE PRESIDENT**
**ON BEHALF OF**
**UNITED STATES TRUST COMPANY OF NEW YORK**

**H. R. 13270: AS IT RELATES TO**
**EXCESS BUSINESS HOLDINGS**
**OF PRIVATE FOUNDATIONS**

September 29, 1969

SECTION 101(b) OF THE BILL RELATING TO EXCESS BUSINESS HOLDINGS

1. There is nothing evil, per se, in a private foundation's ownership of stock of a closely held company -- whether it be 10% or 90%. The evil, if any, arises when the private foundation engages in acts of self dealing, fails to distribute income or invests in such a manner as to jeopardize the carrying out of any of its tax exempt purposes and not by merely owning X% of the stock of a company.

Such abuses can and should be controlled by proper policing such as the courts, the State Attorney General, and by the annual reports filed with the I.R.S.

2. This Committee should not be concerned with a taxpayer's subjective motive in contributing to a private foundation particularly when the contribution is made by will. In order to obtain an estate tax deduction it should be sufficient that the charity actually receives at least the amount of the charitable deduction and the company does not unfairly compete with other businesses whose owners must pay taxes on the income that they derive from the business. This should be especially true if the private foundation merely distributes its income to churches, hospitals, schools or other public charities.

3. To limit the amount of stock a private foundation owns discriminates against the taxpayers whose wealth happens to be in his own company whereas another taxpayer of equal wealth whose assets may consist of a diversified portfolio has no such restrictions. The purpose of our tax laws should be to encourage all taxpayers to contribute to charity rather than to discourage some taxpayers (because of the nature of their assets) from satisfying their charitable impulses.

There should be a way for the owner of a small business (or his family) to bestow substantial benefits to charity and still retain control of his company or at least prevent control of his company from getting into the hands of his competitors, "Corporate Raiders" or into the hands of persons who are interested in turning a quick profit rather than having the long range interests of their employees or the community in which the business is located.

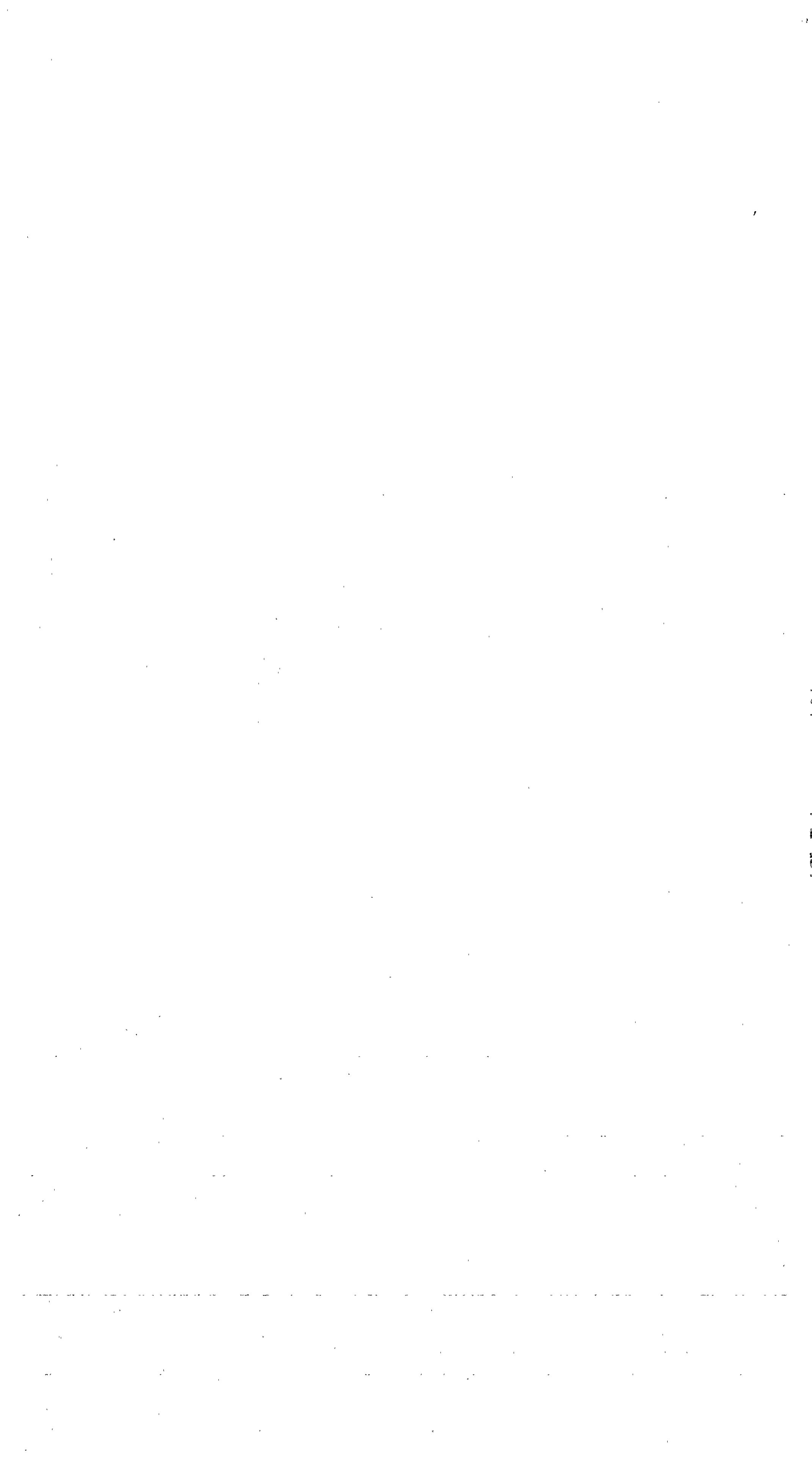
If it is felt that the donor or members of his family should have no control or should not exercise substantial influence over the operation of the foundation, then an independent fiduciary such as a corporate trustee should be permitted to govern the foundation's activities.

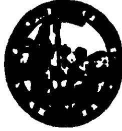
Since corporate fiduciaries are under the supervision of bank examiners, the courts, and state supervisory agencies, such as the Attorney General, any abuse should and would be detected and corrected in short order.

4. If the Committee feels it is necessary to adopt a limit on the ownership of stock by a private foundation and members of the family, we recommend that the amount of stock held in trust be excluded in determining such limit if such foundation is a mere payee. If the terms of the trust are such that the foundation receives an annuity for a term of years or for the life of a natural person, the foundation is in no sense an owner of the assets. The foundation would have no control over the retention or disposition of the assets held in the trust, and ownership by the trustee should not be attributable to the foundation. Additionally, the foundation's interest in the trust diminishes with the passage of time. Therefore, it is conceivable that at inception the business holdings

would be in excess of the permitted limits whereas several years later the holdings could be below allowable limits.

For these reasons we oppose the enactment of Section 101(b) of the proposed bill and the proposed new section 4943 of the code.





**STATE OF NORTH CAROLINA**
**DEPARTMENT OF THE STATE AUDITOR**
**RALEIGH**

September 23, 1969

HENRY L. BRIDGES
STATE AUDITOR

Honorable Russell B. Long, Chairman
Committee on Finance
United States Senate
2227 New Senate Office Building
Washington, D. C.

Subject: H.R. 13270, Tax Reform Act of 1969

Dear Senator Long:

Please accept this written statement in lieu of my appearance before your Committee in opposition to the Tax Reform Act of 1969 as it affects foundations.

I am President of the North Carolina Masonic Foundation, Inc. The assets of the Corporation were built up out of surplus operating funds of the Grand Lodge of North Carolina and transferred into the Foundation. At the present time the entire income from the Foundation is divided equally between the North Carolina Masonic and Eastern Star Home in Greensboro, N. C., and the Oxford Orphanage in Oxford, N. C.

Both of these organizations are supported entirely by the Grand Lodge of North Carolina of Ancient Free and Accepted Masons, and this income amounts to $64,068.73 for the year ending December 31, 1968. As of that date, the total assets of the Corporation is $1,530,850.28 at market value. The proposed tax would mean a reduction of the money available to support these two organizations.

May I urge your Committee to give serious consideration of exempting this type of Foundation from the tax provision of the bill.

Sincerely yours,

Henry L. Bridges
President
The N. C. Masonic Foundation, Inc.



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TESTIMONY TO SENATE COMMITTEE ON FINANCE
REGARDING HR 13270, THE TAX REFORM ACT OF 1969,
BY RESOURCES FOR THE FUTURE, INC.
WASHINGTON, D. C.

September 17, 1969

Certain provisions in Title I relating to tax exempt organizations of the Tax Reform Act of 1969 (HR 13270) now being considered by the Senate Finance Committee could pose serious difficulties to Resources for the Future, Inc., to the point of requiring this organization to change drastically its whole method of financing and operation, or even to go out of business entirely. This possibility results from provisions of the Bill which could disqualify Resources for the Future (RFF) from receiving new grants from our primary source of financial support, and thus jeopardize our capacity to continue the important work of research and education to help solve the nation's pressing natural resource and environmental problems.

Resources for the Future, Inc. is a tax exempt organization, incorporated in the state of New York in 1952, and subsequently has been financed almost entirely by the Ford Foundation through a series of five-year grants. These grants have been used totally and exclusively for the general purpose of RFF, which is to advance research and education relating to the conservation and development of natural resources and the natural environment, and to related subjects. The policies of RFF are established by a distinguished Board of Directors, none of whom is a trustee, officer, or employee of the Ford Foundation. Part of the RFF program involves direct research undertaken by its permanent staff of highly qualified scholars. This staff research is supplemented by studies of other scholars which RFF finances by grants made directly to their universities. Grants made by RFF to universities

* Submitted by Joseph L. Fisher, President.

are approved by the Board of Directors and administered by the officers. The grants now amount to about 30 per cent of RFF's total annual expenditures. During the year ending September 30, 1968, our total expenditures were approximately $1,680,000.

Since our creation in 1952, we have acquired the staff and developed the expertise for carrying out a carefully conceived, objective program in the increasingly important field of resource development and environmental conservation. The results of our research typically are published in scholarly books and articles. The graduate fellowships and other educational activities, which are financed through RFF's grants to universities, contribute to the training of future leaders in this important field. Many of the leading universities of the country have received RFF grants which have yielded high quality research. Our publications, most of which are of book length, are available to the general public. These now number around 100, not counting research results published by grantees (usually by their own university presses).

Members of Congress frequently request copies of our books and are generally aware of our work. For example, a few years ago in hearings before the Joint Economic Committee's Subcommittee on Automation and Energy Resources, Congressman Wright Patman said, "Through the activities of its central staff and grants to other nonprofit institutions, Resources for the Future has established itself as an objective, thorough, and high-level study group." On numerous occasions, RFF staff members have furnished expert testimony on resource and environmental matters at the invitation of Congressional committees.

RFF has responded to requests by the United States Government for objective studies, some of which have been done without cost to the government and others of which have been paid for by the government in whole or in part.

Among these have been studies of: future water supply and requirements prepared several years ago at the request of the Senate Select Committee on National Water Resources (Committee Print No. 32, August 1960); flood insurance undertaken at the request of the Department of Housing and Urban Development (Committee Print of the House Public Works Committee and of the Senate Committee on Banking and Currency, September 1966); research needs on energy resources done at the request of the President's Science Advisor (RFF publication, United States Energy Policies: An Agenda for Research, 1968).

In addition to studies requested by the government, RFF staff have participated in joint research ventures with federal, state and local agencies on environmental problems. Such joint research arrangements have included: a study of ground and surface water management with the U.S. Geological Survey; participation with the Texas Water Commission in preparing part of the Texas Water Plan; and a study of waste management problems in the New York metropolitan area with the Regional Plan Association.

In these studies as in all of its studies, RFF's aim has been to assist in providing the factual basis and analysis for understanding problems more clearly, and not to influence legislation.

Various materials are attached to this statement relating to the program and accomplishments of RFF. A list of directors and principal staff members is included. Our annual reports contain a rather complete account of our research and educational programs as well as a full report on our financial operations; a copy of the latest Report is also included. And, of course,

we shall be happy to provide such additional information as the Committee and its staff would like to have.

Turning again to the difficulties posed by HR 13270 in its Title I, we feel quite sure the House did not intend to terminate, or even to alter drastically, activities such as those RFF carries out. Our work, we believe, will stand whatever scrutiny the Congress or the Internal Revenue Service wishes to give it and in fact we welcome continuing scrutiny of all phases of our operation.

RFF has no endowment funds, nor does it own any real property. The funds we have received have always been used promptly in pursuit of our research and educational objectives. This is true of both our assets which are mainly the incoming grants from the Ford Foundation, now received in equal quarterly installments, and of the small amount of interest we receive from government notes in which we invest that portion of our funds not needed immediately for program expenditures.

TWO ALTERNATIVE SUGGESTIONS

1. An unambiguous solution to our problem with HR 13270, preferable in the long run, would involve an amendment to make clear that an organization like RFF which is clearly a research and educational one, operating openly in the public interest and using its funds fully and promptly for its tax-exempt purposes, is classified in a way similar to a university, and therefore not included within the scope of Title I. In a real sense RFF is a part of the higher educational system of the country in its major characteristics such as qualifications of its directors and permanent staff, objectivity of its research, independence of its program from special interests, closeness of its relations with universities, etc. Only with respect to concentration of the source of its funds does

it depart from a typical university and this in no way is accompanied by control. On the more important matter of how it uses its funds, we believe RFF is completely beyond reproach of any kind and certainly is outside the intent of Congress in this Bill as we understand it. To meet our particular problem any amendment which would classify RFF-like institutions with universities would have to omit any provision limiting the percentage of contributions received from one donor.

2. A more pinpointed solution to our difficulty, and one which does not require elimination of the "percentage of single source support" provision, would be to amend Section 4942(g)(1) of the Bill in which qualifying distributions are defined so that contributions from donors would be qualifying distributions, provided that the recipient (for example, RFF) spent these funds for its tax-exempt purposes. Penalties are provided in Section 4942 of the Bill for failure to distribute income currently. Under this section distributions by the Ford Foundation to RFF might not be "qualified" distributions and therefore might be subject to the penalty tax. In this case, RFF's main source of financial support might in effect be eliminated, thus bringing a worthwhile program to an end.

This result could be avoided, without weakening what we believe to be the intent of Congress, by amending that part of the Bill in which qualifying distributions are defined. The following proposed Amendment to Section 4942(g)(1) would insure that a research and education organization like RFF be allowed to continue its work even though it receives most of its funds from one source, as long as it spends these contributions fully and promptly.

PROPOSED AMENDMENT TO SECTION 4942(g)(1) ON PAGE 30 OF HR 13270
[Changes and additions underscored.]

"(g) QUALIFYING DISTRIBUTIONS DEFINED.

"(1) IN GENERAL.--For purposes of this section, the term 'qualifying distribution' means--

"(A) any amount paid out to accomplish one or more purposes described in section 170 (c) (2) (B), other than any contribution to

( i) an organization controlled (directly or indirectly) by one or more disqualified persons (as defined in section 4946) with respect to the foundation,

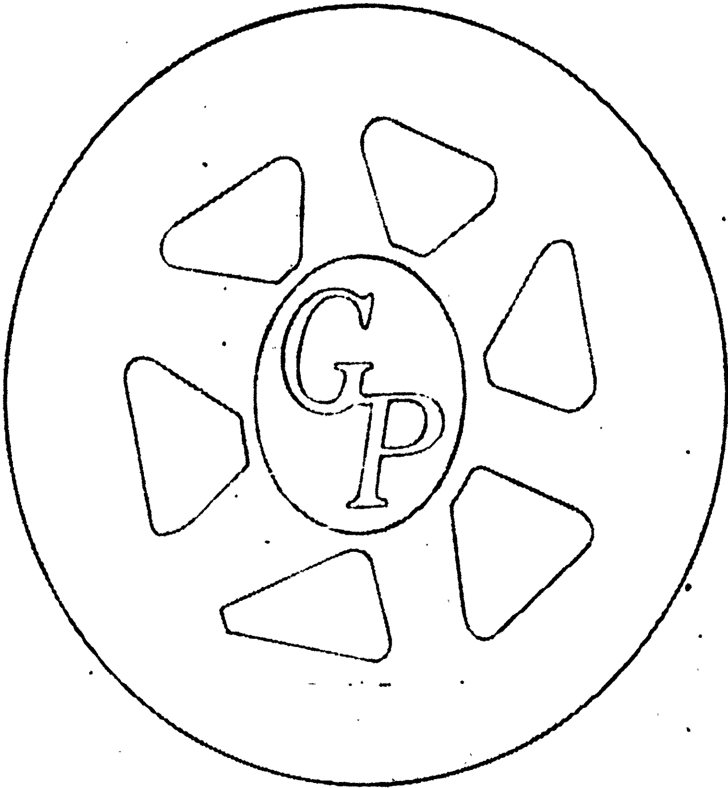
( ii) a private foundation which is neither an operating foundation (as defined in subsection (j) (3) ), nor an organization described in paragraph (C), or

(iii) an organization which would be a private foundation if it were a domestic organization.

"(B) any amount paid out to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170 (c) (2) (B), or

(C) any contribution to another exempt organization, other than an organization described in subparagraphs (i), (ii) or (iii) of paragraph (A), if the recipient organization expends an amount equivalent to such contribution for one or more purposes described in

section 170 (c) (2) (B) not later than the close of the recipient organization's first year after its taxable year in which such contribution is received.



STATEMENT OF ARTHUR H. DEAN, CO-CHAIRMAN FOR THE LAWYERS' COMMITTEE FOR CIVIL RIGHTS UNDER LAW

"The American dream does not come to those who fall asleep. We are approaching the limits of what government alone can do.

"Our greatest need now is to reach beyond government, to enlist the legions of the concerned and the committed.

"What has to be done, has to be done by government and people together or it will not be done at all. The lesson of past agony is that without the people we can do nothing--with the people we can do everything.

"To match the magnitude of our tasks, we need the energies of our people--enlisted not only in grand enterprises, but more importantly in those small, splendid efforts that make headlines in the neighborhood newspaper instead of the national journal.

"With these, we can build a great cathedral of the spirit--each of us raising it one stone at a time, as he reaches out to his neighbor, helping, caring, doing."

(Inaugural Address of President Richard M. Nixon, January 20, 1969)

My name is Arthur H. Dean. On and off for 46 years I have been practicing law with the firm of Sullivan and Cromwell. During this time I have had the privilege of serving my country in various capacities. Over my many years of public and private service, I have come to understand the difficulties you have in putting together the laws of this land. I hope I may be of assistance to you in your consideration of the present bill.

I appreciate the opportunity to present my views on a portion of this momentous piece of legislation called the Tax Reform Act of 1969, produced by the House Ways and Means Committee. The comments I shall make reflect in part my experience as one of the Co-Chairmen of the Lawyers' Committee for Civil Rights Under Law--an organization which is tax exempt under 501(c)(3)

of the Internal Revenue Code. More fundamentally, however, as an attorney, I am impelled to communicate to this Committee my apprehension that the Congress, through inadvertence, may deprive this nation of a valuable resource--at a crucial time in its history; and in that process add new burdens to the Federal government, already heavily overburdened.

H.R. 13270 represents a comprehensive overhaul of our national tax legislation. On the subject of tax exempt organizations it is obvious that safeguards are needed to assure that some organizations do not abuse the privilege of exemptions from the federal taxation, especially in the areas of self-dealing, excessive involvement in commercial enterprises, and, in some few cases, in partisan political activity. The drafters of the tax reform legislation had to, and did, deal with these subjects. My essential question to you, gentlemen, is whether the House has not engaged in legislative "over-kill".

The Lawyers' Committee for which I speak was formed at a meeting of approximately 250 attorneys convened at the White House on June 21, 1963 by President John F. Kennedy. The President, then, noted that the future stability and progress of this nation would be dependent in large measure upon the maintenance of a rule of law which guarantees the equality of rights of all citizens. One response of those lawyers present was the formation of the Lawyers' Committee--an organization dedicated to actively involving members of the legal profession in not only protecting but giving positive effect to the civil and human rights of all citizens.

President Kennedy asked the late Harrison Tweed of New York and Bernard G. Segal of Philadelphia, now President of the American Bar Association, to act as Co-Chairmen in organizing the Committee, fixing its objectives, and working toward their achievement. Both men served until September 1965. At that time President Johnson asked Whitney North Seymour and Burke Marshall to serve as Co-Chairmen. In September of 1967 the current Co-Chairmen, I and Louis F. Oberdorfer responded to President Johnson's request that we succeed to the leadership of the Committee.

During the six years of its existence the Lawyers' Committee has grown to a position of recognized leadership within the legal profession. Its activities in support of civil rights are nationwide and the scope of its program has broadened commensurate with the Committee's increasing assumption of responsibility.

Throughout the years the membership of the Lawyers' Committee has included many outstanding representatives of the organized bar and the legal profession. Among the membership are included three past Attorneys General, the current President and nine past Presidents of the American Bar Association, the President and two former Presidents of the National Bar Association, the Deans of many of our leading law schools, the Presidents or former Presidents of more than half of the state bar associations, and the President and past Presidents of practically every national professional organization of lawyers. Currently, members of the Executive Committee of the Board of Trustees of the Lawyers' Committee are:

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|---|---|
| Morris B. Abram | President, Brandeis University |
| Richard Babcock | Ross, Hardies, O'Keefe, Babcock, McDugald & Parsons, Chicago, Illinois |
| Frederick A. Ballard | Ballard & Beasley, Washington, D. C. |
| G. d'Andelot Belin | Choate, Hall & Stewart, Boston, Massachusetts |
| Berl I. Bernhard | Verner, Liipfert, Bernhard & McPherson, Washington, D. C. |
| Bruce Bromley | Cravath, Swaine & Moore, New York City |
| Cecil Burney | Fisher, Wood, Burney & Nesbitt, Corpus Christi, Texas |
| Warren Christopher | O'Melveny & Myers, Los Angeles, California |
| William T. Coleman, Jr. | Dilworth, Paxson, Kalish, Kohn & Levy, Philadelphia, Pennsylvania |
| Lloyd N. Cutler | Wilmer, Cutler & Pickering, Washington, D. C. |
| James T. Danaher | Danaher, Fletcher, Gunn & Ware, Palo Alto, California |
| Arthur H. Dean | Sullivan & Cromwell, New York City |
| John Doar | Bedford-Stuyvesant Development & Services Corp., New York City |
| John W. Douglas | Covington & Burling, Washington, D. C. |
| Prof. C. Clyde Ferguson, Jr. | Rutgers State University Law School |
| Cody Fowler | Fowler, White, Gillen, Humkey & Trenham, Tampa, Florida |
| Lloyd Garrison | Paul, Weiss, Goldberg, Rifkind, Wharton & Garrison, New York City |
| Arthur J. Goldberg | Paul, Weiss, Goldberg, Rifkind, Wharton & Garrison, New York City |
| Dr. Rita Hauser | Moldover, Hauser & Strauss, New York City |
| Nicholas de B. Katzenbach | Vice President & General Counsel, International Business Machines Corp., Armonk, New York |
| George N. Lindsay | Debevoise, Plimpton, Lyons & Gates, New York City |
| Orison S. Marden | White & Case, New York City |
| Dean Robert B. McKay | New York University School of Law |
| Harry C. McPherson | Verner, Liipfert, Bernhard & McPherson, Washington, D. C. |
| David Nelson | Crane, Inker & Oteri, Boston, Massachusetts |
| Louis F. Oberdorfer | Wilmer, Cutler & Pickering, Washington, D. C. |
| William H. Orrick, Jr. | Orrick, Herrington, Rowley & Sutcliffe, San Francisco, California |
| Robert P. Patterson, Jr. | Patterson, Belknap & Webb, New York City |
| William Pincus | Council on Legal Education for Professional Responsibility, Inc., New York City |
| John H. Schafer | Covington & Burling, Washington, D. C. |
| Whitney North Seymour | Simpson, Thacher & Bartlett, New York City |
| Bernard G. Segal | Schnader, Harrison, Segal & Lewis, Philadelphia, Pennsylvania |
| Jerome J. Shestack | Schnader, Harrison, Segal & Lewis, Philadelphia, Pennsylvania |

| | |
|---|---|
| Asa Sokolow | Rosenman, Colin, Kaye, Petscheck & Freund New York City |
| Theodore C. Sorensen | Paul, Weiss, Goldberg, Rifkind, Wharton & Garrison, New York City |
| William B. Spann, Jr. | Alston, Miller & Gaines, Atlanta, Georgia |
| Honorable David Stahl | Circuit Judge, Pittsburgh, Pennsylvania |
| Cyrus Vance | Simpson, Thacher & Bartlett, New York City |
| Prof. John W. Wade | Vanderbilt University School of Law |
| Bethuel Webster | Webster, Sheffield, Fleichmann, Hitchcock & Chrystie, New York City |

In the broad sense, the Committee's charter is that: to bring the skill, and the commitment of the legal profession to action to ameliorate tensions and in providing remedies under law for the problems of people who have been denied their legal rights by prejudice or poverty all across our nation--north and south--in the urban ghettos and their rural tributaries. And if we are faithful to our professional responsibility, if we are to obey our duty never to reject the cause of the defenseless or the oppressed, then our committee can have no narrower goal.

The Lawyers' Committee is presently engaged in two major programs--the Mississippi Project and the Urban Areas Project. The Committee operates an office in Jackson, Mississippi, handling cases, on behalf of the disadvantaged throughout the State of Mississippi. Since its establishment in June of 1965, the Mississippi office has handled more than 2000 cases. The cases have involved defense of criminal prosecutions, damage actions, suits involving desegregation of public institutions and public accommodations, discrimination in employment, violations of election laws, unlawful actions of law enforcement officers, unconstitutional legislation, misuse of Federal funds, and violation of a wide range of constitutional rights.

The Lawyers' Committee staff in Mississippi now consists of six full-time staff attorneys including a graduate of the University of Mississippi Law School, as well as investigators and clerical personnel. The regular staff is augmented by volunteer private attorneys from law firms throughout the country who serve in Mississippi without pay. Over 170 such attorneys have volunteered their time and service to the Lawyers' Committee office in Mississippi.

In our efforts we have been encouraged to note that some members of the Mississippi bar have begun to take cases which in the past they would have shunned. We have had discussions with the members of the organized Mississippi bar which we believe will lead to active participation by members of the Mississippi bar in the progress of the Committee.

Gratified by the tremendous response of the private bar to the Committee's request for volunteers in the South and encouraged by the urging of President Lyndon B. Johnson, the Lawyers' Committee in July of 1968 broadened its concern to include the racial tension and injustice outside the South. At that time the Committee commenced its Urban Areas Project. This undertaking represented an unprecedented effort to mobilize the legal profession to respond to the summons to action issued by the Kerner Commission. The project is designed to make available the skills of volunteer lawyers, in many cities across the country, to individuals and community groups seeking to overcome the related problem of poverty and discrimination. It is based on the premises that the private bar has something unique and important to contribute to improving the quality of life of the inner-city poor; that lawyers would recognize and discharge their responsibility--as attorneys and citizens--to provide this assistance; and that victims of social and economic disenfranchisement would seek and accept their professional help.

Specifically, the Lawyers' Committee has formed local lawyers' committees in 14 cities: Atlanta, Baltimore, Boston, Chicago, Cleveland, Indianapolis, Kansas City, Los Angeles, New York, Oakland, Philadelphia, San Francisco, San Francisco, Seattle, and Washington, D. C.



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In each city we employ one full-time staff attorney with necessary clerical assistance. He is supported and guided by a panel of private volunteer lawyers known as the local committee.

All fourteen committees are broadly representative of the bars of their respective cities. Each includes in its membership minority lawyers; senior partners from major firms; and younger lawyers with experience in civil rights, poverty law or urban law. This diversity has enabled the committees to draw upon a variety of talents, perspectives and relationships in formulating its policies and executing its projects.

Another factor facilitating the success of the local committees is the stature of the average chairman. He is usually one of the more prestigious members of the local bar. For example, the Co-Chairmen of the Chicago Committee are: Richard F. Babcock of Ross, Hardies, O'Keefe, Babcock, McDugald & Parsons, and William N. Haddad of Bell, Boyd, Lloyd, Haddad & Burns; Chairman of the Indianapolis Committee is Merle H. Miller of Ice, Miller, Donadio & Ryan; Chairman of the Philadelphia Committee is Robert Dechert of Dechert, Price & Rhoads; and the Co-Chairmen of the San Francisco Committee are Richard C. Dinkelspiel of Dinkelspiel, Steefel, Levitt, Weiss & Donovan, and Robert H. Fabian, Vice President of the Bank of America.

The project involves a full range of legal services, from litigation and other forms of representation, to the provision of general counsel services to minority businesses and community action groups. The issues and grievances

addressed by volunteer attorneys from major law firms reflect the breadth of the problems of the urban core: poor housing; deficient education; the breakdown in the administration of justice; discrimination in employment; inadequate health and welfare services; police-community relations; and other major causes of frustration, bitterness and unrest.

In May of 1969, after the Urban Areas Project had been in operation for almost a full year, President Nixon advised the Committee that its "efforts in protecting citizens who might otherwise suffer the loss of their constitutional rights and in developing new methods to solve the urban problems which face our nation, have my continuing support and admiration." He added that "I hope the Lawyers' Committee will continue and expand its efforts to gain the support of the private sector in the struggle for human rights." This, the Lawyers' Committee fully intends to do.

We and numerous organizations like us work daily to engage the talents and expertise of the "private sector" in the task of maintaining the rule of law in this nation and protecting and giving effect to the rights of citizens under law. Since the product we offer has no saleable value we depend for our existence on the generosity of grant-making foundations and individual donors. The actions of this Congress that affect the flow of such funds, therefore, are of vital interest to us.

Part of our support comes from the private bar and private business organizations,part comes from grants from relatively small foundations, but over 80% of our funds comes from a single foundation--Ford Foundation. Therefore, we are particularly concerned about those provisions of H.R. 13270 which define

the terms "operating foundations" and "taxable expenditures".

As we understand the bill before you, all organizations exempt under Section 501(c)(3) of the Internal Revenue Code, with certain exceptions not applicable to organizations like our own, are to be considered "private foundations". For those "private foundations" which do not generate funds of their own it is essential that they be also "operating foundations" if they are to receive funds from grant-making foundations. This is because the grant-making foundations are subject to sanctions if they make grants to organizations like ours which cannot fit into that category. Such grants in the language of the Act would not be "qualifying distributions".

To qualify as an operating foundation an organization must meet two of three requirements set forth in Section 4942(j)(3), i.e., (a) substantially all (approximately 85 per cent) of its income must be used directly in the conduct of activities constituting its exempt purposes and (b) either (1) substantially more than half (approximately 65 per cent) of its assets must be used directly for such activities, or (2) it receives substantially all (approximately 85 per cent) of its support from five or more organizations with not more than 25 per cent coming from any one such organization.

As I have indicated, the Lawyers' Committee receives approximately 80% of its support from one foundation. All of its income and all of its assets (tenants leasehold interest in office space we rent, office equipment, motor vehicles and cash) are used to carry on its program. The Committee, then would qualify as an "operating foundation" under the first two criteria of the statute.

We are disturbed, however, by the uncertainty expressed by some as to the meaning of the report of the House Ways and Means Committee pertaining to this section. In this connection I understand that the American Association for the International Commission of Jurists, Inc., whose chairman is my distinguished friend, Whitney Debevoise, may be jeopardized by a failure to clarify the "assets alternative." At page 42 of Part 1 of that report the Committee states that the "assets alternative is intended to apply particularly to organizations such as museums" and certain named organizations which are engaged primarily in maintaining recreational and historical facilities.

If this report should stand as an indication that the "assets alternative" is to be limited to organizations referred to by the Ways and Means Committee, the Congress may well have effectively pronounced a death sentence on many effective organizations, including the Lawyers' Committee. I respectfully request that the Senate clarify this matter by stating for the record what I believe to be the true intent of Congress, i.e., to facilitate the funding organizations which actively engage in constructive programs by making clear that an organization which has no portfolio and literally spends the donations it receives pursuant to an approved plan and fully commits the few physical assets needed to perform its functions is an "operating foundation".

Even as an "operating foundation" the Committee might face funding problems under the provisions of Section 4945 of the Bill which deals with "taxable expenditures." This Section imposes a 100 percent tax on grant making foundations if their funds are used to finance certain prescribed activities. If the foundation funds a tax exempt

organization it must stand "fully responsible" for the expenditure of those funds by its grantee and, in turn, make "full and detailed" reports to the Internal Revenue Service on the uses of the grant.

As this Section would affect the Lawyers' Committee, and like organizations, the substantive provisions are largely a restatement of current law with the exception of the removal of the substantiality test from the prohibition on legislative and political activities. If this were the full extent of this legislation the Lawyers' Committee and most others, could continue to exist with no appreciable change in its situation. The basic problem raised by Section 4945 is the potentially chilling effect it will have on foundation giving.

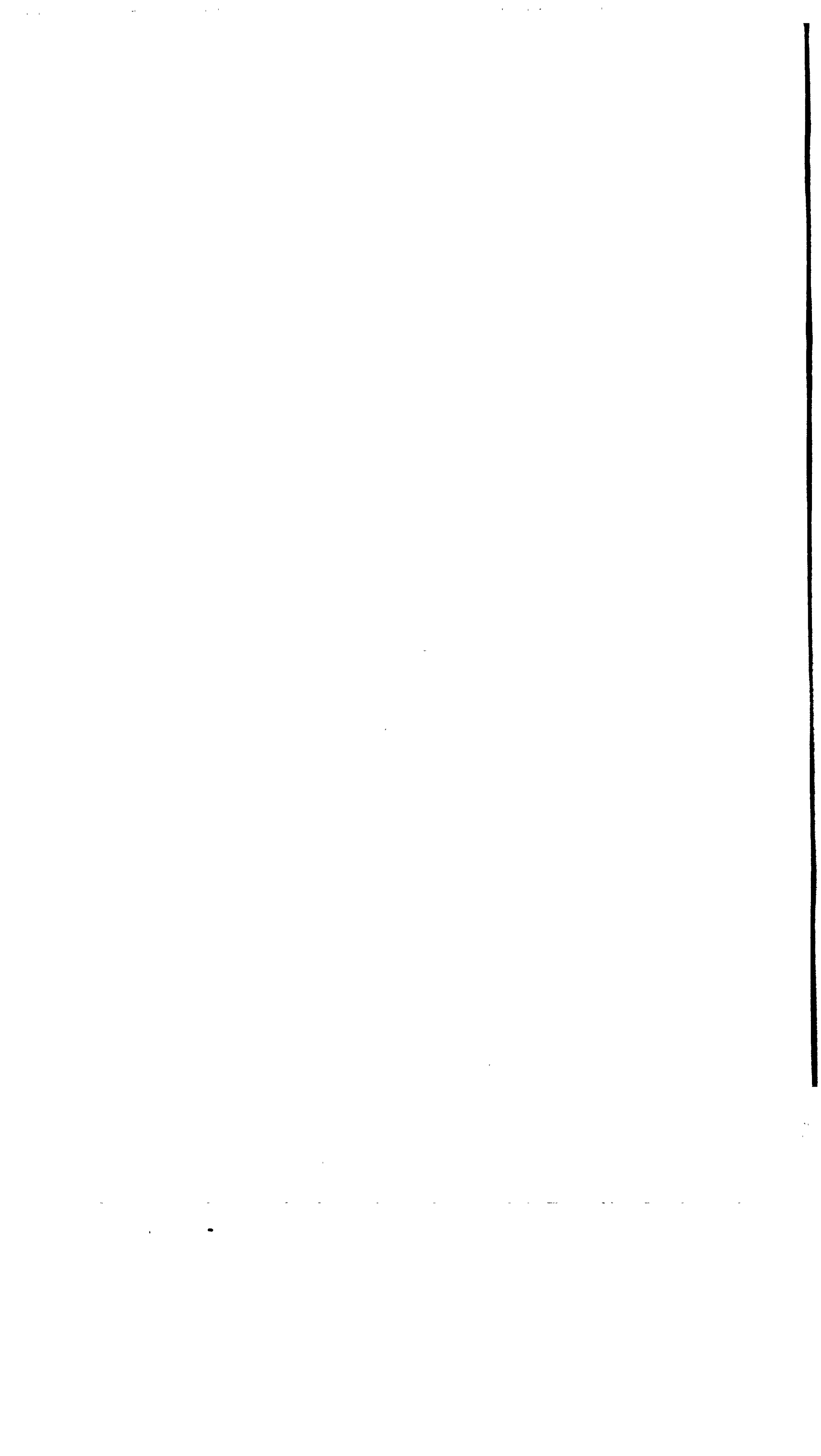
Of special concern is the prohibition on attempting to influence legislation "through an attempt to affect the opinion of the general public or any segment thereof". This language may be sufficiently broad to cover a multiplicity of actions which until now would not be considered as being inappropriate activities for tax exempt organizations. Our fear is that foundations, being uncertain, of the consequences of their expenditure of funds will refuse to fund organizations which might possibly subject them to sanctions. In the case of our organization and other groups providing legal services for the disadvantaged, we are very likely to become involved in novel litigation which raise issues of concern to the general public. Would the prosecution of such cases be prohibited? In our Urban Areas Project one of the major activities of our local offices is giving counsel to the local community organizations. To give these groups a proper perspective of their situations, it may be necessary for lawyers to counsel them as to the restrictions on their actions and the alternative solutions to their problems, be it negotiation, litigation or seeking a statutory change.

Would such counselling be improper under the Bill?

A similar ambiguity is found in a second paragraph of the Bill which purports to amplify the prohibition on attempts to influence legislation. Subparagraph (c)(2) of Section 4945 prohibits attempts 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." This language is broad enough to cover the client being counselled regarding the possible solutions to his problem. Would it also prevent consultation with the American Bar Association on matters of legislative concern? Would this language prevent the Lawyers' Committee from sharing its experiences in the urban areas with the executive branch even if advice on specific matters were requested?

The questions we raise are the types of questions grant-making foundations must raise when reviewing grant applications. If there is doubt as to the answers it will not be the foundation that will suffer, it may be organizations such as ours and the citizens that we serve.

I ask that you give a long hard look at the provisions of Section 4945 and the related Sections to insure those provisions designed to increase true charitable spending does not in fact inhibit such expenditures.



STATEMENT ON H.R. 13270

by Dr. James A. Norton, Director
The Cleveland Foundation

This statement is being submitted on behalf of The Cleveland Foundation and other community trusts or foundations with which I have been associated in community charitable programs for many years.

The Cleveland Foundation was the nation's first community foundation, established in 1914. The basic purpose of The Cleveland Foundation -- and other community trusts and foundations which have followed its pioneering course over the years -- is to provide a responsible community organization to which persons may make contributions to meet the changing charitable and educational needs of the community.

Community foundations throughout the country now number over several hundred, although, of course, they are of different sizes and in different communities take different forms.

Community foundations, whether in trust or in corporate form, generally have the following characteristics: (a) they receive gifts and bequests from a broad segment of the citizens of the community, (b) the funds so received are held in a fiduciary or trust capacity and administered for the charitable and educational purposes of the community, (c) they are governed by a publicly representative governing body (frequently called a

distribution committee), (d) the governing body accepts only those gifts which are consistent with the charitable and educational purposes of the foundation and has authority to vary the terms of any gift so that the funds contributed can meet changing needs and not be rendered obsolete, and (e) they publish financial reports and otherwise are publicly accountable to the community which the foundation serves.

Generally, these community foundations or community trusts are recognized by the Internal Revenue Service as "publicly supported foundations", contributions to which fall in the 30% category of deductions under the existing law. The Treasury Department Regulations issued under Section 170 of the present Code give examples of community foundations which are so regarded as "30% organizations".

There are three points that I would like to make in this statement:

Community Foundations Support Sound Corrective Measures

First, community foundations are not "private foundations", but naturally are very interested in the impact of the pending Bill on all aspects of philanthropy and the support of charitable and educational projects with which community foundations are also concerned. Accordingly, we are vitally interested in the efforts of the Treasury Department and of the Congress in determining the nature and extent of abuses that exist in the operations of private foundations and in adopting corrective measures.

I have previously stated publicly my concerns about such abuses. Appended to this statement is the text of The Cleveland Foundation's quarterly publication, Challenge and Response, for April 1969, in which I strongly expressed my concerns and suggested corrective legislation.

Many other persons have spoken and will speak on whether the solutions now proposed to be adopted in the Bill are effective. I

think it is only necessary to add at this point that we applaud efforts to find proper solutions because the whole field of philanthropy has been tarnished by the improper actions of some. At the same time we urge caution in adopting solutions to problems where the Congress does not have sufficient information or where corrective action direct at errors by a few would adversely affect the good work of foundations generally. We would hope that the effect of new legislation will be to encourage further support for genuine philanthropic programs by foundations and individuals as well as to ensure that abuses by people who are misusing the privilege will be prevented from destroying the proper and strong philanthropic contributions to our society.

This year, a privately-funded study was made in Cleveland of the sources of support of public educational institutions and projects. This study, named The Kent H. Smith Report after its sponsor (who used no tax exempt or tax deductible money of any sort to pay its costs), is described in several other statements to this Committee. Most importantly, it shows the vital and necessary role of foundations in supporting education. Should the Congress, through a tax or otherwise, lessen the incentives to charitable giving in education or other fields, the public will suffer.

We in the Community Foundation movement stand ready to be of any help to the Committee and its staffs in seeking to reach precision in ferreting out problems which require legislative attention without destroying the necessary and vital contributions of foundations to our communities.

Community Foundations are "Public Foundations"

The second point I would like to make is that we believe it is clearly intended by the drafters of the House Bill that community foundations be regarded as public foundations and exempted from the treatment of "private foundations" as that term is

defined in section 509(a) as proposed to be added to the Code by section 101(a) of the Bill.

Section 509(a) includes in the first category of exempt organizations which are not private foundations those organizations that are described in section 170(b)(1)(B) of the Code as amended in the Bill. Section 170(b)(1)(B) corresponds to section 170(b)(1)(A) of existing law -- the category of so-called "30% organizations" or public foundations. As previously indicated, the Treasury Regulations include community trusts and community foundations as examples of publicly supported "30% organizations".

However, I do want to call your attention to an important peculiarity of community foundations as public foundations: Community foundations do file information returns under the Internal Revenue Code (§6033). Community foundations might, on technical and policy grounds, seek exemption from filing such returns, just as universities and similar organizations are exempted. However, community foundations generally, as a matter of policy, have taken the position that because of their public responsibility, they should file information returns on form 990-A. They are supported by the public and they have no objection to filing public information reports. In fact, community foundations were making reports to the public of their activities and finances -- including publishing financial statements in newspapers -- before the Internal Revenue Code was amended to require the filing of information returns.

A particular point of concern to all foundations is the proposed 7-1/2% tax on investment income of private foundations. Even though this tax would not apply to community foundations that are public foundations, it is the view of many responsible community foundation leaders that such tax is unwise because it would reduce the funds available for public philanthropy. A supervisory tax, as proposed by the Treasury Department, would be a preferable alternative to the tax contained in the House Bill. It is understood that this tax, like that in the House Bill, would be imposed only on private foundations. However, if a supervisory tax or a supervisory fee were to be imposed on those §501(c)(3) organizations that file returns, the tax would consequently be imposed on those community foundations which are currently filing 990-A's, making them subject to the tax, whereas it would not be imposed on other foundations, universities, and similar bodies which do not -- and currently need not -- file 990-A's. This, we believe, would be an unfair discrimination against those organizations which have filed returns because of their feeling of public responsibility to do so, and not because they are "private foundations" required to do so.

The Congress, in its wisdom, may decide to charge a fee for administration to all exempt organizations, in which case, of course, it would apply to community foundations, universities, civic organizations, trade associations, unions and the like. Community foundations seek no special privilege, but if the tax in the House Bill is changed to a supervisory tax or similar fee, community foundations should be subject to it -- or exempt -- just as other public organizations.

## Transition Problems under the Bill Should be Corrected

The third point I would like to make is that a matter of particular concern to philanthropy in general, including community foundations, is the problem of transition to the new rules under the proposed Act. The transition affects both the status of foundations and charitable contributions.

The status of many organizations will depend upon regulations and rulings to be issued by the Internal Revenue Service after the Bill is enacted. There undoubtedly will be a period of hiatus until clarifying regulations and specific rulings have been issued. This will create a particular problem for donors who will be uncertain as to whether contributions will be deductible. It will also create a problem for community foundations and other groups which are used to making distributions to other community organizations, the status of which may not be clear under the Act.

It should be clear that community foundations, which have received or will receive rulings that they are "30% organizations" under the present law should be able to rely on such rulings, as determinative that they are not private foundations. However, with respect to foundations which will be dependent upon Treasury rulings that will be forthcoming only some time in the future, it is earnestly suggested that the Committee amend the bill to postpone the effective date of provisions relating to classification of foundations. This postponement should cover a reasonable period of time such as during the year 1970 or until complete

Treasury Regulations have been issued and there is opportunity for specific rulings.

The above matters are submitted for the careful consideration of the Committee to aid it in bringing forth constructive and sound legislation.

James A. Norton
Cleveland, Ohio

September 19, 1969

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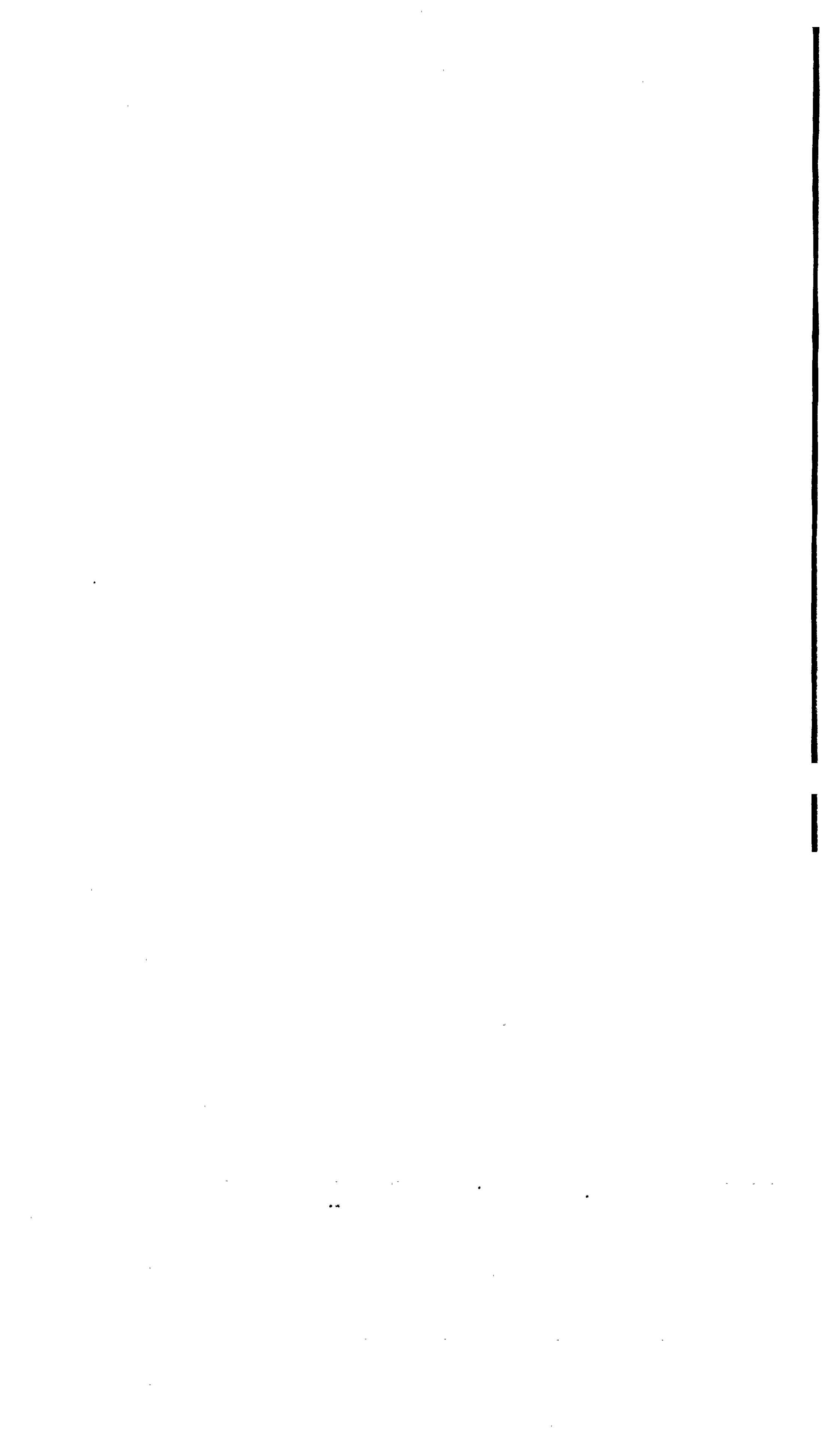

Appendix to Statement of Dr. James A. Norton, Director of the Cleveland Foundation

Challenge and Response
April 1969
(publication of the Cleveland Foundation)

It's been a long time coming, and now it's here — a thorough, open, sometimes painful examination and discussion of the operations and tax-exempt status of America's foundations.

Unfortunately, the examination has produced at least as much confusion as understanding. The headlined description of questionable practices by some foundations had led many, in and out of Congress, to begin questioning the relevance of foundation activity to the public good.

This issue of *Challenge and Response* is devoted primarily to the questions that should now be foremost in the minds of all foundations' trustees, managers and donors. We feel we must speak quite candidly, and encourage others to state their positions also.

In February, 1968's *Challenge and Response*, we reprinted a *Foundation News* article entitled "Muddy Waters." In essence, it recounted the questionable operations of a firm called Americans Building Constitutionally, which was then doing all the paper work to set up foundations for a fee of $10,800 each, so that anyone of means could use the Federal Government's tax-exemption statutes to lessen his income, property and estate taxes. This was an obvious abuse of the intent of tax exemption for private philanthropy.

The same article quoted the late Senator Robert F. Kennedy, who was then calling for tax reforms to plug loopholes: "We cannot — we must not — allow our present tax system to continue unreformed." The article ended with this prophetic statement:

"These and other events suggest that the coming year will at least be an exciting one in the world of the foundation. It could be the year in which the individual foundation comes to have greater concern for foundations as a field."

Since then, Congress did start down the long road toward basic reform of the tax system with the House Ways and Means Committee hearings.

The lead-off witness was Congressman Wright Patman, who has been investigating tax-exempt foundations since 1962.

"I would like to see all these loopholes plugged up," Patman said.

Patman also attacked what he called "foundation foolishness" — a subject to which we too have objected in the past — and described it as the making of grants for "the development of trivia into nonsense." As an example, he cited a study financed by a foundation to determine "the origin and significance of the decorative type of medieval tombstones in Bosnia and Herzegovina." If that is someone's particular interest, fine, Patman said, but it's not adequate reason for Congress to exempt foundations from taxation.

While many of the charges against foundations are not consistent with the facts, the proposals for regulating foundations contained in the U.S. Treasury Department Report of 1965 do have merit. It is time that we examine and respond to them. In that report, six main problem areas are cited:

## 1. Self-Dealing:

Present laws restrict certain transactions between exempt organizations and their donors (and certain other related persons). These include restrictions on loans and payment for services by the donor. In general, these restrictions require that financial transactions be conducted at arm's length.

To meet the problem of "self-dealing," in which foundation assets may be diverted to private advantage, the 1965 Treasury Department Report recommends a general prohibition against financial transactions between a foundation and its founders, contributors, officers, directors or trustees.



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## 2. Deferred Benefits:

Under present law, only some exempt organizations are prohibited from accumulating income unreasonably, and using accumulated income for activities unrelated to the organization's purposes.

To meet the problem of "deferred benefits," in which there may be a substantial delay between the time an exemption for a foundation or a deduction for a donor is granted and the time when philanthropic benefits are derived through actual expenditures by a foundation, the 1965 Treasury Department Report recommends that private foundations be required to distribute their incomes on a current basis.

Generally, a foundation would be obligated to spend its net income (exclusive of income from long-term capital gains) within a year after receipt. Exceptions would be made for foundations that had spent more than their annual income in prior years, or for foundations which were setting aside income for a specific philanthropic project.

## 3. Business Involvement:

The 1965 Treasury Department Report recommends that, with certain carefully limited exceptions, a foundation not be allowed to own 20 percent or more of any outside, unrelated business — incorporated or not — and that a foundation not be allowed to operate any unrelated business.

This is intended to meet objections that private businesses can be placed at a serious disadvantage where foundations have competing operations. It is also intended to meet other subtle concerns, such as the possibility of hidden opportunities for self-dealing, the possibility that foundations can defer grants which benefit the public while accumulating income within a controlled business, and the danger that foundation managements might become so preoccupied with business affairs that philanthropic objectives become secondary.

Whether or not the specific prohibition recommended by the Treasury Department would solve the problem, the concern is certainly legitimate.

## 4. Controlled Property:

Under existing laws, an immediate income tax deduction is granted to the donor of an interest in a business or property to a private foundation, even though the donor retains control over the business or property after the donation. For example, the donation of a 20 percent interest in a family corporation to a private foundation would produce an income tax deduction, even though the donor retained the remaining 80 percent.

In order to meet the problem of such "family use" of a foundation as a device to maintain control of a family corporation or other property, the 1965 Treasury Department Report recommends that where a donor or related party maintains control of a business or other property after contribution of an interest in it to a private foundation, no charitable deduction should be allowed until the foundation disposes of the business or property, the foundation devotes the business or property to philanthropic activities, or the donor's control over the business or property ends.

## 5. Borrowing and Lending:

The Treasury also recommends that speculating and foundation borrowing to purchase investment assets be prohibited, and that foundation lending be confined to categories which are clearly necessary, safe and appropriate within the sphere of the foundation's activities.

The prohibition on lending to high risk projects appears sounder than it is. Actually, the lending of capital for special projects such as poverty-area housing might, in some instances, further philanthropic goals far more than grants to non-profit agencies. The Taconic Foundation has provided leadership in exploring this approach.

The Ford Foundation also has announced that it is investing $10 million of its capital in the decidedly speculative stocks of small businesses to help develop the economies of depressed urban and rural areas, and to help residents of such areas enter the mainstream of American life as owners, managers and employees of such business. The "20 percent" rule recommended in (3) also could adversely affect this sort of effort.

The important point is that high risk loans and investments should not be undertaken for other than philanthropic purposes.

### 6. Broad Management:

Present law contains no limitations upon the life of a foundation or the degree of control that can be retained permanently by the donor and his descendants.

In order to ensure that a private foundation does not continue indefinitely without an objective evaluation of its contribution to society by persons not directly involved in its founding, the 1965 Treasury Department Report recommends that donors and related parties be restricted to 25 percent of the membership of the foundation's governing body after the expiration of 25 years.

Such a rule would allow the donor and his family adequate time to provide direction, spirit and enthusiasm to the foundation's endeavors. On the other hand, it would provide some assurance that private parties can terminate the organization, if, after a reasonable period of time, it has not proved itself to be a useful philanthropic organization.

### GCAF at Hearings:

Many have testified before the House Ways and Means Committee, including Cleveland Foundation Director and GCAF President James A. Norton, who described the formation of the Greater Cleveland Associated Foundation to make grants toward and encourage research on solutions of community problems, to establish priorities for community action, and to encourage wise use of philanthropic funds.

"In our operations we have not been liable to some of the abuses reported . . ." Norton said. "The public character of our board of trustees and of our operation, probably has been a reason for this. As a foundation we deeply regret the abuses that do occur in some instances. Indeed we are indignant with those who abuse the privileges of foundations, not only because of the moral lapses but also because of the very practical concern that foundation philanthropy may be injured with restrictions intended merely to correct abuses."

Later, after listing a number of local efforts and successes, Norton said that "problems of public concern are not either governmental or non-governmental; they are both, and both private and governmental resources must be brought into play.

"This principle permitted the Foundation (GCAF) to assist in planning and launching the first public community college in Ohio, to fight for the development of a juvenile delinquency prevention program, to assist in establishing Cleveland's comprehensive employment program and other projects.

"The resources from government and voluntary agencies have been too meager in manpower and money. Foundation programs have helped draw attention to the need for additional commitment, and we are happy that many more donors are becoming involved."

### Sifting It Out:

First of all, the criticism of some foundations' activities isn't unfounded. In our opinion, abuses do exist.

Some foundations have been used by families primarily to maintain control of family-owned corporations. If the control of a family corporation is the primary goal and philanthropic goals are secondary, such a situation is clearly contrary to the intent of the laws that grant tax exemptions.

Self-dealing and questionable business involvements do occur. The 1965 Treasury Department Report cited some examples of business transactions that are unethical: One donor claimed a tax deduction for giving a foundation $65,000 which was immediately lent back to the donor's company. Another donor made a tax-deductible gift of $400,000 to a foundation which used most of the money to construct buildings which were rented to the donor's business. A third donated real estate to a foundation, claimed a sizable tax deduction, then leased back the properties and rented them out at a profit.

On occasion, foundations have made improper grants to members of their own families, and family members have charged expenses to their foundations. Some legendary examples that we've heard: a foundation for "literary research," which pays expenses of founding-family members to travel to distant places, ostensibly to study literature, and a foundation for "aeronautical research" which owned and maintained its founding family's small plane. Such things are flagrant abuses of the privileges of foundations.

Second, at this point in history when there is a lot of irritation about the income tax surcharge, it is logical for the American people, through Congress, to begin probing rather deeply into the use of the approximate $1.3 billion in annual foundation grants that come from untaxed gifts

and earnings, and which go untaxed to their recipients.

This has led some members of Congress, and many of their constituents, to question the basic usefulness of all foundations, and to wonder whether foundation activities shouldn't be taxed and far more rigidly controlled by the publics which are supposed to benefit from them.

Representative Patman was reported as saying that the U.S. Treasury Department has wrongly permitted the proliferation of foundations (about 2,000 new ones a year) without effective government controls. The unfortunate effect of his remark is to put all foundations and all foundation activities in the same pot.

To quote Alan Pifer, president of the Carnegie Corporation of New York, in an address before the 1968 Conference of the Council on Foundations: "It is customary in American life to talk about 'the foundations' as if they were a collection of comparable institutions, whereas in reality they have little in common except their designation (and not always even that), their tax-exemption, and the animus of Mr. Patman.

"In actual fact, foundations don't even have a separate legal identity, being simply part of the varied assortment of more than 100,000 organizations which enjoy tax-exempt status under the provisions of section 501(c)(3) of the Internal Revenue Code.

"Certainly all foundations don't belong to the Council on Foundations, nor are all of them even listed in the Foundation Directory. Their assets vary from two dollars — this is literally true — to $3.58 billion, and only 28 have assets over $100 million.

"Nevertheless, whether we in the foundations like it or not, everyone else in American life believes there is, and always has been, a homogeneous entity known as the 'foundation field,' in which the members take collective responsibility for each other's actions."

## Our Response:

Foundations have an obligation to lead in the attacks on public problems. Attempts to solve these problems may, indeed, cause some discomfort among those who either do not recognize the existence of problems or who like things the way they are.

In a way, we are saying that foundations are able to do some things that governments and other organizations are not able to do. The document covering the Treasury's tax reform studies and proposals, published jointly by the Committee of Ways and Means of the House of Representatives and the Senate's Committee on Finance, (February 5, 1965) supports this position:

"Private philanthropy plays a special and vital role in our society. Beyond providing financial aid to areas which government cannot or should not advance (such as religion), private philanthropic organizations are 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 in 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 experiences. In doing so, they enrich the pluralism of our social order."

The Treasury report also stated that the "imprecise restrictions in present law against unwarranted private advantage, delay in benefits to charity and participation by private foundations in business have been difficult to administer, hard to enforce in litigation, and otherwise insufficient to prevent these abuses."

So, what do we recommend as a way through all of this?

## Definitions:

First, we agree with Mr. Pifer, as he pointed out to the Council on Foundations, that a more precise definition of foundations is needed. "I have been wondering," Mr. Pifer said, "whether everyone might not find helpful a legal subdivision of the field into two or more distinct categories. As a starter, there might, for example, be subdivisions called *private family charities* and *independent foundations*. [We feel that corporate foundations might be asked to meet all of the standards of *independent foundations*, and therefore should be included in that category. — Ed.]

"The former (*private family charities*) could be of any size, could operate with comparative confidentiality except for filing their annual 990-A's, and could, if they chose, have no one but members of the family as trustees, and could have little or no diversification of their investments. They would, however, by statute, have to be dissolved within a stated period — say ten years — of the donor's death. [We feel that if a time limit is ever established, a family foundation should be able to extend its life if family members continue to contribute to it. However, the Treasury report's recommendation six, on page six, relating to broad management, still should apply in such a situation. — Ed.]

"This type of organization would, therefore, be deemed to be simply an institutionalization of the charitable giving which a man might ordinarily do in his own lifetime, directly out of his own pocket. It would not, once the division had taken place, be considered part of the foundation 'field' as such.

"The second type," Mr. Pifer said, "the independent foundation, would be required by statute to have a specified minimum capitalization and would be required to have a majority of the trustees selected from outside the donor's' family and also be persons who had not been in his direct employment within a specified period. In addition to the 990-A, this type of foundation would be required to publish an annual report listing its investments, its grants and its administrative expenses. It would be required to limit its investment in a single holding to a specified percentage — say 20 percent — of the stock of that company. Lastly, it would be expected, although this could not very well be required by law, to be professionally administered. In exchange for these restraints, it would be permitted to exist in perpetuity and would be given considerable freedom in its program and management."

## Basic Requirements:

We believe there is a great deal to be said for Mr. Pifer's recommendations. However, we disagree with his belief that *private family charities* should be able to operate with relative privacy, relatively free of regulation. We feel that many of the troubles besetting foundations today are a result of some foundations, which Mr. Pifer calls *private family charities*, engaging in questionable practices.

So first we must endorse, with the qualifications noted after their descriptions, all six of the 1965 Treasury Department Report's recommendations. We urge their careful consideration by Congress for the regulation of all tax-exempt foundations, of all sizes and purposes.

Second, the minimum capitalization of an *independent foundation* as described by Mr. Pifer should be sufficient to permit it to engage adequate staff or consultant services to analyze and evaluate the meaningful grant programs that will require the bulk of its income.

Third, we strongly feel that the trustees of all foundations should include community representatives and leaders rather than only the founder's family, friends and employees. Even for *private family charities*, this would assure a degree of objectivity as well as provide a broader perspective.

Fourth, every foundation should establish a policy and program of full, public disclosure of its financial transactions and grant activities. The Cleveland Foundation, following a requirement of its trust agreement, publishes all of its transactions in both Cleveland newspapers each year, and operates a program of public disclosure of grants and activities throughout the year. Such procedure, generally followed, would both apprise the public of the many worthwhile foundation projects and tend to keep foundations from taking steps that will later prove embarrassing.

Fifth, such disclosure should include periodic public reporting of the results of grant programs — the successes and failures of research, pilot projects and other programs. If this is too great a task for a foundation's staff to perform, perhaps the recipients should be required to perform it as the final step in the accomplishment of their grant's purpose.

Sixth, all foundations should welcome examination by the Federal Government — not just now, or this year, but every year. We think that when new rules are written, the Internal Revenue Service should enforce them. But how can the IRS afford to start what amounts to a new operating division to examine organizations that already pay no taxes? It seems appropriate that foundations pay for such an examination, on a fixed schedule of fees, based on assets. Such an IRS examination would turn out to be a great service to philanthropy. It would provide an inspection which foundations have not been able to institute within their own ranks.

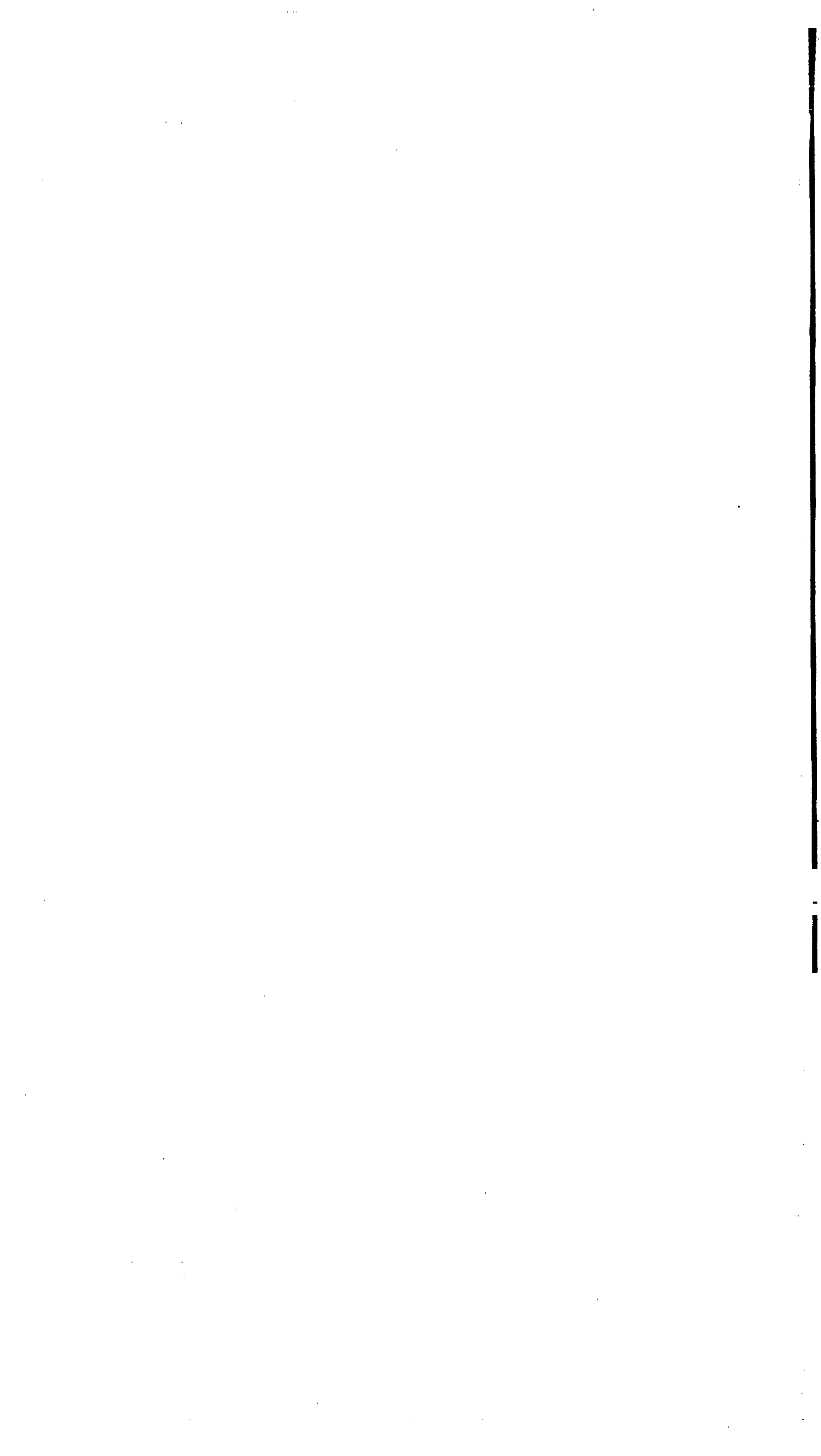
## Action for the individual:

What does all of this mean to an individual who really wants to do the wisest thing with his philanthropic resources?

The current congressional review suggests the need for a renewed focus on philanthropy and its goal of serving man, as contrasted with other reasons for establishing foundations. As Everett Case, former president of the Alfred P. Sloan Foundation pointed out, the freedom to give is "among the basic freedoms which we claim as American citizens." The wisdom and sincerity with which we give will help determine whether other privileges, such as tax deductibility, go with it.

Summary of Statement
by Alvin C. Eurich

The section of the Bill imposing a tax on expenditures to "attempt to influence legislation" would create unduly restrictive program limitations on the activities of private foundations in a variety of areas of social importance. Indeed, this punitive tax would force many private foundations to curtail or even eliminate some of the most socially significant projects being conducted in the private sector. It would, further, foreclose from federal and local governments and their agencies much of the expertise now relied upon in formulating legislative and administrative approaches to matters of current concern. The problem which concerned the House, expenditures by private foundations in connection with grass roots campaigning, can be solved without resorting to the excessive restrictions imposed by the Bill.



**STATEMENT OF ALVIN C. EURICH, PRESIDENT OF ACADEMY FOR EDUCATIONAL DEVELOPMENT INC. TO THE COMMITTEE ON FINANCE OF THE UNITED STATES SENATE**

This statement is submitted for the purpose of presenting to the Committee my serious reservations about certain aspects of the Tax Reform Bill of 1969, H.R. 13270, relating to private foundations. I am, like the vast majority of foundation officials, in complete agreement with the objectives of many provisions of the Bill. I believe, for example, that our federal tax laws should contain stringent prohibitions against self-dealing and financial manipulations, should limit a foundation's permissible ownership of business interests, and should provide for adequate disclosure of a foundation's operations. There are other aspects of the Bill, however, with which I am in strong disagreement -- specifically the 7-1/2 percent tax on investment income, and the tax on expenditures to influence legislation. I will limit my remarks to the provision which is of greatest concern to the Academy for Educational Development, namely, the severe restrictions imposed by the Bill on the programs and activities that can be conducted by a private foundation.

Taxes on expenditures to carry out propaganda, or otherwise attempt to influence legislation. The Bill imposes taxes, of a punitive nature, on foundations and foundation managers for the making of what are called "taxable expenditures".

This term is defined to include, among other things, any amounts paid or incurred by a private foundation to influence legislation through an attempt to affect the opinion of the general public or any segment of the general public, and 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. The only exception to this extremely broad language is for making available the results of nonpartisan analysis or research.

In my judgment, this provison of the Bill, above all others, poses the greatest threat to the continuance of the vital work conducted by private foundations in areas of current social significance. Foundations active in the fields of air and water pollution and other environmental problems, education, judicial and governmental improvement, and poverty could continue many of their activities only under the threat of being subjected to the taxes imposed by the Bill. Since the end product of much of the work of foundations in these areas consists of reports and recommendations, and since some of the problems studied will almost certainly be the subject of legislation at some point, foundation managers would have to decide whether such activities were prohibited attempts to influence legislation. To guess wrong, of course, could result in horrendous financial penalties. In the face of such

circumstances, only the most hardy, or the most reckless, of foundation executives would embark on an untried or controversial project. Needless to say, the health and vigor of the private sector cannot be maintained in such a climate.

I would like to illustrate my concern by reference to the activities of the foundation which I represent, the Academy for Educational Development. The Academy is a section 501(c)(3) educational organization that serves schools, colleges, universities and local, state and federal government agencies and other organizations by examining their operations in the field of education and helping them develop plans for the future. The Academy has a staff of 34 regular members, 12 regular consultants and advisors, and hundreds of educational consultants who provide services for periods ranging from one day to several months. Our staff has used its wide experience to analyze complex problems and develop plans for local school systems, state boards of regents, United States Government agencies, and legislative bodies and committees. For example, over the last 12 months the Academy has completed projects for advisory groups dealing with higher education in Washington, D.C. and the states of California, Delaware and Michigan. It has evaluated the operations and developed future plans

for the school systems of Milwaukee, Wisconsin and Sacramento, California. It has provided studies for the New York State Commissioner of Education and has acted as consultant on educational matters to the university system of Georgia and to the University of South Alabama. It has, since April 1968, been preparing a report for the United States Commission on Instructional Technology, which was established by the Secretary of Health, Education and Welfare through the United States Office of Education to study every aspect of instructional technology and every problem which may arise in its development. The Commission on Instructional Technology, in turn, selected the Academy to undertake the necessary staff work and it has since been engaged in that project.

In the light of this brief review of the type of work in which the Academy is involved, I think you will understand the concern which I and other Academy officers feel over the program limitation provisions of the Bill. Given its far reaching and uncertain language, we would be foolhardy to accept a project from any federal, state or local agency without first consulting our attorneys as to the permissibility of the proposed activities. Whether our attorneys would, in the future, approve the activities we have conducted in the past is open to question. Certainly

the results of some of our work may influence legislation. Indeed, we have in the past been selected by various agencies for the specific purpose of making recommendations that may provide legislative solutions to problems in the field of education. That this is the case is not surprising. We have an expert staff well trained and widely experienced in a variety of educational problems. Our advice is sought because we are experts, and as experts we are accustomed to making recommendations.

I believe our work for the Commission on Instructional Technology is especially relevant. The Congress in the near future may well be called upon to enact legislation in the areas of educational radio and television and other aspects of instructional technology. Responsible agencies of the federal government have sought the aid of a private foundation with expertise that can be of value to the agencies and to the Congress. I find it inconceivable that the House intended to prohibit foundations from rendering such assistance. Under the far reaching provisions of the Bill, however, I feel that such may be the case.

The House seems to have been primarily concerned with the expenditure of foundation funds in connection with grass roots campaigns or lobbying activities. This, of course, is an understandable concern. The House cure for

this problem, however, is restrictive in the extreme and would seriously hamper the important work done by private foundations in areas of current social importance.

October 2, 1969

Alvin C. Eurich

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