TAX REFORM ACT OF 1969

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-FIRST CONGRESS

FIRST SESSION

ON

H.R. 13270

TO REFORM THE INCOME TAX LAWS

PART 7 OF 7 PARTS

GENERAL OUTLINE OF MATERIAL CONTAINED IN PART 7:

- Complete contents and index to hearings
- Summary of H.R. 13270 as reported by the Committee on Finance
- Written testimony received:
  - Foundations
  - Various subjects

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WRITTEN TESTIMONY RECEIVED BY THE COMMITTEE EXPRESSING AN INTEREST IN THE SUBJECT OF FOUNDATIONS

Written testimony received by the committee expressing an interest in the subject of foundations

U.S. CONFERENCE OF MAYORS,
Washington, D.C., September 10, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate,
Washington, D.C.

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 Mayor 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 wtih 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 program 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.

STATEMENT BY MORRIS B. ABRAM, PRESIDENT, FIELD FOUNDATIONS, INC.

SUMMARY

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 definitions of operating foundations 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

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 bill 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 incomes. 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 7½% 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 involvment in influencng 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 he need for wider registration and the dangers of nonersponsible 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 progam 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 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 portion 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 an 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 burdensom 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 as 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).

ANIMAL RESCUE LEAGUE OF BOSTON,
Boston, Mass., September 30, 1969.

Re H.R. 13270—Tax Reform Bill of 1969.

HON. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: The Animal Rescue League of Boston is seriously concerned over the possible effect on its operations in the event of enactment of those sections of the above Bill relating to "Private Foundations."

As one of the older (incorporated in 1899) and well-established societies for the protection of animals and normally receiving more than one-third of its income from "gross investment income," the League might, under the Bill as presently worded, be classed as a "Private Foundation" and subject to a tax on net investment income, including capital gains.

Since its founding, the League has been recognized as a society operating in the interest of public welfare and safety. As an example, it has for years served as Dog Officer and Pound for the City of Boston as well as serving as the City's Quarantine Agent for the control of rabies. In this dual capacity it is conservatively estimated that the City has been saved an amount in excess of five million dollars ($5,000,000.) In addition, the League maintains a livestock conservation department, operates a small-animal clinic and conducts a humane education program in the Greater Boston public and parochial schools.

The Bill, if enacted as written, might subject the League (and societies of a similar nature in the United States which have accumulated substantial endowments from separate gifts over the years) to restrictive requirements designed for the correction of alleged abuse by an entirely different type of organization.

We respectfully recommend that in new Section 509 there be added an additional exempt classification as follows: "(5) A society for the prevention of cruelty to animals or children."

Since this phrase has been in the Internal Revenue Code without change since the Revenue Act of 1918, it clearly indicates Congress' determination that such societies do have a public purpose and that there is no need to create a separate test for humane organizations.

Respectfully yours,

JAMES B. AMES,
Chairman of the Board.

JOINT STATEMENT* OF THE ASSOCIATED COLLEGES OF THE MIDWEST AND THE GREAT LAKES COLLEGES ASSOCIATION

We recognize the reasons that prompted the authors of HR 13270 to recommend a 7½% tax on the investment income of private foundations: unhappily, there have been instances when foundations did not use their resources to accomplish the purposes for which they were created. As recipients of foundation funds, we are keenly concerned that foundation resources are properly allocated.

Nevertheless, we submit that the proposed 7½% tax would significantly constrict the support the recipients of foundation funds now receive. We submit also that foundation activities could be appropriately supervised by the imposition of a lower tax rate, the institution of a licensing system, or other means.

The two associations responsible for this paper represent twenty-four private institutions whose chief concern is with undergraduate education. During the last ten fiscal years, these twenty-four institutions received $113,827,000 from private foundations. This amount is 33.2% of *all* gifts from private sources during that ten-year period. (All private gifts amounted to $342,727,000.) Foundation support is therefore a most important component of our private gift income.

Further, we call attention to the fact that our member institutions—and many others like them—have contributed a disproportionately large amount of individuals to national leadership in the sciences, the arts and humanities, the social sciences, commerce, industry, and politics. The sound, well-rooted, private undergraduate sector of American higher education has clearly demonstrated its capacity to produce such leadership. (And we shall be happy to present statistics to support this statement.)

Nevertheless, private undergraduate institutions are now under intense economic pressure. Deservedly, our faculty salary scales are high; our plants and equipment are modern; our scholarship programs are generous. Yet tuition income supports only some 50% of our disbursements. The rest must come from other sources, the chief of which is private. Any reduction of the capacity of private foundations to help us would unquestionably lessen our ability to do the educational job we have been doing. And such a lessening could reduce the numbers and quality of our graduates who help direct and advance the affairs of this nation.

We turn now from the deep concern we feel for our member institutions to the equally deep concern we feel for the total community of American higher

**The Associated Colleges of the Midwest* (Beloit, Carleton, Coe, Colorado, Cornell, Grinnell, Knox, Lawrence, Macalester, Monmouth, Ripon, St. Olaf).
The Great Lakes Colleges Association (Albion, Antioch, Denison, DePauw, Earlham, Hope, Kalamazoo, Kenyon, Oberlin, Ohio Wesleyan, Wabash, and Wooster).

education. *What* a system—or series of systems—it is! It offers the most creative and lively collection of educational programs ever devised by mankind. A constant fountain of new educational patterns, it is in a state of unparalleled ferment. In other countries, it is progressively being imitated in place of the older, tradition-bound, and stereotyped European systems.

One of the important reasons for this unusual creatively of our system lies in the diversity that we not only allow—*we encourage*: huge tax supported universities; huge private universities; hundreds of small, medium, and large colleges, progressively binding themselves into associated groups; arts and technical colleges and universities; two, four, and six year institutions; those concentrating on the undergraduate, those on the graduate, and those educating both.

This educational system is one of the reasons our American culture has been, and continues to be, a vast creative force in science and technology, in the arts and humanities, and in the social sciences.

Over the past ten years, private foundations have provided several billions of dollars for American higher education, at an ever increasing rate. Not only have these foundation dollars been put to work in ordinary educational tasks, but they have even more importantly stimulated some of the most potent educational thinking, planning, program development, reforms, and advances ever seen in education anywhere. Some mistakes have been made, to be sure, but the overall effect of these grants on American education has been profound.

Since the end of World War II almost every educational advance of any importance in America has been carefully nurtured—particularly during its beginning stages—by a thoughtfully planned and executed program supported at least in part and at least during its early stages of formulation, by a Foundation Grant—sometimes by a series of grants.

At a time when an educational innovator is afire with an idea which eventually could make a difference in the lives of men, he most often would have nowhere to turn if it were not for Foundations. In many instances these Foundations are his only sources of early encouragement. The funds they can allocate at exactly the right time often bring results far in excess of the amount of funds themselves.

Someday the world will look at this period of American history and will recognize that we are truly in a stage of renaissance and that private foundations have been important facilitators of this renaissance.

Had we attempted to make up this loss in revenue from the private foundation by charging added tuition to our students or by asking for public funds, we might have been unsuccessful in our quest. Had we been unsuccessful, our country would be weaker in top level manpower than it now is.

Foundation support is, in a most real way, an assurance that higher education in America will continue to advance. To the extent that this support is lessened, our progress will be slowed.

Respectfully submitted.

HENRY ACRES,
President,
The Great Lakes Colleges Association.
SUMNER HAYWARD,
President,
The Associated Colleges of the Midwest.

AMERICAN LIBRARY ASSOCIATION,
Chicago, Ill., September 8, 1969.

Senator RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I am Executive Director of the American Library Association, a not-for-profit corporation organized in 1869, chartered under the laws of the Commonwealth of Massachusetts in 1879, and having its principal office at 50 East Huron Street, Chicago, Illinois. A general description of the Association and its activities is appended hereto as Exhibit A.

On August 12, 1969, you announced that the Committee on Finance would begin hearings on H. R. 13270, the Tax Reform Act of 1969, on September 4. In this connection, you indicated that the Committee would receive written statements in lieu of testimony on issues of concern.

This letter is intended to constitute the Statement of the American Library Association in respect of those provisions of the Tax Reform Act of 1969 relating to Tax Exempt Organizations, and more specifically, Sections 101 and 201 of such Act relating to Private Foundations and Charitable Contributions.

At the outset, it should be understood that the Association strongly supports the objectives of the Act to the extent those objectives involve the elimination of self-dealing by tax-exempt organizations and the requirement of full disclosure. The primary concerns of the Association relate to those provisions which:

First, define a "Private Foundation";

Second, impose a tax equal to seven and one-half per cent (7½%) of the net investment income of every Private Foundation;

Third, limit the right of Private Foundations to communicate with members and employees of a legislative body or others participating in the formulation of legislation; and

Fourth, change the tax treatment of contributions of appreciated property.

I. Position in respect of proposed definition of "private foundation"

The Association strongly supports the exclusion of those membership organizations, like itself, carrying on extensive educational, scholarly, scientific and charitable activities from the definition of a "Private Foundation" where such members contribute significantly to the support of such activities. The American Library Association would not be defined as a Private Foundation under H.R. 13270. While the Association is an organization described in Section 501(c)(3) of the Internal Revenue Code, it normally receives more than one-third of its support in each taxable year from qualified gifts, grants, contributions or membership fees and less than one-third of its support in each taxable year from gross investment income.

There is, in our view, no rational basis for distinguishing between a 501(c)(3) organization receiving its support from direct or indirect public contributions described in Section 170(b)(1)(A)(vi) of the Internal Revenue Code and an organization, such as the Association, receiving its support from its members, particularly when the public is eligible for membership. In our opinion, the public interest is more certain to be served and protected if it not merely pays the bills for a 501(c)(3) organization but affirmatively and democratically participates in its management and activities.

II. Position in respect of the imposition of a 7½ percent tax on private foundations

While the Association would not be defined as a "Private Foundation" under the provisions of H.R. 13270 and hence would not be subject to the proposed 7½% tax on Private Foundations, the Association and its educational and scholarly activities would be directly and adversely affected were such tax to be enacted.

The American Library Association has for many years conducted programs of great national and international significance to education and scholarly research. Many of the most significant of these programs have been supported by organizations, such as the Council on Library Resources, the Carnegie Corporation, the Knapp Foundation, the Rockefeller Foundation, and the Ford Foundation, to name but a few, which H.R. 13270 would appear to classify as "Private Foundations."[1]

Obviously, the imposition of the proposed tax on Private Foundations would reduce the resources available to support the educational programs of the Association.

However, the opposition of the Association to the proposed tax is not predicated primarily on so parochial a basis as the effect on its own financial resources. The real concern of the Association is with the change in Congressional policy which the proposed tax represents. Obviously, the primary objective of the tax is not to produce revenue, since the 50 to 75 million dollars it would produce is of negligible significance to federal fiscal policy. Similarly, the objective of the tax cannot be to defray the costs to the government of auditing and supervising the foundations and administering the laws applicable to them, since the rate of the tax and its basis appears wholly unrelated to such costs.

Consequently, the tax must represent a marked departure from the long-accepted Congressional policy of encouraging private eleemosynary endeavors. The Association affirms its support of this policy and strenuously opposes any departure from it.

[1] Exhibit B is a representative list of specific programs funded by eleemosynary organizations.

In this connection, we would draw the attention of the Committee to the following facts:

First, that real impact of the tax is not on the Private Foundations which pay it but on the schools, religious organizations, charities and other non-foundation exempt organizations which are the beneficiaries of foundation distributions;

Second, that, by its own terms, the tax provides less favorable treatment for charitable activities than *for* non-charitable activities;

Third, that, notwithstanding various comprehensive investigations of foundation activities, the Treasury Department has *never* recommended a general tax on foundations; and

Fourth, that the tax in no respect reaches the abuses which, in earlier Congressional hearings, provoked Congressional criticism.

It is no justification to assert that the tax will encourage greater reliance upon the public than upon the one-time beneficence of one individual or family. Indeed, it would be an odd policy which would discourage the charitable contributions of the wealthy in order to encourage contributions from the poor.

We submit that, in lieu of the proposed tax, the Committee consider the imposition of an audit fee to cover the cost to the government of administering Private Foundations.

III. Position in respect of the proposed limitation on right of private foundations to communicate with members and employees of a legislative body or others participating in the formulation of legislation

The American Library Association concurs with the philosophy of H.R. 13270 insofar as it would prohibit foundations from (a) engaging in grass-roots political campaigning or grass-roots efforts in favor of or opposition to particular legislation, (b) lobbying individual legislators, or (c) electioneering on behalf, directly or indirectly, of individual candidates. The Association is concerned, however, that Subsection (e) of Section 4945 as proposed in Section 101(b) of the Act is broader than the Congressional policy and introduces uncertainties which would discourage foundations from supporting many legitimate and worthwhile activities. In our opinion, the intent of Congress, as we understand it, would be more clearly expressed if Subsection (e) of Section 4945 of Section 101(b) of the Act was amended to read as follows:

"CERTAIN ACTIVITIES EXPRESSLY INCLUDED WITHIN SUBSECTION (b)(1).—For purposes of subsection (b)(1), the term 'taxable expenditures' means—

(1) any attempt to influence legislation through an attempt to urge or encourage the general public, or any segment thereof, to contact members or employees of a legislative body for the purpose of proposing, supporting or opposing such legislation, and

(2) any attempt to influence legislation through private communication with any member or employee of a legislative body, except in response to a request by such member or employee,

other than through making available the results of non-partisan analysis, study or research, or providing non-partisan technical assistance. This subsection shall not apply to any amount paid or incurred in connection with an appearance before, or communication to, any legislative body with respect to a possible decision of such body which might affect the existence of the private foundation, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation."

IV. Position in respect of provisions relating to charitable contributions of appreciated property

Since the American Library Association represents the libraries of schools, colleges, and public libraries, it is of course deeply concerned with the provisions of Section 201(c) and (d) of the Bill governing the tax treatment of charitable contributions of appreciated property, particularly gifts of art works, paper collections and other tangible personal property.

The present tax treatment afforded contributions of appreciated property has greatly encouraged owners of irreplaceable books, documents, pictures and other personal property to contribute such treasures to exempt institutions. In turn, these institutions have made these treasures available to the public and have provided for their preservation. The result has been a vast accretion of the art and literature available to the public and future generations.

We do not deny that significant tax benefits are realized from contributions of appreciated property. However, in the experience of our members, there must be an extraordinary incentive to motivate owners of treasured art or literature to forego exclusive control of rare and unique works and collections. On balance, the Association believes the social and cultural benefits generated by the present tax treatment of personal property vastly outweigh the revenue benefits realizable by the federal government through the elimination of such treatment.

In opposing a change in the tax treatment afforded charitable contributions of appreciated art, literature and other tangible personal property of similar character, the Association does not ignore the abuses which have occurred involving inflated and specious appraisals. However, the Association believes that these abuses are better cured by Internal Revenue Service review of appraisals rather than by a change in tax treatment. In this connection, the Association has offered to work closely with the Internal Revenue Service to develop meaningful criteria for the appraisal of literary property. By this effort we hope to aid in the elimination of the principal abuses under the present tax law arising from improper appraisal.

We would be most pleased and privileged to meet with you, your Committee, or your staff to discuss the foregoing positions further and to provide such additional information as you may require.

Yours very truly,

DAVID H. CLIFT,
Executive Director.

EXHIBIT A—GENERAL DESCRIPTION OF AMERICAN LIBRARY ASSOCIATION

The Association was created over ninety years ago "to promote library service and librarianship." [Article II, Constitution of American Library Association] Tho terms "library service" and "librarianship" as used in the Constitution encompass all activities which serve to preserve the world's accumulated knowledge and wisdom and to improve man's access to it.

Since the acquisition and dissemination of knowledge and wisdom is the very essence of education, the Association has achieved and maintained for many years a preeminent position of authority and respect among educators and those concerned with the advancement of education. The Association is internationally recognized as the primary educational resource for the solution of problems involving library service and librarianship.

Utilizing the collective knowledge, experience and talents of its members, which today number in excess of 40,000, the Association is actively engaged in an almost infinite variety of programs in direct support of education, scholarship, charity and science. Thus, the task of preserving the world's accumulated knowledge and wisdom involves the Association in such activities as (a) programs to improve the size and quality of library collections and access to rare books and documents; (b) programs for the interchange of catalog information between libraries; (c) library development and training programs throughout the United States; and (d) programs for the restoration of collections which are damaged or destroyed by natural disaster or war.

Similarly, the task of improving access to the world's knowledge and wisdom involves the Association in such activities as (a) programs to improve library service and facilities at every educational level, college, junior college, high school and elementary school; (b) programs to encourage people to read more (National Library Week is Association-sponsored in cooperation with the National Book Committee); (c) programs to develop reading aids for the visually handicapped and reading guides for adult illiterates; and (d) programs to develop uniform cataloging procedures.

The activities of the Association, of which the foregoing are merely representative examples, involve extensive work with all governmental agencies, local, state, regional and national, concerned with libraries and library service. Such work involves not only work with boards of education and of public libraries but joint programs with the Office of Economic Opportunity, the Department of Health, Education and Welfare, the National Science Foundation, the Department of State, the United States Agency for International Development, the National Agricultural Library, the Civil Service Commission, the Department of Defense, and the Library of Congress.[1]

[1] Appended hereto is a representative list of specific programs conducted under the auspices of agencies and departments of the Federal Government.

REPRESENTATIVE LIST OF SPECIFIC PROGRAMS CONDUCTED UNDER THE AUSPICES OF OR IN COOPERATION WITH DEPARTMENTS AND AGENCIES OF THE FEDERAL GOVERNMENT

1. Bibliotherapy Project

U.S. Department of Health, Education & Welfare.—Conduct of an interdisciplinary workshop on bibliotherapy—the use of books as an adjunctive to mental health therapy—involving sociologists, psychiatrists, therapists, institutional administrators, and other concerned with mental health and rehabilitation.

2. Acquisition Study

National Science Foundation.—Analysis of current decision-making activities relative to the acquisition of science library materials in college and university libraries, with particular emphasis on smaller facilities.

3. Multiarea Group Libraries

U.S. Department of State.—Program under which librarians from other countries visit the U.S. to become better acquainted with American libraries and librarianship through 3-week seminar, 5-week internship, and several weeks of professional travel and visits.

4. National Conference on Library Statistics

U.S. Department of Health, Education and Welfare.—To support a conference, held in cooperation with the National Center for Education Statistics and the Division of Library Services and Educational Facilities, U.S. Office of Education, to consider the best means of implementing the statistics handbook; to discuss the national plan for the collection and dissemination of library statistics; and to explore the relationships between the DLSEF, ALA, and state libraries in the gathering and dissemination of library statistics.

5. National Union Catalog

Library of Congress.—To provide for the publication, in book form, of the National Union Catalog of publications with imprints of 1955 and earlier (now only a file of more than 16 million cards at the Library of Congress) showing the combined library holdings of more than 2,000 libraries in the United States and Canada. The editorial cost of preparing the catalog for the press will be paid in full by the publisher, and the work will be carried out by the Library of Congress. The work, when completed, will be the largest single publication in the history of printing.

EXHIBIT B—REPRESENTATIVE LIST OF SPECIFIC PROGRAMS SUPPORTED IN WHOLE OR IN PART BY FOUNDATION GRANTS

1. American Library Laws

Council on Library Resources, Inc.—A compilation of all current state, federal and territorial laws concerning libraries. Supplements to the third edition, 1964, the second of which was published in 1967, are issued biennially, and contain laws added, amended or repealed since the previous supplement.

2. ACRL Foundation Grants Project

Various donors.—To improve the library collections of privately endowed institutions whose curriculum constitutes or incorporates a four-year program of undergraduate instruction.

3. Haile Selassie I University of Ethiopia

Ford Foundation.—To purchase books, periodicals, and other library materials for the development of the general library.

4. Library/USA

Various donors.—To establish the demonstration library in the U.S. Pavilion at the New York World's Fair of 1965 and 1966.

5. Study of Systems of Public Libraries

Council on Library Resources, Inc.—To test the validity of the concept that cooperative library systems can provide service comparable to that supplied by city libraries.

6. University of Delhi Project

Rockefeller Foundation.—To provide for improvement of the program of library education at the University of Delhi, through the recruitment of American visiting professors and consultants, selection of Indian librarians to study in the U.S., provision of observation tours of the U.S. for the Director of the Institute of Library Service, Delhi, acquisition of supplies and materials, and continuing advice and consultation.

7. Compilation of List of Non-Government Printing Office Federal Government Publication

Council on Library Resources, Inc.—Program to identify and compile Federal Government Publicatons not printed by Government Printing Office to provide libraries with billgraphic information permitting greater access to such publicasuch publications.

8. Adult Illiteracy Study

Jo Morris Jones—World Book Encyclopedia—Ala Goals Award Study.—Study of library services to adult illiterates in a limited number of localities to determine what adult education agencies offer literacy programs; the personnel, methods, and instructional and supplementary materals used; the relationships between these agencies and the local libraries; and the library services and supplemental reading materials available and/or needed.

9. University of Brasilia Project

Ford Foundation.—To support and develop the library system of the University of Brasilia, including the purchase of books and other materials, the recruitment of consultants, and the selection of Brazilian librarian candidates for specially arranged training programs in the United States.

STATE OF NORTH CAROLINA,
DEPARTMENT OF THE STATE AUDITOR,
Raleigh, September 23, 1969.

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

HON. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

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.

NATIONAL FEDERATION OF
SETTLEMENTS AND NEIGHBORHOOD CENTERS,
New York, N.Y., July 10, 1969.

HON. RUSSELL LONG,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. LONG: The Senate Finance Committee is rendering an important public service in designing measures for tax reform, including the correction of any abuses in foundation practices.

We are most alarmed, however, about the proposal that would restrict a foundation from engaging directly or indirectly in any activities "intended to influence the decision of any governmental body (whether or not such activity is substantial." If an informed citizenry is essential to a democracy, this provision would strike at the very heart of the concept.

Voluntary organizations are unique expressions of a free society, and their importance has been recognized through measures which foster contributions to their support. Partisan political activity is clearly prohibited and control meassures are adequate.

It would be foolish, however, to cut off support for educational efforts which encourage citizens to exercise their franchise, and which provide them with information which makes them more capable of making sound choices in a complex society.

One of the major threats to our nation is the frustration of citizens who feel overwhelmed, unable to make their voice heard. We need desperately to increase their sense of belonging, and to see that government can be responsive to their needs. The proposed restriction is completely contrary to this goal.

Voluntary agencies such as ours have freedom and flexibility which is needed as we struggle to find creative solutions to urban problems. Foundation grants are of great importance in this effort. We urge that no limitation be placed on voter registration or providing information on legislative issues.

We also are against any proposals which will reduce charitable giving, since such contributions are not loopholes, but are constructive and unselfish acts by citizens. We feel that such giving should be encouraged rather than limited.

Sincerely yours,

MARGARET BERRY,
Executive Director.

NATIONAL FEDERATION OF MUSIC CLUBS,
Gastonia, N.C., July 3, 1969.

HON. RUSSELL B. LONG,
Chairman, U.S. Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: The six hundred thousand members of the National Federation of Music Clubs urges that the U.S. House Ways and Means Committee and the U.S. Senate Finance Committee consider the following as they formulate the actual tax reform legislation that will be submitted to the House of Representatives and the Senate respectively.

1. Thru clarification of the definition in the legislation, remove the threat that nonprofit, tax exempt music organizations, their supporting endowment funds and auxiliaries might be deemed "private foundations", but rather give them the same favored treatment that is proposed for churches and colleges.
2. Make no changes in existing rules regarding tax deductibility of appreciated property when contributed to nonprofit, tax exempt music organizations.
3. Eliminate the proposed tax on private foundation income since such tax would necessarily lead to reduction of foundation support of nonprofit, tax exempt music organizations.
4. Protect the right of private foundations to make direct grants for study, training and research to creative and performing artists (composers, singers, conductors, instrumentalists, etc.), musical scholars and administrative trainees.

As Chairman of the Legislative Action Committee of the National Federation of Music Clubs, I am writing to thank you for all the consideration given to our requests for your support of the proposed tax reform legislation.

Most sincerely,

MRS. JAMES W. BOLDING, Jr.,
Chairman, Legislative Action Committee.

STATEMENT BY BERNARD BERELSON, PRESIDENT OF THE POPULATION COUNCIL

Anyone who gives even cursory attention to public affairs these days cannot fail to know that the population problem is high on the world's agenda. In recent years, there has been a remarkable increase of awareness that undue population growth is threatening the quality of human life throughout the world, and particularly in the developing countries that are struggling to emerge into the modern era. In the last few years, this awareness has been signaled by the development of population efforts in the United Nations, the expansion of USAID programs into this field, the issuance of the World Leaders' Statements signed by thirty heads of state from all parts of the world, and, most recently, the first Presidential message on population ever submitted to the United States Congress. In short, the problem is great and consequential, and efforts are now being made to do something about it.

That is where the Population Council comes in. The Population Council was established in November 1962 "to stimulate, encourage, promote, conduct, and support significant activities in the broad field of population." We seek to advance and apply knowledge in this field by fostering research, training, and technical assistance in the social and bio-medical sciences. The Council enjoys a highly respected and central position for its professional work on this problem around the world. We are a leading clearinghouse of scientific information; we have advisory technical personnel resident in 15 developing countries; we have administered a major fellowship program in this field over the years, with over 600 recipients; our Bio-Medical Division conducts a basic scientific program to advance contraceptives technology, the major effort in the public sector and perhaps otherwise; we have on our staff what is probably the broadest range of scientific and professional expertise devoted to population matters in a single organization, across the whole range of relevant disciplines from demography and economics through public health administration and health education, all the way to reproductive physiology and obstetrics/gynecology.

The Council exists through the support of interested donors—foundations, individual contributors, and the Federal government itself. We consider it a double tribute, to the problem and to our own work, that this organization sustains an annual budget recently increased to the $11–12 million level, almost completely from such outside support.

In view of the seriousness of the problem and the growing recognition that actions must and can be taken to alleviate its consequences, I sincerely believe that if the Population Council did not exist it would have to be invented. Hence the implications of the Bill for this organization are serious indeed.

If H.R. 13270 were enacted into law in its present form it would have a disastrous effect upon the Population Council—an effect that we believe is entirely inadvertent. The reason is that under the Bill's present language the Council does not qualify as a "private operating foundation". We do receive significant support from five or more independent exempt organizations but not "substantially all" our support since we also receive substantial contributions from two other sources—individual contributors and the Federal government, chiefly AID. If these latter two sources are not subsumed under the term "the general public", as appears to be the case, then the Council is not a "private operating foundation" and hence is excluded from receiving "qualifying distributions" from the major foundations which have generously supported us in the past.

It is hard to understand what useful social purpose is served by this arbitrary exclusion, or indeed to believe it was intended particularly in view of the clear recognition in the House Committee Report of the value of "Special-purpose foundations, such as learned societies, association of libraries, and *organizations which have developed an expertise in certain substantive areas* and which provide for the independent granting of funds and direction of research in those specialized substantive areas." (page 42). There is no question of "hoarding", since we promptly expend our funds for our exempt purposes and have even run a deficit last year and this year.

Accordingly, we seek release from this danger to the viability of our organization. I respectfully append two suggestions for such release. One would allow us to include governmental funds and large individual contributions in the "support test" of the definition of "private operating foundation." The other suggestion is to have the term "qualifying distribution" include any amount paid to a private foundation which expends contributions received by it within one year.

We cannot believe that, in view of the expressed policy of this government with respect to the great problems of population growth, it is sound public policy to penalize a scientific, technical, and professional organization such as the Population Council—an organization more needed now than ever to work on this problem—by arbitrarily removing it from sources of funds that have enabled it to make major contributions in the field of population.

[Suggestion No. 1]

H.R. 13270 IN THE SENATE OF THE UNITED STATES, SEPTEMBER, 1969

Ordered to lie on the table and to be printed

AMENDMENTS

Intended to be proposed by Mr. -------------- to H.R. 13270, an Act to reform the income tax laws, viz:

On Page 34, strike out the words on lines 8 through 16 and insert:

"(ii) Substantially all of the support (other than gross investment income as defined in section 509(b)(2) of which is normally received from a governmental unit referred to in section 170(c)(1), or 5 or more persons except exempt organizations described in section 4946(a)(1)(H) with respect to each other or the recipient foundation, and not more than 25 percent of the support of which is normally received from any one such person."

[Suggestion No. 2]

H.R. 13270 IN THE SENATE OF THE UNITED STATES, SEPTEMBER, 1969

Ordered to lie on the table and to be printed

AMENDMENTS

Intended to be proposed by Mr. -------------- to H.R. 13270, an Act to reform the income tax laws viz:

On page 30, on line 15 strike out the word "or", and on line 19 strike out the period and insert:

", or

(C) Any amount paid out to a private foundation or an organization which would be a private foundation if it were a domestic organization, if such private foundation or organization pays out such amount to accomplish one or more purposes described in section 170(c)(2)(B) within one year of the receipt of such amount."

SOCIETY OF ARCHITECTURAL HISTORIANS,
Philadelphia, Pa., October 3, 1969.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: The Society of Architectural Historians, at a special meeting on 27 September 1969, voted strong support of the testimony prepared for the Senate Finance Committee by President Frederick Burkhardt, of the American Council of Learned Societies. Specifically, the Society feels HR13270 should be rewritten, as follows:

(1) Scholarly organizations should be excluded from the foundations category, not by formulas as to sources of support, but by explicit definitions as to functions performed; and

(2) Private foundations able to demonstrate their service to the public good should be exempt from taxation.

It clearly is not the intent of the legislation to penalize private foundations that aid scholarly activity but rather to curb improper abuses of the foundation status. The provisions of HR13270 would however have a detrimental effect on scholarly foundations and institutions. The Society urges, therefore, that a wording be devised that would both encourage scholarly institutions and foundations and terminate the abuses that have caused some of the clauses of House of Representatives' Bill 13270.

Sincerely,

HENRY A. MILLON, *President.*

STATEMENT OF FREDERICK BURKHARDT, PRESIDENT, AMERICAN COUNCIL OF LEARNED SOCIETIES

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 definition 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 on 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 organizations 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 organizations 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 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.

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

VIRGINIA COMMONWEALTH UNIVERSITY,
Richmond, Va., September 30, 1969.

Senate Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SIR: It has come to my attention through the Council on Foundations, Inc., that you would be interested in comments from Grantees with regard to the Tax Reform Bill, H.R. 13270.

Virginia Commonwealth University is a state-supported university offering a wide range of programs for almost 14,000 students. We have a large School of Medicine, the only School of Dentistry in Virginia, the only School of Pharmacy in Virginia, a large program in Nursing, and a large program in various allied health professions. We offer the doctorate in several areas of the biological and physical sciences, particularly those related to medicine. This past year the University received a total of almost $7 million in gifts and grants. Our efforts in the money-raising area have not been commensurate with the size of our programs, and we would hope that the future will find us sharing in the gift dollar more significantly than we have in the past.

As a state-supported institution, we can only agree wholeheartedly with the desire to correct some of the abuses of tax privileges which have occurred in the name of various foundations. In a number of situations, it is merely another name for an operating business.

However, a number of foundations, and particularly a few very large ones, play a very significant role in the support of research and educational progress in the field of higher education. To seriously inhibit the beneficial progress which has been made possible through these foundations would seem to be a short-sighted approach to revenue collection. The overall progress of the country might be seriously impeded over a period of years.

The percentage level of the tax is obviously a difficult question and quite unrelated to the control of abuses. The 7½ percent level would seem to be higher than it might be if the foundations were private corporations.

The requirement to pay out annually the greater of either the adjusted net income or 5 percent of the income-producing assets is not, in itself, an undesirable restriction. However, the failure to recognize the cost of the extensive grant program activities of some foundations as part of this allotment would seem to be a punitive restriction on certain foundations.

In my experience at this and other institutions, I have come to regard the support of Research Corporation for various types of programs in the sciences as highly beneficial. I have also taken advantage of the service they provide in evaluating and processing patents for faculty. From a selfish standpoint, we could only hope that this type of activity, when done in a philanthropic manner such as has been pioneered by the Research Corporation, would be encouraged and recognized in the Bill through the appropriate definition of "operating" and "qualifying distributions" terms. It may not appear desirable in a Bill which is seeking to close loopholes to provide for some sort of review of unforeseen situations in which the Bill restricts some philanthropic foundation in an unreasonable manner.

In various situations the disqualification of foundation directors because of their association with a university could cause serious punitive effects on particular institutions. If one of Virginia Commonwealth University's top scientists were invited to serve on such a Board, I would feel that it would be most desirable for achieving the best philanthropic utilization of the funds and would not like to feel that it would exclude us from consideration.

We greatly appreciate your interest in creating an effective legislative document. We are pleased to have the opportunity to offer our comments on the good and bad features of the Bill under consideration.

Sincerely,

WARREN W. BRANDT, *President.*

STATEMENT OF THE AMERICAN BAPTIST HOME MISSION SOCIETIES, AN AGENCY OF THE AMERICAN BAPTIST CONVENTION, SUBMITTED BY ATHA J. BAUGH, DEPUTY EXECUTIVE SECRETARY

We of the American Baptist Home Mission Societies are in accord with the intent and with many of the provisions of the Tax Reform Act of 1969, H.R. 13270, passed by the House of Representatives and now under consideration by the Senate Finance Committee. We approve the section of the bill which would correct tax evasion by penalizing contributions of property or funds to spurious "tax haven" foundations.

However, as an organization deeply interested in the maintenance and/or restoration of our urban areas, we take exception to some of the provisions which deal with private foundations. We feel that some of these would almost certainly lead to unfortunate results not anticipated by the writers of this bill. These we hope the Senate will see fit to correct.

One such provision is the denial of tax exemption on contributions for nonpartisan voter registration. We have read the bill's limitation of this definition—for instance, that a contribution may be made for a nonpartisan voter registration campaign if it covers at least five states. Nevertheless, we feel that the requirement is so stringent that it would almost certainly cripple foundations in their attempt to back small but worthy organizations, working in limited areas for wider citizen participation in the electoral process, on a nonpartisan basis.

Many such organizations concentrate their efforts in areas where the percentage of registered voters has been low and where the need is greatest. Such concentration serves a dual purpose: it attempts to solve the problem where it is most acute, and it conserves funds. The requirement that a five-state area be covered could easily make such an attempt impossible.

Regarding the structures on the activities of foundations which might influence legislation, it is hard to imagine any forward-looking program which might not be so interpreted. Private foundations, in studying the projects to which they will contribute, analyze social issues. These studies are essential to their work, yet it would be difficult to conceive of any statement or analysis of a social problem or situation which, if taken seriously, might not have some influence—perhaps indirectly—on legislation.

Though the bill would permit "nonpartisan analysis and research" each foundation would be responsible for seeing that its results would not affect legislation. Since, in a democracy, this cannot be guaranteed, the effect would be to limit foundations to "safe", noncontroversial, noninnovative projects, with resulting loss to the country.

Private foundations have been increasingly involved in public welfare programs. In many instances they have been able, through their support of pioneering projects, to discover techniques which have been of great value to both governmental and private agencies in planning permanent programs. If private foundations are not able to engage in such experimentation, the government itself will be deprived of a valuable social laboratory.

The House bill proposes to regulate the operations of foundations by provision that they must receive substantially all their support from five or more tax-exempt organizations and from the general public, and that not more than 25% may come from any one such tax-exempt organization. This would make it impossible for a wealthy donor to carry the burden of any one activity. We believe it is better to encourage donors to contribute to any socially useful program that is of concern to them.

We respectfully suggest, therefore, that the Senate amend this bill to these ends:

1. to make it possible for private foundations to support nonpartisan voter registration efforts in limited areas and without the multi-organizational base now written into H.R. 13270.

2. to make it possible for private foundations to study and analyze social questions without regard to the possible effect of the findings on legislation.

3. to make it possible for foundations to contribute to pioneering and innovative projects without fear of inadvertently violating this law.

4. to make it possible for foundations to accept contributions from interested donors, whether persons or organizations, without crippling restrictions.

Amendments which would accomplish these objectives would help provide socially useful agencies, both private and governmental, with useful studies and experiments, would increase the number of socially useful programs carried on by educational and social welfare institutions, and would strengthen our system of government by keeping open "the market-place of ideas," in the behalf that American citizens, whom we already trust with the ballot, can discern what is in the best interest of their country and will act accordingly.

Statement Concerning the Impact of Distribution Requirements of Section 4942 on the Cooper Foundation, Waco, Tex.

The Cooper Foundation was created in 1943 with an initial grant of $50,500 from its founder, M. A. Cooper, Jr. This was supplemented at his death by the bequest of all of his estate, approximately $2,500,000. The purpose of the Foundation as set out in the trust indenture is "to make Waco, Texas a better and more desirable place in which to live." For over twenty-five years the Trustees of the Foundation, none of whom can ever be selected from the Cooper family until after the year 2000, have fulfilled that purpose by making 150 different grants for the education, planning, recreation, civic promotion, cultural support, beautification, health and medical care for the betterment of Waco. Income of the Foundation since its inception totals $1,113,000, of which all has been expended for grants except $68,647, being the balance of income available for grants as of the last audit date, March 31, 1969. The Foundation for the last twelve years has published and distributed annual audited reports of its activities setting forth in detail its assets, income, expenses, and grants.

A significant portion of the assets of the Foundation is in real estate, consisting of marginal downtown property, farms and ranches. All leases are "arms length" transactions for the highest available return to tenants, none of whom are connected with either the Trustees or the Cooper family. The Foundation owns no controlling interests in the stock of any corporations. Despite good management, the return from real estate (representing approximately one third of the Foundation's assets) is less than 2% of fair market value and the return from its securities portfolio (65% common stocks and 35% bonds) averages

3½% of market value. The Trustees are prohibited under the trust indenture from ever selling any real estate and from invading corpus to make grants. Thus it is impossible for the Trustees to comply with distribution requirements of Section 4942 based on a five per cent minimum investment return, without violating the terms of the governing instrument and the intention of the trustor expressed a quarter of a century ago for the perpetual concern for his native city.

As originally drawn, Section 4942 provided for an exclusion of those foundations whose governing instrument did not permit invasion of corpus. This provision was deleted a few days before final passage of the bill by the House. It is submitted that this exclusion be restored with appropriate sanctions to safeguard against unwise use of corpus. A suggested restatement of that provision is as follows:

RESTATEMENT OF A PORTION OF SECTION 4942

SEC. 4942.—In the case of organizations organized before May 27, 1969, Section 4942 shall—

(A) for taxable years beginning before January 1, 1972, apply without regard to the minimum investment return provision (as defined in section 4942(e) as added by this act);

(B) not apply to an organization which is prohibited by its governing instrument from invading corpus to the extent the rules of section 4942 are inconsistent with such prohibition; *provided all of the income of such foundation shall be distributed annually and the corpus of such foundation shall each year be shown to the satisfaction of the Secretary of the Treasury or his delegate, to have been invested according to the "reasonably prudent man" rule or similar standard as shall be required by the Secretary of fiduciaries in carrying out their investment responsibility.*

It is submitted that the above underlined sanctions should adequately safeguard the prudent investment of corpus, insure the maximum distribution of income, and still permit carrying out the philanthropic intentions of trustors of existing foundations.

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

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(5) of the proposed bill and the proposed new section 4943 of the code.

Statement by James Stacy Coles, President, Research Corporation, a Foundation for the Advancement of Science

Research Corporation, a foundation for the advancement of science incorporated in New York State almost 58 years ago, before the income tax was instituted, agrees that there should be legislation to control any abuses of tax privileges. By the correction of such abuses, foundations could be even greater contributors to the national welfare than they have been in the past. H.R. 13270 contains many provisions, however, that do not accomplish these objectives, and which would detract from the value and effectiveness of present foundation programs.

In the brief debate upon this bill in the House, a number of Representatives seemed to be of this opinion. As reported in the Congressional Record of August 7, 1969, a majority of those who addressed themselves to the foundation portion of the bill took exception to certain measures which appear punitive. There was also a rather generally expressed hope that the Senate in its consideration of the bill would correct these unintended punitive effects. We join in that hope.

Certain provisions of H.R. 13270 would specifically and adversely affect Research Corporation, an organization which has a long history of supporting the physical, biological-medical and nutrition sciences, and which has for many years brought science into public usefulness through its patent assistance program.

I. Background of Research Corporation

Research Corporation is a nonprofit organization established in February 1912, operating under the provisions of section 501(c)(3) of the Internal Revenue Code. Its Certificate of Incorporation provides two principal purposes: (*a*) to render inventions and patents more available and effective in the useful arts and manufactures and for scientific purposes; and (*b*) to provide for the advancement and extension of technical and scientific investigation, research and experimentation by contributing its net earnings to scientific and educational institutions and societies to enable them to conduct investigations, research and experimentation.

In accordance with these purposes, Research Corporation was supporting fundamental scientific research some thirty years before the conception of the National Science Foundation and the development of other massive Government support of science. For example, in 1923 Research Corporation made a grant of $5,000 to The Smithsonian Institution to support the experiments of the then unknown scientist, Robert H. Goddard, on rockets. From Goddard's pioneering work, we now have men in space and on the Moon. In 1930, a grant later described as "critically important" was made to the University of California to support the development of the cyclotron by Professor Ernest O. Lawrence. Today advanced medical research makes use of radioactive isotope tracers, cancer patients benefit from radiation therapy with radioactive cobalt, and remote areas have electricity generated from nuclear power.

Immediately after World War II Research Corporation developed the program of Project Grants to support scientific research in colleges and universities. This was a precursor for the similar National Science Foundation program of research grants inaugurated in the 1950s. In the early 1960s we developed a program of Departmental Grants to help strengthen the sciences broadly in the liberal arts colleges and smaller universities. Many concepts of this program are now found in the COSIP Program of the National Science Foundation. In our recent and current work, our Regional Grants Directors, themselves trained scientists, spend much time on college and university campuses in developing with faculties and administrations the most effective form of support for science by Research Corporation that might apply in a particular situation. This is an operating program activity which provides a firm and well informed basis for the program of grants.

An equally important program of Research Corporation is the rendering of patent assistance to colleges, universities and other nonprofit institutions. It was conceived, as directed by our Certificate of Incorporation, so as to bring inventions from the laboratory into wide use for the benefit of the public. Outstanding examples of successful endeavors are represented by vitamin B_1, used widely for the combat of beriberi and in diet enrichment, and such pharmaceutical compounds as cortisone, reserpine and nystatin, which have done so much to relieve human suffering. (In other countries where no organization like Research Corporation has existed, governments have established quasi-public corporations at government expense to perform the function of bringing inventions from university and government laboratories into public use, e.g., the National Research Development Corporation of Great Britain, and the Research Development Corporation of Japan.)

Research Corporation is unique among foundations in three ways: (1) its special purpose is the support of scientific research; (2) it has highly developed skills and capabilities in its patent assistance program which it provides to colleges and universities without charge; and (3) this foundation was not the creation of a man of wealth, nor created from nor existing on surplus wealth.

Dr. Frederick Gardner Cottrell, a professor of chemistry from the University of California who founded Research Corporation in 1912, gave as the foundation's only endowment his concept of a need and a useful purpose to be served, and undeveloped patent rights on electrostatic precipitation devices for the control of air pollution. His ideal later effectively implemented, was that this organization would develop for the public benefit these patent rights as well as those of other inventions which might come into its possession. Any net earnings were to be turned back to support further scientific research, rather than have them used for personal profit to him or to other persons who similarly donated their inventions.

Cottrell's own words are pertinent: ". . . there are a great many men who would not feel that it was worthwhile to work out an invention merely to dedicate it to the public in the loose, general way now provided for in our patent law and who have not the time or do not care to work out the full practical applications, but who would still be glad to donate their ideas and cooperate to a certain point with a public bureau whose business it was to develop just such problems."

This summary states very succinctly the unusual nature of Research Corporation—partly an operating foundation and partly a grant-making foundation, which has proved its unique value and usefulness in our society again and again.

2. Specific comment on HR 13270 with respect to research corporation

Research Corporation recognizes in the Tax Reform Bill of 1969 as passed by the House the desirable goal of curbing certain abuses with respect to foundations. However, the bill in its present form has introduced features which would clearly reduce foundation activity in many significant areas and severely limit foundation effectiveness. Explicit restrictions, the ambiguity of language of some parts of the bill, and the bill's failure to recognize foundation programs (especially those of the highly technical or specialized foundations) which are in part operating and in part grant-making, would effectively destroy important and worthy organizations which by their past performance have proved extremely valuable to our nation.

(a) The Committee will undoubtedly have before it much testimony on the effect of a tax on foundation income. This 7½% tax seems to bear little relation to the intended correction of abuses committed by a minority of so-called foundations. Furthermore, what was originally recommended at a 5% level, and then suddenly proposed in HR 13270 at a 7½% level, might well be set at 10%, 20%

or 50% at some later date, if the principle of taxing foundations is to be accepted. However, any tax on net investment income of the foundations which make grants is really a tax on their grantees, the 501(c)(3) organizations which are specifically exempted from the proposed tax, since they are the direct beneficiaries of foundation grants. The funds then available to them from such income would be reduced by at least the amount of the tax.

Research Corporation is now receiving a constantly increasing number of grant applications from young scientists whose research cannot be funded by the National Science Foundation or other Government granting agencies because of reduced governmental budgets. It is ironic that, at a time when the private foundations are being asked to help fill the gap resulting from decreased Federal grants, this bill would cut back on the funds available to these scientists from this foundation. It is also ironic that the Federal Government might then have to step in with its own new or expanded programs, directly at taxpayer expense, to substitute for private foundation programs thus restricted. Even with increased Government support for activities now supported by foundations—and that certainly is not the asserted intention of this legislation—it is doubtful that any Government agency could provide the necessary diversity, the new and imaginative concepts, and the small-scale and selective experimentation in approaches to new knowledge which is possible under our present system of widespread private foundation support.

(b) The stated objective of the bill's additional requirement for distribution of income is one with which we agree. Obviously it is intended to insure that the foundations act solely for the philanthropic purposes upon which their exempt status is based. Further, a foundation which does not invest its funds so that they produce maximum income consonant with prudent practice, as well as to devote or commit to its exempt purposes all or substantially all of its income, is not truly a philanthropic organization. While recognizing the objectives of the income distribution requirement, we must point out the serious implications of this bill with respect to the continued existence of our foundation.

As the bill is presently drawn, the necessary administrative expenses of a foundation (other than those relating to the production of gross investment income) must be taken out of the corpus of the foundation's endowment. Section 4942 defines undistributed income as the distributable amount minus the qualifying distributions, and taxes such undistributed income first at 15% and ultimately at 100%. Section 4942(g), in defining qualifying distributions, makes no provisions for the general administrative and grant-making expense of the foundation, unless one could interpret such administrative expense to be an amount paid out to accomplish one or more purposes described in Section 170(c)(2)(B). Rather than to rely on such interpretation, the bill should explicitly state that such expense is recognized as a proper charge against income.

Further, it would appear that the proposed tax of 7½% on net investment income (Section 506) would not be considered in determining the distributable amount (Section 4942(c)) in cases where the minimum investment return (Section 4942(e)) is involved. Accordingly, this tax would also have to be paid out of the corpus of income producing assets. This is a tax on principal.

(c) Still further, qualifying distributions are so defined as to exclude grants to organizations which would employ the funds for approved purposes, but which might not themselves qualify either as 501(c)(3) organizations or as operating foundations as defined in the bill. For example, the grants to the National Research Council for the work of the Food and Nutrition Board made regularly by Research Corporation since 1945 might not be regarded as a qualifying distribution under this bill. Yet this quasi-govermental body is the authoritative voice on matters of vital nutritional concern to the United States. Under the bill as now worded, grants made to the National Research Council and similar organizations could well have to be paid out of corpus.

If such defects remain in the bill, a foundation would have to pay out annually the greater of either its adjusted net income or 5% of its income-producing assets as qualifying distributions, and each year would in addition have to reduce its assets by an amount equal to the sum of costs of administration and staff program activities, plus grants to institutions not defined as qualified, plus the 7½% tax on net investment income where minimum investment return is involved. It is obvious that this would rapidly shrink foundation assets to the point of ineffectiveness; in the case of Research Corporation this might take place within fifteen years. Perhaps this is the intent of the bill. If so, it should be so stated; if not, the bill is punitive and confiscatory.

(d) The definition of the term "operating foundation" in H R 13270 is confusing as it relates to a "private foundation," particularly with respect to foundations which are in part operating with active programs and in part grant-making.

Research Corporation operates active programs in the promotion of scientific research through its Regional Grants Directors who visit and work closely with science departments on college and university campuses, and through its program of patent assistance to colleges, universities, nonprofit scientific institutions, and some Government agencies The expenses of such active "operating" programs accounted for about one-quarter of our 1968 expenditures, but would not count as "qualifying distributions' (Section 4942(g)). Neither can Research Corporation qualify as an "operating foundation" (Section 4942(j)(3)). In its present form the bill does not recognize nor provide for those foundations like Research Corporation which have substantial direct eleemosynary "operating" program activity in addition to their grant-making operations.

If this bill in its present form became law, Research Corporation would have to restrict or modify drastically its unique and valuable patent assistance program to some 200 colleges, Universities and other nonprofit organizations. Provided without charge to educational and scientific institutions, this program assumes the major expense and the problems of evaluating, patenting, and licensing of their inventions to bring them into use for the benefit of the public. Our cost in providing these services is a contribution to colleges and universities in many instances as valuable to them as the grants we make to support their research. Yet under the provisions of this bill as now written these operating program expenditures would not be "qualifying distributions," nor would they be allowable deductions in the computation of adjusted net income. The directors of Research Corporation, if the present bill becomes law, would be forced to choose between hastening the demise of the foundation by reducing its capital annually to provide these services to educational end scientific institutions, or to cut back or terminate this unique contribution to these institutions. In the later event, if the experience of Great Britain or Japan is any example, the Government itself might have to create and fund a new Federal agency or corporation to provide this service.

3. Excess business holdings

With respect to excess business holdings, Research Corporation has, in recent years, divested itself of its stock ownership in Research-Cottrell, Inc. (the formerly wholly-owned company based on the original Cottrell air pollution control patents) first to a 65% level and more recently to a 35% level. Our intention has been that our ownership shall be less than 20% at a time when this can be practically arranged without harm to Research-Cottrell, Inc., or diminution of the foundation's total assets.

Research Corporation is thus not only in agreement with the concept of elimination of excess business holdings, but several years ago recognized the desirability of this elimination, and anticipated the provisions of this bill. However, Section 4943(c)(4) of this bill is unnecessarily restrictive in causing foundations *"to dispose of"* present excess holdings in order to dilute their ownership. There are other ways by which a foundation's holdings and control of a corporation can be reduced. For example, dilution of its holdings by the issue of additional shares of stock would reduce the fraction the foundation's holdings represent without its *disposing of* any stock. It is suggested that the language of 4943(c)(4) should permit any legitimate means of reducing a foundation's excess holdings.

4. Governing instruments

Section 508(g)—Governing Instruments—seems an unnecessary redundancy. This section would presumably require that a foundation such as Research Corporation (whose Certificate of Incorporation was issued in 1912, and ratified by action of the New York State Legislature in 1932) obtain action by the New York State Legislature merely to have its Certificate provide explicitly for the following: (1) that its income for each taxable year must be distributed so as to not subject the foundation to tax under Section 4942; (2) that it eschew any act of self-dealing; (3) that it not retain any excess business holdings; (4) that it not make any speculative investments; and (5) that it not make any taxable expenditures. Without any action by the foundation, all of these would be requirements of the law resulting from this bill, with appropriate penalties for violation. To require the amendment of Certificates of Incorporation simply to explicitly state these requirements and prohibitions seems unreasonable as well as redundant.

5. "Disqualified" persons

Section 4941 contains a provision which would have harsh effects on Research Corporation. Since the directors of the foundation are "disqualified" persons, either (1) the foundation could make no further grants to organizations controlled directly or indirectly by them, or (2) Research Corporation would not be able to have as directors men who exert any measure of control over any organization which might receive grants from the foundation.

Had this legislation been in effect in the past, Research Corporation could not have made grants at various times to some of the most prestigious American institutions, including The Smithsonian Institution, the National Academy of Science, Massachusetts Institute of Technology and the Carnegie Institution of Washington, because their chief executive officers were directors of the foundation. It could thus have prevented Research Corporation from granting funds to The Smithsonian Institution for the pioneering work on rockets by Robert H. Goddard.

From another point of view, this stipulation could prevent Research Corporation from having on its Board of Directors men such as Frederick Seitz, S. Dillon Ripley, Leonard Carmichael, James R. Killian, Karl T. Compton and Vannevar Bush, who have been chief executive officers of the institutions mentioned above while serving as directors of Research Corporation. In fact, it would in effect forbid to the foundation the advice and experience of the very scientific and academic leaders it needs as directors to insure the wise and effectual carrying out of its chartered purposes.

If the stipulation of section 4941 is read to include not only foundation directors who are officers of other organizations, but also those who are directors or trustees of those organizations, the number of forbidden organizations for Research Corporation grants would be multiplied several times, or conversely the number of officers or directors of such organizations which Research Corporation might elect as its own directors would similarly decrease.

6. Conclusion

Correction of the defects of the Tax Reform Bill as passed by the House of Representatives will be required if it is not to be a confusing and ambiguous and a seemingly punitive law, applied to a segment of American philanthropy which has most certainly contributed to the development of the American enterprise and governmental systems, as well as to human welfare throughout the world.

SUMMARY

1. Research Corporation is a foundation established in 1912 (1) to render inventions and patents more available and effective in the useful arts and manufactures and for scientific purposes; and (2) to provide for the advancement and extension of technical and scientific investigation, research and experimentation by contributing its net earnings to scientific and educational institutions.

Partly an operating foundation and partly a grant-making foundation, Research Corporation has amply demonstrated its unique value and usefulness in our society.

2. With respect to foundations, while directed at the desirable goal of curbing abuses, H.R. 13270 would, in its present form, attenuate or even eliminate desirable and worthy programs of Research Corporation at a time when Government support for the sciences via the National Science Foundation, National Institutes of Health, etc., has been cut back, and the Government is seeking to encourage and increase the private sector's contributions to national problems. Four specific instances are:

(a) By taking as taxes funds that would otherwise support 501(c)(3) organizations such as colleges, universities and scientific institutions.

(b) By requiring that general and administrative exepnses (apparently including expense of evaluating of grant requests, etc.) and also monies for the proposed 7½% tax on income both be taken from corpus under certain circumstances, which would diminish and eventually extinguish the source of funds for grants.

(c) By excluding from "qualifying distributions" all grants to organizations which while employing the funds for approved purposes do not themselves qualify as 501(c)(3) organizations nor as operating foundations, and

(d) By differential treatment of "private" and "operating" foundations, which creates an anomalous and almost impossible set of circumstances for organizations such as Research Corporation, which are both operating entities with active programs and also grant-making.

3. Research Corporation has anticipated and already acted on provisions of the bill calling for disposition of excess business holdings but respectfully suggests that the purpose of eliminating foundations' control over profit-making enterprises can be accomplished not only by disposing of such holdings, but by reduction in the percentage of total shares held by any one of several other means.

4. The section relating to governing instruments of foundations appears to be redundant since all of the stipulations required by it would already be requirements of other sections of this bill, with appropriate penalties for violation.

5. The section dealing with grants to organizations controlled directly or indirectly by such "disqualified persons" as foundation directors or trustees would impose special hardships on Research Corporation by prohibiting grants to nationally respected scientific and academic organizations whose officials or trustees are directors of Research Corporation, or denying to Research Corporation the services of such officials or trustees whose counsel and experience are vital to the conduct of the foundation's exempt purposes.

Statement Submitted for the Amon G. Carter Foundation, Fort Worth, Tex.

Amon G. Carter Foundation, a non-profit Texas corporation organized and operated for charitable, religious, literary, and educational purposes, sometimes hereinafter styled "Foundation," hereby respectfully requests modification of certain provisions of H.R. 13270 dealing with the taxation and regulation of "private foundations," as defined in said H.R. 13270. H.R. 13270 will sometimes hereinafter be referred to as "the Bill" or "the House Bill."

The provisions of the Bill as to which such modification is urged are:

Those limiting the percentage of the total voting stock in a business corporation which may be owned by a private foundation, requiring the disposition of so much of said stock as is in excess of the specified limit, and imposing penalties and sanctions for failure to comply with these requirements, whether or not it is legally impossible for the private foundation to dispose of the stock.

FACTS

Amon G. Carter Foundation was incorporated as a non-profit Texas corporation in 1945. It has no capital stock. It was organized to support charitable, religious, literary, and educational undertakings. Shortly after its organization, it was classified as an organization exempt from Federal income taxes under what is now Section 501(c)(3) of the Internal Revenue Code of 1954, and it has continuously maintained that exempt status and its right so to do has never been questioned.

At its organization, Foundation received substantial gifts from Amon G. Carter, Sr., and his former wife, Mrs. Nenetta Burton Carter, from whom he was then divorced. Foundation functioned primarily under the direction of Amon G. Carter until his death in 1955.

By his will, which was duly admitted to probate in 1955 and which has never been in any respect contested or modified, Amon G. Carter bequeathed and devised to the Foundation all of the stock which he owned at his death in Carter Publications, Inc., under provisions which prohibited the Foundation from in any manner disposing of the stock so devised except under specified circumstances for the length of time shown in excerpt from the will hereinafter set forth. The pertinent provisions of the will are as follows:

"2. The Foundation shall not sell, exchange, mortgage, or pledge, or in any manner dispose of, encumber or hypothecate my stock in Carter Publications, Inc. for the length of time hereinafter set forth, except with the unanimous consent of all who are then directors of Foundation.

(a) Foundation may, at any time, join all other stockholders in Carter Publications, Inc. in a sale of all of its capital stock; or

(b) Foundation may join with the number of other stockholders then required by law in completely liquidating Carter Publications, Inc., if it has sold substantially all of the assets directly employed by it in its business. If, but only if, my stock in Carter Publications, Inc. is disposed of by Foundation in accordance with either of these exceptions, then the purchase rights granted in the subsequent paragraphs of this Article shall be completely extinguished without any right to compensation from or claim upon the proceeds of such disposition inuring to any of those to whom such purchase rights are hereinafter given.

"3. The restrictions set forth in the preceding paragraph 2 shall continue in full force and effect until June 23, 1994, or until twenty (20) years after the death of the last survivor of such of the following named as are living at my death: Amon G. Carter, Jr. (my son), Ruth Carter Johnson (my daughter), James M. North, Jr., B. N. Honea, and Harold V. Hough (all of Fort Worth, Texas, and now stockholders in Carter Publications, Inc.), and any child of any of these five (5) who may be living at my death, which ever period is shorter, and for six (6) months thereafter, but no longer; which six months' period is hereinafter referred to in this Article as the 'option period'."

The stock in Carter Publications, Inc. so received under the Amon G. Carter will, with stock dividends subsequently received, amounts to 26,257 shares, which is more than 20% of the authorized, issued and outstanding capital stock of Carter Publications, Inc. of 120,000 shares. The restrictions on disposition cannot be expected to expire prior to 1994.

Carter Publications, Inc. is the owner and publisher of the Fort Worth Star-Telegram, one of the important newspapers in the State of Texas, and also owns and operates a television and radio station. It was developed from a very small beginning into a successful and valuable organization under the direction and control of Amon G. Carter, with the assistance of a small group of individuals who were actively connected with its operation and who were minority stockholders in Carter Publications, Inc. For many years prior to his death, Amon G. Carter and members of his family, including his former wife, Mrs. Nenetta Burton Carter, had complete stock control of Carter Publications, Inc. All of those associated in the development of the enterprise, except B. N. Honea, have died and their stock holdings have been acquired by Carter Publications, Inc. and retired.

The present capital stock of Carter Publications, Inc. consists of 120,000 shares of a par value of $100 each. 29,951 of these shares are owned by Foundation; 69,013 by members of the Carter family, which term includes Mrs. Nenetta Burton Carter, and Amon G. Carter, Jr. and Ruth Carter Johnson (the children of Amon G. Carter and Nenetta Burton Carter), and the children of Amon G. Carter, Jr. and Mrs. Ruth Carter Johnson. B. N. Honea and members of his family own 21,206 shares of the stock; the attorney for Carter Publications, Inc. owns 148 shares; and another employee and director owns 12 shares. All of the shares owned by Foundation were acquired under the will of Amon G. Carter except 2,000 shares which Foundation acquired prior to the death of Amon G. Carter from the estate of a deceased daughter. Eliminating this 2,000 shares and the increases therein by stock dividends, the remainder of the Carter Publications, Inc. stock held by Foundation, which was acquired under and was subject to the provisions of the Amon G. Carter will, exceeds 20% of the outstanding capital stock of Carter Publications, Inc.

Since shortly after the death of Amon G. Carter, Sr., Foundation has been managed and controlled by a self-perpetuating board of three directors, consisting of Amon G. Carter, Jr., Mrs. Ruth Carter Johnson, and Mrs. Katrine Deakins, who, during the lifetime of Amon G. Carter, Sr., was his confidential and executive secretary and who is more familiar with his plans and wishes than any living person.

No member of the Carter family has ever received any compensation or other financial benefit of any kind or character from Foundation. Amon G. Carter, Jr. and Mrs. Ruth Carter Johnson serve without compensation and devote a considerable portion of their time to its affairs.

The book value of the assets of Foundation at the end of the first period after it received the residue of the Amon G. Carter Estate was approximately $25,000,000. The book value of its assets on July 31, 1969, was over $33,600,000, and the market value of these assets at that time was between $45,000,000 and $50,000,000. Since its organization, the Foundation has made gifts and grants of approximately $16,500,000, and in addition, has about $5,000,000 in assets in Amon G. Carter Museum of Western Arts and its contents. The establishment of this museum was required by the provisions of the will of Amon G. Carter. It is operated for public use and without any admission charge and will ultimately go to the City of Fort Worth. The recipients of the gifts made by Foundation are churches, educational institutions, hospitals, and similar organizations such as the Carter Blood Center in Fort Worth, Texas, and numerous other qualified and worthwhile recipients. The Foundation's activities, both financial and charitable, have been conducted with a minimum of expense. The Foundation has consistently disbursed, for charitable and related purposes, all or more of its income than present laws direct it to disburse. It has no accumulation of such earnings.

The Carter Publications, Inc. stock bequeathed to Foundation was valued for estate tax purposes at $1,125,000. The company has regularly paid cash dividends for many years. Its present dividend rate is $8.37 per share. During the period of administration on the Amon G. Carter Estate, it received $501,244 in cash dividends on the stock owned by the decedent at death, and the total cash dividends received by Foundation on Carter Publications stock from 1956 through 1969 amounted to $2,398,103. This stock was valued at $81.00 per share at Amon G. Carter's death, so the present cash dividend rate is more than twenty per cent (20%) per year on the value of the stock at Carter's death.

Foundation's holdings of the stock in Carter Publications, Inc. acquired from the Amon G. Carter Estate cannot, as shown by the excerpt from the Amon G. Carter will quoted above, be disposed of for a great many years except under the limited circumstances specified in the will, which, in effect, would require the disposition by all stockholders in Carter Publications, Inc. of all of their stock in that company or the sale by Carter Publications, Inc. of all of its assets and its complete liquidation. The properties of Carter Publications, Inc. are very valuable with necessarily a very limited number of possible purchasers, and even if its stock or its properties could be sold, the prospective purchasers would probably be limited to one of the several newspaper chains which in the past have acquired newspaper properties in various sections of the country. To place the ownership of the Fort Worth Star-Telegram and the television and radio station associated with it in the hands of any such purchaser would deprive North Texas and West Texas of an enterprise which has for almost half a century been devoted primarily to the development of those areas, and promote further and undesirable concentration of the ownership of news media throughout the United States. Further, any such disposition would require the cooperation of all of the stockholders in Carter Publications, Inc. and it is entirely beyond the power of the Foundation to secure such cooperation.

Foundation has been advised and believes that it would be impossible to secure a judicial determination which would remove the restrictions contained in the Amon G. Carter will upon the disposition of Carter Publications, Inc. stock which was bequeathed by said will to Foundation. Such a judicial determination would, in effect, be a rewriting of a plain and unambiguous will which was admitted to probate approximately fifteen years ago and the provisions of which have never been contested or in any respect modified. For the same reasons, it appears impossible for Foundation to dispose of any portion of the stock in Carter Publications, Inc. received under the Carter will within the two-year and five-year periods specified in Section 4943(c) (4) (B) and (C) of the Bill. Thus, the Bill, as presently drafted, would not only impose very severe sanctions and penalties on all concerned, but would destroy this very worthwhile organization.

SUGGESTED MODIFICATION

It is believed that if there is added to Section 4943(c)(4)(D) the following provision:

"No holdings of a private foundation shall be classified as 'excess business holdings' for so long as, by the terms of the applicable instrument (in effect on January 1, 1969) by which the private foundation acquired such holdings, it is prohibited from disposing in any manner of such holdings without the consent of a person or persons who are not 'disqualified persons,' as defined in Section 4946(a), if, in a proper judicial proceeding to which the highest law officer of the State having jurisdiction is a party, it is determined that such prohibition cannot be modified so as to permit such disposition without such consent."

it will remedy the existing situation which, as aforesaid, would accomplish very inequitable results not intended by the authors of the Bill.

The provision above quoted is submitted without pride of authorship, and any other provision which would accomplish the intended result would be satisfactory to the Foundation and to any other foundations similarly situated.

The relief suggested is substantially similar to the relief presently afforded by the Bill in those provisions of the Bill dealing wtih accumulated income and affording relief in those cases where the governing instrument provides for the accumulation of a part of the foundation's income over an extended period. See

In connection with this relief provision the statement of Hon. Edwin S. Cohen, Assistant Secretary of the Treasury for Tax Policy, found on Page 32 of the government publication entitled "Statement of the Hon. David M. Kennedy, Secretary of the Treasury," where Assistant Secretary Cohen said:

"There is, however, a permanent exemption from the income pay-out rules of those organizations which are required by their governing instruments to accumulate income and which find it impossible to effect a change. It appears that the provision pertaining to disposition of business holdings is too stringent and should be changed to conform to the income pay-out rule."

Respectfully submitted,

AMON G. CARTER FOUNDATION,
By AMON G. CARTER, *President.*
HARRY C. WEEKS
FRANK B. APPLEMAN

Attorneys for Amon G. Carter Foundation, Fort Worth, Tex.

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

[Inaugural Address of President Richard M. Nixon, Jan. 20, 1969]

"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."

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 or rights of all citizens. One response of those lawyers present was the formation of the Lawyers' Committee—an organization dedicated to involving members of the legal profession actively 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-Chairman in organizing the Committee, fixing its objectives, and working toward 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:

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, Philadephia, 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 Lawyer's 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, Seattle, and Washington, D.C.

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 percent) 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 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 it clear that an organization which has no portfolio and literally spends the donations it receives pursuant to an approped 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 raises 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 do not in fact inhibit such expenditures.

STATEMENT OF E. J. DOERNER, ON BEHALF OF SAND SPRINGS HOME, SAND SPRINGS, OKLA.

CHAIRMAN RUSSELL B. LONG AND MEMBERS OF THE SENATE FINANCE COMMITTEE: I am submitting this statement on behalf of the Sand Springs Home of

Sand Springs, Oklahoma, a charitable foundation, and of which it has been my privilege to have been a Trustee since October 9, 1947.

This communique relates to the sections of the above mentioned legislation dealing with the taxation of charitable foundations.

SAND SPRINGS HOME AND WIDOWS' COLONY

Founded.—Conceived and founded by the late Charles Page on June 2, 1908, one year after Oklahoma Statehood.

Incorporated.—It was incorporated on August 9, 1912, under the Laws of the State of Oklahoma. No capital stock. Charles Page said "the kids are its capital stock." Charles Page, until the day he died, was constantly trying to improve the corporate foundation to ensure its perpetuity.

Endowment.—Perpetual and private. Neither solicits nor accepts outside aid. Financed from its beginning by Charles Page and endowed under his last Will and Testament with his private fortune, earned as an independent oil producer and industrialist.

Purposes.—Care and rearing of orphaned and needy children to the age of majority, or until they are self-supporting, under a plan that is as nearly like a normal family life as possible, and the care of widows and their families of children. Cottages are furnished for these families along with all utilities and nursery for their children, and all the necessities of life where the mother is unemployed.

Nonsectarian.—Children are reared "in the faith of their fathers" and attend their respective churches regularly. Presently, we have 3 Lutherans, 52 Baptists, 7 Church of God, 11 Assembly of God, 1 Episcopalian, 7 Presbyterians and 4 Methodists.

Education.—Public Schools through high school, after which, if wish higher education and training, the colleges or vocational training schools of their own selection. The Home and Colony have produced lawyers, doctors, preachers, chemists, nurses, policemen, farmers, musicians, veterinarians—there is no field, we can truthfully say in which a former Home child has not lived and worked. At present there are 3 students at Oklahoma Technical College and 1 at Oklahome University and others taking vocational training in professions and trades.

Medical care and Hospitalization.—Both preventative and curative, by reputable dentists, physicians and surgeons, which also includes proper hospitalization.

(Only 3 deaths have occurred among children in the Home during its 61 years' existence.)

Number cared for by Home and its Widows' Colony in 61 years:

Children in home	653
Widows and their children	1,847
Total	2,500

Admission to Home.—Children admitted to the Home are commited to it by State District Court Order, and are the responsibility of the Home for care, maintenance and education.

Admission to Colony.—Widows and their children are admitted to the Colony under rules and regulations authored by Sand Springs Home, but the children remain under the jurisdiction of their mothers. The Widow's Colony is a separate department of the Home and is located on its own grounds, with separate residences for each family. A nursery is provided for working mothers.

Family Life Fostered.—Family life, for both the Home and the Colony, is preserved, nurtured and encouraged as much as possible, to have children grow up as brothers and sisters and mothers and children, in their respective abodes.

No Adoptions Permitted.—Children are kept together in the secure knowledge that they will not be separated by adoptions from the Sand Springs Home.

Institutional Atmosphere.—This is eliminated wherever possible. Children dress as individuals, according to their own tastes and desires (within reasonable limits), grow up as families, have their own family at individual tables in the big dining room, and the family ties are maintained to an astonishing degree. The Home simulates for its children home life, rather than the usual institutional care.

Aid is Offered.—First to those in Oklahoma and then to outside the State and, if there is room, to anyone in any State. We now have 75 children from Oklahoma, 3 from California, 2 from Missouri, 1 from Arkansas, 2 from Idaho and 3 from Tennessee, a total of 86 children in the Home. From my limited research of the Home's records, we have had at least 66 children (and in all probability more) in the Sand Springs Home from at least 12 States other than Oklahoma, as follows: Alabama, 4; Arkansas, 8; Arizona, 1; California, 8; Florida, 4; Georgia, 2; Idaho, 5; Kansas, 3; Kentucky, 1; Missouri, 20; Tennessee, 5; Texas, 5. (Widows' Colony not included in this list.) (There are, however, 20 widowed mothers and 67 children now in the Colony.)

Homecoming Time.--Finds former Home children from nearly every State in the Union present, from Maine to California and from Washington State to Florida, and even one or two in Hawaii and Alaska. Those in foreign countries (in service) can't attend. Recently the one now on Tiawan was here.

Military Service.—Sand Springs Home had boys in the first World War, and in the second World War. 65 boys served in World War II. Only 4 were lost, one on Iwo Jima, one at Sea, one on Bataan and one (paratrooper) on Normandy. Since those wars there has been a continuous list of boys in military service, some of whom have been killed in action, all of whom are in different branches, air, sea, infantry, special services. We number our dead with sorrow and pride, as families the world over are now doing, with hope and with prayer.

Personal assets of children are held in trust under guardianships established under the Probate Division of the District Court of Tulsa County, Oklahoma.—Individual bonded guardians are appointed by the Court, and all personal assets, including Social Security, Veteran's benefit, etc., are impounded in the duly established guardianships which are administered under the watchful eye of the above mentioned Court until its approval of the final distribution by the guardian of assets, and all increment accuring thereto, to said child on reaching his or her majority. No personal funds of any child are ever accepted into, or commingled with the account of San Springs Home. Sand Springs Home's Legal Department protects each child in effecting settlement of claims for death, insurance, Social Security and Veteran's benefits from which such guardianship assets customarily accrue.

Aid to Public Schools and Churches.—The Home makes available, to the Public School System of Sand Springs and to the various churches of Sand Springs and immediate area, lands belonging to it as long as such lands are occupied and used for educational or religious purposes as the case may be.

Charitable and Philanthropic Expenditures.—It is conservatively estimated that the Home since its humble founding in June, 1908, has expended funds in excess of 20 Million Dollars for charitable and philanthropic purposes. For the year 1969 the Home will expend for charitable purposes an estimated $650,000.00, a greater portion of which has already been disbursed.

Modifications of Tax Reform Act of 1969—H.R. 13270.—In view of the fact that all income of the Sand Springs Home is used for the purpose of furnishing a home, clothing, food, education and related items for widows and children, we recommend that:

(1) All of proposed Section 506 as to the tax of Seven and One-Half Percent (7½%) on net investment income be eliminated from the Act.

(2) All of proposed Section 507 as to the tax at up to One Hundred Percent (100%) on termination of private foundation status be eliminated from the Act.

(3) The return on investment under proposed Section 4942 should be modified from a fixed Five Percent (5%) to "a reasonable return under all the facts and circumstances of the particular case."

(4) All of proposed Section 4943 concerning confiscation tax rates on excess business holdings should be eliminated.

(5) All of proposed Section 4944 concerning confiscation tax rates on the bad investments should be eliminated. This proposed section would apparently let a revenue agent use "hindsight" to determine whether a given purchase was a "bad investment." See also, Appendix "A" attached.

CONCLUSIONS

Exempt foundations should be forbidden:

(*a*) To use any of its funds for political purposes;

(*b*) Propagandizing controversial, high tensioned public or legislative issues;

(*c*) Trustees or "Managers" of the foundation be forbidden from and penalized for inter-dealings with the foundation;

(*d*) Foundations should be required to expend at least Seventy-five Percent (75%) annually of their current net income for charitable, educational or other exempt purposes of the foundation. (The suggested figure of Ninety-five Percent

(95%) is unrealistically high, and would force many foundations to eat heavily of their principal assets.)

(e) The abuses and evils practiced by some foundations should be corrected, but in correcting such evils, the good and the worthwhile foundations should not be penalized or destroyed.

(f) As was aptly observed by Congressman Aime J. Forand, Rhode Island, to Secretary of Treasury Snyder in the hearings before the House Committee on Ways and Means pertaining to Revenue Revision of 1950:

"I hope that when we get into the exemption of charitable trusts, as such, that we can find a line of demarcation where the legitimate trust will be given carte blanche and permission to operate, but that those fellows who are trying to evade the taxes and avoid the law, would be brought to task."

To paraphrase Mr. Forands observation on a current colloquial level, it is my belief that valid, sound and just legislation can be enacted, which would separate the "boys who wear the white hats" from "those who wear the black hats."

Man's achievements are both mental and physical accomplishments, sustained by Hope, Faith, and Charity, and it has been wisely said for generations, "that the greatest of these is Charity."

Respectfully submitted,

E. J. Doerner.

Appendix "A"

In order to separate the private foundations organized and in continuous existence prior to the time there was an income tax law, which organizations should not be grouped with the thousands of private foundations organized annually in recent times, it is respectfully urged that the Senate Finance Committee amend H.R. 13270 (91st Congress, First Session) at Section 4943(c)(2)(A)(i) by inserting therein the following on page 36, line 5:

"(i) Up to 100% of the stock if such stock holdings were acquired prior to March 1, 1913."

This would necessitate restating the present page 36, line 5 "(i)" to "(ii)" and the present page 36, line 7 "(ii)" to "(iii)."

Northeast Louisiana State College,
Monroe, La., September 25, 1969.

Re testimony submitted by the Woodrow Wilson National Fellowship Foundation to the Finance Committee of the U.S. Senate in its hearings on the Tax Reform Act of 1969.

Senator Russell B. Long,
Chairman, Senate Committee on Finance,
Senate Office Building, Washington, D.C.

Sir: It has just been called to my attention by Hans Rosenhaupt, President of the Woodrow Wilson National Fellowship Foundation, that the wording of certain provisions of H.R. 13270 would pose a threat to the continuation of the Woodrow Wilson National Fellowship Foundation.

As a Woodrow Wilson Fellow (1963) with first-hand knowledge of the Foundation's commendable service both to human understanding and to the national welfare, I cannot believe that it is the aim of H.R. 13270 to make the Foundation's continued operation impossible. I am asking you to do everything in your power to insure that the effective operation of this distinguished organization in no way be impaired unintentionally by legislative act.

Please advise me at once concerning the intentions of H.R. 13270 and its possible implications for the continuance of the Woodrow Wilson National Fellowship Foundation.

Yours very truly,

Jim W. Evers,
Assistant Professor, Department of English.

Statement of Sheldon H. Elsen, Chairman, 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 utiltiy. 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 7½% 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 formation 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.

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 distinctions 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 33⅓% 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."

Be 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 foundations 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 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 Alvin C. Eurich, President, Academy for Educational Development, Inc.

Summary

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

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 7½ 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 provision 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 recommendation, 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 U.S. 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 fool-hardy 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.

STATEMENT OF H. D. M. GRIER OF THE FRICK COLLECTION

SUMMARY

The principal points contained in the attached statement of H. D. M. Grier are:

1. The current distribution requirement as presently drafted would seriously impair the ability of the Frick Collection to continue to operate its art museum for the benefit of the public.

2. Clarification is needed to permit art museums such as the Frick Collection to meet the definition of "operating foundations" which are exempt from the current distribution requirement.

STATEMENT

The Frick Collection, created under the will of Henry C. Frick, operates an art museum located in New York City. The museum, renowned throughout the world for its collection of paintings, sculpture and the arts, emphasizes Western European painting and contains celebrated works by Rembrandt, Vermeer, Velazquez, Bellini, Holbein, Turner, Boucher, Fragonard and others. The museum is open to the general public; admission is free. Since its opening in 1935, the museum has been visited by approximately five million people. Currently, annual attendance is in the neighborhood of 250,000. In addition to the exhibition of its art work, the museum presents lectures on the fine arts daily without charge. Publications and reproductions are sold without profit.

Expenses of the museum are met out of income from an endowment fund which is invested in portfolio securities. Additions to the art collection are made from time to time as income permits and as suitable works of art become available.

The primary goal of the Collection is to continue to maintain the museum for the benefit of the general public, without charge, on a permanent basis. Attainment of this goal will of course be possible only so long as the endowment fund is preserved so as to provide a sufficient level of income to cover the expenses of operating the museum. The secondary goal of expanding the art collection, while highly desirable, must be subordinated to the primary objective.

To date, income from the endowment has proved sufficient to cover operating expenses, and to provide a surplus for acquisitions. The margin, however, is decreasing. Over the past five years expenses of operating the museum have increased by approximately 35%, while investment income has increased by only 8%. In 1968, operating expenses consumed approximately 80% of income (excluding capital gains). The value of the investment portfolio also has increased, but the rate of increase has been much less than that of operating expenses.

The proposed tax on investment income would of course cut into this margin further. Indeed, at the proposed 7½% rate, in 1968 the tax would have reduced the margin of income over operating expenses to only 5%.

There is cause for concern that the current distribution requirement contained in H.R. 13270 would unduly hamper the attainment of the Collection's primary goal. It would in effect require the museum to spend all income not needed for current operating expenses for additions to the collection on a current basis, without regard to whether this would impair the ability of the museum to operate in the future, or whether suitable acquisitions were available in the limited market in which the museum operates. More disturbing, the prescribed minimum investment return would tend to compel distributions of principal of the endowment fund, or at least the placing of undue emphasis on current investment yield at the expense of the protection against inflation necessary to insure that income in future years will continue to be sufficient to provide for expenses. The prescribed minimum investment return of 5% exceeded the 1968 total of the Frick Collection's income and appreciation in portfolio values. Had the museum been subject to the minimum distribution requirement in 1968, it is estimated that required distributions of principal would have resulted in a net *reduction* in the value of the portfolio of some ½% during the year. During a period of mounting inflation, the import of such a result for the future is ominous.

It is our belief that the exception from the current distribution requirement provided for "operating foundations" was intended to apply to museums such as the Frick Collection.[1] We are concerned, however, that the definition of "operating foundation" contained in the bill might be interpreted in such a manner as to deny eligibility to the Frick Collection and other museums having substantial endowments.

The principal problem lies in the uncertainty as to the meaning of the term "income", substantially all (85%) of which must be expended for the active conduct of the activities for which the foundation is organized. Since this portion

[1] The Administration proposals submitted to the Congress on April 21, 1969, indicated that "a private foundation which has, as its only substantial asset, a public museum, and which uses any income for the operation of the museum would be an operating foundation". While the illustration given does not indicate what, if any, limit was intended as to the amount of income which could be received by such a foundation, presumably the requirement that substantially more than half the assets be devoted directly to charitable activities represents a judgment that the income fund should be kept commensurate in size with the charitable activity which it supports.

of the definition parallels the current distribution requirement, presumably it is intended that capital gains would not be considered "income" for this purpose, but the present language of the bill is susceptible of a contrary interpretation. As the definition of "adjusted net income" in proposed § 4942(f) recognizes, distribution of capital gains is inimical to the continued existence of a charitable foundation, and inclusion of capital gains in the "income" required to be expended in order to qualify as an "operating foundation" would tend to deprive this exemption of utility in the case of museums such as ours.

A related area of uncertainty concerns the period over which the 85% expenditure test must be met. Presumably, the income expenditure criterion was intended to refer to the normal, or average, operating practice of the foundation, rather than to impose a rigid requirement that the 85% test be met each and every year, but again the language of the provision seems susceptible to contrary interpretation. In our case, total expenditures over the past five years have been approximately 105% of income (excluding capital gains), but expenditures in individual years have ranged from a low of 80% to a high of 159%. Because of fluctuations in the relative levels of income and expense, and the inherently sporadic nature of acquisitions, such variations are extremely difficult, if not impossible, to control. It would seem appropriate in this case to make the determination on some average basis over a limited period, such as five years, rather than to disqualify the museum, permanently or temporarily, if it fails to meet the 85% test in a single year.

We would hope that these points might be clarified before final enactment of the proposed bill, so that the Frick Collection and other museums similarly situated may continue to serve the public interest as they have in the past.

H. D. M. GRIER, *Director.*

STATEMENT OF RESOURCES FOR THE FUTURE, INC., WASHINGTON, D.C., SUBMITTED BY JOSEPH L. FISHER, PRESIDENT

Certain provisions of Title I relating to tax exempt organizations of the Tax Reform Act of 1969 (H.R. 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 male by RFF to universities 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 typicaly 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 H.R. 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 H.R. 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 4912(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 4912(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 4912(g)(1) ON PAGE 30 OF H.R. 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 organiztaion, 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.*

MAINE STATE SOCIETY FOR THE PROTECTION OF ANIMALS,
Portland, Maine, September 25, 1969.

HON. MARGARET CHASE SMITH,
U.S. Senate,
Washington, D.C.

MY DEAR SENATOR: The Maine State Society for the Protection of Animals wishes to solicit your support in reference to H.R. 13270, Section 509, before the Committee on Finance, U.S. Senate, to the effect that the new Section 509 be redrafted to clearly restrict it to "real" private foundation, or that at the end thereof there be added an additional classification as follows: "(5) A society for the prevention of cruelty to animals or children." The latter phrase has been in the Internal Revenue Code without change since the Revenue Act of 1918. This specific reference to such organization clearly indicates Congress' determination that such organizations have a public purpose. Therefore, there is no need to create a separate test for Humane Organizations to re-establish their public nature.

I am sure I need not elaborate on the role the Humane Societies have played in our state over the past hundred years. This roll has been supported continuously thru donations of pennies to dollars and maintained only through income with wise and prudent investment at no cost to the tax payer. In todays competion for public donation our roll is becoming increasingly more difficult. The passage of such a measure as now contemplated would all but bring our work to an end, placing the burden directly on the tax payer.

We count on you to support our request in behalf of the Humane effort in Maine and the United States.

Sincerely yours,

DR. GWENDOLEN E. FLANAGAN,
President.

MACCOY, EVANS & LEWIS,
Philadelphia, August 28, 1969.

HON. HUGH D. SCOTT,
Senate Office Building,
Washington, D.C.

DEAR SENATOR SCOTT: This letter is directed to you on behalf of The Scholler Foundation and with the the purpose of making certain comments on the Tax Reform Bill of 1969 which has passed the House of Representatives and will shortly go before the Senate. My information is that hearings on the bill will commence in the Senate on September 9.

The Scholler Foundation is located in Philadelphia with its office at 2010 Two Penn Center Plaza. The Foundation was established by a Deed of Trust dated June 22, 1939 and, following a period of operation and intensive review by Internal Revenue Service, was accorded tax exemption by letter of the Treasury Department dated February 19, 1947 and signed by Joseph B. Neman, Jr. as the Commissioner.

The writer has general acquaintance with the objectives of the Tax Reform Bill of 1969 as they relate to private foundations and a general knowledge of the abuses that it is designed to eliminate. The Scholler Foundation, with which I have been associated for many years, has an excellent record and I say without reservation that the Foundation has not been guilty of any of the practices that have been criticized by Representative Patman or in hearings on the present bill. The Foundation has independent auditors and has secured an independent audit by a Certified Public Accountant each year. All forms required by the Treasury Department have been filed and Form 990A as filed by The Scholler Foundation each year contains a full disclosure of its assets and the grants that it has made.

Furthermore, as a result of certain litigation connected with the Foundation, the Pennsylvania Supreme Court has reviewed the Deed of Trust favorably and a full accounting was filed some time ago in the Orphans' Court of Philadelphia County. Subsequent to that accounting our assets have been periodically examined by an official examiner appointed by the Orphans' Court.

The current program of the Foundation places a major emphasis on assistance to small community hospitals. This program decision was arrived at by the trustees with the purpose of providing maximum benefit by expenditure of the relatively limited amount of income available. It was the feeling of the trustees that the small community hospital is one that could be helped effectively by grants ranging from $1,000 to $5,000 since these institutions have been generally ignored by the larger and better-known foundations.

The provisions of the bill referred to above that would most seriously affect the Foundation are contained in proposed Section 4943 of the Code and Section 101(b) of the bill. These provisions limit to 20% of the combined ownership of a corporation's voting stock which may be held by a foundation and all disqualified persons. Among the assets of The Scholler Foundation is the 100% ownership of Scholler Brothers, Inc., a company that manufactures textile soaps, softeners, finishes and other chemicals for the textile industry. This company was founded by Frederick C. Scholler, the settlor under the deed of trust that established the Foundation, and the latter acquired the stock both by gift inter vivos and under the will of Mr. Scholler who died in October of 1957.

The reasons advanced by the Committee for forcing divestiture were that some foundations were used to maintain control of a business for purposes other than producing income for charitable purposes; that some foundations were tempted to direct their interest primarily to improvement of the business enterprise to the neglect of their responsibilities to charity; and that such a conrolled business enterprise could operate unfairly to competitors who must pay taxes.

These reasons do not apply to The Scholler Foundation. No member of the settlor's family is connected with the Foundation or with Scholler Brothers, Inc., and the Foundation has no purpose to exercise control other than to protect its investment and to see that the Foundation secures a proper return on its investment. So far as being unfair to competitors is concerned, Scholler Brothers, Inc. is in no better position tax-wise than its competitors. It is discharging its tax obligations, and the mere fact that a charitable foundation owns all its stock does not give it any tax advantage over any other comparable legal entity.

The Trustees of the Foundation believe that Scholler Brothers, Inc. is a company that is being operated efficiently and we feel quite secure in our investment in its stock. We have much more opportunity to protect our investment here than we would with almost any other corporate stock available to us on the open market. The company constitutes a large proportion of our assets, being valued at $1,000,000 in our statement for the year ending December 31, 1968, at which time the total principal of the Foundation was valued at $2,668,957.76. Out of the Foundation's average total annual income of approximately $125,000 the dividends received from Scholler Brothers, Inc. amounted to $50,000 in 1966, $50,000 in 1967, $80,000 in 1968 and $40,000 has been paid thus far in 1969. These figures would seem to rebut any inference that the Foundation's 100% ownership of this company has in any way detracted from the charitable purposes of the Foundation.

If the provisions above referred to were finally enacted into law the Foundation would be required to divest itself of all but a 20% interest in Scholler Brothers, Inc. This company has always been a closely held corporation and its stock has never been available to the public. It would be impossible, in my opinion at least, for the Foundation to dispose of this stock on a piece-meal basis, and accordingly we cannot take advantage of the ten year period allowed for disposing of the excess holdings. Realistically, in any armslength transaction we would have to offer the entire company for sale. To require the Foundation to do this would result in extreme and unnecessary hardship to it. This would amount to a forced sale and accordingly we could not expect to secure fair value for the company. Furthermore, the threat of a forced sale will be a demoralizing factor on our key men and will seriously interfere with the company's relationships with its customers. It is likely that we would have serious problems in both these areas at such time as the general public became aware that we would be forced to sell the company within a two year period, which is what the present bill would in effect require in our particular case.

It is submitted that the practices that this particular section of the bill is designed to eliminate could be achieved without the hardship which would result to foundations such as this one. It is our request that every effort be made to amend the bill so that foundations owning a majority interest in closely held non-public corporations which are discharging their income tax liability, and which are not used in any way to avoid the payment of taxes or to unfairly compete in the market place, not be required to dispose of such an asset on a forced sale.

Any assistance that you can afford the writer in presenting the Foundation's position to the Senate will be greatly appreciated.

An identical letter is being sent to the Honorable Richard S. Schweiker, with a copy to Tom Vail, Chief Counsel, Senate Finance Committee.

Sincerely yours,

FREDERICK L. FUGES,
Secretary,
The Scholler Foundation.

STATEMENT OF TYRONE GILLESPIE ON BEHALF OF THE HARRY A. AND MARGARET D. TOWSLEY FOUNDATION

SUMMARY

Any diminution or change of pattern in foundation giving will have serious repercussions in private colleges and universities and in specialized departments of major universities.

The 7½% tax on foundations (Sec. 506) is discriminatory and class legislation and is not rational unless applied to labor unions, churches and colleges and non-profit corporations also.

The "self dealing" provisions (Sec. 4941) will have unexpected, negative results not contemplated by the authors of H.R. 13270 and the present law is adequate. If additional proscription is needed it should be done by criminal law thus giving Constitutional protection to the accused.

The provision (Sec. 4942) covering minimum investment return is not realistic and turns the attention of the foundation from its exempt purposes, suggestion that amendment of Sections 170 or 2055 to tax unproductive property given to foundations would be more fair and acceptable.

The experience of the witness is that the foundations with which he has been concerned have hewed to high ethical and moral standards and that the rationale for the legislation is either unproven or unimpressive and urges the Committee to balance the social good of the legislation against the evil it will do and to devise legislation which will correct the alleged abuses without destroying the effectiveness of complying foundations.

STATEMENT

I am Tyrone Gillespie, a partner in the law firm of Gillespie and Riecker of Midland, Michigan.

Today I represent the Harry A. and Margaret D. Towsley Foundation of Ann Arbor, Michigan.

For a number of years I have associated myself with the financial concerns of several small colleges and universities and am presently serving as trustee and Vice-Chairman of one of them and have served as National Alumni Finance Chairman of another. I am also President of a small foundation. Out of these experiences I have had opportunity to observe the interrelation of foundations and education.

It seems to me that in two areas in particular any blow dealt to foundations will strike at the very heart of higher education.

The first area is that of private colleges and universities. There is attack from some quarters on this segment of our educational system, but most objective people recognize that these institutions have served our country well. A quick review of *Who's Who in America* will demonstrate that the ratio of names deemed worthy by accomplishment for inclusion in that Volume will preponderate in favor of the small college. My experience has been that from 25 to 50% of the financial support for these colleges is derived from private foundations.

Many of these colleges are on subsistence financing, with inadequate endowment, and the slightest deterrent to current giving patterns could easily mean collapse. This Committee has a great responsibility in that if H.R. 13270 is passed in its present form there can be no question but that the pattern of foundation giving will be restricted and altered.

To put it another way we would ask if our country will be better served to close tax loopholes or to enact legislation that will close colleges? In Michigan we have one private college for sale—to the frustration of five hundred students and their families. This is a tragedy that we must avoid.

The other area of education where foundation help is critical and indispensable is in the specialized and professional colleges or departments of our large universities. In the management of a large university there must be a rough equality of spread in its budget between its several departments and disciplines. It is a system of broad compromise. But there are departments that cannot compromise. One such is a medical college. If such a college is not operating in the light of the best of current knowledge and researching for the future it becomes a menace rather than an asset to society.

The gifts of the Harry A. and Margaret D. Towsley Foundation have been directed to fill these critical areas I have just described.

We have a disquieting feeling that the Bill as written is more concerned with the hole than the doughnut and that while it is comprehensive it lacks sufficient background and study and its passage under the pressure that was and is behind it would be a disservice to our society.

To take the first instance the 7½% tax on private foundations which in the words of the sponsors "to make a small contribution, a tax of 7½% of their investment income, toward the cost of government" is not rational. It can only be rationalized if all charitable and non-profit associations such as labor unions, churches and colleges are included likewise. If this is not done it is class legislation which has been abhorred by our system of law. The tax has the effect of shifting to the government to the extent of 7½% of foundation income the right to determine social good. There are many who would prefer the determination of social good be dispersed and diversified and not centralized in any institution, including government. Most objective people upon careful reflection and the weighing of the good and evil of this provision would conclude that this provision should be scrapped by this Committee.

One of the provisions which particularly concerns the Foundation which I represent is the "self dealing" provision and I can quickly tell you why.

One of the donors of the Towsley Foundation is Dr. Harry Towsley, who is a distinguished physician. He was in the enviable position of having an independent income and therefore could choose a life work with minimal worry of the economic consequences. He chose to devote his life to medicine and particularly the care and cure of children. He became a Professor of Pediatrics at the Medical College of the University of Michigan. Three years ago he was elected President of the American Academy of Pediatrics. Today he is Chairman of the Department of Post Graduate Medicine of the University. His whole life has been centered in public service. The same is true of his wife, Mrs. Margaret Towsley who has been often honored for her services, personal and financial, to causes of social service, education and government.

Dr. and Mrs. Towsley are clearly "disqualified persons" under the definition of H.R. 13270. Section 4941 defines "self dealing" as any direct or *indirect* sale or leasing of property, lending of money, furnishing of goods or services, payment of compensation, reimbursement of expenses or use or transfer of any assets or income.

We interpret the word "indirect" to mean that a disqualified person may not have any business relationship, no matter how fair or under arms length circumstances, with the Foundation or any beneficiary of the Foundation.

Our law firm is prepared to advise Dr. and Mrs. Towsley that in the event this Bill is enacted into law it will be inadvisable for the Towsley Foundation to make any further gift to the University of Michigan so long as Dr. Towsley is on the faculty.

Is this what the Committee is seeking to accomplish? We think not but we dare not take a chance to advise our clients to go ahead and make gifts to the university and then have them accused of "self dealing" and charged with a penalty tax.

If this Bill passes, a hospital drive which is planned in our town will fail as a contractor who will want to bid on the work is being looked to through his Foundation to be a substantial giver. Perhaps paragraph (d) of the special rules under Sec. 4941 would save him, but I doubt if he will take the chance.

I believe that the solution to curbing "self dealing" lies in conscientious enforcement of Section 503 of the Code and that the rules against "self dealing" in that Section are adequate without bringing into our enforcement system the offensive, punitive measures of Section 101(b) of the Bill. If we *must* force foundation trustees, other disqualified parties and "managers" to pay for their misdeeds, then I submit they should be indicted under a criminal code.

Long ago in *Schick* v. *United States*, 195 U.S., 65, our Supreme Court defined a crime as an act committed or omitted in violation of public law commanding or forbidding it and imposing a penalty.

This is exactly what the "self dealing" provisions do. They have all the elements of a criminal law without saying so. There are charges that some foundations have abused the purposes for which they were formed. If the Committee finds that these abuses are true and corrections are needed why should it not specify the prohibited acts with particularity and declare them to be crimes.

It would seem that this course would be preferable to trustees and foundation managers for if they were accused of "self dealing" they would then be presumed innocent until proven guilty. The law would be strictly interpreted. They would have the cloak of protection of the Constitution and the laws. They would have a right of counsel and the unbiased judgment of a grand jury, a petit jury and a judge before the penalties were exacted. Under the system suggested by HR 13270 the person accused has the burden of proof to demonstrate innocence, the law may be subject to multiple hazy interpretations, the Revenue Service is prosecutor, judge and jury and the penalties are harsh to an extreme.

As a number of witnesses have suggested only the stupid or the brave will agree to serve a foundation with the Damoclean sword constantly hanging overhead.

Our recommendation is that the self dealing provisions be redrafted with more precision to apply only to those who are cheating by use of foundations and then enact criminal sanctions against such acts.

Our third area of concern is that provision which deals with minimum investment return.

The rationale, we assume, is to prevent accumulations of economic power not reached by taxation.

We do not quarrel with a requirement that all income of a foundation be used for charitable purposes, but we fail to see a compelling reason to require a foundation to earn a certain level of income or to contribute an equivalent sum from principal.

I have seen in my own experience an endowment fund of a college turned to professional trust management of highest repute for investment. The return was in the range of 4.2%. I have seen a trust under a Will managed by competent professional managers with a return of 2.8%. I have felt I could do better but I did not feel that I should interfere. To set an arbitrary standard that a foundation must earn or slowly emasculate itself is not fair or rational.

The results may be investment in Cigarette and Tobacco stocks which have high returns and little growth.

The answer perhaps lies in not giving credit to a donor who gives non-productive property to a foundation in order to reap tax benefit under Section 170 or 2055. This will prevent the gift of non-productive items to foundations in trade for tax credit.

Foundation managers should not be required to be stock speculators to avoid gradual forced liquidation of the foundation for which they are responsible.

For several years as background for this legislation there have been horror stories circulated and printed of flagrant misuse of foundations for self dealing and tax dodging. We have had experience with perhaps ten or fifteen foundations and we have never observed the slightest departure from high moral and ethical standards in their operations and management. Further, we hear the stories, but we have observed that all of the stories describe situations amenable to present law and we have never heard what was done under present law to correct the situations portrayed so vividly.

To use an anology, if I had a corral full of fine horses and a few escaped, I would catch the runaways and hobble them. I would not hobble all of the horses in the corral.

We agree that the government should have an interest in foundations because it has foregone taxes which might have been collected to allow them to exist for laudable purposes. However, is the ratio of those misusing foundations great? The figure is 154 individuals, which is .000000077 per cent of our population escaping some tax due to use of foundations and other gifts does not seem to justify this rigorous legislation.

We are hopeful that this Committee will avoid this radical reform until it has weighed the evil that it will do against the good it will accomplish. We feel certain that corrections can be made which will not kill the goose that laid the golden egg.

THE MOODY FOUNDATION,
Galveston, Tex., July 11, 1969.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee, U.S. Senate, Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: In connection with your review of the proposed legislation regarding foundations that is presently being considered by the House Ways and Means Committee, we are enclosing a summary of the problems this legislation causes The Moody Foundation.

We would be pleased to present additional information or appear personally in the event you would consider an additional presentation desirable.

Also enclosed is a copy of the most recent Moody Foundation Annual Report.[1] We hope you will agree with us that the granting history of this Foundation has been a furtherance of the constructive purposes of foundations.

Very truly yours,

PAUL R. HAAS, *Chairman, Board of Trustees.*

OUR COMMENTS AND RECOMMENDATIONS OF THE MOODY FOUNDATION

(NOTE.—With reference to Press Release dated May 27, 1969, announcing tentative decisions by the Committee on Ways and Means of the United States House

[1] This report was made a part of the official files of the committee.

of Representatives relating to tax treatment of private foundations. Numbers relate to similarly numbered provisions of press release.)

1. Prohibitions on Self-Dealing

Since there are occasions when benefits would accrue to foundations from certain transactions which would be construed as "Self-dealing" under the language of the suggested statute, relief from this prohibition should be made available where approval for a covered transaction is obtained from the Attorney General of the State in which the foundation operates and permission is granted by a court of general jurisdiction of that state. For instance, there are properties which, because of sentimental attachments, will bring a higher price from a donor or trustee, and no useful purpose is served by prohibiting such a transaction, if safeguards for its review are utilized.

2. Distributions of Income

These provisions would create a severe hardship to The Moody Foundation since the principal assets of The Moody Foundation consist of insurance company common stock and ranch land, neither of which provides income equal to five (5) percent of the fair market value of those investments.

Alternatives are suggested as follows:

(a) That all income, irrespective of the percentage of such income, be distributed by the end of the year following the year in which the income is earned with no requirement to earn a specified percentage; or,

(b) A period of five years be allowed in which to make accumulated distributions of income if such income is fixed at a required percentage. This would afford the foundation the time to dispose of assets in a business-like manner in order to create the availability of the specified percentage in cash or its equivalent. The requirement to sell assets within a one-year period in order to meet the required percentage would frequently cause the sale of assets at a highly discounted value. Or,

(c) Provide for the specified percentage on a gradually increasing basis; for instance, the first year require a one (1) percent distribution with a gradual increase to the final required percentage. This would afford the Foundation time to rearrange or sell portions of its assets to obtain the required percentage of income.

3. Stock Ownership Limitation

The Moody Foundation feels that there are substantial advantages in being in a control position of a company or unincorporated business interest whether such control position is availed of by an individual, a partnership, a trust, a foundation or any entity, because such controlling entity can frequently more effectively and efficiently direct the activities of a company or unincorporated business interest.

However, if legislation requiring disposition of control (as defined in proposed statute) is finally felt necessary, we would point out that it would be difficult and perhaps impossible to arrive at the twenty (20) percent level of ownership of the principal asset of The Moody Foundation within a five-year period. This is because the one asset involved representing eighty (80) percent or more of the value of the Foundation has a potential market value of such a large amount (several hundred million dollars) that it would take a great deal of time to negotiate the sale of this single substantial asset. This asset consists of common stock in American National Insurance Company, an unlisted stock. In addition, there is a restriction under an existing will which implies that portions of this stock can never be sold. Litigation is in process in an attempt to remove this restriction but there is opposition to such removal by interested parties. The time involved in settling this litigation and in handling the negotiations relevant to sale of the stock owned and controlled by this Foundation down to a level of twenty (20) percent would require a minimum of ten years to conclude the entire transaction.

The requirement to reduce control to less than fifty (50) percent within five years would be detrimental to the over-all transaction because the ability to sell a control position is precisely the advantage that would help to create the highest possible value for this asset. Eliminating fifty (50) percent control within a five-year period would tend to cause a serious reduction in the price the Foundation could obtain for its most important asset.

4. Limitation on Use of Assets

The intent of this limitation on use of assets of a private foundation requires further detail statutory definition since it is not clear what is meant by the present wording which simply states that assets cannot be "invested in a manner which jeopardizes the carrying on of its exempt purpose."

5. Tax on Investment Income

A tax on the net investment income of a foundation is in reality a tax on the eventual recipient of that income, and The Moody Foundation can see no reason to thereby reduce the amount of dollars available to the grantees of this Foundation.

6. Other Limitations

It would be highly desirable to allow private foundation to continue to make grants directly to individuals subject to reviewing and determining that such grants are in accord with the purposes of the Foundation. Constructive and highly desirable activities, such as presently existing scholarship programs, would be seriously impaired by this restriction.

7. Disclosure and Publicity Requirements

The Moody Foundation presently prepares an annual return and attempts to give it wide distribution.

ELBRIDGE STUART FOUNDATION,
Los Angeles, Calif., September 8, 1969.

Re: Tax Reform Act of 1969 (H.R. 13270) ; Tax on Excess Business Holdings; and Tax on Failure to Distribute Income.

Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SIR: This statement is filed by the Elbridge Stuart Foundation on its own behalf and on behalf of three other charitable foundations, described below, hereinafter collectively referred to as "Stuart Foundations". Facts concerning these Foundations are as follows:

Carnation Company, since its founding in 1899, has been controlled by its founder, E. A. Stuart, who died in 1944, and by its descendents. Approximately 6.8% of the value of all Carnation Company common stock is now held by the Stuart Foundations established by members of the Stuart family. The Carnation Company stock ownership is held by the Foundations through ownership of shares of a family holding company. The four Stuart Foundations are identified as follows:

Name	Established	Trustee	Carnation Co. common stock equity (shares)
Elbridge Stuart Foundation	Nov. 30, 1937	Crocker-Citizens National Bank.	217,568
Elbridge and Mary Stuart Foundation	Nov. 13, 1941	do	174,055
Mary Horner Stuart Foundation	Sept. 4, 1941	Seattle-First National Bank	102,257
Elbridge and Evelyn Stuart Foundation	Nov. 28, 1961	Security Pacific National Bank	32,026

The Stuart Foundations are distributing or pledging all of their income to recognized charities, such as colleges, secondary schools, hospitals, religious organizations, and organizations for improving human conditions, such as Boys Town, Big Brothers of America, National Urban League, Goodwill Industries, etc.

We believe that the great majority of foundations are operated within both the spirit and the letter of the law and do not question the propriety of portions of the Act which would eliminate any departure from the broad charitable purposes of the exemption provisions and would curb abuses by any foundation. Prohibitions upon self-dealing, requirements that all net income be distributed currently, disclosure and publicity requirements, payment of reasonable fees or taxes by foundations sufficient to reimburse the Treasury Department for the expense of policing and auditing all foundations, and other similar provisions, would certainly be appropriate. They would receive our support and, we believe, the support of other foundations which sincerely wish to use their funds, and the funds of future donors, exclusively for charitable purposes.

We would, however, seriously question the propriety of two provisions of the Act; namely the requirements that—

1. If a private foundation, the donor, and the members of his family, together, own more than 20% of the voting stock of an incorporated business enterprise, the foundation must divest its stockholdings to the extent of the excess, ratably over a ten-year period; and that

2. A private foundation must annually distribute to charity an amount equal to a specified percentage of the market value of its assets, regardless of its income, the percentage being fixed at 5% for 1970, and subject to determination by the Treasury Department in later years.

For the reasons set forth below, we believe that—

I. It is of overriding importance that these provisions be completely eliminated from the Act.

II. If such elimination cannot be effected, exceptions should be made in the divestiture provisions which would be applicable to the Stuart Foundations; or in the alternative

III. Exceptions now contained in the Act for a few foundations, including, we understand, the W. K. Kellogg Foundation, should be broadened to do justice by including a wider group of the many equally deserving foundations, including the Stuart Foundations.

I. Elimination of the provisions in question

A. *Divestiture requirement.*—The divestiture requirement seems to arise from a groundless assumption or nebulous fear that family control of a business is undesirable per se. It is law-making of a far reaching social and economic nature and is not appropriate in tax legislation:

(1) *The divestiture requirement is not necessary for correction of the alleged evils.*—One of the purported evils is that the family members will use the foundation's stockholdings to assert business control and ignore the production of income for the foundation. This assumption ignores the fact that in most cases other individuals, including the donor and other disqualified persons, will also hold stock personally and will be as interested in the financial success of the corporation as is the foundation.

Another abuse which has been mentioned is that family members will devote too much time to the business to the detriment of the foundation. Where, as in the case of the Stuart Foundations, a bank acts as corporate trustee and income is donated only to operating, tax exempt charities, the demands upon family members are limited and it is not likely that either management of the business or the proper functioning of the foundations will suffer. Other possible abuses such as self-dealing are remedied in other sections of the Act.

In the case of companies such as Carnation Company, where substantial amounts of stock are held by the public, the public owners can exercise their strong minority rights in the event of abuses by controlling interests. Thus, the arbitrary divestiture rule is unnecessary.

(2) *Retroactivity.*—The Act is wholly retroactive in that it affects established planning for family businesses which have been built up over many years. These businesses include some of the most successful and progressive in the United States and should not be disturbed except for far more compelling reasons than have been disclosed in the testimony before the Ways and Means Committee and in the Treasury Report. If abuses persist in individual cases, these can be corrected individually.

The Act seems to include, as family members, descendants of any donor who was a significant contributor to a particular foundation. Such a provision can take us back many generations in our search for ancestors who were contributors and whose descendents must now be treated as disqualified persons. An exhaustive retroactive search will be required into all branches of a family to determine who has held stock, how it was disposed of and who now holds it. We are not aware of any prior legislation in any field of law which has so drastically disturbed, and on a retroactive basis, important family and business arrangements made in good faith and within the spirit and letter of the law existing at the time of establishment.

If divestiture provisions such as these must be included in the final legislation, they should at the most be made applicable only to gifts of voting stock made after the enactment of the law.

(3) *The Donor's Motivation.*—Indeed, in the case of the Stuart Foundations, and, no doubt, in the case of other foundations, the establishment was not only in accordance with the law, but was prompted by the best of motives; namely,

the desire to benefit educational, religious and other charitable activities. Certainly, some tax benefit was obtained by the donors, but this benefit in no event could equal the full amount of the gift, tax brackets in every case being less than 100%; further, in the case of most of the Stuart Foundations the major gifts were made at a time when tax rates were considerably lower and tax savings correspondingly less than those resulting from comparable gifts at today's rates.

(4) *Impact Upon Charitable Giving and Increased Tax Burden.*—Inevitably, the proposed legislation will reduce the amount of giving to charity and correspondingly increase the burden on the federal government and the general taxpaying public. In many cases, the primary asset which a donor will have for contribution to charity will be the stock in his corporation. If he cannot make the gift in a manner to give some assurance of a degree of continuity of enterprise, he may well sell the stock or dispose of it by a tax-free exchange for stock of a larger publicly held company. Without the satisfaction of preserving an interest in a going business for himself and his family, while substantially benefitting charity, the incentives to give will be much more limited. Even at today's maximum 70% tax rates, not including the surtax, the donor gets 30¢ more for each dollar by keeping it compared with giving it away; hence, an additional incentive is somewhat conducive to the making of larger charitable gifts.

The Tax Reform Act is intended to ease the tax burden on the average taxpayer. In reality, it may increase the burden by shifting a substantial part of educational and welfare costs now borne by charities to the federal government and thence to taxpayers generally. In seeking to cure abuses which we have no reason to believe are availed of by other than a very small minority of the thousands of foundations existing today, the Act is jeopardizing contributions of millions of dollars which would otherwise go to worthwhile charities. Would not the average taxpayer prefer that these costs come from the pockets of willing donors than from his own pocket through increased taxes?

(5) *Investment Considerations.*—The divestiture provisions, as well as the income distribution provisions discussed hereafter, unreasonably interfere with the investment powers of the foundation trustees. Since the Act fixes the present distribution rate at 5%, an amount substantially in excess of the yield on quality stocks, which is now probably less than 2½% on an average basis, it apparently is the intention of the Act that a very substantial portion of foundation assets be invested in debt securities which now yield over 5%. Thus restricting the investment powers of the trustees will, in the long run, jeopardize the financial abilities of foundations through depletion of assets by forced capital contributions to maintain the 5% rate or by forced investment in debt securities whose principal values appear subject to erosion by inflation. For example, as to inflation, the cost of living increase in June 1969 was at an annual rate of 7.2%.

The advantage of appropriate stock investments over debt or other fixed income securities is demonstrated by the chart attached hereto as Exhibit I. It shows that if in 1937, when the first Stuart Foundation was established, it was required to invest, say $3500.00 in bonds, as the Act now seeks to require, the cumulative income received from 1937 to date would have been only $3700.00; had the same amount been invested in a cross section of Dow-Jones industrial stock approximately $9700.00 of dividends would have been received; by investing the same amount in Carnation Company common stock the dividend income would have been approximately $18,000.00, although the annual dividend rarely if ever approached 5% of market value of the stock. It is thus seen that application of the principles of the "5% rule" through the years to the Stuart Foundation, combined with the forces of inflation, would have resulted in heavy losses to the worthy charities which have benefited from Stuart foundation contributions. Thus almost five times as much income would have been available for distribution to charity from the Carnation stock investment, and almost three times under an investment in a broad group of Dow Jones Industrial Average Stocks, than from the bond investment. This is also true in the case of stocks held by many other foundations. The record of Kellogg Company, for example, is set forth in the record of proceedings before the Ways and Means Committee.

Exhibit II sets forth the appreciation in market value of the Carnation Company common stock compared with the appreciation of the stocks comprising the Dow Jones Industrial Averages from 1937 to 1968. The Dow Jones investment would have appreciated 5.07 times based on a 1937 index of 1, whereas the Carnation stock would have appreciated 37.34 times based on the same index. Also on Exhibit II is charted the inflationary increase in the cost of living index over the same period, indicating that both Carnation Company common stock and the Dow Jones composite stock investment to a lesser extent fully preserved and, in fact, enhanced the capital values over the years. In 1968 the $3,500 bond referred to in Exhibit 1 still represented $3,500 but was worth only $1404.00 in the terms of 1968 compared with 1937 dollars, in which case substantial loss of real principal would have taken place.

Thus the Act in attempting to cure isolated abuses is endangering the future charitable functioning of many foundations and is making adequate hedge against inflation virtually impossible.

(6) *Anti-Trust Considerations.*—In forcing private foundations to divest under the 20% and 5% rules of the Act may well compound problems confronting other Committees of Congress. We refer to the acquisition of relatively smaller companies by larger companies, including conglomerates, under circumstances which may violate the anti-trust laws. This can result even though the stock to be divested by the foundation is less than a controlling interest; often an additional floating supply of as little as 20% or even 10% of a stock will make the difference between success or failure in an acquisition or take-over move.

(7) *Harmful Effect on Smaller Communities.*—Many of the foundation "controlled" businesses are centered in one or more smaller communities in which the foundations and the companies have played an important and valuable role in community life. As such foundations are forced to divest their holdings, leaving some corporations far more vulnerable to take-over, the community will generally be seriously disadvantaged. A recent study indicated that when a smaller local company was acquired by a larger company having a centralized headquarters at another location, the local community was more often harmed than helped. Local services such as banks, suppliers, contractors, etc. were often bypassed for services regularly used by the acquiring company. Local employment suffered because staff and executive personnel were terminated or moved to the parent's headquarters. This is but another example of the possible social and economic dislocation which can flow from the Act which has been passed under the guise of mere tax legislation.

B. Income Distribution Requirement.—We urge that this requirement also be eliminated from the Act. By requiring distribution of an arbitrary percentage of the value of a foundation's assets, this provision dictates to independent fiduciaries throughout the country, (and in many cases to the detriment of charitable organizations) how foundation assets should be invested.

(1) *Relationship of the 5% distribution requirement to the 20% divestiture rule.*—Much of what has been said regarding the divestiture rule is applicable to the 5% distribution rule. Indeed, in practically all cases the distribution rule will operate as a partial divestiture, unless a heavy ratio of investments are in recently acquired debt securities, since few, if any, foundations will approach a 5% return upon stock of either a family corporation or a diversified group of companies; i.e. many of these family corporations are conservative, growth oriented companies which in the interest of sound business management would not pay out in dividends an amount equal to as much as 5% of the current market value of their stock. In fact, the more successful the corporation has been the more the foundation shareholder is penalized, because the public will usually pay a much higher multiplier for stock of a successful corporation. If a stock is selling at a price-earnings ratio of 20 a payout of 100% of earnings would be necessary to produce a 5% return. In many instances multipliers approach 30 and 40 times earnings and in these cases a dividend payout of 5% of value is obviously impossible; at a 40 times multiplier a 2½% payout on value would require all earnings. The inevitable result will be sale of all or part of the voting stock held by many foundations to provide cash for contributions from capital or for investment in bonds of current high yield, thus in either event accomplishing a gradual divestiture.

Indeed, we submit that if the 5% distribution rule is to remain in the Act, the divestiture rule becomes even more unnecessary and unreasonable and should be eliminated.

(2) *Unreasonable government control over independent fiduciaries.*—The distribution rule virtually dictates to fiduciaries the type of investment which must be made. These fiduciaries include many of the most respected and competent bank trust departments throughout the country. The effect of the rule is to require such fiduciaries, irrespective of their own opinions in the matter and regardless of the resulting serious erosion of capital through inflation, to invest funds for current high yield with the almost assured prospects of future loss of principal. Thus the future benefits to charities are being mortgaged in the interest of current excess distributions.

Exhibit I demonstrates how much better charity would have fared since 1937 with the distributions from an investment in Carnation Company common stock, or would have fared albeit to a lesser extent, in a cross section of Dow Jones industrial stocks, than would have been the case with a bond investment.

Income from Carnation Company common stock has permitted many charitable recipients to continue and even to expand their activities despite today's inflated prices throgh the vehicle of the Stuart foundation. The income from other investments such as bonds, or even the "blue chip" Dow Jones industrial stocks, would not have accomplished this result.

(3) *The Future of Public Charities Jeopardized.*—We cannot emphasize too strongly that the arbitrary distribution rule will provide excess distributions to charities for a very few years now with the penalty of a tremendous cost in the future. Be removing funds that would otherwise be available for future charitable purposes, the Congressional purpose of encouraging charitable organizations will be frustrated. Less income will be available for charities tomorrow, thus requiring increasingly large distributions of principal, with the end result being the virtual liquidation of existing assets of private foundations. Such foundations have contributed too much to our civilization and way of life to allow this to occur. Further, the end result of these provisions will be the necessity for the government to make up from general tax funds much of the cost of activities today borne by private charities.

II. If Congress is not willing to eliminate the divestiture provisions entirely, the special exemptions provided in the Act should be expanded to exempt the Stuart Foundations along with the other meritorious foundations

The exceptions are so restricted as to be meaningless in most cases and exclude from their benefits many foundations which areas worthy of exemption as those included within the exception. One such provision exempts from the divestiture requirements stock owned by a foundation, if, generally speaking, the foundation (1) was created by an inter-vivos trust which was irrevocable on December 31, 1939; (2) owned on July 28, 1969, together with all disqualified persons, not more than 55% of the stock of a corporation, the common stock of which was traded on a public exchange after 1960; (3) received at least 80% of its net income in each of the last 4 taxable years ending on or before December 31, 1969, from the stock in question, (4) had no donor or member of his family as a foundation manager, and no such individual was a member of the board of directors of the corporation on July 28, 1969; and (5) does not acquire any additional stock in the business enterprise after July 28, 1969.

While it is difficult, if not impossible, to reconcile all of the detailed and apparently arbitrary requirements as to dates and other circumstances which a foundation must satisfy to fall within the terms of the exemption, certain of the requirements are germane to the conditions which the divestiture provision purports to remedy. We refer to the provision limiting stock owned by the foundation and all disqualified persons to 55% of the total outstanding and requiring that the common stock be traded on a public exchange after 1960. Under the 55% limitation it follows that at least 45% of the stock must be in the hands of persons other than the foundation and disqualified persons.

We submit that if the common stock of a corporation is traded on a public exchange, and a minority interest as large as 45% exists, the strong minority public interest will provide an effective deterrent to any abuses which might otherwise arise. Thus, if a specific exemption is made on these terms the other arbitrary requirements become unnecessary and the exemption does justice to a broader group of foundations.

With respect to the requirement that no donor or member of his family can be a foundation manager or director of the corporation, if such a condition must remain, it should be phrased to permit such individual to be a director of the corporation provided he is not a foundation manager. It is an injustice to deny a corporation the services of a person with long experience in the business and special capabilities merely because he, or a member of his family, may have been a donor to the foundation; this provision takes no cognizance of good business practices. If he is not a foundation manager the fact of his, or a member of his family, having been a donor should not be relevant. We wish to note that, under certain circumstances, the provisions of the Act as it now stands do not remove the exemption from a professional management team which controls a corporation by their positions as directors of a foundation which owns a majority of stock. Why should a family management team be treated otherwise just because they may have had a common ancestor several generations ago who was donor to a foundation?

If conditions of an exemption are to be fulfilled upon specific dates, the dates should be fixed at a time in the future to provide a reasonable period for foundations to comply.

III. If Congress is not willing to eliminate the divestiture and income distribution requirements entirely, it should provide a broad exemption from the divestiture requirement and a more moderate income distribution requirement

A. Exemption from the divestiture requirement.—Where, as in the case of the Stuart Foundations, the entire net income is used for contributions to recognized "public" charities and not for any purpose related to the company whose voting stock is held, or for individual grants, or for purposes requiring supervision by any State or Governmental authority, no reason exists for requiring divestiture. Accordingly, the Act should provide that foundations operated in the manner of the Stuart Foundations are exempted from the divestiture requirements. *That is, if the entire net income of the foundation will be distributed annually or pledged for payment within a reasonable time to organizations of the type described in Section 170(b)(1)(B) of the Internal Revenue Code, as amended by this Act, it should be exempt from the divestiture requirements.*

If considered absolutely necessary, restrictions could be included to prevent family members from serving in the capacity of both corporate directors and foundation managers, but they should be permitted to serve in one capacity or the other.

B. Modification of the income distribution requirement.—We firmly believe that the "5% rule" should be completely eliminated. It will be difficult for the Internal Revenue Service to administer and will create uncertainties in the management of private foundations, basing, as it does, the distribution requirement on a percentage of a market value of the assets held by the foundation. A complicated annual valuation problem will exist where foundation assets consist of property other than securities which are regularly traded on an exchange, or over-the-counter, in sufficient volume to indicate true value Even where a measure of the value of a stock is provided through regular purchases and sales thereof, the valuation of a large block held by a foundation will be complicated by questions of "blockage" and the valuation of any "control" feature. Foundation managers will act at their peril in fixing such values, and, in the event of disagreements with the Internal Revenue Service, extended litigation is likely.

Furthermore, in the case of common stocks, the value at any one time may be seriously inflated by investor fads which drive stocks for relatively short periods of time to unrealistically high values, requiring increased inroads into capital to make up the required contributions to charity. As previously noted, distribution of the entire earnings of a corporation whose stock is selling at a price-earnings multiple in excess of 20 would not provide a 5% return.

Accordingly, we urge that a different standard be adopted.

In establishing such a standard, the private foundation investments to be taken into account will presumably consist of one or more of the following classes of property:

(1) Ordinary income producing property, such as improved rental properties, bonds, and stocks of publicly held corporations not connected with the donor or other disqualified persons.

(2) Dividend paying stocks of one or more corporations, shares in which are also held by the donor or other disqualified persons.

(3) Non-income producing property, such as vacant land, art objects, etc.

As to property in the first category, a requirement that all net income therefrom be used annually for charitable purposes should be adequate.

As to stocks in the second category, one of the abuses said to exist is the failure of such corporations to pay dividends large enough to provide adequate current benefits to charity. A solution as to such stocks would be to provide relief from the "5% rule" if the corporation elected to distribute a designated percentage of its net earnings, or a "reasonable" percentage, as dividends, and if the foundation in turn contributed all of its net income to charity.

As to property in the third category a prohibition upon the holding of non-income producing property by private foundations can be included, or a requirement that in the relatively few instances in which such property is held, a fixed percentage of value must be paid annually to charity. Thus, the circumstances in which determination of value is necessary will be limited to a relatively few cases.

It is our understanding that the purpose of the income distribution requirement is to insure that current benefits are bestowed on charity commensurate with the grant of the current tax exemption. Surely this purpose is satisfied if the investments are producing a reasonable income to the foundation and if all of the income less reasonable expenses is contributed to charity. In fact, where the capital of the foundation has been contributed in prior years, the only benefit accruing currently to the foundation is the exemption of its income, and upon the distribution to charity the benefit of the exemption would appear to be fully discharged.

In the event proposals other than the foregoing are adopted for exemption from these provisions of the Act, we submit that they should be broad enough to cover a wide range of foundations, including the Stuart Foundations.

In conclusion, we wish to make note of published reports of personnel changes made in some corporate directorships and some foundation managements since the publication of the Act, in last minute efforts to at least partially fall within one or another of the "special interest" divestiture exemptions of the Act.

Each of the four Stuart Foundations has an independent bank trustee; because, however, of the broad definition of the term "Foundation Manager" in the Act, one or more of the Stuart family would fall within this definition as to each foundation. Any effort to comply with the arbitrary exemption requirements of the Act by personnel resignations or adjustments on an anticipatory basis, has been deemed ill advised and not in the best interest of the foundations.

We accordingly respectfully request that, if the Act as enacted into law, does contain divestiture requirements with exemption provisions, there be no terms precluding corporate or foundation personnel changes after enactment of the law, if such changes are required to comply with exemption provisions or otherwise cause a foundation to be without the scope of the divestiture requirements.

Respectfully submited.

S. A. HALGREN,
Member, Board of Advisers.

STATEMENT OF WALLACE HOWLAND, ASSISTANT ATTORNEY GENERAL OF CALIFORNIA, ON BEHALF OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

1. Authority to Make Statement.
2. Resolution of Nat'l. Assn. of Attorneys General.
3. Analysis of H.R. 13270 as it Affects Resolution.
4. Amendments Requested.

STATE OF NEW JERSEY,
September 9, 1969.

Hon. WALLACE HOWLAND,
Assistant Attorney General of California,
Washington, D.O

DEAR MR. HOWLAND: As the Assistant Attorney General of California in charge of the Atorney General's supervision of charitable trusts and charitable corporations in California, you are aware of the background and the purposes of the National Association of Attorneys General that are expressed in the formal Resolution of the Association adopted June 24, 1969, seeking the enactment of H.R. 12135.

I have before me your letter of August 22, 1969, and the Analysis of the Tax Reform Bill, H.R. 13270, as it affects H.R. 12135 and the Resolution of our Association. I concur with the views you have expressed and find that your recommendations, if adopted, would effectively implement the purposes and wishes of the National Association of Attorneys General as expressed in the said Resolution.

I am advised that you will be in Washington seeking to obtain congressional action along these lines. It will be most helpful to the National Association of Attorneys General if you would act as the spokesman of the Association in seeking implementation of its Resolution, and this letter will be your authority to do so.

Sincerely,

ARTHUR J. SILLS,[1] *Attorney General.*

[1] Attorney General Sills is President of the National Association of Attorneys General.

Resolution Adopted by National Association of Attorneys General

Resolution concerning the coordination of State and Federal activities in the enforcement of charitable trusts

Whereas, in recent years an increasing number of states, acting through their respective Attorneys General, have been and are actively supervising the administration of charitable trusts and the affairs of charitable corporations; and

Whereas, state Attorneys General have traditionally been authorized to act as the legal representative of the beneficiaries of property dedicated to charitable purposes, and the substantive laws of the several states generally provide effective and flexible provisions to certify illegal and improper practices that may occur in the administration of such charitable assets; and

Whereas, the federal government uses its taxing power to deter certain specified types of illegal or improper conduct in the administration of property dedicated to charitable purposes; and

Whereas, the denial or revocation of federal tax exemption and the imposition of taxes upon assets dedicated to charitable purposes diminishes the funds otherwise available for charitable and, hence, public uses in the several states without thereby directly punishing or detering the individuals responsible for the maladministration of charitable assets; and

Whereas, there has been an increasing number of instances in which federal taxing authorities and a state attorney general have both taken action with respect to specific illegal or improper actions by a charitable organization, with the result that federal taxes have been imposed upon charitable assets that have been recovered from misuse or otherwise freed from the effects of the unlawful or improper acts complained of as the result of corrective action taken by the state attorney general under substantive state law; and

Whereas, present federal tax law makes no provision for the coordination of the respective efforts of federal and state authorities to insure the proper administration of property dedicated to charitable purposes and fails to recognize that corrective action taken with respect to a charitable organization by a state attorney general under substantive state law serves the same public interest, policy and purpose as that embodied in the above-mentioned provisions of applicable federal tax laws; and

Whereas, by message to the Congress of April 21, 1969, the President of the United States made Tax Reform Proposals that contained, among other things, certain provisions to bolster the efforts of state Attorneys General in their enforcement of the administration of charitable trusts; and

Whereas, H.R. 12135 has been introduced in the 91st Congress, at the request of the Attorney General of California, that would give effective assistance to a state Attorney General by notifying him of all instances in which federal tax exemption is revoked or suspended and of the facts giving rise to such action, and by further providing for the abatement of federal taxation of charitable assets that have been preserved for or restored to their intended purpose by corrective action taken by a state Attorney General pursuant to state law;

Now, therefore, be it resolved by the 1969 Annual Convention of the National Association of Attorneys General that the Association endorse and support the purpose, the provisions and the effect of H.R. 12135 of the 91st Congress; and

Be it further resolved that this Association seek the active support of the Governors and of the Senators and Members of the House of Representatives of their respective states in obtaining the prompt enactment of such legislation.

Adopted June 25, 1969.

Analysis of Tax Reform Act of 1969 as it Affects H.R. 12135 and the Resolution of the National Association of Attorneys General[1]

Summary Analysis

H.R. 13270, entitled "Tax Reform Act of 1969" (herein "the Bill"), was, for all present purposes, passed by the House of Representatives in the form in which it was reported by the Committee on Ways and Means.[2]

In one impotrant respect the Bill ignores, and in other ways some of its provisions contravene the resolution the National Association of Attorneys Gen-

[1] Prepared by Wallace Howland, Assistant Attorney General of California.

[2] The Report of the Committee on Ways and Means (herein "the Report"), House Report No. 91-413 (Part 1), dated August 2, 1969.

eral adopted June 25, 1969, and the Corman Bill, H.R. 12135. These latter measures deal with the coordination of state and federal activities in the enforcement of charitable trusts. They are directed to the problem of federal taxes being imposed upon charitable assets that have been recovered from misuse or otherwise freed from the effects of unlawful or improper conduct by a State attorney General acting under state law. The problem is not a minor one. For example, in 1968, in two states alone, in three instances state actions were pending to restore or preserve charitable assets on which over $1.5 million in federal taxes had been assessed following rvocation of exempt status for the very conduct upon which the state actions were based.

The tax reform Bill simply ignores this problem to the extent that its pertinent provisions apply only to those organizations that the Bill defines as "private foundations."[3]

However, the jurisdiction and responsibility of State attorneys general are not so limited. On the contrary, they are concerned with the entire range of charitable organizations. These include, but are not limited to, all such organizations granted federal tax exemption under section 501(a). For example, in California the Attorney General is charged with examining and taking corrective action with respect to all non-profit corporations. (Calif. Corp. Code § 9505) Federal tax exempt status is granted to numerous types of non-profit organizations other than private foundations. As to these, the Bill makes no change in present law with which we are here concerned. Present law gives the Secretary of the Treasury no discretion or authority whatsoever to abate or ameliorate the necessity of imposing retroactive income taxes upon the assets of charitable and non-profit organizations in cases of the types considered here. This is the situation that gave rise in 1968 to the introduction of H.R. 18464 in the 90th Congress and, more recently to H.R. 12135 in the 91st Congress.

Even with respect to private foundations, the Bill aggravates the problem in its most acute form by the provisions of sections 4944 and 4945(b)(5). (Bill pp. 42, 44). These provisions would mandate the immediate and unavoidable taxing of the assets of a private foundation dedicated to charity that have been either misappropriated or imprudently invested to the extent of 100 percent of the assets involved in such transactions. No provision is made for the abatement or return of such tax on charitable assets, even if a State attorney general expends the public funds of his office either to recover them intact or to surcharge the responsible trustees or officials for any loss resulting from their misconduct. Yet these types of misconduct rank high in the priorities of a State attorney general for the simple reason that the results of corrective action are so tangible, immediate, and financially beneficial to the public interests of the State.

It may be that such a result of the operation of sections 4944 and 4945(b)(5) was not intended by Committee on Ways and Means, and that there was some misunderstanding of the effect of the exact terms of these two sections. The Committee Report may express its real intention in saying, with respect to the 100 percent tax imposed by section 4944 on foundation assets imprudently invested so as to jeopardize the carrying out of its exempt purposes (p. 31):

"It is expected that the 100 percent tax in this case could be avoided where a State attorney general exercises his powers to preserve a foundation's assets for charity. . . ."

On the contrary, however, there is nothing in section 4944 that would permit the 100 percent tax to be avoided. No authority or discretion to abate or avoid the mandatory tax required by this section is given to the Secretary or his delegate.

The tenor of the above quotation from the Committee Report was repeated by the Chairman of the Committee on Ways and Means in answering a question put to him on the floor of the House during debate on the Bill, viz:

> "Mr. CORMAN. If I may pose a question to the Chairman of the Ways and Means Committee, it is my understanding that H.R. 13270 is intended to accomplish substantially in Title I, subsection A, the purposes of H.R. 12135. Is that correct?
>
> "Mr. MILLS. Would the gentleman yield? Yes, this does accomplish substantially what was intended by H.R. 12135. It does not automatically provide for the waiving of the penalties where a State attorney general corrects a situation by causing a distribution of the assets of a foundation to a public charity, but it is provided that the Secretary, or his delegate, can delay the

[3] Sec. 509(a), p. 16. [Herein reference will be made only to the sections of the I.R. Code as amended or enacted by the Bill, and to pages of the Bill as printed under date of August 2, 1969.]

> imposition of the penalty. He can do this where he has reason to believe the State attorney general's office will correct the situation. After it is corrected by the State attorney general, then, of course, there is no reason for imposing the penalty. In fact, examples of this type are included in the Committee Report." (Cong. Rec., Aug. 7, 1969, p. 7096).

Actually, however, there is nothing in either section 4944 or 4945(b) (5) that would permit the Secretary or his delegate to delay the imposition of the penalty, Much less is there any authority for him to decide that, after correction of the situation by a State attorney general, there is no reason for imposing the penalty. The Bill gives him no discretion, in either case.

It is in this respect (as will be shown in detail hereinafter) that sections 4944 (imprudent investment) and 4945(b) (5) (misappropriation or unauthorized use of funds) differ sharply from the provisions of the Bill relating to foundation misconduct in the form of self-dealing (§ 4941), failure to distribute income (§ 4942) and having excess business holdings (§ 4943). In these three cases, the Bill provides for not one but several levels of taxation or sanction, including a "period of correction," nominally 90 days but extendable to, for example, ". . . any other period which the Secretary or his delegate determines will be conducive to bringing about correction of the act of self-dealing." (§ 4941(e) (4) (B), Bill, p. 25).

Undoubtedly the Chairman, who had many much more weighty things on his mind, was thinking of these "periods of correction" in making the statement quoted above and overlooked the fact that they are not provided for in sections 4944 and 4945(b) (5).

RECOMMENDATIONS

To fairly coordinate the respective efforts of federal and state efforts to insure the proper and efficient administration of property dedicated to charitable and other non-profit purposes, the Congress should act to accomplish the following:

With respect to private foundations and within the framework of H.R. 13270:

1. Amend sections 4944 and 4945(b) (5) to provide multiple sanctions comparable to those now provided for other types of forbidden conduct. These should include a "period of correction" that could be extended as long as the Secretary or his delegate "determines it will be conducive to bringing about correction of the [forbidden] act."

2. Amend each definition of "Correction" and "Period of Correction" in the Bill to define the word "correction" as follows:

> "The term 'correction' includes corrective action taken under applicable state law at the instigation of the appropriate State official."

This is desirable to make it appear on the face of the statute that the Secretary, in exercising his discretion in extending the correction periods provided, is to consider the effect of State action. As the Bill now stands, he may regard the proceedings as involving only the I.R.S. and the taxpayer, with the State official relegated to the position of anything between a pure volunteer and a downright interloper.

3. Amend the Bill to effectuate the statement of the Chairman of the Committee on Ways and Means that—

> "After it [the mis-use of the charitable assets] has been corrected, there is no reason to impose the penalty."

Thus, all of the sections of Chapter 42 of the Bill should be amended to specifically authorize the Secretary or his delegate to abate or avoid the tax in cases where he is satisfied that State action has substantially corrected the abuses and taken steps to effectively prevent their recurrence. We do not think it sufficient that the Secretary may be authorized by the present Bill merely to extend the "period of correction" indefinitely so that a permanent suspension of tax collection becomes, in effect, a substitute for an actual order of abatement. If, as the Chairman indicated, Congress considers that correction obviates the need for a penalty tax, it should be expressly so provided.

With respect to tax-exempt nonprofit organizations other than private foundations:

Provision should be made to abate federal taxation in cases where revocation of exempt status for cause and the retroactive imposition of income taxes puts the federal taxing authorities and an involved State attorney general on a collision course.

We believe that all of the foregoing conflicts can best be resolved by adding new provisions to the Code that would apply to all situations where either tax exemption of a "non-foundation" is revoked for cause or an excise tax is imposed upon a private foundation as provided in the present Bill. The result should be that:

1. Where State action results in the transfer of all of the assets of the offending organization to one or more publicly-supported charities, the Secretary should be *required* to refund any tax collected or abate the liability for any uncollected tax to the successor charities. This is the effect of the pending Corman Bill, H.R. 12135.

2. Where State action results in a correction short of actually divesting the offending organization of all of its assets, the Secretary or his delegate should be *authorized* in his discretion to refund tax paid or abate liability for unpaid tax imposed for the same offense, if he is satisfied with the adequacy of the correction and the effectiveness of the steps taken to prevent its recurrence. This would have been the effect of the Utt Bill, H.R. 18464 of the 90th Congress.

Provisions of H.R. 13270 That Relate to State Action To Enforce a Trust of Property for Charitable Purposes

(What follows is primarily for the benefit of those not familiar with the detailed provisions of the Tax Reform Bill relating to private foundations:)

The Tax Reform Bill makes an important change, almost a revolutionary change, in the method by which the federal taxing power will be used to control the activities of private foundations in certain respects.

Under present law, all charitable organizations exempt from federal income taxes under section 501(c)(3) must maintain certain standards of conduct in order to maintain their exempt status. These are principally set forth in sections 503 and 504. Generally speaking, with exceptions not material here, a 501(c)(3) organization will have its tax exemption denied for each and all tax years during which it violated or failed to maintain any of the prescribed standards. Subject to statutes of limitation, exemption will be revoked retroactively to the time the first violation occurred. Such retroactive revocation or denial of exemption is followed by imposition of the income taxes that would have been payable in each such year.

H.R. 13270 (herein "the Bill") makes no change in this revocation of exempt status and the imposition of income taxes for the period of revocation for violations by 501(c)(3) organizations other than private foundations. With respect to private foundations, however, the Bill makes a drastic change.

For the first time the Bill defines a private foundation. (Section 509.)

In order to prevent existing private foundations from escaping the regulatory provisions of the Bill, it is provided that existing foundations shall maintain their status as such. To terminate its status as a private foundation, an organization must either become an operating charity or repay to the government the aggregate tax benefits, with interest, that have resulted from its having exempt status since 1913. If such aggregate tax benefits exceed the net value of the foundation's assets the repayment may be limited to the latter amount. Further, this termination tax may be abated if the foundation distributes all of its net assets directly to existing publicly supported charities. (Section 507.)

With respect to any new organization claiming exemption under section 501(c)(3), the Bill requires such organization to notify the IRS of its existence and the fact of its claim to such exemption. Further, with some exceptions, new organizations must also notify the IRS of any claim to exemption from the restrictions applicable to private foundations. Failure to give this latter notice will result in a presumption that the organization is a private foundation. (Section 508.)

Having thus cast all private foundations, as defined, into a definite, permanent status, the Bill resorts to the use of excise taxes to compel them to adhere to the standards of conduct that it establishes.

THE FIVE MAJOR TYPES OF TAXABLE MISCONDUCT BY PRIVATE FOUNDATIONS

The Bill would amend the Internal Revenue Code relating to miscellaneous excise taxes by adopting a new Chapter 42 (Bill, p. 17) dealing with five types of conduct on the part of private foundations that will result in tax liability. These are—

Section 4941. Taxes on self-dealing.

Section 4942. Taxes on failure to distribute income.

Section 4943. Taxes on excess business holdings.

Section 4944. Taxes on investments which jeopardize charitable purposes.

Section 4945. Taxes on taxable expenditures, especially 4945(b)(5) expenditures for any purpose other than for a purpose specified in section 501(c)(3).

The last two sections provide a drastically different treatment of the penalty imposed than do the other sections listed above. The practical effect of this difference is to discriminate against those states whose attorneys general engage in a vigorous enforcement of substantive state laws governing the conduct of charitable corporations and charitable trusts. This difference in treatment is central to our objection to the Bill in its present form and, specifically, to sections 4944 and 4945(b)(5).

SELF-DEALING

With respect to self-dealing, failure to distribute income, and having excess business holdings, the Bill adopts what the Committee Report refers to as several "levels of sanction." This scheme is given full play in connection with self-dealing. The Bill (§ 4941, p. 17) imposes upon the self-dealing donor or other disqualified person who participates in any act of self-dealing a "first level" tax of 5 percent of the amount involved for each year of the taxable period. Likewise, a tax equal to 2½ percent of that amount but not exceeding $10,000, is imposed upon any foundation manager who knowingly participated in the act.

The Bill then provides for a "correction" of the act of self-dealing and a "correction period."

"Correction" is defined to mean the undoing of any act of self-dealing to the extent possible, but in any case, putting the foundation in a financial position not worse than that in which it would have been if the transaction had been made under the highest fiduciary standards. (§ 4941(e)(3), p. 25).

The "correction period" begins with the date on which the act of self-dealing occurred and ends 90 days after the date of mailing notice of the first level tax deficiency. It may, however, be extended to include:

> "(B) Any other period which the Secretary or his delegate determines will be conducive to bringing about corrections of the act of self-dealing." (§ 4941(e)(4), p. 25).

Elsewhere in the Bill the applicable statutes of limitation on the filing of a petition in the tax court with respect to the taxes imposed (§ 6213(e), p. 62) and the statute of limitations on the making of assessments or the collection of any tax imposed by Chapter 42 is suspended for any period during which the correction period is extended. (§ 6213(h), p. 64).

This provision for a period of time within which to make the charitable assets whole by appropriate corrective action is central to the whole scheme of the Bill, as we understand it. It demonstrates that the acts and conduct forbidden by the Bill are intended to maximize the assets that are, in fact, expended for their intended charitable purposes, and that its sanctions are designed to further the design of the Bill rather than to be merely punitive. As the Chairman of the House Committe on Ways and Means stated, during the debate on the Bill:

> ". . . After it is corrected by the State attorney general [sic], then, of course, there is no reason for imposing the penalty. In fact, examples of this type are included in the Committee Report." (Cong. Rec., Aug. 7, 1969, p. 7096.)

Concerning the correction period, the Committee Report makes this significant comment (P. 23):

> "The 90-day period for the second level of tax . . . could be extended if the Service believes that would be conducive to correcting the self-dealing. For example, extensions would be granted if State officials took appropiate equity or other action to correct the self-dealing and preserve the assets for charity."

The Committee Report further stresses the intended role of State enforcement in these words (p. 24):

> "To limit opportunities for improper self-dealing, and to facilitate appropriate action by State officials to supervise private foundations, the Bill requires, as a condition of tax exemption, that the foundation's governing

instrument prohibit it from engaging in self-dealing." (§ 508(g)(1)(B), p. 14).

Presumably for the same purpose, i.e., to facilitate State action, the Bill further requires that foundation governing instruments also prohibit it from engaging in the other acts forbidden by Chapter 42.

In the event that correction of the act of self-dealing is not made within the correction period, then the Bill imposes a "second level" of tax. This second level tax upon the self-dealer or other disqualified person is 200 percent of the amount involved. Further, a second level tax equal to 50 percent of the amount involved, with no maximum limit provided, is also imposed on any foundation manager refusing to agree to any part of a correction. (§ 4941(b), p. 18).

A penalty doubling the amount of the first or second level of tax is imposed in the case of repeated violations or a willful and flagrant violation. (§ 6684, p. 56).

A "third level" of tax is applied in cases of willful, repeated acts or a flagrant and willful act. This third level of tax (and only the third level tax) is applied to the foundation's assets. In such case the foundation is literally taxed out of existence by the imposition of the same tax that would be imposed under section 507 in case of its voluntary termination of its status as a private foundation, as set forth above. (§ 508(e), p. 12).

FAILURE TO DISTRIBUTE INCOME

Section 4942 provides that to avoid tax private foundations must distribute all income in the year in which the money is received or in the next year, unless specific set-asides are approved in advance by IRS. It further provides that in any event the annual distribution must be not less than 5 percent of the fair market value of the investment assets, i.e., exclusive of assets used directly for the foundation's exempt purposes.

Failure to make the required distribution will result in what the Committee Report refers to as "A graduation of sanctions, designed to produce current benefits to charity." (Report, p. 25).

As in the case of self-dealing, failure to distribute income will result initially in a first level tax. However, the tax in this instance is imposed upon the foundation's assets and is in the amount of 15 percent of what should have been but was not paid out as a distribution.

As in the case of self-dealing, a correction period is provided prior to the imposition of the second level tax. Again, this correction period is nominally 90 days but is extendable by the Secretary to any period he deems reasonable and necessary to permit a required distribution. (§ 4942(j)(2), p. 33). Here again, the policy of the Bill must be taken to afford every reasonable opportunity to actually put the charitable assets to their intended purposes before imposing taxes that are, practically speaking, confiscatory.

If the necessary distributions are not made within the correction period then a second level tax of 100 percent of the amount required to be paid out is imposed. The third and terminal level of taxation for repeated or flagrant violations is also provided.

EXCESS BUSINESS HOLDINGS

Section 4943 would limit to 20 percent the combined ownership of the voting stock of any corporation that may be held by a foundation and all disqualified persons. Substantial periods of time are provided for the disposition of presently existing excess holdings. Similarly, disposal periods are provided for excess holdings acquired in the future from gifts or bequests, but not from a future purchase by the foundation.

Failure to meet the divestiture requirements results again in several levels of sanction. The first level sanction is a tax of 5 percent each year on the value of the greatest amount of excess holding at any time during the year. Again, an extendable 90-day correction period follows. (§ 4943(d)(3), p. 41). If excess holdings are not disposed of during the correction period a second level tax of 200 percent of the value of the excess holdings is imposed on the foundation. The third and terminal level of sanctions is the same as in the case of self-dealing.

The Bill Provides for Mandatory and Immediate Taxation of Misappropriated or Imprudently Invested Assets of a Foundation that Have Been Restored or Preserved by a State Attorney General.

For present purposes, the most significant aspects of the provisions concerning self-dealing, failure to distribute income and excess business holdings are (1) their consistent establishment of a period for correction prior to the imposition of the heavy second level tax, and (2) the repeated references in the Committee Report to the role the States are expected to play in accomplishing effective correction before it is necessary to impose the second level tax. Such provisions are conspicuously absent from the sections of the Bill relating to the misappropriation and imprudent investment of the charitable assets of foundations. Instead, the Bill provides for a mandatory and immediate tax at confiscatory level of foundation assets involved in misappropriation or imprudent investment.

IMPRUDENT INVESTMENT

Section 4944 (Bill, p. 42) provides:

> "(a) *Tax on the Private Foundation.*—If a private foundation invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes, there is hereby imposed on the making of such investment a tax equal to 100 percent of the amount so invested. The tax imposed by this subsection shall be paid by the private foundation."

A tax would also be imposed on any foundation manager knowingly jeopardizing the foundation's exempt purposes, such tax being equal to 50 percent of the amount so invested. (§ 4944(b), p. 42). With such a penalty upon the persons who, knowing the character of their acts, are responsible for the making of improper investments, we have no quarrel.

It is to be noted that, financially speaking, an investment taxable under section 4944 because it jeopardizes the charitable purpose of the foundation, would also violate the so-called "prudent man rule" that governs the investment practices of trustees under state laws (e.g., Calif. Civ. Code § 2261). Under such laws, in the event that a foundation suffers any financial loss in the liquidation or recovery of any funds imprudently invested, the trustees are liable to be personally surcharged for such losses.

Action to correct improper investment of assets dedicated to charity ranks high in the priorities that a State attorney General gives to necessary corrective action because of the immediate and direct financial consequences. In fact, a State attorney general can much more readily and effectively deal with trustees making imprudent investments than in some cases of "self-dealing" with a foundation by those whom the Bill defines as "disqualified persons." Hence, there is an even more compelling reason to provide for an extendable period of correction before the imposition of a heavy tax in cases of imprudent investment than in cases of self-dealing.

Neither the terms of the Bill nor the Committee Report give any clue for the failure of the Bill to provide three levels of sanction and a correction period prior to imposition of the second level tax comparable to that provided for the violations considered above. Indeed, the Committee Report contains a statement concerning section 4944 that cannot be reconciled with its uncompromising terms and which would seem to contemplate the existence of a correction period. The Report states (p. 31):

> "It is expected that the 100 percent tax in this case could be avoided where a State attorney general exercises his powers to preserve a foundation's assets for charity by appointing new trustees, by requiring the distribution of the offending foundation's assets to a public charity, or by taking other appropriate action."

On the contrary, there is no provision in section 4944 that would permit the 100 percent tax to be avoided. No authority or discretion to avoid or abate the mandatory tax required by section 4944, or even to delay its imposition or collection, is given to the Secretary of the Treasury or his delegate.

MISAPPROPRIATION OF FUNDS

Under section 4945(b)(5), for present purposes, any foundation expenditure is taxable if it is made—"for any purpose other than for a purpose specified in section 501(c)(3)." Such an expenditure would, by definition, also constitute an unlawful misappropriation or diversion of the funds from authorized trust purposes that is actionable under state law. In point of fact, actions to recover charitable funds that have been improperly spent or to forestall threatened improper expenditure rank high on the enforcement docket of an attorney general in his enforcement of charitable trusts.

The Bill specifically requires a mandatory and immediate tax on misappropriated assets recovered by a State attorney general in the exact amount of his recovery. Section 4945 provides (Bill, pp. 43-44):

> "Sec. 4945. TAXES ON TAXABLE EXPENDITURES.
>
> "(a) GENERAL RULE.—
>
> "(1) TAX ON PRIVATE FOUNDATION.—There is hereby imposed on each taxable expenditure a tax equal to 100 percent of the amount thereof. The tax imposed by this paragraph shall be paid by the private foundation.
>
> * * * * * * *
>
> "(b) TAXABLE EXPENDITURE.—For purposes of this section, the term 'taxable expenditure' means any amount paid or incurred by a private foundation. . . .
>
> "(5) For any purpose other than for a purpose specified in section 501(c)(3)."

Provision is also made for the imposition of a tax equal to 50 percent of the wrongful expenditure by any knowing foundation manager (§ 4945(a)(2), p. 43).

It may be that the draftsman of the foregoing provision was unaware of the implications to a State attorney general of the generalized reference to "any purpose other than one specified in section 501(c)(3)" which includes a "charitable" purpose. Subparagraph (5) is the last of a series of acts specifically prohibited by section 4945. Seemingly a "catch-all" provision, it follows specific prohibitions against carrying out propaganda, attempting to influence legislation, influencing the outcome of a public election, as by conducting voter registration drives, and the making of direct grants to an individual for specified purposes.

In any event, as presently drafted, section 4945(b)(5) would have the necessary and unescapable effect of confiscating to the federal government the entire sum recovered by a State attorney general which had been wrongfully spent for any purpose other than the charitable purposes for which it was intended and held in trust. In this respect, it is subject to the same objections as have been made to section 4944, relating to imprudent investments.

CONCLUSION

In sections 4944 and 4945(b)(5), the immediacy of the 100 percent tax, its mandatory nature, the absence of any period within which corrective action can be taken before imposition of heavy, second level taxes, and the failure to grant any discretion to the Secretary in the event there is a timely correction made, are inconsistent with the tenor of the Committee Report, the quoted statement of the Chairman of the Committee on Ways and Means, and the terms of the other provisions of Chapter 42 of the Bill.

One is impelled to the conclusion the treatment actually given sections 4944 and 4945(b)(5) is inadvertent; something that was overlooked in the press of the consideration that had to be given to the many other major aspects of the Bill.

Amendments should be made in the Senate to these sections, so as to provide uniformly an extendable period of correction within which improperly used charitable assets can be restored to their intended purpose and, thus, obviate any "reason for imposing the penalty" of heavy second level and terminal third level taxes.

Finally, it must be emphasized that amendments that deal only with private foundations will not do the job that needs to be done to obtain effective coordination of federal and state enforcement efforts. There is equal need for similar correction periods and abatement of income taxes with respect to charitable organizations, exempt under section 503(c)(3), other than private foundations. The present situation of these "other" organizations is not altered by the Bill. This situation has been correctly characterized by the Committee Report in these words (P. 25): ". . . it frequently happens that the only available sanction (loss of exempt status) either is largely ineffectual or else is unduly harsh."

Twice, within the past year, the National Association of Attorneys General by formal resolution have endorsed and sought the enactment of bills that would protect the interests of the States and, at the same time, effectuate the purposes of the Bill with respect to all types of charitable organization. The presently preferred method of accomplishing this, in view of the provisions of the Bill, is set forth in the recommendations made herewith.

POSTSCRIPT: DISCLOSURES TO STATE OFFICIALS

Most importantly to State attorneys general, the Bill amends section 6104 to direct that notice of federal tax action be given and federal records pertaining to such action be made available to State officials engaged in enforcing state law. These provisions are a direct and gratifying response to the requests for such notice and disclosure made in the Resolutions of the National Association of Attorneys General and contained in the Corman and Utt Bills referred to above.

These provisions (Bill, pp. 60–61) are described in the Committee Report in words that signify the intent (Report, p. 37):

> "In order to facilitate effective enforcement of State common law and statutory requirements regarding exempt organizations, the bill directs the Internal Revenue Service to notify the appropriate State officer (attorney general, tax officer, or other official charged with overseeing charitable organizations) of: (1) any refusal by the Service to recognize the exempt status of any organization that is now exempt or that applies for exemption; (2) any violation by such organization of the requirements of its exemption; and (3) the mailing of a notice of deficiency regarding the tax described below in "Change of Status" or any of the taxes described above relating to self-dealing, income distributions, business holdings, jeopardizing of charitable purposes, and improper expenditures. In addition, the Service will be required to make available, under regulations, any information about the items listed above that is relevant to any determination under State law."

This amendment is not limited to private foundations. By its items the Bill makes the foregoing applicable "In the case of any organization which is exempt from taxation under section 501(a). . . ." (§ 6104(c)(1), p. 60).

AMENDMENTS TO H.R. 13270 RELATING TO THE COORDINATION OF FEDERAL AND STATE SUPERVISION OF THE AFFAIRS OF CHARITABLE ORGANIZATIONS[1]

AMENDMENT NO. 1

Section — of the bill is amended to provide that part I of subchapter F of chapter 1 of the Internal Revenue Code of 1954 (relating to exempt organizations) have added at the end thereof the following new section:

"SEC. 505. COORDINATION WITH STATE SUPERVISION OF CHARITABLE ORGANIZATIONS WHERE EXEMPTION IS DENIED OR EXCISE TAX IMPOSED.

"(a) ORGANIZATIONS TO WHICH SECTION APPLIES.—This section shall apply in the case of any organization which has been exempt from taxation under section 501(a) for any taxable year pursuant to section 501(c)(3) and which subsequently either—

"(1) has been denied exemption from taxation under section 501(a) by reason of having been operated in a manner which does not meet, or no longer meets, the requirements of its exemption, or

"(2) has been sent a notice of deficiency of tax imposed under section 507 or chapter 42.

"(b) REFUND OF ABATEMENT OF TAX WHERE CORRECTIVE STATE ACTION IS TAKEN.—If, following the notification prescribed in section 6104(c) to the appropriate State officer, such State officer—

"(1) Within one year notifies the Secretary or his delegate that corrective action has been initiated pursuant to State law to accomplish a transfer of all of the assets of the organization to which this section applies to an organization or organizations described in section 503(b) (1), (2), (3), (4), or (5) for such charitable purpose as may be ordered or approved by a court of competent jurisdiction, and upon completion of the corrective action. the Secretary or his delegate receives certification from the appropriate State officer that such action has resulted in the transfer of all such assets to such organization or organizations, then—

[1] References are to page and numbered lines of H.R. 13270 as printed under date of August 2, 1969.

"(A) in the case of an amendment of tax attributable to the denial of exemption or imposed by section 507 or chapter 42 that has been paid by the organization, such amount shall be paid to the appropriate State officer or to his order to be distributed in accordance with the State corrective action, or

"(B) in the case of an amount of such tax or any liability in respect thereof not yet collected, the Secretary or his delegate shall abate such tax and any liability in respect thereof.

"(2) Within any correction period provided by chapter 42 or ninety days after the notification prescribed in section 6104(c), whichever is longer, notifies the Secretary or his delegate that corrective action is being initiated under State law to obtain appropriate relief from the conduct or operations which gave rise to the denial of exemption or the imposition of tax under section 507 or chapter 42, then the Secretary or his delegate may, for any period which he determines will be conducive to bringing about such correction, defer action on the assessment or the collection by levy or a proceeding in court in respect of any tax attributable to the denial of exemption or imposed by section 507 or chapter 42. If, as the result of corrective action taken under State law other than the result referred to in paragraph (1), the Secretary or his delegate determines that adequate provision has been made—

"(A) to correct, insofar as practicable, the effects of the act or conduct or operation which led to the denial of exemption or the imposition of tax, and

"(B) to effectively prevent any recurrence of such act or conduct,

he may abate the unpaid portion of the assessment of any tax attributable to the denial of exemption or imposed by chapter 42 against an organization to which this section applies or any liability in respect thereof.

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

"(1) TAX ATTRIBUTABLE TO DENIAL OF EXEMPTION.—Tax attributable to denial of exemption does not include the amount of tax which would have been imposed under section 511 (relating to imposition of tax on unrelated business income of charitable organizations) if an organization to which this section applies had not been denied its exemption.

"(2) FINAL DISPOSITION.—A "final disposition" of assets results if after such disposition is made nothing further remains to fix the rights and obligations of any party with respect to such assets, and no further controversy or litigation can arise thereon.

"(3) ASSETS OF AN ORGANIZATION.—The assets of an organization to which the section applies include the assets held by or for the benefit of such organization and assets held by or for the benefit of a fiduciary or such organization for which by reason of his liability as a fiduciary under State law, such fiduciary is liable to pay to such organization."

AMENDMENT NO. 2 (CONFORMING)

Section 101(g) of the bill, concerning the suspension of the period of limitations for the assessment and collection of tax, is amended as follows:

Page 64, line 16, strike out the word "or".

Page 64, line 16, following 4943(d)(3) insert: ", or 505(b)(2)."

STATEMENT BY SAMUEL P. HAYES, PRESIDENT, FOREIGN POLICY ASSOCIATION

I am Samuel P. Hayes, President of the Foreign Policy Association. I appreciate this opportunity to present my written views on H.R. 13270 to this committee.

The Foreign Policy Association has been in existence since 1918, when it was formed by a group of distinguished Americans, among whom were Charles A. and Mary Beard, John R. Commons, Walter Dramrosch, John Dewey, Felix Frankfurter, Judge Learned Hand, William E. Hocking, Ralph S. Rounds, Jacob H. Schiff, E. R. A. Seligman and Ida M. Tarbell. Its basic purpose is to present facts on America's foreign policy problems to as large an audience of editors, writers, educators and other interested persons as possible. It is devoted to making available to the American public the results of careful study of all sides of every international question affecting the United States to the end that the American people might understand fully what our problems are and how they can be dealt with most effectually.

The Association is a non-profit membership organization exempt under Section 501(c)(3) of the Internal Revenue Code. Its income in the last fiscal year ending June 30, 1969 was 1.6 million dollars. Of this amount, foundations provide the greatest portion (28%), corporations contribute (18%), individuals (11%) and income from Association services and materials the rest. I believe that, under the terms of the Act, the Association will not be classified as a private foundation under the exceptions provided in proposed Section 509. This is, of course, a variable determination from year to year, depending upon our sources of support.

Our concern stems from the fact that a substantial amount of our support is in the form of grants from foundations, many of which will undoubtedly be classified as "private foundations" under proposed Section 509. And under the proposed Tax Reform Act, grants by such foundations to other foundations, private and non-private alike, will we believe be subject to proposed Section 4945, the "taxable expenditures" provision. Therefore, we are vitally concerned that the ambiguities in that Section—particularly those parts dealing with "political activities"—be clarified. Unless this is done, we are convinced that cautious foundation managers will cease making grants to our Association, and similar organizations, for the fear that our activities, even though not intended to be covered by Section 4945, would nevertheless subject them to the harsh sanctions of the Act.

Section 4945 imposes taxes on "taxable expenditures" by a private foundation. The foundation pays a tax equal to 100% of the amount of the expenditures, and any foundation manager who knowingly agrees to the making of such an expenditure must pay a tax equal to 50% of the amount involved (with no maximum). Under Section 4945(b) in relevant part, the term "taxable expenditure" includes any amount "paid or incurred" by a private foundation (1) to carry out propaganda or otherwise attempt to influence legislation; (2) to influence the outcome of any public election, including voter registration drives carried on by or for such foundation. This category is further defined under Section 4945(c) as follows:

> "For purposes of subsection (b)(1), the term 'taxable expenditures' includes (but is not limited to)—
>
> "(1) any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof, and
>
> "(2) any attempt to influence legislation through private communication with any member or employee of a legislative body, or with any other person who may participate in the formulation of the legislation, *other than through making available the results of nonpartisan analysis or research. . . .*" [Emphasis added.]

Our activities have through the years been in the highest tradition of dispassionate examination of public issues. As such, they have clearly constituted "educational" activities for tax purposes within the long-standing interpretation of that term as it is used in Section 501(c)(3) of the Internal Revenue Code. For many years, the Treasury has recognized, quite rightly, that the term "educational" includes ". . . the instruction of the public on subjects useful to the individual and beneficial to the community . . ." and that "an organization may be educational even though it advocates a particular position or view so long as it presents a sufficiently full and fair exposition of the pentinent facts as to permit an individual or the public to form an independent opinion or conclusion." Regs. § 1.501(c)(3)-1(d)(3). This definition applies even to an organization expressing a partisan viewpoint as long as it presents a "full and fair exposition" of the pertinent facts. Our Assoc ation has not only always sought to present such a "full and fair exposition of the pertinent facts" but, in fact, does not attempt to advocate a particular position or viewpoint. We intend to continue to follow this guiding principle in the future.

It seems evident that the language of subsection (c) clearly evidences a Congressional intent to exclude activities such as those engaged in by our Association as activities "making available the results of non-partisan analysis or research." However, since the meaning of this succint exclusion is not made clear in the House Committee Report, cautious foundation managers may cease making grants available to our Association because of their fear that we are not covered by the exclusion and hence, such grants would be "taxable expenditures."

Therefore, we respectfully request that language be inserted in the Committee Report to make it clear that the statutory term "making available the results of non-partisan analysis or research" is at least intended to be coextensive with, and thus to include, the "educational" activities described in Regs. § 1.501 (c)(3)-1(d)(3), previously referred to. Further, we hope that the Committee Report will also make clear that the educational activities of the Foreign Policy Association are specifically what Congress had in mind when it excluded from the "taxable expenditures" provision activities which make available the results of non-partisan analysis or research.

STATEMENT SUBMITTED ON BEHALF OF THE HECKSCHER FOUNDATION FOR CHILDREN OF NEW YORK, AND PUBLIC WELFARE FOUNDATION, INC., OF THE DISTRICT OF COLUMBIA, BY LYMAN G. FRIEDMAN, OF WENCHEL, SCHULMAN & MANNING, WASHINGTON, D.C.

The proposed addition to the Internal Revenue Code of Section 4943 (Taxes on Excess Business Holdings), as contained in section 101(b) of H.R. 13270, should be rejected by your Committee for at least three reasons. First and most significantly, section 101(b) attacks charities which do not in fact commit the evils which the legislation, according to the Committee report, was designed to eliminate. Second, the ultimate impact of section 101(b) would be to impair the operations of bona fide charitable beneficiaries of those institutions which are hit by the new rule although they have not used exempt status improperly. And, third, the practical consequence of section 101(b) conflicts with the repeated call, often endorsed by the government, for the private sector of society to increase its participation in charitable matters.

Turning to these objections in somewhat greater detail:

First, the proposed section goes far beyond the reasons offered for its enactment in House Report No. 91-413, page 27. The major reasons advanced by the House are that (1) in some cases foundations which have retained control of businesses have been ". . . relatively unconcerned about producing income to be used by the foundation for charitable purposes." and (2) in other cases, the business controlled by the foundation ". . . may be run in a way which unfairly competes with other businesses whose owners must pay taxes on the income that they derive from the businesses."

Instead of attacking these abuses directly, the proposed legislation makes control of a business evil by a foundation *per se*, regardless of whether that control is in fact used to produce income which is used by the foundation solely for charitable purposes, and regardless of whether the business is in fact run in a fairly competitive manner. Thus, under the House bill, instances of improper control of a business by a foundation, serve to contaminate all other foundations which have in no way misused control. This blanket condemnation of control amounts to a case of overkill.[1] The abuses which can occur through improper foundation conduct should, of course, be eliminated to the greatest extent possible. We would suggest that the bill as it stands interdicts the potential for misconduct in an overgeneral way, rather than interdicting specific misconduct if, as and when it actually occurs.

The second and third reasons the proposed law should be rejected are closely interrelated. At the outset, its ultimate cost must be borne by those who can least afford it, that is by the beneficiaries of the charities which will be required to relinquish their control of profitable businesses, losing thereby the income which would have been used for charitable purposes. Where a charity uses its control of a business to produce reasonable income, and in doing so competes fairly with taxable businesses, it does so because its financial yield from that business is as great or greater than that which could be obtained by selling control and reinvesting the proceeds. In many cases the controlled business yields a larger than normal return, but is not readily saleable. To compel a sale will in many instances result in a great sacrifice of capital, and in other instances may result in a disastrous liquidation. The requirement to dispose of a holding in excess of 20% assumes, contrary to the fact, a holding for which a market

[1] Also, it is highly questionable whether it is appropriate to use the Internal Revenue Code as the vehicle by which to impose, in the guise of a revenue measure, regulations on the activities of fiduciaries, i.e., the officers anad directors of a charitable foundation.

exists. Actually, the reverse is true. Rarely does a charitable organization hold as much or more than 20% of a corporation whose stock is publicly traded. Under those circumstances, divestiture of control may result in a diminution of income to the charity, with a concomitant diminution of its charitable grants. Those persons and organizations which otherwise would be the recipients of those grants will be the ones to suffer from the diminution of the foundation's income, which in turn directly stems from its divestiture of control.

The only way for such reduction in charitable grants to be recouped, if it is to be recouped at all, would be for the government to subsidize the grants. To suggest that the government assume that burden is directly contrary to this and previous administration's repeated call upon the private sector of our society to increase its participation in necessary social and charitable matters. One of the historic means by which the private sector has been able to participate in social and charitable activities is through tax-exempt foundations. If enacted, the proposed section would diminish the financial ability of the private sector through use of such foundations to carry on needed social and charitable activities.

We therefore recommend that this system be considered, and that the legislation finally enacted be that which is directed towards prohibiting and punishing *misuse* of control, and not the *existence* of control. The law should not punish on the basis of a potential for misconduct; such an approach is too superficial an analysis of the actual workings of the foundations affected by this law. Indeed, it is apparent from the proposed legislation that the Ways & Means Committee recognized that control, *per se*, is not an evil. In subsection (k)4 of Section 4947 of H.R. 13270, two foundations (reported by the press to be the W. K. Kellogg Foundation and the Benwood Foundation) were given specific exemptions from the proposed legislation. Manifestly, if those two foundations are to be exempt because *they* do not misuse control, certainly all *other* foundations which do not misuse control should be granted similar relief from the requirements of proposed Section 4943.

This statement is submitted on behalf of two foundations which, we submit, have used their control of fully taxable corporations to compete fairly with other businesses and to produce substantial income which has been used exclusively for charitable purposes.

One foundation, The Heckscher Foundation For Children of New York, is 48 years old, and was created by a special act of its state's legislature. By prudent management of fully taxable corporations it has been able to pay out over $3,640,000 for recognized charitable purposes—principally in the field of child welfare. Its board, and those of the fully taxable corporations it controls consist, almost exclusively, of persons unrelated to the foundation's donor.

During the period September 30, 1942 to December 31, 1968, Heckscher Foundation had a gross dividend and interest income of $3,643,000. Its income in 1942 was $29,000 and in 1968, $300,000. During the same period of time it has distributed to various charities, principally those concerned with child welfare, $3,257,000. Administrative expenses for the 27 year period have been $415,000, for an average of about 11%, but, whereas income has increased more than tenfold over the period, administrative costs have only doubled and are currently 6.4% of income.

From 1921 to 1947, the Heckscher Foundation operated, in its own or rented building, a dental clinic, employment agency for teenagers, thrift shop, infant foster care services and a community center for children, which had a daily attendance of 1,000 children, with facilities for sports, arts and crafts, musical instruction, etc.

Since 1947, its method of operation has been to contribute its income directly to childrens' charitable organizations operated by others, such as community centers, camps and hospitals.

The other foundation, Public Welfare Foundation, Inc. of the District of Columbia, is approximately 18 years old. This foundation, in order to satisfy the Internal Revenue Service's requirement that it not engage in business, approximately three years ago transferred its business assets to fully taxable subsidiaries which, while competing fairly with others, over the years have provided the foundation with approximately $6,000,000 with which to make charitable grants. Those grants have been principally in support of higher education, child care institutions and child development programs.

One of Public Welfare Foundation's primary objectives is making higher education possible for young people who would otherwise be deprived of the opportunity. Continuous support has been given to work-study, low-tuition schools and colleges, scholarship and loan funds, vocational training programs, etc. As an example, the foundation has encouraged and supported the development of Warren Wilson College in North Carolina over a thirteen year period, from a small junior college for mountain youth to a fully accredited four-year institution which last summer graduated its first class of 65 seniors with baccalaureate degrees. Other such institutions are Spartanburg Junior College in South Carolina; College of the Virgin Islands; Ohio State University; Piney Woods Country Life School in Mississippi; Berea College; Navajo Community College in Arizona; Knox College in Jamaica; Stillman College, Alabama, to name a few.

Improved child care institutions and child development programs also are major concerns of Public Welfare Foundation. The National Capital Area Child Day Care Association has been helped to establish good neighborhood centers to care for the children of working mothers, many of whom have been removed from the welfare rolls and are now self-supporting. All areas of child welfare and development have been aided, including training for the retarded and emotionally disturbed, foster homes, medical facilities, tutoring programs, etc. A number of programs initiated by the federal government in Appalachia have been aided through the Council of the Southern Mountains.

For either foundation to divest itself of the stock of the fully taxable corporations it controls, under threat of a deadline, would compel it to sacrifice its valuable assets at less than their full value, and before their full potential has been realized by the charities. Under the usual concepts of a fiduciary's obligations to beneficiaries, such sale might well be considered improper. For these foundations to obtain sales prices sufficient to produce the same annual income from reinvestments, they would have to obtain a maximum price for their present assets. To do so under the proposed statutory deadlines may prove impossible.[2] The first deadline is two years away, and would require sale of at least 10% of the holdings. Sales of a minority interest, particularly in a small company, generally can be made only at a discount. This problem may also exist as to a sale of 51% in order to satisfy the 5 year deadline. Thus, the practical choice is for the foundations either to sell part of their holdings at a discount, or to rush to a sale of all of their holdings within the two year period. In either event, the result could be a substantial loss to the beneficiaries of their charitable grants.[3]

POWELL BUTTE, OREG., *October 1, 1969.*

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance, Senate Office Building, Washington, D.C.

Re: H.R. 13270, Tax Reform Act of 1969: Retain the 7½% on Foundation incomes; and also retain the 100% penalty taxes for violations, Secs. 4944 and 4945.

HONORABLE SIRS: This letter and supporting exhibits reveal the practice whereby tax-free Foundations are abusing the tax-exempt privilege accorded to them by the American people.

Tax-exempt Foundations are dispensing tax-exempt funds to certain organizations which are affiliated with the Public Administration Clearing House (PACH).

The 83d Congress, 2d Session took note of PACH by these words: (p. 221, TAX-EXEMPT FOUNDATIONS, House Report #2681, 12/16/54, Special Committee to Investigate Tax-Exempt Foundations, Hon. B. Carroll Reece, Tennessee,

[2] The conditions imposed by section 101(b) would seem to anticipate that they would apply to foundations holding stock in large corporations whose shares are publicly traded and hence readily disposable without financial sacrifice. This would not be so in the case of a wholly or closely owned enterprise for which only a limited market exists.

[3] Because the relief from the two year deadline intended by subsection 4943(d)(4)(B)(i) may not contain sufficient yardsticks (as to what constitutes, and who decides if, ". . . a severe depressive effect on the value . . ." is created) to assure its being granted administratively without the risks of protracted and expensive litigation, fiduciaries, in order to avoid such risks, may find an early sale at a discount the more prudent course. To do so would, of course, reduce the principal and thus the income out of which to make future grants. Thus, again, the beneficiaries of the charity, the people least able to afford it, would be the ones to pay the ultimate costs of this legislation.

Chairman): "There are some special foundations or similar organizations to which we have been able to give insufficient attention in some cases and none in others. These should all be studied. Among those which we have not heretofore mentioned (or have mentioned only briefly) are these:

"THE PUBLIC ADMINISTRATION CLEARING HOUSE (PACH headed the list) etc."

The bulk of my private continuing research on PACH, extending over the past dozen years, has been published in books and national magazines, and is appearing weekly in newspapers in several states.

Highlight of this brief résumé is the timely proof that tax-exempt funds currently are being used to REPRESS federal legislation. Please see photocopies attached (Exhibits D, E, F, G)[1] regarding H.R. 20 regarding the 1970 Census Implicated are Ford Foundation and the National Association of Counties. Both Ford Foundation and NACo, are tax-exempt. NACo, through an interlocking directorate and purpose, is affiliated with PACH.

I respectfully request that this letter and enclosures be made a part of the record of the Hearings on the "Tax Reform Act of 1969."

Respectfully,

J. HINDMAN.

For these reasons, we again request that the statutory prohibitions be limited to misuse of control and not to control, *per se.*

THE 91ST CONGRESS SWAYED BY TAX-EXEMPT FOUNDATION ACTIVITIES

Carnegie Corporation, Ford Foundation, Rockefeller (Spelman Fund) tax-exempt foundations long have contributed heavily to a political syndicate that spearheads attempts to influence legislation, legislators and legislatures in the United States.

The subject example pertains to HR 20 introduced January 3, 1969, by Hon. Jackson E. Betts, M. C. (Ohio), a bill to remove the jail sentence penalty on all decennial census questions and the $100 fine on all but six subjects essential to the population count.

Exhibits attached, A, B, C, list appropriations taken at random from various annual reports of Carnegie, Ford and Rockefeller foundations.

Beneficiaries listed: Council of State Governments, National Municipal League (New York) are influential affiliates of the Public Administration Clearing House at 1313 E. 60th St., Chicago (Exhibit H). Descriptions of appropriations reveal the political nature of the activities supported.

Spring 1969, Council of State Governments moved its headquarters to Lexington, Kentucky, but maintains an office at "1313" in Chicago, at its former quarters at that address. (Exhibit I (Eye))

The entire PACH complex is linked by an interlocking directorate plus a mutual goal which was explained officially by the Reece Report (Tax-Exempt Foundations). See Exhibit C.

Current Example in 91st Congress:

National U.S. legislation is tampered with, also. The burial of the 1970 census-correction bill, HR 20, demonstrates. (Exhibit J).

Tax-exempt money, expended by a tax-exempt foundation (Ford) to other tax-exempt organizations (National Assn. of Counties and National Service to Regional Councils) combined to work against the best interests of U.S. citizens. HR 20 and similar bills would limit the census questions to a basic six; it would free Americans from penalties should they decline to answer a long census questionnaire. (Exhibit G)

The NSRC, a PACH–1313 propaganda service that reaches newspaper editors, government officials, etc., launched an attack against HR 20. As late as Sept. 22, 1969, the bill lies dormant. NSRC is jointly sponsored by National Assn. of Counties (NACo) and the National League of Cities, both PACH–1313 adjuncts. (Exhibit F).

[1] Appendixes D, E, and F are made a part of the official files of the committee.

NACo went even further, urged its members to contact legislators, naming names. (Exhibit E) NACo is tax-exempt. Ford Foundation which has given at least $485,000 to NACo in recent years, likewise is tax-exempt. (Exhibit D). Both Ford Foundation and NACo, for similar violations, probably would draw 100% penalties under the income tax reform bill, HR 13270, if enacted.

It is earnestly expected that the Senate Committee on Finance will retain the 7½% tax on Foundation incomes; and also retain the 100% penalty taxes for violations, Secs. 4944 & 4945.

LIST OF EXHIBITS

Exhibit A—Carnegie Corporation appropriations, various years.

Exhibit B—Ford Foundation appropriations, various years.

Exhibit C—Rockefeller Foundation.

Exhibit D—(photocopy) page from *The County Officer*, NACo publication.

Exhibit E—(photocopy) "Washington Report", page from. April 14, 1969, by NACo, 1001 Connecticut Ave., N.W. Wash., D.C. 20036

Exhibit F—(photocopy) overlays re: Congressman Betts' bill, HR 20 pages from NSRC (National Service to Regional Councils), sponsored by National Assn. of Counties (NACo) and National League of Cities (NLC, formerly American Muncipial Assn.)

Exhibit G—(photocopy) letter of Congressman Jackson E. Betts re: HR 20, introduced Jan. 3, 1969, a bill to remove the jail senteace penalty on all decennial census questions, etc.

Exhibit H—MetroChart by Jo Hindman, flow chart of PACH-1313 complex.

Exhibit I—current newspaper release by Jo Hindman, brief history of PACH-1313's Council of State Governments and tax-exempt support of. Release dated 9/30/69.

Exhibit J—Newspaper tear sheet containing Jo Hindman published column re: 1970 census questionnaire, from The Ledger, Montrose, California, June 26, 1969, exposing PACH-1313 interference, and suppression of federal legislation. Caption, "Solons Argue, But Census Forms Done."

EXHIBIT A

CARNEGIE CORP.

Annual reports, years	Recipients and purpose	Page	Appropri-ation allocation
1965	Citizens Conference on State Legislatures (X-3098) Note: CCSL is linked with PACH-1313's National Municipal League.	68	$100,000
	Committee for Economic Development (X-2989) Government management. Note: CED recommends abolishment of about [illegible] of elective offices.	69	379,000
	Council on Foregin Relations (B-3217) General support.	69	400,000
1967	Council of State Governments (X-3215) Note: PACH-1313 for Governors Conference.	83	52,000
	National Municipal League—PACH-1313 (B-3301) For research on State constitutional conventions.	87	285,000
	Rutgers, the University of New Jersey (B-3266) For seminars for State legislators conducted by the Eagleton Institute of Politics (1313 linked).	89	90,000
	World Law Fund (X-3179) Research on world order.	91	14,000
1968	Citizens Conference on State Legislatures (1313-linked) (B-3342) For research and education on State legislatures.	81	300,000
	Council of State Governments (PACH-1313) (X-3243) For Governors conference.	82	9,700
	Rutgers (B-3266, X-3260) Eagleton Institute for seminars for State legislators.	86	260,000
	Study of independence and accountability in the contract State (B-3355)	89	60,000

EXHIBIT B

FORD FOUNDATION

Year	Annual reports information, statement of grants	Page	Amount
	LEGISLATIVE PROCESS		
1957......	American Society for Public Administration Expansion of its activities, membership (PACH-1313 linked).	67	$215,000
	National Municipal League (PACH-1313) For constitutional amendment and revision.	68	150,000
	Rutgers (1313 linked) Study of selected State constitutional problems.	68	15,000
	Washington State Research Council, Inc Prelegislative conference of members of Washington State Legislature.	68	24,397
	West Virginia University Prelegislative conference of members of West Virginia Legislature and public.	68	23,000
	URBAN AND REGIONAL PROBLEMS		
	Institute of Public Administration (1313 linked) Conference on research on metropolitan government.	70	2,500
	National Municipal League PACH-1313 General program.	70	70,000
	St. Louis University St Louis referendum campaign.	70	12,500
	Southern California, University of Planning on interuniversity approach to urban problems in the California region.	70	25,000
	Washington University St. Louis referendum campaign.	70	12,500
	THE LEGISLATIVE PROCESS		
.958......	American Political Science Association Program of Congressional fellowships.	117	169,000
	California, University of (Berkeley) Interuniversity program of legislative internships.	117	200,000
	Columbia University Research and publication on State constitutional amendment and revision.	117	53,220
	URBAN AND REGIONAL PROBLEMS		
	National Association of County Officials (NACO) Local Government Education and Research, Inc.—Program to improve county government, in cooperation with NACO 1313-linked.	120	160,000
	National Municipal League (PACH-1313) Program to improve government on State and municipal levels.	120	30,000
	URBAN AND REGIONAL AFFAIRS		
1964.......	National Association of Counties (NACO) (1313-linked) Research, advisory services.	119	200,000
	National Municipal League (PACH-1313) Legislative apportionment.	119	50,000
	PUBLIC AFFAIRS PROGRAM (special reprint, p. 11)		
1965.......	National Municipal League [1]	1	918,500
	John F. Kennedy Institute of Politics	5	2,000,000
	Internships in State legislatures	5	70,972
	Penjerdel (Pennsylvania-New Jersey-Delaware metropolitan project)	5	185,000

[1] Following is copied from p. 1 of the 11-page excerpt-reprint:

"With a $918,500 grant, the National Municipal League will commission State-by-State studies of the changes likely to result from the court decisions on reapportionment of voting districts for State legislatures. (Previously, on the heels of the historic 1962 Supreme Court decision giving Federal courts review over the constitutionality of State legislative reapportionment, the League received an emergency grant to establish an information center on reapportionment. Its services have been widely utilized by the Department of Justice, Federal Judges, Congressmen, and private groups * * *"

EXHIBIT C

ROCKEFELLER FOUNDATION (SPELMAN FUND)

Tax-exempt Rockefeller (Spelman Fund) built the political syndicate core at 1313 E. 60th St., Chicago, site of the Rockefeller university. The core was named PUBLIC ADMINISTRATION CLEARING HOUSE and was self-dubbed "1313" and Thirteen-Thirteen in the organizations' own literature.

Between 1931–52, PACH–1313 received from Rockefeller-Spelman $8,068,740. (Cf. page 894 "Tax-Exempt Foundations"—The Reece Committee).

(See page 894 of the Hearings) (1954)

Hearings—p. 895: "There is nothing ambiguous about the warning on p. 9 of the 1941 annual report of the Rockefeller foundation: 'If we are to have a durable peace, if out of the wreckage of the present a new kind of cooperative life is to be built on a GLOBAL SCALE, the part that science and advancing knowledge will play must not be overlooked'."

Hearings—p. 893: "It is only natural to wonder about the agencies selected to work in these inviting areas to build 'a cooperative life on a global scale.' . . ." (continuing, same page): THE PUBLIC ADMINISTRATION CLEARING-HOUSE . . . is also a guarantee of the foundation." (Spelman Fund, Ed.)

"Composed of 21 organizations of public officials representing functional operations of Government (such as welfare, finance, public works, and personnel) the clearinghouse is designed to keep public officials in touch with 'the results of administrative experience and research in their respective fields' . . ."

On page 221 of the Reece Report on Tax-Exempt Foundations followed the recommendation which I quoted in my letter to your Senate Finance Committee regarding the PUBLIC ADMINISTRATION CLEARING HOUSE, (PACH.)

The numerous organizations which are affiliated and linked with PACH would have become extinct had not the tax-exempt funds of many foundations—Carnegie, Ford and Rockefeller are just three that have been included here—been placed at their disposal.

Exhibits D-through-J follow, as incorporated, numbered pages 8 through 14, belonging to this documentation.

CONCLUSION: I urge the Senate Finance Committee to retain in HR 13270 or any re-titled or re-numbered legislation regarding the reform of the income tax federal law the 7½% (or any higher percentage) tax on Foundations income; also the penalty 100% tax for violations of the law.

EXHIBIT G

CONGRESS OF UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C.

DEAR FRIEND: The census reform issue is very much alive in the 91st Congress. Favorable action depends on expressions of support for this objective sent to every Congressman and Senator from their constituents. You and your friends can help by writing letters and circulating petitions to your Congressman and Senators.

On January 3, 1969, I introduced H.R. 20, a bill to remove the jail sentence penalty on all decennial census questions and the $100 fine on all but six subjects essential to the population count. More reforms than these are needed in the long, complex and overly personal nature of the forms which are a vast extension of the census from its Constitutional purpose of enumerating the population. The repeal of offensive mandatory requirements on all census questions is a significant beginning. My position is outlined in the enclosed statement.

The final months before the April 1, 1970 census are at hand. Anything you can do will be appreciated. The people you talk with about this subject and who want to do something should *not* write to me but to their representative in Congress. I need all the support for hearings and an early vote by the House that can be generated by concerned citizens.

Thank you for your expression of concern.

Sincerely,

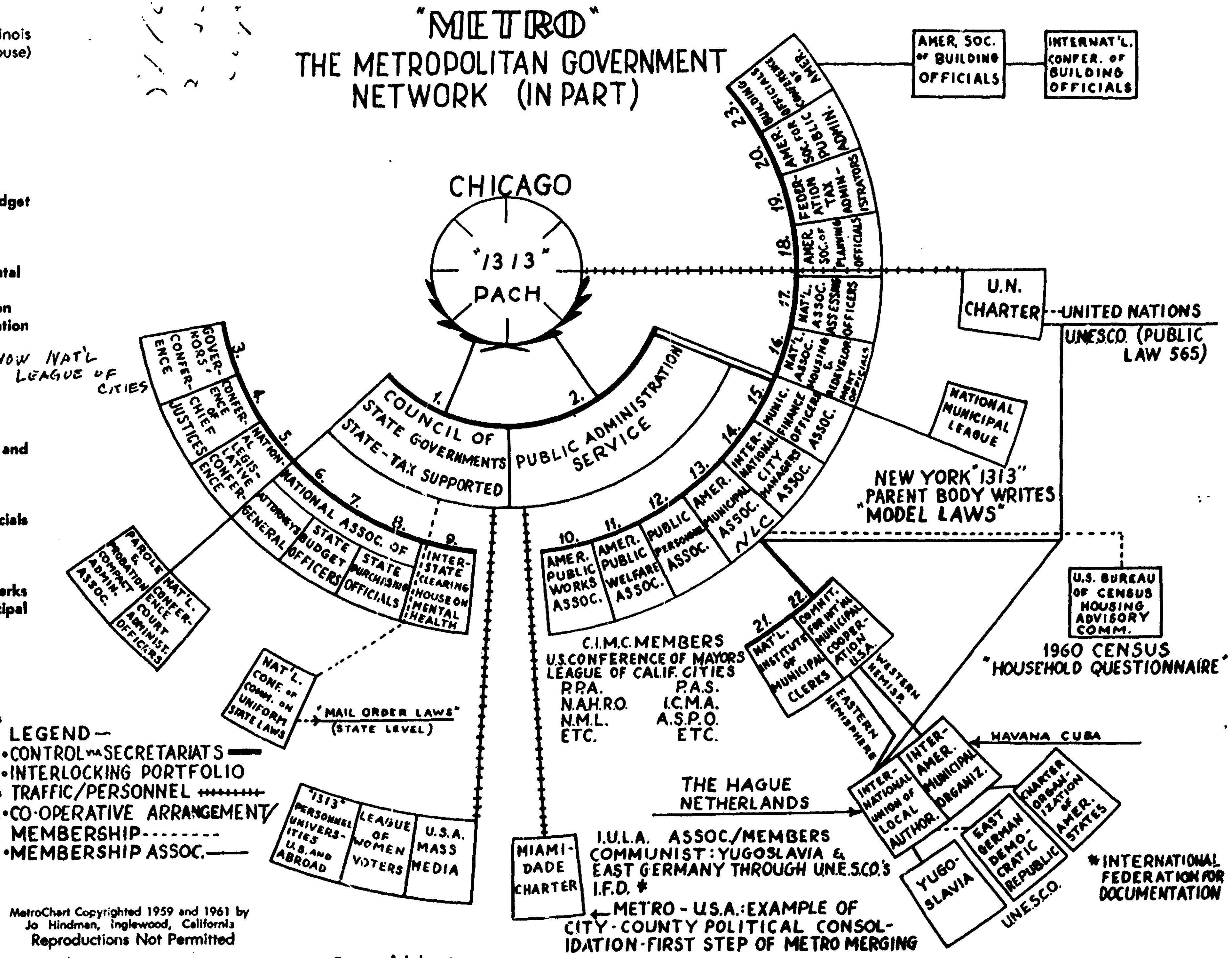
JACKSON E. BETTS.

EXHIBIT H
PAGE 12

1313 East 60th Street, Chicago, Illinois
(Public Administration Clearing House)

1. Council of State Governments
2. Public Administration Service
3. Governors' Conference
4. Conference of Chief Justices
5. National Legislative Conference
6. National Association of Attorneys General
7. National Association of State Budget Officers
8. National Association of State Purchasing Officials
9. Interstate Clearing House on Mental Health
10. American Public Works Association
11. American Public Welfare Association
12. Public Personnel Association
13. American Municipal Association, NOW NAT'L LEAGUE OF CITIES
14. International City Managers' Association
15. Municipal Finance Officers Association
16. National Association of Housing and Redevelopment Officials
17. National Association of Assessing Officers
18. American Society of Planning Officials
19. Federation of Tax Administrators
20. American Society for Public Administration
21. National Institute of Municipal Clerks
22. Committee for International Municipal Cooperation– U. S. A.
23. Building Officials Conference of America

NML	National Municipal League
NCCUSL	National Conference of Commissioners on Uniform State Laws
NCCAO	National Conference of Court Administrative Officers
PPC	Parole and Probation Compact Administrators Association
IULA	International Union of Local Authorities
OAS	Organization of American States
IMO	Inter-American Municipal Organization
ASBO	American Society of Building Officials
ICBO	International Conference of Building Officials


"METRO"
THE METROPOLITAN GOVERNMENT NETWORK (IN PART)
CHICAGO
"1313" PACH
1. COUNCIL OF STATE GOVERNMENTS
STATE-TAX SUPPORTED
2. PUBLIC ADMINISTRATION SERVICE
3. GOVERNORS' CONFERENCE
4. CONFERENCE OF CHIEF JUSTICES
5. NATIONAL LEGISLATIVE CONFERENCE
6. NATIONAL ASSOC. OF ATTORNEYS GENERAL
7. STATE BUDGET OFFICERS
8. STATE PURCHASING OFFICIALS
9. INTERSTATE CLEARING HOUSE ON MENTAL HEALTH
PAROLE & PROBATION COMPACT ADMIN. ASSOC.
NAT'L CONFERENCE COURT ADMINIST. OFFICERS
NAT'L CONF. OF COMM. ON UNIFORM STATE LAWS
"MAIL ORDER LAWS" (STATE LEVEL)
"1313" PERSONNEL UNIVERSITIES U.S. AND ABROAD
LEAGUE OF WOMEN VOTERS
U.S.A. MASS MEDIA
10. AMER. PUBLIC WORKS ASSOC.
11. AMER. PUBLIC WELFARE ASSOC.
12. PUBLIC PERSONNEL ASSOC.
13. AMER. MUNICIPAL ASSOC. NLC
14. INTERNATIONAL CITY MANAGERS ASSOC.
15. MUNIC. FINANCE OFFICERS ASSOC.
16. NAT'L ASSOC. HOUSING & REDEVELOPMENT OFFICIALS
17. NAT'L ASSOC. ASSESSING OFFICERS
18. AMER. SOC. OF PLANNING OFFICIALS
19. FEDERATION TAX ADMINISTRATORS
20. AMER. SOC. FOR PUBLIC ADMIN.
23. BUILDING OFFICIALS CONFERENCE AMER.
AMER. SOC. OF BUILDING OFFICIALS
INTERNAT'L. CONFER. OF BUILDING OFFICIALS
U.N. CHARTER
UNITED NATIONS
UNESCO (PUBLIC LAW 565)
NATIONAL MUNICIPAL LEAGUE
NEW YORK "1313" "PARENT BODY WRITES "MODEL LAWS"
U.S. BUREAU OF CENSUS HOUSING ADVISORY COMM.
1960 CENSUS "HOUSEHOLD QUESTIONNAIRE"
21. NAT'L. INSTITUTE OF MUNICIPAL CLERKS
22. COMMIT. FOR INT'L MUNICIPAL COOPERATION U.S.A.
WESTERN HEMISP.
EASTERN HEMISPHERE
C.I.M.C. MEMBERS
U.S. CONFERENCE OF MAYORS
LEAGUE OF CALIF. CITIES
P.P.A. P.A.S.
N.A.H.R.O. I.C.M.A.
N.M.L. A.S.P.O.
ETC. ETC.
HAVANA CUBA
INTER-AMER. MUNICIPAL ORGANIZ.
INTERNATIONAL UNION OF LOCAL AUTHOR.
THE HAGUE NETHERLANDS
CHARTER ORGANIZATION OF AMER. STATES
YUGOSLAVIA
EAST GERMAN DEMOCRATIC REPUBLIC
UNESCO
* INTERNATIONAL FEDERATION FOR DOCUMENTATION
I.U.L.A. ASSOC./MEMBERS COMMUNIST: YUGOSLAVIA & EAST GERMANY THROUGH UNESCO'S I.F.D. *
MIAMI-DADE CHARTER
← METRO - U.S.A.: EXAMPLE OF CITY-COUNTY POLITICAL CONSOLIDATION - FIRST STEP OF METRO MERGING
LEGEND—
•CONTROL VIA SECRETARIATS
•INTERLOCKING PORTFOLIO TRAFFIC/PERSONNEL
•CO-OPERATIVE ARRANGEMENT
MEMBERSHIP
•MEMBERSHIP ASSOC.

MetroChart Copyrighted 1959 and 1961 by
Jo Hindman, Inglewood, California
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Jo Hindman 10/1/69

1313...What IS It?

Copyright by Jo Hindman 1965

1313 is an idea, a "movement," and a clearinghouse address, 1313 E. 60 St., Chicago, Illinois. (See MetroChart on reverse side)

At that location, Thirteen-Thirteen's capitol building teems with a briefcase crowd which devises and distributes through 1313's agent network a dangerous product--a "wild" GOVERNMENT TO RULE YOU--Metropolitan Government which is the exact opposite of U.S.American self-rule.

- IF YOU OWN PROPERTY, Metro-1313 can run up your taxes, at the same time paralyzing your efforts to save yourself. Examples: Rezoning for higher taxes, lavish spending on new government centers, mental health clinics, merging cities under multi-county and interstate regions where you pay for upkeep of distant territory. Also, urban renewal that seizes homes, businesses, and farmlands. The total spectacle is 1313's attempt to reshape America into a land of giant puppot cities manipulated by Metrocrats now imbedded in Wash.,D.C. The federal department on urban affairs,a reality in 1965,is a nurtured scheme out of 1313. Likewise Reapportionment, which empowers cities to plunder the countryside.

- IF YOU ARE A VOTER, Metro-1313 is cutting off your rightful control over your government. National Municipal League's "short ballot" scheme will prevent you from electing your representatives. 1313's city managers, county and regional appointed directors, under Metro, can exert paralyzing power. And you don't vote those appointees into their jobs.

- IF YOU ARE AN ELECTED OFFICIAL, Metro-1313 is slowly wiping out your position. Your powers of office are being reduced/eliminated by 1313's charter-busting (substituting Metro administrative law in place of existing state constitutions and local city and county charters).

Money - $ - Money - $ - Money:
1313 erases tax limits (ceilings on public spending); hikes debt.
1313 causes bond issues to pass easily--writes laws that give non-property votes more weight than property owners' votes(who pay).
1313 helped force the U.S.A. off the monetary Gold Standard.

Each 1313 department is assigned to a specific task in establishing Metro government, e.g. Taxing (Federation Tax Administrators); rezoning for higher taxation (Municipal Finance Officers Assn.); prefabricated Metro systems (Public Admn.Service); urban renewal (National Assn.Housing & Redevelopment Officials); masterplanning (American Soc. Planning Officials); international affairs (Int'l.City Managers Assn.;Committee for Int'l. Municipal Cooperation); mental health propaganda (Interstate Clearing House on Mental Health); erasing state sovereignty (Council of State Governments); retroactive building codes (Building Officials Conference of America). American Municipal Assn. has name-changed to National League of Cities. Those and more are at the 1313 address.1313's "White House,"(top policy maker),is National Municipal League, 47 E. 68 St.,N.Y. and nearby Institute of Public Administration.

Lavishly financed by tax-exempt foundations, such as Ford, Carnegie, and Rockefeller whose Spelman Fund created 1313, the paralyzing machinery is plucking you of rights and substance. Before Metro-1313 reaches the point of no stopping, urge Congress and state officials to start a public investigation of 1313. ##

References:TERRIBLE 1313 REVISITED,$2,Caxton Printers,Ltd.Caldwell,Idaho
MetroNews syndic.columnsby Jo Hindman. [redacted]

Jo Hindman
Powell Butte, Oregon
97753

EXHIBIT I

[From Metro News, Sept. 30, 1969]

METRO HUB SPLITS, GETS NEW KENTUCKY HOME

(By Jo Hindman)

Americans who wonder how the Metro phase-out-voters movement keeps going can get some of the picture by noting the Council of State Governments (CSG) which has moved into palatial new quarters in Kentucky.

CSG, one of the bellwethers of the 1313 political syndicate, operates as the mail-order law factory that is reshaping American legislatures.

When CSG was flat on its face, Rockefeller money from the tax-exempt Spelman Fund put CSG on its feet. That original $40,000 grant in 1930, conditioned on Henry W. Toll becoming CSG's director, was the first of many appropriations by the R-S tax-exempt fund. It gave long life to CSG-1313's proselyting among U.S. legislators.

CSG moved into the building that Rockefeller-Spelman built in 1938 at 1313 E. 60th St., Chicago, spending a half-million dollars dispensed through Beardsley Ruml, then R-S Fund director. The "other half" of the then fingerling syndicate, government reform groups assembled by the late Louis Brownlow, joined CSG at self-dubbed "1313," the Public Administration Clearing House, the troublesome syndicate of today.

After leaving the Rockefeller launch pad, CSG's financial boosters included tax-exempt Carnegie Corporation. Today, CSG is on the verge of remaking all fifty state legislatures according to its Metro format, staffing them with Metrocrat professionals and providing mail order statutes.

Recommendations by the Eagleton Institute of Politics at Rutgers, the State University, New Jersey, became a part of the CSG state remodeling job.* Tax-free Carnegie Corporation appropriated $260,000 in 1968 to Rutgers to hold bull sessions among state legislators. The illustration shows how the abused tax-exempt privilege is keeping political meddling alive and working against the best interests of citizen self government.

In Spring 1969, CSG moved from the "1313" core into the splendored headquarters provided by the State of Kentucky on a 40 acre site in the Lexington bluegrass country. As one visitor put it, "far from the madding crowd and maddening information seekers." Brevard Crihfield, present CSG director, is said to have signed the lease for one dollar ($1) per year. CSG headquarters: Iron Works Pike, Lexington, Ky. 40505.

CSG's new rectangular building is designed with thirteen tall arches on each of the longer sides. Thirteen-thirteen. CSG regional offices are in New York, Atlanta and San Francisco. Its midwestern office remains at the Chicago 1313 core where the "other half" of the syndicate will also carry on, the coterie led by Public Administration Service.

Governors Conference, one of the many 1313 organizations which CSG staffs and manages, chose to relocate in Washington, D.C., presumably at CSG's lobbying center, 1735 De Sales St., N.W., D.C. 20036.

To its original brood, including the state governors, chief justices, attorneys-general, state budget and purchasing officials and legislators, CSG has added new wards: ** The National Conference of Lieutenant Governors, National Conference of State Legislative Leaders, The Council of State Planning Agencies, The Adjutants General Assn. of the U.S., Assn. of State Mental Health Program Directors, and more.

On top of tax-exempt Foundation funds, CSG collects whopping annual tribute from all fifty states. That brings up the serious question: If taken to court, would CSG be declared an unconstitutional alliance of the fifty sovereign states? Art. I, Sec. 10, paragraph 1 of the U.S. Constitution prohibits states from entering into alliances with other states without the consent of Congress.

*"Legislative Modernization," by CSG, Dec. 1968, R-M 425, $2.50, 1313 E. 60th St., Chicago.

**"The Council of State Governments and Affiliated Organizations," 16 page booklet, Iron Works Pike, Lexington, Ky. 40505, no charge.

EXHIBIT J

[From the Montrose (Calif.) Ledger, June 26, 1969]

SOLONS ARGUE, BUT CENSUS FORMS DONE

(By Jo Hindman)

Syndicate Metro-1313 is working feverishly against the efforts of Congressman Jackson E. Betts and others who hope to make the coming 1970 decennial census safe for Americans.

Representative Betts' H.R. 20 would remove the jail sentence penalty and the $100 fine on all census questions except six subjects essential to the population count as required by the U.S. Constitution. Congressmen from 39 states have sponsored similar measures, and 100 representatives and more are supporting action to abolish the destructive features that disgraced the last decennial census of 1960.

But the politico-syndicate, its core located at 1313 E. 60th St., Chicago, is against all those safety measures. 1313's National League of Cities (NLC), Conference of Mayors (CM), and National Association of Counties (NAOC), to name a few 1313 agencies, have placed themselves on record opposing Congressman Betts' Bill specifically, and all other similar measures.*

During May, pubic hearings were progressing in Washington, D.C. on the matter of the census questions. Yet 1313's NACO had announced a month earlier, "The questionnaire is now on the press . . . if unduly restrictive legislation is passed, the questionnaire would be unusable."**

Syndicate Metro-1313 is the disruptive force that has hatched urban renewal, regional government, land-use regimentation, state constitution revisions, and the destruction of check-and-balance government—stifling the rural voice by legislative reapportionment.

Hear more from the NACO report on the 1970 census: "Data on state and local areas is essential for legislative apportionment and districting, for local planning, administering programs such as—urban renewal . . . If the (restrictive) legislation were passed, both the Census and users of census data would suffer."

The 1313 syndicate thus reveals that nothing less than a repetition of the outrageous 1960 census will be acceptable to its purpose. The U.S. Census has been twisted into a 1313 tool to revolutionize American government.

Syndicate 1313 groups are busy census users. Ten years ago, the census list was top-heavy with 1313 names, and probably still is. This writer's letter to the Bureau of Census requesting a current listing of census users has, to date, gone uaanswered.

In the meantime, 1313 has sounded an alarm throughout its nationwide web against Congressman Betts' census reform bill. 1313's National League of Cities and NACO through a joint newsletter circulated by their National Service to Regional Councils specifically attacked the Betts proposal.

In its own "Washington Report," NACO again urged Thirteen-Thirteeners to pressure U.S. Senators and Congressmen to retain the "present" census with al its prying questions.

Americans resented the meddling, punitive 1960 Census and raised an outcry against another census like it.

As this is written, the Subcommittee on Census and Statistics of the House Committee on Post Office and Civil Service is continuing hearings on the 1970 census questions. You and your friends can help keep your privacy intact by writing letters and circulating petitions to your Congressman and Senators.

*1313's National Service to Regional Councils, 1700 K St. N.W., Wash, D.C. 20006, Newsletter 4/3/69.

**National Assn. of Counties "Washington Report" 1001 Connecticut Ave., N.W., Wash., D.C. 20036, 4/14/69.

THE NEW WORLD FOUNDATION,
New York, N.Y., September 22, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: The New World Foundation shares with you a deep interest in the deliberations of the Committee on Finance on the subject of tax reform, especially as it relates to the tax status and program regulation of foundations, Specifically, we have reviewed the Tax Reform Act of 1969, H.R. 13270, as passed by the House of Representatives on August 7, 1969 and now under consideration by your Committee.

We agree wholeheartedly that there is a need for a review of the practices of foundations. We feel that some of the proposals set out in the House Bill have considerable merit. We would endorse the proposed new legislation which deals with prohibitions on self-dealing, distribution of income, stock ownership limitations, and most wholeheartedly with the section dealing with disclosure and publicity requirements. We are however concerned with what appears to be the punitive nature of the House Bill in several important areas.

First, it is difficult for us to see what useful public purpose would be served by the taxation of foundations. Second, we have reservations about the section which would unduly restrict foundations in the making of grants to individuals. And, third, and most important, we question the highly restrictive prohibitions dealing with foundation program activities, and we are deeply concerned about what appear to be excessive penalties to be levied against foundation executives and trustees with respect to "taxable expenditure" as defined in Section 4945 of the House Bill. Please permit us to explain briefly why we hope the Committee and Congress will not adopt measures of this nature or at least drastically amend the House Bill proposals.

The foundations were made possible by special legislation enacted by the Congress after careful consideration and on the premise that the public welfare could and would be served by private as well as public enterprises. Congress, of course, has the right to establish procedures under which the foundations as tax exempt public service institutions may function. Assuming that the Congress still feels that foundations are useful to society. we can see no purpose in taxing foundation income. This tax could only reduce the effectiveness of the foundations by the amount of the tax. Any suggested tax would not raise appreciable sums for the government's needs but would be a major reduction to the recipients of foundation grants. The public interest, we believe, would not be advanced thereby.

We have provided funds for government and quasi-government operations including the Board of Education of the City of New York, the Board of Education of the District of Columbia, the United States Conference of Mayors, the New York State Education Department, the Department of Education of the State of New Jersey, the Peace Corps, and White House conferences. In many instances these grants, although small by federal government standards, enabled these agencies to promptly carry out useful programs that otherwise would have been considerably delayed or rendered impractical. If foundations did not make these grants, general tax funds would be required.

To unduly restrict foundations from making grants to individuals directly would be positively harmful. Great work has been done by persons so supported with foundation funds. The names of Gunnar Myrdal, Jonas Salk, James Bryant Conant and Robert Hutchings Goddard come to mind.

The House Bill also imposes a heavy tax on foundations and their knowing managers upon amounts spent "to carry out propaganda, or otherwise attempt to influence legislation," and "to influence the outcome of any public election (including voter registration drives carried on by or for such foundation)," other than through "making available the results of nonpartisan analysis or research." There can be no dispute with the view that the foundations should not become involved in a partisan manner in elections. Indeed such activities are prohibited by existing laws. We cannot understand, however, why anyone would object to foundations facilitating all nonpartisan voter registration programs. As you know, the foundations under present law are allowed "to engage in educational activities which present a *full and fair exposition* of the facts and which take note of civil rights secured by law, even though such activities could indirectly affect political campaigns." The New World Foundation, in cooperation with other foundations, has been carrying on such educational efforts in a manner which we feel is deeply in the national interest and equivalent with the interest of the Congress. We have made grants to the Southern Regional Council for its Voter Education Project as well as to the NAACP Legal Defense and Educational Fund, Inc. working in cooperation with the Voter Education Project in the preparation of educational material for use in the Project and, in addition, permitting the NAACP Legal Defense and Educational Fund, Inc. to protect the civil rights of individuals as voters and seekers of public office. We are sure you will agree that such activities do not contravene the will of the Congress, having in mind the Civil Rights Acts of 1964 and 1968 and the Voting Rights Act of 1965. On the contrary, it appears that our activities have helped to carry out the very purposes envisaged by these Acts. It is our contention that this activity is one of the most important contributions our Foundation has made and can continue to make.

It would seem to us that strict enforcement of the present regulations together with carefully worded additional safeguards could prevent any possible misuse of foundation funds.

The House Bill also forbids "any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof," 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 the legislation." We feel strongly that a well-informed public on major issues of concern to the nation is vital in a democracy. The New World Foundation has made grants to such reputable organizations as the World Affairs Center for the United States, the Foreign Policy Association, the International Association of Chiefs of Police, the North Central Association of Colleges and Secondary Schools, the National Institute for Labor Education, the National Urban League, Educational Services Inc., the National Association for Intergroup Relations Officials, the American Friends Service Committee, and the National Board of the Young Women's Christian Association of the U.S.A. Most of these institutions could not qualify to receive foundation grants under the proposed legislation.

In addition, the proposed restrictions would prevent this foundation from being involved in areas of genuine concern to the Congress, such as litigation on behalf of constitutional and statutory rights carried on by the NAACP Legal Defense and Educational Fund, Inc., the Lawyers' Committee for Civil Rights Under Law, The Southern Center for Studies in Public Policy at Clark College, The Legal Aid Society, The Roger Baldwin Foundation of the American Civil Liberties Union, The Lawyers Constitutional Defense Committee of the American Civil Liberties Union, and the Law Students Civil Rights Research Council. The House Bill would make it difficult for us to assist major institutions of higher learning in important public education and research activities. The New World Foundation has made grants to the universities of Chicago, Minnesota, Michigan, Denver, Wisconsin, Massachusetts, Boston University, Columbia University, Yale University, Harvard University, Reed College, Howard University, Goddard College, and Grinnell College to enable these institutions to undertake special educational projects which ordinarily could not be financed in any other way. The proposed restrictions would also hinder us from assisting such organizations as the American Library Association, the Rural Advancement Fund of the National Sharecroppers Fund, National Association of Independent Schools, Penn Community Services, and Farmers and World Affairs in their inquiry into major issues of deep concern to the general public in the fields of education, foreign policy and international affairs.

The number of serious current problem studies 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.

Another "taxable expenditure" under Section 4945 entitled, "expenditure responsibility," seems to us to be an ineffective and a potentially disruptive proposal. It requires that a 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."

At the present time these requirements are those of the recipient operating organization under Reg. 501(c)(3). The new proposal would force the grant-making foundation to unduly interfere with the operating foundation. Surely the present regulations are more equitable since they provide that a grant-making foundation which is acting in good faith is not punished because of the wrong-doing of a grantee over which it does not and should not have immediate supervision and control. If the foundation exhibits reasonable prudence, e.g. investigating the bona fides of the applicant, getting a clearly defined commitment to the terms of the activity and the budget to be supported, and requiring adequate reports on the actual use of the funds, it is only fair that any further burden should rest on the grantee.

For some time we have been interested in persuading foundations and other charitable institutions to adopt a more imaginative investment policy. We are therefore concerned with the Section 101(b) (new code section 4944), which would severely penalize the foundation and its manager for making any investments "so as to jeopardize the carrying out of any of its exempt purposes." This wording is so vague and uncertain as to discourage any active investment program involving common stocks which tend to participate in the economic growth of the country. Any imaginative investment program involves a degree of risk that one or more of the individual investments may fail and no manager can foretell whether the acceptance of such a risk will constitute unlawful, "jeopardizing" action.

Finally, may we make an alternate suggestion to the proposed tax on foundations? Would it not be more useful to see to it that a larger portion of their funds are used to serve the general public within the stated purposes of the foundations? This could be accomplished to some degree by the proposed requirement that a minimum of five per cent of the assets per year be so expended. In our opinion, this figure should be increased, at least over a period of time, to a minimum of ten per cent of the market value of the assets each year. This would permit the foundations to make a larger contribution toward the resolution of the enormous social problems now facing this country at a time of urgent need. We are not concerned that such a procedure may limit the life of foundations; we have sufficient confidence in the continued growth of the economy of the country to believe that new foundations will arise and that old ones need not be continued in perpetuity. In order to safeguard the formulation of new foundations, some of the proposed restrictions on contributions to foundations should be rescinded.

We are grateful for the opportunity to bring our views before the Committee for its consideration.

Respectfully,

ANNE BLAINE HARRISON,
President.
VERNON A. EAGLE,
Executive Director and Treasurer.

STATEMENT OF HARVEY B. HOBSON, ESQ., THOMPSON, HINE AND FLORY CLEVELAND, OHIO

As a lawyer with thirty years experience in probate and trust law in Ohio, I have taken an active interest in both public and private charitable foundations in the Greater Cleveland area. Through such associations I have gained some first-hand knowledge of the operations of private foundations and desire to make certain observations with respect to three sections of H.R. 13720:

Section 101(a)—Tax on Investment Income;

Section 101(b)—Private Foundations Must Expend Each Year Not Less Than 5 Per Cent of Its Investment Assets; and

Section 201 (c) and (b)—Charitable Contribution of Appreciated Property to Private Foundations.

SECTION 101(a)

Tax on investment income

The 7½ per cent tax on net investment income will deprive local philanthropic activities served by the private sectors of the amount of such tax. The tax will become part of the general revenues of the Federal government and will be consumed in the costs of collection and administration. Thus, the real loss falls on the local recipients of charity who are being forced to turn more and more to the Federal government for help. The tax is another "chipping away" at the private sector which is essential in dealing with local charitable needs.

I am old fashioned enough to believe that private charitable organizations are more innovative than government and can´use the funds more quickly and to a better advantage. Also, we should be moving toward a decentralization of our charitable efforts rather than placing more and more reliance on the Federal government.

The law needs little change to catch the violators. Why not enforce the present law and apply sanctions against the violators rather than to tax all private foundations, the vast majority of which are living within the spirit and letter of the present law.

SECTION 101(b)

Private foundations must expend annually not less than 5 per cent of the value of its investment assets

I know of no charitable foundation of any standing in the Greater Cleveland area which has a net income equal to or in excess of 5 per cent of its investment assets. It is true that interest rates and yields on bonds today are in excess of 5 per cent but the yield on good quality investment stocks is considerably less than 5 per cent. The Trustees of the private foundations, acting as prudent fiduciaries, usually have a diversified list of securities, some income stocks, some growth stocks, in order to offset the creeping inflation which is reducing the purchasing power of the dollar.

If the 5 per cent requirement prevails the private foundations will have to sell some of their common stocks and purchase higher yielding income securities or invade principal of the foundations for the difference between 5 per cent and the net income. In other words, a "capital assessment" against private foundations. The Federal government should be encouraging the private sector to take over more and more of these philanthropic activities instead of trying to undermine the many private foundations which have done much good in the past and I am sure will continue to do so in the future.

SECTION 201(C) AND (D)

Charitable contributions in appreciated property

I have created a number of private foundations for clients. In substantially all cases one of the motivating factors was that appreciated property could be contributed at its fair market value. All except one of these foundations that I have been connected with are the so-called "feeder type" foundations which do not carry on any charitable activities except to distribute at least annually the net income to public charities qualifying under Section 501(c) I.R.C., all for the best interest of the charitable needs in the Greater Cleveland area. I assume that this is also true in other parts of the United States. I recognize that a few private foundations have taken advantage of their exemption and have failed to comply with the law. It would seem to me that enforcement of the law and revocation of the exemption should be the sanction used against the violators—not a "shot gun approach" which catches the good with the bad. By revoking the incentive to create a private foundation, Congress will be drying up the well-springs that create private foundations, the vast majority of which have been doing good in this country.

I doubt the wisdom of any law which discourages creation of private foundations. It is unsound to require recipients of charity to look more and more to the Federal Government. The plurality of our way of government must be preserved. The private sector is a potent force in dealing with needs at local levels and should not be destroyed.

GENERAL COMMENTS

It is my expectation that the Senate Finance Committee would study carefully the Tax Reform Act of 1969 and make such amendments as may be necessary to modify the harsh rules imposed upon all private foundations and to enact sanctions that reach the violators but yet do not harm those foundations which are doing a great good in this country. We should try to preserve the plurality of our way of government.

INTRODUCTORY STATEMENT

The House of Representatives, recently passed the TAX REFORM ACT OF 1969, H.R. 13270, which is now before the Senate Finance Committee. As a lawyer with thirty years' experience in private and public charitable foundations, I deem it necessary to send to the Committee my written comments on the more important sections of the Act which relate to charitable foundations.

The substantive changes proposed are the first frontal attack by the Federal government to curtail the activities of private charitable foundations. The new provisions of the Act go way beyond those which would be required to correct the abuses disclosed during recent hearings on the Bill and are hidden under the high-sounding name of "tax reform".

It is incumbent upon your Committee, and it is your urgent duty, to carefully examine all of the ramifications of the Act which relate to charitable foundations.

In fact, the Act attacks the principle of the right to the continued existence of private charitable foundations. This is a serious charge and I use the term advisedly.

In my opinion, the Act will require extensive amendments in fairness to the many legitimate charitable foundations which live not only within the letter of the law, but also the spirit of the law and in best interests of the American people who support such foundations. Nothing should be allowed to remain in the Act which would, in any way, deprive the private foundation from advancing knowledge and alleviating human suffering.

The speed with which the Tax Reform Act of 1969 was put together and its passage through the House without any meaningful debate, on a vote of 396 to 30, suggests to me that the House passed the Bill without adequate consideration as to the real effect on charitable foundations. In my opinion, it is a perfect example of a politically expedient piece of legislation. Some of the sections suggest an "over kill".

The news media demonstrated their *inability* to disseminate to the public any true account of the effect of the Act as it related to charitable trusts and the enormous good such trusts have, and will continue, to perform in the future. On the other hand, the news media did demonstrate the *effectiveness* in disseminating the sensational few abuses by some of the private foundations (which need prompt correction) and establishing the popular slogans that the Bill was a tax reform act to stamp out the abuses by the wealthy and a relief act for the low and medium income taxpayer.

Some sections of the Bill were required to correct abuses; however, many other sections go further than necessary to correct any abuses. In fact, many sections dealing with alleged abuses introduce a whole new concept to what I refer to as social legislation. A word which I have used advisedly.

Many of the provisions of the Act strike at the continuation of the dual system of public and private charitable activities which have been a part of the system of our government since its founding almost 200 years ago.

The problems facing the government and private charitable foundations today are growing by leaps and bounds and will need the joint efforts of all concerned. We should join together and work at all levels and not take any steps to destroy the effectiveness of the private charitable foundations.

SECTION 101(A)—NEW SECTION 506 OF THE CODE: I AM OPPOSED TO TAXING THE NET INCOME OF FOUNDATIONS

I am opposed to the 7½ per cent tax upon net invested income imposed by Section 101(a), new Section 506 of the Code. It violates the basic principles of encouraging private philanthropy. Moreover, it may well serve as a pattern for state governments to impose a state excise tax which would further reduce the funds available for charitable purposes at the local level. History proves that once a tax is imposed, it is almost never repealed and more often than not, the rate is increased as an easy source of additional revenue. Moreover, the suggested tax would be more than consumed in the cost of the bureaucracy which the Federal government would establish to administer it. In my opinion, such "tax" could be spent to better advantage at the local level.

More "policing" of private, as well as public, foundations is necessary to reduce the possibility of abuse. Let the burden and the sanctions fall on those who abuse their tax exempt status. Such organizations should have their exemption revoked and penalties applied.

I would not be opposed to an annual registration fee to help pay for the task force necessary to examine the expanded 990–A Returns.

SECTION 507 OF THE NEW CODE: DEFINITION OF PRIVATE CHARITABLE FOUNDATIONS

This Section leaves much to be clarified with respect to what type of organization will be classified as a private charitable foundation.

SECTION 101(B)—NEW SECTION 506: PRESENTING OPPORTUNITIES FOR PERSONAL ADVANTAGE AND PERSONAL GAIN MUST BE ELIMINATED

The use of a private charitable foundation to gain a private advantage or a personal gain is clearly wrong and everyone agrees that all such abuses should be promptly eliminated so that charitable funds held by private foundations may be used only for proper charitable purposes.

The drafters followed the reports of the Ways and Means Committee released May 27, August 2 and August 4. The Bill is far reaching and imposes harsh and unnecessary sanctions against private charitable foundations and their Officers and Trustees. The drafters of the Bill proceeded on the theory of the so-called "shot-gun" approach—"mowing everything down in front of them" to catch the few violators exposed during the hearings on the Bill. Such an approach is detrimental to the vast majority of the foundations which are doing a great service in this country at the local level where each can most effectively operate. The method used in the Bill is not a sensible approach to solving the problem.

SECTION 4943: STOCK OWNERSHIP LIMITATIONS

It is repugnant to me to tax the right of a foundation on the basis of the property held as an asset of the foundation. The real concern to me is, are the assets of the private foundation producing a reasonable return on their fair market value and is the net income currently being used for proper charitable purposes without private gain or personal benefit to any individual That is the basis for allowing the deduction from gross income in computing income tax and for the granting of the tax-free status of the recipient charitable foundation.

Once property comes into the possession of a private foundation, its investment goal should be to invest in the type of securities which, under all the existing circumstances, a Trustee—as a prudent fiduciary—would invest—some in high grade fixed income securities, others in solid common stocks and some in common stocks with growth potential. In other words, a balanced portfolio which gives the foundation "some run for its money" during periods of inflation as well as deflation. It is especially important during a period of inflation, with the declining purchasing power of the dollar, to have a balanced portfolio which will help accomplish the charitable objectives of the foundation, to increased dividend income and a greater principal value.

Those unfortunate charitable foundations, which today have only fixed income investments, are in trouble as the reduced purchasing power of the fixed income investment is proving insufficient to carry out the expressed intentions of the foundation. The eroding value of the fixed income dollar has caught up with them.

NO ONE BATS 1000 PER CENT—SO LET'S LOOK AT THE AVERAGES

None of us bats 1000 per cent, not even the President, the Congress, the Supreme Court, you or me. As long as human beings are involved, abuses will occur solely out of greed of one kind or another. Laws and Regulations must be enacted to reduce such abuses to the possible minimum.

Certain of the well known private foundations recently criticised for certain of their grants to individuals, all have high batting averages and have done a great good, not only here in the United States, but throughout the world. If you think of the great good which they, and the thousands of smaller private foundations, have done over the years and will continue to do in the future, the recent picayune errors in judgment over certain grants and expenditures have not materially reduced their high batting average.

SECTION 4941(B): IN GENERAL, ALL SELF-DEALING SHOULD BE PROHIBITED

I agree with the principles against self-dealing provided under Section 4941, however, the sanctions, in many instances, seem severe. The out and out fake or fraudulent foundation should have its exemption revoked immediately, with penalties for violation of the law. Rules and regulations can be adopted, and if enforced, substantially eliminate all other abuses.

COOPERATION BETWEEN THE FEDERAL GOVERNMENT AND CHARITABLE ORGANIZATIONS

I believe the House of Representatives lost sight of the importance of the private sector in charitable efforts which are required today. I cannot point out too strongly that the Federal and all charitable foundations must work together to advance knowledge and alleviate human suffering. The Federal government, alone, cannot solve these problems. The red tape and inefficiencies of our national bureaucracy would erode a substantial portion of each tax dollar it collected for such purposes. Sheer big business produces some of it. The "big brother" in Washington cannot do it alone and the American people would not accept it.

There is a necessary place in the scheme of things for the legitimate private charitable foundation which is agile, innovative, and quick to respond to the needs of the local community it serves. This does not mean that there should not be laws and regulations to prevent abuses, but it is unnecessary, in my opinion, to enact laws which would reduce the freedom of many private charitable foundations, to reach the few who abuse the law.

I DO NOT BELIEVE THAT THE CHARITABLE BENEFITS DISPENSED BY PRIVATE CHARITABLE FOUNDATIONS SHOULD BE GRADUALLY TAKEN OVER BY THE FEDERAL GOVERNMENT

The recipients of awards and grants for charitable purposes, previously obtained from private foundations, should not be required to look more and more to the Federal government for assistance. The trend of Section 201 of the Bill evidences a desire to shut off the funding of private charitable foundations. I am definitely opposed to further centralization of all things in the Federal government.

SECTION 4941: IN GENERAL, ALL SELF-DEALING SHOULD BE PROHIBITED

I agree with the principle against self-dealing provided under Section 4941, however, the sanctions seem almost too severe. It will become increasingly difficult, with these penalties, to secure outstanding citizens to serve on Boards of private foundations. It almost seems this is an attempt to eliminate the private charitable foundation by forcing them to turn over their assets to the so-called public charitable corporations.

SECTION 4942: NET INCOME SHOULD BE DISTRIBUTED AT LEAST ANNUALLY

I am in accord with the imposition of a tax on the failure to distribute the net income of the private charitable foundation as required under Section 4942(a). The statutory definition of "net income" must be expanded to provide that the net income is determined only after deducting all legitimate operating expenses of the foundation. The penalties and sanctions seem too harsh and should be revised.

I am also *inalterably* opposed to any requirement for a distribution of an amount of money equal to 5 percent, or at any other percentage, on the fair market value of the assets held by the foundation, provided the ordinary net income of the foundation is less than such amount.

I know of no substantial private or public charitable foundation which is, today, currently yielding 5 per cent or more on the fair market value of its assets.

It is quite true that with the high interest rates of today, the yields on government Bonds and corporate Bonds are considerably in excess of 5 per cent. *But*, by the same token, the yield on sound common stocks and stocks with growth potential, are considerably below 5 per cent. It is wrong to impose a capital assessment by requiring the private foundation to pay out annually from the principal, the difference between 5 per cent of the fair market value of its assets and its net income, whichever is greater. As an alternative, of course, the foundation could sell its assets yielding less than 5 per cent and reinvest the proceeds in high yielding fixed income securities so as to raise the net income to the 5 per cent minimum level. Such action would result in a severe loss to the capital account of the foundation. Thus, it would be in effect, a capital assessment against the foundation. Moreover, it must be borne in mind that fixed income securities pay off in dollars acceptable at maturity regardless of their purchasing power. The whole concept of Section 4942(b) is a serious threat to all private charitable foundations and should receive the Committee's corrective attention.

STOCK OWNERSHIP LIMITATION UNDER SECTION 4943 SHOULD NOT OF ITSELF BE A LIMITING FACTOR

I can appreciate the opportunities made available in a private foundation owning an excessive business holding, but I cannot agree that the mere existence of such a holding requires divestiture. Again I say, it is not the type of the asset held by the foundation that is illegal but is the propertly so held a sound investment, does it pay a reasonable return on its net value and is the income being currently used for a legitimate charitable purpose. I believe that Congress can, without too much difficulty, find a solution to the problem of eliminating any private personal gain of those associated with the foundation without ordering divestiture. Here again, I believe that the sanctions imposed are unduly severe and it will be difficult to secure outstanding public citizens to serve on the managing Boards of such private charitable foundations.

I FAVOR GREATER DISCLOSURE AND PUBLICITY OF ACTIVITIES OF THE FUND SECTIONS 101(D) AND 101(E) AMENDING RELATIVE SECTIONS OF THE CODE

I agree with the requirements for additional disclosure of information which, in large measure, can be accomplished by expanding the present Form 990–A. However, I do disagree with the extent to which a foundation must police its grants and contributions but some workable solution should be easily forthcoming. The penalties for delayed filing seem harsh and should only be imposed if there has been repeated, willful, and flagrant disregard of the law.

SECTION 4944: I OPPOSE UNAUTHORIZED INVESTMENTS

Investments which jeopardize the carrying out of the foundation's function are clearly not a proper investment. A private foundation, however, should not be penalized for having some of its assets invested in solid growth companies, and I would cite as only one example—International Business Machines Corporation Common Stock. In these changing times it is necessary, where possible to disregard the old trust concept of the division between income and principal. The real growth of a foundation is measured by the increase of its annual income and the value of its principal account. Many foundations today which have diversified portfolios are disbursing increased amounts of income and in addition portions of the principal account and yet the total value of its total assets are increasing, thus creating a foundation with more income for charitable uses and some growth in the principal of the fund, all of which have the tendency to offset the effects of inflation which we have been going through for many years.

SECTION 4945: HAS SOME DANGEROUS CONSEQUENCES

The restrictions relating to propaganda, or otherwise attempting to influence legislation, imposed under Section 4945, are too severe and go way beyond what is reasonably necessary to accomplish the cited abuses. A great deal of heat was generated over a voter registration drive conducted in Cleveland in 1967 which was financed by The Ford Foundation. The penalties and sanctions imposed in the new Act are too severe but effective substitutes, I am sure, can be agreed upon. I do agree that the funds of charitable foundation should not be used to support one candidate or issue over another, once they are established for presentation to the voter.

Everyone should be ashamed of the low percentage of the eligible voters who turn out to vote on election days. Unfortunately, there are too many persons who fail to exercise their franchise to vote. I am sure we would all agree that everyone should be encouraged to exercise his voting franchise.

In addition, a charitable foundation should be permitted to conduct research on any reasonable subject within its particular field of operation and make it available to the general public as well as local, state and Federal authorities. I agree that charitable foundations should not lobby in favor of or against any pending legislation. In my opinion, this whole section should be carefully studied by the Committee so that a workable amendment could be agreed upon.

Moreover, the further provisions of Section 4945 relating to taxable expenditure, seems to me to be overly harsh and should be carefully reviewed. I am particularly opposed to the rather strict limitations on grants to individuals. Some of the finest research developed in many fields has been the result of grants to individuals from private charitable foundations. I believe grants must be made for worthwhile purposes but here again, enforcement could curb the abuses such as the extensively quoted "sending of ex-presidential Aids to Europe for foreign study". Here again we should look at the batting average of the private charitable foundation to determine the results from its research grants to individuals. I am in agreement that some form of follow-up and checking on the use of the funds awarded is necessary, but you can't send a policeman along on each grant or scholarship. I am sure there is some better way of solving this problem instead of ham-stringing laws which affect all grants to individuals from private charitable foundations.

I feel particularly strong on this matter since I am a Trustee of a medium size private foundation that has accomplished a great deal of good in the field of education of young children in the public school systems by making individual grants to teachers to improve themselves in their particular teaching areas and in the presentation of their materials to their students.

DOES SECTION 201 RELATING TO THE INCOME TAX DEDUCTION FOR GIFTS TO CHARITY OF PROPERTY APPRECIATED IN VALUE RING THE DEATH KNELL FOR FURTHER SIMILAR GIFTS TO PRIVATE CHARITABLE FOUNDATIONS?

If Sections 201 (c) and (d) of H.R. 13270 are passed in essentially their present form, it will remove an important motivation for the creation of private foundations. Moreover, it will have the effect of drying up the "well springs" of contributions which keep such foundations in existence.

Section 201 denies the donor-taxpayer the right to claim a deduction in his income tax return for the fair market value of any appreciated property he gives to an exempt charity, without serious income tax consequences to the donor-taxpayer. Such section is penal in nature and contrary to the history of private philanthropy.

The reason for such action given by the Committee is, I believe, based on the fallacious reasoning that the donor-taxpayer of appreciated property escapes a capital gains tax because, if he had been required to sell the appreciated property and had then made the gift in the form of the cash proceeds, he would have generated a capital gains tax. By not selling he avoided a capital gains tax. How is this unfair to the man who has no appreciated property and makes his contribution in cash? The mere fact that a person has appreciated property should not affect the amount of his deduction for a gift to charity. The deduction should be limited to the fair market value of the property donated—whether in cash or kind—to the charity—no more, no less. If Congress enacts these Sections and they become law, the door to the creation of many new private charitable foundations will be closed and will materially reduce any additional contributions to existing foundations. I find these sections repugnant and contrary to what has been the law and also as to what is fair.

We should all remember that charity begins at home and not only in Washington, D.C., or by the larger community foundations. Moreover, I question the often quoted statement that private foundations should turn over their funds to so-called community foundations. I have considerable doubt as to the wisdom of such action because I believe there is a place in the scheme of things for a private charitable foundation serving at the local level. Also, whenever I see the socialistic tendencies of some of our so-called community foundations, I wonder if it would be wise for private foundations to distribute their property to them for ultimate distribution.

In considering the section of the Bill dealing with private charitable foundations, we should keep in mind that the vast majority of them act as "feeder" organizations who do not expend funds themselves for carrying on any charitable activity, but act as a conduit to distribute the income to exempt charitable institutions selected by the creator of the foundation or by its Trustee. Such foundations serve a sound function at the local level and nothing should be done to hinder their efforts or to destroy the vital need for their support.

DOES SECTION 201 RELATING TO THE DEDUCTION FOR FEDERAL ESTATE TAX OF GIFTS OF INCOME AND REMAINDERS SPELL THE DEATH KNELL FOR PRIVATE CHARITABLE FOUNDATIONS

Sections 201 (a), (e), (f), (h), and (i) of the Act disallows a charitable deduction for Estate Tax purposes if a decedent leaves any part of his estate in trust with the income to be paid to a non-charitable use with the remainder passing to charity on the termination of the non-charitable use; also, if a decedent leaves a part of his estate in trust with the income to go to charity for a stated number of years, and after the expiration of said years, the principal would pass to a non-charitable use. These two testamentary devises have been used for many years as a part of estate planning. The new sections of the Act would allow a deduction only if the charity was to receive a specific percentage of the income for a given number of years, of the total value of the trust assets, computed annually, or in the case of a remainder interest in principal if such gift was stated in a dollar amount. Many Wills and Trusts have been drawn over the years containing the long established pattern of charitable giving of income and interest in principal as outlined above. In many instances the instruments are already in existence and there is no way in which they can be changed.

Here again, the Act violates long established principal of tax laws. There is no need for a harsh and technical approach to the allowance of an estate tax charitable deduction for such a testamentary gift or for the income tax deduction allowed for such inter vivos gifts. If the Bill is enacted into law then an adequate grace period must be given to allow for changes to be made in instruments in order to comply with the new tax law, similar to the grace period provided in the Revenue Act of 1942 with respect to taxable testamentary powers of appointment.

I am sure that the pending Act was passed by the House of Representatives without the full realization of the actual affects of these sections on private charitable foundations.

I know that the Senate Finance Committee, and each of the Senators, will give thoughtful consideration to the problems presented by the Act as they relate to charitable foundations.

Unfortunately, you will find certain portions of the Act almost incomprehensible because of the technical language used by the drafters. In my opinion, it is another "patch on the quilt".

Respectfully submitted,

HARVEY B. HOBSON.

MEMORANDUM SUBMITTED BY LEROY E. HOFFBERGER, PRESIDENT, HOFFBERGER FOUNDATION, INC.

The purposes of this memorandum are to: (i) set forth certain proposed changes in the tax treatment of private foundations and gifts of appreciated property to charity under the "Tax Reform Act of 1969" (H.R. 13270); (ii) analyze the reasons given by the House Ways & Means Committee for such changes; (iii) indicate the effect of the changes on both private foundations and beneficiary public charities; and (iv) recommend amendments to the proposed changes, where appropriate.

1. TAX ON INVESTMENT INCOME (NEW SECTION 506 OF THE CODE)

The bill proposes a *7½% tax on the net investment income* of a private foundation.

The general reason for the change is (stated on Page 19 of the Committee Report):

" . . . 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."

The Committee's attitude on this section is in accordance with its general position (set forth on Page 9 of the Committee Report) vis a vis the tax reform bill itself:

"Tax reform is also necessary in order to make general tax reductions possible. Only if all individuals and corporations are bearing their fair share of the tax burden is it possible to have a sufficiently broad-based tax to obtain the necessary revenue without unduly burdening some classes of taxpayers."

While the above reasons have validity with regard to other portions of the Tax Reform Act", I submit they are *totally without merit* as applied to private foundations. As a part of a unique American system of "voluntary charity", private foundations have provided substantial support for public charitable organizations rendering services normally considered by other countries to be the responsibility of government. Americans have, since the founding of this nation, expressed a desire to be *directly involved* in providing the financial and human resources required to meet the health, welfare and the educational needs of our people.

While the federal government has been playing an ever increasing role in supporting public charities, it has, heretofore, acknowledged and fostered this tradition by granting tax exemption to the non-profit organizations and institutions (including private foundations) which make up this philanthropic network. The proposed 7½% tax constitutes a *major shift* in attitude by the federal government toward "voluntary charity" and announces the likelihood of not only increased taxation of foundations, in years to come, but of an extension of this philosophy to all exempt organizations, as well.

As a result of the proposed tax, the ability of private foundations to fulfill their responsibilities will be diminished at a time when public charities are desperately in need of greater foundation support. It has been estimated that a minimum of $20 billion must be raised during 1969 from all sources for philanthropic causes—an increase of $5.5 billion over the total estimated contributions in 1967. Needless to state, the effect of the proposed tax will be to decrease the flow of foundation funds to public charities, thereby seriously affecting their viability.

It is recommended that in recognition of the fact that, by and large, private foundations have benefited our society, the federal government should continue to grant them complete tax exemption on all passive net investment income.

2. PROHIBITIONS ON SELF-DEALING (NEW SECTION 4941 OF THE CODE)

The bill proposes to generally *prohibit self-dealing transactions* by certain "disqualified persons", (i.e. a substantial contributor to the foundation, a foundation manager, etc.). and to provide various sanctions for engaging in such acts.

The reasons stated for the change (on Page 21 of the Committee Report) are:

". . . to minimize the need to apply subjective arm's-length standards, to avoid the temptation to misuse private foundations for non-charitable purposes, to provide a more rational relationship between sanctions and improper acts, and to make it more practical to properly enforce the law . . ."

The Committees' hearings clearly revealed that there have been abuses by some private foundations of the tax exemption privilege extended to them. Such wrong doing is a *breach of the public trust* placed in them and *cannot be condoned.*

The proposed change should permit the Internal Revenue Service to objectively determine when an act of self-dealing has been committed by a "disqualified person", to apply a sanction, sufficiently severe, to both punish and deter such self-dealer, those managing the foundation who had knowledge of the transaction and the foundation itself.

I, wholeheartedly, support the proposed prohibitions.

3. DISTRIBUTIONS OF INCOME (NEW SECTION 4942 OF THE CODE)

The bill provides that to avoid tax, private foundations must distribute *all income currently but not less than 5 percent of investment assets* and imposes sanctions for failure to distribute.

The reasons given by the Committee for the change are (as set forth on Page 25 of the Committee Report):

". . . if a private foundation invests in assets that produce no current income, then it need make no distributions for charitable purposes. As a result, while the donor may receive substantial tax benefits from his contribution currently, charity may receive absolutely no current benefit. In other cases even though income is produced . . . no current distribution is required until the accumulations become 'unreasonable' . . ."

The proposed change taxing a private foundation if it does not distribute all income currently is a considerable improvement over the present law which requires that the exempt status of a foundation be revoked if its aggregate accumulated income is "unreasonable".

However, the additional proviso that a private foundation must distribute the greater of all income or 5 percent of investment assets is a cure far worse than the ill it is intended to alleviate. Its immediate or short range effect will, undoubtedly, be to increase the amount of income distributed by private foundations to public charities. Its long range effect, on the other hand, will be quite the opposite.

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

Moreover, if private foundations are unable to achieve a 5% annual return, then the minimum requirement of the proposal will cause the ultimate liquidation and distribution of their assets. The end result of such an occurrence would, likewise, be the loss of support for public charities.

It is recommended that the required 5% minimum distribution be deleted from this proposed Section but that a private foundation be required to pay out all of its "current income" as proposed. Furthermore, it is recommended that in determining the amount of such "current income", a private foundation be required to attribute a "fair return" (predetermined by the Treasury), based on the value used by the donor as a charitable deduction, to any security or other interest, held by such foundation, of a corporation or in a business entity controlled by it and/or by a disqualified person. Thus, a private foundation which is the recipient of a "controlled" asset would, if such property had no or a low yield, be required to distribute an amount related to the charitable deduction received by the donor. This would satisfy the concern of the Committee, but would not force a foundation to change its overall investment policy or to gradually liquidate its assets.

4. STOCK OWNERSHIP LIMITATION (NEW SECTION 4943 OF THE CODE)

The bill proposes to *limit to 20 percent the combined ownership of a corporation's voting stock* held by a private foundation and all disqualified persons.

The Committee's reasons for the proposal are (stated on Page 27 of the Committee Report):

"The use of foundations to maintain control of businesses, particularly small family corporations appears to be increasing . . . Those who wish to use a foundation's stock holdings to retain business control in some cases are relatively unconcerned about producing income to be used by the foundation for charitable purposes . . . there is a temptation for the foundation's managers to divert their interest to the maintenance and improvement of the business and away from their charitable duties . . . the business may be run in a way that unfairly competes with other businesses . . ."

Despite the relatively long periods allowed a private foundation (or a disqualified person) for divestiture of a combined holding of over 20 percent of a corporation's voting stock, I submit that the proposal is likely to result in the eventual sale of such assets (particularly if they consist of securities of a closely-held company) at substantially less than their true value and under circumstances that could adversely affect the operation of the corporation. The Committee Report recognizes the fact that many foundations have holdings in "small family corporations . . ." for whose closely-held stock there is not likely to be any market (unless control is offered for sale). In such cases, divestiture of the foundation's (or disqualified person's) holding to meet the requirements of the proposai really means sale of the family business if a fair price is to be obtained. I submit that this is an inequitable and unsound method of dealing with the problem (assuming there is one).

I do not believe that the ownership by a private foundation of a security which is a factor in the control of a corporation or that the increasing incidence of foundation ownership of a closely held family corporation is inherently bad. According to the Office of Policy Research of the Securities & Exchange Commission, the estimated ownership by foundations of common and preferred stock (including unlisted and foreign issues outstanding in the U.S.) was only 2.1% of the total stock outstanding in 1968. Such ownership by foundations is substantially less than that owned by private noninsured pension funds (7.4%), investment companies (7.4%), and common trust funds (10.7%). Furthermore, the percentage of ownership by foundations did not increase as greatly between 1967 and 1968 as it did for the aforementioned institutions. It could, thus, be argued that the concentration of wealth and the control of corporations by such institutions poses a far greater threat to our society than ownership by private foundations.

I am of the opinion that there is justification for not permitting a foundation and/or any disqualified person to use its control of a corporation to engage in a policy of limiting or not paying dividends. A provision similar to that recommended by me in lieu of the 5 percent minimum distributon would, likewise, be appropriate to resolve this situation. By requiring a private foundation to distribute all income currently including a predetermined (by the Treasury) yield on securities of a controlled corporation, its charitable purposes would thereby be served.

If the Congress believes it is against public policy to permit private foundations to be a factor in the control of corporations (which I submit does not, today, appear to constitute an economic threat), then, it should exclude from the proposal such assets presently held by foundations which were donated *in good faith* under existing law. This could be done by the inclusion of a "grandfather" clause excepting stocks (or other interests) currently held by private foundations.

5. CHARITABLE CONTRIBUTIONS OF APPRECIATED PROPERTY (SECTION 201 (c) AND (d) AND SECTIONS 170 AND 83 OF THE CODE)

The Bill provides that for certain types of charitable contributions of appreciated property, the taxpayer must either reduce his charitable contribution deduction to the amount of the cost (or other basis) in the property or take a full charitable deduction based on the fair market value of the property, but include in his taxable income the untaxed appreciation. The types of charitable contributions affected are a gift to a private foundation; a gift of ordinary income property, tangible property, or a future interest in property; and "bargain sales".

The reason given by the Committee for the change is (stated on Page 53 of the Committee Report):

"The combined effect, in the case of charitable gifts of appreciated property, of not taxing the appreciation and at the same time allowing a charitable contributions deduction for the appreciation is to produce tax benefits significantly greater than those available with respect to cash contributions."

Until the above pronouncement was made, it must be assumed that the federal government wished to encourage charitable gifts by taxpayers. Such a policy gives recognition to the existence in America of an elaborate and effective system of voluntary charitable institutions and, also, acknowledges that it is the will of the people that they be directly involved in the maintenance and operation of such institutions. Because the Committee now questions ". . . how much charitable motivation actually remains . . ." where the tax saving is large, a change in the law has been proposed that will undermine (if not destroy) this system.

At present, many pledges or commitments (for future payment) to educational and other charitable organizations are made in amounts that are beyond the capacity of the donor to pay from his "earned income". Under the present law, such donors are sufficiently motivated to make large pledges anticipating that by investing "in the market" they will be able to fulfill their pledges through the donation of appreciated securities.

I submit that such persons could not be accused of lacking "charitable motivation" if, because of the proposed Section, they did not continue to make pledges in such large amounts. It is unreasonable to expect that any donor (no matter how charitably motivated) would incur the risks inherent "in the market" in order to meet his pledge, if, when successful, he could only deduct the cost of the security as the amount of the charitable contribution or the appreciated market value of the security after paying a substantial tax.

I predict that such a donor will, henceforth, merely make a cash gift that he can afford to pay out of his "ordinary income". The total of such cash contributions will, in my opinion, be substantially less than the contributions heretofore made.

It is, therefore, recommended that the federal government continue to look favorably on charitable contributions by not changing the existing law with regard to gifts of appreciated property regardless of the type of charitable recipient.

THE LILLIA BABBITT HYDE FOUNDATION,
Elizabeth, N.J., September 5, 1969.

Reference: H.R. 13270.

Committee on Finance,
New Senate Office Building,
Washington, D.C.

GENTLEMEN: It is with deep concern that I view certain provisions of this proposed legislation as it affects privately-endowed philanthropic Foundations, and hence their beneficiaries (Section 101). It is regrettable that the House of Representatives devoted so little time to review and study of its potential effects and that The Senate Committee on Finance also has only a short period to consider it.

Consideration of the following points may not be covered in the oral testimony:

I. VALUE OF THE FOUNDATION CONCEPT

The value of charitable Foundations has long been recognized by the law. Through the multiplicity of their separate independent sources of funds, medical, educational, and research institutions receive essential support for the vitally needed operation and growth of their programs and services. Moreover, the careful screening of grant applicants forces recipients to operate efficiently.

Equally, or more importantly, with so many people examining requests for grants, there is a better chance that truly valuable projects will receive necessary financial support. Correspondingly, the potential availability of such Foundation support tends to stimulate the bright minds of the citizenry to work on and find solutions to the many important social, medical and educational problems of today.

Encouragement of such activity, in my opinion, should be one of the most desirable objectives of a truly wise government. One need only glance through the published annual reports of the many well-managed Foundations to find numerous examples of the success of Foundation support in this area in the past.

There may have been a few glaring abuses of Foundation status, but it would be lamentable if restrictions to correct such abuses should impair the great many effective present and future contributions of the vast majority of Foundations.

II. TAXATION OF FOUNDATIONS

Since a properly managed privately-endowed Foundation distributes in the form of grants *all* of its residual income (after necessary operating expenses) to carefully screened and monitored qualifying eleemosynary organizations, the tax exempt status granted such income is not a tax "loophole" in any rational sense. On the contrary, it reflects recognition of their unique value and desirability to the general public. It also reflects recognition of the fact that such Foundations do not operate for any private or personal gain but only for the public benefit as stated in their charters. Any tax levied on Foundations would, in essence, amount to a loss of a corresponding amount to the recipients of their grants.

III. ABUSES AND THOROUGH AUDITS

More thorough annual audits of Foundation operations may be appropriate followed, if necessary, by legal action to correct any current abuses of Foundation status and to inhibit future abuses.

If it is decided that some income is necessary to cover the cost of such auditing, and annual fee charged to each Foundation would be more equitable than a tax, since the monies involved would be specifically directed for that purpose. Such a fee could be soundly based on a percentage of net assets[1] of each Foundation totaled at fair market value as of the preceding year end, similar in form to the New York State Annual Filing Fee. This would be much more equitable than a basis on a percentage of income, since expense of auditing would most likely be proportional to such net capital asset value for well-managed Foundations.

An alternate method would be to charge each Foundation individually for the costs of the audits. This kind of fee system is used by state banking commissions in auditing commercial banks.

IV. INCOME-BASED TAX OR FEE

If, however, a tax or fee based on income should be imposed, there are three main features of Section 101(a) that appear seriously inequitable;

(1) Exclusion of capital gains; the case for continued foundation growth

Foundations are pools of capital which do not usually receive replenishment from outside sources. Their trustees have the responsibility of conserving the capital funds so that annual income is not jeopardized. As a result, in our constantly changing capital markets, alert management should make prudent switches in capital assets. Any gains that might result from such transactions should be reinvested to the best advantage and should not be depleted by an arbitrary tax assessment. Otherwise, part of capital asset value and hence current and future income would be forfeited.[2]

"Gross investment income" as defined in Section 101(a) should not include capital gains, either short or long-term. Capital gains represent the principal sound means of growth of a privately-endowed Foundation, growth essential to the continued fulfillments of its relative role in helping meet the growing needs of hospitals, schools, colleges, etc. I respectfully but strongly urge that careful consideration be given to fostering, not hindering or limiting, such sound growth. The beneficiaries of such Foundation asset growth are not the Foundation officers and trustees but the general public which receives the benefits of the growth of the institutions that receive the larger grants thus made possible.

[1] Where fair market values of investment assets are not readily obtainable, such values for the fee basis could be mutually agreed upon by the Foundation and the Internal Revenue Service, with recourse to a Court of Law in cases of non-agreement.

[2] N.B. *Capital Gains and the Minimum Distribution Requirement* (*Section 101(b)*.).

The inclusion of short-term capital gains in "net adjusted income" would tend to cause a far greater similar undesirable impairment of inveстment flexibility since *all* such capital gains would be lost from capital assets, and distributed, thus reducing total future annual grants.

(2) *Deductions from "gross investment income"*

In determining "net investment income" upon which the proposed tax is to be based, Section 101(a) allows a deduction from "gross investment income" only for "ordinary and necessary expenses paid or incurred for the production or collection of gross investment income or for the management, conservation or maintenance of property held for production of such income". It would be only just to include a deduction *also* for *all* other expenses incurred in the sound operation of a private Foundation. For example, of equal necessity and importance with property management is the thoughtful distribution of the income to selected grant recipients. Furthermore, to a recipient an intelligent analysis of a project by a Foundation is frequently a contribution almost as valuable as the financial aid in terms of improving the efficiency or effectiveness of the project. In other words, the careful placement of financial assistance is an important part of Foundation operations, and its cost deserves deductible status.

(3) *Tax is too high*

Finally, the 7.5% figure for such a tax or fee based on income, in general, far exceeds the cost of any practical audit of a Foundation's operations by an experienced auditor. I strongly recommend that the tax, or preferably the fee, be *only* as high as that estimated necessary to cover the costs of the audit.

Since an avowed purpose of the extensive auditing is to assure prompt and proper use of their funds for the charitable purposes specified by their charters, an excessive tax or fee would only reduce the available funds for those vital institutions and projects dependent on Foundation support.

Thank you for this opportunity to present these comments on this very important bill.

Very truly yours,

ROBERT W. PARSONS, Jr.,
President.

STATEMENT BY JOSEPH E. JOHNSON, PRESIDENT, CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

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 fillfully 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 Endownment for International Peace was founded 50 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 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 perhps 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.

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 of his delegate would add nothing to their fairness, and might restrict their flexibility.

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?

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.

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 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 7½%—would do virtually nothing to correct the abuses that troubled 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.

COMMENTS OF MR. WILLIAM R. JUDY, ON BEHALF OF REID AND RIEGE

PRIVATE FOUNDATIONS

Section 101 of the bill, *Private Foundations*, would create new Section 508 of the Internal Revenue Code. We are especially concerned with the proposed Section 508(g)(2) relating to the governing instruments of a private foundation organized before January 1, 1970. This rule as to existing foundations is vague, confusing and internally inconsistent. Proposed Section 508(g)(1) would require a private foundation to amend its governing instruments to specifically prohibit certain undesirable activities. The report of the House Ways and Means Committee states that the intent of Section 508(g) is to "encourage and facilitate" effective State involvement in the supervision of charitable organizations. This is a worthy intent. But when Section 508(g)(2) speaks to existing organizations, the intent is unclear. Section 508(g)(2)(A) purports to allow an existing organization to leave its governing instrument unamended without losing its Section 501(c)(3) status. But then Section 508(g)(2)(B) gives the organization two years (or more, if necessary) to effect these very amendments they are not required to make. We foresee an inadvertent invitation to unnecessary litigation unless this provision is made more clear at the outset.

We can imagine three possible ways that the problem of the amendment of governing instruments might be handled: (1) provide that no existing organization will have to amend its governing instrument in any way; (2) provide that every existing organization must amend its governing instrument, or; (3) provide that existing organizations whose governing instruments would allow amendment without the necessity of judicial proceedings or appeal to a State official shall make the amendments, but those organizations whose governing instruments would necessitate such procedures shall not be required to make the amendments. The choice of which alternative should become law is a matter of balancing policies. On the one hand, there is the desire to make it easier for the State to supervise charitable organizations. On the other hand, there is the substantial inconvenience and expense not only to the foundations themselves but to the State official or agency who would have to approve such amendments to a foundation's governing instrument. To provide that no existing organization would have to make amendments to its governing instrument in any way ignores completely the goal of State involvement and enforcement. But conversely, to require that all existing organizations make the amendments would place a great burden upon some organizations and surely upon the appropriate State officials who supervise charitable organizations. We refer specifically to those organizations whose governing instruments do not allow for amendment or at least require State approval before amendment may be made. To amend an "unamendable" instrument would involve voluminous litigation. Those State officials who have the duty to supervise charitable organizations would be inundated with extra work, not to mention the already over-crowded State court systems in most jurisdictions. The charitable organization itself would incur substantial legal fees which would otherwise go toward charitable ends. But when a governing instruments is by its own terms amendable, for example, merely by a vote of the trustees, no great expense or inconvenience to the organization or the State would be involved.

Consequently we urge adoption of the third alternative noted above. We therefore offer the following substitute for proposed Section 508(g)(2):

> "(2) Special rule for existing foundations.
>
> In the case of an organization organized before January 1, 1970, Paragraph (1) shall apply only to taxable years beginning after December 31, 1971; provided that, if it is impossible for such an organization to amend its governing instrument to meet the requirements of paragraph (1) without judicial proceedings or the approval of an appropriate State official, the organization shall not cease to be treated as an organization described in Section 501(c)(3) because of a failure to comply with paragraph (1)."

GENERAL DRAFTING CO., INC.,
Convent Station, N.J., September 5, 1969.

Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SIRS: We wish to bring to your attention a situation in which we believe the proposed restrictions on ownership of stock by private foundations—proposed Section 4943 of the Internal Revenue Code of 1954 contained in Section 101(b) of H.R. 13270 as passed by the House of Representatives—should not apply.

The Lindberg Foundation (the "Foundation"), a private charitable organization, owns all the stock (except for a small amount of preferred stock owned by Massachusetts Institute of Technology) of General Drafting Co., Inc. (the "Company"). Otto G. Lindberg, the founder of both the Company and the Foundation and contributor of the Company's stock to the Foundation, is deceased; no relative of his is now connected with either the Foundation or the Company. The Foundation regularly receives from the Company and contributes to public charities substantial dividends. A more complete explanation of the facts is attached hereto as Exhibit A.

As a practical matter, disposition by the Foundation of 80% of the Company's stock could only be accomplished by permitting a larger corporation to acquire the Company. From our long and intimate knowledge of the Company's operations, we are certain that such an acquisition would undermine the factors upon which the Company's success is based and, in essence, destroy the Company.

Mapmaking, the Company's principal business over the years, is an art requiring skilled and experienced craftsmen. Although one of the largest mapmakers in the United States, the Company is a comparatively small company and its profits inure entirely to charity, with emphasis on local charitable organizations. These features, together with a Company tradition of fair and generous treatment of all employees, have resulted in outstanding employee loyalty, the factor primarily responsible for the Company's prosperity.

Loss of the Company's identity and independence of action would, we submit, not only cripple what is now a prosperous business paying tax at the full corporate tax rates and deprive charities of the income therefrom, but would also work a hardship on the Company's many dedicated employees.

We therefore respectfully request that you consider the proposed addition to Section 101(k) of H.R. 13270 set forth as Exhibit B hereto. Your support of such an amendment would be greatly appreciated.

We would be happy to furnish any additional information, regarding the Foundation, the Company or the proposed amendment, which you may feel would be helpful to your consideration of our request.

Very truly yours,

A. A. KAUPPINEN,
Chairman of the Board.

EXHIBIT A

Otto G. Lindberg came to the United States in 1907, just prior to his 21st birthday. In 1909 he started the drafting business subsequently incorporated as General Drafting Co., Inc. (the "Company"). From a one-man business, the Company has grown to be one of the largest map makers in the United States with annual sales in excess of $4,600,000.

As President until 1965 and chairman of the board of directors until 1968, Mr. Lindberg personally supervised every aspect of the Company's growth. He hoped and expected that his sons would continue the Company's traditions of excellent craftsmanship and fairness to employees. Tragically, both his sons predeceased him, his younger son having been lost in the Pacific in 1943 while serving as a United States Air Force Major.

Having no family to carry on the Company which he had built up over 54 years, at age 77 Mr. Lindberg decided to contribute his stock of the Company to The Lindberg Foundation (the "Foundation") to preserve the Company and devote its earnings to worthwhile charitable endeavors. A copy of Mr. Lindberg's announcement to the Company's employees explaining his decision is enclosed as Exhibit A-1. Of the 7,600 shares of the Company's common stock which he owned, he contributed 6,100 shares to the Foundation in 1963; he contributed an additional 1,000 shares to the Foundation prior to his death, and bequeathed the remaining 500 shares to the Foundation by his will.

The only other shares of common stock issued by the Company were those which Mr. Lindberg had given to employees prior to 1963. These shares were subsequently redeemed at book value or purchased by the Foundation (200 shares). The Company's only other class of stock outstanding is $100,000 of 6% preferred stock contributed by Mr. Lindberg to and currently held by Massachusetts Institute of Techonology.

The Foundation is a charitable membership corporation, formed under the laws of New Jersey in 1961, which the Internal Revenue Service has determined to be an organization described in section 501(c)(3) of the Internal Revenue Code of 1954. The Foundation is governed by a board of trustees who serve without compensation. None of the present trustees is related to the late Otto G. Lindberg, founder of and principal contributor to the Foundation.

The Foundation's only assets are a small amount of cash (less than $25,000 at December 31, 1961) and all the outstanding common stock of the Company. Except for $1,407 of interest from a temporary investment in United States Treasury Bills, the Foundation's sole source of income has been dividends on the Company's stock. Over the past five years it has received $134,150 from this source. During the same period the Foundation contributed $115,430 to over 100 public charitable organizations. The only expenses incurred by the Foundation have been for accounting and legal services and have never exceeded $560 in any year.

The Foundation's retention of the Company's stock has proven to be a sound investment decision. Since 1963 (when Mr. Lindberg contributed a majority of the Company's common stock to the Foundation) the net book value per share has increased from $63 to $117; the Company's 1968 earnings per share are 87%

higher than in 1964. The annual dividend per share paid to the Foundation has been increased from $3.00 in 1964, 1965 and 1966 to $5.00 in 1967 and $5.25 in 1968.

EXHIBIT A-1

GENERAL DRAFTING CO., INC.,
Convent Station, N.J., December 2, 1963.

To all employees of General Drafting Co., Inc.:

For a long time I have been thinking over various ways of which to assure the perpetuation of General Drafting in years to come and to make sure that control of it will not fall into the hands of people other than you who have worked with me to make it the successful company that it is today. In addition, I should like to feel that what I have decided to do will be an incentive to all of you to make this firm, which is so much part of me, even better and more successful as the years go on.

There are, of course, several ways to bring about part of the above, such as merger with a larger company, outright sale, etc., etc. However, all of these would affect each one of you in perhaps reducing your present well-being and your future security.

Therefore, I have decided to give to the Lindberg Foundation my present control of General Drafting in perpetuity. Through this institution we shall be able to make our charitable contributions and have assurance that our present high standards will always continue to be paramount in our company, which simply means integrity in our dealings with one another, our customers and society in general. The majority of the trustees are and will be employees of General Drafting, who will serve without compensation. The present trustees are:

Otto G. Lindberg, President.
A. A. Kauppinen, Vice President
J. G. Maurer, Treasurer.
R. F. Darby, Secretary.

OTTO G. LINDBERG.

PROPOSED ADDITION TO SECTION 101(K) OF H.R. 13270, 91ST CONGRESS, 1ST SESSION, AS PASSED BY THE HOUSE OF REPRESENTATIVES

(7) Section 4943 shall not apply with respect to an organization which, on January 1, 1969 and at all times subsequent thereto, holds as its principal asset 100% of the outstanding voting stock of an incorporated business enterprise and, in each calendar year subsequent to 1963, derives more than 90% of its gross income from such stock but only if

(1) no disqualified person owns any shares of any class of stock in such business enterprise,

(2) no donor to the organization of stock in such business enterprise, or a member of his family, is a foundation manager with respect thereto or a member of the board of directors or other managing body of such business enterprise on or at any time after July 28, 1969, and

(3) it does not purchase any stock or other interest in such business enterprise after July 28, 1969, and it does not acquire any stock or other interest in any other business enterprise which would constitute excess business holdings if the organization were subject to the provisions of section 4943.

AMERICAN STATISTICAL ASSOCIATION,
Washington, D.C., October 2, 1969.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of the American Statistical Association, I wish to express our desire to be associated with the statements of Frederick Burkhardt, President, American Council of Learned Societies, and Henry W. Riecken, President, Social Science Research Council, on the Tax Reform Act of 1969. The statements were submitted on September 8, 1969.

When H.R. 13270 was under consideration by the House Ways and Means Committee I wrote Chairman Mills and the Committee about the concern of

ASA for its own future under the proposed legislation. I am happy to say that because of the membership nature of our organization and our limited activities in terms of disbursing funds, the bill as passed by the House would not be likely to have an adverse effect on this Association. We are still concerned however with the effect of the present bill on two organizations with which we have a formal and informal association.

The first of these is the Social Science Research Council. We are one of seven associations responsible for the election of the Board of Directors of the SSRC and we have three members of the American Statistical Association who serve on that Board as individuals. Within the past year we have completed work with a Committee of the SSRC which developed a proposal for improving state and local government statistics and from time to time have other projects of common interest.

While we do not hold formal membership in the American Council of Learned Societies, we have worked with them on various programs and are aware of the important role the ACLS plays in a great range of research and educational activities.

We particularly support therefore the proposal of these societies for the development of appropriate language that would amend Section 509(a) to provide a fifth kind of organization which could be exempt from consideration as a private foundation. We believe it would be most desirable to develop a definition couched in functional language, rather than in terms of sources of support, to exempt these learned societies and other scholarly research organizations which, under the present language, would be included with private foundations.

Both of these organizations have a long history of useful service in the improvement of the social sciences and the development of research projects which have made wide contributions to knowledge. We earnestly solicit your assistance in clarifying the language in the current bill and will be happy to discuss the matter further either with the Committee or the Committee staff.

Sincerely yours,

John W. Lehman,
Executive Director.

National Information Bureau,
September 30, 1969.

Hon. Russell B. Long,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

Dear Chairman Long: On behalf of the Board of Directors of the National Information Bureau, I should like to inform you of our great concern about several provisions for the regulation and taxation of philanthropic foundations that were included in the Tax Bill recently passed by the House of Representatives and now under consideration by your Committee.

First, let me identify the National Information Bureau. We are a nonprofit organization which has since 1918 (fifty-one years) provided a continuous *advisory service to contributors* through the analysis of hundreds of charitable and philanthropic organizations that solicit contributions at the national and international level. We also endeavor to *maintain sound standards* within our part of the field of national philanthropy through voluntary self-discipline and, where that fails, through public exposure.

The eight basic standards which we uphold appear on the back cover of the enclosed annual report. As you will note, we require for accreditation a sound program; a responsible volunteer Board of Directors, serving without compensation, holding regular meetings, and with adequate administrative control; an annual audit; a budget, etc.

Included in our membership are business corporations (110 of the 200 largest U.S. industrial corporations by way of illustration), foundations, chambers of commerce, united funds and councils in about 1,400 local communities, certain governmental bureaus, mass media, and individual contributors. (Since foundations do not generally solicit contributions, they have not fallen within our field of reporting.)

As we are not a foundation, we have no direct immediate stake in the proposed legislation with respect to foundations.

Returning to the Tax Bill before your Committee, we wish to commend two basic principles evident in its preparation:

1. Self-dealing generally between a nonprofit foundation and the foundation's donor or trustees should be prohibited. Sound and responsible foundations should serve the public interest, not private interests.

2. There should be full disclosure of all pertinent facts by foundations.

These are sound principles. We are persuaded, however, that the three provisions noted below rest on unsound principles.

American society is based, as you know, upon the conviction that there should be a variety of channels, in addition to government, open to citizens for public service—such as voluntary charitable and philanthropic organizations to aid the distressed, provide education, do vital research, heal and care for the sick, enhance the arts, preserve the nation's heritage of culture and beauty, experiment with new solutions to social, health and educational problems and to demonstrate new ways of serving our fellowmen.

These voluntary channels for public service, paralleling government, have we believe contributed greatly to the ability of the United States, as a relatively young country, to advance in a number of fields well beyond the achievements of other countries. Federal, state and local governments have long recognized the importance of these channels by *excluding them from taxation and by allowing tax deductions generally for contributions to them.* Which brings us to our first suggested change:

1. *Proposed 7½% Tax of Income of Foundations*—We are not greatly disturbed by the 7½% figure of and by itself. In relation to the billions of dollars of federal taxation and of philanthropic income each year, the figure is relatively small. We are, however, very much disturbed by the fact that this is the first breach in the U.S. Government's wise policy of keeping multiple channels of public service, paralleling government, *tax free* as an encouragement to citizens generally to use and to support them.

If the principle is sound, it should not be breached by even a 1% tax (a registration fee could be substituted if the purpose is adequate funds to police foundations). If the principle is unsound, shouldn't we abandon tax deduction privileges for all charitable, educational, religious and philanthropic organizations? And if we do that, will we not damage and perhaps destroy the very pluralism in our society which we all cherish?

Please give careful consideration to the principle, not the proposed percentage amount. If the principle is undermined by the precedent of a 7½% tax on one group of nonprofit organizations, it will probably open the flood gates of escalating taxation by governments—national, state, and local—not only of foundations but also of other vital nonprofit charitable, educational, religious and philanthropic organizations. In practical terms, moreover, the proposed 7½% tax on foundations would amount in effect to a 7½% indirect tax on the traditional beneficiaries of foundation grants, such as colleges, hospitals, medical schools, charitable and philanthropic organizations, and so forth.

2. *Proposed Debarring of Foundations from all Grant Actions Related to Government*—We believe we understand the concern of the House Ways and Means Committee here. Money can mean power, and power may be used for or against the public interest. Your Committee has highlighted one or more recent instances of the ill-advised use of foundation grants in relation to local elections. On the other hand, we could document thousands of instances during the past fifty years of fine public service by foundations to and for governments which would have been impossible under the proposed legislation. From our view of foundations in relation to governments, we know that they have frequently made an outstanding contribution to public service.

We have the impression that the remedy proposed for errors in judgment in relation to several recent local elections is far out of proportion to the evil it undertakes to prohibit. It would be comparable to prohibiting anyone from driving an automobile because a certain number of people are injured in accidents each year. Prohibit if you must direct grants by foundations to encourage nonvoters to register *on one side* of a specific local election, but please don't prohibit foundations from helping government by research, experimentation, demonstration and broad education, as they have so usefully done for two generations.

3. *Proposed Prohibition of Grants to Individuals*—We oppose this restriction, not because it may not have been abused recently through errors of judgment by

one or more foundations, but because these exceptions really serve in our estimation to highlight the basic fact that the vast majority of such grants for generations have been responsible and in the *public* interest.

To sum up, we believe it is wise and constructive to require, as the House Tax Bill does, full disclosure of the finances and programs of foundations. A spotlight on their actions is likely to serve the salutary purpose of encouraging ethical conduct at levels in which it is difficult, if not impossible, to legislate in detail. As Chief Justice Warren stated some years ago, "Law floats in a sea of Ethics. . . . Without Law, we should be at the mercy of the least scrupulous; without Ethics, Law could not exist. . . ."

Full public disclosure will, we believe, be very helpful to producing the ethical climate needed, whereas an attempt to legislate conduct *in every detail* is likely to be more harmful than helpful. If we can be of aid to your Committee by answering questions, we will be very glad to do so.

Sincerely yours,

ALEXANDER LINDEY,
President.

COMMUNITY TELEVISION OF SOUTHERN CALIFORNIA,
Los Angeles, Calif., October 3, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: As Executive Vice President and General Manager of Community Television of Southern California, a nonprofit corporation which is licensed by the Federal Communications Commission to operate noncommercial television station KSET, Channel 28, which serves Los Angeles, California, I strongly support the testimony that has been presented to this distinguished Committee by Mr. Macy on behalf of the Corporation for Public Broadcasting, and by Mr. Harley on behalf of the National Association of Educational Broadcasters. Their testimony made clear the unfortunate impact certain aspects of H.R. 13270 could have on noncommercial broadcasting unless clarifying language is added, particularly with respect to Section 4945. I would like to take this opportunity, however, to illustrate briefly the effect that failure to make the revisions proposed by Messrs. Macy and Harley could have on our station, simply to underscore that this effect at our station and at other noncommercial stations throughout the country would be clearly contrary to the public interest.

It is my firm belief that noncommercial, or "public" television, as it is often called, is at its best when it is providing programs that stimulate viewers to think about and form opinions on matters that are of vital concern to the community. Indeed, perhaps the ultimate goal of this type of programming is realized when the public is sufficently stimulated and concerned so as to seek to remedy current problems in specific ways, including the passage of new legislation, whether it be at the local, county, state, or national level. And it is ,of course, in this respect that funds for our programming would run afoul of Section 4945 of the proposed legislation, which provides that:

> ". . . the term 'taxable expenditures' includes (but is not limited to)—
> (1) Any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof . . ."

It is, of course, of no concern to KCET whether proposed solutions, sought through legislation or otherwise, conform to the philosophical outlook of any particular political organaiztion or group. What does matter to us, and where we think our responsibility lies, is to stimulate action by concerned citizens to make their community and our community a better place for us all.

To illustrate the kind of programs I am referring to, this September KCET initiated a daily program series about the Mexican American community of Los Angeles, in all its aspects: art, music, economics, politics, problems, accomplishments and aspirations. From a remote television studio in the Mexican American community, the station will carry a one half-hour live program each weekday evening at seven o'clock that is being produced principally by Mexican Americans in cooperation with numerous social clubs and civic organizations of the Southern California Mexican American community. It is our hope and expectation that out of this series, Mexican Americans of Los Angeles will realize a greater sense of participation in their community's affairs and will, with this access to the powerful medium of television, be able to deal more effectively with problems they face in their community.

Another illustration, on a nationwide level, of educational television seeking to fulfill its role as a catalyst in community and national affairs, is the recently begun public affairs program, "The Advocates." Each week, in a live interconnected program, two lawyers will confront a high ranking official with arguments and supporting data on opposing sides of a vital national issue, over which the official has decision-making control. The effectiveness of these arguments will be measured by members of the studio audience, who will give their opinions at the beginning and end of the show, and by the response of viewers, who will be able to call in to express their opinions. Computer tallies of the votes will be announced during the course of the program, in an attempt also to persuade the decision maker, and as a gauge of the effectiveness of the opposing presentations.

These are the kinds of programs which offer, I feel, great hope for enabling television better to fulfill its promise of being a constructive force in our society, and which now receive support, in whole or in substantial part, from private foundations.

I therefore urge that the revisions to H.R. 13270 that have been suggested by the Corporation for Public Broadcasting and by the National Association of Educational Broadcasters be given favorable consideration.

Sincerely,

JAMES L. LOPER,
Executive Vice President and General Manager.

GRAND RAPIDS FOUNDATION,
Grand Rapids, Mich., September 3, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: Grand Rapids Foundation is an organization which meets the description of *Example (1)* 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. 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,

EDWARD C. MCCOBB,
Executive Director.

ASSOCIATION OF RESEARCH LIBRARIES,
July 17, 1969.

Hon. RUSSELL B. LONG,
Chairman of the Senate Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: The Association of Research Libraries appreciates the position of the Chairman of the Senate Finance Committee, as expressed in the Committee press release of July 8, that there should be full discussion and representation of views on suggested tax reforms offered to H.R. 12290. We are happy to have the opportunity to submit this written statement of the position of the ARL on this very important subject.

At this time, of course, we are unaware of any specific proposals for tax reform which will be made to the Committee. We are aware, however, of the Tentative Decisions on Tax Reform of the House Ways and Means Committee, published in the press release of that Committee on May 27. While the Association was favorably impressed with what it understands to be the primary objective of the Tentative Decisions—namely the correction of certain abuses of their privileged status on the part of some private foundations—the officers of the Association were concerned to discover that several sections of the Decisions could have a deleterious impact on the ARL and on similar eduactional associations. In the event that proposals similar to those contained in the Tentative Decisions were to be offered to the Senate Finance Committee, the Association wishes to express itself on them—as it has done to the House Ways and Means Committee—in order that Committee members may be fully informed of our situation which is shared by many literary, scientific and educational associations throughout the country.

We are particularly concerned about the prospect, possible under the Changes in Definition proposed in the Tentative Decisions, that our organization might be defined as a private foundation and thus subject to the proposed limitations on these institutions.

First a word about the Association of Research Libraries. The ARL is a convention of research libraries, mostly university libraries. Its members are the institutions themselves; there are no personal members. The membership also includes separately established research libraries of national significance, such as: The John Crerar Library of Chicago, and the Linda Hall Library of Kansas City, both public institutions established by bequests; the New York Public Library, specifically its great research unit at 42nd and Fifth Avenue and most importantly the three national libraries (the Library of Congress, the National Agricultural Library and the National Library of Medicine). At present the membership numbers 85 libraries of which 76 are university libraries. A membership list is attached for the information of the Committee together with our certificate of incorporation and our bylaws.

The purpose of the ARL is, by coordinate discussion and action, to improve the quality of research library service to the nation at large—to advanced students, faculty, research workers, the industrial community, and to government officials at all levels. The Association has been recently involved in such projects as the following: reviewing the procedures and regulations whereby books and journals are loaned from one institution to another across the country, analyzing the management practices of large research libraries with an eye to greater efficiency, studying the potential for automation in large libraries and the possibilities for interaction in this expensive new field, the development of a national system for shared cataloging in order to reduce duplication of effort, and the design and development of national bibliographical tools.

The need for such interaction and concerted planning has become increasingly important to the public interest in recent years as we have begun to realize that library and information services are a public commodity of basic importance to the well-being of American society. For this reason there is much discussion of the concept of national networks of libraries. The ARL has always conceived of itself in these terms.

In all of these national activities the three national libraries are active participants and in many instances a central force. Several of our projects have been undertaken specifically in behalf of the national libraries; therefore, we are necessarily involved in influencing the decisions of these and other governmental bodies. They serve our users and we serve theirs. Our responsibilities and our fates are essentially intertwined in the service of education and learning. Moreover, a number of our special projects have been made possible by direct support from Federal departments and foundations as well as from private foundations. For these reasons we are concerned about the possibility that an organization such as the ARL would be subject to taxation and inhibited in its relationship with governmental bodies.

Beyond this technical question relating to our own status and functions, the ARL members are deeply disturbed by some of the basic implications found in the Tentative Decisions regarding the proposed methods for dealing with private foundations in general. We, and other libraries have had long and creative relationships with the country's distinguished foundations.

We fully appreciate the fact that some have not acted with a responsible concern for the public interest. Most assuredly, Congress should seek the means to end such specific abuses of a privileged status. The prohibition on self-dealing, the limitation on stock ownership and on the improper use of assets, and the requirements for disclosure and publicity all seem highly proper and desirable.

However, some of the other proposed limitations would seem to work against the public interest because it must be equally evident that many philanthropic foundations have a long and honored record of furthering the public interest. Generous and creative philanthropy, on the part of individual citizens and of foundations, is a notable, even a laudable, aspect of American life. Perhaps no other society can boast of so effective and openhearted a tradition of private benefaction in the public interest, a tradition which assures that the private sector works arm-in-arm with the public sector in seeking ways to improve man's status.

The free public library is another greatly admired American concept, an essential component of the American heritage. Basically tax supported, the library, whether academic or municipal, has also, almost from the beginning, depended to a considerable measure on philanthropic benefaction.

The flourishing of free libraries in this country was particularly fostered by the nineteenth century grants that established Carnegie library buildings for colleges and towns all across the country. The Carnegie library building, in fact, until quite recently, was the very symbol of a democratic public library movement that has been widely admired in other less favored countries. Those Carnegie library building grants were in the earliest and best tradition of matching grants, for the recipient municipalities were required to assure an adequate level of public funding for continuous maintenance of services. Thus the private and public sectors work together creatively.

In more recent years the whole new frontier of automated library services was initiated by a series of experimental foundation grants.

Moreover, the history of libraries in this country is marked with private benefaction. Friends of libraries groups are an important aspect of effective library support. Many of the greatest libraries in the country, members of the ARL as has been indicated, are themselves privately established and endowed institutions. Others are, of course, the libraries of the private universities.

Thus, as beneficiaries of this essentially American tradition, we as librarians feel obligated to address the Committee in behalf of the honorable foundations. Without them American society would be the poorer both in spirit and in substance.

We would hope that the Finance Committee would address itself specifically to those practices and procedures whereby a few foundations have failed in their obligations to society. However, we think it of equal importance that the Committee both protect and foster the honorable tradition of the philanthropic foundations. They have been a strong arm of American society and should not be weakened in this great tradition. They would, we believe, be weakened by taxation, by an inhibition against working creatively with governmental bodies, and by an inability to make direct grants to individuals.

There is one other section of the Ways and Means Committee's Tentative Decisions which if implemented could do serious harm to the Nation's research libraries. That is the section which deals with gifts of books, collections of papers and works of art to libraries and museums. Here, again, we are aware of abuses and we do not defend them. We support their elimination.

We would ask the Finance Committee, however, if this matter is brought before it, to bear in mind the importance of gifts of books and collections of papers in developing the resources and collections of research libraries. These benefactions are significant sources of valuable library materials. The present law provides an incentive to donors to present their collections to libraries thus making them available to the public. We would urge that in correcting present abuses the Committee avoid destroying the incentive to make these gifts. Libraries, universities, and the general public would be the losers if this should occur.

This letter comes to you on behalf of the 85 constituent members of the Association of Research Libraries and, we are certain, of the scholars, students and the general public which they serve. The officers of the Association would be pleased to discuss these matters further with members of your Committee or its staff if you see fit.

Sincerely yours,

Stephen A. McCarthy,
Executive Director.

Certificate of Incorporation of Association of Research Libraries

We, the undersigned, all citizens of the United States and a majority citizens of the District of Columbia, of full age, desiring to associate ourselves as a corporation pursuant to the provisions of Title 29, Chapter 6 of the Code of Laws of the District of Columbia, 1951 Edition, do hereby certify as follows:

1. The name or title by which such society shall be known in law is: Association of Research Libraries.
2. The term for which it is organized shall be perpetual.
3. The particular business and objects of the society shall be: Exclusively for literary, educational and scientific purposes by strengthening research libraries.
4. The number of its trustees, directors or managers for the first year of its existence shall be nine (9).
5. Membeship in the society shall be on an institutional basis and in accordance with the By-Laws, the initial members being those libraries which are members of the Association of Research Libraries on the date of this incorporation.

The names and respective addresses, including street and number, of the incorporators are:

James W. Barry, 3415 38th Street NW., Washington, D.C.
Miriam D. Hawkins, 2500 Wisconsin Avenue NW., Washington, D.C.
M. Ruth MacDonald, 2500 Wisconsin Avenue NW., Washington, D.C.
Dated: December 5, 1961.

District of Columbia, *ss:*

I, Doris C. A. Richardson, a Notary Public in and for the District of Columbia, do hereby certify that James W. Barry, Miriam D. Hawkins, and M. Ruth MacDonald, parties to a certain Certificate of Incorporation bearing date on the 5th day of December, 1961, and hereunto annexed, personally appeared before me in said District, the said James W. Barry, Miriam D. Hawkins, and M. Ruth MacDonald being personally well known to me as the persons who executed the said Certificate of Incorporation, and severally acknowledge the same to be their act and deed.

Given under my hand and seal this 5th day of December, 1961.

[SEAL]

Doris C. A. Richardson,
Notary Public.

My Commission expires October 31, 1964.

Certificate of Amendment to the Certificate of Incorporation of Association of Research Libraries

We ——— President, and James E. Skipper Secretary, certify that the written consent of two-thirds of the trustees or directors being first had and obtained, a copy of which is attached hereto, filed the following amendment to the Certificate of Incorporation:

Upon dissolution of the Association, the assets ofthe Association shall be applied and distributed as follows:

(a) All liabilities and obligations of the Association shall be paid, satisfied, and discharged, or adequate provision shall be made therefor;

(b) Assets held by the Association upon conditions requiring return, transfer, or conveyance, which condition occurs by reason of the dissolution, shall be returned, transferred, or conveyed in accordance with such requirements;

(c) Assets received and held by the Association subject to limitations permitting their use only for literary, educational, scientific, or similar purposes, but not held upon a condition requiring return, transfer, or conveyance by reason of the dissolution, shall be transferred or conveyed to one or more organizations exempt from income tax as organizations described in section 501(c)(3) of the Internal Revenue Code having as and pursuing purposes substantially similar to those of the Association, pursuant to a duly adopted plan of distribution;

(d) Any remaining assets shall be distributed to one or more organizations exempt from income tax as organizations described in section 501(c)(3) of the Internal Revenue Code for any one or more literary, educational, or scientific purpose or purposes, or to the federal government, or to a state or local government, for a public purpose, pursuant to a duly adopted plan of distribution, or by a court to one or more such organizations to be used in such manner as in the judgment of the court will best accomplish the purposes for which the Association was organized.

We, ——— President, and James E. Skipper Secretary, have hereunto set our hands and seal this day of ———, 1963.

Dated 1963.

——— ———,
President.
JAMES E. SKIPPER,
Secretary.

WRITTEN CONSENT OF BOARD OF DIRECTORS OF ASSOCIATION OF RESEARCH LIBRARIES TO AMENDMENT OF CERTIFICATE OF INCORPORATION

The undersigned, constituting two-thirds or more of the Board of Directors of the Association of Research Libraries, hereby consent to the amendment of the Certificate of Incorporation of said Association by the insertion of the following provision:

Upon dissolution of the Association, the assets of the Association shall be applied and distributed as follows:

(a) All liabilities and obligations of the Association shall be paid, satisfied, and discharged, or adequate provision shall be made therefor;

(b) Assets held by the Association upon condition reuiring return, transfer, or conveyance, which condition occurs by reason of the dissolution, shall be returned, transferred, or conveyed in accordance with such requirements;

(c) Assets received and held by the Association subject to limitations permitting their use only for literary, educational, scienctific, or similar purposes, but not held upon acondition requiring return, transfer, or conveyance by reason of the dissolution, shall be transferred or conveyed to one or more organizations exempt from income tax as organizations described in section 501(c)(3) of the Internal Revenue Code having as and pursuing purposes substantially similar to those of the Association, pursuant to a duly adopted plan of distribution;

(d) Any remaining assets shall be distributed to one or more organizations exempt from income tax as organizations described in section 501(c)(3) of the Internal Revenue Code for any one or more literary, educational, or scientific purpose or purposes, or to the federal government, or to a state or local government, for a public purpose, pursuant to a duly adopted plan of distribution, or by a court to one or more such organizations to be used in such manner as in the judgment of the court will best accomplish the purposes for which the Association was organized.

Dated: January, 1963.

———— ————, Director; B. E. Powell, Director; William S. Dix, Director; M. A. Mileywski, Director; ———— ————, Director; Louis Koplon, Director; Stanley L. West, Director; ———— ————, Director.

STATE OF ILLINOIS,
County of Cook, ss:

I, Florence Cannon, a Notary Public for the County of Cook, State of Illinois, do hereby certify that Robert Vasper and James E. Skepper, parties to a certain Certificate of Amendment bearing date on the 28th day of January, 1963, and hereunto annexed, personally appeared before me in said County of Cook, State of Illinois, the said Robert Vasper and James E. Skepper, being personally well known to me as the persons who executed the said Certificate of Amendment, and severally acknowledged the same to be their act and deed.

Given under my hand and seal this 28th day of January, 1963.

[SEAL]

FLORENCE CANNON,
Notary Public.

BYLAWS OF THE ASSOCIATION OF RESEARCH LIBRARIES

ARTICLE I—OFFICES

The principal office of the Association shall be located in the office of the Executive Director. The Association may have such other offices as the Board of Directors may determine, or as the affairs of the Association may require from time to time.

ARTICLE II—MEMBERSHIP

Section 1—Member Institutions

Membership in the Association shall be on an institutional basis. Membership shall be open, on invitation of the Association, to major university libraries and to certain other libraries whose collections and services are similarly broadly based and are recognized as having national significance. Invitations to membership shall be issued at the initiative of the Board of Directors, subject to the approval of the membership.

Section 2—Qualifications

Major university libraries are considered to be those whose parent institutions emphasize research and graudate instruction at the doctoral level and which support large, comprehensive collections of library materials on a permanent basis. In evaluating potential university library members the Board of Directors will give consideration to the following objective criteria:

The number of Ph.D. degrees conferred;

The number of distinct disciplines in which the Ph.D. degree is offered;

The amount spent for books, periodicals and binding; and

Any other criteria which the Board of Directors may deem desirable for purposes of evaluation.

Section 3—Transfer of Membership

Membership in the Association is not transferable or assignable.

ARTICLE III—BOARD OF DIRECTORS

Section 1—Board of Directors

There shall be a Board of Directors which shall manage the affairs of the Association. The number of Directors shall be not less than nine nor more than twelve. The President, Vice-President, and Immediate Past President of the Association shall be members of the Board. Directors shall be elected for terms of three years, three to be elected annually as provided in Article IV. Each Director shall be chosen from among the chief librarians representing member institutions of the Associatuion. Each Director shall take office at the close of the Annual Meeting at which he is elected and shall serve until the end of the Annual Meeting held at the close of his term of office. Notwithstanding any other provision contained in these Bylaws, an officer of the Association who is serving as a member of the Board of Directors may continue to serve as a member of the Board until the expiration of his term as officer despite the fact that his normal. three-year term as Director may have expired. Any vacancy arising in the Board of Directors shall be filled by the Board of Directors, the appointee to serve until the next Annual Meeting, when a successor for the unexpired term shall be nominated and elected by the members of the Association.

Section 2—Quorum and Action

A majority of the members of the Board of Directors shall constitute a quorum. Action by the Board of Directors shall be a majority vote of the Directors present except that, as provided in Article V, Section 4 of these Bylaws, election of the Vice-President shall be by the vote of an absolute majority of the total membership of the Board.

Section 3—Notice of Meetings

A regular meeting of the Board of Directors shall be held without other notice than this Bylaw, after the Annual Meeting of the Association, either on the same day thereof, or on the next succeeding day thereafter, at the time and place announced by the President at the Annual Meeting. The Board of Directors may provide by resolution the time and place for the holding of additional regular meetings of the Board of Directors without other notice than such resolution. Special meetings of the Board of Directors may be called by or at the request of the President or any two Directors. Notice of any special meeting of the Board of Directors shall be given at least ten days previously thereto by written notice delivered personally or sent by mail or telegram to each Director at his address as shown by the records of the Association. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail in a sealed envelope so addressed, with postage thereon prepaid. If notice be given by telegram, such notice shall be deemed to be delivered when the telegram is delivered to the telegraph company. Notice of a meeting need not be given to any Director who signs a waiver of notice whether before or after the meeting, or who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to him. The business to be transacted at, and the purpose of, any special meeting of the Board of Directors shall be specified in the notice or waiver of notice of such meeting.

ARTICLE IV—NOMINATIONS AND ELECTIONS OF THE BOARD OF DIRECTORS

Section 1—Nominating Committee

There shall be a nominating committee of three persons one to be the Vice-President who shall serve as chairman of the Nominating Committee; and two persons to be appointed annually by the President of the Association.

Section 2—Nominations

It shall be the duty of the Nominating Committee to select annually a slate of five nominees for the Board of Directors. No Director, having served a full three-year term, may be nominated to succeed himself. The consent of the candidates to serve if elected must be obtained before nominations are accepted. The report of the nominating committee shall be distributed to the members at least thirty days before the election.

Additional nominations may be made from the floor.

Section 3—Elections of the Board

Each member may vote for not more than three nominees, except for the election of a successor for an unexpired term.

The three candidates receiving the highest number of votes shall become members of the Board for three-year terms.

ARTICLE V—OFFICERS

Section 1—Officers

The officers of the Association shall be a President, a Vice-President, an Immediate Past President, and an Executive Director. The officers, except the Executive Director, shall serve for terms of one year each. The Vice President shall automatically succeed to the Presidency at the end of his term as Vice-President. The President shall preside at meetings of the Association and of the Board of

Directors. The President shall perform all duties incident to his office and such other duties as may be prescribed by the Board of Directors. In the absence of the President or in event of his inability or refusal to act, the Vice-President shall perform the duties of the President and when so acting, shall have all the powers of and be subject to all the restrictions upon the President. The Vice-President shall perform such other duties as from time to time may be assigned to him by the President or by the Board of Directors. The officers shall have and may exercise all the powers of the Board of Directors between meetings of the Board, when necessary. Their action shall be subject to subsequent ratification by the Board of Directors.

Section 2—Executive Director

There shall be an Executive Director of the Association, appointed by the Board of Directors, who shall serve at its pleasure. The Executive Director shall serve as Director of the Association but shall not be a member of the Board of Directors. He shall also serve as Treasurer of the Association and shall be bonded.

Section 3—Duties of the Executive Director

The Executive Director shall be in charge of the principal office of the Association's administrative affairs; he shall be responsible for the execution of all orders of the Board of Directors; he shall prepare an annual budget and carry out the activities provided for in the budget as adopted by the Board of Directors; he shall have charge and custody of and be responsible for all funds and securities of the Association; he shall receive and give receipts for moneys due and payable to the Association from any source whatsoever and deposit all such moneys in the name of the Association in such depositories as shall be selected by the Board of Directors; he shall see that all notices are duly given in accordance with these Bylaws or as required by law; he shall keep a register of the post office address of each member which shall be furnished to the Executive Director by such member; he shall keep all minutes, and issue minutes and reports as required by the Board of Directors; he shall perform such other duties as from time to time may be assigned to him by the Board of Directors.

Section 4—Vice-President

The Vice-President shall be chosen from among members of the Board of Directors. Notwithstanding Article III, Section 2 of these Bylaws, he shall be elected by the vote of an absolute majority of the total membership of the Board. In the event that no one candidate for Vice-President receives an absolute majority in the first election, there shall be a run-off election between the two candidates receiving the highest number of votes, and that candidate receiving a majority in the run-off election shall be elected Vice-President. In the event the run-off election results in a tie, additional elections shall be conducted until one candidate receives a majority.

ARTICLE VI—MEETINGS

Section 1—Annual and Special Meetings

There shall be an Annual Meeting of the Association at a time and place to be determined by the Board of Directors. The Association may meet at such other times and places as may be determined by the Board of Directors.

Section 2—Notice of Meetings

Written or printed notice stating the place, day and hour of any meeting of the Association shall be delivered, either personally or by mail, to each member entitled to vote at such meeting, not less than ten nor more than fifty days before the date of such meeting, except as otherwise required by law or by these Bylaws, by or at the direction of the Board of Directors, the President or the Executive Director. When a meeting is adjourned to another time or place, it shall not be necessary to give any notice of the adjourned meeting if the time and place to which the meeting is adjourned are announced at the meeting at which the adjournment is taken, and the adjourned meeting any business which might have been transacted on the original date of the meeting may be transacted. In case of a special meeting or when required by law or by these Bylaws, the purpose or purposes for which the meeting is called shall be stated in the notice. If mailed, the notice of a meeting shall be deemed delivered when deposited in the United States mail addressed to the member at its address as it appears on the register of members, with postage thereon prepaid.

Section 3—Quorum and Action

A majority of the total membership shall constitute a quorum for the transaction of business, an an affirmative vote of a majority of the members voting, but not less than one-third of the total membership, shall be sufficient except as otherwise required by law or by these Bylaws.

Section 4—Voting

Each member shall be entitled to one vote on each matter submitted to a vote of the members. A member shall be represented in proxy by its chief librarian, or in his absence, by its associate or one of its assistant librarians. Voting may be by proxy or by mail or by a combination thereof.

Section 5—Parliamentary Procedures

The conduct of meetings shall follow Robert's *Rules of Order*.

ARTICLE VII—COMMITTEES

In addition to the Nominating Committee, such other standing and *ad hoc* committee as may be needed to carry out the business of the Association may be appointed by the Board of Directors.

ARTICLE VIII—DUES

Section 1—Fixing of Dues

Membership dues shall be proposed by the Board of Directors and shall require approval by an affirmative vote of a majority of the total membership of the Association after due notice.

Section 2—Forfeiture of Membership for Failure to Pay Dues

A member failing to pay dues for two successive years shall automatically forfeit membership in the Association.

ARTICLE IX—CONTRACTS, CHECKS, DEPOSITS AND FUNDS

Section 1—Contracts

The Board of Directors may authorize any officer or officers, agent or agents of the Association, in addition to the officers so authorized by these Bylaws, to enter into any contract or execute and deliver any instrument in the name of and on behalf of the Association and such authority may be general or confined to specific instances.

Section 2—Checks, Drafts, etc.

All checks, drafts or orders for the payment of money, notes or other evidences of indebtedness issued in the name of the Association, shall be signed by such officer or officers, agent or agents of the Association and in such manner as shall from time to time be determined by resolution of the Board of Directors. In the absence of such determination by the Board of Directors, such instruments shall be signed by the Executive Director and counter-signed by the President or Vice-President.

Section 3—Deposits

All funds of the Association shall be deposited from time to time to the credit of the Association in such depositories as the Board of Directors may select.

Section 4—Gifts

The Board of Directors may accept on behalf of the Association any grant, contribution, gift, bequest or device for the general purposes or for any special purpose of the Association.

ARTICLE X—BOOKS AND RECORDS

The Association shall keep correct and complete books and records of account and shall also keep minutes of the proceedings of its members, Board of Directors and committees having any of the authority of the Board of Directors, and shall keep at the principal office a register giving the names and addresses of the members entitled to vote. All books and records of the Association may be inspected by any member, or his agent or attorney for any proper purpose at any reasonable time.

ARTICLE XI—FISCAL YEAR

The fiscal year of the Association shall be the calendar year.

ARTICLE XII—WAIVER OF NOTICE

Notice of meeting need not be given to any member who signs a waiver of notice, whether before or after the meeting. The attendance of or voting by any member at a meeting, without protesting, prior thereto or at its commencement, the lack of notice of such meeting, shall constitute a waiver of notice by such member.

ARTICLE XIII—AMENDMENTS

Amendment of these Bylaws requires an affirmative vote of a majority of the total membership of the Association, at any meeting of the Association, provided that notice of such meeting and the proposed amendment has been given in writing at least thirty days in advance of the meeting by the Executive Director with the approval of the Board of Directors.

ARTICLE XIV—DISSOLUTION

Upon dissolution of the Association, the assets of the Association shall be applied and distributed as follows:

a. All liabilities and obligations of the Association shall be paid, satisfied, and discharged, or adequate provision shall be made therefor;

b. Assets held by the Association upon condition requiring return, transfer, or conveyance, which condition occurs by reason of the dissolution, shall be returned, transferred, or conveyed in accordance with such requirements;

c. Assets received and held by the Association subject to limitations permitting their use only for literary, educational, scientific, or similar purposes, but not held upon a condition requiring return, transfer, or conveyance by reason of the dissolution, shall be transferred or conveyed to one or more organizations exempt from income tax as organizations described in section 501(c)(3) of the Internal Revenue Code having as and pursuing purposes substantially similar to those of the Association, pursuant to a duly adopted plan of distribution;

d. Any remaining assets shall be distributed to one or more organizations exempt from income tax as organizations described in section 501(c)(3) of the Internal Revenue Code for any one or more literary, educational, or scientific purpose or purposes, or to the federal government, or to a state or local government, for a public purpose, pursuant to a duly adopted plan of distribution, or by a court to one or more such organizations to be used in such manner as in the judgment of the court will best accomplish the purposes for which the Association was organized.

Adopted January 28–29, 1962.
Amended June 22, 1968.

MEMBERSHIP LIST, MAY 1969

University of *Alabama* Library, Tuscaloosa, Alabama 35486; W. Stanley *Hoole*, Librarian.

University of *Alberta* Library, Edmonton, Alberta, Canada; Bruce *Peel*, Director.

University of *Arizona* Library, Tucson, Arizona 85721; Robert K. *Johnson*, Librarian.

Boston Public Library, Boston, Massachusetts 02117; Philip J. *McNiff*, Librarian.

Boston University Library, Boston, Massachusetts 02215; John *Laucus*, Acting Director.

University of *British Columbia* Library, Vancouver 8, Canada; Basil *Stuart-Stubbs*, Librarian.

Brown University Library, Providence, Rhode Island 02912; David A. *Jonah*, Librarian.

University of *California* Library, *Berkeley*, California 94720; James E. *Skipper*, Librarian.

University of *California* Library, *Davis*, California 95616; J. R. *Blanchard*, Librarian.

University of *California* Library, *Los Angeles*, California 90024; Robert *Vosper*, Librarian.

Case Western Reserve University Libraries, Cleveland, Ohio 44106; James V. *Jones*, Director.

Center for Research Libraries, Chicago, Illinois 60637; Gordon R. *Williams*, Director.

University of *Chicago* Library, Chicago, Illinois 60637; Herman H. *Fussler*, Director.

University of *Cincinnati* Libraries, Cincinnati, Ohio 45221; Bruce *Kauffman*, Acting Librarian.

University of *Colorado* Library, Boulder, Colorado 80304; Ralph E. *Ellsworth*, Director.

Columbia University Libraries, New York, N.Y. 10027; Richard H. *Logsdon*, Director.

University of *Connecticut* Library, Storrs, Connecticut 06268; John P. *McDonald*, Director.

Cornell University Libraries, Ithaca, New York 14850 David *Kaser*, Director.

Dartmouth College Libraries, Hanover, New Hampshire 03755; Edward C. *Lathem*, Librarian.

Duke University Libraries, Durham, North Carolina 27706; Benjamin E. *Powell*, Librarian.

University of *Florida* Libraries, Gainesville, Florida 32603; Gustave A. *Harrer*, Director.

Florida State University Library, Tallahassee, Florida 32306; N. Orwin *Rush*, Librarian.

Georgetown University Library, Washington, D.C. 20007; Rev. James B. *Horigan*, Director.

University of *Georgia* Libraries, Athens, Georgia 30601; W. P. *Kellan*, Director.

Harvard University Library, Cambridge, Massachusetts 02138; Douglas W. *Bryant*, Librarian.

University of *Illinois* Library, Urbana, Illinois 61803; Robert B. *Downs*, Dean of Library Administration.

Indiana University Libraries, Bloomington, Indiana 47405; Robert A. *Miller*, Director.

University of *Iowa* Libraries, Iowa City, Iowa 52240; Leslie W. *Dunlap*, Director.

Iowa State University Library, Ames, Iowa 50010; *Warren Kuhn*, Director.

The *John Crerar* Library, Chicago, Illinois 60616; William S. *Budington*, Director.

Johns Hopkins University Library, Baltimore, Maryland 21218; John H. *Berthel*, Librarian.

Joint University Libraries, Nashville, Tennessee 37203; Frank P. *Grisham*, Director.

University of *Kansas* Library, Lawrence, Kansas 66044; David W. *Heron*, Director.

University of *Kentucky* Libraries, Lexington, Kentucky 40506; Stuart *Forth*, Director.

The *Library of Congress*, Washington, D.C. 20540; L. Quincy *Mumford*, Librarian.

Linda Hall Library, Kansas City, Missouri 64110; Joseph C. *Shipman*, Librarian.

Louisiana State University Library, Baton Rouge, Louisiana; T. N. *McMullan*, Director.

McGill University Library, Montreal 2, Canada; Keith *Crouch*, Director.

University of *Maryland* Library, College Park, Maryland 20742; Howard *Rovelstad*, Librarian.

University of *Massachusetts* Libraries, Amherst, Massachusetts; David *Clay*, Director.

Massachusetts Institute of Technology Libraries, Cambridge, Massachusetts 02142; William N. *Locke*, Director.

University of *Michigan* Library, Ann Arbor, Michigan 48104; Frederick H. *Wagman*, Director.

Michigan State University Library, East Lansing, Michigan 48823; Richard *Chapin*, Librarian.

University of *Minnesota* Libraries, Minneapolis, Minnesota 55455; Edward B. *Stanford*, Director.

University of *Missouri* Library, Columbia, Missouri 65202; Ralph H. *Parker*, Librarian.

National Agricultural Library, Washington, D.C. 20250; John *Sherrod*, Director.

National Library of Medicine, Bethesda, Maryland 20203; Martin M. *Cummings*, Director.

University of *Nebraska* Libraries, Lincoln, Nebraska 68508; Frank A. *Lundy*, Director.

New York Public Library, New York, N.Y. 10018; Edward G. *Freehafer*, Director.

New York State Library, Albany, New York 12224; John A. *Humphry*, Librarian.

New York University Libraries, New York, N.Y. 10003; Charles F. *Gosnell*, Director.

University of *North Carolina* Libraries, Chapel Hill, North Carolina 27515; Jerrold *Orne*, Director.

Northwestern University Libraries, Evanston, Illinois 60210; Thomas R. *Buckman*, Librarian.

University of *Notre Dame* Libraries, South Bend, Indiana 46556; Rev. James W. *Simonson*, Director.

Ohio State University Libraries, Columbus, Ohio 43210; Lewis C. *Branscomb*, Director.

University of *Oklahoma* Library, Norman, Oklahoma 73069; Arthur M. *McAnally*, Librarian.

Oklahoma State University Library, Stillwater, Oklahoma 74075; Roscoe *Rouse*, Librarian.

University of *Oregon* Library, Eugene, Oregon 97403; Carl W. *Hintz*, Librarian.

University of *Pennsylvania* Libraries, Philadelphia, Pennsylvania 19104; Warren J. *Haas*, Director.

Pennsylvania State University Library, University Park, Pennsylvania 16802; W. Carl *Jackson*, Director.

University of *Pittsburgh* Library, Pittsburgh, Pennsylvania 15213; C. Walter *Stone*, Director.

Princeton University Library, Princeton, New Jersey 08540; William S. *Dix*, Librarian.

Purdue University Library, Lafayette, Indiana 47907; John H. *Moriarty*, Director.

University of *Rochester* Libraries, Rochester, New York 14627; George R. *Parks*, Chief Adm. Officer.

Rutgers University Library, New Brunswick, New Jersey 08901; Roy L. *Kidman*, Director.

St. Louis University Library, St. Louis, Missouri 63108; Eugene P. *Kennedy*, Director.

University of *Southern California* Library, Los Angeles, California 90007; Lewis F. *Stieg*, Librarian.

Southern Illinois University Library, Carbondale, Illinois 62901; Ralph E. *McCoy*, Director.

Stanford University Libraries, Stanford, California 94305; David C. *Weber*, Acting Director.

State University of New York at Buffalo, Lockwood Library, Library Circle, Buffalo, New York 14214; Miles *Slatin*, Director.

Syracuse University Library, Syracuse, New York 13210; Warren N. *Boes*, Director.

Temple University Library, Philadelphia, Pennsylvania 19122; Arthur *Hamlin*, Director.

University of *Tennessee* Libraries, Knoxville, Tennessee 37916; William H. *Jesse*, Director.

University of *Texas* Libraries, Austin, Texas 78712; Fred *Folmer*, Librarian.

Texas A&M University Library, College Station, Texas 77843; James P. *Dyke*, Director.

University of *Toronto* Libraries, Toronto, Ontario, Canada; Robert H. *Blackburn*, Chief Librarian.

Tulane University Library, New Orleans, Louisiana 70118; John H. *Gribbin*, Director.

University of *Utah* Library, Salt Lake City, Utah 84112: Ralph D. *Thomson*, Librarian.

University of *Virginia* Libraries, Charlottesville, Virginia 22903; Ray *Frantz*, Librarian.

University of *Washington* Library, Seattle, Washington 98105; Marion A. *Milczewski*, Director.

Washington State University Library, Pullman, Washington 99163; G. Donald *Smith*, Director.

Washington University Libraries, St. Louis, Missouri 63130; Andrew J. *Eaton*, Director.

Wayne State University Library, Detroit, Michigan 48202; G. Flint *Purdy*, Librarian.

University of *Wisconsin* Libraries, Madison, Wisconsin 53706; Louis *Kaplan*, Director.

Yale University Libraries, New Haven, Connecticut 06520; Rutherford D. *Rogers*, Director.

AMERICAN SOCIETY FOR TESTING AND MATERIALS,
Philadelphia, Pa., August 22, 1969.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In reviewing the bill passed by the House of Representatives entitled the Tax Reform Act of 1969 (H.R. 13270), we note with concern the possible effect on ASTM and similar scientific and technical societies of the definition of private foundations contained in Section 509—Private Foundation Defined.

The American Society for Testing and Materials is a non-profit membership organization, founded in 1898 and incorporated in 1902 in the Commonwealth of Pennsylvania. The chartered purpose of ASTM is "the promotion of knowledge of the materials of engineering, and the standardization of specifications and the methods of testing." In its 71 years of existence it has become the world's most renowned developer of engineering standards of all kinds. Its more than 4000 standards—specifications, methods of test, recommended practices, definitions, and performance standards—cover materials and products of all kinds, including steel, concrete, building materials, water, surgical implants, plastics, paints, fire tests, textiles, methods of air sampling and analysis, and performance tests of building constructions, to name but a few areas.

ASTM standards are used by engineers, architects and scientists throughout the world for specifying and measuring the performance of materials and products. ASTM standards have gained repute and standing because of the Society's long insistence on the participation of all parties at interest, representing producers, users and the general interest, and upon the balance ASTM requires in its technical committees developing standards where the producers may not outnumber the nonproducers.

Its 16,000 members include engineers and scientists from industry, education and government at all levels, federal, state, county, and municipal. Its 107 main technical commitees combine the talents of more than 19,000 committee members from producing industry; from using interests, and from education, the professions and governments representing the public or general interests. There are members from federal government agencies on each of its 107 main technical committees. For example, 139 members of the staff of the National Bureau of Standards are filling more than 450 committee memberships in the Society.

The Society's annual gross income from membership fees accounts for about 22 per cent of its present income. About 60 per cent of its income is from the sale of its standards and other publications and the remainder is from miscellaneous sources, registration fees at meetings, advertising, investment income, etc. The 1969 annual budget of the Society is $3,400,000.

In recognition of the public-interest, non-profit nature of its activities, ASTM has been accorded exemption under Section 501(c)(3) of the Internal Revenue Code of 1954 as a "scientific and educational organization." This exemption goes back to 1937 and has been examined many times by IRS without change, the most recent examination having been conducted in 1968.

Section 509(a) defines a "private foundation" as "an organization described in Section 501(c)(3) other than . . ." Regrettably, we believe, the exceptions omit a category of organization that would be seriously hampered in continuing to provide scientific and technical service to the government in the public interest. As in the present tax law, there is no specific provision for what might be termed "scientific and technical societies." Under the revisions passed by the House of Representatives, the scientific and technical societies may be placed under all of the restrictions placed on private foundations and, among other things, would thus be prohibited from communicating with the Congress of the United States and the legislative bodies of the various states, counties, and municipalities.

As Congressman Emilio Q. Daddario, chairman of the Subcommitee on Science, Research and Development of the Committee on Science and Astronautics of the House of Representatives, so ably stated in a letter on July 15, 1969, to the Honorable Wilbur D. Mills, chairman of the Committee on Ways and Means of the House of Representatives, "The Congress and the Executive Branch are dealing with increasingly complex scientific and technical issues these days, and in order to legislate properly we must have the latest and most up-to-date science information. To inadvertently cut off a source of this information would be, I believe, most unfortunate."

While we fully support the principles of changes to control the questionable practices of some foundations, we do not believe that the scientific and technical societies which conduct their activities in the public interest should be similarly restricted and hampered in fulfilling their public responsibilities.

We would, therefore, urge the inclusion in the revised Section 170(b)(1)(B)—referred to in Section 509(a)(1), and contained in Section 201(a)(1) of Title II of H.R. 13270—of an additional item (vii) as follows:

(vii) a membership organization or a federation of membership organizations organized and operated exclusively for scientific, engineering, or technical purposes.

or, alternatively:

(vii) a membership organization or a federation of membership organizations organized and operated exclusively for scientific, engineering, or technical purposes, which normally receives more than one-third of its support in each taxable year from any combination of gifts, grants, contributions, membership fees; or gross receipts from admissions, sales of merchandise, performance of services or furnishing of facilities, in an activity which is not an unrelated trade or business (within the meaning of Section 513), not including such receipts from any person in any taxable year which are in excess of 1 per cent of the organization's support in such taxable year.

There are several salient points, as exemplified by ASTM, which differentiate the scientific and technical societies referred to from private foundations, viz:

(1) As a membership organization, membership dues accounts for about 22% of the Society's annual financial support.

(2) No single organization, donor, or member (not including government contracts or grants) accounts for as much as ½ of 1% of total annual financial support.

(3) Each member, regardless of dues paid, has one, and only one, vote on the election of directors and establishment of Society policies.

(4) The Society has never had any financial transaction, other than dues, registration fees at meetings, and sales of its publications with any of its members.

(5) Its investment portfolio is small and investment income accounts for less than 2% of its total annual financial support.

There would be no way for the Senate Finance Committee to know, because of the largely technical nature of their activities, that not only the American Society for Testing and Materials, but also such other outstanding scientific and technical societies as The American Society of Mechanical Engineers, the Institute of Electrical and Electronics Engineers, the Society of Automotive Engineers, and the United States of America Standards Institute, to name but a few, have been responsible for standards adopted by the United States Government for the proper conduct of such vital functions as safety, health, and national defense. For example, in the initial standards issued by the Federal Water Pollution Control Agency, 28 were based upon standards developed by ASTM. For another example, the field of fracture mechanics, developed by

ASTM at the request of the Department of Defense, played a major role in the success of the Polaris missile program. From their beginnings the societies have also provided useful technical advice to the Congress as well as to the Executive and Judicial Branches.

I am enclosing some random examples of ASTM standards that have been adopted as Federal or Military Specifications. Also enclosed, as another example, is a compilation of ASTM standards that are referenced in, and thus become a part of, building codes throughout the United States.

ASTM is in no sense a "private foundation." It is a non-profit, scientific and technical, membership society performing services that have been recognized by the courts as "charitable and educational" and in the public interest.

Because of its activities in the public interest, a federal court decision handed down in 1964 concluded that: "There is a strong public policy in favor of protecting ASTM's standardization work." The same order further stated: "Because of the heavy reliance of federal, state, and municipal governments upon ASTM for specifications, the Society may be regarded as an essential arm, or branch of government and its acts may be entitled to immunity from the antitrust laws accorded governmental acts."[1]

I hope the Finance Committee will concur with our request for an addition to Section 170(b)(1)(B) as contained in Section 201(a)(1) of Title II of H.R. 13270. If not, or if you desire further information or clarification, we would be pleased to appear before the committee during its hearings on the Tax Reform Act.

Sincerely yours,

T. A. MARSHALL, Jr.,
Executive Secretary.

FEDERAL WATER POLLUTION CONTROL ADMINISTRATION, ANALYTICAL QUALITY CONTROL BRANCH, OFFICIAL INTERIM METHODS FOR ANALYSES OF SURFACE WATER SAMPLES

STORET PARAMETER NO. 00940

Parameter: Chloride (mg/1).
Method: Volumetric, mercuric nitrate.
Reference:

1. Standard Methods for the Examination of Water and Wastewater, 12th ed., APHA, Inc., N.Y., 1965, 87–90.
2. ASTM Book of Standards, Part 23, 1967 D512–67, pp. 25–27.

Modifications: None.
Date: September 1968.

FEDERAL WATER POLLUTION CONTROL ADMINISTRATION, ANALYTICAL QUALITY CONTROL BRANCH, OFFICIAL INTERIM METHODS FOR ANALYSES OF SURFACE WATER SAMPLES

STORET PARAMETER NO. 00681

Parameter: Organic Carbon, Dissolved (mg/1).
Method: Dow Beckman-type organic carbon analyzer.
Reference: ASTM Book of Standards, Part 23, 1967 D2579–67T, pp. 716–719.
Modifications: None.
Date: September 1968.

FEDERAL SPECIFICATION—STEEL, CARBON: STRUCTURAL SHAPES; PLATES; AND BARS

This specification was approved by the Commissioner, Federal Supply Service, General Service Administration, for the use of all Federal agencies.

1. SCOPE

1.1 This specification covers carbon steel shapes, plates, and bars of structural quality.

[1] Memorandum Opinion and Order in *Application of ASTM*, U.S. District Court, Eastern District of Pennsylvania (Van Dusen, J.) 231 F. Supp 686 (1964).

2. APPLICABLE DOCUMENTS

2.1 The following documents, of the issue in effect on date of invitation for bids or request for proposal, form a part of this specification to the extent specified herein:

Military Standard: MIL-STD-163—Steel Mill Products, Preparation for Shipment and Storage.

(Copies of Military Standards required by suppliers in connection with specific procurement functions should be obtained from the procuring activity or as directed by the contracting officer.)

2.2 *Other publications.* The following documents form a part of this specification to the extent specified herein. Unless otherwise indicated, the issue in effect on date of invitation for bids or request for proposal shall apply.

American Society for Testing and Materials (ASTM) Standard: A36—Structural Steel.

(Application for copies should be addressed to the American Society for Testing and Materials, 1916 Race Street, Philadelphia, Pa., 19103.)

(Technical society and technical association specifications and standards are generally available for reference from libraries. They are also distributed among technical groups and using Federal agencies.)

3. REQUIREMENTS

3.1 *Description.* The structural shapes, plates, and bars shall be in accordance with ASTM A36. When specified (see 6.2), copper-bearing steel shall be furnished.

3.2 *Dimensions.* Dimensions, weights, and cross-sectional designations for the structural shapes, plates, and bars shall be as specified (see 6.2).

3.3 *Identification marking.* Marking shall be in accordance with ASTM A36.

4. QUALITY ASSURANCE PROVISIONS

4.1 *Responsibility for inspection.* Unless otherwise sepicified in the contract or purchased order, the supplier is responsible for the performance of all inspection requirements as specified herein. Except as otherwise specified in the contract or order, the supplier may use his own or any other facilities suitable for the performance of the inspection requirements specified herein, unless disapproved by the Government. The Government reserves the right to perform any of the inspections set forth in the specification where such inspections are deemed necesary to assure that supplies and services conform to prescribed requirements.

4.2 *Classification of inspection.* Inspection shall be classified as follows:

(a) Quality conformance inspection (see 4.3).
(b) Inspection of preparation for delivery (see 4.5).

4.3 *Quality conformance inspection.*

4.3.1 *Lot.* Unless otherwise specified, a lot shall consist of structural shapes, plates, or bars from the same heat or blow submitted for inspection at one time.

4.4 *Inspection procedure*

4.4.1 *Examination and tests.* Examination and tests shall be as specified in ASTM A36. Nonconformance to 3.1 shall constitute failure of the examination and tests.

4.5 *Inspection of preparation for delivery.* The preservation, packaging, packing, ad marking shall be inspected to determine compliance with MIL-STD-163.

5. PREPARATION FOR DELIVERY

5.1 *Preservation, packaging, and packing.* Preservation, packaging, and packing shall be in accordance with MIL-STD-163, level A or C as specified.

5.2 *Marking.* In addition to any special marking required in the contract or purchase order, marking for shipment shall be in accordance with MIL-STD-163.

6. NOTES

6.1 *Intended use.* The structural shapes, plates, and bars are intended for use in riveted, bolted, or welded construction of bridges and buildings and for general structural purposes.

6.2 *Ordering data.* Purchasers should select the preferred options permitted herein and include the following information in procurement documents:

(a) Title, number, and date of this specification.
(b) When copper-bearing steel is required (see 3.1).
(c) Dimensions, weight, and cross-section required (see 3.2).
(d) Lot if other than as specified (see 4.3.1).
(e) Level of preservation, packaging, and packing required (see 5.1).

MILITARY INTEREST

Custodians: Army—ME, Navy—YD, Air Force—11.
Review activities: Army—MI, MU, MR, CE; Air Force—84.
User activities: Army—AT, CE; Navy—SH, MC.
Preparing activity: Army—ME.

CIVIL AGENCIES INTEREST

AGR, GSA, JUS.

ASTM A370 67 Notice 1, November 24, 1967

ACCEPTANCE NOTICE

The following Industry Standardization Document was adopted on 24 November 1967 for use by the Department of Defense. The indicated industry group has furnished the clearances required by existing regulations. Copies of the document are stocked by DOD Single Stock Point, U.S Naval Supply Depot, Philadelphia, Pennsylvania, for issue to Military Activities only.

Title of Document: Methods and Definitions for Mechanical Testing of Steel Products.

Document Number: A370-67.

Date of Specific Issue Adopted: 1965.

Releasing Industry Group: American Society for Testing and Materials.

Method of Superseded Fed. Test Method Std. No. 151 that is being replaced: None.

Custodians: Army—MR, Navy—AS, Air Force—11.

Preparing Activity: Army—MR; 95GP—0014

ASTM B117-64 Notice 1, November 24, 1967

ACCEPTANCE NOTICE

The following Industry Standardization Document was adopted on 24 November 1967 for use by the Department of Defense. The indicated industry group has furnished the clearances required by existing regulations. Copies of the document are stocked by DOD Single Stock Point, U.S. Naval Supply Depot, Philadelphia, Pennsylvania, for issue to Military Activities only.

Title of Document: Method of Salt Spray (Fog) Testing.

Document Number: B117-64.

Date of Specific Issue Adopted: 1964.

Releasing Industry Group: American Society for Testing and Materials.

Method of Superseded Fed. Test Method Std. No. 151 that is being replaced: 811.1.

Custodians: Army—MR, Navy—AS, Air Force—11.

Preparing Activity: Army—MR; 95GP—0014.

Federal Test Method Standard—Metals; Test Methods

INDUSTRY METHODS AND DEFINITIONS ACCEPTED UNDER THIS STANDARD[1]

American Society for Testing and Materials (ASTM):

A90: Methods of Test for Weight of Coating on Zinc-Coated (Galvanized) Iron or Steel Articles.

[1] Copies of industry methods are not contained in this standard (see section 6, General Section).

A219: Methods of Test for Local Thickness of Electrodeposited Coatings.

A225: Methods of End-Quench Test for Hardenability of Steel.

A309: Methods of Test for Weight and Composition of Coating on Long Terne Sheets by the Triple Spot Test.

A317: Macroetch Testing and Inspection of Steel Forgings.

A370: Methods and Definitions for Mechanical Testing of Steel Products.

A393: Recommended Practice for Conducting Acidified Copper Test for Intergranular Attack in Austenitic Stainless Steel.

B117: Method of Salt Spray (Fog) Testing.

B151: Method of Nitrate Test for Copper and Copper Alloys.

B193: Method of Test for Resistivity of Electrical Conductor Materials.

E6: Definitions of Terms Relating to Methods of Mechanical Testing.

E7: Definitions of Term Relating to Metallography.

E8: Methods of Tension Testing of Metallic Materials.

E10: Method of Test for Brinell Hardness of Metallic Materials.

E18: Methods of Test for Rockwell Hardness and Rockwell Superficial Hardness of Metallic Materials.

E23: Methods for Notched Bar Impact Testing of Metallic Materials.

E45: Recommended Practice for Determining the Inclusion Content of Steel.

E52: Industrial Radiographic Terminology for use in Radiographic Inspection of Castings and Weldments.

E92: Method of Test for Vickers Hardness of Metallic Materials.

E94: Recommended Practice for Radiographic Testing.

E109: Method for Dry Powder Magnetic Particle Inspection.

E112: Methods for Estimating the Average Grain Size of Metals.

E113: Recommended Practice for Ultrasonic Testing by the Resonance Method.

E114: Recommended Practice for Ultrasonic Testing by the Reflection Method, using Pulsed Longitudinal Waves Induced by Direct Contact.

E138: Method for Wet Magnetic Particle Inspection.

E140: Standard Hardness Conversion Tables for Metals (Relationship Between Brinell Hardness, Vickers Hardness, Rockwell Hardness, Rockwell superficial Hardness and Knoop Hardness).

E142: Method of Controlling Quality of Radiographic Testing.

164: Method of Ultrasonic Contact Inspection of Weldments.

E165: Methods of Liquid Penetrant Inspection.

E175: Definitions of Terms Relating to Microscopy.

E268: Definitions of Terms Relating to Electromagnetic Testing.

E269: Definitions of Terms Relating to Magnetic Particle Inspection.

E270: Definitions of Terms Relating to Liquid Penetrant Inspection.

E273: Methods for Ultrasonic Inspection for Longitudinal and Spiral Welds of Welded Pipe and Tubing.

E290: Semi-Guided Bend Test for Ductility of Metallic Materials.

Aerospace Materials Specifications (AMS):

2300A: Premium Aircraft Quality Steel Cleanliness—Magnetic Particle Inspection Procedure.

2301C: Aircraft Quality Steel Cleanliness—Magnetic Particle Inspection Procedure.

American Welding Society (AWS): C3.2: Standard Method for Evaluating the Strength of Brazed Joints.

FEDERAL TEST METHOD STANDARD—METALS TEST METHODS

Title	Method number	
	Federal test method standard No. 151b	Federal test method standard No. 151a
Definitions of terms:		
Electromagnetic testing	ASTM E 268	
Liquid penetrant inspection	ASTM E 270	
Magnetic particle inspection	ASTM E 269	
Mechanical testing	ASTM E 6	
Metallography	ASTM E 7	
Microscopy	ASTM E 175	
Radiography	ASTM E 52	

FEDERAL TEST METHOD STANDARD—METALS TEST METHODS—Continued

Title	Method number Federal test method standard No. 151b	 Federal test method standard No. 151a
Composition:		
Chemical analysis	111.2	111.1
Spectrochemical analysis	112.2	112.1
Mechanical properties:		
Tension test	ASTM E 8	211.1
Charpy impact test	ASTM E 23	221.1
Cold-bending test	ASTM E 290	231.1
Hardness conversion table for steel	ASTM E 140	241.2
Brinell hardness test	ASTM E 10	242.1
Rockwell hardness test	ASTM E 18	243.1
Diamond pyramid hardness test	ASTM E 92	244.1
Strength of Brazed joints	AWS C3.2	
Method and definitions for mechanical testing of steel products	ASTM A 370	
Metallographic		
Austenite grain size in steel	ASTM E 112	311.1
Grain size in wrought copper	ASTM E 112	312
Macro-etch test for steel	ASTM A 317	321.1
Leak testing:		
Leak testing (helium mass spectrometer)	441.1	441
Leak testing (pressurized gas)	442.1	442
Leak testing (vacuum)	443.1	443
Coatings:		
Weight and composition of coating on long terne sheets	ASTM A 309	511.1
Weight of zinc coating	ASTM A 90	512.1
Weight of coating on hot dip tinplate and electrolytic tinplate	513.1	513
Weight and composition of coating on short terne plate (for manufacturing purposes and for roofing).	514.1	514
Electronic test for local coating thickness	520.1	520
Microscopic test for local coating thickness	ASTM A 219	521.1
Magnetic test for local coating thickness	ASTM A 219	522.1
Chemical dropping test for local coating thickness	ASTM A 219	523
Electrical: Resistivity test of electrical conductor material	ASTM B 193	611.1
Heat treat response: End-quench hardenability test	ASTM A 255	711.1
Corrosion:		
Salt spray test	ASTM B 117	811.1
Synthetic sea water spray test	812.1	812
Intergranular-corrosion test for corrosion-resistant austenitic steels	ASTM A 393	821.1

FEDERAL TEST METHOD STANDARD NO. 175A—ALPHABETICAL INDEX OF TEST METHODS OF THIS STANDARD WITH SUPERSEDED METHODS

Title	Superseded methods	Replacement methods Pt. I. Federal	 Pt. II. ASTM
Adhesives for brake lining and other friction materials			D1205–61
Amylaceous matter in adhesives			D1488–60
Applied weight per unit area of dried adhesive solids	3011		D898–51(1965)
Applied weight per unit area of liquid adhesive	3012		S899–51(1965)
Ash content of adhesives		4032	
Blocking point of potentially adhesive layers	2041		D1146–53(1965)
Brushing properties of adhesives		3021	
Cleavage strength of metal-to-metal adhesives	1071–T		D1062–51(1965)
Cleavage strength of metal-to-metal adhesive bonds			D1062–51(1965)
Copper corrosion by adhesives	4031	4031.1	
Climbing drum peel test for adhesives			D1781–62
Conducting creep tests of metal-to-metal adhesives, recommended practice for.			D1780–62
Consistency of adhesives			D1084–63
Delamination	2021	2021.1	
Density of adhesives in fluid form			D1875–61T
Determining the effect of moisture and temperature on adhesive bonds.	2052–T		D1151–61
Effect of moisture and temperature on adhesive bonds			D1151–61
Fatigue strength of adhesives	1061	1061.1	
Filler content of phenol, resorcinol, and melamine adhesives			D1579–60
Flexibility of adhesives		1081	
Grit or lumps (or undissolved matter) in adhesives		4041	
Hydrogen ion concentration of dry adhesive films			D1583–61
Impact strength of adhesives	1051		D950–54(1961)
Impact strength of adhesive bonds			D950–54(1961)
Impact value of adhesives	1051.1T		D950–54(1961)
Nonvolatile content of aqueous adhesives			

FEDERAL TEST METHOD STANDARD NO. 175A—ALPHABETICAL INDEX OF TEST METHODS OF THIS STANDARD WITH SUPERSEDED METHODS—Continued

Title	Superseded methods	Replacement methods	
		Pt I. Federal	Pt II. ASTM
Odor test for adhesives		4051	D903-49(1965)
Peel or striping strength of adhesive bonds			D903-49(1965)
Peel or stripping strength of adhesives	1041.1		D1781-62
Peel strength of adhesives (climbing drum apparatus)	1042-T		D1781 62
Peel resistance of adhesives (T-peel test)			D1876 61T
pH of adhesives and bonded assemblies	4011		D1583 61
Resistance of adhesive bonds to chemical reagents	2011.1		D896 66
Resistance of adhesive bonds to water (wet strength)	2031		D1151-61
	2031.1-T		D1151 65
Resistance of adhesives for wood to cyclic laboratory aging conditions	2051.T		
Resistance of adhesives to cyclic laboratory aging conditions			D1183 61T
Rubber cements			D816 55(1965)
Shear-strength properties of adhesives by compression loading	1031		D905-49(1965)
Shear-strength properties of adhesives by flexural loading	1021		D1184-55(1965)
Shear-strength properties of adhesives by tension loading	1033.1-T		D1002-64
Shear-strength properties of adhesives determired with single-lap construction by tension loading	1033		D1002-64
Shear-strength properties of adhesives in plywood-type construction by tension loading	1032		D906-64
	1032.1T		D905-64
Strength of adhesive bonds on flexural loading			D1184-55(1965)
Strength properties of adhesive bonds in shear by compression loading			D905-49(1965)
Strength properties of adhesives in plywood-type construction in shear by tension loading			D906 64
Strength properties of adhesives in shear by tension loading (metal to metal)			D1002 64
Tensile properties of adhesives	1011.1		D897-49(1965)
Tensile properties of adhesive bonds			D897-49(1965)
Tensile properties of adhesives for rubberlike materials	1012		D816-55(1965)
Total solids content	4021	Procedure A use	D553 42(1965)
		Procedure B use	D1489-60
Viscosity and total solids content of rubber cements			D553-42(1965)

NUMERICAL INDEX OF TEST METHODS OF THIS STANDARD WITH SUPERSEDED METHODS

Part II. ASTM Methods

Title	ASTM method	Superseded Federal test method standard No. 175 method
Viscosity and total solids content of rubber cements	D553-42(1965)	
Total solids content (procedure A)	D553-42(1965)	4021
Tensile proparties of adhesives for rubberlike materials	D816-55(1965)	1012
Rubber cements	D816-55(1965)	
Resistance of adhesive bonds to chemical reagents	D896-66	2011.1
Tensile properties of adhesives	D897-49(1965)	1011.1
Tensile properties of adhesive bonds	D897-49(1965)	
Applied weight per unit area of dried adhesive solids	D898-51(1965)	3011
Applied weight per unit area of liquid adhesive	D899-51(1965)	3012
Peel or stripping strength of adhesive bonds	D903-49(1965)	
Peel or stripping strength of adhesives	D903-49(1965)	1041.1
Shear strength properties of adhesives by compression loading	D905-49 (1965)	1031
Strength properties of adhesive bonds in shear by compression loading	D905-49 (1965)	
Shear strength properties of adhesives in plywood-type construction by tension loading.	D906-64	1032
Strength proparties of adhesives in plywood type construction in shear by tension loading	D906-64 D906-64	1032.1T
Impact strength of adhesives	D950-54 (1961)	1051
Impact strength of adhesive bonds	D950-54 (1961)	
Impact value of adhesives	D950-54 (1961)	1051.1T
Shear strength properties of adhesives by tension loading	D1002-64	1033.1-T
Shear strength properties of adhesives determined with single-lap-construction by tension loading	D1002-64	1033
Strength properties of adhesives in shear by tension loading (metal-to-metal)	D1002-64	
Cleavage strength of metal-to-metal adhesives	D1062-51 (1965)	1061-T
Cleavage strength of metal-to-metal adhesive bonds	D1062-51 (1965)	
Consistency of adhesives	D1084 63	
Blocking point of potentially adhasiva layers	D1145-53 (1965)	2041
Determining the effect of moisture and temparature on adhesive bonds	D1151-61	2052-1
Effect of moisture and temparature on adhasiva bonds	D1151-61	
Resistance of adhesive bonds to water (wet strength)	D1151-61	2031
Resistance of adhesives for wood to cyclic laboratory aging conditions	D1183-61T	2051-T
Resistance of adhesives to cyclic laboratory aging conditions	D1183-61T	

NUMERICAL INDEX OF TEST METHODS OF THIS STANDARD WITH SUPERSEDED METHODS—Continued

Part II. ASTM Methods

Title	ASTM method	Superseded Federal test method standard No. 175 method
Shear strength properties of adhesives by flexural loading	D1184-55 (1965)	1021
Strength of adhesive bonds on flexural loading	D1184-55 (1965)	
Adhesives for brake lining and other friction materials	D1205-61	
Amylaceous matter in adhesives	D1488-60	
Nonvolatile content of aqueous adhesives	D1489-60	
Total solid content (procedure B)	D1489-60	4021
Filler content of phenol, resorcinol, and melamine adhesives	D1579-60	
pH of adhesives and bonded assemblies	D1583-61	4011
Hydrogen ion concentration of dry adhesive films	D1583-61	
Conduction creep tests of metal-to-metal adhesives, recommended practice for	D1780-62	
Climbing drum peel test for adhesives	D1781-62	
Peel strength of adhesives (climbing drum apparatus)	D1781-62	1042-T
Density of adhesives in fluid form	D1875-61T	
Peel resistance of adhesives (T-peel test)	D1876-61T	

SECTION 3.—NUMERICAL INDEX OF TEST METHODS

Method No.	Title of method	ASTM No.[1]	AASHO No.[1]
101.01	Sampling stone, slag, gravel, etc	D 75-48	T 2-46
101.11	Sampling bituminous materials	D 140-49T	T 40-49
101.21	Sampling joint filler, expansion, preformed	D 544-49	
101.3	Sampling paving brick	C 7-42	T 31-42
101.42	Sampling joint sealer, hot- or cold-application type		
201.0	Unit weight of aggregate	C 29-42	T 19-45
202.01	Sieve analysis of fine and coarse aggregates	C 136-46	T 27-46
202.11	Amount of material finer than No. 200 sieve in aggregates	C 117-49	T 11-43
203.01	Soundness of aggregates	C 88-46T	T 104-46
204.0	Fineness modulus of aggregate		
205.0	Percentage of clay lumps in aggregates	C 142-39	T 112-42
206.01	Measuring mortar-making properties of fine aggregate	C 87-47	T 71-48
206.1	Potential alkali reactivity of cement-aggregate combinations	C 227-51T	
207.0	Toughness of rock	D 3-18	T 5-35
208.0	Abrasion test by rock by use of the Deval machine	D 2-33	
208.11	Abrasion of coarse aggregate by use of the Los Angeles machine	C 131-49T	T 96-49
209.0	Specific gravity and absorption of coarse aggregate	C 127-42	T 85-45
209.1	Specific gravity and absorption of fine aggregate	C 128-42	T 84-45
209.2	Specific gravity of bituminous materials		T 43-35
210.0	Determination of bitumen	D 4-49T	
211.0	Bitumen soluble in carbon tetrachloride	D 165-42	T 45-45
212.C	Bitumen in soluble in paraffin naphtha		T 46 35
213.0	Test for specific viscosity		T 54-35
213.1	Viscosity by means of the Saybolt viscosimeter	D 88-44	T 72-46
214.01	Penetration of bituminous materials	D 5-49	T 49-49
215.0	Ductility of bituminous materials	D 113-44	T 51-44
216.0	Softening point of bituminous materials (ring-and-ball method)	D 36-26	T 53-42
217.01	Flash and fire points by means of open cup	D 92-46	T 48-46
217.1	Flash point with Tagliabue open cup		T 79-42
218.0	Distillation of tar products suitable for road treatment	D 20-30	T 52-42
218.11	Distillation of gasoline, naphtha, kerosene, and similar petroleum products	D 86-46	T 115-46
218.21	Distillation of cutback asphaltic products	D 402-43	T 78-49
219.0	Loss of heating of oil and asphaltic compounds	D 6-39T	T 47-42
220.01	Water in petroleum products and other bituminous materials	D 95-46	T 55-46
221.01	Float test for bituminous materials	D 139-49	T 50-49
222.01	Testing emulsified asphalts	D 244-49	T 59-49
223.01	Preformed expansion joint fillers for concrete	D 545-49	
223.12	Sealing compound, hot-poured and cold-application types, for joints in concrete		
224.0	Rattler test for paving brick	C 7-42	T 31-42
225.0	Sulfonation index of road tar	D 872-48	T 108-44
226.0	Inorganic matter or ash		T 111-42
227.0	Settlement ratio of mineral matter in bituminous filler		T 109-42
228.0	Soft pieces in coarse aggregate	C 235-49T	
229.0	Compressive strength of molded concrete cylinders	C 39-49	T 22-49
230.0	Flexural strength of concrete (using simple beam with third-point loading)	C 78-49	T 97-49
231.0	Making and curing concrete compression and flexure test specimens in the laboratory	C 192-49	T 126-49
232.0	Slump test for consistency of portland-cement concrete	C 143-39	T 119-42
233.0	Weight per cubic foot, yield, and air content (gravimetric) of concrete	C 138-44	T 121-45

[1] In those cases in which the method covered herein essentially corresponds in technical details with a corresponding method of the American Society for Testing Materials or the American Association of State Highway Officials, the designation given by the society or association is also included.

SECTION 3.—NUMERICAL INDEX OF TEST METHODS

Method No.	Title of method	A.S.T.M. No.[1]	A A S H O. No.[1]
234.0	Resistance of concrete specimens to slow freezing in air and thawing in water.	C 310-53T	
234.1	Resistance of concrete specimens to rapid freezing and thawing in water	C 290-52T	
234.2	Resistance of concrete specimens to rapid freezing in air and thawing in water	C 291-52T	
234.3	Resistance of concrete specimens to slow freezing and thawing in water or brine.	C 292-52T	
235.0	Organic impurities in sand for concrete	C 40 48	
236.0	Lightweight pieces in aggregate	C 123-53T	
301.0	Sieves for testing purposes (specifications for)	E 11-39	M 92-42
302.0	Terms relating to specific gravity (definitions of)	E 12-27	M 132-42

[1] In those cases in which the method covered herein essentially corresponds in technical details with a corresponding method of the American Society for Testing Materials or the American Association of State Highway Officials, the designation given by the society or association is also included.

ALPHABETICAL INDEX OF TEST METHODS

Method title	Method No.	Substitute method number	
		Federal standard	ASTM
Acid and base No. (color-indicator titration)	5105.5		D 974-64
Acid and base No. (potentiometric titration)	5106.4		D 664-58
Active sulfur in cutting fluids	3180		D 1662-59T
Adhesion of dry solid film lubricants	3310		
Aniline point and mixed aniline point	3601.7		D 611-64
Aniline point change (hydrocarbon oil)	3602.1		
Apparent viscosity of lubricating greases	306.4		D 1092-62
Aromatic hydrocarbons in mixtures with naphthenes and paraffins (silica gel absorption).	3702.2		D 936-55
Ash content	5421.2		D 482-63
Bearing compatibility and stability of turbine oils	3452		
Bromine number of petroleum distillates by electrometric titration	1050		D 1159 61
Burning quality of kerosene	2106.5		D 187 49
Carbon residue (conradson)	5001.10		D 189-64
Carbon residue (ramsbottom)	5002.7		D 524 64
Carbonizable substances in paraffin wax	5011.1		D 612-45
Carbonizable substances in white mineral oil (liquid petrolatum)	5012		D 565-45
Channeling characteristics	3456		
Chemical activity toward copper of universal gear lubricants	5316		D 130 56
Chlorine in lubricating oils (bomb)	5651.4		D 808 63
Cloud and pour point	201.8		D 97-57
Cloud intensity at low temperature	202		
Coking tendency of oil	3462		
Color of gasoline	103.5		
Color of lubricating oil and petroleum	102.7		D 1500 64
Color of motor gasoline (military)	104	103	
Color of refined petroleum oil (saybolt chromometer)	101.7		D 156 64
Compatibility characteristics of universal gear lubricants	3430		
Compatibility of turbine lubricating oils	3403		
Contamination in piston engine oils	3006.1		
Conversion of kinematic viscosity to saybolt universal viscosity or to saybolt fural viscosity.	9101.3		D 2161-63T
Copper corrosion by petroleum products	5725.2		D 130-56
Copper stain test for high-sulfur oils	5324		
Corrosion (copper strip, 212° F.)	5303	5325.2	
Corrosion (fog cabinet)	5312.1		
Corrosion resistance of dry solid film lubricants	3814		
Corrosion test at 450° F	5305		
Corrosive sulfur compounds and free sulfur	5302	5325.2	
Corrosive sulfur in electrical insulating oils	5328.2		D 1275-64
Corrosiveness and oxidation stability of light oils (metal strip)	5308.5		
Corrosiveness of greases (copper strip, 212° F.)	5309.3		
Corrosiveness of greases or semisolid products (room temperature)	5304.3		
Corrosiveness of greases (oxygen bomb copper strip)	5314.1		D 1261-55
Corrosiveness of soluble cutting oils	5306.3		

SEPTEMBER 4, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In response to your request that organizations interested in H.R. 13270 submit written statements indicating their views, there is respectfully submitted the statement of The John and Mary Franklin Foundation, Inc., as follows:

Your committee is to be commended for its reasoned inquiry into the activities of foundations and their potential for abuse of their tax exempt status. Surely every one of us would support action to assure that foundations always serve the best interests of the community at large in accordance with the principles under which they were originally granted government sanction. However, it is our opinion that certain of the H.R. 13270 proposals will place undue restrictions on the activities of bona fide foundations whose exemplary performance has contributed much toward development of education and scientific research in their respective local communities. In particular, acceptance of the H.R. 13270 proposal regarding foundation ownership of unrelated businesses may have substantial deleterious effects. We refer specifically to ownership of a business that has been donated to the foundation. May we respectfully suggest that you give especial consideration to the following points in this regard:

(1) The public interest would suffer if a forced sale of a small wholly owned business were required. The lower market value resulting from a forced sale would benefit private individuals and public philanthropy would be the loser.

(2) The acquisition of a foundation owned business by competitive firms would reduce competition, and thus intensify and promote some of the alleged evils the proposal seeks to correct.

(3) Entrepreneurial incentives would suffer if an entrepreneur could not visualize that the business that he struggled to develop could be perpetuated and the fruits of his labor accrue to the benefit of his fellow citizens. To discourage such commendable gifts would be a tragic public loss.

The recent Treasury Department Report on private foundations acknowledges, quote:

"It is quite true that, occasionally, beneficial consequences have stemmed from the business activities of a particular foundation. The Internal Revenue Service has, for example, discovered several instances in which foundation businesses have been profitable, their proceeds have been applied to charitable operations without undue delay, and private benefits for the foundations donors or controllers have been avoided. In these situations, it may well be true that charity has been advanced, and no one else harmed, by the ability of the foundations to carry on business endeavors."

Such is the case with our foundation.

Our principal asset is a wholly owned corporation known as The Audichron Company, which was acquired by bequest. The Audichron Company is a service oriented company providing time and weather announcement equipment to the telephone industry such as 844-2525 in Washington, D.C. This corporation pays regular corporate income tax and all other state and local taxes that any other similar corporation pays. It provides approximately 7–8% yield, and the Foundation in turn over the years has paid out more than 100% of its income annually. It has always rigidly adhered to existing federal and state laws and to the strict Code of Ethics of the National Association of Foundations. This Foundation has never delved into politics, engaged in so-called boot strap operations, nor has any trustee received any remuneration for his service. It has, however, provided major grants to local educational institutions including University of Georgia, Georgia Tech, Georgia State College, Emory University, Auburn University, Oglethorpe College, Presbyterian College, Andrew College, Mercer University, Shorter College, Reinhart College, LaGrange College, and Young-Harris College. These colleges, particularly the private colleges and universities, need this type of support for their very existence. There is no question that the cause of private philanthropy will suffer if this Foundation is required to make a forced sale of its principal asset.

In summary: We respectfully submit that the H.R. 13270 proposal that would require the sale of a wholly owned business acquired by bequest would produce far more harmful side-effects. Adherence to the Code of Ethics of the National Association of Foundations, rigid compliance with existing federal laws and regulations regarding proper use of funds, and if necessary, even limited taxation of foundation income would seem to be a more equitable approach to the question.

Therefore, we respectfully ask that you not penalize our Foundation, as well as many other will intentioned foundations, for the misdeeds of a few. Thank you for your kind consideration.

Sincerely,

W. KELLY MOSLEY,
Chairman of the Board of Trustees,
The John & Mary Franklin Foundation, Inc., Atlanta, Ga.

STATEMENT OF THE NATIONAL BUREAU OF ECONOMIC RESEARCH, INC., SUBMITTED BY JOHN R. MEYER, PRESIDENT

SUMMARY

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 by 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

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 Natio'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;

Satistical series on consumer credit, by the Federal Reserve System; and

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 subscribers 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 Business 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 continuity 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.

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 Foundations 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 these 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 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 of this income ineligible for the support needed to qualify for 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.

Statement of Dr. Lewis I. Maddocks, on Behalf of the Council for Christian Social Action, United Church of Christ

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 involving 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.

STATEMENT

In our statement on tax reform of last February, and the General Synod pronouncement of July 1, the following paragraph was included:

"The 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.

THE NEW YORK INSTITUTE FOR HUMAN DEVELOPMENT,
New York, N.Y., October 6, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: The New York Institute for Human Development, Inc., views with grave misgivings the catchall curbs H.R. 13270 would impose upon legitimate and sound foundations and private health and welfare agencies with a tradition of sharing social responsibilities with government.

If endorsed by the Senate Finance Committee in its present form and subsequently passed without amendment by the Senate, the complex omnibus Tax Reform Act of 1969 would cripple rather than cure practices of voluntary giving and private social service spending in the United States.

This bill would also cripple the aspirations and potential contributions of hundreds of thousands of urban Americans who are directly and indirectly dependent upon the aid of private grants and technical assistance for the development of grassroots self-help programs.

These people, in the process of regenerating their lives and their communities, are the concern of the New York Institute for Human Development.

The New York Institute for Human Development is a non-profit and non-sectarian community development organization. It provides technical and professional services, organizational and administrative expertise, to local groups attempting to eradicate poverty, crime and unemployment in their communities through neighborhood run and focused service and action centers. The efforts of the Institute for Human Development extend through the ten metropolitan and upstate counties which comprise the New York Archdiocese.

The community services and action centers, often the sole local source of information, referral, counseling and self-help programs, frequently depend for much of their seed funding on private foundation and institutional sources.

At this period in our history no region—be it Newark, Cleveland, Detroit, Chicago, Watts, Hartford or New York City—is totally free from its share of unrest. The efforts of the poor to direct their futures and those of their neighbors towards productive citizenship must not be aborted by lack of funds and supportative services.

This is in effect what a number of provisions of H.R. 13270 would achieve, aside from increasing the burdens upon the Federal government.

We call particular attention to the 7½ percent tax on foundation net investment income which would serve to raise foundation taxes generally above those of corporate businesses and to decrease their available grants for health and welfare and urban improvement. We also cite those discouragements to voluntary philanthropy by private persons who are seeking not loopholes but effective and constructive means of responding to human needs.

It is for these reasons and for the pressing demands of these times that we of the New York Institute for Human Development urge you to dismiss the Tax Reform Act of 1969 in its present 368-page encyclopedical form and evaluate the multiple provisions of the bill as separate and self-contained entities.

Sincerely,

WILLIAM F. DEMARLE,
Executive Director.

WASHINGTON INTERNATIONAL ARTS LETTER,
Washington, D.C., September 11, 1969.

Hon. RUSSELL LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: You may wish to enter the enclosed article from the current issue of the Washington International Arts Letter into your record of hearings about the tax bill now under consideration.

Sincerely,

DANIEL MILLSAPS.

[From the Washington International Arts Letter]

TAX CHANGES AND CONTEMPORARY ART

The House of Representatives favored disallowance of the appreciated part of the value of works of art and other personal property given tax-exempt institutions such as museums, from deductibility against income for Federal tax purposes. This means that gifts in these categories would only be deductible at the price paid for them or at the rate of an evaluation at the date of their acquisition by the donor. The change, being vigorourly taught by museums, has several ramifications, one of which is that it could possibly help put money into the pockets of contemporary artists!

Under such a disallowance museums would probably not find it so easy to come by art of the past which has appreciated to any great degree because private owners generally prefer to keep it in their possession and possibly sell it on the open market rather than give it away at the price they paid with the resulting smaller deduction. (Nobody can foretell if the change would affect the continued meteoric rise in art prices in general but it is doubted that it would because the deductibility possibilities are not major factors in art buying.)

Thus, the museums will be looking around for other material for their possession and there are now many new museums and community arts centers in the U.S. which badly need material. Since appreciated value of stocks will still be deductible under the House-passed tax-law changes, these museums will probably have more gifts of this nature as compared with gifts of art itself and it is entirely possible that they will find it necessary to spend their purchase funds more for contemporary art. It remains to be seen if this will indeed be the effect but it is highly likely that it would be. There is a shortage now of available old master art and a trend toward purchase of contemporary art by many museums and centers, helped along somewhat by small grants from the Federal government (AE) in some cases and in other cases done at the initiative of the institutions or State Councils.

One of the reasons for the change in the tax law in this matter is the number of people who have reportedly tried to take unfair advantage of the old provision which allowed deduction of the full appreciated value. The true number of these is, however, relatively small and if indeed the proposed change is finalized and does not work in favor of contemporary artists it should be reversed. Still it might be worth the try. Since artists in America get no direct benefit from the sale of works which have appreciated in value after they have left their hands the change would not affect their pocketbooks unless the change would have an effect of depressing the whole art market. This, as stated above, is unlikely.

Museums may be being somewhat shortsighted in their rush to oppose the disallowance. They have been saying particularly strongly all year that what they need most is money—for salaries, facilities, and numbers of other things, presumably including acquisitions. If the chances of their receiving unwanted gifts (and having to accept them for political reasons) were cut down, and the encouragements for more stock and dollar gifts which are included in the House version of tax changes go through, then they would be in a better position to acquire what they, as experts that they claim to be, think best for their collections.

The change in the tax law to require foundations to spend their earned income in grants the year after they are received is a great boon to these in the arts if indeed the foundations continue to go into the arts and humanities as has begun to happen. But the 7½% tax on the earned income of foundations which is in the law as passed by the House would decrease the overall funds available for these grants. On the basis of the individual grants restrictions passed by the

House, IRS would have to approve categories of grants and if this part becomes law there is little doubt that grants in the arts-humanities would be placed in the approved category. In effect, if this becomes the case, it could be a boon rather than a disadvantage, for such grants would then have approved government status. Final tax changes are not expected to come about before the end of October at the earliest and many provisions will not take effect until future years, so that there is still time to take advantage of the present rules.

STATEMENT 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 directed 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 not want to call your attention to an imporatnt peculiarity of community foundations as public foundations: Community foundations do file information returns under the Internal Revenue Code (§ 6033). Community foundation 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 7½% 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 alterative 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 more constructive and sound legislation.

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

Challenge and Response, April 1969

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 American Building Constitutionally, which was then doing all the paper work to set up foundations for a fee of $10,500 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 that 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.

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 becomes 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 it. 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 stock 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 limitation 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 rstricted 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 GFAC 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 firs 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 26 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, 1969) 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?

DEFINITION

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 . ewspapers 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.

STATEMENT OF THE JOHN HUNTINGTON ART AND POLYTECHNIC TRUST, SUBMITTED BY A. DEAN PERRY, CHAIRMAN, BOARD OF TRUSTEES

To point out the effect of proposed Internal Revenue Code Section 4942 (HR-13270) the Trustees of The John Huntington Art and Polytechnic Trust have applied the provisions assessing a tax on the "Failure to Distribute Income" to the income and disbursements of this Trust for 1968 as shown in audited Financial Statements prepared by Ernst and Ernst. (Copies of audits are mailed annually to the Ohio Attorney General and all Treasury forms 990--As have been filed.)

Market value of trust on December 31, 1968	$35,460,311
Gross income from dividends, interest and rents	1,382,463
Expenses	45,417
Net income	$1,337,046
Distributions:	
The Cleveland Museum of Art	825,000
The John Huntington Fund for Education	378,500
The John Huntington Benevolent Trust	50,000
Total distributions	1,253,500

The distribution to The Fund for Education and to The Benevolent Trust are not "qualifying distributions" as they are private foundations which are not "operating foundations" as defined in the Bill.

The proposed basis for computing "undistributed" income is 5% of $35,460,311, the market value of the Trust, or $1,773,016.

The amount subject to the tax on "Failure to Distribute Income" is $948,016. ($1,773,016 minus $825,000). This is subject to an "initial tax" of 15%, or $142,202, plus an "additional tax" of 100% of any amount remaining undistributed "at the close of the correction period."

The result is that the Trust must elect either to pay an additional tax of $948,016 or to distribute this amount to The Cleveland Museum of Art as the only qualifying distributee under Mr. Huntington's Will, at least without further Court proceedings.

But this would require distributions from principal for this year, contrary to the provisions of the Will, in the amount of $864,500, computed as follows:

Tax under section 4942 or additional distribution	$948,000
Distributions to charity	1,253,500
Total distributions and/or tax	2,201,500
Less net income	1,337,000
Deficit or annual principal distribution	$864,500

The John Huntington Art and Polytechnic Trust was created under the Will of John Huntington, who died January 10, 1893, a resident of Cleveland, Ohio. The principal beneficiaries have been The Cleveland Museum of Art, and for many years, a free evening school known as The John Huntington Polytechnic Institute. In 1953 the Trustees concluded that conducting such a school was an uneconomical duplication of other evening courses being offered in Cleveland by other schools, colleges or universities. The Trustees obtained from the Cuyahoga County Common Pleas Court authorization to discontinue the Institute and to substitute a program of making grants for scholarships and other grants for educational purposes. The Court also authorized the Trustees to change the name of the corporation, which they had formed to operate the Institute, to The John Huntington Fund for Education. During 1968, the Fund for Education distributed to 90 colleges and universities approximately $245,000 to apply on the tuition charges of 473 students and made supplemental grants totaling $28,500 to Case Western Reserve University, John Carroll University and Baldwin-Wallace College.

Mr. Huntington established The John Huntington Benevolent Trust by an irrevocable Trust Agreement dated March 8, 1889. The beneficiaries of this Trust are hospitals, homes for aged and other active charities. Mr. Huntington's Will authorized the Trustees to make payments to The Benevolent Trust in such amounts as they deemed appropriate. For a number of years the Trustees of The John Huntington Art and Polytechnic Trust have distributed $50,000 annually to The Benevolent Trust.

Clearly Mr. Huntington had a well thought out plan for distribution of part of his wealth for charitable purposes. This plan has been carried out faithfully to this time. The effect of the proposed Section 4942 would be to completely disrupt his plan. It would probably compel, at some future time, a final distribution of The John Huntington Art and Polytechnic Trust, which would be a violation of the terms of his Will.

In singling out this one outstanding injustice, it is not our intention to imply that the other provisions of the Bill relating to private foundations are approved by the Trustees of The John Huntington Art and Polytechnic Trust. It is the conviction of this Board that properly handled as we claim this Trust has been handled, the private foundations with their flexibility enabling them to meet changing conditions, are of great value to our country and fairly deserve the aid given them by exemption from all taxation.

Statement of the United States of America Standards Institute Submitted by Donald L. Peyton, Managing Director

Information Concerning Request by USA Standards Institute and Other Technical and Scientific Societies for a Change in the Internal Revenue Law

I. Requested Amendment

It is requested that an additional sub-section (5) be added to the proposed Section 509(a). This sub-section would exclude the following types of groups from the definition of "a foundation":

"A membership organization or a federation of membership organizations organized and operated primarily for scientific, engineering or technical purposes."

II. The Reason for the Request

This is requested so that there will be no question that the technical, scientific society group will not be covered by the restrictions on government activity and the liability for excise taxes which apply to foundations generally.

III. Types of Organizations Involved

The types of organizations involved are those which are normally classified as scientific or technical societies. These groups have a great deal of information available in the scientific and technical areas which are needed by both the Executive and Legislative Branches of the Government. Restrictions on these groups would hamper the national economy and our national defense system.

UNITED STATES OF AMERICA STANDARDS INSTITUTE,
New York, N.Y., September 4, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: We are writing on behalf of the technical and scientific societies listed in the attachment to this letter, all of which have been granted exemption from Federal Income Tax under Section 501(c)(3) of the Internal Revenue Code. We are seriously concerned by the apparent effect of H.R. 13270 to classify them as "private foundations" under that legislation. We believe that this result was completely inadvertent and unintended by the drafters of the Bill. If not corrected, this classification could seriously injure the public interest by denying the Congress and various Government Agencies access to the scientific and technical information and expertise which these organizations develop in the conduct of the tax-exempt activities.

We are taking the liberty of attaching a letter dated July 15, 1969 written by the Honorable Emilio Q. Daddario, Chairman of the Subcommittee on Science, Research and Development of the House Committee on Science and Astronautics. Congressman Daddario has done an excellent job in outlining the problem presented and we will be glad to fill you in on the details.

Under present law, the activities of a Section 501(c)(3) organization in "carrying on propaganda, or otherwise attempting to influence legislation" will not adversely affect its tax-exempt status provided that such activities do not constitute a "substantial part" of its total activities.

Under the provisions of H.R. 13270, as passed by the House, the same test would continue to apply to Section 501(c)(3) organizations except for those to be classified as "private foundations". "Private foundations" would be absolutely barred from engaging in any legislative activity. Under new Section 4945 of the Code, an excise tax would be imposed upon the organization and a separate excise tax on any officer or director or other responsible employee of the organization with respect to any expenditures incurred by the organization "to carry out propaganda, or otherwise influence legislation". Such activities would include "any attempt to influence legislation through private communication with any member or employee of a legislative body, or with any other person who may participate in the formulation of the legislation, other than through making available the results of non-partisan analysis or research".

The term "private foundation" is defined in a new Section 509 of the Bill. Section 509(a)(2) would exclude from the category of a "private foundation" any organization described in Section 501(c)(3) which "normally receives more than one-third of its support in each taxable year from . . . membership fees" (and certain other enumerated sources) provided that such membership fees (and other qualifying types of income) are received from persons other than "a disqualified person". The term "disqualified person" is defined in new Section 4946(a)(1) of the proposed Bill as including a "substantial contributor". Section 4946(a)(2) defines the term "substantial contributor" as a person described in Section 507(b)(2) of the Bill. Section 507(b)(2) defines the term "substantial contributor" to include any person who contributes more than $5000 to the private foundation in any one calendar year.

In describing the exception to the private foundation category, the Report of the Ways and Means Committee (H. Rept. No. 91–413 Part 1), 91st Cong., 1st Sess. p. 41) states, "At least one-third of its support must come from other than disqualified persons in the form of gifts, grants, contributions, membership fees, and gross receipts from admissions, etc.". The Report also states that—

"The organizations which usually will be excluded from the definition of private foundations if they satisfy this provision (at least ⅓ support from membership fees) include symphony societies, garden clubs, alumni associations, Boy Scouts, Parent-Teacher Associations and many other membership organizations."

Moreover, the Supplemental Report of the Committee (H. Rept. No. 91–413 Part 2), 91st Cong., 1st Sess. p. 6) states that "This category generally excludes from the private foundation definition parent-teacher associations, membership organizations such as professional societies . . .". Accordingly, it is clear that the Committee intended that membership organizations generally, including organizations such as the attached, qualify for the exclusion afforded by the proposed Bill for membership type Section 501(c)(3) organizations. However, in setting an arbitrary maximum of $5000 on the amount of annual membership fees which will apply in determining the qualification of an organization under this exception, the Ways and Means Committee obviously believed that it had chosen a figure sufficiently high to include the types of organizations specifically described in the portion of its Reports quoted above.

A number of the attached organizations derive significant portions of their support from membership dues and would thus be exempted from the "private foundation" category under Section 509(a)(2) except for the fact that such dues exceed $5000 per year from each member. We do not believe that there was any intention that such organizations should be treated as "private foundations" merely because of the arbitrary $5000 limitation. Others of the attached organizations, while not exceeding the $5000 limitation, do not derive a significant enough portion of their support from dues to meet the "one-third" test of proposed Section 509(a)(1).

New Section 509(a)(2) would exempt from "private foundation" category organizations described in Section 170(b)(1)(B), so-called "publicly supported" organizations. While it is possible that some of the attached organizations might qualify for exemption under this category, because of their particular form of organization, it is by no means clear that all would so qualify.

In view of the significant contributions of the attached organizations to the public interest in their respective areas of scientific, engineering and technical expertise, we believe Congress would wish to exclude them generally from the "private foundation" category. H.R. 13270, and any other definition based on source of support, would arbitrarily include some and exclude others, because of the differing structure of these organizations. Accordingly, we respectfully suggest that an additional subsection (5) be added to proposed Section 509(a) to exclude—

"A membership organization or a federation of membership organizations organized and operated primarily for scientific, engineering or technical purposes."

The foregoing definition would cover any organization whose activities fall within its terms, regardless of its source of support. We note that a similar approach is taken in proposed Section 509(a)(4) which excludes from the "private foundation" category "an organization which is organized and operated exclusively for testing for public safety".

We would like to have this letter and Congressman Daddario's letter made a part of the Record. We are not asking for an opportunity to appear at your hearings as we understand you have a very crowded calendar. If you feel we should appear we will be very pleased to do so. I hope the Committee can give this amendment very serious consideration.

Very truly yours,

Donald L. Peyton,
Managing Director.

United States of America Standards Institute,
New York, N.Y., September 4, 1969.

List of Organizations Approving the Proposed Amendments to Section 509(a) Concerning the Scientific and Technical Societies

Accoustical Society of America, 335 East 45th Street, New York, N.Y. 10017.

American Concrete Institute, P.O. Box 4754, Redford Station, Detroit, Michigan 48219.

American Foundrymen's Society, Golf & Wolf Roads, Des Plaines, Illinois.

American Institute of Aeronautics and Astronautics, Inc., 1290 Avenue of The Americas, New York, N.Y. 10020.

American Institute of Physics, 335 East 45th Street, New York, N.Y. 10017.

American Meteorological Society, 46 Beacon Street, Boston, Mass.

American Public Health Association, 1740 Broadway, New York, N.Y. 10019.

American Society for Metals, Metals Park, Ohio.

American Society for Testing and Materials, 1916 Race Street, Philadelphia, Pa. 19130.

American Society of Mechanical Engineers, 345 East 47th Street, New York, N.Y. 10017.

American Welding Society, 345 East 47th Street, New York, N.Y. 10017.

Instrument Society of America, 530 William Penn Place, Pittsburgh, Pa. 15219.

Marine Technology Society, 1730 M Street, NW., Washington, D.C. 20036.

National Association of Corrosion Engineers, 2400 W. Loop South, Houston, Texas 77027.

COMMITTEE ON SCIENCE AND ASTRONAUTICS,
House of Representatives,
Washington, D.C., July 15, 1969.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means,
House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: I appreciate the action taken by the Committee on Ways and Means in announcing its tentative decisions on tax reform and inviting comment. I believe this is an entirely responsive and responsible method of preparing legislation, and I commend the Committee.

I would like to comment on one provision which is of great concern to me, and which I believe affects our entire research and development effort. This concerns paragraph 6(a) on page 4 of the report which states that private foundations may not "directly or indirectly engage in any activities intended . . . to influence the decision of any governmental body (whether or not such activity is substantial)."

This is considerably stronger than the present language in the Internal Revenue Code, and it would prohibit scientific and technical societies from communicating not only with Congress, but also the various government agencies, and presumably even including local government bodies. The Congress and the Executive Branch are dealing with increasingly complex scientific and technical issues these days, and in order to legislate properly we must have the latest and most up to date science information. To inadvertently cut off a source of this information would be, I believe, most unfortunate.

When the Subcommittee on Science, Research and Development was formed in 1963, one of the first things we did was to conduct a study to determine how Congress could get the best scientific and technical information necessary to deal effectively with the many research and development programs. Our inquiry sought to determine the type of scientific and technical information required by Congress, and also where this information could be obtained.

One obvious source was the various scientific and technical societies, and we conducted interviews with a number of these organizations. When talking with the representatives of one of these societies, they mentioned their reluctance to take an active role because of their tax exempt status under section 501(c)(3). Subsequently, we went into this issue in some depth, and concluded that tax exempt organizations could take a more active role in formulating science policy.

As you are aware, section 501(c)(3) provides that "no substantial part" of the activities of these organizations may be devoted to "carrying on propaganda or otherwise attempting to influence legislation." The problem was that these organizations, because of their coveted tax position, were taking an extreme position and reading "no substantial part" to be, in effect, "no part".

It was our position that this was neither necessary from the tax standpoint, nor desirable from a national point of view. Since 1963 we have urged the organizations to take a more active role, and there has been a noticeable improvement. We have explained the guidelines to these organizations, and have told them that if they do have any questions concerning their participation to contact the Exempt Organization Branch of the IRS in Washington.

I believe the situation which has developed over the years is a healthy one, and I would recommend that the current language in the Act be retained.

However, to provide additional guidance on what is permitted and what is not, I would suggest that the Committee define more precisely in the report what it means by "substantial". In the case of Seasongood v. Commissioner of Internal Revenue [227 F2d 507 (1955)], the Court found that when an organization devoted less than 5 percent of its time and effort to political activities, that this did not constitute a "substantial part" of its activities. On the other hand, in denying section 501(c)(3) status to the Sierra Club in 1966, the IRS found that the Sierra Club engaged in political activities in almost every month covered by the ruling, including the placing of full-page newspaper advertisements and the employment of a professional legislative representative in Washington. I think it would be helpful if the Committee would give these organizations some guidance as to the dividing line between the permitted and the unpermitted, preferably in percentage terms of effort, money, manpower, or a similar quantitative measurement.

I also would like to stress that I belive it is a mistake to extend this provision from legislative bodies to "any governmental body." These organizations frequently are called upon by the agencies to evaluate programs in certain disciplines such as chemistry or physicis because they have the expertise within their organizations, and they perform a valuable function for the agencies in this regard. In addition, the local chapters of these organizations can perform a valuable function at the local government level. Air and water pollution are problems to many localities, and these local chapters have members with the experience and knowledge to help local officials solve some of these problems which they otherwise would be unable to afford.

Finally, Mr. Chairman, I would like to comment upon a provision which may cause some confusion and perhaps inequities. Paragraph (9) on page 5 defines a private foundation as any organization exempt under section 501 (c) (3) except "(d) an organization which normally receives a substantial part of its support from a governmental unit or from contributions from the general public."

Besides the inherent difficulties in defining what is "substantial", this provision could provide certain inequities as it applies to scientific and technical organizations which, in their organization and purpose, should be treated the same. In particular, there are certain organizations now exempt under section 501 (c) (3) which receive funds from the National Science Foundation to operate the Foundation's discipline oriented science information systems and participate in the up-dating of the National Register of Scientific and Technical Personnel. These funds can average between $1 and $2 million per year, and probably these organizations also receive funds from other government agencies. The question then arises, would these funds be considered "substantial" thereby removing them from the limitation on political activities? I do not believe there is any real reason why these organizations which do frequent business with the government should be treated differently in respect to communicating with Congress than other organizations which do only periodic business.

Similarly, although I understand it is not the intention of the Committee to exempt Sierra Club type activities from the limitation, it could be argued that since such an organization receives contributions from the general public, that this type of organization could qualify under section 501(c) (3) if the contributions were substantial because it would then not be subject to the limitation on political activities. Again, I think this point should be clarified in the Committee report.

In summary, Mr. Chairman, I commend the Committee for the responsible way it has gone about its business, and would appreciate your consideration on my suggestions. If I can be of any help, particularly in regard to some of the points I have raised, or if you need any additional information, please let me know.

Sincerely yours,

EMILIO Q. DADDARIO,
Chairman, Subcommittee on Science, Research and Development.

UNITED STATES OF AMERICA STANDARDS INSTITUTE,
New York, N.Y., September 4, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: We are writing on behalf of the technical and scientific societies listed in the attachment to this letter, all of which have been granted exemption from Federal Income Tax under Section 501(c)(3) of the Internal Revenue Code. We are seriously concerned by the apparent effect of H.R. 13270 to classify them as "private foundations" under that legislation. We believe that this result was completely inadvertent and unintended by the drafters of the Bill. If not corrected, this classification could seriously injure the public interest by denying the Congress and various Government Agencies access to the scientific and technical information and expertise which these organizations develop in the conduct of the tax-exempt activities.

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Under present law, the activities of a Section 501(c)(3) organization in "carrying on propaganda, or otherwise attempting to influence legislation will not adversely affect its tax-exempt status provided that such activities do not constitute a "substantial part" of its total activities.

Under the provisions of H.R. 13270, as passed by the House, the same test would continue to apply to Section 501(c)(3) organizations except for those to be classified as "private foundations". "Private foundations" would be absolutely barred from engaging in any legislative activity. Under new Section 4945 of the Code, an excise tax would be imposed upon the organization and a separate excise tax on any officer or director or other responsible employee of the organization with respect to any expenditures incurred by the organization "to carry out propaganda, or otherwise influence legislation". Such activities would include "any attempt to influence legislation through private communication with any member or employee of a legislative body, or with any other person who may participate in the formulation of the legislation, other than through making available the results of non-partisan analysis or research".

The term "private foundation" is defined in a new Section 509 of the Bill. Section 509(a)(2) would exclude from the category of a "private foundation" any organization described in Section 501(c)(3) which "normally receives more than one-third of its support in each taxable year from . . . membership fees" (and certain other enumerated sources) provided that such membership fees (and other qualifying types of income) are received from persons other than "a disqualified person". The term "disqualified person" is defined in new Section 4946(a)(1) of the proposed Bill as including a "substantial contributor". Section 4946(a)(2) defines the term "substantial contributor" as a person described in Section 507(b)(2) of the Bill. Section 507(b)(2) defines the term "substantial contributor" to include any person who contributes more than $5000 to the private foundation in any one calendar year.

In describing the exception to the private foundation category, the Report of the Ways and Means Committee (H. Rept. No. 91-413 Part 1), 91st Cong., 1st Sess. p. 41) states, "At least one-third of its support must come from other than disqualified persons in the form of gifts, grants, contributions, membership fees, and gross receipts from admissions, etc.". The Report also states that—

"The organization which usually will be excluded from the definition of private foundations if they satisfy this provision (at least ⅓ support from membership fees) include symphony societies, garden clubs, alumni associations, Boy Scouts, Parent-Teacher Associations and many other membership organizations."

Moreover, the Supplemental Report of the Committee (H. Rept. No. 91-413 Part 2, 91st Cong., 1st Sess. p. 6) states that "This category generally excludes from the private foundation definition parent-teachers associations, membership organizations such as professional societies . . . .". Accordingly, it is clear that the Committee intended that membership organizations generally, including organizations such as the attached, qualify for the exclusion afforded by the proposed Bill for membership type Section 501(c)(3) organizations. However, in setting an arbitrary maximum of $5000 on the amount of annual membership fees which will apply in determining the qualification of an organization under this exception, the Ways and Means Committee obviously believed that it had chosen a figure sufficiently high to include the types of organizations specifically described in the portion of its Reports quoted above.

A number of the attached organizations derive significant portions of their support from membership dues and would thus be exempted from the "private foundation" category under Section 509(a)(2) except for the fact that such dues exceed $5000 per year from each member. We do not believe that there was any intention that such organizations should be treated as "private foundations" merely because of the arbitrary $5000 limitations. Others of the attached organizations, while not exceeding the $5000 limitation, do not derive a significant enough portion of their support from dues to meet the "one-third" test of proposed Section 509(a)(1).

New Section 509(a)(2) would exempt from "private foundation" category organizations described in Section 170(b)(1)(B), so-called "publicly supported" organizations. While it is possible that some of the attached organizations might qualify for exemption under this category, because of their particular form of organization, it is by no means clear that all would so qualify.

In view of the significant contributions of the attached organizations to the public interest in their respective areas of scientific, engineering and technical expertise, we believe Congress would wish to exclude them generally from the "private foundation" category. H.R. 13270, and any other definition based on source of support, would arbitrarily include some and exclude others, because of the differing structure of these organizations. Accordingly, we respectfully suggest that an additional subsection (5) be added to proposed Section 509(a) to exclude

"A membership organization or a federation of membership organizations organized and operated primarily for scientific, engineering or technical purposes."

The foregoing definition would cover any organization whose activities fall within its terms, regardless of its source of support. We note that a similar approach is taken in proposed Section 509(a)(4) which excludes from the "private foundation" category "an organization which is organized and operated exclusively for testing for public safety".

We would like to have this letter and Congressman Daddario's letter made a part of the Record. We are not asking for an opportunity to appear at your hearings as we understand you have a very crowded calendar. If you feel we should appear we will be very pleased to do so. I hope the Committee can give this amendment very serious consideration .

Very truly yours,

DONALD L. PEYTON,
Managing Direct
UNITED STATES OF AMERICA STANDARDS INSTITUTE,
New York, N.Y., September 4, 1969.

LIST OF ORGANIZATIONS APPROVING THE PROPOSED AMENDMENT TO SECTION 509(a) CONCERNING THE SCIENTIFIC AND TECHNICAL SOCIETIES

Acoustical Society of America, 335 East 45th Street, New York, N.Y. 10017.

American Concrete Institute, P.O. Box 4754, Redford Station, Detroit, Michigan 48219.

American Foundrymen's Society, Golf & Wolf Roads, Des Plaines, Illinois.

American Institute of Aeronautics and Astronautics, Inc., 1290 Avenue of The Americas, New York, N.Y. 10020.

American Institute of Physics, 335 East 45th Street, New York, N.Y. 10017.

American Meteorological Society, 45 Beacon Street, Boston, Mass.

American Public Health Association, 1740 Broadway, New York, N.Y. 10019.

American Society for Metals, Metals Park, Ohio.

American Society for Testing and Materials, 1916 Race Street, Philadelphia, Pa. 19103.

American Society of Mechanical Engineers, 345 East 47th Street, New York, N.Y. 10017.

American Welding Society, 345 East 47th Street, New York, N.Y. 10017.

Instrument Society of America, 530 William Penn Place, Pittsburgh, Pa. 15219.

Marine Technology Society, 1730 M Street, N.W., Washington, D.C. 20036.

National Association of Corrosion Engineers, 2400 W. Loop South, Houston, Texas 77027.

COMMITTEE ON SCIENCE AND ASTRONAUTICS,
House of Representatives,
Washington, D.C., July 15, 1969.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means,
House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: I appreciate the action taken by the Committee on Ways and Means in announcing its tentative decisions on tax reform and inviting comment. I believe this is an entirely responsive and responsible method of preparing legislation, and I commend the Committee.

I would like to comment on one provision which is of great concern to me, and which I believe affects our entire research and development effort. This concerns paragraph 6(a) on page 4 of the report which states that private foundations may not "directly or indirectly engage in any activities intended . . . to influence the decision of any governmental body (whether or not such activity is substantial)."

This is considerably stronger than the present language in the Internal Revenue Code, and it would prohibit scientific and technical societies from communicating not only with Congress, but also the various government agencies, and presumably even including local government bodies. The Congress and the Executive Branch are dealing with increasingly complex scientific and technical issues these days, and in order to legislate properly we must have the latest and most up to date science information. To inadvertently cut off a source of this information would be, I believe, most unfortunate.

When the Subcommittee on Science, Research and Development was formed in 1963, one of the first things we did was to conduct a study to determine how Congress could get the best scientific and technical information necessary to deal effectively with the many research and development programs. Our inquiry sought to determine the type of scientific and technical information required by Congress, and also where this information could be obtained.

One obvious source was the various scientific and technical societies, and we conducted interviews with a number of these organizations. When talking with the representatives of one of these societies, they mentioned their reluctance to take an active role because of their tax exempt status under section 501(c)(3). Subsequently, we went into this issue in some depth, and concluded that tax exempt organizations could take a more active role in formulating science policy.

As you are aware, section 501(c)(3) provides that "no substantial part" of the activities of these organizations may be devoted to "carrying on propaganda or otherwise attempting to influence legislation." The problem was that these organizations, because of their coveted tax position, were taking an extreme position and reading "no substantial part" to be, in effect, "no part".

It was our position that this was neither necessary from the tax standpoint, nor desirable from a national point of view. Since 1963 we have urged the organizations to take a more active role, and there has been a noticeable improvement. We have explained the guidelines to these organizations, and have told them that if they do have any questions concerning their participation to contact the Exempt Organization Branch of the IRS in Washington.

I believe the situation which has developed over the years is a healthy one, and I would recommend that the current language in the Act be retained.

However, to provide additional guidance on what is permitted and what is not, I would suggest that the Committee define more precisely in the report what it means by "substantial". In the case of Seasongood v. Commissioner of Internal Revenue [227 F2d 907 (1955], the Court found that when an organization devoted less than 5 percent of its time and effort to political activities, that this did not constitute a "substantial part" of its activities. On the other hand, in denying section 501(c)(3) status to the Sierra Club in 1966, the IRS found that the Sierra Club engaged in political activities in almost every month covered by the ruling, including the placing of full-page newspaper advertisements and the employment of a professional legislative representative in Washington. I think it would be helpful if the Committee would give these organizations some guidance as to the dividing line between the permitted and the unpermitted, preferably in percentage terms of effort, money, time, manpower, or a similar quantitative measurement.

I also would like to stress that I believe it is a mistake to extend this provision from legislative bodies to "any governmental body". These organizations frequently are called upon by the agencies to evaluate programs in certain disciplines such as chemistry or physics because they have the expertise within their organizaitons, and they perform a valuable function for the agencies in this regard. In addition, the local chapters of these organizations can perform a valuable function at the local government level. Air and water pollution are problems to many localities, and these local chapters have members with the experience and knowledge to help local officials solve some of these problems which they otherwise would be unable to afford.

Finally, Mr. Chairman, I would like to comment upon a provision which may cause some confusion and perhaps inequities. Paragraph (9) on page 5 defines a private foundation as any organization exempt under section 501(c)(3) except "(d) an organization which normally receives a substantial part of its support from a governmental unit or from contributions from the general public."

Besides the inherent difficulties in defining what is "substantial", this provision could provide certain inequities as it applies to scientific and technical organizations which, in their organization and purpose, should be treated the same. In particular, there are certain organizations now exempt under section 501(c)(3) which receive funds from the Natiotnal Science Foundation to operate the Foundation's discipline oriented science information systems and participate in the up-dating of the National Register of Scientific and Technical Personnel. These funds can average between $1 and $2 million per year, and probably these organizations also receive funds from other government agencies. The question then arises, would these funds be considered "substantial" thereby removing them from the limitation on political activities? I do not believe there is any real reason why these organizatiotns which do frequent business with the government should be treated differently in respect to communicating with Congress than other organizations which do only periodic business.

Similarly, although I understand it is not the intention of the Committee to exempt Sierra Club type activities from the limitatiton, it could be argued that since such an organizatiton receives contributions from the general public, that this type of organization could qualify under section 501(c)(3) if the contributions were substantial because it would then not be subject to the limitation on political activities. Again, I think this point should be clarified in the Committee report.

In summary, Mr. Chairman, I commend the Committee for the responsible way it has gone about its business, and would appreciate your consideration of my suggestions. If I can be of any help, particularly in regard to some of the points I have raised, or if you need any additional information, please let me know.

Sincerely yours,

EMILIO Q. DADDARIO,
Chairman, Subcommittee on Science, Research and Development.

STATEMENT OF THE AMERICAN HUMANE ASSOCIATION

Mr. Chairman and members of the committee: The American Humane Association is a 93 year old federation of more than 800 societies for the prevention of cruelty to animals and children, with headquarters in Denver, Colorado. Some of its member societies are over 100 years old, others have recently been formed. Some are small, depending upon the efforts of dedicated volunteers, others are larger with tens or scores of professionals. All seek to prevent cruelty to those who cannot always protect themselves. Many perform important public or semi-public functions on a local, or even on a statewide basis. Almost every society spends a large portion of its time and money on humane education, particularly among elementary school children. Almost all the cities of the United States engage such societies to perform their animal control responsibilities, with excellent results. Also, in our largest metropolitan area, for example, societies for the prevention of cruelty to children carry a large part of the burden of protecting children from abuse and neglect, which burden would otherwise fall upon public agencies, or be left undone from lack of personnel or funds. It is fair to say the country at large benefits greatly from the efforts of our member societies.

H.R. 13270, as presently worded, raises a serious threat to the continued success of the efforts of many of these societies, particularly those provisions of the Bill concerning "Private Foundations" found in Sec. 509. It is safe to say that neither the supporters of humane organizations, nor the general public, think of them as private foundations. Many have hundreds, even thousands, of members and contributors, many are scores of years old. Yet some of the member societies of the American Humane Association may be held to be private foundations, while others will not. Some, too, may change their classification from year to year, depending on the level of contributions, or of some emergency which requires the liquidation of invested contributions.

Ironically, it is the older, well established societies, many of which carry a large burden of humane work, both private and semi-public, which are most likely to fall under the present definition of "Private Foundations." Not only would they be subjected to a tax on net investment income (including capital gains) but would be subjected to numerous highly onerous and restrictive requirements designed, it is submitted, for the correction of alleged abuses by an entirely different type of organization, what might be called the "real" private foundation, often a family controlled organization. The application of these restrictions would, in our opinion, drastically affect the efficiency of humane organizations.

The public support, if any there is, for the extremely restrictive provisions concerning "Private Foundations" is based on an awareness of those allegations that private individuals have attempted to obtain tax exemption, yet control and even profit from dealing with their own foundations. This situation patently does not apply to humane society 100 years old, with scores of full time employees and thousands of supporters. Yet such an organization may be pulled under these restrictive rules on the "coattails" of the "real" private foundation.

As the national federation of humane organizations, with the day by day experience of assisting and councilling such organizations, the American Humane Association is firmly of the opinion that the present definition of "Private Foundations" would greatly hamper the most effective humane organizations across this country, with harm to animals, children, and the general public.

It is recommended that new Sec. 509 be redrafted to clearly restrict it to "real" private foundations, or that at the end thereof there be added an additional classification as follows:

"(5) A society for the prevention of cruelty to animals or children."

The latter phrase has been in the Internal Revenue Code without change since the Revenue Act of 1918. This specific reference to such organizations clearly indicates Congress' determination that such organizations have a public purpose. Therefore, there is no need to create a separate test for humane associations to re-establish their public nature.

Respectfully submitted.

THE AMERICAN HUMANE ASSOCIATION,
RUTHERFORD T. PHILLIPS,
Executive Director,
JO V. MORGAN, Jr.,
Washington Representative.

STATEMENT OF THE AMERICAN ACADEMY OF ARTS AND SCIENCES, SUBMITTED BY TALCOTT PARSONS, PRESIDENT

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 America 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, associations 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 pomotion 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.

THE UNITED FUND OF JOHNSON CITY,
Johnson City, Tenn., September 9, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washinngton, D.C.

DEAR SENATOR LONG: This is a brief letter with two basic purposes. First, I want to express appreciation to you for the part you had in improving the Tax Bill of 1969 and especially for the revisions made in regard to appreciated property and the replacement of the 7½% tax on foundations by a 2% "supervisory tax."

The second matter, however, is one of concern; because if my understanding is correct, there is considerable ambiguity in regard to the definition of a foundation. Indeed, the United Fund might conceivably be included in this category; and I would hope that the legislation when it finally come before the Congress of the United States would make it perfectly clear that the United Fund is in the same category as churches and educational institutions and not as a foundation. It would seem to us that this matter could be very easily clarified.

At the meeting of the Board of Directors of the United Fund here in Johnson City on September 8, a resolution was passed requesting us to write this letter to you expressing our concern.

Thanking you for your continued interest in this matter and for your evident concern in meeting the needs of citizens of our great nation, we remain

Most sincerely,

THOS. P. POTTER, Jr.,
President.
F. HEISSE JOHNSON,
Educational Chairman.

ANALYSES OF FOUNDATION PROVISIONS OF TAX REFORM BILL OF 1969 (H.R. 13270)

(By Anthony Z. Roisman)

It can no longer be doubted that there is a need for federal tax reforms. Preferential treatment such as allowing mineral depletion allowances unrelated to the costs of production and permitting some very wealthy taxpayers to completely avoid taxes must be abolished. Loop-holes allowing sophisticated tax lawyers to draw up business schemes using accelerated depreciation or combinations of interest deductions and other expenses to turn out-of-pocket losses into tax savings must be closed. Outmoded and archaic tax provisions dealing with tax exempt organizations and capital gains provisions which have no relation to present day problems and goals must be amended.

The proposed Tax Reform Bill of 1969 (H.R. 13270) attempts to meet some of these problems, ignores others and in some cases creates new and far worse problems than it was intended to solve. In at least one case, the reforms relative to tax exempt organizations, the bill displays a wanton disregard for the public interest, and for the tax exempt organizations and for any semblance of fair and equitable taxation. Instead the bill is an obvious vendetta motivated by a few isolated examples of gross abuses by tax exempt organizations but might just as well have been motivated by the belief that tax exempt organizations, particularly those engaged in charitable, educational and social welfare work and now exempt under Section 40(C)(3), are going too far and being successful in obtaining their tax exempt objectives.

An adequate analysis of the more than 135 pages of the bill which deal with tax exempt organizations and charitable contributions is impossible in the few weeks in which the public has had an opportunity to view the bill. However, even a cursory analysis of the proposed provisions clearly indicates that this is one of the most complex and vindictive pieces of tax legislation ever proposed. Under existing law a taxpayer found guilty of civil tax fraud pays a penalty equal to 50% of the tax due. Under the proposed bill a private foundation which innocently makes a grant for an activity which IRS later determines is an attempt to influence legislation must pay a tax equal to 100% of the amount of the grant. (New Section 4945)[1] Such obvious discrimination against private foundations is wholly unjustified.

In the next few pages I shall indicate other areas in H.R. 13270 dealing with tax exempt organizations which are equally discriminatory. There are also many other provisions which are too vague to provide any proper statutory standard or are so worded as to create results which were obviously never intended and I shall also indicate some of these provisions.

My purpose is to establish beyond any reasonable doubt that the so-called reform provisions relating to tax exempt organizations are so ill-conceived and so poorly drafted that no amount of cutting, pasting or patching could possibly produce an intelligent legislative proposal; that in the face of a genuine desire on the part of most tax exempt (Section 501(C)(3)) organizations to have honest reform which will abolish the abuses of present law, including those abuses which unduly limit tax exempt activities, now is the time to undertake a really new look at tax exempt organizations; and finally that the Senate Finance Committee should remove the tax exempt provisions from H.R. 13270 and should immediately schedule separate hearings on that subject setting a specific time in the future when concrete proposals shall be submitted and when a study of these proposals shall begin.

The bludgeon of the reform provisions fall on the head of a newly defined entity—the "private foundation". The underlying premise of this brutal attack is that any organization which does not rely upon year by year contributions from a large segment of the populace does not really deserve to be tax exempt. Reliance upon large contributions from a few public spirited individuals has frequently been the backbone of charitable and social welfare activity. Even our elected officials usually must rely upon a few heavy contributors or their own wealth for their campaigns.

The mere fact that a charitable organization is supported by a relatively few contributors is no basis to automatically subject the organization to the burdens of the proposed bill. We have a National Gallery of Art in Washington due in large measure to the philanthrophy of one family. Colleges, civic buildings, public parks, student aid programs and thousands of other socially useful projects are the results of one-family or one-man philanthropy. It is merely lazy legislating which results in proposals like H.R. 13270 that punish the good with the bad. If abuses flow from some narrowly supported organizations then the legislature should have the ingenuity to draft legislation which will cure the disease, not kill the patient. As a result of the broad and irresponsible sweep of new section 509, defining private foundations, many legitimate and worthwhile activities will be curtailed or even worse eliminated.

NEW SECTION 506

The first limitation imposed on the "private foundation" is a 7½% tax on net investment income. (New Section 506) I have no objection to fairly taxing the tax exempts to pay the cost of administration of the tax law, but why only "private foundations" and why at a 7½% rate. A simple fee to be paid upon application for tax exempt status, by all tax exempt organizations, could be imposed, graduated according to the size of the organization. If additional funds are needed an additional fee, clearly limited to the costs of operation could be im-

[1] Unless otherwise specified new section numbers refer to the section numbers which will exist if the tax reform legislation is passed. Other section references are to present provisions of the 1954 code.

posed annually. (See for instance the fee schedules for the salary and expenses of referees in bankruptcy 11 U.S.C. 68(c)(2)).

What is really disturbing about Section 506 is the method of computing the net investment income. First in subsection (b)(4)(A) the market value of investments as of December 31, 1969, is automatically set as the minimum fair market value. In today's depressed security market this virtually eliminates any possible net capital losses. Certainly ease of administrative computation cannot be the excuse for the artificial cutoff because in New Section 507, the foundation is required to trace back to 1913 to determine the aggregate tax benefit accruing to it and contributors to the organization—a far more complex computation. A fair law would at least permit the foundation to use the donors basis (if it can be established) or the December 31, 1969 figure whichever is higher.

In subsection (b)(4)(B) the law creates one of many counter productive results. If capital gains are added to net investment income only where the assets are held for production of income, foundations will be encouraged to avoid the safe blue chip securities and bonds which have income and buy instead the non-dividend paying common stocks which produce only capital gain, which will not be taxed. This policy clearly conflicts with the policy in New Sections 4942(e) and 4944 which encourage to some extent holding assets which produce safe and steady rates of return.

NEW SECTION 507

New Section 507 is one of those provisions which is so ludicrous that merely reading it vividly displays its most blatant defects. The whole idea of tracing the aggregate tax benefit back to 1913 for taxpayers long since dead whose tax returns, if not destroyed, are private documents which can probably never be obtained, is absurd. Yet the section requires that the tax imposed be the *lower* of the aggregate tax benefit or the total net assets. Only IRS can be sure of having access to the foundations' contributors tax returns. How can the IRS determination be challenged by the foundation?

Another one of the counter-productive effects of the new law is the use of a tax measured by net assets. For that foundation which intentionally desires to terminate its private foundation status the tax can effectively be avoided by heavy expenditures financed by loans (to get net assets to zero) before taking the acts which culminate in the termination. For the foundation which inadvertently has its private foundation status terminated it may be caught with massive net assets. A law which encourages intentionally well-planned violations is hardly desirable.

In subsection (b)(1)(B) of New Section 507 is further evidence of unjustifiable discrimination. Aggregate tax benefit is measured by the tax benefits which the 501(c)(3) private foundation has obtained since 1913. However, these tax benefits, i.e. tax exemption, are available and would have been available to every tax exempt organization even those permitted to lobby or engage in other activities prohibited to the 501(c)(3) organizations. Given the massive burden already imposed by New Section 507, an additional penalty requiring forfeiture of benefits which any tax exempt organization could obtain would appear to be another case of legislative over-kill.

Subsection (b)(2) is an example of the muddled language and sloppy drafting which pervades the bill. It is impossible to determine on the face of the statute whether a "substantial contributor" refers to human beings only or also to corporations and other non-personal entities. Reference to the "spouse" of the contributor implies a human donor. But in New Section 4946(a)(1)(c), the phrase "substantial contributor" (defined by New Section 4946(a)(2) as being the definition in New Section 507(b)(2)) clearly refers to the corporation, partnership or unincorporated enterprise which is a substantial contributor to the foundation." Even if this obvious confusion were clarified New Section 507(b)(2) leaves much to be desired. It is unclear if the grants from other foundations are to be used in determining under subparagraph (B) who contributed the greatest amount to the foundation. In addition, in the case of little "private foundations" receiving small contributions, a single donor of $100 may suddenly find himself thrust in the spotlight as the "substantial contributor" and therefore as a "disqualified person". (See New Section 4946(a)(1)(A)). This status immediately throws his entire financial holdings and activities under the scrutiny of the IRS by virtue of the self-dealing provisions in New Section 4941 which are triggered by the presence of a "disqualified person". A wholly innocent purchase of goods or services from this $100 donor or sale of goods to him will automatically result in a self-dealing tax regardless of the motives of the parties involved or the fairness of the transaction, and could produce a tax as high as 200% of the amount involved in the transaction, under New Section 4941(b) (1).

The real evil is not even the case in which any foundation is caught but the dilemma in which the small "private foundation" finds itself. Unable to grasp the intricacies of this legislative thicket, too poor to hire tax counsel, the small and private foundation will certainly go under. The result—fewer small foundations, more big foundations, precisely the opposite result which tax reformers have been seeking. Unfortunately, this is not the only area in which pressure against the existence of small foundations is created in the proposed law.

New Section 507(c) is an excellent example of how to draft a statute to create the maximum confusion and litigation. One can hardly imagine a date less susceptible to precise identification than the date on which "action is taken by the private foundation which culminates in its ceasing to be a section 501(c) (3) organization". Is the date to be when appropriate board resolutions are passed, when funds are collected, when funds are expended, when the first newspaper ad appears, when the first voter is registered, when the research leading to the prohibited activity is begun, or what? Subsection (d) has the same defect. Both subsections require determination of a precise date but neither has any sound basis for accurately determining that date.

New Section 507(e) is hardly a taxpayer benefit. What good does it do a private foundation to have the unpaid portion of an assessment abated 5 years after the assessment became due and payable? Is the section intended to reward the foundation which can avoid payment of the tax for 5 years? Does subparagraph (2) of subsection (e) suggest that an organization could be treated as meeting the requirements of New Section 170(b) (1) (B) for years before the enactment of the new section? Given the technical requirements of New Section 170(b) (1) (B) any organization which has met these requirements did so by the sheerest coincidence.

A far more disturbing aspect of subsection (e) is that the Secretary is given the discretion to determine whether the unpaid assessment will be abated. Certainly in the case where a "private foundation" terminates its status by qualifying under New Section 170(b) (1) (B) (i.e. by becoming a publicly-supported foundation (there is no reason at all to allow the Secretary to exercise discretion in abatement of the assessment. The bill is based upon the belief that private foundations should be encouraged to become publicly supported. Even the *risk* of a tax equal to the total net assets of the foundation would deter the foundation. Yet, under New Section 508(e) if the foundation meets the requirements of New Section 507(e), is a good boy for 5 years, its status as a private foundation automatically "shall be terminated". If there is any doubt that the Secretary's discretionary refusal to abate the assessment is virtually irreversible, that doubt should be dispelled by the decision in *Transport Manufacturing and Equipment Co. of Delaware* v. *Trainor, et al*, 382 F.2d 703 (C.A. 8th, 1967).

New Section 507(f) places another nail in the coffin of the small independent foundation. In subsection (1) (B) the charitable contribution is denied to any substantial contributor to a terminated private foundation starting in the year in which the first act which culminates in termination occurs. Maybe the big foundation can give their contributors adequate assurances. The little foundations will clearly founder, each contributor (in light of New Section 507(b) (2) (B)), rather than attempting to keep his contribution at least $.01 below that of the largest contributor will merely avoid the contribution.

NEW SECTION 508

The theory of subsection(b) which penalizes foundations for not making their existence know to IRS is sound. The execution is questionable. As written, subsection(b) could apply to organizations which are described in Section 501(c) (3), but which have not sought, nor have its contributors sought, any of the tax benefits of Section 501(c) (3) organizations. What justification is there for imposing a presumption on such organizations? Furthermore, the subsection is apparently aimed at requiring disclosures of the existence of organizations. If the foundation makes its existence known and does not, through inadvertence or ignorance, claim it is not a private foundation, why should the presumption apply against it? A fairly-drafted provision would have eliminated these defects.

The open-ended exemption granted by subsection (c) (3) is only as effective as one's faith in the IRS. Congress could and should give a better set of guidelines. One possible standard would be to set a minimum standard based on total assets and yearly income and provide no coverage of these new provisions at all for organizations below the minimum. Adequate protection to prevent abuses caused by the fragmentation of large foundations can be easily built into the statute.

The harshness of the penalty imposed upon a private foundation, which terminates its status makes it all the more necessary that termination be found to occur only in the most serious cases, yet in subsection (e)(1), a *single* willful and flagrant act of self-dealing, of excess business holdings, of engaging in taxable expenditures, of investing in a manner which jeopardizes charitable purposes, or of a failure to distribute income, will result in imposing the full termination tax. These various actions are not equally band and imposition of a single harsh penalty for all prohibited actions is unjustified. While willful and flagrant acts should not be condoned, nonetheless a single such act should not result in total destruction of the foundation (a result which a tax consisting of the total net assets of the foundation will produce). This is particularly true since the taxes imposed under New Chapter 42 are based on such imprecise standards that no organization will ever know whether it is conforming with the law or not.

The consequences of subsection (f) is that unless the foundation which has fought 5 long years to terminate its private foundation status to become a public foundation and which has had the good fortune to have the termination tax abated, remembers to notify the Secretary that it is not a private foundation then it will automatically be presumed (New Section 508(b)) to be a private foundation and its troubles will start all over again.

NEW SECTION 509

Much can be said and will be said during the hearings about the overly-broad definition of a private foundation. In addition, the section has some drafting problems. In subsection (a)(3), there is much confusion. Is an organization qualified which meets the requirements of subparagraph (A) or must it also, as does a subparagraph (B) organization have to meet the requirements of subparagraph (C). Subparagraph (A) is so broad that it may be interpreted to allow large public foundations to protect what would otherwise be private foundations by allowing the latter to operate for the benefit of it. If this is intended it will greatly lighten the burden of the reforms. This should be made far clearer in the legislation in order to avoid any confusion.

Subsection (b) imposes the status of "private foundation" on all existing organizations based upon their past conduct, even though the past conduct may have been perfectly legal and without any adverse tax consequence when engaged in. This seems to be unduly harsh, inasmuch as the private foundation status apparently cannot be terminated any sooner than 1974 since not until then will any organization meet the continuous operating standards of New Section 507(e).

NEW SECTION 4941

This is one of the most difficult sections to justify in terms of sound tax policy. Under existing law (Section 503(c)), self-dealing results in loss of tax exemption and is directed at activities which are not arms length dealings. The absolute prohibition on any dealing between foundations and disqualified persons is far more severe than similar provisions dealing with dealings between related parties such as husband and wife or related corporation.

On subsection (a)(1), the tax imposed is not merely 5% of the amount involved because that 5% is imposed for each year during the taxable period—the period from when the act of self-dealing occurred until it is corrected or a deficiency notice is mailed Furthermore, the person liable for the tax is any disqualified person "who participates in the act of self-dealing". This is an extremely vague standard and is open to much conjecture and confusion.

Subsection (b)(1), imposes a 200% tax on the disqualified person if the act of self-dealing is not corrected within the correction period. Not even a willful refusal to correct is required as a condition of this tax being imposed. Under subsection (e)(3), the correction requires at requires at least placing the foundation in the position in which it would be if the disqualified person were dealing under the highest fiduciary standard. This minimum standard of correction is totally unworkable. In any given case it will be necessary to re-examine all relevant financial and economic data to determine what the highest fiduciary standards would require. With a 200% tax riding on the outcome, there can hardly be any room for error yet the standard is too vague to ensure any accuracy in the corrective actions taken.

In subsection (b)(2) a 50% tax is imposed on the foundation manager who refuses to agree to the correction regardless of whether the correction is legally required or not and leaves the foundation manager no independent judgment in the matter. Since the "foundation manager" includes directors and trustees (New Section 4946(b) it is possible that he will be faced with the dilemma of either allowing the correction and violating his fiduciary obligation to the foundation or refusing the correction and paying the tax. Normally, at the time corrective action is to be taken no one will know whether the action meets the vague standards of New Section 4941(e)(3).

A frequent practice among foundations is to sell products or services to contributors who are then able to have something for their contribution. Conversely a foundation will frequently obtain a contribution by being allowed to make a bargain purchase. Surely a way can be found to deal with the abuses of self-dealing without automatically cutting off these commonly used fund raising devices as is done in subsection (d)(1). Even the exceptions in (d)(2)(B), (C) and (D) do not permit the freedom of action which is required or desirable.

In subsection (d)(2)(F) there is no provision for corporate adjustments required by law, such as bankruptcy reorganizations, in which the foundation did not receive fair market value. Surely any transaction approved by a court in an adversary proceeding should be protection enough to avoid undesirable self-dealing.

In subsection (e)(2) the "amount involved" for purposes of computing the tax in subsection (a)(1) is keyed to the highest fair market value of the properties involved in an act of self-dealing. Where the act involved is a bargain sale of goods by a disqualified person to a foundation (an act which itself seems free of any abuse) the disqualified is subjected to the penalty tax based upon a value which he did not even receive in the transaction. It would be fairer to measure the amount involved by the fair market value of the property received by the person who is being subjected to the tax.

More of the inequities created by the unworkable standard for correction in subsection (e)(3) appear in subsection (e)(2)(B) where the 200% penalty tax is based upon the highest fair market value, during the correction period, of the property involved in the transaction. This merely creates another arguing point and will surely create more litigation as the IRS and the taxpayer attempt to find the highest fair market value and to determine whether or not a correction has been made. Isn't a 200% tax penalty enough? Doesn't this additional burden merely further increase the incredibly difficult task of administration of this law?

NEW SECTION 4942

Taxes on undistributed income are not unique in Revenue Code. Sections 531–537 impose such a tax on accumulated business income. What is unique in Section 4942 is the imposition of the 15% tax and the further imposition of a special 100% penalty tax under subsection (b). Inasmuch as the 15% tax is due every year in which the amounts remain undistributed there is no good reason to treat a charitable or educational organization with more severity than a private for profit business.

Subsection (e) will have an indirect deterrent effect on investment policies of foundations which the bill should encourage. Many securities, such as government and municipal bonds, do not produce a 5% rate of return and are generally lower than the commercial rate of return. By in effect forcing the foundation to obtain an investment return at the commercial rate, subsection (e) is driving the foundation to the higher risk and less socially desirable investment. In addition subsection (e)(2) values the assets for purposes of the computing the rate of return on the basis of current markket value rather than value at the time of acquisition. This really makes the rate of return required higher than 5% because by using current market values, it will be necessary to include unrealized capital gains. This means the return of 5% on a stock worth $100 will be inadequate when the stock's market value reaches $120. In a market of appreciating asset values a foundation might either have to actively trade and realize its capital accretions, or seek investments returning 10% or 12% on the purchase price to keep the return above 5% on the increasing but unrealized fair market values of its investments. One must wonder if the sound tax policy really requires the burdensome impact and administrative paperwork which subsection (e)(2) will entail.

On subsection (f) the foundation is limited in the deductions which it may claim. Taxes paid under New Sections other than New Section 506 are not allowed as deductions. Also the provisions of subsection (f)(1)(B)(i) raise some interesting problems. May the foundation, like a corporation subject to tax under Section 11, be permitted to deduct its lobbying expenses directly related to its incoming-producing activities under Section 162(e) of the 1954 Code? If the expense is allowable, as it clearly seems to be and should be if the foundation is to be fairly treated, will that lobbying activity be prohibited activity under New Section 4945(b)(1)? There is also something which offends one's sense of fair play in subsection (f)(2)(B) which compels the foundation to include net short term gains but not to deduct new short term losses. Compare this with Section 1231 of the 1954 Code which allows where the average profit making businessman is allowed to treat certain gains as capital gains but if they are losses, they are ordinary losses. It hardly pays to be interested in educational and charitable pursuits. You can get better tax treatment as a profit making amoral businessman.

Subsection (g)(2) allows "set asides" in certain limited cases. However, a set aside to be treated as a qualifying distribution must first be approved by the Secretary or his delegate. Given the usual backlog in IRS administration, this requirement of an advance ruling and the concommitant lack of precise statutory standards may unduly interfere with the prompt commitment of funds for worthwhile projects. There is no adequate standard to guide the Secretary in setting the necessary terms and conditions for the use of set asides although the use of such multi-year projects is a common and important practice of most foundations and should be subjected to some more specific and easily followed standards.

No one would deny that the new tax reform measures are extremely complex. It may be many months or years before meaningful Treasury Regulations are promulgated. Note the 16 year delay in developing comprehensive regulations under Sections 511–513 relating to the unrelated business income tax. In the meantime many foundations will be reluctant to take actions which will subject them to the severe penalties of the law. As a result many foundations will greatly curtail their giving, a result which in itself raises grave doubts as to the wisdom of the immediate effective date of this law. However, under subsection (h), this cautionary attitude might result in endless years of excess taxes. Subsection (h) clearly indicates that distributions made in subsequent years will be treated as paid out of the earlier year's undistributed income. A foundation which is now distributing all income and curtails giving for a year or two in order to get better guidelines for action will, unless it unloads massive grants in one year, never get out from under the results of its earlier caution, a caution dictated by a desire to act in conformity with the law. A period of grace, perhaps one year after final regulations are promulgated by IRS, should be given with respect to every section of the new bill to avoid these disastrous cross pressures on the foundations. This is particularly necessary where the permissible course of action cannot be determined until the final Treasury Regulations have been published. See, for instance, New Sections 4942(b)(2), 4941(e)(4)(B), 508(c)(3).

The statute should clarify whether the election under subsection (h)(2) will give rise to refunds for prior years. It is also unclear what periods of statute of limitations apply to the various transactions and computation dates created by the new provision. These are relevant both for purposes of the right to seek refunds and for purposes of legally permissible time for assessment of taxes. It is hoped that the bill does not intend, in the absence of fraud (for which a six year statute of limitations applies) or failure to file a return (for which no statute of limitations applies), that the foundations will be subjected to more burdensome statute of limitations than he average business corporation or other taxpayer.

Subsection (i) fails to clearly indicate when and how it operates. Does subparagraph (1) require that in each of the five years there be an excess of distributions or only that the total distributed for the five years exceed the total required to be distributed. The latter interpretation would appear to be fairer and would allow a carryover of any excess not used in the sixth and subsequent taxable years to amounts not distributed in those years. The subsection does not indicate whether in making the compilation for the five year period it is permissible to consider years before the enactment of these new provisions.

The newly created entity—operating foundation—is inadequately defined in subsection (j)(3). What is the status of a foundation whose exempt purpose is to fund worthwhile educational activities which deal with consumer education? Is the direct active conduct of the foundation the giving of grants? In what manner must its assets be devoted directly to such activities? Even if the foundation engaged in research itself would its assets be directly devoted to the activities if they produced income for it or would the assets have to consist of books, libraries, desks, etc? Would the asset be directly devoted if it were used to fund an annuity program to attract high quality scholars to the educational organization?

Even greater problems exist under subsection (j)(3)(B)(ii). Under subsection (g)(1)(A)(ii), distributions to foundations which are not operating foundations are not qualified distributions. Thus, a foundation needs to know in advance if its recipient is or is not an operating foundation. Since five or more foundations must be distributing to a foundation for it to qualify under subsection (j)(3)(B)(ii), any potential operating foundation will be forced into a very difficult task of obtaining funding commitments from any single foundation. The belief that this task can be done presupposes a far more precise method of operation than foundations can or should obtain. Many foundations can only afford one or two funding meetings a year. If a potential grantee is not clearly qualified when the meeting occurs, it will likely be passed over, regardless of the merit of its project. These substantial problems of operation must be weighed against the questionable virtue (as discussed earlier) of requiring diversified support for foundations.

NEW SECTION 4943

Subsection (a)(2)(B) contains another of those unnecessarily harsh and difficult to administer provisions. What good reason is there for judging excess holdings on the basis of the highest holdings during the year. A new corporation which issues 1% of its stock to a foundation but does so for convenience only one day before the remaining 99% of the stock is issued will subject the foundation to the excess holding provision. In addition the IRS investigation is required to check every day of the year both as to foundation holdings and as to the total stock or other interests held in the business. The benefits, if any, to be gained by this provision certainly do not outweigh the considerable difficulties which it creates. An end of year determination of holdings would appear to be more than adequate.

I assume that the principal abuse which this section is intended to reach is the control of businesses by foundation. Other sections deal with the wisdom of the investment (New Section 4944) or the danger of self-dealing (New Section 4941). Why then is it not permissible under this section to own any percentage of nonvoting stock or other securities (including bonds and other evidences of indebtedness). Clearly subsection (c)(2)(A) does not allow such holdings but the reasons for such exclusions remain a mystery.

Under subsection (d)(1) a foundation will have to examine the holdings of all disqualified persons and the holdings of all the entities in which such disqualified persons have holdings to be sure that no violations exist. This is so because the percentage of holdings allowed includes, in effect, the holdings of disqualified persons. (New Section 4943(c)(2)(A)(ii)? This kind of intricate tracing of stock ownership, which ownership can shift from day to day is a monstrous burden upon the foundation. A minor stockholder in a corporation which owns a very large percentage of stock of a corporation in which the foundation owns stock may be the inadvertent cause of a completely innocent violation of the statute. The situation is not dangerous and should not be covered by the proposed section, which as is true elsewhere in the bill, sweeps broader than necessary.

Subsection (d)(4) creates a wholly new concept in the tax exempt law—"functionally related business." Inasmuch as Sections 511-513 of the 1954 code already contain a similar concept ("related business") it would be far wiser to use that definition or to modify that definition to also refer to "functionally related business."

NEW SECTION 4944

It is difficult to imagine a less precise standard for the imposition of such a massive tax (100%) than that provided in subsection (a). How any foundation can accurately judge whether its investments will "jeopardize" the carrying out of its exempt purposes is beyond comprehension. One immediate problem is whether actions taken with regard to investments which subject the foundation to new taxes, such as excess holdings, net investment income, etc., would be investments which jeopardize the carrying out of its function by reducing available funds. The need for such a provision at all is also puzzling. State law governs the conduct of foundations and a suit would lie by the attorney general on behalf of the public against a foundation's managers for improper conduct endangering its exempt purposes. It is anamolous that this section which is apparently intended to protect the exempt objectives of the foundation should do so by subjecting it to a massive tax which could in some cases completely destroy the foundation.

NEW SECTION 4945

While many may sympathize with the objectives of this section, although I am not one, it is difficult to imagine much legitimate support for the imposition of a 100% tax on any expenditure which no matter how innocently entered into turns out to be a prohibited expenditure. This is clearly carrying the concept of taxation as a penalty beyond the point of reasonableness. Even willful tax evasion does not result in such a penalty. The kinds of activities being condemned are, in some cases, those which most businessmen may engage in and obtain tax deductions (see, for instance, Sections 1.162-14 and 1.162-20 of the Treasury Regulations of the 1954 code) or at least those which private individuals only pay normal taxes, up to a 70% maximum, upon. For what reasons are the foundations placed in a less favorable position than the average taxpayer?

Under subsection (b)(4) grants to private foundations are prohibited unless there is expenditure responsibility. Those responsibilities are set out in subsection (f) and are so burdensome as to be totally useless. In particular the requirement in subsection (f)(2) that reports be verified seems incredible. It is obviously necessary to hire auditors and even private detectives to verify the report. The expenses incurred in providing this verification coupled with the substantial risks of a 100% tax will virtually abolish all small grants and will drive small private foundations out of the tax exempt area. This will produce the very over-emphasis on big foundations which the law was intended to cure.

Earlier I talked about the problem of foundations holding grants until clear guidelines are published thus increasing undistributed income and the tax thereon (see New Section 4942). Under subsection (e) of this section individual grants can only be made pursuant to a procedure approved in advance by the Secretary. With organizations across the country seeking approval of procedures immediately upon enactment of this bill there will be an inevitable delay in approval and thus through no fault of their own private foundations which emphasize individual grants will be subjected to an undistributed income tax.

NEW SECTION 4946

The most troublesome part of this section is subsection (b) defining foundation managers as officer, director, or trustee of a foundation. Many foundations have an honorary board of well known men and women who agree with the basic principles of the organization, but do not participate in day-to-day operations of the foundation or even set overall policy. These honorary board members may well be designated trustee or directors but will certainly not lend their names to any foundation where they may be treated as a foundation manager. Nonetheless they are valuable additions to the foundation, lending their prestige and stamp of approval to the foundation objectives but unable because of the press of other matters to devote significant time to the foundation activities. Their participation even on an honorary basis should not be discouraged.

CONCLUSION

There are, of course, many other provisions of the Tax Reform bill relating to foundations and charitable contributions which are equally objectionable, but which time does not permit me to explore at this time. Based upon the present analysis, it is clear that the presently proposed legislation is unacceptable. Even if the objectives sought to be obtained are accepted, the proposed law goes much too far and in a much too careless manner to be enacted as Federal tax legislation. There is much work to be done if truly imaginative and desirable reforms for foundations are to be forthcoming. No consideration was given to problems created by the availability of tax deductible lobbying activities on behalf of business interests (Section 162(e)' of the 1954 Code) without some similar advantage for the pro-consumer, pro-conservationist, pro-public interest lobbying. No consideration was given to expanding the definition of a charitable organization to include all social welfare activities such as conservation and consumer interests. These and many other "liberalizing" reforms must be considered in conjunction with any new strictures on foundation activities. The 501(c)(3) tax exempt organizations for the most part serve an invaluable function in our society by providing non-partisan education, partisan representation of social values which would otherwise not be represented because they are not always important to and are even sometimes opposed by the business community and its economic interests, and the doing of good works. Any diminution of these socially desirable activities should be carefully studied before any action is taken. The foundation provisions of H.R. 13270 have not had and will not have adequate consideration in the present political climate which appears to demand immediate tax reform legislation on areas other than the foundations. It would be a grave mistake to let this pressure for other tax reforms result in hasty and regrettable legislation respecting foundations.

CO-ORDINATING COUNCIL FOR FOUNDATIONS, INC.,
West Hartford, Conn., August 20, 1969.

Sen. THOMAS J. DODD,
Senate Office Building
Washington, D.C.

SIR: The recently passed house version of the Tax Reform Bill is of great c ncern to those of us who have responsibility for administration of funds and distribution of income involving charitable trusts and foundations.

We particularly invite your attention to two sections, the first being Title I Subtitle A; Part II, Section 506, having to do with a 7½% tax on private foundation investment income, including capital gains. The application of this tax and its implications fo the future are a distinct threat to charitable foundations acting in behalf of institutions and projects in the public interest. The real losers, however, would be the people served by institutions in the Greater Hartford area that benefit from the existence of the foundations at issue.

By far the great majority of the income of foundations we represent is spent in the Greater Hartford area in behalf of the public at large. A few of the institutions involved are the hospitals in Hartford, colleges and universities in the area, public school programs for the disadvantaged, numerous Red Feather social agencies and public recreation commissions.

The loss of revenue by these and other tax exempt agencies supported by private foundations would seriously jeopardize their economic well being, and would certainly result in curtailment of projects and services in the public interest.

If this tax is finally enacted, the portents for the future are of particular concern to us: inevitable increases in the amount of tax, plus the sure application of state and local taxes following Federal action. This would seriously weaken the work of private foundations in the public interest.

The second item of concern involves Section 509—b—amendment of Subtitle D, Section 4942 covering taxes on failure to distribute income. Enactment of this legislation would mean that we would be unable to accumulate income for a long range capital project. Very often, however, large civic projects must be planned years in advance of the actual need for funds. Without the benefit of long range planning on the part of interested foundations, many capital projects will be in jeopardy.

We do not approve of the accumulation of income for its own sake. We are convinced, however, that freedom of action is necessary in specific instances. We believe it would be preferable to have legislation requiring prior Internal Revenue Service approval of income accumulation for a particular project, subject to a time limitation of no more than five years .

We are convinced that the overwhelming majority of foundations operate conscientiously and ethically in the public interest. Our great strength lies in our detailed knowledge of specific projects, and in our ability to act quickly with seed money pending later action by state and Federal agencies.

We are equally convinced that this legislation was brought about as a result of questionable judgment on the part of certain foundations and individuals. There must be a better way, however, to regulate unethical practices of the few than through the imposition of punitive taxes that would imperil the many.

As an alternative, we believe Federal legislation is necessary to prevent self dealing by foundation officials, provide full public disclosure of activities, assure adequate return of income to charity and crack down on organizations established to avoid taxes. We suggest serious consideration be given to the initiation of foundation registration fees to fund a Federal office of foundations in the Internal Revenue Service. Such an office would provide the regulation required, without curtailing the legitimate activities of foundations established in the public trust.

JOHN H. RIEGE,
President.

STATEMENT OF THE SOCIAL SCIENCE RESEARCH COUNCIL, NEW YORK, N.Y., SUBMITTED BY HENRY W. RIECKEN, PRESIDENT

SUMMARY

H.R. 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

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 a individuals, not as agent 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 H.R. 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 assets 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 yea, 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 H.R. 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 Board of Directors 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 purposes 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.

STATEMENT BY THE WOODROW WILSON NATIONAL FELLOWSHIP FOUNDATION, SUBMITTED BY H. ROSENHAUPT, PRESIDENT

Gentlemen: May we respectfully call your attention to certain provisions of H.R. 13270 which would, we believe unintentionally, pose a threat to the continued existence of the Woodrow Wilson National Fellowship Foundation and perhaps other organizations with distinguished records of service to our nation and to humanity.

Our organization draws its leadership from the academic community; it has representatives on the faculties of most colleges in the United States and Canada and advisory committees of scholars drawn from leading institutions of higher learning. This uniquely qualifies it to select individuals to receive fellowships and other forms of financial aid on the basis of accepted standards of scholarship, and to respond to developments in higher education by proposing new programs to meet new needs.

Funds for the support of our programs come primarily as grants from private foundations. It seems clear to us that the intention of H.R. 13270 was that organizations such as ours be operating foundations" and that grants from other private foundations for the support of our work be "qualifying distributions" for the granting foundation. However, a letter from our legal counsel states "it appears to us that the bill as presently drafted poses a real threat to the continued existence of the Foundation," and continues "we think you should bring this problem to the attention of the Senate Finance Committee with the hope that some solution can be worked out which would permit the Foundation to continue its operations in the future as they have been conducted in the past."

Although the definition of "private foundation" contained in the bill does clearly apply to us, the definition of "operating foundation" may not. We are a program-oriented organization, not a fund-raising organization, and usually obtain money in the form of large grants from a few sources so that most of our efforts can be devoted to the effective conduct of our programs. There has scarcely been a time in our 20 year history when the Foundation 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.

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 THE ROY AND EVA MARKUS FOUNDATION, INC.

In 1954, Roy and Eva Markus established a Foundation in Cleveland, Ohio, to make higher education scholarships available to needy inner-city youth.

In 1966, faced with a successful program where the needs soon outstripped the resources, the Cleveland Scholarship Programs, Inc was established, supported by the Markus Foundation, to provide for wider community involvement with the same objectives.

With the Programs now operating in nine inner-city high schools, the principals make the selections and the winners receive up to $1,800, with half in a direct grant and half in a loan.

This June, a major breakthrough was made as 345 graduates received awards, bringing to over 600, the number of students being served by the Programs. Most awards go to students with C plus to B average grades.

The Cleveland Scholarship Programs, Inc., has successfully coordinated this community effort which is spearheaded by a top-level representative group of business and civil leaders. Corporations, foundations and individuals are making the scholarships possible—banks and savings and loans are making the loans possible—business and industry are providing summer employment; and, colleges are cooperating in facilitating entrance and counseling.

The Programs are making it possible for worthy disadvantaged youth to lift themselves into the mainstream of American life through education.

[From the Cleveland Press, July 18, 1969]

SCHOLARSHIP PROGRAM DESERVES AN A+

This fall, more than 617 inner-city high school graduates will be attending college on scholarships from the unique Cleveland Scholarship Programs Inc.

Many of the winners had B and C plus averages and would have been overlooked by traditional scholarship programs. Nearly all are from low-income families.

The 345 scholarships just announced are valued at more than $1,800,000. Half the cash is from a number of foundations; the rest of each grant is a bank loan. The program, begun only two years ago, now is one of the largest of its kind in the nation. It is something in which all Clevelanders can take pride.

STATEMENT OF THE CANNON FOUNDATION, SUBMITTED BY JAMES L. RANKIN

ONE FAMILY FOUNDATION'S REACTION TO THE PROPOSALS IN TAX REFORM ACT OF 1969

These comments are prepared by one actively associated with the Cannon Foundations, Concord, North Carolina, for the past twenty-five years.

It is generally conceded even by the Treasury Department that private philanthropy plays a special and vital role in our society and that private foundations have an important part in this work. There should be no interference with groups who act wisely and aid helpful charitable projects which otherwise would suffer.

There have been abuses on the part of some foundations. To a great degree the proposals in the House Act, particularly the prohibition against self-dealing and the requirement of prompt distribution to charity, will go a long ways towards ending those abuses. However, other provisions will harm and handicap many family foundations.

This is recognized by "Time" which in its August 15, 1969 issue, in referring to the Tax Reform Law, said. "The measure could put a serious crimp in the activities of some of the country's most respected philanthropic operations which now donate substantial portions of their income to private universities, museums and charities."

THE ACT DISCUSSED

Income Tax. The Foundation is willing to pay such tax as the Congress deems wise. This will reduce the amount which will be received by the charitable organizations to whom The Foundation distributes its investment income. This tax affects only foundations and does not relate to investment income of colleges, churches, hospitals and other organizations.

Prohibition on Self-dealing. We believe that these provisions are sound and we have no objection to them.

Delays in Benefi to Charity. We agree that the proposals in the Act will require distribution to charity within the year of the receipt of investment income or the year next following, with the suggested recognition of definite commitments.

We agree with the proposals relating to *financial transactions unrelated to charitable functions.*

THE NEED TO SELL EXCESS HOLDINGS

We object to the proposal that foundations be limited to 20% ownership in the voting stock of any one corporation *less* the combined holdings of all of the donors who include a broad group of people, namely, those who have contributed as much as $5,000 in any one year and those who happen to be the largest single contributor of any year during the history of the foundation. This will often create great difficulty in learning the holdings of that group.

The following statement as of September 30, 1968, shows prompt distribution of our income to charity and presents the problem we will face if we must sell all of our so-called excess stock:

Total assets at value placed by donors at time of gift plus the purchase price	$23,434,369
Investment income in last year	1,478,498
Distribution to charities in last year	1,488,327
Total undistributed income after 25 years	266,393

$11,889,000 represents the "cost" of common stocks in four companies.

	Value of voting stock (percent)	Cost	Dividends
Company A	17	$9,736,000	$673,300
Company B	48	1,036,000	265,860
Company C	41	566,000	21,050
Company D	39	551,000	8,790
Total		11,889,000	[1] 969,000
Remaining assets		11,550,000	[2] 510,000

[1] Equals 8 percent.
[2] Equals 4 percent.

Therefore, about 50% of the assets on the basis of cost or value at time of gift is stock in four companies with respect to which all of the holdings held by The Foundation must be sold. As is true in many cases, our donors have given of their chief assets, namely, holdings in their own family companies. The requirement to sell so-called excess stock is ex post facto treatment of lawful transactions.

In our case, these four companies are all well managed and they are paying good dividends.

The statement shows that over its twenty-five years of life, The Foundation has distributed almost all of its investment income, retaining at the end of the last business year less than one-fifth of that one year's investment income. Its administration costs have been very small.

While its is true that the Act authorizes donors to purchase at fair market value the stocks which must be sold, a difficult situation arises because the stocks are now worth about $12 millions and for any individual, or group of individuals, to raise that amount will be difficult. In addition, there is the danger that competitors might succeed in acquiring the stock being sold which would lead to difficult and disastrous complications.

We submit that there should be no requirement to sell any so-called excess holdings where the foundation in good faith continues to follow the other requirements of the law, namely: No self-dealing except as specifically authorized; wise investment of its assets; prompt distribution to charity of all investment income; payment of such income tax, if any, as may be required; adherence to all of the other requirements under statutes and decisional law.

We realize that there is the problem of unproductive assets for which the donor has been given income tax benefit. In place of the suggested minimum distribution of say 5% of market value of investment assets (which value is difficult to ascertain for closely held shares) and to meet the problem of gifts of non-productive assets, we suggest: An annual distribution to charity of 4% of the declared value of the non-income producing items *plus* the higher of all actual investment income or 4% on the investment assets based upon the valuation declared by donors for their income tax benefit and the purchase price of other holdings. This eliminates all need to determine market value from time to time and establishes a known definite amount for determination of the minimum requirements. This approach will lead to realistic appraisals of values by the donors because foundations will hesitate to accept gifts if the values are overstated.

We believe that it is wrong to require the donor to pay a capital gains tax on the increment in value of his gift in order to use the full value for income tax purposes. This is directed at foundations alone and does not apply to gifts to churches, hospitals, colleges or any other non-profit activities.

It will discourage many from giving and if this happens, foundations and their beneficiaries will suffer.

The Cannon Foundation during recent years has contributed to many worthwhile activities which are well known to its directors. During a recent year, these beneficiaries included four hospitals, seven colleges, five schools, and orphanages, a local school district, eighteen small churches, eight United Funds or Community Chests and twenty-three other causes, including Y.M.C.A., Y.W.C.A., Boy Scouts and Girl Scouts, thus encouraging others to support good causes. The Foundation is providing funds for sixty-five scholarships to students in nine different colleges.

PENALTIES

The penalities for which provision is made in the form of taxes (5%, 15%, 200% and even confiscation of all of the assets of the foundation) are excessive and almost oppressive. It will discourage the creation and operation of foundations and may cause men to hesitate to act as directors because penalties are imposed upon the directors as well as upon the foundation assets.

As of August 15, 1969, a list of twelve large banks showed dividends to be slightly less than 4% on present lower prices. A list of 56 industrial, railroad and utility listed stocks of good quality showed a dividend yield of about 4.14%. We suggest that others might make a similar test to ascertain the actual dividend yield on representative stocks of investment quality.

CONCLUSION

Accordingly, we request that there be no requirement to sell so-called excess holdings of stock and that the minimum distribution be as above requested, namely, 4% on non-income producing items and 4% on the investment assets based upon valuation declared by donors at the time of the gift plus purchase price of investments purchased.

Statement of the Battelle Memorial Institute, Submitted by Paul T. Santilli, General Counsel

This statement is concerned with the application of Section 509 of the pending Tax Reform Act of 1969, relating to the definition or classification of exempt organizations, as to those that are "private foundations" and those that are not "private foundations."

Battelle Memorial Institute (which is exempt as an educational and scientific organization) is not a private foundation in any usual sense of that term—it is not controlled by any one individual or family, it has a wholly independent governing board of scientists, educators, and community leaders, it is supported by funds from a broad segment of industry and from the Government, its scientific research facilities are available on a non-discriminatory basis, and its research and educational programs benefit the public through dissemination of new knowledge and new innovative products and processes. Battelle has been advised that under the Bill as it passed the House it is not a "private foundation", but would like confirmation of its understanding.

WHAT BATTELLE IS AND DOES

Battelle is an independent not-for-profit scientific research and educational organization dedicated to the advancement and utilization of science for the benefit of mankind through the processes of technological innovation. It is exempt from income tax under Internal Revenue Code Section 501(c)(3). It was incorporated in 1925 and has been actively engaged for nearly 45 years in a broad pattern of activities which includes the conduct of contract research and the effective training of scientists and scholars at advanced levels of education.

Battelle's primary support is derived from sponsors of research, both Government and industry, and from income realized on its capital funds. Thus, in terms of support, as well as its service, Battelle considers itself a public institution. It does not receive any significant support from any single person, although the major portion of its sponsored research is for the U.S. Government. As an example of the public service performed by Battelle, in 1965 Battelle began operation of the U.S. Government-owned Hanford Laboratories at Richland, Washington. The Government invited Battelle to perform this function in anticipation of reductions in Government support for the Laboratories and because of Battelle's unique capabilities and unbiased approach. To date, Battelle has expended more than 20 million dollars of its own funds in this program, and Battelle's expenditures are continuing.

As indicated in the foregoing information and the attachment describing Battelle in greater detail (Battelle President's Report for 1968), Battelle is engaged in a variety of activities benefitting the public. Each year the Institute characteristically spends, for its exempt purposes, at least as much as its combined gross investment income[1] and contributions received.

ANALYSIS OF THE PERTINENT TAX BILL PROVISIONS

Section 509(a), as proposed to be added to the Code, beginning on page 15 of the Bill, lists four categories of organizations as "other than private foundations". The pertinent provisions of Section 509(a) are attached. We believe that the second category (Section 509(a)(2)) of such non-private foundations covers Battelle.

As we understand, the concept of Section 509(a)(2) is that a Section 501(c)(3) organization is not a private foundation if (A) more than one-third of its support is from members or the public and (B) not more than one-third is from its gross investment income. Battelle clearly fits this concept.

However, there is a limitation in Section 509(a)(2)(A) to the effect that in determining receipts to be included in computing the more than one-third support required to come from the public, there is not to be included "such receipts from any *person* in any taxable year which are in excess of 1 percent of the organization's support in such taxable year". (Italics added.)

The term "person" is a defined term in the Internal Revenue Code (Section 7701(a), and as defined does not include the Government (or a Governmental unit). Thus, the 1 percent limitation does not apply to support from the Government. This is quite proper because, of course, the Government is not a private person—it is the public.

Under this reading of the Act, which we believe is correct, Battelle is not a private foundation.

However, if the word "person" were read as including the Government, then the anomaly would occur that because of Government support an organization, such as Battelle, must be treated as a "private foundation" rather than as a public organization.

FACTS AS TO BATTELLE

Except for its Government research, Battelle would clearly qualify as a publicly- and broadly-supported organization, and not a private foundation. If the contrary interpretation of "person" (Section 509(a)(2)(A)) were to be successfully propounded, Battelle would be penalized for performing Government research, and especially for undertaking the operation of the U.S. AEC's Hanford Laboratories at the Government's request.

[1] As that term is defined in Section 506(b)(2) of the Bill.

To demonstrate the above in financial terms, over a recent period (from 1961–1968) Battelle's support consisted of 55.4 percent Government research, 20.7 percent industrial research, and 2.4 percent gross investment income (as defined in Section 506(b)(2)). The balance of income (as defined in Section 506) is capital gains, which were unusually high during this period. Therefore, 76.1 percent of our support was from the performance of services. If the Government is considered a "person", and thus all Government research in excess of 1 percent is excluded, our remaining support from services is 21.7 percent of the total support. It can be seen that under this circumstance Battelle would be defined as a "private foundation", contrary to its basic public character. As a further indication of the anomaly created by such an interpretation for the same 8-year period, if all Government research were totally excluded from Battelle's support, the support would consist of 46.4 percent industrial research and 5.3 percent gross investment income from endowment. Hence Battelle would clearly qualify as a publicly and broadly-supported organization. A brief consolidated financial statement for 1968 is shown in the President's Report which is enclosed.

If Battelle was classified as a "private foundation" it would be subject to operating restrictions that would severely hamper the conduct of scientific and educational activities and innovative processes essential to continuing progress and the national welfare. Such restrictions would be particularly severe if Battelle were further treated as a "non-operating foundation". Such an interpretation would impair its ability to continue its activities in the Pacific Northwest, and also it would be forced to substantially reduce other programs of research and education which have been ongoing at Battelle for many years and we believe have been of considerable benefit to the public. Included in this important activity is the conduct of self-supported basic research and the education and training of scientists and scholars at the highest levels.

In addition, because of the potential burdens and restrictions of the pending Bill and because of the severe sanctions that may be applicable, Battelle would be concerned about its ability to attract outstanding public-spirited citizens to serve as trustees and officers.

The interpretation of "person" so as to treat Government support as not public support is clearly not a natural construction and thus could lead to unintended, as well as unexpected, penalties.

In short, Battelle has played a major role in the quality and international standing of American science and learning since its organization. The Institute should be able to continue these important activities without undue or unintended restraints.

BATTELLE'S UNDERSTANDING OF SECTION 509 (A) (2) SHOULD BE CONFIRMED

As previously stated, we believe that both technically and conceptually a proper reading of Section 509(a)(2)(A) is that the 1 percent limitation on support by any "person" does not apply to the Government. However, we also believe that this reading of the Act should be confirmed to prevent any future misunderstanding.

This may be done by including in the Committee Report a sentence to the following effect: "The term 'person' as used in Section 509(a)(2) does not include a Government unit referred to in Section 170(c)(1)".

If a statuatory change were to be made (different from the language suggested above) Battelle could live with a test which eliminated Government support *both* from *receipts* and *total support*, as long as up to 1 percent (or some higher percentage) of receipts from others are included in receipts and support. This would be appropriate because then, as in Battelle's case, if the organization qualified under Section 509(a)(2) on the basis of support from other scources, it should not be disqualified because it is also supported by the Government.

FURTHER COMMUNICATIONS

Should you desire more information about Battelle, please contact Paul Santilli at 505 King Avenue, Columbus, Ohio 43201, telephone: Area Code 614, 299–3151, Extension 3655.

SPORT FISHERY RESEARCH FOUNDATION
Washington, D.C., August 15, 1969.

Hon. RUSSELL B. LONG
Chairman, Finance Committee
Senate Office Building
Washington, D.C.

DEAR SENATOR LONG: I am enclosing a brochure describing the program of this fledgling foundation, an IRS-designated 501(c)(3) organization of relatively recent birth.[1] Our tax-exempt status was recognized by the IRS as of July 1, 1964.

Total receipts since that time have amounted to $78,920.41 through April 30, 1969. Total disbursements, correspondingly, were $55,404.11. Of the latter, 23 annual graduate-level partial fellowships have been awarded in the amount of $52,250.00 to university graduate students. Remaining disbursements were to defray incorporation, printing, fidelity bonding, and accounting expenses ($2,279.11), symposium expense ($650.00), and student scientific paper awards ($225.00).

The balance between cumulative receipts and cumulative disbursements ($23,516.30) is represented by an earmarked student award fund ($3,558.57), a fledgling conservation leaders memorial award fund ($570.97), an earmarked fellowship award in 1970 ($5,444.95), and a start ($13,041.81) toward accumulation of funds for endowment of fellowships. All of these funds were deposited in several federally-insured savings and loan association accounts.

No salaries of any kind are paid out of Foundation assets. The sole objects are to raise funds through charitable contributions in order: (1) to provide graduate-level fellowships to help accelerate the training of needed new professional fish conservationists, and (2) to provide grants to qualified research scientists to stimulate more research on fishery biology and fish conservation problems.

This organization recently solicited $100,000 of a potential contributor for endowment of a fellowship in the biology of Atlantic salmon and/or billfishes. He has sufficient money to make such a contribution and appears to be interested in doing so. However, he is reluctant to take any action pending the outcome of current tax-reform considerations now before your Committee.

In order to highlight the problem with respect to small foundations such as this one, whose role I trust will not be destroyed inadvertently in the process of assuring certain types of reform that are your legitimate purpose, I quote for your information a pertinent passage from the recently-received interim response, viz:

"With respect to your suggestion of my setting up an endowment for a fellowship, I will keep this before me but at the moment I am not making any commitments related to eleemosynary contributions until the so-called tax reform legislation has been considered and dealt with by Congress .In my opinion, the proposed legislation will, unless substantially altered by the Senate Finance Committee, interfere markedly with ellemosynary contributions."

A reaction of this nature is discouraging, to say the least, and unless relieved, could prove most damaging to the worthy objectives of a number of legitimate non-governmental programs being conducted in the public interest. This organization hopes that your Committee can clarify this matter of tax reform vis-a-vis foundations at an early date so that the flow of charitable contributions to worthy causes will not be seriously interrupted.

If we can assist your Committee in any manner in our small way, we should be most delighted to cooperate as you may desire. It will be appreciated if you would *include this communication* in your record of hearings on this important matter.

Sincerely yours,

RICHARD H. STROUD,
Vice-President.

[1] The brochure was made a part of the official files of the committee.

Statement By Robert G. Chollar, Chairman, Board of Trustees, Charles F. Kettering Foundation

SUMMARY

1. The 7½ percent tax on the investment income of private foundations would unwisely impair the important role of private philanthropy in our society. Further, the principal impact of the tax will fall on colleges, universities, religious organizations, hospitals, and publicly supported charities—the very organizations the House intended to exclude from the tax.

2. The tax on expenditures to influence legislation will seriously hamper the important work done by private foundations in the fields of education, judicial and governmental improvement, environmental control, and other areas of social concern, and will not prevent any serious abuse that cannot be dealt with by vigorous enforcement of existing laws.

3. Although the minimum distribution concept is sound, I believe that grants to an affiliated foundation which promptly spends the contribution for charitable purposes should be included as "qualifying distributions". In addition, the definition of "operating foundation" should be clarified and "qualifying distributions" should be defined to include contributions to organizations of the type described in section 170(g) (3) of the Internal Revenue Code.

STATEMENT

This statement is submitted to present to the Committee my views on the provisions of the Tax Reform Bill of 1969, H.R. 13270, as they relate to private foundations. Since I am in general accord with the objectives of many provisions of the Bill, such as those designed to prevent self-dealing and other abuses, I will not comment on those aspects of the House proposals. I do believe strongly, however, that certain provisions of the Bill may seriously, and pointlessly, hamper much of the important work done by private foundations. The provisions of the Bill with which I am concerned are those dealing with: (i) the 7½ percent tax on investment income, (ii) the tax on expenditures to influence legislation, and (iii) the minimum distribution requirements.

I. *The 7½ percent tax on investment income*—The Bill imposes a tax of 7½ percent on a private foundation's net investment income and its net capital gains. This proposal represents a radical departure from the long-standing Congressional policy of exempting private foundations from the burdens of taxation. That policy has been wisely based on Congressional recognition of the special role played by private philanthropy in our society and Congressional awareness that many of the programs and activities supported by private foundations might otherwise have to be financed by government. Those policy considerations are as vital today as at any time in our history.

Further, although the Bill purports to impose the tax only on private foundations, and not on other classes of exempt organizations such as colleges, universities, religious organizations, hospitals and publicly supported charitable organizations, it seems clear that the principal impact of the tax will fall precisely on these latter organizations. As this Committee is undoubtedly aware, the principal beneficiaries of private foundation grants are charitable organizations of the type not subject to the tax on investment income. Accordingly, to the extent that the proposed tax reduces the funds available for distribution by private foundations, grants made to such other tax exempt organizations will be correspondingly reduced. The result, of course, is not a tax on private foundations but a tax on colleges, universities, hospitals, research organizations, etc.—the very organizations that the House desired to shield from the impact of the tax on investment income.

For these reasons, it is my firm view that the proposed tax on the investment income of private foundations is an unwise and unwarranted departure from long-standing traditions and Congressional policy.

II. *Tax on expenditures to influence legislation.*—The Bill imposes severe taxes on foundations and their managers for so-called "taxable expenditures". The term "taxable expenditures" is defined to include amounts paid to attempt to influence legislation through (i) "an attempt to affect the opinion of the general public or any segment thereof", and (ii) "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". Activities are not made subject to the tax if they consist only of "making available the results of nonpartisan analysis or research".

This aspect of the Bill has caused a great deal of anxiety and confusion among foundations that are active in the fields of education, judicial and governmental improvement, environmental control, and other areas of social concern. Many of the problems studied by these foundations are or will be dealt with by existing, pending or future legislation. By the very nature of the work conducted by such organizations, and the expertise that they develop, the results of their study or research will culminate in the formulation of positions or recommendations. This, indeed, is often the very purpose of their critically important work. Under the ambiguities of the Bill, many such foundations and their managers would be constantly working under the threat of being subjected to the severe financial penalties proposed by the House. Intimidation, lack of effectiveness, and abandonment of desirable projects would almost certainly result.

It seems to me the prevailing view of those knowledgeable in this area of our tax laws that existing laws, if vigorously enforced, are adequate to prevent any of the serious abuses that concerned the House. No good reason exists, therefore, for enacting legislation that would have the effect of substantially diminishing the significant contribution made by private foundations in seeking solutions to some of the most troublesome problems facing our civilization.

III. *Minimum distribution requirement.*—The Bill provides that a private foundation must currently distribute, by way of "qualifying distributions," an amount equal to the greater of its net income for the year or 5 percent of the value of its invested capital. I am in complete accord with the requirements that private foundations currently devote their income to charitable activities and that the amount so devoted represent a reasonable return on the foundations' investment assets. I am concerned, however, with the Bill's narrow definition of qualifying distributions.

My first objection is that the Bill excludes from the definition of "qualifying distributions" contributions to an organization controlled by trustees or substantial contributors with respect to the grantor foundation. This exclusion creates the anomaly that a direct project expense of a foundation would constitute a "qualifying distribution," but the same expense, if incurred through a "subsidiary" or "brother" foundation to the grantor, would not qualify. Such affiliated foundations have served a variety of useful purposes in organizing and defining responsibility in the foundation world. Since the purpose of the minimum distribution provisions of the Bill could be accomplished by requiring affiliates to promptly devote contributions received to active charitable uses, the absolute exclusion of such contributions from the definition of "qualifying distributions" would unnecessarily impede sound organizational planning.

I am also concerned with the Bill's definition of an "operating foundation" as an organization substantially all of the income of which is spent directly for its charitable purposes and which either (a) devotes substantially more than half its assets directly to such activities or to functionally related activities, or (b) derives its support from at least 5 independent exempt organizations or from the general public, and not more than 25 percent of such support is normally received from any one such exempt organization.

In the first instance, the definition contains undesirable ambiguities. While I would assume that the distribution of grants would qualify under the income expenditure test, the Bill does not make this clear. In addition, the status of contributions received but not yet expended by the foundation as assets devoted directly to exempt activities is not clear. While it seems reasonable to assume that such assets, either kept in bank accounts or invested in short-term securities prior to expenditure, would qualify as assets devoted directly to exempt activities, the Bill does not specifically so provide.

Secondly, the alternative support portion of the definition is unduly restrictive. The House Ways and Means Committee Report indicates that this alternative was added to qualify as operating foundations certain foundations which are used by other foundations to funnel contributions into certain areas in which they have expertise. There exists a substantial number of private foundations which operate in this fashion, and which have developed considerable expertise in their areas of operation, but which could not meet the alternative support requirement of the Bill because they are either not supported by five or more exempt organizations or they receive more than 25 percent of their support from one foundation, or both. If the support alternative of the operating foundation definition is to serve its purpose, it should be considerably broadened in scope.

In light of the foregoing, I suggest that this Committee give consideration to the approach taken in section 170(g)(3) of the Internal Revenue Code in describing the organizations to which qualifying distributions can be made. Section 170(g), which deals with the unlimited charitable contributions deduction, is also concerned with the prompt distribution of funds to charitable activities. Section 170(g)(3) describes, as an organization contributions to which constitute "qualified contributions" for purposes of the unlimited deduction, a foundation which expends an amount equal to 50 percent of the contribution in question for its charitable purposes within three years. It seems that the objectives sought to be achieved in the Bill can be fully accomplished, without any of its unwarranted restrictions, by defining qualifying distributions as including distributions to organizations of the type described in section 170(g)(3).

Statement of Harry Scherman, President, Scherman Foundation, Inc.

SUMMARY

The attribution of stock held in trust to a foundation under proposed Code section 4943(d)(1) of the "excess business holdings" provisions of the Tax Reform Bill will, if the trustee is not subject to foundation control and refuses to sell such stock, require the foundation to sell an unmarketable trust interest at a sacrifice price, at a detriment to the foundation's resources available for charitable activities. In some cases, moreover, sale of such a trust interest may be prohibited by spendthrift provisions of state law. To prevent such apparently unintended adverse consequences to charitable foundations, a restriction on the application of this provision in the case of irrevocable trusts created before May 26, 1969 should be added to the Bill.

STATEMENT

I am the President of The Scherman Foundation, Inc., a private foundation which has income and remainder interests in various trusts. I am making this statement in order to bring to the attention of the Committee an apparently unintended result of the constructive ownership rules contained in the "excess business holdings" provisions of the Tax Reform Bill, H.R. 13270.

Proposed Code section 4943, as set forth in section 101(b) of the Bill, requires in effect that private foundations having excess business holdings on May 26, 1969 dispose of such holdings within ten years from that date, and take partial steps toward such divestiture at the close of periods of two years and five years from that date. Foundations failing to comply with this provision are subject to a penalty tax on the amount of their excess business holdings. Proposed Code section 4943(d)(1) provides, inter alia, that the excess business holdings of a foundation shall be determined by treating the foundation as owning stock actually owned by a trust of which it is a beneficiary, in proportion to its interest in the trust.

Insofar as section 4943(d)(1) seeks only to measure the amount of stock actually owned by a foundation which the foundation must dispose of, it imposes no hardship from the standpoint of compliance. However, the provision may also have the result of subjecting to tax a foundation which has disposed of all direct holdings, but which remains a beneficiary of a trust having a substantial stock interest in a single company. If the trustee of such a trust is willing and able to sell the stock in question at a fair price, the constructive ownership rules will obviously present no such problem. However, the constructive ownership principle becomes onerous in its application if a trustee over which a foundation has no control refuses to make a sale of stock, and the foundation as a result is subjected to a tax on excess business holdings.

Where the trustee is unwilling to sell enough stock to terminate the foundation's excess business holdings, the effect of the constructive ownership rules of section 4943(d)(1) is to require the foundation to sell all or a portion of its interest in the trust. However, in some cases, this may not be permissible under spendthrift provisions of state law, which restrict the power of beneficiaries to dispose of interests held for them in trust. Where such a sale is allowable under state law, moreover, an adequate price is unlikely to be obtained for an interest in trust, whose value depends on such contingencies as the lifetime of other beneficiaries. The result of forcing a sale of a trust interest in such cases would be to diminish rather than augment the charitable benefit from the operations of the foundation, and would thus be contrary to the purposes of the Bill.

In the future, of course, trust arrangements which would involve foundations in the predicament described above can be avoided by informed counsel. In the case of irrevocable trusts previously created, however, the present language of proposed Code section 4943(d)(1) may require foundations to make sales of unmarketable trust interests at sacrifice prices, at a detriment to the foundations' conduct of their charitable activities. To prevent such adverse consequences to charitable functions, it is suggested that the committee give consideration to appropriate language which would limit the application of proposed Code section 4943(d)(1) in the case of irrevocable trusts created before May 26, 1969. Such an amendment would, of course, leave intact the foundation's obligation to dispose of any excess business holdings which it comes to own directly as a result of termination of a trust in which it has a remainder interest.

Statement of Stephen M. Schwebel, Executive Vice President, American Society of International Law

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 7½% 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) means 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 "nonpartisan 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, 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 7½ 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 SEVEN AND ONE-HALF PERCENT 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 7½ percent 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 nongovernmental 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 7½ 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.

Statement Submitted for the Sid W. Richardson Foundation, Fort Worth, Tex.

Sid W. Richardson Foundation, a non-profit Texas corporation organized and operated for charitable, religious, literary, and educational purposes, hereby requests modification or elimination of certain provisions of H.R. 13270 dealing with the taxation and regulation of "private foundations" as defined in said H.R. 13270 now under consideration by the Committee on Finance.

DEFINITIONS AND ABBREVIATIONS USED

Sid W. Richardson Foundation will hereinafter be referred to as "Foundation." H.R. 13270 will sometimes be referred to as "the Bill." The late Sid W. Richardson will be referred to as "Richardson," and Perry R. Bass, Richardson's nephew and his partner for many years prior to Richardson's death, will be referred to as "Bass."

REQUESTED MODIFICATIONS OR ELIMINATIONS

The provisions of the Bill as to which modification or elimination is requested are:

1. The provisions of Section 507(b)(2), which define the term "substantial contributor."

2. The provisions of Section 4946(b) of the Bill, defining the term "Foundation Manager," insofar as it affects permitted stock holdings in a corporation under Section 4943(c)(2) of the Bill.

FACTS

Foundation was incorporated as a Texas non-profit corporation in 1947. It has no capital stock. Its articles of incorporation, which have never been modified provided that the Foundation should be managed and controlled by a self-perpetuating board of directors. It was organized at the instance of Richardson, and he, Bass, Richardson's two sisters, and a brother-in-law were the original directors. Its present directors are: Bass, his wife, H. B. Fuqua (Chairman of the Board of The Fort Worth National Bank and unrelated), E. W. Sampson, and M. E. Chappell, the latter two of whom are long-time executives of Richardson and Bass, Richardson's two sister, and a brother-in-law were the original directors.

Shortly after its organization, Foundation was classified as exempt from income taxes under what is now Section 501(c)(3) of the Internal Revenue Code of 1954, and it has continuously preserved that exempt status and is now so classified.

Prior to Richardson's death, which occurred on September 30, 1959, Foundation's only contributors were Richardson and Bass. In lieu of Richardson and Bass individually or their various enterprises making direct contributions to charitable, religious, and educational undertakings, those just referred to contributed to Foundation, which in turn distributed substantially all of these contributions to appropriate educational, religious, and charitable undertakings. From organization through the calendar year 1961, Foundation received from the sources indicated contributions of $800,500.00, and through 1961, it had disbursed in contributions $804,747.46. Of this total amount, Bass contributed, directly and as his share of contributions made by enterprises jointly owned by him and Richardson, a total of $147,500.00. In several years during this period. Bass' direct contributions exceeded $5,000.00, so that under the Bill as presently drafted, he would be classified as a "substantial contributor." See Section 507(b)(2) of the Bill. Other than as above stated, Bass has made no contributions to Foundation, either directly or indirectly.

Richardson, who was a bachelor and a very active and successful business man, after making certain specific provisions in his will for various members of his family (which provisions have no bearing on the problem dealt with herein), left the residue of his estate and the income received from it during its administration to Foundation. The administration of the estate was closed as of January 1, 1962, and the entire residue delivered to Foundation at that time, although the obligations of the estate and a considerable portion of the death duties (which aggregated some $48,000,000.00) had not been paid. Foundation immediately borrowed $30,000,000.00 to pay off the balance of the unpaid death duties and certain claims, and subsequently has proceeded to pay off these obligations subject to which it received the residue of the Richardson estate and to carry on the religious, charitable, and educational activities which it was organized to support. Bass, Howell E. Smith, Richardson's brother-in-law, and John B. Connally, who, at Richardson's death, was employed by the Richardson and Bass organizations, were the independent executors of the Richardson estate.

At the close of the year 1962 (the first year that Foundation had possession of the residue of the Richardson estate), the net book value of Foundation's assets was $71,051,714.52. At the close of the calendar year 1968, the net book value of these assets was $72,852,530.52, and the market value of certain of its investments in excess of book value was $19,038,208.47, resulting in what might be called an increase in actual value over carrying value to $91,900,738.99.

From the time Foundation received the residue of the Richardson estate until the close of the year 1968, its net income, exclusive of capital gains, amounted to $16,303,138.19, but its contributions and firm commitments to make contributions during the same period largely exceeded this net income, so that, considering its firm commitments, it had a deficit in accumulated income at the close of the year 1968 of $1,339,179.73.

The greater portion of Foundation's contributions and commitments were to institutions such as Rice University at Houston, Texas, Austin College at Sherman, Texas, St. Luke's Episcopal Hospital at Houston, Texas, Texas Wesleyan

College at Fort Worth, Texas, the Boy Scouts of America Longhorn Council, Fort Worth, Texas, Texas Christian University at Fort Worth, Texas, Trinity University at San Antonio, Texas, the University of Texas, at Austin, Texas, and Howard Payne College at Brownwood, Texas.

It is clear from the above that under Section 507(b) (2) of the Bill as presently written, Bass would be classified as a "substantial contributor" to Foundation, and because of this fact and the fact that he is presently, as he has been since its organization, a director of Foundation, he would be classified as a "disqualified person" under Section 4946(a) of the Bill for all of the situations dealt with in the Bill, such as those dealing with "excess holdings" (Section 4943), as well as those imposing taxes on self-dealing.

It is equally evident that in bringing the Foundation into existence in 1947, and by naming Bass and his brother-in-law as two of the independent executors of his will, and by the continuation of Bass as a director of Foundation, Richardson intended that members of his family who were familiar with his wishes and the interests which he wanted his fortune to serve should have an important voice in the management of the Foundation which received the residue of his estate.

DISCUSSION

The facts above summarized show that Foundation has had two entirely separate periods of existence. The first period began with the Foundation's incorporation and extended to the year 1962 when Foundation received the residue of the Richardson estate. During this period, Foundation might be likened to a private community chest which received contributions from Richardson, Bass, and their common interests, and distributed the amounts so contributed to qualified and acceptable donees—religious, charitable, and educational undertakings. All amounts contributed during this period—those contributed by Bass and the interests with which he was identified, as well as those contributed by Richardson and the interests with which he was identified—had been disbursed prior to January 1, 1962. This closed the "private community chest" era of the Foundation. Since that time, Foundation has received no contributions other than the residue of the Richardson estate which was received under the terms of his will. Leaving for subsequent discussion the fact that Bass is a director of Foundation, it is wholly unconscionable and inequitable to treat Bass or anyone else as a "substantial contributor" under the section of the Bill above referred to, because that definition applies no matter how long ago such contribution was made. This results in an untenable, retroactive confiscation that violates all concepts of equity and fairness.

The same undefendable, retroactive operation of the Bill will follow as to the determination of "permitted holdings" in a corporation by a foundation if the present provisions defining a "Foundation Manager" as a disqualified person (Section 4946(b) (1) of the Bill) remain unmodified.

It is submitted that the situation so presented requires, in fairness and in equity, and to avoid retroactivity of a taxing provision that virtually all citizens abhor, modification of the Bill so that the holdings of Bass should not be taken into consideration in determining whether or not this or any other similarly situated foundation has "permitted holdings."

It is intended by the modifications in the Bill hereinafter suggested to remove the provisions of the Bill which, as now written, classify Bass or anyone similarly situated as a "substantial contributor" to a foundation for purposes only of determining whether Foundation has "permitted holdings," but it is not intended thereby to relieve Bass or any other officer, director, or trustee, or any individual having powers and responsibilities similar to those of an officer, director, or trustee of a foundation, so long as such person remains in such position with the foundation from the application of the provisions of Section 4911 of the Bill imposing taxes, penalties, and sanctions on "self-dealing."

SUGGESTED MODIFICATIONS

It is believed that the objections to the present Bill herein pointed out can be removed by the following:

The following should be substituted for Section 507(b)(2)(A) and (B):

"(A) Any person who (by himself or with his spouse) contributed or bequeathed to a private foundation in any one calendar year beginning on or after January 1, 1965, more than $5,000.00, and

"(B) Any person who (by himself or with his spouse) contributed or bequeathed the greatest amount to the foundation in any one calendar year, on or after January 1, 1965."

To prevent Bass or anyone else similarly situated from being classified as a "disqualified person" because of the fact that he has continuously been a director of Foundation since its organization, and thereby resulting in having his holdings and those of his family taken into consideration in determining "excess holdings," it is believed that the following addition to Section 4946(b)(1) should be made, so that the entire subsection 4946(b)(1) would read:

"An officer, director, or trustee of a foundation (or an individual having powers and responsibilities similar to those of officers, directors, or trustees of a foundation), except that in the determination of 'permitted holdings' there shall be excluded as a disqualified person an officer, director, or trustee of a foundation (or an individual having powers and responsibilities similar to those of officers, directors, or trustees of a foundation) who occupied such capacity at the organization of the foundation prior to January 1, 1965, and who thereafter has continuously held such office or had such powers and responsibilities."

Respectfully submitted,

Sid W. Richardson Foundation,
By E. W. Sampson, *President*.
Harry C. Weeks,
Frank B. Appelman,
Attorneys for Sid W. Richardson Foundation.

Statement of the Center for Information on America, Washington, Connecticut, Submitted by Townsend Scudder, President

(Statement on the effect proposed changes in the tax law might have on such nonprofit organizations as the Center for Information on America, Inc., which engage in civic education)

The Articles of Association of the Center for Information on America, incorporated in 1952 pursuant to the statute laws of the State of Connecticut, declare its objects and purposes to be:

"To foster, promulgate and disseminate among Americans generally of this state and other states American culture and ideals, a knowledge and understanding of American history, its meaning and purpose and its guarantees of personal and individual rights and privileges;

"To gather, compile and distribute information about all aspects and phases of life in America, and to make such information available by any means to educational or other institutions of any kind, for the purpose of carrying on studies of life in America."

". . . To gather, compile and organize such information by any and all means of research, study and recording, and to publish, print, circulate, distribute and disseminate such information by any and all means of communication, transmission and transcription."

An important part of this area is Civic Education.

Under date of May 22, 1953, the Center for Information of America, Inc., received from the Office of the Commissioner of Internal Revenue, U.S. Treasury Department, a letter stating that "It is the opinion of this office, based upon the evidence presented, that you are exempt from Federal income tax under the provisions of section 101(6) of the Internal Revenue Code, as it is shown that you are organized and operated exclusively for educational purposes." This became Section 501(c)(3) after the adoption of the Internal Revenue Code of 1954.

The Center's Editorial Advisory Committee (list of present membership appended), under whose general supervision its materials are produced, has maintained a policy of scrupulous objectivity, non-partisanship, and scholarly accuracy. Its success in living up to these standards is attested to by the comments listed in the accompanying exhibit, "*As Others See Us.*"

There are sections in H.R. 13270 which, if not modified in their wording by the Senate, could work great harm to non-profit, non-partisan corporations dedicated to civic education even though, like the Center for Information on America, Inc., they have been classified as 501(c)(3) by the U.S. Treasury Department under the Internal Revenue Code.

As I understand the legislation, H.R. 13270 imposes a 100% tax on a foundation, and 50% tax on its trustees and officers who act knowingly, on the amount of any grant which carries out voter education or registration projects (unless grants are made to a 501(c)(3) organization, whose principal activity is nonpartisan political activity and which operates in five or more states, receives support from five or more organizations, no one of which provides more than 25% of its support, and does not receive funds earmarked for use in a particular area).

The Center carries out voter education, is completely non-partisan, operates in five or more states, may or may not receive support from five or more organizations, could receive more than 25% of its support from one organization, and has and could receive funds earmarked for use in a particular area such as health, conservation, civic curriculum in schools, etc.

If passed by the Senate, restrictions such as these could so influence Foundations that they would cease support even to organizations like the Center classified as 501(c)(3). Lack of such support would close the Center, putting an end to an organization which, over the past twenty years, has been producing excellent material for use in schools, colleges, libraries, government agencies, and industry. The Library of Congress, for example, rates our material highly and orders largo quantities.

Such phrases as "attempts to influence legislation," or the carrying out of "voter education" could even be applied adversely to every university that has a Department of Political Science, for it is impossible to study the processes of government without including thought on ways of improving government. Surely the survival of our great experiment of self-government in the United States depends on an informed and conscientious citizenry. To borrow President George Washington's phrase, "It is essential that public opinion should be enlightened," and he advocated founding of institutions and academies, like the Center, devoted to that very objective.

The more the American people cultivate an intelligent understanding of public affairs, the greater is the likelihood that freedom and democracy will prevail and flourish. To threaten the very existence of educational organizations devoted to civic education by laying obstacles in the way of their receiving foundation grants should not be the result, however unintentional, of any legislation.

Respectfully submitted,

TOWNSEND SCUDDER,
President, Center for Information on America, Inc.

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AS OTHERS SEE US

Kind words about the services and materials from the Center have come from leaders in all areas of American life. Only a few of the many typical examples follow:

Government officials

I am most pleased to see the continuing fine effort your organization is putting forth to stimulate political interest.—RICHARD M. NIXON.

The Center is performing an important service through its efforts to encourage a better informed citizenry on subjects of national and international concern.—JOHN F. KENNEDY.

I am certain that The Center for Information on America is performing a much-needed service, one in which I am interested.—Dwight D. Eisenhower.

The Center is doing an important job by broadening the public understanding of both our national and international affairs, and I wish it . . . all possible success.—Adelai E. Stevenson.

I might venture to say that the whole process by which we go about selecting our Presidential candidates is generally confusing to the average citizen. But when he is faced with the convention itself, he may just want to throw up his hands in bewilderment.

Your Grass Roots Guide to the nominating conventions should do much to clear up the confusion and give the voter a clearer picture of what takes place.—Hubert H. Humphrey.

It is just this sort of thing that our nation needs to improve the problems on racial issues. (comment on "Negro History—What Should Be Taught In School, and Why?' in the Center's monthly Vital Issues series)—Fred R. Harris, *U.S. Senate.*

I was very impressed with the way in which you handled this difficult (*Foreign Trade*) issue.—John S. Monagan, *U.S. Congressman.*

I am delighted to have this . . . excellent pamphlet (*The State Of The States: What's Their Job? Are They Doing It?*) as it is accurately and well written without extra words or over complicated language.—John H. Chaffee, *Former Governor of Rhode Island.*

Government departments and agencies

A most excellent publication about a most hopeful subject. ("U.S. Rivers: Can Their Natural Values Be Restored And Their Economic Values Retained?"—Vital Issues series)—Stewart L. Udall, *Former Secretary, U.S. Department of the Interior.*

This type of material is of interest in all of our Information Centers overseas.—Emilie M. Miller, *Program Services Branch U.S. Information Agency.*

We are pleased with your presentation of the youth fitness article, and the layout is very attractive and effective.—V. L. Nicholson, *Director of Information, The President's Council on Youth Fitness.*

Educators

I have been in on the Vital Issues Experiment since almost the beginning and would like to commend you for the excellent job which you are doing.—Ben M. Snyder, *Cranbrook School, Bloomfield Hills, Mich.*

Please rush 10 copies of your booklet, "Presidential Primaries of 1968" at 30 cents each. I need them for a unit in American Problems on the upcoming election for President.

Your booklet was recommended by the League of Women Voters.—Mary A. Widenhouse, *Northern High School, Baltimore, Md.*

This publication (Vital Issues) . . . will be of great value because of its compactness, its timeliness, and the authoritative qualifications of its contributors.—Sister M. Madeleva, *St. Mary's College, Notre Dame, Ind.*

I am very much impressed with your Grass Roots Guide on "The Presidential Nominating Conventions." It is an excellent summary of what will be going on there. The three recent uumbers of Vital Issues are informative and useful and up to your usual high standards.—Idisore Starr, *Former President, National Council for the Social Studies.*

I consider this the best statement I have seen on the subject (Conservation and Pest Control) and I wish I had known of it earlier.—LaMont C. Cole, *Professor of Zoology, Cornell University.*

They (various Vital Issues) are very well done, and I particularly like the frankness but impartiality with which you deal with these ticklish problems.—Edwin O. Reischauer, *Harvard University.*

I have just received your most recent Grass Roots Guide, "Public Office At The Local Level."

As a person with a strong professional interest in responsible government, I am heartened by this addition to your very fine series.—Stephen K. Bailey, *Dean, Syracuse University.*

There has been so much interest for Grass Roots Guide No. 34 that I want to get more copies. Please send me 55 copies of "The Presidential Nominating Conventions of 1968" as soon as possible.—Preben V. Askgaard, M.A., *Stenkrogen, Denmark.*

Librarians

Vital Issues and Kit received. It is a *great* contribution to teaching.—Sister MARY BEATRICE, *Librarian, Star of the Sea Academy, San Francisco, Calif.*

This school library would like to be put on your mailing list to receive your publication, Vital Issues. The issue recently received, The European Common Market, is just the kind of information we look for to file—well-written, informative and current. Thank you very much.—MARGARET L. HARDING, *Librarian, Old Lyme, Conn., High School.*

We find the *Vital Issues* series a valuable source of authoritative information and is a great help in answering our patrons' questions.—JOHN CLARK, *Adult Services Librarian, Farmingdale, N.Y. Public Library.*

A standard subject area in which we are asked to supply information is that concerned with American politics and government. It is here that the Grass Roots Guides have been most useful. The constituents (writing to their Congressmen) do not generally ask for a specific title . . ., but when we are asked to supply information on a particular subject, such as the national conventions or Presidential primaries, we will send a copy fo the Grass Roots Guide concerned with that subject.—*Legislative Reference Service, Library of Congress.*

Students

I would like to thank you very much for your pamphlet, for it was a great service to (me) in writing my term paper on Indians.—KAREN WHITE, *Philadelphia, Pa.*

My local League of Women Voters has recommended to me your pamphlet, "Electing the President—Should the Electoral College System be Changed," as reference for a research paper I am doing for my United State's History course. I am enclosing 35 cents.—NANCY FISCHBACH, *Harrison, N.Y.*

I am a foreign exchange student from Italy, and I have come to the United States with the American Field Service Program (International Scholarships, New York). I am now attending the senior year at the Soquel High School. I am studying and trying to learn about America, and let the people here know about Europe and Italy in particular, as much as I can. I believe this is the best way for international understanding, friendship and peace.

Of course, as a senior at SHS, I have a government class, and we study and debate about different aspects of American life. In our research we are greatly helped by your "Vital Issues", we read usually once or twice a month. I like them very much, because they are clear, open-minded and sincere.—ED G. BENELLI, *Soquel, Calif.*

Nonprofit organizations

I have read with great interest your Vital Issues paper on Negro History (Jan. 1969). This material would be valuable for a group of women within our local societies across the country who have volunteered to be a part of a special action effort directed toward the racial crisis in America.—MARIE L. MEYER, *Associate Secretary, National Woman's Missionary, Society of the Church of God, Anderson, Ind.*

We have received several requests for information on the history of the International Court of Justice, and I have not been able to commend anyone to a better capsule history than that published by Vital Issues.—PHILIP R. BILANCIA, *Executive Secretary, Committee for Effective use of the International Court.*

"Profit Sharing—Does Or Doesn't It Pay Off?" is an excellent article.—EVELYN SCHWARZ. *Research Assistant, Joint Council on Economic Education.*

Congratulations on your fair and interesting appraisal of the Peace Movement.—JAMES L. VAUGHN, *National Student Christian Federation.*

I can't tell you how very good we think your Discussion Guides are. Time after time, we have had occasion to refer our correspondents to your Center because of the valuable non-partisan information which you issue.—ANN KAHN, *League of Women Voters of the United States.*

We at the U.S. Committee for the UN want you to know that we are glad you prepared the leaflet on the UN's Economic and Social Programs and that we think Forrest Murden did a very fine job in summarizing the UN's varied activities in these fields.—DOROTHY CROOK, *Executive Director, U.S. Committee for the U.N.*

I want to congratulate you on doing a comprehensive and compact job. A great deal of information and sage advice is contained in the four printed pages of your publication.—WERNER WARMBRUNN, *President, National Association for Foreign Student Affairs.*

Our executive director, Matthew Rockwell, was quite impressed with your newsletter on "Regional Planning: What Is It? What's Its Purpose?" This is just the kind of information which we hoped to make available to readers of our newsletter in the Chicago region.—ANITA R. DAVIS, *Information Officer, Northeastern Illinois Planning Commission.*

It appears to us that your Vital Issues series is an excellent educational tool, and we commend you on the quality of the latest issue ("Our Tremendous Traffic Snarl: How Cope With It?").—HOWARD PYLE, *President, National Safety Council.*

Little has been done to create local conservation commissions in this part of the country and the excellent discussion in Vital Issues should help focus attention on the value of such bodies for implementing conservation programs.—WILLIAM E. SIRI, *President, Sierra Club, San Francisco, Calif.*

Industry and labor

The Vital Issues on retirement programs presents the opposing cases for the rigid and flexible policies more clearly and concisely than I have even seen it done before.—WILLIAM A. HANWAY, *Secretary, International Paper Co.*

We have reviewed with interest and admiration various materials sponsored by your organization.—WILLIAM F. LEONARD, *Director of Corporate Relations, Olin.*

You and your organization are to be congratulated on an effective presentation of an important subject (*UN Economic and Social Programs*). ARTHUR K. WATSON, *IBM.*

I have seen your very fine booklet "The Fundamentals of Freedom" and would like to know if you have a catalogue describing your publications and films.—JOHN F. IRWIN, *Training Representative, Gulf States Utilities.*

As always, I look forward to each of your illuminating and educational guides.—STUART D. BYKOFSKY, *Research Director, United Hatters, Cap & Millinery Workers International Union.*

Miscellaneous

"America: A Nation of Migrants" . . . is a well written and important piece.—ROBERT C. COOK, *Former President, Population Reference Bureau.*

While engaged in a graduate management research project on desalinization, I read the article "Salt Water Into Fresh" found in your February 1966 publication, Volume XV, Number 6. I found this article very meaningful, and would appreciate a reprint. My check for 35¢ is included.—ROBERT B. BARTON, *Major, U.S. Air Force.*

"The American Peace Movement" is a brilliant account of this complex field. I can't recall seeing such a thorough and balanced job done on the subject in twice the space.—NORMAN COUSINS, *Editor, Saturday Review.*

Very shortly I am planning to enter local politics, and I had the pleasure of reading your very informative booklets, "Public Office at the Local Level," and "Who, Me a Politician?" There was more information in these two booklets than in the last two books I have read.—FRANCIS P. BAKEY, *Somerville, Mass.*

Once again, the Center has taken a complex problem (*Urban Transit*) and stripped it to its essentials, forcefully pointing out the steps which must be taken to cope with it.—ANDREW HEISKELL, *Chairman of the Board, Time, Inc.*

I read your article (*Australia and New Zealand*) with great interest and approval and I thought that you dealt with your subject admirably.—HOWARD BEALE, *Ambassador from Australia.*

I think your organization is doing a fine job of researching the new frontiers of metropolitan problems.—DON E. WEAVER, *Editor, Columbus Citizen-Journal.*

Testimonials come in other ways as well. More and more references are being found in bibliographies of all kinds. Requests for rights to reprint in whole or in part are on the increase. And use by newspapers and journals of various sorts for reference, quotation, or as the basis for editorial comment is becoming quite common.

Statement of the Association of American Law Schools, Submitted by Michael H. Cardozo, Executive Director

THE ASSOCIATION OF AMERICAN LAW SCHOOLS

The Association of American Law Schools was founded in 1900 for the express purpose of "the improvement of the legal profession through legal education." This continues to be its exclusive purpose. In pursuit of this aim, the Association acts as an accrediting agency for law schools in the United States, sharing this function with the American Bar Association. Both associations are nationally recognized as accrediting agencies in this field. The A.A.L.S. also conducts research in the area of legal education, for the purpose of improving the administration of law schools and the methods and content of law teaching. In addition, the Association provides general services to law schools, law teachers and law students, as well as others concerned with the field of legal education.

The principal support of the activities of the Association comes from the payment of annual dues by its 119 member law schools. Special activities, such as research projects, are supported by grants from various private foundations and from government agencies.

THE EFFECT OF H.R. 13270 AS PASSED BY THE HOUSE

The A.A.L.S. is concerned over the probability that H.R. 13270, if enacted in the form passed by the House of Representatives, would have serious adverse effects on legal education. The nature of these effects are fully described in a number of statements already presented to this Committee on behalf of other non-profit educational and research organizations. In general, the effects that are of concern to the A.A.L.S. are twofold: (1) the likelihood of a significant lessening of the contributions to education that would be made from private sources, and (2) serious restrictions on funds provided from private sources for research and experimentation for the improvement of education in general and legal education in particular, and similar restrictions on the use of funds from private sources for research aimed at the improvement in legal processes and legal rules, and the administration of justice.

Although the complexity of the Internal Revenue Code, as amended by the proposals in H.R. 13270, make any conclusions concerning their reach highly problematical, it has been our tentative conclusion that the House version of H.R. 13270 would not include the Association of American Law Schools in the definition of "private foundation." However, many of the activities of the A.A.L.S. in the field of legal education are carried on in conjunction with other private, non-profit organizations. Many of those organizations do fall within the definition of "private foundation" in the present version of the bill. While some of them might occasionally qualify as "operating foundations" and thereby escape some of the strictures in the bill, they could do this only at the expense of much of the freedom of action they need for effective operation. Consequently, many important activities of the A.A.L.S. would be seriously affected.

We are attaching hereto a list and brief description of a number of organizations with which the A.A.L.S. is closely related in the pursuit of its aims in legal education. We do not believe that any of these organizations have carried on any of the activities to which the criticisms contained in the Report of the Committee on Ways and Means of the House of Representatives, in reporting out H.R. 13270, were addressed. Consequently, in order to carry out the worthy motives of the House Committee in the drafting of the bill, it is not necessary to include organizations of these kinds within the definitions and restrictions. In expressing this view, the Association aligns itself with the arguments on this point made by several other organizations in their statements to this Committee, and particularly the following:

Joint Statement Presented on Behalf of Advanced-Study and Research Institutions with Respect to the Provisions of H.R. 13270 Affecting Private Foundations, to be presented by:

Caryl 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.

Statement of Frederick Burkhardt, President, American Council of Learned Societies.

Statement of the American Council on Education.

Statement of Ross L. Malone, President of the American Bar Foundation.

PROPOSED CHANGES IN H.R. 13270

In conformity with the foregoing comments, the Association of American Law Schools proposes, and requests that the Committee:

1. Amend the provisions of H.R. 13270 in order to exclude from the definition of "private foundation" the kinds of organizations to which this statement is addressed. Those organizations include (a) "learned societies," whose activities are devoted to the extension of knowledge in established fields of scholarship and education (example, The Law and Society Association); (b) "scholarly research organizations," whose activities are limited to the conduct, encouragement, planning or support of pure or applied research, the results of which are fully available to the public, in the particular fields of scholarship related to the purposes of the organizations (example, American Bar Foundation); and (c) educational support organizations, whose activities are limited to the conduct, encouragement, planning or support of programs for the improvement of (1) educational methods in particular fields of learning, or (2) the needed skills and knowledge of persons participating in those particular fields of learning as teachers, scholars and students (example, Council on Legal Education for Professional Responsibility). If these kinds of organizations were clearly removed from the definition of "private foundation," the aims of the Committee could be protected by including in the Act a requirement that the provisions applicable to "private foundations" be applied to those organizations if they engaged in any of a specified list of disapproved activities;

2. Amend the bill so that the ability of foundations to make grants to the kinds of organizations described above will not be adversely affected; and

3. Give an opportunity to the Association to present its views on the precise language proposed by the Committee to apply to organizations such as the A.A.L.S. and those with which it is related, bearing in mind that each of these organizations, although serving only slightly different purposes, are likely to differ significantly in the manner of their organization and operation and the sources of their support.

We will, of course, welcome the opportunity to consult with members of the Committee's staff in drafting language that would carry out the above suggestions.

CERTAIN OTHER ORGANIZATIONS RELATED TO ACTIVITIES OF THE ASSOCIATION OF AMERICAN LAW SCHOOLS AND ITS MEMBER SCHOOLS

1. *American Council of Learned Societies (New York City)*

The AALS is a member of this Council, along with 32 other learned societies in the field of the humanities. The Council is a scholarly research organization which carries on studies in the humanities, acts as the conduit for grants from private and governmental sources for research and travel in that field, and in various ways contributes to the welfare of its constituent societies.

2. *American Association of Law Libraries*

This is an Association of libraries and librarians in the field of law. It is a scholarly research organization which studies the needs of law libraries, presents panel discussions in that field, and helps in the training and placement of law librarians.

3. *Council on Legal Education for Professional Responsibility (New York City)*

This is an independent Council made up of nominees by the AALS, the American Bar Association, the National Legal Aid and Defender Association, and others. As an educational support organization it makes grants for the promotion of teaching through the clinical method. The source of its funds is The Ford Foundation.

4. *Council on Legal Education Opportunity (Atlanta)*

This Council is made up of nominees by the AALS, the American Bar Association, the National Bar Association, and others. Its purpose is to increase the number of disadvantaged and minority students in the law schools. Funds come from various private foundations and the Office of Economic Opportunity. Its financial operations are administered through the Fund for Public Education of the American Bar Association.

5. *The Law School Admission Test Council*

This independent Council is made up of representatives of the law schools that are members of the AALS and require the Law School Admission Test for admission to the study of law. Its funds are derived from the fees paid by applicants for admission to law school desiring to take the test. It is both an educational support and a scholarly research organization which administers admission tests to applicants to law schools and conducts research on testing of students to determine their ability to succeed in law school and on other matters closely related to the field of admission to law school.

6. *Council on Law-Related Studies*

This independent Council is related to the Walter E. Meyer Research Institute of Law, and will conduct and sponsor scholarly research projects in the field of law, somewhat like the work of the Social Science Research Council in other social sciences.

7. *American Bar Foundation*

This is a separate research arm of the American Bar Association, and sponsors scholarly research into various subjects of wide interest in the field of law.

8. *Joint Committee on Continuing Legal Education of the American Law Institute and the American Bar Association*

This Committee acts as a coordinating agency for most of the continuing legal education programs throughout the nation, conducts continuing legal education programs on a national scope, and publishes a newsletter of developments in continuing legal education, all of which are of direct interest to law teachers and others concerned with legal education, and consequently to the AALS.

9. *The Law and Society Association*

This is an independent learned Society whose purpose is the "Study of Society," primarily from points of view of special interest to legal scholars and sociologists. It publishes "The Law and Society Review." The Society has frequently scheduled its meetings in conjunction with the A.A.L.S. Annual Meeting.

Association for the Aid of Crippled Children,
New York, N.Y. September 8, 1969.

Hon. Russell B. Long,
Chairman, Finance Committee,
Senate Office Building,
Washington, D.C.

Dear Senator Long: This foundation is seriously concerned that H.R. 13270, if enacted into law without important modification of those sections dealing with private foundations, will greatly impair the thrust of our programs to improve the health and life potential of American children.

For 70 years the AACC has fought to prevent and relieve crippling diseases in children and to advance understanding of the origins and nature of handicapping. At present it is devoting approximately $1,000,000 a year to these purposes.

For the first 50 years of its existence, the AACC was almost entirely dependent on funds raised by public subscription. Then, in 1945, the AACC received major bequests from Milo M. Belding and his family, and since that time it has operated from income generated by this endowment (with a present market value of approximately $28,000,000) supplemented by annual bequests which usually range approximately from $20,000–$80,000. Because of the source of its funds, AACC would apparently be classified as a "private foundation" under H.R. 13270. However, no member of the Belding family is associated with the AACC, and the AACC does not own, to the best of its knowledge, any stock of any corporation in which a controlling interest is now held, or was ever held, by the Belding family. The Board of Directors and the Council of Members of the AACC are comprised solely of distinguished members of the medical, academic and social services professions and members of the business community.

This letter sets forth our consideration of certain sections of H.R. 13270 dealing with private foundations which in our view are discriminatory and ill-conceived and which would impair the public services historically provided by independent and well-managed foundations such as AACC.

DEFINITION OF PRIVATE FOUNDATION

Since the new restrictions on foundations and the new taxes sought to be imposed by H.R. 13270 apply almost exclusively to "private foundations", the question of whether the term "private foundation" is appropriately defined is the fundamental first question raised by the House Bill.

In the view of the AACC the definition of "private foundation" proposed in the House Bill cannot be logically defended. The selection of the types of charitable organizations which would be included--and excluded—from such definition has no apparent justification.

The Committee Report accompanying the Bill does not discuss in any detail the bases on which the Committee arrived at its definition. In discussing the proposed tax on investment income, however, the Committee Report hints at the considerations the Committee had in mind. First:

"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." (Comm. Rep., Part1, p. 19)

To the extent the Committee is proceeding on a concept of "ability to pay", its definition of private foundation is wholly inconsistent with the concept. A church, university, publicly supported organization or an organization which tests for public safety may or may not be better "able to pay" than the charitable organizations described as "private foundations" in the Bill. In short, the definition of private foundation has nothing whatsoever to do with ability to pay.

Secondly, the Committee stated:

"Also, 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." (Comm. Rep., Part 1, p. 19)

Here the Committee is suggesting that reform is necessary to assure the proper application of funds for charitable purposes. There is no question that the well-publicized abuses in the handling of charitable funds by a small minority of tax-exempt organizations require correction. But again it is crucial to determine where the abuses have occurred, which foundations are to be subject to the new restrictions, and which foundations are to be exempted.

Apart from the so-called "30% organizations" (which are exempted without explanation), the principal category of organizations excluded from most of the new reforms are those which normally do not receive more than one-third of their support from investment income and which normally do receive at least one-third of their support from the public. The Committee apparently proceeded on the assumption that *where* the funds come from determines *how* they will be spent. In the view of the AACO the ability to raise funds from the public provides no assurance that the funds will be properly spent.

For example, the AACC's support for the first 50 years of its existence was, as indicated earlier, derived alomst exclusively from a multitude of contributions from the general public. It was the AACC's distinguished record of public service which attracted gifts and bequests from the Belding family 20 years ago. These were of sufficient magnitude to permit the AACO to cease active solicitation of funds from the public and to operate principally out of its own investment income. As also indicated, for many years no member of the Belding family has been directly or indirectly connected wth the AACC in any way. The AACC is governed as it has always been, by independent leaders of the community of unquestioned competence, experience and integrity. There is no rational basis for subjecting the AACO to the new restrictions of the Bill solely because a 50-year record of service inspired a sizable gift two decades ago.

Conversely, under the Bill, a "one-man foundation" can be established tomorrow and engage professional fund raisers to solicit funds from the public. Then (assuming the creator of the foundation is careful not to make overly generous gifts of his own) the foundation can operate completely free of almost all of the new reforms proposed by the Bill. The House Committee has suggested that where support comes from the public "the organization is responsive to the needs of the public" (Comm. Rep., Part 1, p. 41). Fund raising ability, however, is not an indication of purity of purpose. The concept that the public will somehow cut off contributions if, for example, self-dealing occurs, simply ignores the facts of fund raising.

It is no secret that the overwhelming majority of abuses in the expenditure of charitable funds arise when a foundation is used to serve, directly or indirectly, the private financial interests of the creator or donor. In the view of the AACC, reform legislation can be justified only if drawn to meet the abuse. If distinctions are to be made as between various kinds of tax-exempt organizations for reform purposes, then, we submit, the line is properly drawn between those foundations which are under the effective control of the creator or donor and those which are not. It is the *administration* of the charitable funds that matters—not the *source* of the funds. To call an organization such as the AACC a "private foundation" is a misnomer. And to subject such organizations, solely on the basis of the misnomer, to the elaborate safeguards proposed by the Bill is an absurdity.

TAXATION

The imposition of a 7½% tax on private foundations proposed by H.R. 13270 would reverse the historic decision to exempt endowed foundations and thus raises for question the interpretation of the public nature of foundation funds. Tax exemption has been permitted upon the satisfactory demonstration by a foundation that its funds were being spent entirely in the public interest, both short range and long range. For instance, the widely recognized and critical need to improve the care of crippled children was the reason for establishing the AACC and incorporating it as a privately sponsored fund raising charitable organizaton. To achieve this purpose large numbers of public-spirited citizens have voluntarily contributed their time and energy for some 50 years. Since conversion to an endowed foundation 20 years ago, the Board of Directors and the Council of Members of the AACC have continued to serve without compensation for their services as such. The intent of the original legislation exempting foundations from taxation because of their eleemosynary nature has been strictly respected by the AACC which has regularly reported the charitable and educational purposes for which its funds have been expended. Since these funds are construed not only to be held in public trust and, in addition, their use to be complementary to the expenditures of tax funds by the government for social purposes, the initiation of taxation seems inappropriate and not in the public interest as originally conceived.

Taxation at the Federal level will invite taxation by state and local governments. Such a pernicious expansion of taxation may well cripple the effectiveness of our limited funds. In reviewing the projections of income to be derived from private foundations as outlined in Part I of the Committee Report, we believe that the social loss in reducing the relatively small pool of funds available to foundations such as the AACC far outweighs any potential revenue gains.

The amounts spent by the AACC are insignificant compared with the expenditures of governmental agencies in the health fields. But no doubt due in part to its independence from governmental funding, the AACC has come to be recognized as an impartial, experienced institution of established professional competence. Thus the results of its efforts, produced by relatively small expenditures, often serve to provide new thought and direction to the expenditures of incomparably greater amounts of public funds.

Accordingly, we believe that, subject to complete public accountability, foundations such as the AACC should not be subject to tax, particularly when such tax would be discriminatory when compared with the tax status of other "exempt" organizations.

INFLUENCING LEGISLATION

Billions of dollars are being spent annually by Federal, state and local agencies to improve the quality of health care of the general population. With the expenditure of funds of this magnitude, it becomes essential to review in detail the question of how and where the funds are being applied and to seek continuously to determine whether the funds are being applied with maximum effectiveness. Reviews of this character are, of course, regularly carried on by the governmental agencies responsible for disbursement of the funds. However, the private sector of the community also has much to offer in terms of new guidance and new perspective in health care. This is particularly true of foundations such as the AACC which possess the capability to provide independent, impartial and professional evaluation of governmental actions in the health services field and which are not dependent on governmental funding.

The AACC does not believe lobbying in the usual sense of that term is a proper function of any foundation, and the AACC's mission has not been hampered by the provisions in existing law relating to the influencing of legislation. If the existing provisions are to be changed, however, great care must be taken to permit foundations to continue to speak out publicly and without temerity on the broad public issues facing the country. This is particularly important in the health field where because of the massive governmental involvement—still experimental in many areas—new approaches and new perspectives may quickly be reflected in new legislation.

In the past some of the most important activities of the AACC have ultimately been reflected in action by governmental entities and, in the broadest sense of the term, the governmental entities were "influenced" by the AACC. For example, the AACC has initiated projects in the provision of health services for the purpose of demonstrating the social necessity of such services for prospective transfer to and continuation by governmental agencies, and a number of such programs have been taken over and absorbed by local health departments. In addition, the AACC has served to coordinate, and has become a catalyst for, the development of new policy guidelines in the health field. In 1961, for example, the then director of the AACC chaired the White House Conference on Mental Retardation— a conference one of the principal purposes of which was to assemble the nation's finest talents to "influence" the direction of governmental policies.

We do not believe that the House Committee intended to discourage the type of activities the AACC has carried or in the past. Indeed, it is precisely this type of activity that justifies the continued existence of foundations such as the AACC. The House Committee recognized the importance of encouraging the free flow of discussion on broad policy issues and, in its explanation of proposed Section 4945(c), stated:

'One of the provisions contained in the bill (sec. 4945(c) (1)) applies specifically to expenses incurred in connection with grass root campaigns or other attempts to urge or encourage the public to contact members of a legislative body for the purpose of proposing, supporting, or opposing legislation. This prohibition is substantially similar to the provisions of present law (sec. 162(e)), which prohibits business deductionss for grassroots lobbying activities. Another provision in the bill (sec. 4945(c) (2) precludes direct attempts to persuade members of legislative bodies or governmental employees to take particular positions on specific legislatives issues. It does not extend to discussions of broad policy problems and issues with such members or employees." (Comm. Rep., Part 1, p. 33).

As drafted, however, proposed Section 4945(c) could be interpreted as going far beyond the Committee Report. The Bill provides:

"For purposes of subsection (b)(1), the term 'taxable expenditure' includes (but is not limited to)--

'(1) any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof, and

'(2) any attempt to influence legislation through private communication with any member or employee of a legislative body, or with any other person who may participate in the formulation of the legislation, other than through making available the results of non-partisan analysis or research."

The Bill has eliminated the specificity contained in the Committee Report and, in so doing, opens a floodgate of ambiguity. For example, almost any public statement made by the AACC on national health policy might be regarded as an "attempt to influence legislation through an attempt to affect the opinion of the general public." Similarly regarded might be the national and international meetings and conferences sponsored by the AACC which are specifically aimed at exploring the role of public and private agencies in the health services field and the areas in which the expenditure of public funds can maximize social returns. Specificity on these questions, with the restrictions narrowly drawn to meet demonstrated abuses, is vital if foundations such as the AACC are to continue to perform the public purposes for which they were formed. And, in the view of the AACC, specificity is too important an issue to be left to administrative regulation. Accordingly, we urge that Section 4945(c) be redrawn in precise terms consistent with the Committee Report.

Finally, the AACC finds it difficult to understand—if the specific practices to be taxed under Section 4945 are deemed to be undesirable—why the identical practices are permitted if carried on by foundations which, solely because they receive more funds through public fund raising than from endowment, are exempted from the Section. Once again the fundamental definition of "private foundation" contained in the Bill seems incongruous and discriminatory.

SELF-DEALING

In general the AACC approves the purposes sought to be achieved by the proposed provisions directed at self-dealing. However, the breadth and scope of the proposed provisions are such that compliance by organizations such as the AACC would not be possible simply as a practical matter. Moreover, the provisions go beyond what is necessary to remedy whatever potential abuses may be involved.

For example, the definition of "disqualified person" for self-dealing purposes includes a "substantial contributor", i.e., any person who has contributed or bequeathed more than $5,000 to the organization in any one calendar year and any person who has contributed or bequeathed the greatest amount to any organization in any one calendar year. Since the AACC was formally incorporated in 1908 and has received contributions, to the best of its knowledge, in every subsequent year, then by definition it starts off automatically with 60 "substantial contributors". To these must be added a large number of other persons who have contributed $5,000 or more in any one calendar year (but less than the greatest amount received in such year). Then we must add all members of the "family" of this already unmanageable number of "substantial contributors", determined after applying the complex attribution rules of Section 341(d). As a result, there are literally hundreds of "substantial contributors" to the AACC. The overwhelming majority of such persons are not known to the AACC and could not be ascertained without employing special personnel to search through family trees over a 60-year period. Obviously this kind of tracing is not the type of charitable purpose for which large amounts of charitable funds ought to be spent.

The definitions of "substantial contributor" and "disqualified person" are another indication of why it is inappropriate to categorize organizations such as the AACC as "private foundations". When the self-dealing abuses have occurred they have almost invariably been in cases where a foundation is under the effective control of identifiable persons or family groups. When such control does not exist, we are not aware of any evidence suggesting that self-dealing is a problem.

Moreover, the Committee Report makes it clear that "in the case of the self-dealer, the tax is to be imposed automatically, without regard to whether the violation was inadvertent" (Comm. Rep., Part 1, p. 23). It is difficult to understand how the Committee believes self-dealing can be involved when the parties who are dealing with each other are totally unaware of their relationship. If the self-dealer does not know of his relationship to the charitable organization, then, by definition, he is not self-dealing in any normal sense of that term.

Under the Bill, if the AACC desired to lease office space and, through normal real estate brokerage channels, found space in a New York City office building, it would be necessary for the owners of the building to trace the charitable contributions of their spouses, their respective brothers and sisters and their respective spouses, their children, their parents and grandparents and related corporations, partnerships, trusts and estates to determine whether any of those persons or entities may have—during a 60-year period—contributed funds to the AACC. Even in the unlikely event a landlord were prepared to undertake this search, what would happen if in fact he discovered his grandfather had made a $5,000 contribution to the AACC in 1910? Could it really be the intent of the Congress that the AACC (with a portfolio of $28,000,000) should be prohibited from entering into the lease?

Dozens of similar examples can be given. The practical answer is, of course, to restore to the self-dealing concept the one feature that has *always* been associated with the concept—i.e., actual knowledge on the part of the self-dealer that he is in fact in a self-dealing position.

GRANTS TO INDIVIDUALS

According to the Committee Report, it is expected that the proposed pro^visions restricting grants to individuals "will encourage the further development of systematic nondiscriminatory grant-making." (Comm. Rep., Part 1, p. 35) The Committee's concern was that "expertise and fairness replace whim and personal relationships in such matters." (Comm. Rep., Part 1, p. 34)

The AACC believes it entirely appropriate that *grantmaking procedures* be reviewed by the Service to determine whether such procedures provide appropriate assurances of objectivity and expertise. However, under proposed Section

4945(e) as presently drafted it would seem that not only must the grant-making procedures be approved by the Service but also, possibly, that the foundation must demonstrate that the purpose of *each individual grant* is to achieve one of the goals specified in that Section.

A considerable portion of the AACC's income is spent in grant-making to support individual research, principally in the biomedical field. In most cases the grants are made to the university or college where the individual will pursue his research. But in some cases the character of the research project, the interdisciplinary approaches being utilized, the geographical areas in which the research will be carried on or the affiliations of the researchers involved require that the grant be made directly to the individuals and be administered by the AACC itself.

In the view of the AACC, it would be impossible, simply as an administrative matter, to require governmental review of individual research grants made by organizations such as the AACC. Moreover, it is the *grant-making procedures* which provide the objectivity and expertise sought by the House Committee. If the procedures are appropriate the review of individual grants would merely invite "second guessing" by agents of the Service. Even if the staff of the Service were augmented to provide the necessary manpower, it would hardly be expected, particularly in the biodmedical field, that the agents would possess the academic background necessary to perform individual grant review.

PAYMENTS TO GOVERNMENT OFFICIALS

Under proposed Sections 4941(d) and 4946(c), reimbursement of government officials for international travel would be prohibited. From time to time, AACC has sought from governmental health personnel professional evaluation of biomedical research projects being conducted under AACC's aegis in foreign countries. For this purpose, such personnel have been reimbursed basic travel and living expenses. Likewise, AACC has provided travel and living expenses to permit governmental personnel to attend international professional meetings when such funds have been temporarily unavailable from government sources for reasons of budgetary restriction.

Clearly such complementary professional activity between the government and private foundations has been in the public interest. Yet the new restriction would unnecessarily rule out continuation of these arrangements which have proven so valuable in the past.

For more than a century we have had Federal laws dealing with improper attempts to influence government officials and with the conflicts between responsibilities of government officials and their individual financial interests. As the nation grew, these laws multiplied to cover a plethora of different situations of varying degrees of subtlety, and these laws were scattered—with little effort at consistency—throughout the Federal statutes and administrative regulations.

By the 1950's the disorder and confusion in this area had grown to such a degree that a thoroughly revised and consolidated approach to conflicts of interest seemed essential to the orderly functioning of government. The existing Federal laws were inconsistent, ambiguous, inadequate, and often difficult to find; the situation cried out for reform. Late in the decade, three major steps were taken:

1. In 1958 a comprehensive analysis of then existing conflict laws was published by the Antitrust Subcommittee of the House Committee on the Judiciary following a detailed study ordered by Chairman Emanuel Celler. The report included a draft bill principally intended to consolidate existing laws.
2. In 1958 a Special Committee of the Association of the Bar of the City of New York undertook an intensive two-year study to re-examine the fundamental principles of conflicts of interest legislation. The Committee published its report in 1960, together with a new draft of legislation.
3. In 1961 President Kennedy's Advisory Panel on Ethics and Conflict of Interest in Government recommended a basic revision of the Federal conflict of interest laws, accompanied by an implementing bill drafted by the Department of Justice.

Each of the three bills referred to above was prepared after exhaustive analysis and research. The bills were then studied by the House and Senate for two years, during which time efforts were made to develop a new draft bill which would incorporate the best features of each of the three proposals. Finally, in 1963, Congress enacted an entirely new, comprehensive and detailed Federal Conflict of Interest Law (18 U.S.C. § 201, *et seq.*). Since that time major departments and agencies of the government have further implemented and refined the new law through elaborate administrative regulations.

H.R. 13270, in dealing with payments by private foundations to government officials, ignores the enormous and successful efforts to frame for the first time in the nation's history a rational and comprehensive bill dealing with conflicts of interest of public officials. The House Bill would introduce—not by amendment of the Federal Conflict of Interest Law, but rather as a new excise tax—provisions which are out of accord with the principles embodied in the recently adopted legislation, thus tending to destroy the consistency and consolidation that so many labored so long to achieve. Moreover, all of this has been done hastily, without adequate review by governmental and private committees and panels that possess the necessary expertise on the subject matter involved.

What, then, is the justification for this extraordinary measure? The Committee Report accompanying H.R. 13270 merely states that "For purposes of the self-dealing provisions Government officials are disqualified persons." It is obvious, of course, that the provisions in the House Bill applicable to government officials have nothing whatsoever to do with "self-dealing" in any normal sense of that term. Prohibitions against self-dealing are intended to protect against diversion of assets of a foundation to persons in a position to control the actions of the foundation. When government officials are involved, the problem is quite the opposite of self-dealing—it is to protect against the corruption of government officials by private interests.

We do not minimize the seriousness of any attempt to improperly influence government officials. We submit, however, that the problem is far too serious to be dealt with in an excise tax bill. Attempts at corruption are now, and should continue to be, major crimes. Under the 1963 Federal Conflict of Interest Law anyone who gives, offers or promises anything of value to a public official with intent to influence any official act, or to influence such official to aid in committing or allowing any fraud on the United States, or to induce such official to do or omit to do any act in violation of his duty is subject to fifteen years imprisonment as well as heavy fines (18 U.S.C. § 201(b)). Identical sanctions are provided for any public official who corruptly seeks, accepts or receives anything of value for himself or any other person (18 U.S.C. § 201(c)).

Possibly the provisions of the 1963 Federal Conflict of Interest Law are inadequate. Now, with six years' experience under the law, perhaps the legislation ought to be reviewed; if existing provisions against corruption and conflicts of interest are inadequate they should be changed. But if corruption is the issue, the place to deal with it is in the Federal criminal code.

The substance of the provisions in the House Bill applicable to government officials moves far beyond the decisions reached by Congress in 1963. Section 209 of the Conflict of Interest Law prohibits in very broad terms the payment to government officials from any private source of compensation for the officials' services to the government—and this prohibition exists, irrespective of whether or not any corrupt motive is involved. Congress did not, however, enact any blanket prohibition against all payments to government officials. Nor did Congress deem it necessary to prohibit public officials from receiving outside income from outside employment. See Perkins, *The New Federal Conflict-of-Interest Law*, 76 Harv. Law Rev. 1113, 1137 (1963). In any review of its 1963 decisions Congress might now determine that any payment of any nature to government officials creates such an intrinsic danger that all such payments should be outlawed, irrespective of any intent to exercise improper influence; such a decision would then result in amending the Federal criminal code to include prohibitions of the character suggested in the House Bill. If Congress should so decide, however, such prohibitions would necessarily be of general applicability and could not logically be limited to payments received from private foundations. If payments made by private foundations, irrespective of motive, are to be outlawed because by their very nature they are determined to be corrupting, then such payments would seem equally corrupting whether made by a university, church, foundation, brokerage firm, newspaper, defense contractor or private individual.

In 1963, a fine balance was struck between the government's need for high ethical standards in its officials and the government's need to recruit the best available talent for the Federal service. This balance necessarily will have to be adjusted and refined as experience with the new law develops. We urge, however, that these changes be made by amendments to the existing comprehensive provisions of the Federal Conflict of Interest Law and not through the mechanism of a complicated excise tax applicable only to one sector of the community. We further urge that, in the interest of a consistent and rational Federal policy in this area and in the interest of orderly functioning of government, these changes be made only with the greatest care after adequate study by Congress, the executive branch and legal profession.

I wish to reiterate the unqualified support of the AACC for strong and rational measures designed to assure public accountability of all charitable funds. However, for the reasons stated above, the present Bill goes far beyond what is necessary to achieve this desirable end and, in so doing, would impede the very charitable purposes for which organizations such as the AACC exist. We strongly urge that the provisions of H.R. 13270 dealing with "private foundations" be redeveloped, following a careful analysis of the type of organizations to be classified as "private," so that restrictions will be imposed on the performance of charitable functions only when the necessity for such restrictions has been clearly shown. In this effort it is essential that the Congress, in its understandable desire to curb abuses of some family-controlled foundations, carefully avoid impairing the operations of foundations such as the AACC which, under independent professional management, have compiled long and distinguished records of public service.

Sincerely,

ROBERT J. SLATER, M.D.,
President, Association for the Aid of Crippled Children.

STATEMENT BY HENRY STRONG ON BEHALF OF THE HATTIE M. STRONG FOUNDATION

By 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. As 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 expending 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 and 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.

HATTIE M. STRONG FOUNDATION OFFICERS

Henry Strong, President, 5039 Overlook Road, NW., Washington, D.C.

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

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

Barbara B. Cantrell, Treasurer, 7400 Oriole Avenue, Springfield, Va.

Thelma L. Eichman, Assistant Treasurer, 4219 Longfellow Street, Hyattsville, Md.

HATTIE M. STRONG FOUNDATION BOARD OF TRUSTEES

Mrs. L. Corrin Strong, Whitehall Road, R. D. No. 2, Annapolis, Md.

Mrs. C. E. Bowers, 930 Washington Building, Arlington Towers, Arlington, Va.

Richard S. T. Marsh, 701 Folger Building, 725 15th Street NW., Washington, D.C.

C. Peter Strong, 127 East 73rd Street, New York, N.Y.

Henry Strong, 5039 Overlook Road NW., Washington, D.C.

Robert W. Wilson, 929 E Street NW., Washington, D.C.

A. B. Trowbridge, Jr., 4111 Fairfax Road, McLean, Va.

John N. Andrews, 2000 North Adams Street, Arlington, Va.

Trowbridge Strong, 401 Woodbine Avenue, Norberth, Pa.

Lew G. Colt, 3930 Connecticut Avenue, NW., Washington, D.C.
Dr. Bennetta B. Washington, 1200 19th Street, NW., Washington, D.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, NEW YORK CITY-RAND INSTITUTE

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 definiti n 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 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 expected 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:

The application of new technologies. 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.

The design of new procedures. For the Housing and Development Administration new information systems have been designed and procedures recommended, which should enable the City to help arrest and 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.

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 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 incedence of false and genuine alarms with sufficient accuracy to allow the Department to predeploy and re-deploy equipment on the basis of anticipated requirements.

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 of employee of a legislative body, or with any other person who may participate in the formulation of the legislation" if 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 purpose or activities be needed.

BOARD OF TRUSTEES, THE NEW YORK CITY-RAND INSTITUTE

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Gustave Levy, Senior Partner, Goldman Sachs & Co.
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Frank Stanton, President, Columbia Broadcasting System, Inc.
Peter L. Szanton, President, The New York City-Rand Institute.
Lewis Thomas, Dean, New York University School of Medicine.
Franklin Williams, Director, Urban Center of Columbia University.

AMERICAN HISTORICAL ASSOCIATION,
Washington, D.C., October 7 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
Old Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: I have the honor to report to you, for the record, the following recent action:

The Council of the American Historical Association, at its regular meeting on September 13, 1969, votes to associate itself with the testimony prepared for the Senate Finance Committee by President Burkhardt of the American Council of Learned Societies, in respect of his arguments.

First, that the Tax Reform Bill H.R. 13270 may unintentionally do serious harm to tax exempt scholarly organizations in the United States unless amended to exclude them, not by formulas as to sources of support, but by explicit definitions as to functions performed, and

Second, that in their interests the Federal Government should refrain from introducing the novel principle of taxation of *bona fide* private foundations.

According to response received to date by this office, the following have taken similar official action in support of Mr. Burkhardt's testimony: American Philosophical Association, American Sociological Association, American Statistical Association, College English Association, Mathematical Association of America, Organization of American Historians, Renaissance Society of America, Rhode Island Historical Society, Society of Architectural Historians, and the Speech Association of America. The following have supplied a similar endorsement of an individual officer, due simply to shortness of time: American Political Science Association. History of Education Society, and the Vermont Historical Society. The following have submitted to your Committee similar statements of their own: American Association of Law Libraries, American Institute of Physics, American Society of International Law, and the Association of American Law Schools.

We should appreciate your entering all this in the record where appropriate.

Sincerely yours,

PAUL L. WARD, *Executive Secretary.*

STATEMENT OF D. T. WEYRAUCH, MANAGER, CHARITIES FOUNTATION, TOLEDO, OHIO

Re: H.R. 13270—A bill to reform the income tax laws.

It is respectfully requested that the following comments be incorporated in the printed hearing pertaining to Subtitle A—Private Foundations:

As Manager of Charities Foundation, which under the proposed legislation would be classed as a private foundation, may I present a few comments and suggestions.

Charities Foundation is a charitable trust established in 1937. The Foundation has made distributions to qualified organizations since its inception through December 31, 1968, in the amount of $8,956,715. During the same period, net income from investments amounted to $2,427,224 exclusive of capital gains which amounted to $2,029,257.

The proposed legislation which has been passed by the House and is scheduled for review and action by the U.S. Senate, contains a sector relating to charitable foundations. This section has features which are detrimental to the continued existence of "private" foundations.

A review of the basic premise for the existence of private foundations seems appropriate. It is the opinion of the writer that private foundations were formed to provide a means of lending continuity of grants to local charities regardless of the economic cycles. In a year when income or profits were high, corporations and/or individuals could set aside funds to be dedicated to charitable purposes. This enabled the donors to eliminate the peaks and valleys in their contribution programs to local charities such as churches, schools, hospitals, Boy Scouts, Girl Scouts, United Funds, and the like. This in turn enabled the recipient organizations to have a sound basis for the development of annual budgets upon which an operating of capital program could be built.

Proposals that would assure distribution each year of all net income are in keeping with the privilege of tax exemption. However, to force distribution for capital gains or trust corpus would destroy the endowment element of the foundations. The endowment element is necessary in order to provide for the expanding costs of all charitable programs brought on by inflation. I do not feel that the proposal to measure the minimum annual distribution by 5 per cent of the average market value of assets is appropriate.

Since most private foundations place greater emphasis on support of local charities, the proposed levy of the 7½ per cent tax on all income results in a diversion of funds from the local sphere of influence to a centralized location in the federal treasury. This seems contrary to the recent emphasis by President Nixon to reduce central control and enlarge state and local responsibility and control in the welfare area.

Changes in the treatment of gifts of appreciated property and on bargain sales of appreciated property in the House bill will have a tendency to reduce charitable giving in general. It appears the new changes would prohibit a bargain sale to a private foundation under the section covering self dealing, since any transaction between a disqualified person and a foundation would be prohibited.

Favorable tax treatment of contributions in general was predicated on the desire of the government to encourage philanthropy on the part of those with means, both great and small. Any proposals which would tend to penalize foundations in general for the transgressions of a few will discourage philanthropy in general. Thus the support of charitable activities would have to come from a centralized location—the federal government. Many local operating charities do not have, nor can they afford, the staff to process requests for assistance through Washington; nor is there assurance that such assistance would be forthcoming.

It is hoped that the Senate, upon review, will simplify the present proposals with emphasis upon taxing the foundations for failure to distribute income. This could be accomplished by having a high levy on income not distributed within the current year or the year thereafter. The present code already includes provisions for self dealing. The abuses uncovered in the investigation by the House will not be cured by the present legislation. The abuses can only be cured by the proper policing and reporting requirements. A possible step to improve reporting would be to require certification by a certified public accounting firm to accompany the usual 990–A report.

It is also suggested that the effective date of all proposed changes be for tax years beginning after the date the bill becomes law.

Respectfully submitted,

D. T. WEYRAUCH,
Manager.

THE KAHN TRUST,
Memphis, Tenn.

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

Hon. RUSSELL LONG,
Chairman, Senate Finance Committee, U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: I am greaty disturbed by the proposed tax treatment of private foundations section of Tax Reform Act.

The Kahn Trust was created by the Last Will and Testament of Jacob M. Meyer, deceased. Under the terms of the Will, three trustees were named. The Trustees were also given authority in the event of the death or resignation of any Trustee to select his successor.

None of the Trustees have been compensated from the time that the Trust came into being. Moreover, we personally pay the costs and expenses of operating this Trust, so as to leave the largest available amount of money to be spent as provided by the Will.

We are further given the authority to make loans to under privileged students who could not otherwise obtain a college education.

The only expenses of the Trust that we do pay consists of payments made to the real estate firm handling the collection of rents and making repairs on our property.

We have annually had a large number of students. This aid takes the form of either scholarships or loans. The Trustees followed the practice, in the beginning, of charging no interest on loans. However, we soon found that students made loans from more than one source of aid. Further, we discovered that many of them paid off on loans that carried no interest, but not until they had paid off all interest-bearing loans. This meant that the money did not come back quickly to our Trust and frequently we were among the last to be paid off. It was this fact that impelled us to provide for interest payments. However, we permit the student to fix his own rate of interest and many of them fix the rate of 4% per annum.

We have been exempt from taxation by the State of Tennessee.

Our annual income is not large and the only effect of the proposed tax will be reduce the number of students and the number of colleges and universities that we can aid.

Our annual income is reflected on the tax returns (which are information returns) that we have filed annually.

If you would be interested in having a report on the annual income, I shall be glad to furnish it. However, I do not think our income exceeds $50,000 per year.

We do not require that students maintain a "B" average or better, as a condition of continuing aid to them. During the years that this Trust has been in existence, we have sought to do the greatest good to the greatest number. We only require passing grades; and when we give aid to students, we allocate the aid over a four-year period.

In addition, we are given the authority under the Will to supplement faculty salaries. One of the restrictive influences on Southern education is that when the more heavily endowed schools of the North and East seek to obtain the services of our faculty members in this area is we can supplement salaries. We have done so on several occasions.

We have given scholarships and financial aid to a number of educational institutions; among them are Memphis State University, Millsaps College at Jackson, Mississippi (a Church related school supported by the Methodist Church).

I cannot believe that this great Government of ours is so pressed for funds that they must discontinue a time-honored practice of exempting a small foundation like ours from taxation.

It would be appreciated if you would call this situation to the attention of the Committee that passes on this question, both in the House and the Senate.

We sincerely trust that the proposed amendment will not be adopted.

When the hearings resume, I trust that the proposed amendment will not be recommended for adoption.

If you think a personal appearance by me would be of help to either committee, I shall be glad to come to Washington at my own expense to give personal testimony on the activities of this Foundation.

Respectfully yours,

ABE D. WALDAUER,
Chairman.

AMERICAN ANTHROPOLOGICAL ASSOCIATION,
Washington, D.C., October 1, 1969.

Hon. RUSSELL B. LONG,
Chairman, New Senate Office Building,
Washington, D.C.

DEAR SIR: The American Anthropological Association wishes to call your attention to the adverse effect of the proposed Tax Reform Bill (HR 13270) on the development of innovative research and training in its profession.

University resources suffice for only a fraction of research needs. Customarily, therefore, anthropologists have depended extensively on organizations such as the Social Science Research Council, American Council of Learned Societies, National Research Council and some of the foundations of varying size such as Wenner-Gren, Carnegie, Rockefeller and Ford.

Legislation that threatens to reduce current levels of non-government sponsored research at the very time that the profession is expanding and government is reducing its support is a matter of deep concern to this Association.

In drawing up new tax legislation, we urge that the Congressional Committees concerned recognize the special nature of councils, learned societies and certain categories of foundations. Particularly we express our support for the position of the SSRC, ably expressed by its President, Henry W. Riecken, before the U.S. Senate's Committee on Finance on September 8, 1969 and the position of the ACLS, expressed on the same date and before the same Committee by its President, Frederick Burkhardt.

Respectfully,

CORA DU BOIS, *President.*

STATEMENT OF WHIRLPOOL FOUNDATION, SUBMITTED BY F. S. UPTON, PRESIDENT

Whirlpool Foundation is a Michigan non-profit corporation qualified as an exempt organization under Section 501(c)(3) of the Internal Revenue Code of 1954. The purpose and operation of this corporation has historically been the support of educational and charitable causes including grants to various other charitable organizations and the granting of scholarships to deserving students. The present organization and support of Whirlpool Foundation raises the substantial possibility that it will be included as a "private foundation" under Subtitle A, Title 1 of H.R. 13270. This possibility impells Whirlpool Foundation to make its feelings upon several provisions of this Bill known to the Senate Finance Committee.

An analysis of the Bill indicates that many of the proposed provisions concerning charitable organizations are designed to accomplish legitimate ends. If a tax-exempt organization or its benefactor abuses the privilege of tax exemption, the abuses should be corrected. Each time funds are diverted from legitimate charitable purposes, the public is deprived of the benefits for which it exchanges the freedom from tax. We respectfully submit, however, that H.R. 13270 as drafted goes far beyond the legitimate purpose of reasonably regulating all charitable organizations and imposes a penalty upon a limited group of exempt organizations with apparent disregard for the benefits which the vast majority of these organizations have contributed to society. Two particular provisions of H.R. 13270 as drafted appear particularly onerous to organizations which have been guilty of no improprieties. Accordingly, our comments will be limited to Section 506, imposing a tax on net investment income of "private foundations", and Section 4945, concerning accounting for the use of contributions, although there are other provisions upon which adverse comment can be fairly offered.

SECTION 506

Taxing net investment income of foundations results in depriving charitable causes of necessary funds for no valid reason and is in effect a tax on gross income which has historically been considered unfair. There appears to be no reasonable relationship between this provision and proper regulation of charitable organizations. Unreasonable accumulations of income have no relationship to this section and are prohibited by other portions of the Bill. No reason has been given for taxing an organization designated a "private foundation" which uses its funds for the benefit of the general public, while excluding from tax certain other tax exempt organizations which serve a lesser public need. If the revenue is needed, the tax should be first imposed on organizations not devoted to public purposes.

Past experience indicates that when charitable needs are not met by voluntary contributions, the necessary services must be provided by a governmental agency at a much higher administrative cost. Even if we assume that all funds collected as a result of this tax were applied to identical purposes by the government, the administrative costs would result in a smaller amount ultimately being used for charitable purposes.

Assuming that abuses have existed in the past, the imposition of a penalty on all similar organizations is not justified. If this rationale were followed to its logical conclusion, the operation of some churches or schools for profit will justify imposing a tax on all similar organizations. As a charitable organization which has always attempted to meet both the spirit and letter of existing legislation, Whirlpool Foundation feels that Section 506, imposing a tax on 7½% on the net investment income of all "private foundations", is inequitable and without logical justification. Although the proposal of the Administration to lower the rate lessens the impact of this proposal, it does not change the principle that this is a discriminatory tax on one particular type of charitable organization.

An additional matter of importance should be considered. Organizations which will be defined as "private foundations" are becoming an increasingly important factor in a multitude of local projects for the disadvantaged. Many such projects have been initiated or are now supported by contributions from "private foundations". These organizations are best supported through the use of "private foundations" because income can be stabilized from year to year rather than fluctuating with profits of the supporting donors.

Examples of substantial direct benefits to the public which flow from this aid are: Every program undertaken by a "private foundation" for programs designed to provide housing for the disadvantaged relieves some governmental agency of its obligation to provide such person with adequate housing. The administrative costs incurred in completing such housing are also minimal when contrasted with that which the governmental body would expend. Programs for the disadvantaged in the areas of education and business ownership, in addition to their social significance, also tend to increase tax revenues. Imposing a tax on net investment income or placing strict controls on "private foundations" may very well require curtailment of these activities. If this is done, foundations or their donors are not injured, only the public.

SECTION 4945

An additional area of major concern in H.R. 13270 as now drafted appears in Section 4945 imposing the responsibility upon "private foundations" for the use of funds by a donee. It is respectfully submitted that the responsibility for tracing funds through the hands of a donee should not be placed upon a foundation if the donee has been determined by the Internal Revenue Service to be exempt from tax under provisions of the Internal Revenue Code. This objection is not to the principle that all funds donated to a charity should be accounted for, but to the undue burden placed upon a foundation by making the foundation responsible for the accounting of another organization over which it rarely will have control or access to the donee's records.

In the past, many donors have relied in utmost good faith upon the fact that an organization determined by the Internal Revenue Service to be exempt under Section 501 of the Code has satisfied both the organizational and operational requirements under the law. The Bill as now drafted patently vitiates any such reliance and requires prospective analysis—and then supervision—of the ultimate use of each contribution. In almost all instances both prospective analysis and supervision will be nearly impossible and certainly impracticable. The proposal in the Bill delegates the control of exempt organizations to "private foundations", which do not have the ability, power, nor desire to police each contribution, whereas historically this has been a function of the Internal Revenue Service which logically has the duty and ability to exercise such control.

Even if a foundation desires to perform this policing activity with respect to all organizations to which it contributes, it would be nearly impossible to do so adequately. Some readily apparent considerations are—

1. Practically speaking, information furnished to a donor foundation may not be verified or certified while that furnished to the Internal Revenue Service is under penalty of perjury.
2. An adequate audit of the donee will be time consuming and expensive, but may be accomplished quickly in an official examination of the information return filed with the Internal Revenue Service by the donee.
3. The only remedy available to a donor foundation, if a donee fails to comply with a request for information, is to withhold future contributions, which is in contrast to the many means of enforcement and remedies available to the Internal Revenue Service.

4. The burdens involved in the proposed required verification will discourage or eliminate gifts to deserving organizations, some of which will otherwise require public funds for their support.

A more reasonable and effective alternative is close scrutiny of the operation of all tax-exempt organizations by the Treasury.

CONCLUSION

The announced purpose of H.R. 13270 is to prevent abuses which have occurred in various tax matters. This purpose is commendable and Whirlpool Foundation wholeheartedly supports any legislation which assures that every taxpayer will pay no more nor less than his fair share of taxes. However, H.R. 13270 as drafted does not contribute to that end. What it does do is place undue burdens upon a limited class of organizations performing an acknowledged worthwhile public service. Accordingly, we strongly urge striking all of Subtitle A of Title 1, or as a minimum measure striking Sections 506 and 4945, from the Bill as drafted.

STATEMENT OF TYRONE GILLESPIE, ON BEHALF OF THE HERBERT H. & GRACE A. DOW FOUNDATION

SUMMARY

I. *The Problem.*—The Bill's tax upon the net investment income of private foundations would, particularly for a common "family foundation:"

A. Destroy the synergetic balance between private foundation "innovation" and public section "maintenance and continuance."

B. Be inconsistent with tax treatment of private *individual* donors.

C. Bring down all the complexities of determining what are deductible expenses against gross income.

D. Fails to recognize that the "family foundation" is only an extended and less mortal arm of a charitable individual.

A Solution.—Further examinations as a public duty as in any tax matter; or as a compromise, charge an "examination fee" for office or field audits of private foundations structured according to national or state bank examiners' fees and earmark same for Internal Revenue Service costs.

II. *The Problem.*—The Bill's prohibition against self-dealing *even* at arm's length is unrealistically harsh.

A. Individual donors may deduct the *cost* and *expense* of personal services incurred in the making of gifts of money or property, and private foundations should have the same privilege.

B. Often a foundation can make a fuller, more unique gift by use of services, talents or property of a noted donor or trustee and should not be penalized by the "accident of affinity" with such persons.

A Solution.—Better enforcement of existing Code Section 503, which was enacted for the express purpose of curbing self-dealing. Remove personal monetary penalties against self-dealers and instead require offending persons to "undo the wrong" with the foundation else the latter's exemption is revoked for two years and donor's gift deduction similarly denied.

III. *The Problem.*—The requirement for minimum distributions of income appearing in the Bill does not recognize investment market conditions and greatly "overkills" because of alleged violations.

A. The annual pay-out requirement of 5 percent of "net investment assets" is arbitrary and transient.

B. "Growth stock" yields are usually lower than 5 percent, but in actual, absolute dollars returned over a period of years such stocks far exceed a fixed return.

C. Family foundations are conduits of charitable funds not investment trusts.

D. No matter who high the rate of return on foundations assets, the vagaries of an inflation market can raise capital value faster than income rates.

A solution.—Remove proposed Code section 4942 from the Bill and in its place:

A. Enlarge Code section 170 and 2055 to deny tax benefits for any individual gifts or bequests of "nonproductive property" to private foundations.

B. Apply the provisions of Code section 531 (covering profit corporations) to private foundations. Thus the latter would be presumed taxable (similar to the "accumulated earnings tax" rules on corporate profits) on income held for more than one year after receipt, with an allowance of not more than $100,000.00.

C. Drop "private foundations" from the list of non-qualified recipients of tax-exempt distributions. In view of above proposals, this troublesome classification is unnecessary.

STATEMENT

Mr. Chairman and members of the committee, I am Tyrone Gillespie, a practicing attorney, and I am here as counsel for The Herbert H. and Grace A. Dow Foundation of Midland, Michigan. Some of you may not know of this Foundation since by its charter it is limited to charitable, educational and scientific grants within the State of Michigan. Its present trustees are lineal descendants of the creators, for whom the Foundation was named when it was incorporated as a Michigan non-profit corporation in 1936. It currently receives total income at an annual rate of $1.7 million. Its assets consist almost entirely of capital stock of The Dow Chemical Company—in aggregate less than 2½ percent of that Company's outstanding common. The last substantial bequest or gift of principal to the Foundation was made under the Will of Grace A. Dow, who died in 1953. A catalogue of its gifts and grants would be impressive but would not be directly responsive to the purpose of your Committee's hearings.

I should say in preface that I have had the benefit of reading the testimony of most of the distinguished witnesses before the Committee this month on the "private foundations" portion of HR 13270, the Tax Reform Bill of 1969. Being thus familiar with the statements you have already heard, I hope not to be repetitive or redundant in presenting my views on behalf of the Dow Foundation. Chiefly I am concerned with three aspects of the Bill, which are—

1. The 7½ percent tax upon a private foundation's net investment income. (Sec. 101(a) of the Bill and new Section 506 of the Internal Revenue Code.)
2. The scope of the prohibitions on self-dealing between private foundations and "disqualified persons" as defined by the Bill. (Sec. 101(b) of the Bill and new Section 4941 of the Code.)
3. The "distributions of income" requirement and its formula. (Sec. 101(b) of the Bill. and new Section 4942 of the code.)

I will treat these issues *seriatim* in the statement which follows. Whenever my remarks on behalf of the Dow Foundation are critical of the proposed Bill, I shall advance an alternative for the Committee's consideration which I intend as both positive in thrust and related to existing rules and known regulations of the present Code.

I. *The 7½-percent tax upon net investment income*

As other witnesses before this Committee have pointed out, we have seen during this century a waxing of Federal and State involvement in public health, education, welfare, housing and needs of indigent persons and a corresponding and relative waning and attrition in their private support. Ultimately, of course, the government's activity in these areas is still based largely upon tax dollars paid by the private sector, but the areas themselves and the needs which must be satisfied have become so all-pervasive and complex that the broad-scope support of federal government has had to enter and occupy the field. This exchange of roles between individual charity and government grant has caused private charitable, scientific and educational organizations to a larger extent to be initiators, innovators, and inspirers of creativity. They have planted the seed money which in successful projects has germinated into a harvest often beyond the capacity of the private groups to maintain. At this point government has on occasions picked up the burden of further development and cultivation until the flower blooms on the stalk. Private foundations and governmental agencies have increasingly since 1945 accepted this synergism, lived with it and been satisfied with its results. Indeed, the chief activity of the Foundation for which I am speaking has been to find areas of need in science and education where governmental grant has not entered and, by appropriate gifts and matching grants, to create and stimulate in these areas a growth of endeavor for the public good. The Foundation's orientation is *creative*—in seeking to help people help themselves.

In our opinion the imposition of *any* tax upon private foundations would not only upset the vital balance between private creativity and innovation and public maintenance, it would also run contrary to the ancestral treatment of private, individual giving and "charity" which has been woven into our culture as a nation. In a very real sense most private foundations have been conceived by their donors as a means to systematize private giving and insure its continuance beyond their deaths. The "family foundation" is nothing other than an extension of the charitable instincts and tendencies of private (and mortal) family members, a longer, broader and more knowledgeable out-reach to the needs of others. It is obviously impossible today for one individual to finance (let alone know about!) the extent of use for, let us say, medical funds which he may wish to furnish. Drawing upon the additional resources, wider knowledge, and physical dispersion of other family members, their successors and counselors, the same individual can vastly multiply the effect of his donations, particularly if he can establish an on-going mechanism to survive his death and inculcate in those living on the same charitable inclinations which insure the continuity of giving.

Since the first federal income tax statute in 1913, no one has seriously proposed that a private individual be penalized, monitored or otherwise regulated for gifts to qualified tax-exempt organizations other than by limitation as to the amount of such gifts which are deductible for income tax purposes (an amount, indeed, which HR 13270 proposes to increase). If private foundations, which we believe are best characterized as extensions of individual effort in these areas, are to be made subject to income tax at a rate of 7½ percent or any future rate, then a "taxable event" must take place in their acts of giving which does not occur if the same gifts are made by an individual person. We look in vain for such a taxable event! Any tax on a private foundation is a levy on charity, science or education itself.

The "General Explanation" accompanying the Tax Reform Bill of 1969 (Part IV, A, 1) states 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* . . . Also 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." (my emphasis)

This statement of the House Committee overlooks the fact that private foundations are in main *supplementing* the "benefits of government" out of their own funds—funds which they have dedicated in many instances to the same recipients as make use of government grants. As to the need for "vigorous and extensive administration" of tax laws policing the activities of private foundations, it appears that a small portion of private foundations may have indeed transgressed such laws and abused the privilege of tax-exemption. We are familiar with the earlier findings and reports of Congressman Wright Patman and are aware of the relatively few violations of Sections 501(c)(3), 503 and 504 which the Congressman's subcommittee brought to light. Yet even the subcommittee conceded that many of these violations could have been caught and properly corrected by diligent enforcement of existing regulations under Section 503 and 504 of the Code by the Internal Revenue Service. We must conclude that abuses exist not because of the law as written, particularly after the 1950 amendments (Section 503), but because of laxity in its enforcement.

Indeed many of the witnesses before your Committee have admitted that private foundations should contribute toward the expense of policing adherence to the cited code sections and they have proposed an annual fee levied according to foundation assets, such fee to be used for supervision costs (see, e.g., statement of J. George Harrar, Alan Pifer, and David Freeman). We agree that institutions which do not normally owe a tax are perhaps not paying the cost of enforcement efforts by Internal Revenue Service personnel whose costs are usually offset by increased collection of delinquencies from taxable sources. At the same time it is unjust to charge all private foundations—the vast majority of which even by Congressman Patman's subcommittee findings scrupulously adhere to reporting, disclosure, and other legal requirements—a fixed or indiscriminate fee for enforcement, and we would oppose any tax or fee for such purposes, for if the enforcement is for public good, the cost should be borne as a governmental expense.

The alternative which is not fair but which might be a compromise would be that private foundations be billed on a *per diem* basis for the time of field or office examinations and audits by Internal Revenue Service personnel, with a specified maximum charge, graduated according to the foundation assets or income. Such a practice would be similar to the charges made by national and state bank examiners under a Federal Reserve System audit. We note that Mr. John J. McCloy made a proposal to the same effect to this Committee.

If these audits were to be conducted only upon complaint or failure of a foundation to properly report or upon occassions where there is grounds to believe that the foundation is not complying with the rules governing foundation conduct, such a charge would favor those private foundations having clear and accountable records and penalize those whose activities are unaccountable or do not readily square with the guidelines of Sections 503 and 504 of the Code. In our opinion private foundations (like all privately owned banks) are subject to that degree of public trust making such examinations proper and expected in event that trust be not met.

Such a feed for examinations of private foundations would be a far more economical means of enforcing compliance with existing law than the proposed 7½ percent tax on foundation net investment income. The latter would involve, as do all taxable income determinations, an analysis of what foundation expenses are "ordinary and necessary" and thus deductible from gross investment income as well as what expenses are or were incurred for the "management, conservation or maintenance of property held for the production of income." In examing such expenses of private foundations the Service would encounter the same enormous complexity of regulation which exists in the area of profit corporations under Section 162 of the Code and fills the pages of tax reporters. The game would hardly be worth the candle, and the expense of such an examination would seriously erode the expected $100 million revenue gain from the proposed tax.

II. Scope of prohibitions on self-dealing between private foundations and "disqualified persons"

The 1950 amendments to the Internal Revenue Code, emanating from investigations of the Reese Committee and others and embodied in Section 503, were designed to curb previous abuses in the operation of private foundations where a certain few creators and substantial donors played fast and loose with assets of foundations over which they exercised control and enjoyed favoritism. Section 503 of the Code now imposes arm's-length standards with respect to the purchase or sale of property between a foundation and a related party, requires loans between such persons at competitive terms and interest rates, prohibits excessive compensation for services rendered by a related party, and bars preferential receipt of services by such persons. A "related party" is a substantial donor to the foundation, his family (as defined by Code Section 267(c)(4), or a corporation controlled by such person or persons. The sanction now imposed by Section 503 of the Code is loss of tax-exemption by the offending private foundation plus denial of deduction of gifts to the organization under Section 170 made after the taxable year in which the offense occurred. The latter provision is lenient but recognizes that an unrelated donor could not be expected to be immediately aware of the act of self-dealing.

The theory of HR 13270 in putting forth new Section 4941 of the Internal Revenue Code is that the arm's-length standards of Section 503 require disproportionately greater enforcement efforts and, further, that a party related to the private foundation is still preferred and advantaged even if a transaction *inter sese* is at arm's length. For example, a foundation could purchase property from a substantial donor at an objectively fair price but might do so in order to provide a ready market to the donor; or a foundation could lend money to the donor (with adequate security and a bankable rate) but at a time when the donor finds the general money market tight; or a foundation could purchase the services of a donor when otherwise there would be a lack of call for such services. All of these hypothetical situations advantage a donor or other "disqualified person," but the advantage—given arm's length standards—is not great enough to justify the ends resulting from the proposed cure. The proposed Bill imposes a triply-graduated set of penalties for such self-dealing both upon the dealer and the "foundation manager"—regardless of the fact that the dealing had been at arm's length. Other witnesses before your Committee has declaimed the need for these penalties, and we will not presume upon time and space to add to their remarks though we do concur with them.

In seeking to defend the present sanctions of Section 503 which proscribe dealing between a private foundation and related (or disqualified persons), sanctions which proposed Section 4941 would excise from the Code in favor of others, we shall again draw upon the similarity of a private foundation and a private person, both entertaining a charitable purposes. An individual is not penalized under Section 170 of the Code if he accompanies his gift of money or other property to charity with personal services, except that he cannot deduct the value of the latter. He may, however, deduct from his taxable income the unreimbursed cost or expense of furnishing his services (see Treas. Reg. § 1.170-2(a)). Why, then, should not a private foundation, which we believe to be the extended charitable arm of an individual or individuals, be accorded similar treatment where it must pay reasonable (not excessive) compensation to a disqualified or related party in order to bring its gift into fruition? Or purchase a needed facility from such person in order to put into effect a charitable project? Or work with its creator or substantial contributor in an area where the latter is an acknowledged expert?

It certainly must be true that in a number of private foundations a creator or trustee or other "disqualified person" (as defined by the Bill and Exhibit B to statement of Dana S. Creel) will often be in a position to seize an opportunity for the foundation by the personal purchase of a piece of property adjoining a university campus, or to enter into a contract for the providing of equipment or funds for qualified research purposes, or simply to pledge his own resources for some emergency, charitable need. Is such a person not to be able to assign his obligation to a foundation of which he is a trustee without a punitive tax liability? Often such opportunities for aid and assistance arise in the hiatus between regular meetings of trustees which would approve or disapprove the commitment. Proposed Section 4941 would impose severe penalties regardless of the lack of any personal profit to the finder or prime mover.

Then, too, there are numerous private foundations in the country which have been created by noted entertainers, famous members of professions and owners of closely-held corporations. Are these foundations to be denied the obvious advantages of purchasing the talents, abilities or facilities of their creators or other related parties—at competitive rates—when such foundations may freely chooose to do or not do so and when they may be motivated by greater familiarity or nexus with such parties? Assuming as we must that the interested party charges the acquiring foundation no more than a reasonable rate, are not the dollars (or benefits) going to charity the same as those which would flow had an unrelated foundation purchased the same offering?

We acknowledge that Section 4941 of the Code (Section 101(b) of the Bill) would permit pyment for services by a private foundation to a disqualified person provided that such payment is not "excessive" and that the personal services "are reasonable and necessary to carrying out the exempt purpose of the private foundation" (Sec. 4941(d)(2)(E)). But where the foundation has a choice between or among the providers of such personal services, who is to say which one is "reasonable and necessary'" to its exempt purpose? The proposed statutory language is just vague enough that I would be constrained as any foundation's counsel to discourage *any* dealing with an interested party even if that party offered obvious advantages or beneficial terms to the foundation. I would hate to see any private foundation penalized by the "accident of affinity" with an energetic, enterprising or talented trustee. There also arises a difficulty in defintion of the words "exempt purposes."

More effective enforcement of existing Section 503 would stunt the growth of abuses caused by the alleged favoritism between foundations and related or "disqualified" persons. The more frequent examinations would induce prompter, more efficient policing of private foundation dealing with interested parties, or vice-versa. Coupled with this, and instead of the arbitrary and punitive tax which the Bill imposes upon the self-dealer and the foundation manager with knowledge of the prohibited transaction, should be the requirement that the self-dealer "undo the wrong" to the foundation and its charitable recipients by resorting to the foundation (for pay-out within the taxable year of such restoration) the "demonstrable" excessive compensation he received from the foundation, or the demonstrable and "provable" financial advantage he received from any other self-dealing. Failing the accomplishment of such corrective measures within 90 days of the Service's notice of deficiency on that account, the foundation would lose its exemption and would have to re-apply for this privilege after the end of the taxable year next following the violative occurrence. This added sanction of restitution by the proven wrong-doer plus increased enforcement of the existing provisions of Section 503 would not only secure compliance with present law but not invade foundation funds otherwise destined for needed charitable, scientific or educational purposes.

III. The requirement for "distributions of income"

There are two aspects to the proposed new Section 4942 of the Code: How much money or property should a private foundation give away annually, and to whom. The Bill provides that to avoid an initial penalty tax of 15 percent of the amount involved, a private foundation must distribute currently all its net income other than net long-term capital gains—*but not less than* 5 percent of its "net investment assets." And, payouts do not count which are made to nonqualifying recipients—by which the Bill means other private foundations.

This new measure is one of acute concern to the Dow Foundation for virtually its entire income comes from dividends paid on Dow Chemical Company stock (while not prohibiting diversification out of Dow, the Foundation's charter precatorily expresses the creators' wish that the principal of Dow stock be retained as long as productive). The rate of return or income yield of Dow common has never exceeded 4 percent and historically has been closer to 2 percent per year. Often, and at the time of this writing, the Foundation has elected to borrow in excess of one year's income from banks to meet its commitments for gifts beyond current income. Whatever the future yield of its capital assets might be, fluctuations in the stock market over which the Foundation has no control could change the effective rate of return overnight. Under no definition of "control" or "attribution" in the existing Code or the new Bill does the stock owned by the Dow Foundation or any of its trustees or other disqualified parties come within the stock ownership limitation of new Section 4943 or constitute any control over financial policies of The Dow Chemical Company. Thus in our opinion the enforcement of Section 4942 against the Dow Foundation would not only be arbitrary but would result in a forced liquidation of the Foundation's capital or principal over a period of years. The above relationship (or lack of relationship) between this Foundation and its major endowment is believed typical of countless others.

I might ask this Committee as an attorney: What is it the wrong foundations have committed which justifies the penalty-type divestiture provisions of Section 4942? Surely hundreds of private foundations in the country would be forced into gradual liquidation by the 5 percent payout standard which, parenthetically, can be *raised* by the Secretary after 1970. Were the requirements of proposed Section 4942 given sway, many foundations would suffer extinction or would have to become investment trusts specializing in purchase of high-yield, fixed-value bonds! It is clear that the House Committee feared many foundations are making no contributions to operating charities and that their donors are receiving substantial tax benefits from donating unproductive property. Apparently the apprehension is that either the private foundation may not take steps to convert gifts of nonincome property into more productive assets or it may hoard or accumulate existing income—keeping it from operating charities (see Part 1, "General Explanation" of H.R. 13270, IV, A, 3). I believe, however, that the remedy proposed by Section 4942 to curb this alleged abuse is the greatest example of overkill which can be found in the new Bill.

Indeed, the "real income" a foundation potentially can furnish for charitable purposes is measured only in part by the current yield of its securities or other investments. If the companies whose securities it holds are retaining more earnings than are being paid out, then capital growth is taking place and causing greater additions to the principal value of the security. While the cash dividend rates of the so-called "growth" companies may never reach 5 percent of current stock price, the *absolute* increase in cash paid out may be far greater in the long run. This, for example, has been the experience of the Dow Foundation as historically the Dow Company's absolute paid-out earnings increase has surpassed most other major corporations. I would submit that a 2 or 3 percent yield on a generally rising base is more productive of income than a 7 percent return on a base which never changes. And I would never wish to see foundations (and American industry) penalized for pursuing an investment policy which promises such future growth.

I have stated to this Committee that neither I nor those I represent here wish to impugn the effect of any provision of the new Bill without at the same time offering a positive and viable alternative. We recognize that the retention of non-productive property within a private foundation, except buildings, etc., used directly for an exempt purpose, does not get benefits out to charity and that exempt income of such foundations cannot and should not be accumulated or set aside for vague reasons and periods. Rather than force a mandatory rate of return on private foundations we here suggest that proposed Section 4942 be dropped in favor of an amendment to existing Sections 170 and 2055 of the Code which would deny any charitable deduction for income and estate tax purposes for gifts to private foundations of "nonproductive property." We further suggest that existing Section 504(a)(1) of the Code—which sanctions the unreasonable accumulation of income within a foundation—be enlarged and made more specific to contain the presumption that income accumulated for *more than one year* after receipt and in excess of a "specific project set-aside" is "unreasonably" accumulated and that the penalty tax (of Section 4942) be applied thereto. The project for which funds are "set-aside" would have to be defined in board minutes and materialize in five years.

Our suggestions would in time cure the evils which proposed section 4942 allegedly attacks. Without an accompaning tax benefit under Sections 170 or 2055 few donors would willingly give away unproductive, non-income producing property. In fact, their motives for lifetime gifts would consist more of a desire to shift *high-income* property to an owner with no taxable brackets. The adding of a presumption against accumulations to Code section 504 would parallel and draw from enforcement experience under section 531 (the Code section which imposes an "accumulated earnings" tax upon profit corporations). Under our proposal a private foundation would be allowed a "credit" of, say, $100,000.00 per year without risking characterization of the amount as "unreasonable," but once the amount was exceeded a penalty tax could reach back to pick up the "credit" as well as its excess.

We urge this Committee to consider one other change in section 4942 of the proposed Code (Section 101(b) of the Bill) and that is to scrap the provision disqualifying pay-outs by one private foundation to another private foundation. If private foundation income is to be taxed at all, and if private foundations are to be held to an annual pay-out standard (section 4942), then excluding any pay-outs to other private foundations from being qualifying pay-outs will accelerate the demise of the private foundation in this country. In reading the testimony of Carl Kaysen, O. M. Wilson, Kermit Gordon and Caryl Haskins before this Committee, I am impressed with the number of advanced study institutions and other organizations which are really "private foundations" or are closer to becoming such. Because of the "mechanical test" of Code section 170(g) as well as proposed section 4942, if such an institution receives more than 25 percent of its support from *one* exempt organization, it could become a "private foundation" as defined by the Bill. That this is decidedly a curse and not a blessing is made quite clear by the Bill's provisions as well as by some presently enacted regulations, in that:

1. Such private foundations only qualify for "20 percent" donations, while others may receive an additional 10 percent.
2. No 5-year carry-over period for excessive donation deductibility obtains for private foundations.
3. The Bill proposes to subject to tax contributions of appreciated property to private foundations (section 201(c) of the Bill).
4. The Bill forces a 5 percent pay-out standard annually.

It is our opinion that in the interest of "tax justice" and in a fever of "reform" of tax measures to guarantee that a miniscule number of untaxed entities are not abusing the privilege of tax-exemption, the House Bill has rung the death knell for the private foundation by encircling this institution with the narrowing restrictions set forth above. The combined effect of these provisions is *sub silentio* the same as if an express 20 or 25 year moratorium were placed on private foundations' existence.

I urge your Committee to remember the innovative, inventive and inspiring effect which the ingenuity of private foundation initiative has had upon American health, educational and charitable institutions and to police and not destroy, to preserve and not extinguish, these singularly vital groups.

Statement Prepared for Kent H. Smith, Gates Mills, Ohio, on Behalf of the Urban Reports Corporation, Cleveland, Ohio

The Effects of Organized Private Philanthropy Upon Educational Projects, Programs, Institutions and Systems in Cuyahoga County, Ohio, Which Includes the City of Cleveland and Its Contiguous Suburbs

No part of the cost of this report was borne by tax-exempt or tax-deductible money of any sort.

SUMMARY

From 117 mailed questionnaires, 127 responses were elicited; the ten additional responses were from administrators who replied for more than one program. This return was gathered by mail and telephone during five days following delivery of the first questionnaires.

1. The respondents indicated that support for their educational programs, projects and institutions was received from many foundations in and outside of Cuyahoga County. Six percent indicated support from 21 or more foundations. Fourteen percent indicated support from six to twenty separate foundations.

2. Such support aided many kinds of education-related activity. Forty-one percent of the respondents indicated that foundation aid was given for new and experimental programs.

3. Fifteen percent of the respondents indicated total grants from foundations in excess of $100,000 during 1968 or 1969.

4. Twenty-eight percent of the respondents indicated that foundation support represented their program's total budget.

5. Fifty-three percent of the respondents indicated that, in their opinion, their programs would not have started at all without foundation support.

6. Forty-seven percent of the respondents indicated that they would have sought other funds from individual donors. Many of these commented upon the difficulty of doing so.

In comments written on the backs of questionnaires, respondents indicated that:

1. Foundations provide funds for innovative programs. Respondents said that some of these programs have little immediate popular appeal, so foundations are their only likely fund source.
2. Foundations have moved with great speed to fill imperative cash needs within some programs.

Scope of survey

The research team compiled a list of institutional and non-institutional educational programs in Cuyahoga County that received grants-in-aid from one or more foundations in 1968 and/or 1969. These foundations are The Cleveland Foundation, Greater Cleveland Associated Foundation and The Martha Holden Jennings Foundation. The administrators of the grants were then approached for facts and opinions. Care was taken to separate and identify these in this report.

In many respects, the report is a general evaluation of the subject. However, much data were collected and are presented and analyzed herein. All responsibility for the accuracy of the data contained in this report is assumed by Urban Reports Corporation, Cleveland, Ohio.

Grant recipient mailing list

Administrative Consortium of Heidelberg, Hiram, Oberlin and Wooster: Cooperative Urban Studies Program.

American Negro Emancipation Centennial Authority, Ohio Division: Grant for updating documentary film.

Baldwin Wallace College:

Academic program development
Development (buildings)
Humanities Institute
Student Aid

- Case Western Reserve University:
  - Biology Field Station at Valley View Farm
  - Biomedical Engineering (faculty enlargement)
  - Building Fund—Law School
  - Building Fund—Case Building Fund Campaign
  - Continuing Changes in the Arts Program
  - General Educational Purposes
  - Graduate Program in Public Management Science
  - Industrial & Foundation Graduate Fellowships
  - Inner City Teacher Training Program
  - Junior Scholar Program
  - Literature Conf. for Inner-City Children
  - Lectureship in Urban Housing
  - Management Development Project
  - Medical School:
    - Design and Evaluation of Instructional Material
    - Endowment Capital
    - Faculty Salary Supplements
    - Feasibility Study of Prof. Group Practice
    - Medical Center Development Program
    - New Construction
    - Operating Support
    - Remodeling Labs
    - Research and Research Training
    - Special Travel for Faculty and Students
    - Student Scholarships
  - Library School Scholarships:
    - Demonstration Equipment
    - Faculty Research
  - Pilot Project in Training of Teachers of Disadvantaged
  - Upward Bound
- Cathedral Latin School: Community Education Program
- Catholic Board of Education: Training teachers for slow learners
- Children's Services: Building and equipment
- Children's Theater of Shaker Heights: Drama awards to graduating students
- Cleveland Area League for Nursing: Nursing scholarships
- Cleveland Board of Education:
  - Expenses for teachers attending NDEA
  - Job Development Center
  - Prof. staff conferences for school principals
  - Workshop for secondary and elementary school principals
  - Visiting Scholar Program
- Cleveland Center for Research in Child Development: Training program in psychoanalytic child psychotherapy
- Cleveland Guidance Center, Inc.: Teacher education
- Cleveland Health Museum: Health education
- Cleveland Heights Board of Education: "Russian Abroad" Program
- Cleveland Institute of Music:
  - Deficit funding
  - Eurhythmics for public school teachers and supervisors
  - Faculty salary supplements
  - Implementation of merger with CWRU
  - Memberships
  - Scholarships
- Cleveland Job Corps Center for Women: Training Workshop for Corpsmen and Staff
- Cleveland Music School Settlement: Music therapy program
- Cleveland National Association for the Advancement of Colored People: Afro-American History School
- Cleveland State University:
  - Division of Continuing Education—new and experimental programs
  - Educational Leadership Practicum for Public Schools
- Cleveland Society for the Blind: General Support

- Cleveland Welfare Federation:
  - Summer Work Experience
  - "Careers in Social Work."
  - Scholarships in Graduate Education in Social Work
- Council on Human Relations: The Green Circle Program
- Cuyahoga Community College:
  - Project Search
  - Student Financial Aid
- Cuyahoga County School District: A study to develop regional computer capability for school districts in Northeastern Ohio
- Cuyahoga County School Superintendents Association:
  - Organizational Funding
  - Seminar on Teacher Negotiations
  - Teacher Training—Family Living Institute
- East Cleveland City Schools: Picture Lady program
- Educational Development Center: Research into causes of college dropouts and their effective rehabilitation
- Educational Research Council of America: Teacher education
- Educational Television Association:
  - Buildings and equipment
  - Operating budget
- Euclid Public Schools: Human Relationship Workshop
- Greater Cleveland Associated Foundations: ASPA Summer Internship in Public Administration
- Greater Cleveland Growth Association: Job Skills Survey
- Greater Cleveland Neighborhood Centers Association: "Neighbors Now" Building Campaign
- Hawken School:
  - Elementary art works
  - Film Makers Day Program
  - Fourth Annual Festival of Arts
  - Scholarship and Transportation of Funds
  - Summer Enrichment Program
- Jennings Foundation:
  - Master Teachers Fellowship Program
  - Master Teachers Program—summer research support
  - Special Jennings Scholar Program
  - Summer Fine Arts Scholarship
- John Carroll University:
  - In Service program—teachers of slow learners
  - Scholarship and special training for high school teachers in the area of Democracy vs. Communism
- Lakewood Board of Education: Space Science
- Natural Science Museum:
  - Education—public programs
  - Lecture series on "Search for Survival"
  - Mentor Marsh Nature Reserve
- Notre Dame College:
  - Capital Improvements
  - Project Insight
- Plan for Action for Continuing Education Association (PACE):
  - Citizens Look at School Systems
  - Early Reading Assistance
  - Human Relations Curriculum Dev.
  - Operating Expenses
  - Teacher Instant Mini-Endowment
  - Teacher-Leadership Awards
- Parma School District: Implementation of Social Studies Curriculum
- Police Athletic League: Customized educational training
- Project Work:
  - Motivation visits for 8th grade students
  - Older Worker Youth Demonstration Project
  - Operating Expenses
  - Reading is Fundamental program
  - Woodland Cooperative High School

Shaker Lakes Regional Nature Center: Program development for several school systems

Summer Arts Festival: Arts workshops for inner city children

United Negro College Fund: For institution-awarded scholarships

University Hospitals: To teach diabetic patients self-care

University School:

- Development program
- Endowment Fund
- Institution-awarded scholarships
- Summer Science Project 1968–1969
- Support of Educational program
- Support of Operating budget
- Winter Science Project 1968–1969

Ursuline College:

- Buildings and equipment
- Scholarships to individuals

Western Reserve Historical Society:

- Buildings and equipment
- Endowment
- Exhibits
- Experimental or new educational programs
- Faculty enlargement

A total of 127 questionnaires was returned and analyzed. The tabulations indicate that 41 percent of the grant recipients sought money for experimental or new educational programs. The second largest category of requests (23 percent) was for money for teacher education programs (see Question 1 of this report).

Approximately 59 percent of the grant recipients received less than $25,000 in 1968–69, but 15 percent were granted in excess of $100,000. A list of those institutions which received over $100,000 and the amounts they received in 1968 or 1969 appear below.

Institutional grants in excess of $100,000, as reported

1968:	
Baldwin Wallace College	$289,000
Case Western Reserve University	1,995,500
The Cleveland Society for the Blind	161,000
The Cleveland Summer Arts Festival	274,000
University School	711,907
Ursuline College	268,000
Total	3,699,407
1969:	
Case Western Reserve University	4,537,107
Educational Television Association	129,500
Educational Research Council	423,700
"Neighbors Now" Building Campaign	150,000
PACE Association	125,000
The Cleveland Summer Arts Festival	274,000
University School	383,912
Total	6,023,219

Fifty-two percent of the recipients reported that foundations provided more than 50 percent of each of their programs' total annual budgets. Furthermore, 28 percent said their entire budget was provided by foundations. (See Question 3)

In Questions 4 and 5, the opinions of the grant administrators were solicited. When asked what would have happened if foundation support had been withheld, over 50 percent of the respondents said their programs would not have started at all, and 47 percent said they believed their projects would have been delayed or would have had to lower targets.

Should foundation funds become unavailable, the program administrators indicated that they would try every other source for funds, with 47 percent stating that individuals would be asked to contribute and 41 percent believing that corporations would be approached for funding.

The following table of responses is presented in the format of the questionnaire which the respondents completed and submitted. The percentages of their replies are listed to the left of each question.

[N=127]

1. This program primarily involves:*

	Percent
1. Buildings and equipment	14
2. Unrestricted endowment	8
3. Teacher education	23
4. Experimental or new educational programs	41
5. Institution-awarded scholarships	17
6. Scholarships awarded directly to individuals	12
7. Non-scholarship student aid	2
8. Faculty enlargement	10
9. Other (please specify)	22

Operating expenses, faculty salaries, faculty development and research, special surveys and data analysis, various programs for public education on specific problems, for example, pollution.

* Multiple answers resulted in totals of more than 100 percent.

[N=123]

2. How much money did this program receive in either 1968 or 1969 (choose most representative year) from any or all foundations? (check one)

	Percent
1. Less than $1,000	2
2. Less than $5,000	20
3. Less than $10,000	16
4. Less than $25,000	21
5. Less than $50,000	18
6. Less than $75,000	6
7. Less than $100,000	2
8. More than $100,000 (actual figure, if in excess of $100,000)	15

1968:	
Baldwin Wallace College	$289,000
Case Western Reserve University	1,995,500
The Cleveland Society for the Blind	161,000
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Educational Research Council	423,700
"Neighbors Now" Building Campaign	150,000
PACE	125,000
University School	383,912
The Cleveland Summer Arts Festival	274,000
Total	6,023,219

This support was provided by how many foundations?

	Percent
1 to 5	80
6 to 10	10
11 to 20	4
21+	6

[N=127]

3. What percent of the program's total budget for that year did this money represent? (check one)

	Percent
1. Less than 1 percent	4
2. Less than 5 percent	4
3. Less than 10 percent	10
4. Less than 20 percent	6
5. Less than 30 percent	7
6. Less than 50 percent	17
7. Less than 75 percent	11
8. Less than 100 percent	13
9. Represents the total budget for this program	28

[N=126]

4. Without foundation support, this project: (check as many as apply)*

	Percent
1. Would not have started at all	53
2. Would have been delayed	23
3. Would have received the same amount elsewhere	0
4. Would have lowered its targets	24
5. Would have cut expenses but maintained its target level	8
6. Would not have been noticeably affected	2
7. Other (please explain). Without foundation support money would come from endowment fund. Institutional efficiency would be severely hampered. Programs serving a relatively small and special group would never be funded	6

[N=122]

5. If foundations were not able to provide any assistance to this program, where would you like to seek alternative funds? (check as many as apply)*

	Percent
1. Public fund-raising campaigns	18
2. Corporate contributions (other than corporate foundations)	41
3. Individual donors	47
4. Local government sources	9
5. State government sources	17
6. Federal Government sources	31
7. Other (please specify)	16
8. Would discontinue program	27

*Multiple answers resulted in totals of more than 100 percent.

Representative comments from backs of questionnaires as requested in questionnaire item No. 6:

1. "There was and is a need for teachers qualified to teach family living. What teaching will consist of is also important.

"With foundation help our Association (also funded with foundation money) became the focal point in developing a "Guide to Family Living," in training teachers for the above, in bringing two local universities together in teacher training and in providing the impetus to get one university to recommend that it take on the training of teachers in this area as soon as possible.

"Without foundation money *none* of this would have happened."

Program was titled: Family Living Curriculum Guide and Teacher Training Institute for Family Living. Program received between $25,000 and $50,000 from two foundations.

2. "For this particular program funding by any level of government probably would not be possible. Government funding under the Higher Education Act is

generally restricted to demonstration programs and must go through a university.

"Assistance for the program might be available through a local university; however those funds are limited. The university might also wish to restrict participation to only its students. An advantage of the present program is that it is able to attract students from a number of different universities throughout the United States."

Program was titled: ASPA Summer Internship in Public Administration. It is a summer employment program for college seniors.

3. "Funds for psychoanalytic programs are most difficult to obtain. The government agencies were "oversold" on psychoanalysis after the war and have soured on it. The uncertainty of long range government funding rules it out for us.

"Funds for basic research, long range training such as our are difficult to obtain because of the current emphasis on crash programs for masses of people.

"Only the personal knowledge of our work, our people, available to local individuals and foundations, enables us to succeed.

"The program described here is also funded in approximately similar amount by a second local foundation."

Program was titled: Training Program in Psychoanalytic Child Therapy. It is experimental.

4. "The grant awarded by the Greater Cleveland Associated Foundation was specifically for research into the causes and effective rehabilitation of students, with potential, who fail out of college. It has been our experience that relatively few individual donors are willing to make substantial gifts to a research program. As a result, we have large amounts of data accumulated over the past five years which have not received the statistical treatment necessary to make it meaningful. The foundation, on the other hand, is cognizant of the need for basic research and supports it."

Grantee is: The Educational Development Center. Grantee received more than $25,000 but less than $50,000.

5. "For our purposes, it is more advantageous to receive financial support from a local foundation rather than from the federal government. The local foundation is knowledgeable of the institution to which it gives support, and, in the case of the Jennings Foundation, maintains a personal interest in the program to which it makes a grant.

"A main disadvantage in federal funding is that restrictions often are harmful, as indicated below. For instance, some of the most vital parts of the Baldwin Wallace Humanities Institution programs could not be supported by federal funds because of the all-inclusive nature of our project. There is the added disadvantage of a small college not being able to compete with the great universities of national reputation. In addition, federal funding in many cases is for one year and there is no guarantee of support for subsequent years. The foundation which has supported the Baldwin Wallace program was able to render assistance for a four-year period."—Dr. Neille Shoemaker, Chairman, Humanities, Div., Director, Humanities Institute.

Program received $55,000 in each of 1968 and 1969. It is an experimental program involving teacher education and development, plus development of materials,

6. "This program, supported in large part by the Martha Holden Jennings Foundation, has enabled a young university to initiate a graduate program in school administration for a carefully selected group of sixty school principals in urban and suburban Cleveland, with the unified endorsement and support of superintendents from thirty-three school systems. We have thus been able to establish a program based on genuine current needs, with regard to school learning and school community relations, rather than go the usual route of offering conventional courses to prospective principals with no current leadership role. We will now be able to follow this pattern with graduate programs and in-service education "courses" with public funds almost exclusively. In substance, this has set us on the road to a problem oriented curriculum with much public support. A side benefit has been our ability to attract a new professor of school administration from a superintendency whose imagination has been captured by what we have begun and the expanded possibilities growing out of it for educational leadership improvement."

"As a final note, I have taken personal direction of two programs in the College of Education because of their far reaching potential value. One of them, funded by the U.S. Office of Education, is designed to bring the University, the Cleveland Public Schools, and the citizenship spokesmen together for initiating a school centered program for preparing teacher trainers. The other is the privately supported Educational Leadership Practicum. From the standpoint of this University, both the public dollars and the private foundation dollars will have more impact because of each other. The state and federal government could not have responded so promptly, if indeed at all, to the strategic opportunity that developed by the small subvention of private philanthropy. Conversely, the stimulus grants of foundations could not underwrite the expanding program to be developed from public funding at the state level."

Program was titled: Educational Leadership Practicum for Public School Principals. The administrator is Dean of the College of Education in Cleveland State University.

7. "All of the other procedures for seeking funds would have been far more costly because of being far more time consuming. Disadvantages of governmental funding are as follows:

1. They are increasingly restricted and usually require an impossible degree of matching
2. They usually require application so long in advance of actual funding as to seriously reduce flexibility and responsiveness to community needs
3. They consume an inordinate amount of staff time because of bureaucratic detail

"The alternative of seeking funding would be to charge the client the full cost of the program. In the case of teachers and school districts, this is not feasible."

Program was titled: Contemporary Changes in the Arts Program. It was conducted within Case Western Reserve University. A single foundation grant of less than $5,000 provided between 75 and 100 percent of its budget.

8. (1) "Need an organization to organize a public fund-raising campaign, and it doesn't make sense for special focus programs that are on a relatively small scale.

(2) "The search and persuade process is too exhausting and corporations are not likely to be interested in innovative and ground breaking programs as against other claims of a more traditional nature.

(3) "Run into all kinds of idiosyncratic decision rules that represent unbelievably odd orientations to the granting of funds and desirability of programs and perspectives on social needs and benefits. Moreover, *very* few individuals can make a grant in the $25,000 range, usually spread themselves out on marginally small grants.

(4) "Local governments have no money to spend on other than operating functions. They are deficit systems and will not risk funds to get into social innovations.

(5) "State governments don't know what the hell urban needs are or what local situations are like and have no real connections with the local scene. Moreover, the personal idiosyncracies of partisan politics will just exhaust and disgust anyone trying to do anything. An outside person has no leverage and ideas as such count for nothing in political in-fighting for advantage.

(6) "For the Federal government, what you do has to be consistent with political program and policy of the "ins" at the time. Moreover, you never know who decides and on what basis—unless you have an inside connection who wires you into the cash flow channels. Finally, like all political structures, there has to be an advantage for the organization and its personnel independent of the merit of the proposal. A politically exploitable potential is the "kicker" required beyond the merit of the proposal."

Respondent's program was a series of Black Management Development Seminars conducted by Case Western Reserve University. Two foundations covered its total budget of between $10,000 and $25,000 in 1968.

BANSLEY & BANSLEY,
Atlanta, Ga., October 17, 1969.

SENATE FINANCE COMMITTEE,
U. S. Senate,
New Senate Office Building,
Washington, D.C.

Re: Alonzo F. and Norris B. Herndon Foundation, Inc., 148 Auburn Avenue, N.E., Atlanta, Ga.

GENTLEMEN: We are writing on behalf of the Alonzo F. and Norris B. Herndon Foundation, Inc. of Atlanta, Georgia, at the request of the Trustees of the Foundation. They and we are concerned that the provisions of H.R. 13270 would seriously affect the Foundation and impair greatly its efforts to serve charitable interests in its community.

The Alonzo F. and Norris B. Herndon Foundation, Inc. was granted its charter November 22, 1950 and received its exemption letter on December 18, 1952. The only asset of the Foundation other than a nominal amount of cash is stock of Atlanta Life Insurance Company. On December 31, 1968 this was represented by 12,447 shares or 20.7% of the total shares of the Company outstanding. The creator and principal donor to the Foundation, Norris B. Herndon, owned 42,707 shares or 71.2%. Under terms of Mr. Herndon's will and a revocable trust established by him all of his stock will go to the Foundation on his death. Mr. Herndon has no close relatives.

The Foundation has at all times attempted to act fully within the spirit and letter of the law and regulations. There has at no time been any self dealing between the Foundation on the one hand and Mr. Herndon or any of the other trustees on the other hand. There have been no expenses charged or paid by the Foundation other than the annual State of Georgia $1.00 corporation registration fee. The Foundation distributes all of its income currently and has no accumulation of income. As of December 31, 1968, the Foundation had made contributions out of principal totaling $132,605.19. Contributions have been made principally to Morris Brown College and other units of the Atlanta University system and to the First Congregational Church of Atlanta. In this connection, please see Exhibits "A" and "B" attached.

Our problems, while substantial in many areas appear to be greatest in two: "Stock ownership limitation (sec. 101(b) of the bill and new sec. 4943 of the code" and "Distributions of income (sec. 101(b) of the bill and new section 4942 of the code".

Under new section 4943 of the code, either the Foundation or Mr. Herndon, during Mr. Herndon's life would be forced to divest itself or himself of all of the stock in the Company now owned. Atlanta Life Insurance Company stock has always been closely held. There is no present market for this stock. In order for the Foundation to divest itself of its holdings, it would be necessary to create a market for the stock or to merge the Company with another or to give the stock to another charitable organization. Atlanta Life Insurance Company is a black owned business with branches throughout the South and Midwest. There is not in the black community sufficient financial strength to purchase the stock of the Company and maintain it as a going business. Therefore, should sale of stock or merger become necessary, control, at a time when black businesses are being encouraged, would pass to the white community. Substantial benefits in the form of jobs for black people and financial services in the black community would be lost. To give the stock away to other charitable organizations would subject the Company to control by those of uncertain experience in business management and easily result in less money available for charitable purposes through decreased earnings and decreased value of the stock.

We request that H.R. 13270 be amended to permit the Foundation to continue to hold all of the stock in the Company which it presently holds and additionally any received by gift or bequest. Should this not be possible, we believe that as a minimum the Foundation should be permitted to hold 50% of the stock of the Company.

New section 4942 of the code requires a foundation to distribute all income currently and pay out at least a specified percentage (5% for 1970) of its noncharitable assets. The Herndon Foundation has always distributed its income currently and has consistently made contributions out of principal where it has had the funds to do so. It believes that a requirement to pay out income currently, excepting certain so-called "set asides", is reasonable. To require a foundation to pay funds out of principal in a year in which current earnings do not equal a set percentage of assets becomes an additional divestment provision, forcing liquidation of holdings in what may be a good investment. Certain industries have historically lower earnings on investment than others. This does not necessarily make them a poor investment for foundations. On the contrary, they may produce a steady income which over the years would generate greater benefits than many investments which would have more volatile earnings or be more speculative.

We request that H.R. 13270 be amended to eliminate the provisions of section 4943(d) providing for distribution of a specified percentage of its noncharitable assets.

Proposed section 170(e) of the code denies the donor of appreciated property to a private foundation the right of a full deduction for his donation. We believe that this unfairly discriminates against private foundations and would serve to discourage charitable gifts, particularly on the local level. We request that consideration be given to elimination of this provision from the bill.

Paragraph (5) of section 4943(d) provides a 10 year period in which to dispose of excess holdings in an enterprise which a foundation acquires under the terms of a will which was executed on or before July 28, 1969. Paragraph (6) applies if the will was executed after July 28, 1969. Most of Mr. Herndon's stock will pass to the Foundation under terms of a revocable trust the purpose of which is to provide for Mr. Herndon in case of disability. It is not clear in the bill that a bequest of this type under a trust where the property passes at death comes under the provisions of these paragraphs. We request that consideration be given to clarification to provide that such a bequest under a trust will be treated the same as a bequest under a will.

In all of the above we have discussed possible changes in specific provisions of the bill.

We believe that reasonable regulation by the government is beneficial and would serve to eliminate most of the abuses which may occur. We believe that both from the standpoint of the government and from foundations in general a different approach would provide a more effective method to regulate foundations and protect the public interest without cost to the public.

We propose that a system of examination of foundations be set up whereby all foundations are examined by government examiners on a regular basis. The cost of its particular examinations would be paid for by each foundation. The examination would be sufficiently thorough to uncover any possible abuses, penalties for which could then be assessed. The cost of the examinations and the penalties would be sufficient to provide for the cost of such supervision and only those who abuse their privilege would be penalized. This would at the same time eliminate the complexities and inconsistencies which are found in the present bill and which provide great risk for even the best intentioned and best informed foundation donor, trustee or manager.

Very truly yours,

J. DAVID BANSLEY.

EXHIBIT A.—ALONZO F. AND NORRIS B. HERNDON FOUNDATION, INC., 148 AUBURN AVE. NE., ATLANTA, GA. CONTRIBUTIONS, GIFTS, ETC., RECEIVED DURING THE YEARS 1968-51 AND RECONCILIATION OF CAPITAL SURPLUS

	Shares	Value
Atlanta Life Insurance Co., common stock, voting:		
Donor, Norris B. Herndon, 1951-68	6,440	$2,039,970.00
Donor, Atlanta Life Insurance Co	88	25,765.00
Stock dividend, 1963	3,579	
Stock dividend, 1955	2,340	
Total stock, Dec. 31, 1968	12,447	2,065,735.00
Cash: Donor, Atlanta Life Insurance Co., 1951-60		104,200.00
Real estate (sold 1963): Donor, Norris B. Herndon		17,500.00
Total contributions, gifts, etc., received		2,187,435.00
Reconciliation of capital surplus:		
Add gain on sale of real estate, 1963		17,461.50
Deduct improvements made to real estate		-5,034.76
Total		2,199,861.74
Deduct contributions paid out of principal		-132,605.19
Capital surplus (book value), Dec. 31, 1968		2,067,256.5$_{5}$

STATEMENT OF INCOME AND EXPENSES AND CONTRIBUTIONS DURING THE YEARS 1968-51

Total income for the years 1968-51	$510,527.12
Expenses:	
Annual expenses, Georgia registration fee	16.00
Organization expenses	122.25
Subtotal	138.25
Balance of income	510,388.87
Total contributions paid, exhibit B	642,994.06
Contributions from principal	-132,605.19
Subtotal	510,388.87
Accumulation of income, Dec. 31, 1968	None

NOTES

Ownership of Atlanta Life Insurance Co., common stock, voting, on Dec. 31, 1968, was as follows:

	Shares	Percent
Norris B. Herndon	42,707	71.2
Alonzo F. and Norris B. Herndon Foundation, Inc	12,447	20.7
Others	4,846	8.1
Total	60,000	100.0

Estimated fair market value of Atlanta Life Insurance Co., common stock, voting, owned by the foundation Dec. 31, 1968, $3,651,078.51.

Contributions received by the foundation in 1969 of Atlanta Life Insurance Co., common stock, voting: Donor, Norris B. Herndon, 200 shares; donor, Atlanta Life Insurance Co., 10 shares.

EXHIBIT B

Alonzo F. and Norris B. Herndon Foundation, Inc., Atlanta, Ga., Disbursements of made within the years 1968–51 for the purposes for which exempt

Schools:	
Atlanta University Center:	
Morris Brown College	$216,289.23
Morehouse College	9,000.00
Atlanta University	9,171.00
Clark College	6,551.00
Total Atlanta University Center	241,011.74
United Negro College Fund	31,740.00
Carver Vocational School, Atlanta, Ga	3,011.59
E. A. Ware Elementary School	2,705.80
American Friends of the Hebrew University, Inc	2,500.00
St. Labre Indian School, Ashland, Mont	2,000.00
Other Schools*	9,375.17
Total Schools	293,244.30
Churches:	
First Congregational Church, Atlanta, Ga	178,089.25
Mt. Moriah Baptist Church, Atlanta, Ga	4,725.00
Fellowship Baptist Church	3,000.00
Fort Valley Colored Primitive Baptist Church	3,150.00
West Side C.M.E. Church	2,700.00
Friendship C.M.E. Church, Tavares, Fla	2,645.51
Friendship Baptist Church	2,500.00
Cosmopolitan A.M.E. Church	2,000.00
Other Churches*	17,215.00
Total churches	216,024.76
Other publicly supported charities:	
United Appeal, Red Cross, Atlanta, Ga	37,850.00
Legal Defense and Educational Fund, NAACP	23,500.00
American Cancer Society	15,850.00
YMCA, Atlanta Centennial Fund	10,000.00
Carrie Steel-Pitts Home, Inc	8,000.00
United Appeal, Lake County, Fla	6,000.00
Phyllis Wheatley YWCA	5,800.00
Metropolitan Atlanta Community Services, Inc	5,500.00
Metropolitan Atlanta Association for the Colored Blind	5,500.00
Butler Street YMCA, Atlanta, Ga	3,000.00
Tri-County Community Chest	2,500.00
Atlanta Arts Alliance, Inc	2,000.00
Day Care Development Association	2,000.00
Other publicly supported charities*	6,225.00
Total other publicly supported charities	133,725.00
Total contributions, grants, gifts, etc	642,994.06

*Less than $2,000.00 each donee.

NATIONAL INSURANCE ASSOCIATION,
Chicago, Ill., October 17, 1969.

SENATE FINANCE COMMITTEE,
New Senate Office Building,
Washington, D.C.

GENTLEMEN: We wish to bring to your attention the urgent need for pointed modifications in the Tax Reform Act of 1969, H.R. 13270. There is a great search underway throughout our nation for avenues and effective programs for Minority Economic Development or Black Capitalism. The expressed interest and commitment by the federal government, the President of the United States and the giants of American Industry establishes development of Black Capitalism as a worthy national goal.

The Tax Reform Act of 1969, H.R. 13270, unless modified could destroy one of America's best examples of black economic development, The Atlanta Life Insurance Company (Alonzo F. And Norris B. Herndon Foundation Inc.). The two major provisions of H.R. 13270 that places in serious jeopardy a major portion of black economic development, that the nation is searching to create:

1. The distribtuion of annual income or five per cent of the fair market value of investment assets within 12 months.
2. The requirement that bar a foundation and its "disqualified persons" from owning more than 20% of a corporation's voting stock.

The Alonza F. And Norris B. Herndon Foundation and Mr. Norris B. Herndon own 91.7% of the stock of the Atlanta Life Insurance Company. The Atlanta Life Insurance Company was founded by a slave, Mr. Alonzo F. Herndon, in 1905 in Atlanta, Georgia. His son, Mr. Norris B. Herndon succeeded him as president, and today the Atlanta Life Insurance Company is the largest Capital Stock or Risk Capital business enterprise owned, controlled and managed by Negroes in America. Atlanta Life is one of founding and major members of the National Insurance Association.

The National Insurance Association is an organization of the insurance companies owned and controlled by black citizens of the United States. The American Negro has made its greatest economic stride in the field of life insurance. Atlanta Life is a major factor of the black representation in the insurance industry.

To illustrate the pending disasterous effects, we note the Net Worth or Capital and Surplus of all of the black insurance companies of America, total $64,000,000.00. The Atlanta Life represents 30% of this total ownership.

Capital Stock amounts to $13,000,000.00 of the $64,000,000 and the Stock of Atlanta Life represents over 46% of this stock ownership.

On behalf of the black man in the insurance industry we urge you to give favorable consideration to alternatives that will make it possible for black Americans to maintain control of Atlanta Life.

Atlanta Life nor the Herndon Foundation are guilty of any of the abuses often cited in explanations upon which the Tax Reform Act is based.

Yours truly,

JESSE HILL, JR., *President.*

ATLANTA LIFE INSURANCE CO.,
Atlanta, Ga., October 17, 1969.

FINANCE COMMITTEE,
U.S. Senate,
New Senate Office Building,
Washington, D.C.

Subject: Alonzo F. and Norris B. Herndon Foundation, Inc., 148 Auburn Avenue, Northeast, Atlanta, Ga.; employer identification No. 58-6036028.

GENTLEMEN: As Trustees of the Alonzo F. and Norris B. Herndon Foundation, Inc., we feel that the provisions of the H. R. 13270 would seriously affect the Foundation in the manner set forth in the accompanying letter written, at our request, by Mr. J. David Bansley of Bansley & Bansley.

In addition to the legal and technical aspects of the situation, we respectfully call to your attention the human problems involved.

The Herndon Foundation is unique in the fact that it is the result of efforts of black people and represents the maximum achievement of blacks in the field of economics in the history of our great country. In an era when both the Federal Government and private industry have considered to make special provision for the initiation, operation and encouragement of economic activities on the part of blacks, to our mind any action by the Federal Government that would counteract the opportunities for the future development of black economic progress would not be in keeping with current philosophies and activities.

As you review the enclosed technical document, keep in mind that the changes are proposed solely in an effort to maintain for charity and for all black people of this country a source diligently discovered and protected that will serve not only as an economic beacon, but a bulwark of economic strength providing employment and economic resources for a people too long disfranchised.

The continuity of operation of Atlanta Life Insurance Company, a $70,000,000 black organization, is based on the continued existence of the Herndon Foundation. At the demise of the president, Norris B. Herndon, unless his holdings can be transferred to the Foundation, Atlanta Life Insurance Company, by reason of taxes and the inability of any other black organization, corporation or person to purchase his holdings, will be swallowed up by the white community.

We take the position that black ownership of black enterprise is both symbol and evidence of opportunity, and this is central to the spirit of independence on which orderly progress of black people rests.

We respectfull solicit your aid in any and all ways, including the requested changes that might make Atlanta Life Insurance Company survive in a highly competitive society, even to the point of an outright exception.

Respectfully yours,

Henry N. Brown,
E. L. Simon,
Trustees.

Federation of Conservationists,
United Societies, Inc. (FOCUS),
Barnegat Light, N.J., October 8, 1969.

Senate Finance Committee,
U.S. Senate,
Washington, D.C.

Gentlemen: We support the position of the Conservation Foundation and of other Conservation organizations that the pending tax reform under H. R. 13270 will "inhibit and cripple the work" of many conservation organizations throughout the country. It will moreover, seriously impair research, education and information work for conservation.

Perhaps the most dangerous section of the bill is the section which imposes a 100 per cent tax penalty on foundations expenditures which attempt to influence legislation by affecting public opinion or by "private communication" with a member or employee of a legislative body. The language is so broad that it places under a cloud all but the most theoretical or scientific and technical work of many non-profit organizations.

It is noted that private business continue to finance legislative activities as tax-deductible expenses, yet private foundations would have to pay a 100 per cent tax penalty for activities which are somehow determined to influence public opinion.

We urge the Committee to hold hearings to explore the adequacy of existing legislation on lobbying—in a positive instead of a punitive framework.

We urge you to delete a further provision in the bill requiring foundations to police grants made to another organization. We trust you will consider the recommendations of the Conservation Foundation in your deliberations on this bill.

Sincerely

Robert B. Litch, *Executive Secretary.*

Statement of El Pomar Foundation of Colorado Springs, Colo., by William Thayer Tutt, Russell T. Tutt, Raymond J. Montgomery, and Ben S. Wendelken, Trustees of El Pomar Foundation, Colorado Springs, Colo.[1]

SUMMARY

1. Enactment of proposed § 4943 would require El Pomar Foundation to sell the Broadmoor Hotel to the substantial detriment of the citizens of Colorado.

2. The Committee is urged to delete § 4943 from H.R. 13270 as being drastic and unnecessary departure from existing law. The other private foundation provisions which are designed to ensure the enforcement of existing law are adequate for that purpose.

3. If § 4943 is retained in the bill, it should only be applied to future acquisitions of business enterprises by private foundations. To apply it retroactively to the business enterprises which have previously been donated to foundations would be a breach of faith with the American taxpayers who committed their businesses to charitable uses in reliance upon existing law.

STATEMENT

We appreciate this opportunity to submit this statement on behalf of the El Pomar Foundation of Colorado Springs, Colorado. Our purpose in making this

[1] This statement is referred to on pages 4360–4362, by Hon. Gordon Allott, a U.S. Senator from the State of Colorado, and was submitted for the record by Senator Allott.

presentation is to urge the Finance Committee to eliminate from H.R. 13270 those provisions which would require a private foundation to divest itself of any interest in a business enterprise in excess of twenty percent.

El Pomar Foundation through subsidiary corporations operates several enterprises which would probably be classified as "business enterprises" under the private foundation provisions of the bill, its principal holding of this nature being the Broadmoor Hotel at Colorado Springs, Colorado. In their management of the Broadmoor and the other business activities of El Pomar Foundation over the past 32 years the trustees have consistently devoted their efforts primarily to the charitable activities for which the funds of the Foundation were entrusted to them. At no time during the existence of the Foundation have there been any instances of the various abuses which prompted the private foundation provisions of H.R. 13270.

There is no donor control of El Pomar Foundation. Its founder, Spencer Penrose, died in 1939 and his wife in 1956. Since then there has been no member of the Penrose family associated with the Foundation in any manner. There have been no instances of self-dealing, and the Foundation has consistently distributed all of its net income for charitable uses on a current basis. The trustees have never made any investments which were not prompted by the motive of carrying out the specific charitable purposes of the Foundation or which would in any way jeopardize the ability of the Foundation to do so. El Pomar Foundation has never made any "travel or study" grants or engaged in any of the legislative activities proscribed by Section 4945. While the Foundation is not required by the law of Colorado to do so, each year it prints and distributes its financial statement so that the people of Colorado will know how the funds of the Foundation are being managed and spent for their benefit.

El Pomar Foundation is but one example of many where a private foundation in control of a business enterprise has faithfully and efficiently fulfilled its obligations of public trust. However, under the provisions of § 4943, these foundations will be required to divest themselves of their business interests. Thus, even though they may not have been guilty of any of the abuses complained of, they are to be punished along with those who have.

We submit that it is within the competence of this Committee and of the Congress of the United States to draft a law for the regulation of private foundations which will distinguish the innocent from the guilty. We urge the Committee and the Congress not to inhibit and restrict the legitimate activities of all private foundations just because a few of them may have acted improperly.

History of Spencer Penrose, Founder of El Pomar Foundation

Spencer Penrose, the founder of El Pomar Foundation, was one of the pioneers in the development of the Pikes Peak region of Colorado. He first came to Colorado Springs in 1891. Over a period of the next 25 years he accumulated a substantial fortune from real estate and mining activities in that area. His first big strike came from his ownership of an interest in a gold mining claim, the Cash on Delivery mine in the Cripple Creek area. His largest gains were made from the Utah Copper Company which was formed by him and his associates in the early 1900's. The Utah Copper Company was ultimately merged into Kennecott Copper Company in 1923.

About 1915, Spencer Penrose began to turn his attention from mining to the investment of his fortune and to his other interests wihch were of a less profitable but more satisfying nature. In 1915, he commenced the construction of an automobile highway to the summit of Pikes Peak which was completed in 1916 at a cost of a half a million dollars. He inaugurated the Pikes Peak National Hill Climb Contest for automobiles, which has continued down to the present times. The highway up Pikes Peak has been donated to the government and is now operated by the City of Colorado Springs.

It was about 1916 that he began his animal collection which was ultimately to become the Cheyenne Mountain Zoo. In 1916, he commenced construction of the Broadmoor Hotel. This hotel was completed and had its formal opening on June 29, 1918. It was about 1925 that he constructed an auto highway to the top of Cheyenne Mountain and a lodge at its summit. He later constructed the famous Will Rogers Shrine to the Sun on a granite peak of Cheyenne Mountain in honor of his good friend Will Rogers.

In 1925, he bought the Pikes Peak Cog Line Railway which was nearly bankrupt, and about to go out of business. The railway, which operates a cog train from Manitou Springs just outside of Colorado Springs to the summit of Pikes Peak, is today one of the "business enterprises" operated by El Pomar Foundation. In addition to hiking, there are two ways that tourists can get to the summit of Pikes Peak today. They may either go by automobile or bus over the highway built by Spencer Penrose or on this Cog Line Railway.

Spencer Penrose's animal collection was originally operated as a part of the activities of the Broadmoor Hotel. In 1926 and 1927, the animals were moved from the Broadmoor to the present location of the zoo on the slopes of Cheyenne Mountain. However, it was still managed by the directors of the Broadmoor Hotel. In 1938, the Cheyenne Mountain Museum and Zoological Society was formed by Spencer Penrose and all of the land, animals and other assets associated with this privately owned zoo were donated to that society. Since 1939, the sole source of support for the Cheyenne Mountain Zoo, other than part of its operating expenses which are defrayed by admission charges, has been the funds provided by El Pomar Foundation. Today the Cheyenne Mountain Zoo is considered to be one of the finest zoos in the country, comparable in statute to the San Diego Zoo.

Spencer Penrose's objective in building the Broadmoor Hotel was to provide elegant resort hotel facilities which would attract outsiders to the area. He was very proud of the scenic values of the Colorado Rockies and particularly the Colorado Springs area. The Broadmoor Hotel complex which he constructed at a price in excess of three million dollars included many additional facilities. In addition to the hotel building itself, he built an indoor riding academy which later was to become the Ice Palace and a golf course which was the forerunner of the present championship 36-hole golf course. The complex also included riding stables and a stadium for rodeos and athletic activities.

Creation of El Pomar Foundation

In 1937, Spencer Penrose created the El Pomar Foundation as a charitable corporation under the laws of Colorado. He provided in its Articles of Incorporation that the principal and income of all properties or funds contributed to the corporation were to be applied "to such charitable uses and purposes (including public, educational, scientific and benevolent uses and purposes) exclusively, as will in the absolute and uncontrolled discretion of the trustees of the corporation most effectively assist, encourage and promote the general well being of the inhabitants of the State of Colorado." He added the proviso that its funds and property should be limited for use within the State of Colorado.

His initial contribution and other contributions during his lifetime to El Pomar Foundation totaled $1,459,422. Upon his death in 1939 his entire estate, having a value at that time of $12,193,791, was left by him in his will to the El Pomar Foundation. His wife, Julie V. L. Penrose, made contributions to the Foundation during her lifetime of $238,993, and upon her death in 1956, bequeathed the remainder of her estate after certain specific requests to the Foundation. At the time of her death, the assets of her estate which went to the Foundation had a value of $7,180,871. The total contributions from Mr. and Mrs. Penrose to El Pomar Foundation has been about twenty-one million dollars. Over the years, the Foundation has received contributions from others totaling $1,826,296.

Charitable activities of El Pomar Foundation

From its contributed capital of approximately twenty-three million dollars, El Pomar Foundation has, over the years, made contributions for the charitable purposes for which is was organized totaling $27,114,730. It has contributed approximately $4,8000,000 to Colorado College in Colorado Springs. Over the years, its contributions to the Penrose Hospital and for cancer research have been approximately $7,500,0000. Recently, the Foundation constructed and donated to the City of Colorado Springs a new regional library at a cost of over $2,000,000. Its support to the Cheyenne Mountain Museum and Zoological Society has exceeded $4,600,000.

The Foundation has by no means limited its charitable contributions to the Colorado Springs area. There are few, if any, cities and towns in the State of Colorado which have not benefited from contributions by the El Pomar Foundation to their schools and hospitals.

Also, by its own financial support and the efforts of its trustees on behalf of the Air Force Academy Foundation, El Pomar Foundation has been largely responsible for the donation to the Air Force Academy of its athletic stadium and the Eisenhower Golf Course and is presently raising funds for the Aerospace Education Center at the Academy.

Attached hereto as Exhibit A is a list of the grants paid out by El Pomar Foundation from 1937 to September 1, 1969. We are also attaching, as Exhibit B, a complete summary of the income and contributions paid by El Pomar Foundation from its inception through December 31, 1968. These represent only the direct financial contributions by El Pomar Foundation for the benefit of the inhabitants of Colorado. We shall discuss later the indirect benefits of both a tangible and intangible nature which have been provided through the public service activities of the Broadmoor Hotel and the other "business enterprises" operated by the El Pomar Foundation.

Business Interests of El Pomar Foundation

Most of the assets of the El Pomar Foundation are in the form of cash, government and corporate bonds, and other marketable securities of a strictly investment character. However, in addition to these assets, the Foundation owns 100% of the stock of El Pomar Investment Company and of the Broadmoor Drug Company. The stock of the Investment Company was included among the assets of Spencer Penrose which were left to the Foundation upon his death in 1939. The Broadmoor Drug Company, which operates the drug store at the Broadmoor Hotel, was left to the Foundation by Mrs. Penrose upon her death in 1956.

The El Pomar Investment Company does not itself engage in any business activities. However, it owns all, or a controlling interest in, the stock of other corporations which do. Its principal subsidiary corporation, of which it owns 100% of the stock, is the Broadmoor Hotel, Inc. which owns and operates the Broadmoor Hotel. It also owns 100% of the stock of the Beaver Park Company which operates an irrigation system in the Beaver Park area near Penrose, Colorado. It owns about 75% of the Garden City Company which has substantial landholdings near Garden City, Kansas. It owns 100% of the stock of the Manitou & Pikes Peak Railway Company which operates the Cog Railway to Pikes Peak. It also owns the stock of Mt. Manitou Park and Incline Railway Co., which operates the cable car up the Manitou Incline to the top of Mt. Manitou. It also owns all of the stock of the corporation which operates scenic tours in the Colorado Springs area and one which provides taxi cab service in Colorado Springs. All of these various enterprises were in operation and owned by Spencer Penrose prior to his death. The Foundation has not acquired any new business enterprises since its inception in 1939.

You will note that these business activities are related either to the physical development of the areas in which they operate or to providing facilities whereby members of the general public can enjoy the natural wonders of the Colorado Rockies. This is in keeping with the intent of Spencer Penrose when he first established these business enterprises.

In their management of the Broadmoor Hotel, the trustees of the Foundation have placed primary emphasis upon the excellence of its services and facilities far above the minimum level required to obtain a maximum of profit. Along with such other fine hotels as the Greenbrier and the Homestead, the Broadmoor Hotel has recieved worldwide recognition as providing the finest resort hotel accommodations available anywhere.

The Broadmoor's World Arena (formerly the Ice Palace) has become internationally famous, both as the site for the National Intercollegiate Ice Hockey play-offs and the World Figure Skating Championships, but also as the training place for many of our country's best figure skaters. Broadmoor skaters Hayes Alan and David Jenkins each collected one Olympic and three World Figure Skating Championships. Karol and Peter Kennedy won the World Figure Skating championship as a pair. The Broadmoor Skating Club has produced three Olympic, ten World, five North American, and twenty-one National championships, the latest and current being Peggy Fleming, three times World Champion lady figure skater and winner of the only gold medal award to an American in the 1968 Olympic games at Grenoble.

The Broadmoor's devotion to amateur athletics has by no means been limited to ice skating. Its championship golf course has been the setting for innumerable amateur golf tournaments, the most notable among them being the 1962 International Curtis Cup Match, the U.S.G.A. Mens Amateur Championships in 1959 and 1967, the Women's Western Amateur in 1963, six trans-Mississippi and three National Collegiate Championships.

In 1949 and again this year, the Governors Conference has been held at the Broadmoor. Its recently constructed International Center provides excellent facilities for conventions and brings many more people to Colorado.

Effect of Section 4943 on El Pomar Foundation

While technically the Broadmoor Hotel, the Pikes Peak Cog Line Railway, the Manitou Incline Cable Car, the scenic tour buses, and the taxi cabs owned and operated by the El Pomar Foundation are business enterprises, each of these activities, to a greater or lesser degree, has some relationship to the purpose for which the El Pomar Foundation was established by Spencer Penrose. They are not simply businesses which are operated by the Foundation solely for the purposes of making a profit. However, there is no question but that under the present provisions of H.R. 13270 many, if not all, of these activities would be considered to be unrelated business activities which would have to be disposed of under the provisions of § 4943.

Some of them, such as the Cog Line Railway and the Manitou Incline Cable Car, would probably not be sufficiently profitable over an extended period of time to warrant their operation as an independent business ventures without some form of subsidy from the government. Divestiture of these business organizations would more than likely result in their termination, unless some public support were provided. If the Foundation were required to do so, some of the other organizations, such as its taxi cab company, could probably be disposed of without difficulty.

Our greatest concern is the future of the Broadmoor Hotel. If the Foundation were required to sell the Broadmoor the only potential purchasers who could afford to buy it would be the major hotel chains or perhaps one of the large conglomerate corporations. In either event, the result would be absentee ownership by an organization which had no special interest in the welfare of Colorado Springs or of the inhabitants of Colorado generally. Indeed, management of such an organization would probably not even be aware of many of the problems of the area. Any organization which was oriented primarily towards the profit motive rather than public service would undoubtedly curtail many of the activities presently being conducted by the Broadmoor.

Our concern over the future of the Broadmoor is shared by the citizens of Colorado. As evidence of this concern, the Mayor of Colorado Springs has written a letter to the Finance Committee. With the consent of the Mayor, we are attaching a copy of that letter as Exhibit C.

Opposition to divesture provisions

The basic purpose for including the private foundation provisions in the tax reform bill was to curb certain abuses which were not being adequately dealt with under the present income tax law. These abuses represented, in one form or another, situations where some foundation donors and managers have failed to live up to their obligations of public trust. Specific provisions have been included in the bill to deal with these abuses, Section 4941 with self-dealing, Section 4942 with a failure to distribute income, Section 4944 on investments which jeopardize the charitable purpose and Section 4945 on expenditures of a legislative or political nature. Other provisions require public accountability so that the activities of the private foundations will be open to public scrutiny. We support these provisions, insofar as they encourage the proper administration of private foundations.[1] We think they are adequate to accomplish their objectives. In any event, a sufficient period of time should be given to test the effectiveness of these provisions before more drastic measures are taken.

The divestiture provisions represent a very drastic departure from the present law. The reason given for § 4943 is that some foundation managers have diverted their attention away from their charitable duties and given undue attention to the activities of the business enterprises. We submit that this is by no means the case in regard to the vast majority of private foundations. Another argument made is that the business may be unfairly competing with other businesses whose owners must pay taxes on the income realized. This argument ignores the fact that private foundations also pay taxes on the income they derive from their business activities.

Moreover, the divestiture provisions of § 4943 are not limited to the specific situations complained about, but have been so broadly written as to prohibit all business control by private foundatons. We do not think this is either necessary or desirable. The public benefit derived from the donation of businesses to charitable purposes far outweights any detriment resulting from any specific abuses.

We suggest that this Committee delete the provisions of Section 4943 from the bill entirely. We submit that there is nothing inherently bad in having a charitable foundation own a controlling interest in a business enterprise. We see nothing wrong in having the profits of an operating business corporation inure to the benefit of the public at large rather than just to certain private stockholders. We think that the public welfare is better served by having the beneficial

[1] We do not support the income-equivalency provisions of § 4942 which require a distribution equal to 5% of a foundation's assets since this will force foundations into making high yield, but high risk investments, or require a creeping divesture of the foundation's principal.

ownership of the Broadmoor Hotel in the citizens of the State of Colorado rather than the stockholders of some major hotel chain corporation.

So far as we are aware, the ownership and operation of a business enterprise by a charitable organization has never been considered to be an unlawful activity under either the federal or state laws of the United States. Until now, the type of assets that could be owned by a charitable organization and the nature of its activities has been considered to be a matter governed by local state law· Federal jurisdiction has only been invoked to the extent of prescribing the limits within which a charitable organization must operate in order to obtain the benefits of federal income tax exemption. Even in this limited area, there has never been any prohibition against foundation ownership of business enterprises. The unrelated business income tax provisions which were incorporated into the Internal Revenue Code a number of years ago were for the purpose of insuring that the earnings from such business would be taxable. These provisions did not in any way prohibit such ownership either directly or through the ownership of stock of a subsidiary corporation.

The divestiture provisions of H.R. 13270 as applied to existing foundations are not limited to the question of tax exemption. Any organization which qualified as a tax-exempt organization last year is required to divest itself of its excess business interests regardless of whether it wants to continue to accept the privileges of a federal income tax exemption. In order to withdraw from qualification as a tax-exempt organization, a private foundation must pay the termination tax specified in proposed Section 507. This tax would be the lesser of two amounts; either (1) 100% of the value of the net assets of the foundation; or (2) an amount equal to the federal income, estate and gift taxes which the foundation and the majority of its contributors would have had to pay if the foundation had not been tax-exempt. Those foundations, such as El Pomar, which have lived up to their obligation to distribute for charitable purposes all of their income on a current basis do not now have the income which would have been paid to the federal government as taxes if they had not been tax-exempt. The benefits of the income tax exemption have long since been passed on to the general public through the use of the funds for the charitable purposes of the foundation. Payment of a termination tax computed on this basis would have to be out of principal of the foundation. In those instances where the foundation has been in existence for a substantial period of time the termination tax would result in a complete confiscation of the assets of the foundation regardless of which method of computation were used.

Thus, there is no way out. Private foundations must either voluntarily divest themselves of their excess business holdings in accordance with the provisions of 4943 or turn over their assets to the government in payment of the termination tax.

The net effect of this would be a breach of faith by the federal government with the taxpayers who have placed their business concerns in private foundations under the inducement of tax benefits for doing so.

In essence, the government has asked the American taxpayer to donate his buisness to public charitable purposes, assuring him that he can do so upon his death by leaving his business to a private foundation created by him which will use the profits of that business for the specific charitable purposes he selects. To encourage him to do so, the government has offered income, estate and gift tax benefits. After the taxpayer has irrevocably committed the ownership of his business to such a foundation, the government, by the divesture provisions of H.R. 13270, would now take that business away from the foundation. We submit that the United States government should honor its commitments to those donors and their private foundations who have faithfully abided by both the letter and the spirit of the existing laws.

In other areas of the tax law which are being changed by H.R. 13270, meticulous care has been taken to avoid any retroactive effect before the date when the change was proposed. We submit that if Congress decides to retain the divestiture provisions of Section 4943 it should also insert a provision which would limit the application of that section to business enterprises which are acquired by private foundations after May 26, 1969. Only by incorporating such a non-retroactivity provision in the law, which would permit private foundations to retain their present business interests, can the Congress keep faith with the donors of such businesses to private foundations.

CONCLUSION

To summarize, it is our position that Section 4943 and the other provisions of H.R. 13270 which would require a divestiture of business interests by private foundations should be deleted from the bill. In the event that these provisions are not deleted, they should be applied only to future acquisitions of excess business holdings. We thank you for this opportunity to express our views on H.R. 13270.

EL POMAR FOUNDATION

Grants paid 1937 to September 1, 1969

Education:	
Higher Education:	
The Colorado College (a)	$4,790,762.29
Air Force Academy Foundation (b)	355,000.00
Other Private and State Colleges	722,816.23
Secondary Education:	
Various Private Schools	2,656,198.18
Other	41,800.00
	8,566,576.70
Health:	
Penrose Hospital and Cancer Research (c)	7,455,508.05
Other Hospitals	394,431.00
Various	135,460.50
	7,985,399.55
Humanities:	
Central City Opera House Association	264,250.00
Cheyenne Mountain Museum & Zoological Society	4,666,499.97
Colorado Springs Fine Arts Center	668,488.81
Colorado Springs Symphony Orchestra Ass'n	180,200.00
Various	56,933.29
	5,836,372.07
Religion:	
Various	969,927.20
Resources and environment:	
City of Colorado Springs Library (d)	2,199,541.49
Garden of The Gods Land Purchase	250,000.00
Various	70,456.55
	2,519,998.04
Welfare:	
Boys Club Association (e)	140,896.79
Boy and Girl Scouts	149,460.15
United Funds	792,186.76
Various	153,912.97
	1,236,456.67
Total Grants Paid to September 1, 1969	27,114,730.23

Notes:
(a) Includes only $700,000 of a $1,600,000 grant for Sports Complex.
(b) Includes only $350,000 of a $600,000 grant towards Aerospace Education Center.
(c) Includes only $500,000 of a $750,000 grant for Cancer Research Building.
(d) Total grant was $2,200,000. Small balance to be paid shortly.
(e) Includes only $61,318 of a $200,000 Building grant now under construction.

August 19, 1969.

EL POMAR FOUNDATION—SUMMARY OF INCOME AND CONTRIBUTIONS PAID FROM DEC. 16, 1937, THROUGH DEC. 31, 1968

Year	Revenues	Expenses	Excess of revenues over expenses	Contributions paid [1]	Balance [2]
Dec. 16 through Dec. 31, 1937	$64,650	$7	$64,643	$84,474	($19,831)
1938		6,064	(6,064)	55,254	(61,318)
1939	13,425	6,288	7,137	74,700	(67,563)
1940	365,675	6,745	358,930	100,933	257,997)
1941	323,950	6,823	317,127	403,697	(86,570
1942	347,235	12,569	334,666	248,250	86,416
1943	405,369	23,698	381,671	199,842	181,829
1944	422,116	36,647	385,469	316,611	68,858
1945	473,592	14,814	458,778	282,985	175,793
1946	426,129	10,241	415,888	466,371	(50,483)
1947	438,343	16,519	421,824	366,982	54,842
1948	454,509	12,132	442,377	454,112	(11,735)
1949	452,590	11,159	441,431	693,150	(251,719)
1950	469,392	10,380	459,012	413,945	45,067
1951	470,997	10,983	460,014	540,204	(80,190)
1952	473,872	9,985	463,887	534,532	(70,645)
1953	573,689	10,481	563,208	725,855	(162,647)
1954	1,429,630	11,081	1,418,549	563,224	855,325
1955	1,982,573	10,995	1,971,578	536,961	1,434,617
1956	1,188,831	10,757	1,178,074	1,288,246	(110,172)
1957	1,152,420	11,648	1,140,772	1,569,697	(428,925)
1958	1,032,179	11,797	1,020,382	1,895,458	(875,073)
1959	1,162,431	14,077	1,148,354	1,502,715	(354,361)
1960	1,099,459	14,483	1,084,976	916,312	168,664
1961	1,107,373	14,872	1,092,501	1,169,770	(77,269)
1962	1,110,248	11,123	1,099,125	1,501,597	(402,472)
1963	1,263,162	9,487	1,253,675	1,465,215	(211,540)
1964	918,929	9,524	909,405	920,398	(10,993)
1965	1,686,301	10,834	1,675,467	1,404,550	270,917
1966	1,872,239	9,902	1,862,337	1,166,266	696,071
1967	1,517,824	8,786	1,509,038	1,558,009	(48,971)
1968	1,520,504	9,239	1,511,265	2,394,193	(882,928)
Total	26,219,636	374,140	25,845,496	25,814,508	30,988

[1] This column includes contributions paid and expenses of operating the Carriage House.
[2] Commitments for contributions are not included; at Dec. 31, 1968, such unpaid commitments totaled $2,657,460.

EXHIBIT C

CITY OF COLORADO SPRINGS, OFFICE OF THE MAYOR,
September 19, 1969.

THE FINANCE COMMITTEE OF THE U.S. SENATE,
Senate Office Building,
Washington, D.C.

GENTLEMEN: The Broadmoor Hotel is a unique institution; it was conceived by a man who believed that the Pikes Peak Region was the greatest place to live in the world, with the idea not of extracting profit from it but with the idea of bestowing upon the area facilities unequaled any other place in the world. Under the present control and management these purposes have been admirably effectuated.

The Broadmoor Hotel with its athletic stadium, its International Center, its Ice Palace, its championship golf courses and its outstanding hotel accommodations has in my humble opinion contributed more to the progess and advancement of the City of Colorado Springs and the surrounding area than any other single institution, and without the Broadmoor Hotel, much of the progress and development of this City would have been impossible. The present control and management of the Hotel is oriented completely to the needs of this community. I do not believe that any chain of hotel operators or any conglomerate management that was not attuned to the requirements of this area through life-long residence and interest could possibly operate this Hotel as effectively and as excellently from the point of view of community interest as has been done and is being done by the present management and control.

I feel that any legislation which required a change in the control and management of the Hotel would be a cruel blow to the continued prosperity, development and aspirations of this community.

Sincerely,

T. E. MCCLEARY,
Mayor.

STATEMENT OF WALTER N. TRENERRY, ST. PAUL, MINNESOTA, RE FOUNDATIONS AND CHARITABLE GIFTS

STANDING

Your relator appears in his own right as a taxpayer, and also as counsel for: Certain taxpayers who have gross incomes of more than $1 million a year and make charitable gifts in appreciated common stocks.

Certain foundations which are private foundations within the meaning of H.R. 13270.

SUMMARY

Titles I and II and Subtitle A of Title III of H.R. 13270 hurt only charity when they pile tax burdens on private foundations and the people who give to private foundations.

The Congress has better ways to regulate foundations than taxing them and their managers.

STATEMENT

Your relator, Walter N. Trenerry, of St. Paul, Minnesota, Attorney-at-Law and Member of the Minnesota Bar, respectfully states to the Honorable Finance Committee of the United States Senate:

While he does not *favor* all additions and changes created in the Tax Reform Bill of 1969 (H.R. 13270) your relator *objects* only to the matters in Titles I and II, and Subtitle A of Title III, which he mentions specifically.

Your relator *does object* to the following as unfair as well as unsuited to their contemporary setting:

Title I. Subtitle A.
- Sec. 101(a) Tax on Private Foundation Investment Income (Proposed Sec. 506 of Code)
- Sec. 101(b) Tax on Failure to Distribute Income (Proposed Sec. 4942 of Code)
- Sec. 101(b) Tax on Investments which Jeopardize Charitable Purpose (Proposed Sec. 4944 of Code)
- Sec. 101(b) Tax on Taxable Expenditures (Proposed Sec. 4945 of Code)

Title II. Subtitle A.
- Sec. 201(a) Limit on deductions for gifts of appreciated property (Proposed Sec. 170(b) (1) of Code)
- Sec. 201(c) Tax treatment of Gifts of Appreciated property (Proposed Secs. 170(e) and 83 of Code)
- Sec. 201(i) Charitable Remainder Trusts (Proposed Secs. 170(b) and 664 of Code)

Title III. Subtitle A.
- Sec. 301(a) Appreciation in value of Contributed property, as Tax preference (Proposed Sec. 84 of Code)
- Sec. 302(a) Appreciation value of Contributed property, as Limiting factor (Proposed Sec. 277 of Code)

I. What does the Congress want?

Is private charity a good thing? H.R. 13270 would say "No." The Congress is moving to do away with it.

Scholars, pedagogs, abstract painters, beggars, tuberculars, and others who have been getting help from private charity, will soon get less, but no one else will suffer.

Is rich John Bountiful necessarily a creature of evil? He is a rare man; he is indispensable for charity; and he shies easily.

Congress is doing its best to chase him to the hills.

II. Somebody gets taxed

Even if John Bountiful and his private foundation get out of paying some taxes, his foundation pays out money that in time reaches some Joe Taxpayer in a taxable bracket: a law student, a stenographer, a paperseller, and so on.

Statistics showing untaxed deductions or untaxed foundation income stop too short. They leave out the rise in taxable income put in circulation when Joe and Judy Taxpayer draw salaries from foundations and when Henry Purveyor sells goods to foundations.

III. Side effects are not necessarily bad

John Bountiful's private foundation as trust or corporation does supply a way to keep a block of stock and/or a local charity under Bountiful family control for a longer term than the rule against perpetuities otherwise allows.

It is quite safe to say, however, that until the Income Tax and Estate Tax came along—very recent things in history—no one complained, particularly men and women helped by the Bountiful charity.

Does the Congress now want to use taxes and controls not to raise revenue, or to keep people honest, but to pull all holdings down in the spirit of the English Levellers of 1647 or the more drastic Russian Levellers of 1917?

IV. The contemporary scene

If the Congress thinks private charity a good thing, the contemporary scene in 1969 argues against hobbling it by discouraging charitable givers. The scene today rejoices in these somber atmospheric elements:

A. *War.* An unpopular Asiatic war goes on and on and on. Welfare debts for the future pile up as wounded and diseased soldiers limp home.

B. *International Tension.* The Chinese and the Arabs rattle arms. The Russians browbeat Central Europe. People are already inclined to hoard their money and look after Number One.

C. *Inflation.* The price of meat gallops from $1 to $2 to $3 a pound. Gifts to charity shrink as even rich John Bountiful needs more money to live on.

D. *Welfare.* Since legislators have sworn unending devotion to unending relief rolls, and since people eating well on those rolls never want the meals to end, public welfare costs climb and climb.

E. *Cities.* Nearly every major American city has some huge rebuilding program under way and a prophet runs no risk in predicting that every major American city will want more money for more rebuilding tomorrow.

F. *Conservation.* Along with the twilight of cities goes an erosion in natural environment so steep and so speedy that mankind, not the dodo, faces being wiped out.

G. *Governmental Expansion.* As Uncle Sam moves into any field, John Bountiful gets out; so that as soon as the word is heard, and before government funds actually reach the spot, local charity is dead.

H. *Schools.* If the American commitment requires free college for all Jacks and Jills—and such is at least campaign talk—Joe Taxpayer or John Bountiful has to make it possible for Jack and Jill to get there, to pay tuition, to eat, to pay board and room, and to wear clothes.

With all these clouds drifting over the scene, the Congress nevertheless appears willing to kill off private supplemental help.

Whether Uncle Sam can take all bounteousness over and manage his handouts as cheaply and efficiently is doubtful.

V. Specific short-sighted measures

Your relator believes that the Congress has acted too fast in a feeling of exasperation about abuses. Even if the abuses exist; H.R. 13270 lumps the good with the bad.

The following things in Titles I and II and Subtitle A of Title III of the Tax Reform Bill of 1969 (H.R. 13270) look particularly short-sighted:

A. *Tax on private foundation investment income* (Sec. 101(a) of the Bill, proposed Sec. 506 of the Code).

This tax hits only private foundations and supposedly collects a modest fee for services furnished by Uncle Sam. Public foundations presumably exist without governmental help.

Incidentally, outside the Internal Revenue Code the law knows only a charity; nothing like a private as opposed to a public foundation.

Your relator believes that this tax will bring a quick death to the earlier policy of complete tax exemption; which rested on a partnership in which Uncle Sam gave his services free in order to encourage John Bountiful to spread his money among the needy.

As a footnote to history, the Income Tax of 1913 began with a 1% rate. This 1969 investment tax begins with a 7.5% rate. Since no legislator ever kills a tax once enacted, or lowers it, the reasonable prognosis is that this tax will rise relentlessly until it carries out its planned execution.

B. *Tax on failure to distribute income* (Sec. 101(b) of the Bill, proposed Sec. 4942 of the Code).

This tax also hits only private foundations. Managers of the public ones presumably never face temptation.

Supposedly this tax forces money out of the Bountiful foundation's bank accounts into the open hands of charity takers. Although the goal may be worthwhile, Uncle Sam is taking a paradoxical whack at the very source of the money.

Through the device called Minimum Investment Return this turns into a tax on capital which will in a calculable number of years reduce that taxed capital to zero.

Since the Bill gives The Secretary of the Treasury power to set the percentage of return on capital, this arbitrarily set return, beginning at 5%, can climb readily to 6% or 7% or 8% or whatever the Secretary needs to put a private foundation out of business. The Secretary of the Treasury becomes the Baal of foundations by fixing the level of compulsory offerings.

So far as your relator knows, Uncle Sam lets John and Judy Taxpayer choose their own investments. John Bountiful's private foundation is now going to be a taxpayer and should have the same freedom.

The Secretary of the Treasury has not told the American public what future-scanning device he has to tell him that Electronic Aerobatics, a low-yield investment of today, will never be a high-yield investment tomorrow.

In fact the Bill's taxing policies are inconsistent. If the Congress plans to tax private foundation capital gains as part of investment income, why put private foundation investments in a box which will allow only minimal taxable capital gains?

Until now John Bountiful chose what he was willing to give. Under the Bill, emphasis changes. With licensed presumptuousness a charity may say, "Oh, no, we can't take that. It only yields 3%."

C. *Tax on Investments Which Jeopardize Charitable Purpose* (Sec. 101(b) of the Bill, proposed Sec. 4944 of the Code).

This 100% tax on private foundations has at least the merit of going all the way.

Perhaps the Congress has some hints on how to find managers willing to pay a 50% tax on investments which only a lengthy lawsuit can interpret as taxable or not.

The Bill penalizes investing "in such a manner as to jeopardize the carrying out of any of its exempt purposes." Presumably this means "speculative" investments.

In 1960 your scalped Joe Taxpayer and even rich John Bountiful know that any investment whatever (stocks, bonds, gold, government promises, land) falls into the lap of the gods.

To invest money anywhere is risky and puts something in jeopardy. In times of inflation, not to invest it is risky and puts something in jeopardy.

If this tax goes into effect, no private foundation director or manager can tell just how much liability he is taking on.

To lower their exposure, directors and managers of private foundations will have to hire investment counsel, stick to a cautious investing policy, insist on insurance furnished by the foundation, and trot regularly to the Internal Revenue Service for advance rulings.

This will cost private foundations time, income and capital; and the overburdened Assistant Commissioner, Technical, in the Internal Revenue Service will not streak joyfully toward his new role as everybody's Investment Adviser.

All life is a series of speculations, both inside and outside the charitable frame of reference.

D. *Tax on Taxable Expenditures* (Sec. 101(b) of the Bill, proposed sec. 4945 of the Code).

This 100% tax on private foundations has the same merit as the preceding one and the same built-in problem about hiring managers.

Apart from the unworkable tax on managers, this section of the Bill will really abolish gifts by private foundations to individuals and to other private foundations.

John Bountiful's charity usually gives sparingly to individuals, after copious outside advice. Individuals asking help, however, are as varied as sculptors and scuba divers, and it is usually only the John Bountiful charities that are willing to toss a line to these off-beat characters.

As your relator sees it, the Bill would now require formal, regulated, categorized systems, given their Nil + Obstat in advance by the Secretary of the Treasury.

Farewell to help for the quixotic and uncategorized, like Stephen Vincent Benet, Pulitzer Prize Winner and beneficiary of the John Simon Guggenheim Foundation! Farewell, McDowell Colony!

Gifts by some John Bountiful's foundation to the private foundation of some George Wealthy are rare. When they are made, the Bountiful charity usually looks to see that the wealthy foundation is tax-exempt and then trusts it to perform according to law.

If the Bountiful charity has to be a watchdog whether or not the Wealthy foundation wants a guardian, this kind of giving will collapse.

Even the Ford Foundation could not help the noble work of the Belle Baruch Foundaton in wildlife care without in effect becoming an unofficial and unwanted member of the Baruch board!

E. *Penalties upon Gifts of Appreciated Property to Private Foundations* (Sec. 201(a) of the Bill, proposed amended Sec. 170(b)(1) of the Code; Sec. 201(c) of the Bill, proposed amended Sec. 170(e) and new Sec. 83 of the Code; Sec. 301(a) of the Bill, proposed new Sec. 84 of the Code; and Sec. 302(a) of the Bill, proposed new Sec. 277 of the Code).

These sections all take some kind of swipe at the John and Jane Bountifuls who give to private foundations.

Like the sections dealing with private foundations, these hit nobody but beggars in the soup line and blind men in nursing homes.

For some reason this Bill creates a statutory taint in appreciated property given to charity. John Bountiful may deduct 30% of his contribution base if he uses appreciated property, but 50% if he uses cash.

To the charity it is all one: IBM stock or dollars—both will buy soup.

Not only does John Bountiful face a limitation on deductions if he gives away appreciated property; he runs into a mess of technical complications.

First, he has to choose whether to deduct either—

a. His tax basis in the property, or

b. The fair market value of the property.

He will obviously take the fair market value, which is higher, or he would not be interested in using property to make the gift.

Second, if he takes the fair market value, he now has to treat his gift as a taxablo sale or exchange. One-half goes into income as taxable capital gain, and the other half goes into a new mousetrap called tax preference income.

As an example: John Bountiful has $100,000 in ordinary income and $20,000 in personal deductions for interest and state taxes. He wants to give $20,000 in appreciated property to his private foundation (the Bill lets him do this up to 20% of his contribution base). His tax basis in the property is zero.

He first has to find his contribution base, which in turn depends upon what is in the mousetrap called allowable tax preferences.

The Bill defines John Bountiful's allowable tax preferences as 50% of the sum of his gross income plus tax preference income. Untaxed appreciation in value of property given to charity is a tax preference.

His allowable tax preference would be:

Gross income:	
Ordinary	$100,000
Taxed capital gain	10,000
Total	110,000
Untaxed capital gain	10,000
Total	120,000
50 percent	60,000

His allowable tax preference is the full $10,000.

He may now move to his contribution base, which is his gross income plus his allowable tax preference:

Gross income:	
Ordinary	$100, 000
Taxed capital gain	10 ,000
Total	110, 000
Untaxed capital gain (preference)	10, 000
Contribution base	120, 000
20 percent	24, 000

At this point he knows he may give his $20,000 in appreciated property, but he is not through yet.

He must now apply the new Section 277 formula to see if he can in fact take all his personal deductions, including contributions.

The Section 277 formula disallows the following fraction of personal deductions:

$$\frac{\text{tax preferences}}{\text{tax preferences} + \text{gross income}}$$

The result for John Bountiful is:

$$\frac{10{,}000}{110{,}000} \text{ or } .09 \times \$40{,}000 = \$3{,}600 \text{ disallowed}$$

Accordingly his income tax return would show:

Gross income:	
Ordinary	$100, 000
Capital gain	10, 000
Total	110, 000
Deductions:	
Claimed	40, 000
Less disallowance	3, 600
Total	36, 400
Taxable	73, 600

Under the Bill it is John Bountiful's generosity that gets him into this swamp: the more he gives away in appreciated property the more tax he has to pay and the less he can deduct.

Under the present law his income tax return would show:

Gross income	$100, 000
Deductions	40, 000
Taxable	60, 000

What John and Jane Bountiful can cut out most painlessly is obvious.

F. *Charitable Remainder Trusts* (Secs. 201(c) and 201(j) of the Bill, proposed new Secs. 170(b) and 664 of the Code).

By disallowing as deductions all charitable remainders in trust except those giving the life tenant a fixed yearly sum or a fixed yearly percentage of trust assets, the Bill neatly throws all risks of fluctuation to the charity.

If the capital sinks in value, the charity, not the life tenant, goes hungry.

In the guaranteed annuity (fixed yearly sum) trust the Bill ignores the charitable remainder and makes sure that the life tenant gets his income: out of what would be the charitable capital if necessary.

In the unitrust (fixed yearly percentage of trust assets) the Bill makes it hard for any life tenant to know what he should get on any date. It probably gives him more in fact than he would get under a simple trust paying him the net income and not allowing invasion of capital.

Either requirement is curious. Any trustees' discretion to invest is overridden, and the trustees almost certainly have to invade capital at some point, and the charity finally gets a half-eaten pie.

VI. Is all this proper for an Internal Revenue Code?

The overall hope of Titles I and II and Subtitle A of Title III of the Bill is presumably keeping private foundations righteous by taxing them and their managers, and by loading tax burdens on their supporters.

Uncle Sam will get little internal revenue. The 7.5% excise tax all goes to supervise foundations. John and Jane Bountiful are not going to supply capital gains by making charitable gifts in appreciated property.

In all, H.R. 13270 is pretty heavy artillery for chasing a cuckoo from a nest. There should be some tears in classing foundations with sawed-off shotguns, to be *taxed* out of circulation. (Compare the Act of June 26, 1934, 48 Stat. 1237, now 26 U.S.C. 5801.)

Your realtor suggests with all respect that if the Congress wants to regulate private foundations it has power to do so in other ways.

People violate laws; abstractions do not. The civil and criminal law can reach people who do wrong. Taxing a private foundation—and taking away its money earmarked for charity—is a poor way to punish the human wrongdoer.

The Attorney General, armed with a regulatory statute, could smack wandering fingers more adriotly than the Treasury, which takes little joy in this assignment.

Respectfully,

WALTER N. TRENERRY.

STATEMENT OF THE AMERICAN VETERINARY MEDICAL ASSOCIATION, PRESENTED BY M. R. CLARKSON, D.V.M., EXECUTIVE VICE PRESIDENT

Mr. Chairman and Members of the Committee, the American Veterinary Medical Association appreciates the opportunity to present its views on H.R. 13270.

I am Executive Vice President of the American Veterinary Medical Association, a not-for-profit corporation chartered under the laws of the State of Illinois and having its principal office at 600 South Michigan Avenue, Chicago, Illinois. The purpose of the Association is to advance the science and art of veterinary medicine, including its relationship to public health and agriculture. Its 20,000 members, distributed throughout the United States, are concerned with the maintenance of the health of the nation's livestock and poultry resources; the protection of the United States against the introduction of foreign diseases, such as foot-and-mouth disease; the inspection of meat and poultry products for wholesomeness; the protection of the health of pet and zoo animals; the prevention of the spread of disease from animals to man; and the programs of education, research and development necessary to support these activities.

This letter is intended to constitute the statement of the Association in respect of those provisions of the Tax Reform Act of 1969 (H.R. 13270) relating to tax-exempt organizations, particularly Sections 101 and 201 of that Act, relating to private foundations and charitable contributions. The concern of the Association with these provisions relates to their probable impact on the American Veterinary Medical Association Foundation. The Foundation has been recognized by the Internal Revenue Service as exempt from federal income tax under Section 501(c)(3) on the basis of activities involving the support of research scholarships and fellowships, the making of loans to needy students, and the conduct of special scientific studies and projects.

The Association wishes to be on record as supporting the objectives of H.R. 13270 to the extent those objectives involve the elimination of self-dealing by tax-exempt organizations and the requirement of full disclosure. However, the Association is gravely concerned that in seeking to prevent certain limited but manifest abuses, H.R. 13270 departs from the long-established, Congressionally recognized and uniquely American principle of encouraging private support of educational, charitable, and scientific endeavor. In particular the Association is concerned with the following provisions of the Act:

1. *Definition of Private Foundation.* The Association strongly endorses the exclusion of those broadly supported educational and scientific organizations, such as its Foundation, from the definition of "private foundation." The American Veterinary Medical Association Foundation would not be defined as a private foundation under H.R. 13270 since it normally receives more than one-third of its support in each taxable year from qualified gifts, grants, and contributions and less than one-third of its support in each taxable year from gross investment income. The Association would strenuously oppose any effort to amend Section 101(a) to include in the term "private foundation" charitable, educational, or

scientific organizations deriving broad support from the public or from their membership.

2. *Imposition of a 7½% Tax on Private Foundations.* While the American Veterinary Medical Association Foundation would not fall within the definition of a "private foundation," and hence would not be subject to the proposed 7½% tax on private foundations, the Foundation and its educational and scientific activities would be adversely affected by such taxes. The Association has received from organizations which would be defined as "private foundations" support for various important scientific projects. Current planning contemplates that in the future the Foundation will seek more support for its activities from "private foundation" sources.

The inevitable result of the imposition of the proposed 7½% tax on private foundations will be to decrease the resources available to those foundations and diminish the support which the Foundation will receive from such foundations.

The Association's sole concern is not the financial impact of the proposed 7½% tax on its ability to obtain grants from private foundations. Its concern also is prompted by the fact that this tax represents a signal departure from the long-established Congressional policy of encouraging private eleemosynary endeavor. It cannot be argued that the tax is justified by its contribution to federal revenue, since the 50 to 75 million dollars it would produce is insignificant. Nor can it be justified as a means of defraying the cost of supervising the activities of foundations, since it bears no special relationship to such costs.

We hope that the Congress will reaffirm its historical policy of encouraging private charity and will amend H.R. 13270 accordingly.

3. *Charitable Contributions of Appreciated Property.* While the Association recognizes that the present tax treatment afforded contributions of appreciated property provides significant tax benefits to the donor, the Association nevertheless believes that the public benefit derived from the making of such contributions substantially outweighs any inequities which can be attributed to them. Accordingly, the Association supports the continuance of significant tax incentives to "giving," with full confidence that any loss to the federal government in revenue will be amply recovered through the contributions which private eleemosynary organizations will make to the public good.

We thank the Committee for the opportunity to present this statement and for the courtesy shown to the membership of the American Veterinary Medical Association. We would be pleased and privileged to meet with you, your committee, or your staff to discuss any or all of the foregoing provisions and to provide such additional information as you may desire.

AMERICAN PHILOSOPHICAL SOCIETY,
Philadelphia, Pa., October 15, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: I am taking the liberty on behalf of America's oldest learned society, The American Philosophical society, to submit to you personally, for your consideration and the consideration of your Committee, a short statement with respect to the activities of this Society.

As you may know, the Society was founded by Benjamin Franklin who was its first President; and it has since 1743, I believe I can fairly say, contributed greatly to the advancement of learning and knowledge and to the dissemination thereof. The question we respectfully desire to ask you and your Committee is whether or not this is the type of organization that the Congress wishes to limit or tax.

With best wishes to you personally in all the difficult tasks upon which you are engaged,

Very respectfully yours,

THE AMERICAN PHILOSOPHICAL SOCIETY,
HENRY ALLEN MOE, *President.*

STATEMENT PRESENTED ON BEHALF OF THE AMERICAN PHILOSOPHICAL SOCIETY HELD AT PHILADELPHIA FOR PROMOTING USEFUL KNOWLEDGE

The American Philosophical Society is the oldest and one of the most distinguished learned societies in America. It was created by Benjamin Franklin in 1743 along the lines of the Royal Society of London of which Benjamin Franklin had been elected a member. Benjamin Franklin became its first President. Its second President was David Rittenhouse, and its third President was Thomas Jefferson.

Membership in the Society is limited to five hundred members living in the United States and its foreign members number about one hundred.

At present, the Society includes among its members 54 Nobel Prize winners. In 1968, two of the three American Nobel Prize winners were members of the American Philosophical Society.

The Society has been in continuous existence since its founding. Its members are elected by the existing members. A very large number of them take an active and continuing part in the activities and administration of the Society, without compensation.

The building owned by the Society is one of the Independence Hall group of buildings, and is a few feet from Independence Hall itself on Independence Square in Philadelphia, which is the center of the Independence National Historical Park. The Society's main building was completed and occupied at the time of the writing of the Constitution in 1787.

In 1952 the American Philosophical Society offered to the Congress of the United States a proposal to build, across Fifth Street from its old building, a new and modern Library building to further its research and other scholarly activities.

By Act of July 10, 1952 (Public Law 497), 82nd Congress, the Congress of the United States passed a Bill which was signed by the President, leasing to the American Philosophical Society so long as it continues to use it for a Library a piece of ground on the east side of South Fifth Street, and authorized the Society to build its new Library building on that site. This building was completed and equipped in 1959 at a cost of more than $2,000,000, and is now in active use. One of the conditions of the Congressional grant was that . . . "in a part of the new Library Building readibly accessible there will be special exhibits for the public, from time to time . . ." And this condition has been complied with.

The Society has among its priceless assets some eighty percent of the Papers of Benjamin Franklin; an early draft of the Declaration of Independence with corrections in Jefferson's handwriting; the original "Charter of Privileges" issued by William Penn; the Journals of the Lewis and Clark expedition, and a host of other valuable documents.

The Society conducts meetings of its full membership twice each year for a three day period, and conducts a number of other meetings during the year. Its Committees meet constantly throughout the year, and its buildings are constantly used for advanced study and research. The Society gives research grants, each of which is passed upon and approved by a Research Committee composed of distinguished members of the Society, on an objective basis. Applications for these research grants come in from, and are made to scholars all over the United States.

The Society publishes every year a number of books, including its proceedings, transactions, memoirs, and year book and disseminates these publications widely throughout the world. It was once said by a leading inventor and member of the Society, Elihu Thomson, who had many patents in the electrical field, that almost every important advance in the electrical field throughout his lifetime had been first reported at meetings of the American Philosophical Society and in its publications.

The purpose of the Society, as its title implies, is to add to the fund of useful knowledge and to promote its dissemination.

Under separate cover we are sending you the following documents:

1. A copy of the 1968 Year Book of the Society which shows in detail the names of its members and its activities for the year 1968.

2. A Brief History of The American Philosophical Society prepared by Dr. Edwin G. Conklin, a former President.

3. The Report of the Committee on Finance and the Auditor's Report for the year 1968.

As shown in detail in the attached Reports on Finance for 1968, almost all of the Society's income comes from gifts which have been made over the many years of its existence. Its total investment assets (many of these are held in trust for its purposes or for special purposes within its general purposes) amounted to $27,289,945 as of December 31, 1968. These are in addition to its buildings, books, valuable papers, historical objects and personal effects.

From time to time the Society has joined in projects with other non-profit organizations, such as its program with Yale University for the publication of the Franklin Papers, of which twelve volumes already have been issued. The Society does not solicit the general public for funds in any way, but occasionally gifts are made to it by Will or otherwise by members and former members. At one time, the Society carried on a campaign for funds for a new building among a limited number of donors. It has received no grants from State or Federal Governments and has not sought such grants.

The two questions which we submit with the greatest respect to the Finance Committee of the United States Senate are these:

1. Is the American Philosophical Society the kind of organization which the Congress of the United States wishes to tax?

2. Are the advanced intellectual, research and educational activities of the American Philosophical Society the kind of activities which the Congress of the United States wishes to impair and limit when carried on by organizations of this nature?

AMERICAN PHILOSOPHICAL SOCIETY,
HENRY ALLEN MOE, *President*.

KALAMAZOO FOUNDATION,
Kalamazoo, Mich., October 20, 1969.

Re H.R. 13270—Community foundations.

Committee on Finance,
New Senate Office Building,
Washington, D.C.

DEAR SIR: Kalamazoo Foundation submits the attached letter for consideration by the Committee.

Community foundations are administered by responsible representatives appointed by community leaders. Community foundations support the public charitable needs of their communities. They publish financial data regularly, to keep the general public informed of their operations.

We believe community foundations should be specifically exempted from the rules of the new legislation on private foundations.

Respectfully submitted,

KALAMAZOO FOUNDATION,
D. S. GILMORE,
President and Trustee.

MCDERMOTT, WILL & EMERY,
Chicago, Ill., October 17, 1969.

Mr. D. S. GILMORE,
President and Trustee, Kalamazoo Foundation,
Kalamazoo, Mich.

DEAR MR. GILMORE: At your request we have considered the "private foundation" provisions of H.R. 13270 as applicable to Kalamazoo Foundation and community foundations generally.

SUMMARY AND CONCLUSIONS

We believe that the Bill would have a detrimental effect on community foundations. The detriment seems unwarranted, because community foundations as a group are vastly dissimilar to most "private foundations." Because of their different nature, community foundations are less susceptible than private foundations to the practices sought to be controlled by H.R. 13270.

If H.R. 13270 is enacted in present form, most community foundations could make a strong argument that they should not be regarded as the type of "private foundation" which would be subject to the new rules of the Bill. However there would be no assurance that this position would be accepted by the Internal Revenue Service. Also, a particular community foundation might well be subject to the new rules in one or more years even though it was not subject to them in other years.

The foregoing uncertainty as to tax status can have a major effect on foundation operating policies. Foundation management risks severe personal liability if the foundation operates on the assumption that it is not subject to the new rules, in view of the possibility that the Internal Revenue Service may contend that these rules do in fact apply.

In view of the foregoing we believe that H.R. 13270 should be changed to specifically exempt community foundations from the new rules. At the very least, a delayed effective date should be provided for community foundations, to permit trustees to secure advance rulings as to their status.

KALAMAZOO FOUNDATION

Kalamazoo Foundation is one of the more than 200 community foundations (sometimes called community trusts) in the United States. These foundations have assets in excess of $650,000,000. In 1967 (the latest year for which nationwide figures are available to us) Kalamazoo Foundation was the sixth largest community foundation; its own assets are about $24,000,000.

Kalamazoo Foundation, which is believed to be typical of most community foundations, was created in 1925 by a resolution adopted by the Kalamazoo Chamber of Commerce. The Foundation is administered by a Board of Trustees consisting of five members. Two Trustees are appointed by local banks in Kalamazoo, and one is appointed by each of the President of the Kalamazoo Chamber of Commerce, the Senior Judge of the Probate Court for Kalamazoo County and the Senior Judge of the Circuit Court for Kalamazoo County. These individuals are also the members of the Foundation's Distributing Committee and the officers of the Foundation. All serve without compensation.

The Trustees and the Distributing Committee have sole responsibility for the distribution of Foundation funds. They do not, however, control the investment of the Foundation's assets, which is handled by the three banks in Kalamazoo. Distribution of the Foundation's assets is made for a broad range of charitable purposes, generally in the vicinity of Kalamazoo, Michigan.

The records of the Kalamazoo Foundation are audited annually by a national firm of public accountants and the audited financial statements are published in a two-page spread in the local newspaper. Activities of the Foundation are also publicized in the local paper. Pamphlets describing the Foundation and its activities are distributed in the community.

Many individuals, estates and corporations bave made contributions to or for the benefit of the Kalamazoo Foundation. Most gifts to or for the Foundation are unrestricted. In those cases in which the donor recommends how the income or principal is to be used, the Foundation is not bound by the recommendation.

While most gifts to the Foundation are small, it (like most other community foundations) typically receives the bulk of its annual support from a few large gifts or bequests. During its early years, most large gifts came from members of a single family, which actively supports a number of Kalamazoo charities. In recent years, however, large gifts to the Foundation have also come from other families in Kalamazoo. In 1968, for example, about 80% of total contributions to the Foundation consisted of a $203,000 bequest from a deceased individual whose family had not previously been a major benefactor.

PRIVATE FOUNDATIONS UNDER THE HOUSE BILL

H.R. 13270 limits the operations and investment policy of "private foundations." Violation of the new rules would subject both the foundation and its trustees, officers and directors to heavy penalty taxes.

The House Bill seems based to a large extent on the 1965 Treasury Department study of private foundations. This study concluded that while "the preponderant number of private foundations perform their functions without tax abuse" there was "evidence of serious faults among a minority of such organizations" (Treasury Report on Private Foundations, p. 2).

Although the 1965 report did not suggest a specific legislative definition of a "private foundation," it seems clear that the problems which concerned the Treasury were associated typically with a few family foundations whose operations are controlled closely by the founder or his family. Community foundations were not considered susceptible to similar abuses; for example, the report states (p. 77, footnote 10):

"Since the particular concern of the present study was private foundations, several community foundations which could be readily identified were omitted from the tabulation."

In short, the Treasury had no intention of subjecting community foundations to the type of remedial legislation believed necessary for family foundations.

DEFINITIONS OF PRIVATE FOUNDATIONS IN THE HOUSE BILL

Yet, in spite of this intent, the House Bill does not clearly and safely exclude community foundations from "private foundation" status.

Whether a community foundation would be a "private foundation" under the Bill depends on whether it qualifies under Section 170(b) of existing law as a "publicly supported" organization, eligible for the 30% limitation on charitable deductions. Applicable regulations (§ 1.170–2(b)(5)) set forth two alternative tests of whether an organization is "publicly supported." While most community foundations do not qualify under the "mechanical test" due to the size of individual contributions, most of them probably do qualify under the "facts and circumstances test." Even under this test, however, there can be some question during periods when a single family has been a major benefactor. While it is unfortunate that this ambiguity exists under current law, the risks involved are borne by the donors and not by the community foundation or its trustees and officers. Donors can avoid these risks simply by spacing contributions over a period of years so as to stay within the clearly deductible 20% limitation; in any case, the foundation itself is not directly penalized.

But if this same imprecise "facts and circumstances" test is used to determine whether a community foundation is subject to the new rules of H.R. 13270, severe risks would also be borne by the foundation and its trustees and officers personally. If foundation management guesses wrong in its determination that the new "private foundation" rules are inapplicable, trustees and officers will be exposed to heavy personal liability under penalty provisions of the Bill. However large or small the possibility of personal liability may be, it seems certain to discourage the continued service of responsible public-spirited individuals who now act without compensation as trustees of community foundations.

Even if a community foundation has an Internal Revenue Service ruling that it is a "publicly supported" organization (and thus not a private foundation) the ruling may not give assurance as to the foundation's status in subsequent years. For example, if the community foundation subsequently receives several large donations from a single family, these donations could invalidate the ruling and result in private foundation status. In such case, the investment and distribution policies which were proper for a "publicly supported" organization would become "bad" under the private foundation provisions, thus invoking substantial tax penalties.

Trustees of community foundations appear to have three alternatives to avoid personal liability under the Bill:

1. Resign. This is clearly inconsistent with the public interest in retaining community leaders in the management of public charity.

2. Obtain a ruling as to the current status of the foundation and then refuse to accept any large gifts from a single family. Again this seems inconsistent with legislative intent, in that it would either deny charity the benefit of intended contributions or it would encourage the donor to set up his own private foundation, rather than making gifts to publicly operated, publicly accountable, community foundations.

3. Assume that the community foundation is a private foundation and abide by restrictive rules that probably were not intended to apply to such foundations.

Common sense indicates that community foundations and their public-spirited trustees deserve certainty as to their status under the Bill.

RECOMMENDATION

To provide this needed certainty we suggest:

1. That the Bill specifically exclude community foundations and community trusts from the definition of private foundations.

2. Alternatively, that a procedure be established so that a community foundation may obtain an advance administrative ruling as to its public status. A foundation obtaining such a ruling should not thereafter be treated as a private foundation until the first year after it is notified of the revocation of its ruling. If this alternative is adopted, we recommend that the effective date of the provisions applicable to community foundations be delayed until 1971, to provide sufficient time to obtain the rulings.

Sincerely,

ROBERT B. MCDERMOTT.

MEMORANDUM SUBMITTED BY RICHARD F. BARRETT, ON BEHALF OF THE STACKPOLE-HALL FOUNDATION, ST. MARYS, PA.

This memorandum is submitted on behalf of The Stackpole-Hall Foundation, St. Marys, Pennsylvania.

The proposed Section 101(b) of the Tax Reform Bill of 1969 would amend the Internal Revenue Code by adding Sections 4941-4947 dealing with controls, restrictions and penalties with respect to private foundations. Sec. 4943, which is the subject of the memorandum, in essence imposes penalties on holdings of stock by the private foundation where the amount of voting stock of any corporation held by the foundation and all "disqualified persons" exceeds 20%. "Disqualified persons" are related persons, such as substantial contributors, members of the foundation, 20% plus voting stockholders in the corporation, members of the family of such persons, etc. Relief from the penalty taxes may be obtained by the foundation's divesting itself of its stock holdings within a 10-year relief period, which also may require the reduction in the stock holdings of the disqualified persons to a less than 50% voting stock position. The provisions have an effective date of taxable years beginning after December 31, 1969.

It is submitted that the provisions of the proposed Sec. 4943 are undesirable and unnecessary for the reasons set forth as follows.

1. The provisions are punitive and inequitable, and have an aspect of entrapment. The Federal tax law and the administration of it by the Internal Revenue Service and the courts has authorized and encouraged the creation of private foundations and the holding by said foundations of stock of related corporations. As a consequence, thousands of such family or private foundations have been created and for many years have served an important charitable function. The tax law to date has, accordingly, induced the creation by taxpayers in good faith of a major financial and economic structure. To now adopt a complete reversal of the tax rules and require the dismantling of this structure, with the attendant economic risks and disruptions involved, would seem to be a clearly inequitable action.

2. The provisions are contrary to the economic policy of protecting the independence of small business. Elsewhere governmental policy is to restrict and limit economic "bigness", the growth of conglomerates and the

acquisition of the small independent business corporation by the giants. The effect of the provisions of Sec. 4943, if enacted, would be to the direct contrary, by reason of the sale and divestiture of the corporate stock and ownership control required to avoid the penalty tax.

3. The reforms proposed apart from Sec. 4943 are in themselves sufficient to achieve adequate controlling and policing of private foundations, which is the objective, and make the provisions of Sec. 4943 unnecessary. Sections 4941, 4942, 4944 and 4945 impose taxes and penalties on self-dealing between the foundation and related persons, on failure of the foundation to distribute its income with regularity, on improper investments incompatible with the charitable purpose and on expenditure of funds for improper purposes. If these provisions were to be enacted, private foundations conducting their affairs so as to avoid the application of such penalty provisions would be "clean" foundations operating in a completely acceptable manner.

4. The provisions of Sec. 4943 entail risk of serious economic consequences to persons other than the private foundation and its related persons. As has been indicated above, the requirements for disposal of stock and ownership control in many cases could involve serious economic

results to the persons involved. In addition, many of the private foundations affected are major community institutions, especially in the small community and non-urban areas. The economy and welfare of the area are frequently tied in to a major degree with the activities of the foundation and also with the corporate enterprise involved. If the tax law requires sale of the business to outside interests, a clear risk exists in all such cases of the business leaving the area with the obvious highly prejudicial economic results. Sec. 4943 could in many situations have exactly this effect.

5. Sec. 4943 requires disposal of stock by the foundation when no purpose is served. Under the proposed provisions, if the foundation has no voting stock of the corporation but merely non-voting, it still must sell the stock if more than 20% of the voting stock is owned by disqualified persons outside the foundation. The relation of this to improper use of foundations has not been demonstrated. This provision of the Section should be removed as irrelevant and superfluous.

6. The provisions should at a minimum carry a "gradfather clause". To suddenly change the rules at this date after authorising and encouraging good-faith taxpayers

to create private foundations is legislating of the most dubious and inequitable nature.

The Stackpole-Hall Foundation was created Novembor 9, 1951 as a Pennsylvania trust by the Stackpole and Hall families of St. Marys and Ridgway, Elk County, Pennsylvania. The Stackpole Carbon Company was organized in 1906 by the same families(Mr. Harry C. Stackpole and his father-in-law Senator J.K.P. Hall) and has been controlled by them from organization to date. The Company's main office and plants are in Elk County, and it is the largest business enterprise in said County, employing 3,523 persons at date of this memorandum. The population of Elk County is approximately 35,000. The Company is also the largest independent in the carbon products industry.

Stackpole Carbon Company's stock is unlisted, untraded and closely held by the Stackpole and Hall families, plus a few employees and unrelated persons. The Company is constantly being importuned by national companies to be acquired, but the policy of the owners is to remain independent and continue to operate as such for the benefit of the Company's owners and employees and the surrounding community.

The Stackpole-Hall Foundation has become a major and vital institution in the area and provides a source of funds for community needs not otherwise available. It has distributed all its net income annually since inception, plus substantial amounts of principal. Distributions for 1966, 1967 and 1968 were respectively $252,400, $322,159 and $310,840. Total distributions since organization of the Foundation are $3,522,209, divided between charitable organizations (hospitals, Boy Scouts, YMCA, United Fund, library, etc.) $1,981,721, educational organizations (schools, colleges, educational funds) $601,610 and religrious (churches, convents) $969,575. 88% of the total since organization has gone to area organizations, which is typical of the annual pattern. The contributions to the Foundation have been made by the Stackpole and Hall families and the Company.

The Foundation has been operated with meticulous adherence to the most conservative interpretation of the exempt organizations provisions of the tax law. There has been no dealing between the Foundation and the Company or any individuals or for their benefit in any way. The Foundation holds no voting stock of the Company, but a substantial amount of non-voting common and preferred, which as indicated is without a market.

The Stackpole-Hall Foundation is typical of many private foundations serving a most important function with adherence to the tax laws under which they were organised in good faith. It is submitted that to impose the proposed provisions of Sec. 4943 on the Foundation and its beneficiaries and the Company's stockholders is inequitable, unnecessary and unwise. The revenue and fair and honest dealing will be adequately protected without such provisions in the tax law.

TAX REFORM BILL OF 1969

Private Foundations - Sec. 4943

The Stackpole-Hall Foundation Supplemental Memorandum

This memorandum is submitted on behalf of The Stackpole-Hall Foundation, St. Marys, Pennsylvania. It supplements the memorandum previously submitted and incorporated in the records of the Senate Finance Committee as a statement on behalf of the Foundation.

The previous memorandum discussed the following points:

1. The punitive, inequitable and entrapment characteristics of the provisions of Section 4943, which would unfairly penalize family corporations and related private foundations created in good faith under applicable tax law and which have operated as legitimate, valuable charitable institutions in full observance of and compliance with the charitable purposes of Section 501(c)(3).

2. The inconsistency with general governmental policy of discouraging "bigness" and the acquisition of small businesses by the giants. The divestiture provisions have no logic from this point of view.

3. The existence of adequate controls elsewhere in the present tax law and the Tax Reform Bill insuring compliance by private foundations with the exempt purposes of Section 501(c)(3).

4. The undesirable economic results which could accrue, particularly in small community and urban areas if their sources of charitable support were to be diminished significantly by the effect of Section 4943.

5. Application of Section 4943 in instances where only non-voting stock is owned by the foundation, a proposition completely undocumented as relevant to any foundation abuses. It would seem that as an absolute minimum this extreme provision, which appears to be without any pertinance to the problem, should be eliminated.

The purpose of this supplemental memorandum is to, first, present one additional aspect of Section 4943 which it is believed is important in the proper consideration of the proposed Section, and, second, to outline a proposed amendment of the Section which it is submitted should render it acceptably effective but eliminate the undesirable and inequitable aspects previously referred to.

First, Section 4943 confuses motive with purpose. The motivation of an act may be, and frequently is, entirely different from the objective sought to be attained by the action, in other words the purpose that the action will achieve. Relating this to charitable gifts and foundations, it will be recognized that a charitable gift is made or a foundation created because the individual making the gift or establishing the foundation is motivated by any one of a number of motives: the desire to enhance his personal prestige by being known as a patron of worthy causes, to perpetuate the family name via the use of it for a foundation, to create a favorable influence on the attitude of the community and employees toward the business enterprise that is supporting the charitable activity, to establish an image as a racially tolerant and unbiased individual. It is well conceded that the activities of Urban Leagues and other ghetto-assistance accredited charitable programs are being supported by large business enterprises for, among other reasons, the major motive of protecting the properties and other interests of the contributing business enterprise. Such motivation very properly does not, however, detract from the legitimacy and tax deductibility of the amounts contributed and expended, so long as the purpose for which the amounts are expended comes within the ambit of Section 501(c)(3). Accordingly, although it might be the fact that the existence of a particular private foundation was motivated by a desire to secure protection for the independence and continuity of family ownership of the related business enterprise, if the foundation were organized, under its governing instrument, and is in fact operated exclusively for one or more of the exempt purposes of Section 501(c)(3), motive should not be material to the tax law. If motive were to be made material by the tax law with respect to charitable giving, then there should be much broader, intricate legislation to comprehend the entire spectrum, which obviously is not desirable or feasible. By the same token, it would appear clear that to pinpoint the private foundation-family enterprise situation to equate motive with purpose is inappropriate and that from this point of view Section 4943 should not be enacted.

Second, while it is submitted that Section 4943 should not be enacted for the several reasons previously outlined, it is proposed that if it were to be enacted, it should be amended to make its application effective only in cases where the actual purposes for which the foundation is in fact operated are other than exempt purposes stated in Section 501(c)(3). As the Section now stands, its language creates an irrebuttable presumption of uncharitable purpose and operations regardless of the facts. Elsewhere in the present Code and in the Tax Reform Bill abuse by the foundation must be determined to exist before withdrawal of exemption or imposition of penalty is applied. As a consequence, Section 4943 represents the regrettable approach of penalizing all private foundations operating without blame, in order to punish a handful abusing the charitable foundation status. It is superfluous to say that this is not what Congress feels is the correct way to legislate. Specifically, to improve this aspect, it is proposed that Section 4943, if it is to be enacted, be amended by adding the following sentence, together with such other coordinating language as is required elsewhere:

> "This section shall not apply unless the private foundation after December 31, 1969 has paid or applied its assets or the income therefrom otherwise than exclusively for a purpose specified in section 501(c)(3) for which the private foundation is organized."

In conclusion, it is again urged that the highly undesirable results that would be provoked by Section 4943 be avoided by eliminating the Section from the Tax Reform Bill, and achieving the legitimate and highly desirable policing of private foundations by the other available mechanisms of the law as existing and proposed, which may be used effectively for this result.

Richard F. Barrett
30 Federal Street
Boston, Massachusetts 02110

October 22, 1969

Statement submitted by Julius A. Rippel, President, Fannie E. Rippel Foundation

The views concerning H.R. 13270 which I present to your Committee are my personal views. They result from sixteen years of active service as president of a foundation which is legally restricted to assisting institutions giving care and relief to aged women; erecting, equipping, maintaining and aiding hospitals; and assisting institutions engaged in treatment of or research in heart disease and cancer.

I believe previous Congresses have acted wisely and entirely for the public good in granting exemption from taxes to many charitable and philanthropic non-profit organizations, including foundations. Those which violate the clear letter of the laws applying to them should be dealt with quickly and firmly. I strongly oppose those who do this willfully and knowingly. They constitute a very small minority, and it should be recognized that often they do many other things which are proper and constructively add to the public welfare and benefit. Nevertheless, they do harm to all tax-exempt, non-profit charitable groups. At their worst, they not only violate the rules and regulations which they work under and which aid them, but they tend to diminish the confidence of our people and our legislators in the general structure of philanthropy and charity.

This is tragic because, of all nations on this earth, the United States of America has been most greatly benefited by the money, time and effort given by huge numbers of its people, in small amounts and in very large amounts, to create the finest structure of charity that has ever existed. The various Congresses have long helped in major ways to make this possible. This nation is the envy of countless people in many other countries because of its advanced system of private charity and philanthropy. Any weakening of our structure of philanthropy, whether by legislation, public attitude or decreasing the effort or resources of philanthropy would be harmful for our people.

I have no interest in "covering up" any weaknesses or laxities. I do want the strengths and benefits kept openly in view. I do not seek any delay for its own sake, because the time for clarification is overdue. Nevertheless, I am greatly concerned to have whatever now needs to be done accomplished on the most constructive and encouraging basis possible.

The main purpose of my presentation of views concerning H.R. 13270, now before your Committee, is to request that you remove Title I in its entirety from the Bill you report to the Senate and that the current reconsideration of provisions concerning tax-exempt, non-profit organizations, including foundations, be made a separate and independent matter for further study and analysis by your Committee.

This is a serious and urgent request. It is made primarily for the benefit of the general public, or the "public interest", which private foundations and most non-profit organizations are in existence to serve, whether they be big or little in size and operation. In a second sense, it is also made for the benefit of the federal government itself in relation to its own obligation to serve the public interest and to be concerned with the overall welfare and benefit of the American people. The government needs every possible assistance from the "private sector". To restrain or discourage such assistance could be disastrous at a time when more is needed.

Title I is not genuinely tax-reform legislation - even though, for the first time, the House Bill would levy a tax on the income of private foundations. Title I is related to taxation and to tax exemptions; but it is, nevertheless, a complicated, and complicating, set of regulations and sanctions concerned with the routine operation of foundations, and some provisions are so unclear or uncertain that it would be unfair to enact them into law. The other "taxes" mentioned are actually fines and penalties rather than taxes in a normal sense.

The proposed legislation is too basic in its nature, too fundamental and important to the life and welfare of our nation and too involved in the daily work of the non-profit organizations themselves for it to be finally determined as part of the process of constructing a tax reform bill mainly for profit business and individual persons. There has been pressure to get a major tax bill passed quickly. The matters contained in Title I should not be involved with this pressure and speed, nor decided under these conditions. They need more time and less pressure for their consideration and discussion. They need extensive and adequate opportunity for all non-profit organizations, small and large, to present their views - and, perhaps, of more importance, to discuss the reasons, the background and the operating experience which produce their views. They need this opportunity not only prior to the writing of a specific bill on this subject, but also after the proposed text of such a bill is completed.

Moreover, one important independent group is studying this subject of under what conditions federal tax exemption should be granted to non-profit organizations truly serving our people. A final rewriting of legislation should have the benefit of views of this independent study group. I do not plead for less consideration of the contents of Title I. I plead for a wider and complete consideration, not only of this title, but also of the entire specialized subject.

The House procedure gave no chance for testimony after the Tax Reform Bill's language was available. Most non-profit organizations have not been able to give adequate study to the House Bill. Many could not get a copy until very recently, and normal vacation schedules and prior commitments have restricted the opportunity for study and conferences with professional advisors. Even now, relatively few smaller organizations and not all larger ones are prepared to give their considered views, nor would they have a chance to do so under the prevailing tight time schedule. Information in the press gives only the "highlights" and nothing on some of the most important provisions. These need wide attention and discussion - within the organizations affected, between them and their professional advisors, and by them with members of the Senate. To pass a bill without this chance risks creating continued uncertainty and misunderstanding and also wasting the time, effort and money of non-profit organizations and of the agencies of government involved in these matters. The net unfavorable results will fall ultimat ly upon the people who make up the "public interest". A poor bill, an inadequate bill, an antagonistic bill would be harmful and wasteful.

Urgent need exists to simplify and clarify the statutes concerning the bases upon which non-profit organizations are granted exemption from federal taxes. That should be the limit of federal legislation. The federal government does not incorporate or provide for the creating of these organizations. That is a state government function. The federal statutes are necessary and of great importance - but they should deal with the basic federal problems, the basis upon which non-profit organizations are granted federal tax exemption. Those many citizens who are subject to the provisions of the statutes need to have them written in clear, comprehensible language.

The motive of federal legislation should be to assure this. It ought to provide logical penalties for violating clear provisions of the statutes - but it should not penalize the entire non-profit organization system for the punished or unpunished violations of the few. I have a strong impression that statutes to do clearly and constructively what is needed might best make a fresh start and not necessarily base new legislation on the words and structure of previous statutes.

If such a separate and independent approach were made to reconsidering the statutes' provisions concerning private foundations, I would anticipate the following provisions might be included:

1. No self-dealing, and a clear provision that, once a foundation is in existence, it is to be operated solely as an independent entity devoted to and concentrating on its charitable and philanthropic purposes;
2. A reasonable and constructive provision for minimum annual grant appropriations which would not only prevent a foundation appropriating only a very small amount of grants annually because its capital fund holds securities which pay little or no income, but also which would not force other foundations, which do strive successfully against changing financial conditions to secure adequate income production, to invade their principal against their best independent judgment or the provisions of their charters;
3. No actual accumulation of income not appropriated for grants, but not to eliminate the right to hold in reserve funds which have been appropriated in

firm grants and which await payment until the grantees have met the terms or requirements of the grant to assure actual carrying out of the grants' projects;

4. Possibly, no grants directly to individual persons instead of to established non-profit organizations which might provide support to various qualified persons chosen by them for specified projects and purposes; but this is a very controversial subject;
5. No grants for plainly political purposes or activity;
6. No partisan grants for the purpose of trying to restructure the social fabric; and possibly no such grants, not even "non-partisan" ones; but this would be very difficult to interpret and to supervise;
7. A prohibition on outright "propaganda" by foundations, but with clear protection of their right to express their considered views and opinions on matters which involve their work and their activities and the interests of their grantees - even to legislative committees and individual legislators and other government officials;
8. No general tax levy on foundation income or corpus, but instead a registration or similar fee to support an adequate foundation auditing and supervision section of a branch of the federal government.

My experience and the observations gained from my foundation activity lead me to the firm conviction that no other feasible social or political vehicle exists to produce the benefits which American foundations and other non-profit organizations in the aggregate provide for our people. Any tax levied on the income of the foundation I currently serve will be a tax upon the medical institutions it supports - and at a time when they require greater support, not less. I can think of no reason or justification to tax income of foundations unless the Congress is prepared to decrease the total sum available to operating non-profit organizations which foundations support. That is what such a tax would accomplish. The tax in reality would be a tax on those organizations. This would only punish the grantees of foundations. Moreover, whenever the subject of such taxes is thought of, more attention should be given to the fact that foundation expenditures, including their grants, promptly enter the taxable spending stream and become subject to federal and local taxes very quickly. Foundation income is expended, and it is not tax-sterile. It produces its share of tax revenue.

Many foundations often directly participate with or supplement and complement the work of various agencies of the federal government. Senator Lister Hill and others in government have long pleaded for greater support from the private sector to match the increasing need for appropriations and activity of the federal structure in areas of medical and health care in which many foundations and other tax-exempt organizations concentrate. The recent White House Report on Health Care Needs strongly stated the same essential need for support from the private sector. The Treasury Department's Report on Private Foundations urged greater effort, time and concentration by foundations on their charitable and philanthropic purposes. Every such organization has a limit on these resources, as well as on their money resources. These resources should not be wasted by hobbling them with unclear, threatening or unconstructive regulations. This would be a grave disservice to the welfare of countless individual persons served or aided by these organizations. In a very real sense, the federal government and non-profit organizations are partners in serving the public interest, and I think the White House Report squarely recognizes this. We all need this relationship to expand and to become more meaningful. New legislation should result from the joint thinking and effort of both the Congress and tax-exempt organizations. Both groups have basic responsibility for the public benefit. The most constructive exercise of these responsibilities is urgently needed at this time.

I have no interest in any delay in this matter concerning foundations. On the contrary, I urge that what I have proposed be carried out as quickly as practically possible. Thus, I plead with your Committee to take the course which promises the greatest probability of providing constructive, effective and valuable new legislation concerning foundations and other non-profit organizations. I believe that course is to consider and decide these matters separately and independently of the controversial and complex problem of overall tax reform legislation - and to set this in motion promptly.

In the meantime, a concise action to provide an immediate registration or similar fee could be enacted to promptly support an adequate federal audit and supervision program for foundations and, possibly, for other tax-exempt organisations.

THE MOODY FOUNDATION
GALVESTON, TEXAS 77550

ROBERT E. BAKER
EXECUTIVE ADMINISTRATOR

September 4, 1969

Mr. Tom Vail, Chief Counsel
Senate Finance Committee
2227 New Senate Office Building
Washington, D. C.

Dear Mr. Vail:

The Moody Foundation requested permission to have a representative appear at the public hearing on H.R. 13270 but due to the great number of people desiring to appear you advised that it would not be possible for The Moody Foundation to be heard. You further advised that a written statement would be given consideration. In response to that suggestion, The Moody Foundation is presenting the comments in the following paragraphs regarding H.R. 13270, which we respectfully request you to consider. Numbers relate to similarly numbered sections of H.R. 13270.

Section 506. TAX ON PRIVATE FOUNDATION INVESTMENT INCOME

A tax on the net investment income of a foundation is in reality a reduction in the amount available to the eventual recipient of that income. The Moody Foundation can see no reason to reduce the amount of dollars available to the grantees of this Foundation.

Section 4941. TAXES ON SELF-DEALING

Since there are occasions when benefits would accrue to foundations from certain transactions which would be construed as "Self-dealing" under the language of the suggested statute, relief from this prohibition should be made available where approval for a covered transaction is obtained from the Attorney General of the State in which the foundation operates and permission is granted by a court of general jurisdiction of that state. For instance, there are properties which, because of sentimental attachments, will bring a higher price from a donor or trustee, and no useful purpose is served by prohibiting such a transaction, if safeguards for its review are utilized.

Section 4942. TAXES ON FAILURE TO DISTRIBUTE INCOME

These provisions would create a severe hardship to The Moody Foundation since the principal assets of The Moody Foundation consist of insurance company common stock and ranch land, neither of which provides income equal to five (5) percent of the fair market value of those investments.

Alternatives are suggested as follows:

(a) That all income, irrespective of the percentage of such income, be distributed by the end of the year following the year in which the income is earned with no requirement to earn a specified percentage; or,

(b) A period of five years be allowed in which to make accumulated distributions of income if such income is fixed at a required percentage. This would afford the foundation the time to dispose of assets in a business-like manner in order to create the availability of the specified percentage in cash or its equivalent. The requirement to sell assets within a one-year period in order to meet the required percentage would frequently cause the sale of assets at a highly discounted value. Or,

(c) Provide for the specified percentage on a gradually increasing basis; for instance, the first year require a one (1) percent distribution with a gradual increase to the final required percentage. This would afford the Foundation time to rearrange or sell portions of its assets to obtain the required percentage of income.

Section 4943. TAXES ON EXCESS BUSINESS HOLDINGS.

If legislation requiring disposition of control (as defined in proposed statute) is finally felt necessary, we would point out that it would be difficult and perhaps impossible to arrive at the twenty (20) percent level of ownership of the principal asset of The Moody Foundation within a five-year period. This is because the one asset involved representing eighty (80) percent or more of the value of the Foundation, has a potential market value of such a large amount (several hundred million dollars) that it would take a great deal of time to negotiate the sale of this single substantial asset. This asset consists of common stock in

American National Insurance Company, an unlisted stock. In addition, there is a restriction under an existing Trust which implies that portions of this stock can never be sold. Litigation is in process in an attempt to remove this restriction but there is opposition to such removal by interested parties. The time involved in settling this litigation and in handling the negotiations relevant to sale of the stock owned and controlled by this Foundation down to a level of twenty (20) percent would require a minimum of ten years to conclude the entire transaction.

The requirement to reduce control to less than fifty (50) percent within five years would be detrimental to the over-all transaction because the ability to sell a control position is precisely the advantage that would help to create the highest possible value for this asset. Eliminating fifty (50) percent control within a five-year period would tend to cause a serious reduction in the price the Foundation could obtain for its most important asset. H.R. 13270 attempts to give relief to problems such as those outlined above. However, a strict interpretation of the relief provision which might be helpful to The Moody Foundation problem might not give the relief required. The relief provision referred to is quoted below.

(D) Any period prescribed in subparagraph (A), (B), or (C) for the disposition of excess business holdings shall be suspended 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." The above wording should be expanded to not only refer to the "governing instrument" but to both the governing instrument and any other trust or other instruments which might restrict disposition of such holdings. In the case of The Moody Foundation, a trust is involved which is not the "governing instrument" of the Foundation but this trust contains a provision construed by certain interested parties to be a prohibition against disposition of American National Insurance Company stock. Judicial proceedings are unaer way to attempt to interpret provisions of that trust in such a way that the holdings can be sold.

Adoption of a fixed 10-year period to reduce "control" would seem to be the simplest and most understandable method of accomplishing the purposes of these provisions.

Thank you for your consideration of these comments.

Very truly yours,

THE MOODY FOUNDATION

BY: Paul R Haas
Paul R. Haas, Chairman
Board of Trustees

PRH:de

STATEMENT

of

JOSEPH G. ENGEL, President
of N. R. Leavitt Foundation

SUMMARY

1. INTRODUCTION: Remove treatment of foundations in this revenue raising bill; the subject is not and cannot be adequateıy treated in this fashion.

2. 7½% TAX: No tax, whether based on a foundation's income or asset value is justified; the cost of auditing foundations should be through a fee basis, similar to that system used by many states in auditing banks.

3. LIMITATION OF 20% OWNERSHIP: This provision should not operate retroactively; you cannot destroy what was legal when previously done by a ten year wipe-out program. At the very most, existing situations should have twenty-five years to adjust; the timing and method should be the responsibility of the foundations.

4. The 5% or any other annual minimum pay-out of income very possibly will destroy private foundations. No percentage should be invoked. The present law has adequate standards for annual pay-out.

Dated: September 5th, 1969.

STATEMENT

I am President of the N. R. Leavitt Foundation located in Elizabeth, New Jersey. I am also its legal counsel. I have represented foundations since 1951. I have also been a member of the American Bar Association Committee on Exempt Organizations for some years.

The more study I give to H. R. 13270 since it was passed by the House in August on only two days' consideration after it was reported out of Committee, the more I realize its complexity and the serious consequences that can ensue from the acceptance of the provisions relating to foundations. By foundations, I mean the three categories contemplated by H. R. 13270, namely Private, Private Operating, and Public. Accordingly, I am strongly in accord with the attached August 6th, 1969, editorial of the "New York Times" that urges the removal of this subject from a revenue raising bill so that it may be given proper consideration by your Committee and the Senate. Obviously, the members of the House of Representatives could not have given these provisions or the whole bill careful and adequate consideration in two days' debate. A very serious problem exists if our Supreme legislative bodies will pass such important legislation as embodied in H. R. 13270 without adequate consideration in the House and without opportunity being given to qualified interested parties to appear before your Committee to present oral testimony and answer questions of members of your Committee.

7½% TAX

No income tax or tax based upon the value of assets should be imposed on any foundation. A tax, whether at the rate of 7½% on income or at any other rate, means that the federal government rather than foundations should administer the funds represented by these taxes. This policy is incompatible with the very basic philosophy of charity which is to administer to the wants of mankind and to relieve the government of some of these burdens. This tax means competition and usurpation by government of the function of private charity which has existed, I would like to believe, as long as mankind has been on the face of this earth. In addition, such administration by government is more costly. Studies have shown the foundation costs are almost nominal.

If this attempted tax is rather a desire to help defray the cost of administering the law, then an equitable system of charging the cost against foundations should be adopted. After many years as an attorney connected with foundations, I most heartily believe in the value of audits. These audits prevent abuse and instruct the uninitiated. If Congress had provided adequate funds to the Treasury Department to carry out these audits over the past years, I believe that the abuses found by Congressman Patman and erroneous acts of foundations could have been discovered and terminated under the existing law.

I recommend the adoption of a charge being made against a foundation when the audit is made. This would be similar to the system used for many years by the banking departments of many states in their audit of state banks; see the attached report of The American Bankers Association and the August 25th, 1969 letter of Central Home Trust Company of Elizabeth, N. J.

DIVESTITURE OF MORE THAN 20% INTERESTS

Many persons have made substantial gifts to foundations of more than 20% of the stock of a corporation either during their lifetime of upon death. These gifts have been made in reliance upon the law permitting such gifts and the retention of these securities by the foundations. I am not going to discuss the gradual sell off of such foundations' holdings, but rather the extreme inequity of this proposal itself and the unwarranted harshness of the penalties for failure to comply with the divestiture reliance. Any law as drastic as this should act only upon future gifts. The actions heretofore taken in good faith and in reliance upon the law should be excepted from any divestiture proposals. The breach of faith involved here is similar to the breach rising from the attempt to tax the interest on previously purchased tax-exempt bonds of various states, counties and municipalities. The existing income tax exemption was intended to be an inducement for these purchases and was so relied upon by the purchaser. A change of the law breaches these pacts. The law at best, should be prospective only.

If the retention of holdings in excess of 20% is harmful to a foundation, the present law is well-equipped to remedy the evil. The decisions of the Courts clearly require that foundations be operated for their stated purposes. The statutes provide penalties for doing otherwise. Therefore, any harmful holding may be reduced or eliminated under the existing law. Each case can be judged on its own facts and no arbitrary percentage need be fixed. The parties involved are adequately protected by the right to appeal to the Court from any controversy in this respect.

At the very most, a period of 25 years from the effective date of this law, should be given to permit divestiture without a maximum percentage of holdings being fixed by law and without any method or timetable being built into this period. The foundation will be responsible for any evil effects flowing from its failure to divest improper holdings. Twenty-five years is proper because it represents approximately a generation under today's rules of longevity and will provide adequate notice to the parties.

5% MINIMUM ANNUAL DISTRIBUTIONS

Careful consideration of allowing any government to fix 5% or any greater or lesser figure as the minimum yardstick for pay out by foundations of income or a combination of income and some capital, if the income is below the established figure, reveals that such establishments of a figure will, in all likelihood, ultimately be fatal to the lives of foundations.

Studies show that in times of growth the dividend yields on sound stocks seldom, if ever, reach 5% or 6%. Unusual growth companies, like IBM, Xerox, Dow Chemical, Avon Products and others pay out much less than 5% because they retain so much to meet the growth needs of our country and foregin countries. Historically, the yields on United States Government Bonds have been as low as 1-7/8% and now, in the case of Treasury Bills, have reached historic highs by exceeding 7%. Therefore, there is no assurance that a combination of stocks and bonds can produce a yield sufficient to meet whatever may be the government established minimum distribution figure. This, therefore, means that capital assets must be sold. Such sale will reduce the income-producing ability of the foundations and cause further sale of capital assets, ultimately exhausting a foundation's total capital.

The argument that a foundation can afford to sell some of its stock because it has had appreciation in value overlooks the fact that virtually all the market appreciation in value contains elements of inflation. In order to sustain charitable activities, it is very obvious that larger grants must be made by foundations to give them the same true purchasing power that they had in previous years.

If a foundation could conceivably produce the minimum required distribution income by the purchase of interest-bearing securities, this method would also ultimately result in the exhaustion of the foundations' assets because there would be no equity ownership to meet elements of growth and inflation. This honorable Committee might be interested in knowing that after World War I foundations in Germany were wiped out when the government required that they invest only in governmental bonds. Everybody knows of the inflation that followed World War I and can very well understand that the German government kept printing more and more bonds which were worth less and less. The result was that the foundations were ultimately wiped out because they were forced into the holding of worthless bonds.

The law of foundations and the rule of the prudent investment of trust funds prohibits the holding of non-income producing assets where this would render the foundations unable to carry out its stated purposes. Adequate remedies can be found readily in the existing law to prevent this. There could be no justification for adopting any required percentage of return. The simple requirement that foundations should distribute all their income is sufficient. In my 18 years as counsel to foundations, I have always advised this procedure to be followed each year without deviation.

Respectfully submitted,

THE NEW YORK TIMES, WEDNESDAY, AUGUST 6, 1969

Preserving the Foundations

The House Ways and Means Committee's shotgun approach to the tax-free foundations would buy reform at a very high social cost. It proposes a genuine—and wholly desirable—crackdown on the self-dealing manipulations of foundations that are operated as vehicles for tax avoidance. But great harm would come from the new tax and other restrictions the bill would impose upon the bona fide philanthropic foundations which enrich American life with ideas and innovative social programs.

A leading case in point is the 7.5 per cent tax that would be levied on the investment income—dividends, interest, rent, royalties and capital gains—realized by foundations. The levy is not sufficiently stiff to discourage the tax-dodgers, but it would put a dent in the useful activities of worthier foundations. About two-thirds of their income now goes in the form of gifts to private universities and local charities. Hence, what the Treasury realized in additional revenues—probably not more than $65 million in the first year—would soon be offset by demands for new or expanded Federal programs in the same fields.

Although the foundations tax is described by the committee as a "user fee" to defray the costs of more vigorous policing, no machinery is proposed or funds earmarked for that purpose. A preferable alternative would be a much lower special registration fee for foundations, the proceeds of which would support a special supervisory office in the Treasury Department. With effective supervision of the foundations, dollars destined for philanthropy would actually get where they are supposed to go.

There has been a softening of some of the very harsh restrictions that the committee originally proposed to prevent foundations from engaging in political activities. The Southern Regional Council is specifically cited in the committee report as a foundation that may continue to finance voter registration drives.

But a number of ambiguous and potentially restrictive provisions remain in the bill.

The whole title dealing with tax-exempt organizations should be sent back for redrafting. Its passage by Congress would inhibit creative philanthropic activities, an essential ingredient of a pluralistic society.

STATE BANKING LAW REVISION

Selected Legislative Issues

Edited by
Carter H. Golembe

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FINANCING STATE BANKING DEPARTMENTS

An adequate budget is a prerequisite to a state banking department that measures up to all the requirements inherent in good bank supervision. Accordingly, methods of financing the banking department are among the important topics that arise whenever substantial banking code revisions are under consideration.

Background

The development of substantive bank supervision was one of the notable features of New York's Safety Fund law, which was passed in 1829 to provide for the insurance of bank obligations. Prior to that time, rudimentary bank supervision included generally inadequate condition reports and sporadic, ineffective bank examinations. Departing from traditional supervision, the New York law contained four significant provisions, which were eventually incorporated into the laws of other states: (1) regular and frequent examinations; (2) bank examiners employed on full-time basis; (3) full access to bank records; (4) cost of supervision paid directly or indirectly by the banks supervised. These provisions also became part of the National Currency Act of 1863 and the National Bank Act of 1864.

While these four tenets of bank supervision have been universally accepted, performance has not always been uniform and, as a matter of fact, the fourth, which is the most relevant to this section, has been subject to great variation. Although the banking departments of all 50 states collect examination and other fees and the banks they supervise pay all or a portion of the costs involved in running the department, the diversity in methods of financing banking departments and the application of examination fees and other charges is extremely wide. For example, some departments are financed independently of the state's budget, have sole control over the funds they collect, and are fully self-sustaining. In other

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cases, the fees collected are deposited into the general fund of the state, with complete loss of control by the banking department. The budgets of such departments may have little or no relationship to the amount collected.

There are many variations within these two extremes. The banking department of at least one state operates on a legislative appropriation from the general fund and at the end of the year collects enough money from the banks to reimburse the state for the funds advanced. Some departments collect annual assessments from all state banks regardless of the number of times each one is examined. Some states assess examination fees only, while others charge for processing applications for charters, branches, conversions, and mergers.

While the lack of uniformity in the various state statutes would seem to indicate otherwise, most supervisors and bankers and some other observers generally agree that banking departments should be financed entirely by the bank supervised.

Existing Statutes

In view of differences between the system of fees for national banks and those for most state banks, it will be helpful to begin by describing Federal law and the regulations issued thereunder.

Federal Law

The National Bank Act provides that "The expense of examination herein provided for shall be assessed by the Comptroller of the Currency upon national banks in proportion to their assets or resources. The annual rate of such assessment shall be the same for all national banks, except that banks examined more frequently than twice in one calendar year shall in addition be assessed the expense of these additional examinations."

The current regulations issued by the Comptroller under the foregoing statutory provision can be summarized as follows:

The semiannual rate is a basic assessment of $100 plus $.04 per $1,000 of total assets. (This fee is assessed to coincide, in effect, with the semi-annual call reports, regardless of whether or not one examination each two years is waived.)

The assessment rate for investigations of applications for new branches or changes in location of branches is $100 a day for the examiner-in-charge and $50 a day for each additional examiner plus expenses of each examiner. The same daily rates apply to examinations of affiliates and trust departments and investigations of applications for trust powers.

A filing fee of $2,000 is assessed for investigating and processing each application for a merger.

A filing fee of $1,500 is assessed for investigating and processing each application to organize a new national bank. This includes conversions.

The Federal Reserve Act provides for examinations of member banks by the appropriate Federal reserve bank for that district. While the expenses of such examinations may, in the discretion of the Board of Governors, be assessed against the banks examined, it is not the practice to make such charges.

The Federal Deposit Insurance Act authorizes the Corporation to examine insured banks but it does not provide for examination fees.

State Law

As mentioned earlier, the statutes of all states provide for assessments to be paid by the banks under the supervision of the banking departments. For the most part, these assessments take the form of examination fees, but some states also charge for investigating and processing applications for charters, mergers, conversions, office relocations, and branches.

Several methods are used to establish, collect, and dispose of funds needed to operate banking departments. A summary review should be of interest to a law revision committee.

Application of fees. The statutes of 18 states provide for fees to be levied on all state banks without regard to the number of examinations per bank per year. Another 25 states assess fees for each examination, and any bank not examined during the year pays no fee. The remaining 7 states provide for a combination of the two methods in that they assess all state banks annually (or semiannually) and, in addition, collect fees for each examination.

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Discretionary or fixed fees. Several states do not specify by law a detailed schedule of examination fees and other charges that may be levied on state banks. Generally, these states provide that the commissioner, at his discretion, shall set rates that are the same for all banks and that will result in sufficient income to make the department self-supporting. This is similar to the authority of the Comptroller of the Currency.

The remaining states provide a statutory rate for charging fees, which is applied in three different ways: (1) The rate can be changed only by changing the law; (2) the statutory rate is a maximum, with the commissioner authorized to set a lower rate if expenses of the department justify such action; (3) the statutory rate is a minimum, with the commissioner authorized to increase the rate, if necessary, to cover the expenses of the department.

Disposition of receipts. In 18 states all receipts of the banking department go into a special fund, out of which all operating expenses of the department are paid. This is similar to the method under which the Comptroller of the Currency operates. In a few of these states whenever the banking department fund exceeds a certain amount, usually $100,000, the excess is paid into the general fund of the state. Thus, the banking departments of most of these states have first call on funds derived from fees and other charges, but for a few others legislative appropriations are still required. The banking departments of the other 32 states operate on legislative appropriations. In some cases the funds collected by the department must equal or exceed the appropriation, while in others the appropriation appears to have little relationship to the amount collected. Some departments collect the fees and make monthly deposits to the general fund, while others do not collect fees since they are paid directly to the state treasury by the banks.

Basis and amount of fees. Examination fees are usually based on total resources. However, in one state they are based on total deposits and in three states, on total capital (two of which also collect fees based on resources.) A number of states charge all banks a flat fee or one based on total resources and an additional fee to cover the cost of each examination.

Information on the basis for charging examination fees and the current rate of assessment is provided in Appendix A. A list of the states having a special banking department fund is given in Appendix B.

Policy Considerations

In considering the revision of the section of a banking code dealing with the financial aspects of a state banking department, the basic concern should be the answer to the question, What are the attributes of a well-financed banking department? Doubtless, everyone will agree that the overriding consideration is to provide enough money for an adequate budget. But what is an adequate budget? If a state desires a modern and effective department, fully capable of supervising a strong and dynamic state banking system, it must attract and retain a staff of highly qualified examiners. Of equal importance is that the competence of state examiners should compare favorably with the capabilities of those examining national banks. Thus, the most important requirement of an adequate budget is to provide for a salary scale, fringe benefits, and travel allowances at least equal to those of the Federal bank examiners. There are several views concerning the most favorable means of accomplishing this.

Department Self-supporting

The principle that state banking departments should be financed from examination fees and other charges lies deep in the banking history of this country. It was incorporated into the state banking laws which antedated the National Bank Act and which served as models for establishing the procedures to be used by the Office of the Comptroller of the Currency. Hence, it seems appropriate to examine the financial arrangements of that Office.

The Comptroller of the Currency reported total income of

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$22.4 million for the calendar year 1966.[1] Expenses were $19.8 million, leaving an excess of income over expenses of $2.6 million. These figures provide a classic illustration of a fully self-supporting bank supervisory agency. All funds collected by the Comptroller are retained in a special fund used solely for financing the operations of the office without congressional appropriation. The report also shows that total assets in this fund on December 31, 1966, were over $13.6 million, of which more than nine-tenths consisted of investments. Investment income for the year was $628,000.

Arguments against self-supporting departments. Despite the almost universal belief that state banking departments should be financed by assessments of one form or another paid by the banks supervised, there are theoretical reasons why some, and perhaps all, of the funds needed should come from the general revenues of the state.

First, it can logically be argued that banks are supervised for the benefit of the general public—not for the benefit of the banks—and, therefore, the public should pay the expenses of banking departments.

Second, bank supervision should not be considered an extraneous activity of the state but rather an integral part of governmental services and duties. As such, it seems reasonable that the cost of the banking department should be met in the same way as most other functions of state government.

Third, some observers suggest that a banking department should be independent of the banks supervised; and that such independence is endangered when the banks provide the funds needed to run the department. As the argument goes, unless a department is fully independent, it is less likely to be objective in its supervisory activities and may be more responsive to bank interests than to the public interest. From this it is reasoned that

[1] *Statistical Supplement to the 1966 Annual Report,* Comptroller of the Currency, U. S. Government Printing Office, Washington, D. C., pp. 17–20. Also see Appendix C.

banking departments should rely primarily on legislative appropriations derived from the general funds of the states.

Arguments for self-supporting departments. The basic argument most often advanced as justification for self-supporting banking departments is that this financing is and has been such a prevalent practice that it has become a part of the banking tradition. Furthermore, there have been few, if any, instances in which a state banking department has been remiss because it was financed solely from fees paid by the banks. Moreover, it is often noted that in order to obviate the possibility of undue influence, state statutes generally specify that examination fees and other assessments must be levied impartially upon all banks. Since the payments are mandatory and not voluntary contributions, it is argued that it is virtually inconceivable that they could have any adverse effect upon the quality or impartiality of supervision.

One argument against paying for bank supervision from general taxation stems from the fact that states are already having great difficulty finding sufficient sources of revenue. Elimination of examination fees and other assessments paid by banks would intensify this problem. Moreover, since banks are accustomed to paying examination fees and other assessments and are generally willing to pay whatever is necessary to provide for an adequate budget, it seems reasonable to continue such an arrangement. A self-sustaining banking department is no less a part of state government than one financed by the general revenues of the state since it is generally subject to civil service rules and regulations and the commissioner is almost always responsible to an appropriate state official.

Probably the most forceful argument is that if the expenses of operating a state banking department are not paid by the banks supervised, there is the possibility that some states would shift the entire burden of bank supervision to the Federal agencies, thereby abrogating all responsibility for the creation of a dynamic state banking system.

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Finally, while there is no doubt that the primary purpose of bank supervision is to protect the general public, nevertheless banks and bank stockholders also receive substantial benefits from good supervision. Such supervision contributes to a stable banking system, promotes public confidence, and provides a favorable environment in which a sound bank can operate. Moreover, an examination made by competent examiners can be very valuable to management. An examiner who has experience with many types of banks and banking problems can often point out likely sources of trouble not fully recognized by management, with the result that the banker takes timely action to correct the situation. Chartering unnecessary banks and authorizing new branches not needed by the public can be extremely harmful to existing institutions. Thus, banks and bank stockholders have fully as much to gain from good supervision as the general public and, as a result, can and should be expected to pay examination fees and other charges to secure adequate supervision.

Special Fund for Banking Department

Closely related to the question of making the banking department self-supporting is the problem of how the funds should be treated. As mentioned earlier, the two methods in use are to have a special banking department fund, into which all receipts of the department are paid and which is automatically appropriated for the use of the department, or to have all receipts of the banking department credited to the general fund with the department operating on a budget appropriated by the legislature.

Many of the arguments both for and against creating a special fund for the banking department are the same as those advanced when discussing self-supporting departments. One of the arguments against retaining the receipts of the department in a special fund is that such a practice is at variance with political science theory. Departments so financed, it is maintained, can escape legislative control and operate outside the main structure of government. Without legislative scrutiny during the budgetary process, the departments may not operate in the best interests of the public. Furthermore, it is held that to require banking departments to operate on legislative appropriations does not preclude them from being self-supporting. New York, for example, operates on legislative appropriations and at the end of the year assesses the banks for enough to reimburse the state treasury for the funds advanced.

On the other hand, these arguments ignore the authority of the Governor and the legislature to oversee the operations of the department and the power of the legislature to change the structure and authority of the department. Furthermore, other areas of government, both Federal and state, are frequently given funds to make them self-supporting. For example, in situations somewhat similar to that of the Comptroller's Office, both the FDIC and the Federal Reserve System have their own funds and neither is dependent upon congressional appropriations. Also, many other state agencies, such as fish and game departments and highway departments, frequently are given special funds into which certain receipts are credited and out of which their operations are financed. It is probably worth noting at this point that the use of special funds for specific purposes is an increasing phenomenon at the state and Federal level. This is closely allied to the "user charge" concept. Thus, those benefiting from a specialized service pay for it.

The arguments for a special fund for banking departments center around the need for adequate budgets. In those cases where the budget is inadequate, unless some method is provided whereby all of the money collected by the department is made available to it, there is little or no incentive for organized banking to advocate increased fees. Giving the banking department a special fund may be the best method to make sure that all fees will be used to strengthen the department. The merit of this argument is clearly shown by the fact that all but two of the supervisors of the 18 states which operate from special department funds reported that their budgets were adequate, but only 11 of the other 32 states so reported.[8]

[8] *A Profile of State-Chartered Banking*, National Association of Supervisors of State Banks, Washington, D. C., pp. 23–24. Also see Appendix B.

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Section 13

Desirable Features of Fees

Although a state banking department may be fully self-supporting, with an adequate budget, and with a satisfactory method of handling receipts, another element in the department's overall financing picture should be examined—the nature of the fees and assessments being collected.

Among the criteria for determining the adequacy of fees and the methods in which they are levied are the following: the benefits received by a bank, the cost of an examination, the ability of a bank to pay, ease of understanding and computing, and flexibility to adjust income with changes in the workload.

There are various ways in which these standards can be mutually reconciled to bring about a suitable system of fees and assessments acceptable to all banks. To illustrate, if the principal reason for charging fees is that all banks are benefited, it follows that all banks should be required to support the banking department. The basic charge can be either the same dollar assessment on all banks regardless of size or one that is based on some indication of size, such as total resources. The latter may be preferable if the concept that size measures both the degree of benefits received and the ability to pay is adopted.

Another arrangement to be considered is that fees should be partially related to the cost of the examinations. When coupled with the above-mentioned concept, this suggests an examination fee consisting of two parts—one, a standard amount for all banks; the other, a levy based upon total resources. It also suggests that a bank should pay for the cost of any examination in addition to those ordinarily made, including those made for applications relating to charters, mergers, establishing branches, or moving bank offices. In substance, this arrangement provides that all banks share in the administrative costs of running the department and at the same time each bank pays for the costs of the services rendered to it.

In adopting a fee schedule, consideration should be given to making it as simple and easy as possible to administer. While it might be argued that a bank with most of its assets in Government bonds is more easily examined and, therefore, should pay a smaller fee than one with a large proportion of loans, if an attempt is made to provide for every possibility the fee schedule would become unmanageable. Moreover, in situations where the bank pays the costs of examination, the bank that is more difficult to examine will automatically pay more.

Finally, the schedule of fees should contain a mechanism for increasing fees when the expenses of operating the banking department increase. This requirement could be adequately satisfied through a system of reasonable assessments based on total resources of each bank, but, in addition, it may be prudent to vest the supervisory authority with discretionary power to adjust the fee schedule.

Fixed or discretionary fees. This raises the question as to how these fees are to be put into effect. Should they be set by statute or should the banking department be given broad authority to establish such fees as in its judgment are deemed necessary and equitable? As pointed out earlier under the heading "Statutory Provisions," both methods are found among the various states. A third method in use by several states combines the two by giving the department authority to set fees within prescribed limits.

There are good reasons for authorizing the banking department to establish a fee system without any statutory limitations. Discretionary authority provides flexibility since the rate of assessment can readily be varied from year to year to meet changing needs and is more likely to assure a self-supporting banking department with an adequate budget.

Research Suggestions

No articles or books on the financing of State banking departments have been brought to the attention of the editors. The best sources of information are the banking commissioners, probably

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CENTRAL HOME TRUST
Company OF ELIZABETH, N. J.

ELIZABETH, N. J. 07207

WILLIAM E. SHACKLETON
PRESIDENT

August 25, 1969

Joseph O. Engel,Esq.
31 Parker Road
Elizabeth, N. J. 07208

Dear Joe:

In accordance with your verbal request this morning regarding assessments made by the New Jersey Banking Department for conducting examination of State Banks the following information was received from the New Jersey Department of Banking and Insurance - the Department assesses Banks examined as follows:-

1. Man days at salary of each examiner.
2. Travel and other expenses of examiners incurred in connection with the examination of a State Bank.
3. An overhead charge for administrative operations of the Department.
4. Fringe benefits as incurred in connection with the employment of examiners.

I hope this satisfies the point of your inquiry.

Sincerely,

Bill

HINDRY & MEYER
ATTORNEYS AT LAW
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FRED A. ALBI
JOHN T. GRACE
LOREN L. MALL
PETER C. MAXFIELD
RICHARD B. VONWALD

September 3, 1969

Committee on Finance
United States Senate
Washington, D. C.

Gentlemen:

These comments are directed to the provisions relating to PRIVATE FOUNDATIONS as dealt with in H.R. 13270 and are submitted pursuant to the following telegram:

> "DUE TO LARGE NUMBER OF WITNESSES WHO WISH TO TESTIFY ON TAX REFORM AND SHORT AMOUNT OF TIME AVAILABLE FOR HEARING IT IS IMPOSSIBLE TO SCHEDULE ALL WITNESSES THAT THE COMMITTEE WOULD LIKE TO HEAR. I REGRET THEREFORE THAT IT WILL NOT BE POSSIBLE TO SCHEDULE YOU FOR ORAL PRESENTATION BEFORE THE COMMITTEE. HOWEVER, THE CHAIRMAN HAS INSTRUCTED ME TO ADVISE YOU THAT IF YOU SUBMIT 50 COPIES OF YOUR WRITTEN STATEMENT TO THE COMMITTEE NOT LATER THAN FRIDAY, SEPTEMBER 5, 1969 IT WILL BE PRINTED IN THE RECORD AND BE GIVEN SAME CONSIDERATION AS THOUGH DELIVERED ORALLY.
>
> TOM VAIL, CHIEF COUNSEL, SENATE FINANCE COMMITTEE"

The undersigned is a partner in a Denver law firm that serves as general counsel for a half-dozen private foundations ranging in size of assets from a few thousand dollars to two and one-half million dollars.

We take exception to the H.R. 13270 treatment of Private Foundations (Title I - Tax Exempt Organizations, Subtitle A - Private Foundations) and urge that the Senate repudiate or substantially revise this portion of the Tax Reform Act of 1969.

A. In General:

1. It is apparent from the record that few members of the House of Representatives had an opportunity to be aware of the contents of this complicated bill, much less to give consideration to the details of any of its numerous provisions, such as those dealing with Private Foundations, prior to passage on August 7. In effect, they were compelled to vote for or against "reform" without personal awareness of the contents of this House bill (House Report 91-413; floor debate reported in Congressional Record of August 6 and 7).

2. Private Foundations, through action or non-action of all former Congresses since the advent of the federal income tax, have been given a special preferred status within the taxing laws. Now, suddenly, we have a Congress which seems to feel it has a mandate to punish private foundations, their benefactors and their managers. As to Private Foundations, H.R. 13270 is not "reform," but "eradication"! For example:

a. Where will Private Foundations henceforth find their officers, directors and trustees when persons holding such offices will be personally subject to successive layers of punitive taxes and penalties for acts that might have been incurred in good faith with no possibility of personal benefit?

b. Where will Private Foundations look for future financial support when the persons and organizations historically responsible for their creation and support are substantially prohibited from dealing with them or making further contributions to them because of novel concepts of "self-dealing" or "excess business holdings"?

c. A Private Foundation that runs afoul of the new rules will not merely lose its exemption (which would still leave it in a position, nevertheless, to carry out its "charitable" objectives), but will be subjected to 100 percent confiscation of all its assets.

3. It would seem that the limits of the interest of the citizens of the United States (and hence that of their elected representatives) in the regulation of tax exempt organizations would be to deny the exemption from taxation to any organization that does not conform to the national policies deemed to justify tax exemption. The rationale of H.R. 13270 is that denying tax exemption has been ineffective (see generally "Summary Tax Reform Bill of 1969" prepared by the Staffs of the Joint Committee on Internal Revenue Taxation and the Committee on Finance) and that only punitive confiscation of the assets of a Private Foundation and/or those of its "managers" and "self-dealers" will suffice.

4. It would appear that the draftsmen of H.R. 13270, utilizing the alleged "sins" of a few Private Foundations as justification, have made a political decision that all "charity" henceforth will be the exclusive province of government. If the motivation were merely the correcting of "abuses," it would be hard to conceive of a more notable example of "overkill."

B. In Particular:

1. Tax on Investment Income. This would seem the least objectionable of the "reform" provisions regarding Private Foundations so long as the rate of tax is not excessive. Implicit in Title I of H.R. 13270 seems to be the admission that revenue agents and their superiors are insufficiently motivated to enforce existing law relating to Private Foundations where the only "goal" is the possible loss of the organization's tax-exempt status; hence, the preoccupation with new and massive "taxes." Perhaps a 7 1/2 percent tax on investment income will defray the cost of policing the balance of the existing law and render unnecessary the more punitive provisions of the Act. The risk here is that the 7 1/2 percent rate is probably just the opening wedge to total elimination of the tax-exempt concept in due course.

2. Self-Dealing. The abandonment of any concept of whether the Private Foundation or the interests of "charity" are injured in any so-called "self-dealing"

transaction seems extremely punitive. Literally, if a "disqualified" person purchased 1000 shares of General Motors stock from a Private Foundation at twice the undisputed market at the time of purchase, the "disqualified person" would apparently be subjected to an "initial tax" of 5 percent on the inflated price paid and an "additional tax" of 200 percent of the "amount involved" if the transaction is not or can not be "corrected" within the time specified. In addition, the officers and trustees or directors of the Private Foundation are subjected to personal taxes of 2 1/2 percent and 50 percent (limited to $10,000 for each tax) if they participated in the transaction.

This approach (and other approaches of Title I of H.R. 13270) suggests a total lack of confidence by the House of Representatives in the ability of the judiciary to distinguish situations which abuse the tax-exempt privilege and those which do not.

3. Excess Business Holdings. The typical small Private Foundation (as well as some of the large) has been created by a successful businessman or his corporation. He has been prompted to create a foundation by (1) a desire to share his success with the less fortunate; (2) a desire to protect his business or family from the ravages of other aspects of taxation; or (3) some combination of (1) and (2). So long as the interests of charity are not defeated or threatened by the inclusion of an interest in a related business in the portfolio of a Private Foundation (a matter the judiciary can determine under existing legal concepts), there would seem to be no compelling reason to adopt the harsh prohibitions of H.R. 13270.

Enactment of the "Excess Business Holdings" concept will certainly have a limiting effect on charitable donations and bequests from donors whose estates are substantially one-asset estates. The proposed period for disposing of such existing interests or those subsequently acquired by bequest will not solve problems where the business interest is truly closely-held and there is no third-party market except at a financial sacrifice.

One minor technical point: Apparently the draftsmen of H.R. 13270 are not aware that a substantial number of estates are transmitted at death today by revocable living trusts instead of by wills in order to avoid the disadvantages of probate. The provision dealing with the disposition of business interests acquired from a decedent under a dispositive instrument executed prior to July 28, 1969, etc., refers only to a "will" and ignores the possible use of a revocable trust. This is a further example of the difficulties that exist when Congress tries to be too explicit and leaves nothing to common-sense interpretation by the Courts.

4. Distributions of Income. Existing law, if enforced, would seem adequate to deal with unreasonable failure of a Private Foundation to distribute its income for charitable purposes. The proposal of H.R. 13270 would preempt investment decisions of foundation managers and force investment (at this time) in high yield debt-securities instead of equities, thereby foreclosing portfolio growth. Administration of the proposed provision, with attendant annual valuation problems, would seem very burdensome.

5. Taxable Expenditures. Although existing law should be adequate, the concepts of H.R. 13270 in this area do not appear entirely unreasonable.

6. Investments Which Jeopardize Charitable Purpose. The "second-guessing" opportunities of this provision strike the undersigned as frightening! Any foundation investment that goes sour could, apparently, involve the foundation and its "managers" in painful argument and the peril of expensive non-persuasion. Although borrowed from existing Section 504 (a) (3), the scope of the new proposed law is vastly broader, affecting all investments. The penalties are such that (referring to A.2.a. above), what prudent individual will hereafter be willing to serve as an officer, director or trustee of a Private Foundation?

The answer of H.R. 13270 to the evil that a "charitable purpose" may be "jeopardized" appears cynical in the extreme - confiscate the offending investment on behalf of the government! How does "charity" benefit from that solution?

7. Termination of Private Foundation Status. One may also ask how charity benefits from the total or near total confiscation of a foundation's assets on voluntary or involuntary termination of its tax-exempt status as presently proposed. Is this further evidence that the draftsmen of H.R. 13270 are not really concerned about the role of private, as opposed to public, charity?

8. Penalties for Late Filing of Reports. It is a foregone conclusion that the reporting requirements of Private Foundations under H.R. 13270 will be significantly enlarged and complicated. Not only will the expenses of satisfying such requirements doubtless be burdensome, but the possible $10 per day fine on "managers" for late filing will be one more reason for a prudent man declining the office with thanks.

C. Summary:

There are, in addition to those discussed, many other provisions and details of Title I of H.R. 13270 that appear alien to long-standing concepts of the role of private charitablo giving through Private Foundations. Whatever the abuses that have crept into the operation of some Private Foundations, it is respectfully submitted that they can be dealt with by effective administration of existing laws. The proposed new legislative remedy for the "problems" appears to fall short of distinguishing between the baby and the used bath water and, hopefully, will be repudiated by the Senate in its current deliberations.

Very truly yours,

HINDRY & MEYER

Milton E. Meyer, Jr.

Milton E. Meyer, Jr.

STATEMENT OF C. MAXWELL STANLEY, President, Stanley Foundation

I am the President, a member of the Board of Directors, and a co-founder of The Stanley Foundation. I am a professional engineer and businessman, currently President of Stanley Consultants, Inc., International Consultants in Engineering, Architecture, Planning, and Management, and Chairman of the Board of HON INDUSTRIES Inc., a manufacturer of office furniture and materials handling equipment.

The Stanley Foundation was established in December, 1956. From inception its Board of Directors has been my wife, Elizabeth M. Stanley; my son, David M. Stanley, a lawyer and member of the Senate of the State of Iowa; my son, Richard H. Stanley, an executive vice president of Stanley Consultants; and my daughter, Jane M. Buckles, a university professor and housewife.

The resources of The Stanley Foundation consist almost entirely of common stock of HON INDUSTRIES Inc. which I have contributed to it over the years. In addition, I have made limited cash contributions and we have received cash contributions from others to help finance specific projects. The Stanley Foundation was granted exemption from tax under Section 501(c)(3) on May 22, 1959.

The Stanley Foundation has limited its activities to those consistent with the intent of Section 501(c)(3). It has distributed annually more than its adjusted net income as defined in H.R. 13270 and has carefully avoided self-dealing and other unethical practices restricted in H.R. 13270.

I support the prohibitions against self-dealing (Section 4941); the required distribution of income (Section 4942); the requirements for proving exempt status and taxing foundations which have evaded the law (Sections 507 and 508); and most of the limitations on use of assets and on activities (Sections 4944 and 4954). They are necessary and needed reforms and Congress should enact them.

I offer comments in six other areas of the proposed legislation: (1) the general philosophy of H.R. 13270 as it affects private foundations, (2) discriminatory legislation in favor of particular foundations in Section 6684, (3) the tax on net investment income of all foundations in Section 506, (4) the particular restriction concerning travel expenses of certain governmental officials in Section 4941, (5) the arbitrary percentage tests concerning stock ownership limitations in Section 4943, and (6) unclear legislative intent in Section 4945.

1. General Philosophy. One thrust of the portion of H. R. 13270 directed to foundations is that the costs of government should be borne by those able to pay, including foundations. A second thrust is that private foundations must use their funds for the purposes intended and avoid self-dealing, accumulating funds, using funds for political action, and other purposes incompatible with the basic purposes for which tax exemption is granted.

The second thrust should be demanded and assured of all foundations that seek and are granted tax exceptions. Legislation should prohibit abuses of the tax exempt privilege and insure that all funds are for charitable purposes broadly defined.

If such practice is assured, the taxation of foundations to bear costs of government is contrary to the public interest and would reduce the social benefits the nation derives from legitimate foundations operating in the fields of charity and philanthropy. The ability to pay concept is clearly inappropriate when directed towards taxation of funds that will be used charitably. As the capacity of foundations to perform such functions is reduced, the deficiency will inevitably be assumed by the public through taxation to support various governmental agencies. I oppose the concept of taxation of foundations that perform ethically and legitimately the functions which warrant tax exemption.

I strongly support adequate sanctions against inappropriate conduct on the part of the foundations and the deprivation of their tax exemption in the case of uncorrected violations. Such sanctions should apply to all foundations, not just those included in an arbitrary definition of "private foundations."

2. Discriminatory Legislation. Section 101(K) of the proposed bill is entitled "Effective Dates" and contains two tightly drawn exemptions designed for two specific foundations from the ownership limitation provisions of Section 4943. The exemption for each of these is evidently based on a belief that these foundations have not been guilty of kinds of action against which legislation is directed, have operated in a manner consistent with the rest of the proposed legislation, and would be adversely affected by sale of their holdings.

This may be true. But it also is true of The Stanley Foundation and, I am sure, of many others. Such specific exemptions indicate only effective political lobbying on the behalf of the affected organizations. They do not indicate an attempt to conscientiously deal with the problems corrective legislation has on foundations which have been operating in the manner intended of them.

These provisions are patently inequitable and grossly unfair to the numerous other foundations, including The Stanley Foundation, that have and intend to function in an ethical and legitimate manner.

If Congress desires to resort to exemptions to serve specific foundations, I would be pleased to submit one that would fit The Stanley Foundation.

3. Tax on Investment Income. The proposed tax on investment income of all private foundations is bad tax law. Tax laws should encourage legitimate charity and philanthropy. Encouragement should go to all foundations, not just those who through the arbitrary formula avoid classification as "private foundations." Any tax, whether 1 percent or 7-1/2 percent, limits the capability of truly charitable foundations. Moreover, it invites the natural upward progression of tax to bear the costs of government.

4. Expenses of Government Officials. For purposes of the taxes on self-dealing, certain government officials are included in "disqualified persons," who cannot deal with foundations except to receive nonexcessive payment of compensation and expenses for services and expenses which are reasonable and necessary to carry out the exempt purposes of the private foundation. In addition, in the case of government officials, no compensation can be paid and the only expenses which can be reimbursed are traveling expenses from a point in the United States to another point in the United States.

If it is considered necessary to prevent even reasonable compensation to government officials for actual services, reimbursement for actual travel expenses ought not to be limited to travel between points in the United States. The activities of The Stanley Foundation over the past several years have included Conferences on the United Nations of the Next Decade, involving scholars and officials from all over the world. It is sometimes necessary and desirable to hold these conferences outside of the United States. No compensation is paid to these participants, but their actual expenses are reimbursed. Expenditures otherwise reasonable and necessary should not be limited geographically.

5. Stock Ownership Limitations. The control shareholding limitations in Section 4943 are not realistic when they must be applied from the smallest to the largest of corporations. The proposed legislation permits only 20 percent of the voting stock of a corporation to be held by a foundation and "disqualified" persons connected with it. Much less than 20 percent of the voting stock will control large, very widely held corporations. Much more than 20 percent is necessary to control smaller corporations, less widely held. The legislation should recognize this fact with holding limitations geared to the size and nature of the corporations involved.

In the case of The Stanley Foundation and its holdings of common stock of HON INDUSTRIES Inc., 20 percent is far below the amount required for control and no other individual or group has a holding adequate for control.

6. Unclear Legislative Intent. Section 4945 taxing certain expenditures of private foundations is excellent in its intent. No foundation should engage in any form of political action or propaganda. Legislation designed to prohibit and limit such activity should be encouraged. However, certain of the chosen legislative language is unfortunately broad and unclear and on final drafting should be clarified before final enactment.

For instance, Section 4945(c) includes as taxable expenditures subject to the sanctions of that section: ". . . any attempt to influence legislation through an attempt to effect the opinion of the general public or any segment thereof, 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 formation of the legislation, other than through making available the results of nonpartisan analysis or research."

The Committee report indicates this section is meant to "preclude(s) only direct attempts to persuade members of legislative bodies or government employees to take particular positions on specific legislative issues and does not extend to discussions of broad policy problems and issues with such members or employees." This is not directly apparent from the legislative language and it is not clear to what extent a foundation's reports, discussions, and other functions can be published and stay within the meaning of "making available the results of nonpartisan analysis or research."

STATEMENT ON BEHALF OF

THE WEATHERHEAD FOUNDATION

AND

THE NATIONAL CITY BANK OF CLEVELAND,

AS TRUSTEE UNDER THE WILL OF

ALBERT J. WEATHERHEAD, JR.,

Submitted by

Robert B. Nelson, Esq.
Jones, Day, Cockley & Reavis
Cleveland, Ohio

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SUMMARY

Proposed Code Sections 4942 and 4947 in the 1969 Tax Reform Bill impose a 100% tax on private foundation and non-exempt charitable trust income (or "minimum investment return") except to the extent the income is promptly disposed of in "qualifying distributions". In order to prevent avoidance of this tax, distributions to any "private foundation which is not an operating foundation" and to certain other charitable groups are not recognized as qualifying distributions--but this rule is applicable even though such distributee promptly makes a distribution which would have been a "qualifying distribution" if it had been made directly by the original charitable trust (or private foundation). Since this result is manifestly not intended, this statement suggests technical amendments to Section 4942 which would avoid this result.

STATEMENT

TYPICAL FACT PATTERN: PRIVATE CHARITABLE FOUNDATION AS BENEFICIARY OF CHARITABLE TRUST

The National City Bank of Cleveland is Trustee of a large testamentary trust for the benefit of The Weatherhead Foundation, a tax exempt charitable foundation incorporated in Ohio. The Charitable Trust assets are to be held in perpetuity and the trust income is payable to the Foundation as earned. The Foundation treats all receipts from the Charitable Trust as income, and distributes all of its income (including the Charitable Trust income) on a current basis. All of the Foundation's distributions are "qualifying distributions" within the statutory concept.

At the present time the Foundation is a grant making and not an operating foundation; four out of five Members of the Foundation, and three out of four Trustees of the Foundation, are members of the decedent's family.

This typical fact pattern is the result of a desire to separate investment decisions from responsibility for attainment of charitable objectives, and is repeated with numerous other private foundations.

THE PROBLEM CREATED BY THE PRESENT PROVISIONS OF SECTION 4942

Since there is no real question in this typical fact pattern of unreasonable accumulations of income intended for charity, we assume that there is no intention to tax the Charitable Trust income under proposed Sections 4942 and 4947. Nonetheless, because of the limiting definition of "qualifying distribution" contained in proposed Section 4942(g), it appears that the tax may apply. We propose a simple solution by in effect treating the Foundation's distributions as though made by the Trust.

If these sections are enacted failing to "credit" the Charitable Trust with "qualifying distributions" made by its beneficiary, the Charitable Trust and the Foundation (and others similarly situated) would eventually be taxed out of existence. Such a confiscation of assets would raise Constitutional questions and would not serve to further any announced or legitimate objective of tax reform.

PROPOSED SOLUTION

The solution which we propose to this technical problem is a modification of Section 4942(g) pursuant to which any non-exempt trust subject to Section 4942 or other private foundation would receive credit for any "qualifying distribution" made in a timely manner by a charitable beneficiary of the trust or foundation. Specifically, we propose that Section 4942(g) be amended by adding the following paragraph (3) thereto:

> "(3) QUALIFYING DISTRIBUTIONS BY BENEFICIARY -
>
> If a recipient of a distribution which (i) is made by the foundation to accomplish one or more of the purposes described in Section 170(c)(2)(B), but (ii) is not a qualifying distribution, pays out or sets aside any part or all of such distribution in a manner such that such payment or setting aside by the recipient would have been a 'qualifying distribution' under paragraph (1) or paragraph (2) if made at that time directly by the foundation, then to the extent that such distribution by the foundation is so paid out or set aside by the recipient it shall be treated as a qualifying distribution by the foundation."

STATEMENT OF DR. CHARLES L. McCLASKEY PRESIDENT OF THE NATIONAL ASSOCIATION OF FOUNDATIONS, INC.

SUMMARY

1. Tax on investment income: This tax is self-defeating; it will in a short time reduce the net aggregate of foundation income now passing to charity so low that private charity can exist only if subsidized by the Government, or by higher taxes. It is "robbing Peter to pay Paul."

2. Prohibitions on self-dealing: Not opposed in principle; matter greatly exaggerated; widespread abuse does not now and has never existed. Of the 4,335 audits by IRS of private foundations (1964-67) only 82, less than 2%, warranted recommendation for revocation of tax exemption. We maintain this matter can be best handled by private foundations through self-regulation under the Association's Code of Ethics.

4. Stock ownership limitation: This provision is unconstitutional on two grounds; (1) It is an ex post facto law passage of which is forbidden by Article 1, Section 9, Clause 3, and (2) It purports to take property, "without due process of law" in violation of the (v) Article of Amendment of the Constitution of the United States. It cannot apply to existing private foundations and it is of highly doubtful legality if applied to private foundations created after its passage. Congress cannot do by indirection - such as a requirement for tax exemption - that which it has no legal authority to do directly. This provision which voices an imaginary fear of transactions between foundations and corporations goes back into legislative history many hundreds of years as it is akin to the Statute of Mortmain whose fears have long been proven unfounded and we had thought forgotten.

6. Other limitations: We quote an article, entitled, "ARE TAX WRITERS VIOLATING LAW?", written by David Lawrence, which appeared in the Evening Star, Washington, D.C., August 28, 1969.

8. Change of status: As a penalty for relinquishing its tax exempt status this provision imposes upon a private foundation a tax equal to the aggregate tax benefits granted through tax exemption from December 31, 1912. It rejects all tax exemption legally granted for the last 57 years. This provision is ex post facto and forbidden by Article 1, Section 9, Clause 3, of the Constitution of the United States. If this type of proposal were enacted then all citizens would lose their protection under the law and, of course, their confidence in the stability of their Government.

Comments: Mention of adverse propaganda about private foundations; the extent of the havoc from the passage of the Tax Reform Act of 1969 (H.R. 13270) in the field of private philanthropy; and that the worth and charitable deeds of private foundations are great national assets that must be preserved not destroyed.

STATEMENT

1. Tax on investment income (sec. 101 (a) of the bill and new sec. 506 of the code).

This tax is self-defeating. It will contribute little to the public welfare but there is the strong probability that it will eventually increase the tax burden of the average taxpayer. This tax would be totally unlike any other. This anomaly, where the collection of a tax is not a benefit but a detriment, to the public interest arises from the fact that all of the private foundations' net income now goes toward philanthropy, thus, the levying of a tax would decrease the amount passing to charity. Even if the tax were earmarked for return to charity it would be reduced by heavy collection and administrative costs. The revenue increases are estimated at $65 million the first year, $85 million in the fifth year and $100 million by the tenth year. If these vast sums are withdrawn yearly from the support of private charity it will only be a short time until these services will degenerate to a point where there will be a widespread public demand for a Government subsidy which in turn will increase the tax burden of the average taxpayer. To levy this tax upon the assumption that it will benefit the public is a cruel delusion. If the 7-1/2 percent tax rate is raised which it most likely will be the day of account will come sooner. This tax would be a classic example of the folly "robbing Peter to pay Paul." We oppose the enactment of this proposed tax into law.

2. Prohibitions on self-dealing (sec. 101 (b) of the bill and new sec. 4941 of the code).

Prohibitions on self-dealing are not opposed in principle. Our position is that this matter of self-dealing has been greatly exaggerated, that widespread abuse does not now exist and has never existed. The audit experience of the Internal Revenue Service shows during fiscal years 1964-67, 4,335 audits of private foundations were made and only 82 (less than 2%) warranted recommendation for revocation of tax exemption. Former Commissioner of Internal Revenue Cohen testifying on November 16, 1967 before Subcommittee Number 1, Select Committee on Small Business, U. S. House of Representatives, said, "I do not intend to suggest that all or even a large percentage of the exempt organizations require surveillance. We believe our audit experience indicates rather conclusively that a great majority of the exempt organizations, including private foundations, are complying with the requirements of the tax laws."

We believe that the situation can best be managed by private foundations voluntary self-government under the Association's Code of Ethics, which is as follows:

CODE OF ETHICS

Preamble

The National Association of Foundations, Inc., in order to inspire public confidence, affirm the fairness of the self-assessment tax process and to indorse the basic principle of promoting private philanthropy through tax-exemption, does proclaim ethical standards of conduct for foundations as follows:

1) Be ever mindful that they are organized for philanthropy and not for private gain.

2) Recognize that they hold a public trust.

3) Realize that tax-exemption imposes special obligations to operate solely in the public interest.

4) Never permit a foundation to be used for the self-service or private interests of its donors, trustees, directors, officers or employees.

5) The foundations recognize the need to make distributions annually commensurate with their incomes and consistent with their respective charters.

6) To make investments as a prudent man would in a fiduciary capacity.

7) Willingly furnish required information when requested by duly constituted local, State and Federal authorities.

c The National Association of Foundations, Inc. 1963

4. Stock ownership limitation (sec. 101 (b) of the bill and new sec. 4943 of the code).

Our opposition to this provision is based upon the fact that we consider it to be unconstitutional on two grounds, to wit:

First: It is an Ex post facto law whose enactment is prohibited by Article I, Section 9, Clause 3, of the Constitution of the United States, which states, "No Bill of Attainer or ex post facto Law shall be passed."

The term "ex post facto" is defined as "Done or made after a thing but retroacting upon it; retrospective; as, an ex post facto law is any law enacted with a retrospective effect."

It is clear and beyond the scope of doubt or argument that the mandatory stock divestment requirements and sanctions of this provision are ex post facto, because in 1969 they would declare stock ownership acquired PRIOR thereto illegal and impose sanctions for continued ownership. If this type of legislation were not prohibited by the Constitution no one could feel in 1970 secure in the title and ownership of property acquired in 1969. It is of no significance that this provision is proposed in connection with the requirements of a tax exemption, because an ex post facto law is unconstitutional no matter what the objective may be. Certainly, Congress would not employ an unconstitutional means to enforce a requirement for tax exemption.

It is evident that this provision of the bill can be applied only prospectively, that is to those private foundations formed after its enactment; there is in our opinion, serious questions as to the validity of the provision against private foundations created after its enactment.

We contend the provision is unconstitutional.

Second: It deprives private foundations of property "without due process of law" in violation of the (v) Article of Amendment of the Constitution of the United States.

The mandatory language of a statute is not "due process of law" within the meaning of the term as used in the Constitutional Article of Amendment.

The reasons given for the necessity of this provision are both suppositive as to facts as they are unrealistic. The presumable conflicts of interest between business and foundations simply does not happen. It is a remote potential not a fact. Insofar as concerns alleged unfair competition foundations have to pay an unrelated business tax the same as owners of business have to pay an income tax.

Aside from being unconstitutional this provision is open to another fatal objection. Congress cannot do indirectly what it cannot do directly. Certainly it could not pass a law limiting citizens' ownership of corporate stock to an arbitrary percentage, therefore, it cannot lawfully limit foundations' ownership of corporate stock to an arbitrary percentage, as a condition precedent to the allowance of a tax exemption. Requirements for the allowance of a tax exemption must be constitutional, prospective and reasonable.

This provision which voices an imaginary fear of transactions between foundations and corporations goes back into legislative history many hundreds of years as it is akin to the Statute of Mortmain, whose fears have long been proven unfounded and we had thought forgotten.

6. Other limitations (sec 101 (b) of the bill and new sec. 4945 of the code).

Our views regarding this provision are best expressed in an article by David Lawrence, which appeared in the Evening Star, Washington, D.C., Thursday, August 28, 1969 as follows:

"ARE TAX WRITERS VIOLATING LAW?"

"Perhaps the persons who drafted the tax bill which passed the House of Representatives recently and now is pending in the Senate didn't realize that some of the restrictions to be placed on the operators of private foundations might be declared unconstitutional.

"The House bill says that such organizations will lose a part of their tax exemption if they engage in any activities 'to carry out propaganda, or otherwise attempt to influence legislation' or 'to influence the outcome of any public election, including voter registration drives carried on by or for such foundation.'

"The bill specifies that 'any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof', as well as any effort to influence legislation by lobbying, would result in a tax equal to 100 percent of the amounts spent for such activities. Also a 50 percent tax on the amounts expended improperly would be levied on the management of the foundation as a penalty."

"But the Supreme Court of the United States rules 20 years ago that a labor union - which, of course, is tax exempt - cannot be prohibited from "expressing views on candidates or proposed measures." ****.

'The Supreme Court held that if the Corrupt Practices Act 'were construed to prohibit the publication by corporations and unions in the regular course of conducting their affairs, of periodicals advising their members, stockholders or customers of danger or advantage to their interests, the gravest doubt would arise in our minds as to its constitutionality."

"The high court in another case has also ruled that the tax weapon itself cannot be used as a penalty to restrict freedom of the press or freedom of speech. Private foundations, it will be contended, therefore, have just as much right under the Constitution as any other group to set forth their views on politics or subjects of public concern. Hence, a dimunition of their tax exemption because they have expressed opinions on public questions will certainly be challenged before the Supreme Court."****

"The specific question that arises today, however, is whether there can be discrimination in a tax law against one group while another is permitted to carry on the same kind of activities. Will labor unions retain their tax-exempt status as they engage, directly or indirectly, in politics or propaganda on public affairs?"

"Certainly, the Senate is confronted with some important precedents by the Supreme Court which makes it difficult to tell any private educational or charitable foundation that it will be penalized when utilizing its right of expression on public affairs."

8. Change of status (sec. 101 (a) of the bill and new secs. 507, 508, and 509 (b) of the code).

On page 39 of the Report of the Committee on Ways and Means, House of Representatives to accompany H. R. 13270, a Bill to Reform the Income Tax Laws, there are astounding statements, to wit: "*** your Committee has determined that organizations should not receive substantial and continuing tax benefits in exchange for the promise of their contributions to society, and then avoid the carrying out of these responsibilities. Accordingly, the bill provides that an organization which was a private foundation *** for its last taxable year ending before May 27, 1969, may not escape its obligations by relinquishing its exempt status unless it repays to the Government the aggregate tax benefits (with interest) that have resulted from its exempt status. "** The tax benefits to be repaid in such a case are all of the increases in income, estate, and gift taxes which would have been imposed upon the organization and all substantial contributors if the organization had been liable for income tax and if its contributors had not received deductions for contributions to the organization.*** For purposes of computing the amount of the aggregate tax benefits, all benefits available to the private foundation for taxable years beginning after December 31, 1912, and all tax benefits on contributions made to the foundation after February 28, 1913, are included. In addition, interest on all such benefits shall be added to the amount of the benefits computed, in the case of each benefit, from the first date on which the added tax would have been due if the benefit had not been available."

It is unbelievable that the bill contains a provision which provides for the denial of all legal tax exemptions which have been granted to a private foundation for 57 years before its passage, and holds the private foundation liable for all tax forgiven or exempted during that period, purely as a punitive measure against the private foundation for relinquishing its exempt status.

If this type of legislation is permitted all citizens lose the protection of law and, of course, confidence in the stability of Government.

Because it disturbs and reacts upon by total denial conditions which have existed with the full sanction of law for the last 57 years, this provision of the bill is clearly ex post facto and its enactment into law is prohibited by Article 1, Section 9, Clause 3, of the Constitution, which reads:

> "No ** ex post facto Law shall be passed."

******

Comments: Since early in 1962 there have appeared articles in the public press which, although based 98% on mere assumption of fact, they, nevertheless, have prejudiced the general public against private foundations and have created "a distorted public image" of them. This propaganda seems to be reflected to some extent by the language and passage of the Tax Reform Act of 1969 (H.R. 13270). This is unfortunate for the general welfare. The worth and deeds of them are too much of a national asset to be destroyed. The real beneficiaries of the havoc this bill would do in the field of private philanthropy are the millions of young, old and infirm, sick and helpless treated by our hospitals, the students in our colleges and universities, innumerable research projects in medicine, science, health, education and the support of religion and social welfare. The more than a billion of dollars given annually by private foundations to support the philanthropy of the nation must be preserved not destroyed.

Statement of Dr. Malcolm Moos
President, University of Minnesota
October 6, 1969

These comments are offered from the perspective of one who is currently the president of one of the nation's largest public universities and was formerly a program officer of the Ford Foundation.

I should like to limit my attention to those aspects of the proposed Tax Reform Act of 1969 (H.R. 13270) which seem to me to have important and negative implications for public and private higher education, and the vital supportive role that the best of our foundations provide to both. The word "best" is used advisedly; I have no desire to protect those who would mask their profit-making or political or ideological activities by identifying their organizations as educational foundations. On the other hand, I hope to demonstrate that both public and private education in this nation are in need of greater, rather than less, support from the legitimate foundation activities threatened by the proposed reforms.

I should also like to point out that I am personally in favor of major reform in our tax legislation, and I do not know a single responsible member of the higher education community who is not. First of all, as observers and students of the national scene (and taxpayers ourselves), it is clear to us that inequities and potential for abuse in our current tax structures cripple the morale of taxpayers and raise legitimate questions from them about the degree to which they should be expected to subsidize the opportunism of others. Nothing except broad reform measures, of the scope contemplated by the Congress, can restore the integrity of American tax policy. Second, since the legitimate needs of public higher education in America will require additional tax revenues and since the availability of these additional funds depends on the continuing good faith of taxpayers, the American citizen must not become cynical about the burden of taxes he bears or the uses either of tax revenues or of funds exempted from taxation. Both reason and self-interest argue for major tax reforms.

However, I do take exception to some of the details of the legislation before this committee. In my judgment, they will have unfortunate consequences for universities. I also believe that Congress would not wish those consequences to occur. The health, and possibly the independence and autonomy of many of our institutions can be seriously damaged by the provisions which affect individual and foundation giving to public and private higher education.

- USE OF PRIVATE FUNDS -

Private gifts constitute vital income for the nation's institutions of higher education, both private and public. A state university like the University of Minnesota, of course, is not so dependent on gift income of various kinds for its general operating costs as a private university. I am certain that the private universities can adequately describe both their presently dire financial straits and the damage that reductions in gifts of various kinds would do. For some of them, their very existence would be threatened.

For all of them, the uncertainties add further to the already grave discussions of whether dual private and public systems of higher education sustained in the United States. I need not list the many reasons for the opinion of the higher education community in this country that the nation is best served through widely differing approaches to support organisation and instruction in higher education. Any threat to the financial support and therefore to the quality and quantity of private higher education is a threat to all of higher education.

But private income plays an essential and irreplaceable role in public higher education, as well. At the University of Minnesota, for example, the complete budgeted expenditures of private resources totalled about $31 million during the past five years. These expenditures, of course, constituted a small proportion of the total University budget for that period of time, but analysis of those expenditures is revealing. They have an importance far beyond their amounts in dollars and cents.

1. Budget amounts from private sources are increasing substantially in total dollars and also provide an increasing proportion of the University's income. In the year ended June 30, 1969, the University of Minnesota spent $9,254,925 from these sources, up nearly 40 per cent from the previous year. In the year ended June 30, 1969, expenditures from these sources made up 4.5 per cent of the University's total budget, compared with 3.3 per cent four years earlier. Furthermore, the University of Minnesota is not alone in this regard. Efforts to improve investment of university funds and solicit greater support from private sources have paralleled the huge increase in higher education enrollments throughout the nation and the accompanying pressure on public sources of support.

2. Private support has been used for purposes absolutely critical to the excellence and progress of the University of Minnesota -- purposes for which public funds could not be available at the opportune time or could not be available at all. For example, the following efforts undertaken at the University of Minnesota during the past five years could not have been accomplished without substantial or complete funding from these sources:

a. The initiation of the Center for Programmed Learning

b. The initiation of the Department of Family Practice and Community Health in the College of Medical Sciences

c. The Community-University Health Center

d. The Office for Advanced Drama Research

e. Research on problems in law and society

f. The initiation of a program for low income minority students

In short, the University of Minnesota depends on private resources for special efforts that are vital to its development and its relevance to the society of the 1970's, but for which public support is, for one reason or another, unavailable.

3. The capacity of a university to meet the demands of the public is directly tied to the availability of these private funds. Without them and the extra resources they provide, a university is less flexible, less innovative, less dynamic than it must be if it is to be truly excellent and responsive. With them, it can make the moves, undertake the studies, catalyze the change, strengthen the weaknesses, create the new units -- meet the demands that are not susceptible to regular, proportionately increased state and federal appropriations. These are the hard and real demands of a rapidly changing and problem-ridden society which historically has turned to its resources of

public higher education to address itself to these needs. It is ironic that so often it is the support by private gift or foundation that really enables the public university to do what the public demands of it. One important example at the University of Minnesota is the development of a new program in Family Practice and Community Health, which was made possible by a grant given by the Louis W. and Maud Hill Family Foundation. The development of this program was in response to the public demand of Minnesota that our health care delivery system is presently inadequate to meet the demands for health services.

4. Clearly many of the resources of a university that give it special distinction as a community or national resource are the direct result of gifts facilitated by the tax provisions which are under question before this committee. Works of art, collections of private papers, books, and even whole libraries often come into the possession of a university, museum, or other institution as gifts with tax relief implications for the donors. Such gifts then become public resources, where they once were private and unavailable to their communities. They enhance the institution and the community and help the university to serve its historic role of heightening the quality of life in the society through the careful stewardship and cultivation of educational resources.

-WEAKNESS IN THE LEGISLATION-

Under Sections 101 and 201 of the proposed legislation, H.R. 13270, there could be serious disruption of these vital resources.

1. The proposed legislation would make gift planning extremely complicated for individual donors, especially where appreciated property is involved. The tax advantage to the donor, though it fortunately remains a significant one, would be less than under the present law. How much that one fact will affect the volume of private contributions is unclear. But even more important is the

difficulty of estimating how much the tax advantage would be at any one time. In a given situation the planning of a large gift of appreciated property involves so many indefinites and interdependencies that a donor might be persuaded to do nothing at all, especially since the tax advantage is decreased in any case from its present status. While there is definitely a need to place some limitations on deductibility and avoid relieving donors from having any tax obligations at all, it is unfortunate from our standpoint that the proposed changes should compound the effects of limiting deductions by adding a good deal of confusion to the computation.

2. By discouraging large gifts, the proposed regulations would complicate the use of these gifts by the institutions which receive them. Large gifts have a double advantage for an institution like the University of Minnesota, for they cut the proportional costs of fund-raising at the same time that they make it possible for the institution to make better plans for their use. A single gift, if it is large enough, may be dedicated to a single, independent, long-range use, thus providing assurance of future availability of funds for that purpose. The limitation on gifts of appreciated property to 30 per cent in the case of individuals appears certain to reduce the size of gifts.

3. To the extent that these laws and regulations bring a general reduction in private giving to the University of Minnesota or other educational institutions -- or even a reduction in the rate of increase of giving -- the proposed laws will increase the pressure on students and federal and state treasuries for support of higher education. This is a time of significant change in higher education, and of phenomenal growth as well. Throughout the nation, state governments are reaching the limits of their ability to finance public needs and retain the good will of taxpayers at the same time; and the difficulties of federal

financing of public education need no elaboration before this body. The result is that students in public institutions of higher education are being required to provide an escalating share of the costs of that education. At the same time, institutions are struggling to maintain quality instruction in the face of increased numbers and costs, while they are faced with constant and justified demands to provide education that is more relevant to our complex and technical society.

The members of this committee are well aware of the increasing demand for student assistance funds. In the case of loans a nearly unbearable debt burden is placed on students who are not fortunate enough to have their educations financed for them. To the extent that universities are caught between pressure to limit taxation and this anticipated reduction of private financing, the visible remaining source of income is our students. The proposed changes in tax legislation, while they do not affect public institutions as harshly as private institutions, will nevertheless cause a greater hardship for our students.

-FOUNDATIONS-

4. Finally, there is little doubt that the proposed regulations will adversely affect both the fund-raising and fund-distributing capacities of our private foundations. As a matter of fact, that appears to have been at least partly the intention of the House bill.

As I stated earlier, I have no interest in protecting any organization that tries to dignify its political, profit-making, or ideological thrusts through the protections that have been provided to private foundations under our laws. But it is absolutely vital to distinguish those misuses of the law from the legitimate and very valuable support and services provided by our best foundations to American higher education in particular and to the American society in general.

a. First of all, every effect of the proposed tax reforms on private giving is an effect on foundations as well. Like the universities, they receive and manage gifts from individuals, using the proceeds for their own research and support efforts, many of which are carried on in the universities. Their gifts to the universities, in turn, assist those institutions in the same way that private gifts assist them -- by providing support of critical efforts for which funds would otherwise not be available. A qualifying foundation under the proposed law, then, will suffer from the same problems and the universities will suffer the effects of those problems in potentially reduced income.

b. Besides the total value of the support universities receive from our legitimate foundations, there are other important functions they provide as well. In its relationship to a university, a foundation reduces the costs of fund-raising for that university by acting as a sort of broker. To the extent that the proposed law reduces the capacity of the foundations to accept and distribute funds, it will complicate the fund-raising activities of individual institutions, which have in the past had a dependable and flexible intermediary in the private foundation. The impact of these laws would be especially great in the contribution of appreciated propertiec to foundations.

c. The weakening of the role of foundations in higher education would reduce the contribution foundations make to the improvement of higher education as well. Many private foundations not only act as convenient resources for the collection and distribution of private funds to universities, but also function as coordinators of research and support of specific matters of substance.

A foundation may undertake to study a particular issue or procedure -- for example, the development of university information management systems -- and thus establish itself as a national resource in that field. Through such a function, the foundation reduces the necessity for overlapping studies in individual universities and increases the possibility that an acceptable common practice can be established. Such efforts are expensive and require resources which are not available in a single institution. The foundation can commit the required funds centrally and coordinate the use of resources -- functions which no individual institution can manage.

In this function, in fact, private foundations provide a desirable alternative resource to the involvement of the federal government in such efforts, since the federal government is the only other institution which can muster the financial resources and operate throughout the nation to make use of resources in individual institutions.

d. For foundations which make these contributions to American higher education, perhaps the most unprecedented and undesirable aspect of the proposed legislation is the 7 1/2 percent tax on investment income of the foundations. The effect of this taxation would be a direct reduction in the amount of funds available to universities through the foundations, thus striking at the support of the vital university efforts outlined above. For foundations involved in legitimate educational efforts, this seems unnecessarily punitive.

The Louis W. and Maud Hill Family Foundation in St. Paul is heavily involved in grants to institutions of higher education, including the University of Minnesota, and has provided information that indicates that the 7 1/2 per cent tax, exclusive of tax on capital gains, would diminish the amounts available annually for grant purposes by at least $177, 000. This relatively small foundation supported efforts at the University of Minnesota amounting to more than $600, 000 during the fiscal year ending in 1969. If it should determine that the University of Minnesota must bear the entirs brunt of its new tax-paying status, more than one-fourth of the critically-needed funds from this foundation would disappear from the University's budget. However, if it were to distribute the reduction, essential efforts would be curtailed in the institutions to which the Foundation provides grants. There simply would be that much less money available for distribution. And, as the spokesman for the foundation points out, "Of course, all foundations would be subject to the same tax and would have less funds for grant-making purposes." Furthermore, if capital gains income should be taxed in this foundation, the loss to grant-receiving institutions would be approximately doubled. Interestingly enough, this loss to institutions would be a loss to those organizations which the proposed legislation, for the most part, specifically excludes from taxation.

It makes little sense to require taxes to be paid from funds which would have supported cancer research and student assistance programs but not from those which support the self-serving activities of trade associations and other lobbying organizations. The tradition of Congressional treatment of charitable organizations has been to place them in a favored position. If there are deficiencies in the present tax law, I strongly believe that Congressional acumen can resolve them in a manner consistent with the traditions that have fostered support rather than diminished it. It is difficult to see why the Congress should change that emphasis at a time when educational and charitable causes need strengthening.

Finally, as a student of government stretching across a quarter century of teaching at Johns Hopkins, Michigan, and Columbia, I find the sections of the bill that would muzzle groups from making representations before Congress appalling. Such a sweeping restriction would tend to stifle the very breath of a pluralistic society and in my judgment ought to be eliminated.

-CONCLUSION-

Perhaps the House of Representatives, faced by the praiseworthy pressures for general tax reform, did not give adequate consideration to certain less visible implications of the proposed tax reform bill. The leadership of American higher education, both private and public, hopes these critical issues will receive careful consideration before action is taken in the Senate. Speaking as the president of one of the largest public universities in America who has had experience with private foundations from both perspectives of grant-receiver and foundation officer, it seems to me that the following specific recommendations should be considered by this committee:

1. At the same time that limitations are placed on the deductibility of charitable contributions, including gifts of appreciated property, ways should be found to formulate deductibility so that the complexity of computation does not increase the likelihood of reduced gifts to institutions which need them so badly.

2. In considering the possible reduction in total giving which this proposed law may bring about,further attention should be paid to the public benefits which are achieved by the donation to institutions, libraries, and museums of paintings, books, and collections of valuable papers.

3. In establishing the amount of deductibility of charitable gifts, and therefore assessing the degree to which the federal government should, in effect, encourage such gifts, attention should be given to the public benefits which flow from those gifts -- specific research and educational efforts which make it possible for public as well as private institutions to improve their service to students and the society; the widely accepted viewpoint that the educational

quality of our institutions of higher education and the educational health of the nation both require strong private as well as public efforts in higher education; the relief that these gifts provide to state and federal governments and students, all of whom otherwise bear the burden of supporting a growing and changing higher education system in the Nation; and, therefore, the need to encourage increases rather than decreases in private gifts to higher education.

4. Serious consideration should be given to alternatives to the 7 1/2 per cent tax on foundation investment income and stock ownership limitations by some means which will meet the regulatory necessitities, but not weaken the capacity of these foundations to support vital activities either within the foundations or at the nation's universities. Alternatives are available to cover the costs of investigating and regulating the activities of foundations which would meet the recognized need to maintain constant examination of foundation activities, without penalizing institutions assisted by the foundations or reducing the clear public benefit that legitimate foundation activities now provide.

5. Finally, tax legislation that affects the income of public and private higher education should always be considered in the context of the important question of possible alternatives to the contribution made by foundations to research, instruction, and management of American higher education. Greater dependence on the federal government for financial and management support is the only alternative I can visualize.

STATEMENT OF SOUTHERN EDUCATION BOARD, presented by Governor Mills E. Godwin, Jr., of Virginia, retiring chairman, and Governor Buford Ellington, of Tennessee, incoming Chairman of the Board

The Southern Regional Education Board (SREB) has a genuine concern regarding some of the provisions of the Tax Reform Bill (H.R. 13270) affecting the treatment of private foundations. Prompted by this concern, the Board desires to make known to the Finance Committee of the United States Senate the Board's views on such provisions.

I. BACKGROUND AND ACTIVITIES OF SREB.

SREB is the operating agency of the nation's first interstate compact for higher education. Created in 1948 at the direction of the Southern Governors' Conference, SREB is a pioneer in regional planning and action and in effective multistate use of higher educational resources.

Fifteen states are now members of the compact: Texas, Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, North Carolina, Maryland, Mississippi, Oklahoma, South Carolina, West Virginia, Tennessee, and Virginia.

The Board has no coercive power over any state or institution. Its success depends entirely upon the interest and cooperation of the states and institutions.

SREB conducts cooperative programs aimed at providing better undergraduate, graduate, professional and technical education for all citizens of the South.

The Board works directly with state governments, academic institutions and other agencies concerned with higher education to:

(a) do research on the South's problems and needs in higher education;

(b) provide consultant services to states and institutions on problems related to higher education;

(c) find ways of solving these problems through regional cooperation; and

(d) disseminate information on higher education throughout the region.

SREB is a catalyst for innovation in curriculum and instruction; a goalsetter concerned with the major problems of the South and the role higher education must play in solving them; a resource, conducting research, promoting research by colleges and universities, and offering consultation services to institutions, states and agencies; a communicator, disseminating a continuing flow of meaningful news to the general public, the campus community, state government and educational agencies and organizations.

Reflecting the broadening concerns of higher education today, the Board's activities cover a wide spectrum: computer sciences, nursing, agriculture, instructional television, resource development, special education, international studies, institutional research, and mental health training and research.

Basic support for SREB comes from an annual appropriation of $25,000.00 by each participating state. At present, each state also participates in the Board's mental health research and training program and appropriates an additional $8,000.00 annually to support the program. Funds for special projects come from federal agencies, private foundations and other organizations.

Of the Board's budget for 1968-69, state funds comprised 30 percent; grants from private foundations, 30 percent; and federal funds, 40 percent. The "seed money" invested by the states to operate the Board has brought millions of dollars from other sources for programs to improve higher education in the South.

Private foundations have been an extremely important source of support for SREB almost since it was created in 1948. The support from private foundations varies from year to year but the volume and nature of the support is of the utmost importance. In the 1969-70 budget, support from foundations will be in excess of $420,000.00.

The nature of the support of private foundations to organizations such as SREB is of particular significance. Much of this support has been, and is, for innovative and experimental study and programs - programs for which public funds are not readily available. There is attached to this statement an appendix which briefly describes some of the recent or current programs supported from the private sector.

SREB would be seriously harmed - as would the cause of education generally - if any legislation should be passed which limited the incentives for, or had a repressive effect upon, the continuation of the type of support which has been so beneficial to the region served by SREB and to the cause of education generally in our nation. There is indicated below a brief reference to some of the concerns of SREB as to some provisions of H.R. 13270.

II. VIEWS OF SREB ON CERTAIN PROVISIONS OF H.R. 13270.

A. Section 4942(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 then any distribution 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 not an operating foundation (as defined in subsection (i)(3)), or (iii) an organization which would be a private foundation if it were a domestic organization . . ." (Emphasis added.)

H.R. 13270 generally requires private foundations to distribute specified amounts each year. Section 4942(g) pertains to the type of contributions which would qualify in determining compliance with distribution requirements.

SREB is of the opinion that its purposes fall within those described in §170(c)(2)(b) and that SREB qualifies as an operating foundation as described in §4942(g)(3). However, aside from the question as to whether or not SREB so qualifies, the provisions of §4942(g) appear unduly restrictive. SREB is a §501(c)(3) organization which is exempt from tax under §501(a). SREB must continue to qualify for such status each year, as do all other §501(c)(3) organizations.

SREB's concern is that there be no question as to the qualification of distributions for the support of the type of programs which have been, and are being, supported by private foundations. SREB works with and provides assistance to a large number and variety of organizations which are involved in one phase of education or another and which SREB would not want to be harmed by unduly restrictive qualifications for distributions from private foundations. It would seem that any such organization which qualifies, and continues to qualify, as a §501(c)(3) organization should qualify for distributions. If the requirements for qualification as a §501(c)(3) organization need review and possible revision or if the activities of such organizations require greater scrutiny, then this should be undertaken. However, attempts to draw distinctions between such organizations are almost certain to raise doubts about qualifying distributions and may result in serious injury to fine causes in the field of education. SREB would hope that all organizations which continue to merit the beneficial treatment accorded them under §501(c)(3) would qualify as recipients of distributions from private foundations.

B. Section 506. Tax on Private Foundation Investment Income.

> "(a) Imposition of Tax.--There is hereby imposed for each taxable year on the net investment income of every private foundation (as defined in section 509) a tax equal to 7 1/2 percent of such income."

The privilege of tax exemption is indeed an important one and must be carefully guarded. Those seeking such status must recognize their obligation of demonstrating, and continuing to demonstrate, eligibility. Exemption from federal income tax has been provided by Congress to encourage individuals and organizations to provide support for activities which Congress deems beneficial to our society. The wisdom of this policy has been proven beyond question.

Any abuse of tax exempt status should be dealt with in a manner commensurate with the extent of the abuse. However, the tax suggested would apply to all private foundations and could, we fear, have an extremely detrimental effect on the continuation of the benefits which have come from private gifts and voluntary action.

As a recipient of support from private foundations, SREB would be indirectly harmed by the tentatively proposed tax, as would many educational organizations with which SREB is concerned and with which it works. Further, it is feared that one inroad into a tax structure which now reflects, and is a part of, a policy which has resulted in great benefit to many worthy causes would lead to larger and broader inroads. If one type of tax exempt organization loses that status, this creates a genuine threat to other organizations which are the beneficiaries of an overall tax structure grounded on charitable purposes. In addition to income tax exemption, many organizations are the beneficiaries of exemption from ad valorem and other state and local taxes. Eligibility for federal income tax exemption is frequently given considerable weight in passing upon eligibility for exemption from these other types of taxes.

Certainly no one can justifiably condone abuse of tax exempt status. However, such abuses can be eliminated by enforcement of existing provisions of the law or, if not, these provisions may be revised or greater scrutiny provided. The tax imposed in §506 does not correct abuses; it applies with as heavy a hand to the pure as to the impure; and could undermine, discourage and weaken the type of activity which Congress heretofore has effectively encouraged.

C. Section 4945(b). Taxable Expenditure.

> "For purposes of this section, the term 'taxable expenditure' means any amount paid or incurred by a private foundation (1) to carry out propaganda, or otherwise attempt to influence legislation, (2) to influence the outcome of any public election (including voter registration drives carried on by or for such foundation . . ."

Our concern is with that portion of the above which prohibits any amount paid or incurred to "attempt to influence legislation."

SREB works directly with state governments, federal agencies, educational institutions and other organizations and bodies concerned with education. As before stated, its support comes from states, federal agencies and private foundations. It engages in research, consultation, supervision of demonstration and experimental programs and other activity designed to further its objectives.

For example, SREB provides consultation services to states in the planning and coordination of higher education, including long range planning. Consultation is provided to states, and all types of institutions with respect to academic programs; community service programs for academic credit; the financing of higher education; improving public information programs at universities and colleges; establishing, expanding and improving undergraduate social welfare curriculums, and in many other areas of education. The very nature of such activities is such that the results thereof could influence legislation in matters pertaining to education.

Subsection 4 of §4945 imposes a 100 percent tax on the private foundation and a 50 percent tax on the foundation's manager for expenditures described in §4945. Subsection 4 of §4945 specifically states that the 100 percent tax is imposed on a private foundation which makes a grant to another organization (other than an organization described in paragraph 1, 2 or 3 of §409(a)), unless the private foundation exercises expenditure responsibility with respect to such grants in accordance with subsection (f). There follows a subsection 5 which also imposes the 100 percent tax on the private foundation and a 50 percent tax on the foundation manager who makes distribution for any purpose other than for a purpose specified in §501(c)(3). This latter reference is to an organization operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes or for the prevention of cruelty to children or animals, and it specifically excludes organizations which carry on propaganda or otherwise attempt to influence legislation.

The present language in §4945(b) might raise questions about the eligibility of SREB for certain types of grants from private foundations. We strongly urge elimination of that portion of the section pertaining to attempts to influence legislation.

III. CONCLUSION.

This statement does not purport to reflect a study in depth of H.R. 13270 or an exhaustive reaction to its provisions. It is intended to substantiate SREB's concern as to the following:

(1) That the immense benefit which flows to this country from the charitable impulses of its people not be jeopardized by legislation representing a radical departure from a policy heretofore supported by Congress.

(2) That legislation in the nature of tax reform not be used to remedy whatever abuses there may be under existing laws but that, instead, the existing laws be revised if necessary and enforcement be improved.

(3) That any legislation which is passed not be of so technical a nature as to require the making of fine spun distinctions which may result in irreparable harm to organizations and programs of unquestionable value and desirability.

SOUTHERN REGIONAL EDUCATION BOARD

By:
Mills E. Godwin, Jr., Governor
of Virginia, Chairman, Southern
Regional Education Board
(1968-69)

Buford Ellington, Governor of
Tennessee, Chairman, Southern
Regional Education Board
(1969-70)

APPENDIX TO STATEMENT OF SOUTHERN REGIONAL EDUCATION BOARD ON TAX REFORM BILL (H.R. 13270)

I. THE INSTITUTE FOR HIGHER EDUCATIONAL OPPORTUNITY.

A relative newcomer created in April 1968, the institute is now active on several fronts. During the year, it completed reports on curriculum changes required to prepare Negro students for new career opportunities, interinstitutional cooperation involving traditionally Negro colleges, and the special dollar needs of those colleges.

In the area of curriculum change, a follow-up project, funded by the grant of a private foundation, is under way, supporting intensive revision efforts at 12 predominantly Negro institutions. A second series of case studies of intercampus cooperation is now being prepared with financial assistance from another private foundation. Publication is expected in early 1970.

Five junior colleges - in Florida, North Carolina and Texas - are working with the Board in a three-year project financed by a private foundation and aimed at determining how public junior colleges can attract more black students and serve them more effectively. Additionally, the institute staff is assisting the State of Florida in a comprehensive examination of post-high school educational opportunities for black students.

II. AGRICULTURAL SCIENCES.

Early this year, SREB's Council on Graduate Education in the Agricultural Sciences completed year-long consideration of ways the predominantly white and Negro land-grant institutions might cooperate to improve academic programs in agriculture. The

Council's report, published in the spring, led to follow-up meetings between the presidents, agriculture deans and extension service directors of land-grant institutions in subregional areas. These meetings will reach all of the SREB states.

A six-month project is now under way to develop a basic course in animal science, which is expected to be a model for schools of agriculture throughout the region. This summer, the Board will sponsor an institute in animal nutrition at the University of Georgia.

III. NURSING EDUCATION.

In cooperation with the 124 institutions in the region which offer degree programs in nursing, SREB's Nursing Education Project this year carried out a variety of programs designed to improve nursing education and reduce the critical shortage of nurses in the South.

Programs included: a seminar series for instructors in medical-surgical nursing in master's degree programs; management training seminars for deans of bachelor's and advanced degree programs, sponsored by Emory University; two regional workshops for faculty members in associate degree programs sponsored by the University of Tennessee and the University of Maryland; and a clinical training project in cancer nursing, directed by the University of Texas M. D. Anderson Hospital and Tumor Institute.

More than 150 deans and directors of Southern college nursing programs attended the semi-annual meetings of the Council on Collegiate Education for Nursing, the main planning body of the Nursing Education Project. At one meeting the prime topic was the federal Regional Medical Programs, and at the other, curriculum development in nursing.

IV. CONTINUING EDUCATION FOR JOURNALIST.

Some four years ago SREB began, with the support of a private foundation, a pilot project in continuing education for journalists. The goal was to provide working newsmen with opportunities to discuss contemporary problems with experts from the academic community, and thus to help the newsmen improve their performance. This January, after three and a half successful years, the project came to a happy conclusion. The original intention was that it should become permanent, independent of SREB, and it is well on its way toward that goal.

The foundation and a new Southern Newspaper Publishers Association Foundation are financing it jointly for a five-year period, during which the foundation's support will decrease and publisher support increase annually. If all goes well, the program will be firmly established and entirely supported by SNPAF six years from now. A development of this kind is particularly gratifying to SREB, which seeks to spur new educational activities that can become self-sustaining.

V. COMPUTER SCIENCE.

SREB's Computer Science Project this year completed a national inventory of the use of computers in higher education and undertook an ambitious two-year experiment with different ways to supply computer facilities to small colleges for instructional purposes. The inventory, financed by the National Science Foundation, is regarded as the most up-to-date and comprehensive collection of data about computer equipment, facilities and use, plus computer science degree programs offered, at some 2,000 universities and colleges nationwide.

Twenty small colleges across the region are participating in the current project, also supported by NSF. Nine are using terminals connected to university or commercial computer time-sharing centers, six have their own small computers, and five are sharing a single computer. Techniques of computer use for instruction, and attitudes of students, faculty and administrators toward such instruction, are being studied and evaluated.

STATEMENT BY BREENE M. KERR

Mr. Chairman and Members of the Committee, my name is Breene Kerr. I am a partner in a business consulting firm in Oklahoma City. I have served since its founding in 1963 as Chairman of the Board of Trustees of the Kerr Foundation in Oklahoma.

For many years I have participated in business, government, educational, and charitable activities. This provides a background from which I speak to this Committee regarding some very real concerns over the implications and effects of the proposed Tax Reform Act of 1969.

I am certain it can be clearly demonstrated that proposed changes in personal tax treatment have already had a negative effect on investment decisions and on individual giving to religious, educational, cultural, and other charitable activities. If H.R. 13270 becomes the law, the effect would be even more pervasive. It is, however, Title I of the proposed act and those provisions dealing with private foundations to which I would address these remarks. H.R. 13270 as proposed will in my judgment have such a negative effect on tax exempt private foundations that their continued operation will be jeopardized. It would be unfortunate indeed if the efforts to eliminate abuses that have been cited by certain foundations resulted in the condemnation of all private foundations and in legislation which limited the preponderant majority of these entities in their support to vital and worthy activities benefiting essentially every community in the country.

BACKGROUND AND GENERAL STATEMENT

For years the statutes have encouraged the formation and tax exempt operation of foundations which have been set up for religious, charitable, scientific, literary, educational, and other tax exempt purposes. These have been a remarkable force for good in the country. They provide relatively small but vital resources for a remarkable diversity of activities. In general these activities have easily fit the established criteria for tax exemption. They function in areas where increasingly there are simply no other significant sources of support except individuals.

To say that no abuses have taken place in private foundation operations would be patently untrue. But to deny that the overwhelming majority of these activities have been immensely effective is to ignore the facts. Every major fund-raising activity I know of looks to tax-exempt private foundations as a significant source of support. This is one of the few resources which is readily available to local communities and responsive to them because generally they are under local control. The proposed act would discourage their formation in the future and severely constrain the continued operation of existing private foundations through regulation by the Secretary of the Treasury. If the regulation which is implied by the proposed act and the other conditions which it requires are imposed, we will severely limit one of the remaining expressions of independent and local initiative which has been such a vital part of our economic system.

MINIMUM INCOME REQUIREMENT

The Act requires in effect that any private foundation earn a 5% yield on its capital and subject to certain conditions distribute this on a current basis. The Kerr Foundation of Oklahoma is typical of many foundations in not receiving this kind of current return on invested capital. This Act would *require payments to be made each year from capital* or in the alternative the reinvestment of capital bonds or other forms of money type investments which would result over time in the erosion of capital through inflation. Certainly some standards could be established for yield on capital held by Foundations but these should not be structured in such a way that they require the liquidation of assets over time.

TAX ON INVESTMENT INCOME

The Act clearly established the principle of *taxing the income of tax-exempt organizations.* I have no quarrel with taxing an unrelated business operation. However, the country takes a significant step and, in my view, an undesirable one, when it in effect destroys the meaning of the tax exempt organization by taxing it even though the rate initially might be thought to be modest. Others have pointed out that this is not levied on the organization. The burden falls on the recipient of the foundation's grants or services by reducing directly the resources available for these purposes.

ACCUMULATION OF INCOME

Requirements on distribution of income place a severe limitation on private foundation operations, particularly in the case of operating foundations. Both with respect to developing new areas of activities and in insuring continuity of present operations, prudent administration requires that reserves be established and that from time to time funds be accumulated in a reasonable manner for implementing special programs. It is difficult or impossible to do this under the requirements set forth in the proposed legislation. Although this would drastically affect operating foundations, it by no means suggests that granting foundations are free from the same general problems.

SELF-DEALING

The area of self-dealing is one of proper concern to everyone. However, by setting arbitrary conditions in the Act, perfectly legitimate, straight forward and desirable activities would come under these prohibitions. Many services contracted by the Kerr Foundation in Eastern Oklahoma would fall under these strictures. Elimination of the situation would be relatively simple but would serve only to add to costs of the Foundation by requiring the addition of personnel and equipment which would not be fully utilized or by denying to the Foundation certain services which are not otherwise available. This situation would occur in many places where operating foundations are active in areas where trustees, officers, or employees either live or are active in business. Standards of disclosure and requirements for arms length relationships are perfectly feasible and could insure against abuse.

TAXATION AS AN ENFORCEMENT MECHANISM

Throughout this Act taxes are employed to insure compliance. Self-dealing is converted to dollar amounts and then taxed. Accumulated income is taxed. If investment income is not at a prescribed level, the shortfall, which is nonexistent income, is taxed! Essentially all the enforcing mechanisms of this Act are expressed as taxes *on a tax exempt organization.*

Under present laws the extreme penalty of denial of tax exempt status can be involved. If criteria and standards need to be established, this can be done. But I earnestly suggest that Title I is not the best means to achieve this.

PROPOSAL

Passage of the proposed act would jeopardize the future of private foundations Its impact would be felt in almost every community in his country. The alleged abuses by certain foundations can be eliminated much more effectively through other mechanics. And the effort to bring this about would, I'm sure, be supported by the private foundations of this country.

A special commission or task force should be established to develop the standards and review procedures for insuring the compliance of private foundations with the spirit of the law. Provisions for notice of exceptions and periods for corrections and probation can be set. And ultimate action involving loss of tax exempt status can be provided.

This can be done. It can be done with the active participation and support of the private foundations in both its formulation and implementation. It can be a very effective means of limiting abuses. There are precedents for such self policing activities in a number of areas. This approach would permit retaining to the maximum extent the substantial advantages which the large number of private foundations now provide while still effectively preventing the alleged abuses.

I urgently suggest action on Title I be delayed at this time. Substantial progress can be made in the next few months establishing a task force to deal with this problem and progress could be reported to the Congress early next year. A final decision could be reached during calendar year 1971 and incorporated in legislation at that time.

DUTCHESS COUNTY SOCIETY
FOR THE PREVENTION OF CRUELTY TO ANIMALS, INC.
Poughkeepsie, N.Y., October 17, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: At the meeting of the Board of Directors of the Dutchess County Society for the Prevention of Cruelty to Animals held at Poughkeepsie, New York on October 14, 1969, a resolution was duly made, seconded and carried empowering me, as president of the organization, to write you concerning the hearings now taking place with regard to H.R. 13270, Tax Reform Act, 1969 with particular reference to Section 509 thereof.

In the State of New York, societies for the prevention of cruelty to animals not only serve a humane function in the community, they also serve a quasi-municipal function, being empowered to treat problems, with regard to animals, that confront all communities, whether urban or rural, on behalf of the people of the State of New York. In the urban areas they perform on a contractual basis picking up, sheltering, placing up for adoption, when necessary, "putting down the animals", and disposing of their carcasses.

In rural areas, they can, and in many cases do, operate in conjunction with and in support of the Sheriff's Office to provide similar services to the community.

New York societies are formed under the Membership Corporations Law of the State and are made up largely of volunteers who donate their time and money to the aims above setforth.

The Corporation's funds are cared for by a Board of Directors, who are removed from individual direct control of them. These societies, in most cases, are of long duration. (Our particular society, for example, having been incorporated in the 1890's).

This thumbnail sketch of our organization (and others of its type in the State of New York), does not seem to be even a remote cousin of the "private foundation" which is attempted to be regulated by the proposed legislation now before your committee. They reek of no evil; they do not operate with tax avoidance or evasion as their purpose, principal or otherwise; they perform a humane function, and give aid to their respective communities.

Even though this is so, there is a strong possibility that our organization and other organizations akin to it, would fail the tests setforth in the act as now proposed, and become subject to income taxation.

The historical intention of H.R. 13270's predecessor was clear by the addition of an exemption of, "(5) a society for the prevention of cruelty to animals or children."

The omission of this language seems to be ill-conceived; not in accord with your overriding purpose; a possible burden upon a group of public service organizations. To require each organization of the type described to meet the test in the proposed statute is to require a diversion of their efforts, and quite possibly part of their funds from the purposes for which they are intended, donated and presently used.

Since humane societies of the type described are not the target of your proposed legislation; since they perform an important and necessary function in many governmental structures; since they are, in many cases, being supported by tax funds, directly or indirectly, and since clarity of the legislative intent, in the body of a statute itself, is a virtue all too often forgotten, our organization respectfully requests that you will amend the proposed bill, now before your committee, so that Section 509 contains a provision which clearly excludes societies for the prevention of cruelty to animals or children.

This move can in no way dampen your purpose but your failure to take it can cause great harm to the numerous organizations who are doing large amounts of good in areas often—all too often—ignored by others.

Respectfully,

GORDON W. PLASS,
President, Society for the Prevention of Cruelty to Animals.

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COMMUNICATIONS ON VARIOUS SUBJECTS RECEIVED FOR THE RECORD

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Low- and moderate-income housing proposals of Hon. John Sparkman, a U.S. Senator from the State of Alabama

OCTOBER 14, 1969.

Hon. RUSSELL LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR RUSSELL: I have introduced an amendment to the proposed Tax Reform Act of 1969 (H.R. 13270) which I believe can make an important contribution to our long range objectives to improve the quantity and quality of housing development by private industry for use and ultimate ownership by low and moderate income families.

The proposal would amend H.R. 13270 to provide that upon the sale of a publicly assisted low and moderate income housing project to or for the benefit of persons of low or moderate income the seller would realize gain for Federal income tax purposes only to the extent that the amount realized on such a sale exceeds the cost, without adjustment for depreciation or recapture of depreciation, as determined under Section 1012 of the Internal Revenue Code. A copy of my amendment is attached, together with an explanatory memorandum.

As explained more fully in the attached memorandum, it is a major objective of our National Housing Policy, as most recently articulated in the Housing and Urban Development Act of 1968, to encourage private development of housing for low and moderate income families by a combination of assistance by mortgage guarantees, below-market interest rate, subsidies and rent supplements. A particular object of the 1968 Housing Act was to encourage private ownership of housing by low and moderate income families by special government financing of the sale of rental housing to tenants and organizations of tenants in these income categories. These incentives were developed, as you know, on the foundation of the then tax law which also provided tax incentives to real estate developers in the form of depreciation allowances and interest deductions. It was our expectation that these subsidies in the context of the then existing tax structure would stimulate private industry to develop housing that low and moderate income families could afford.

We are concerned that many provisions of H.R. 13270, if approved by the Senate in the form that they passed the House, could seriously undermine the tax premise which we had hoped would enable us to accomplish our dual objectives of private development and ultimate private ownership of housing for low and moderate income families. I believe, however, that, without attempting to tailor specially the various provisions of H.R. 13270, it should be possible to protect these objectives by adoption of a provision along the lines of my amendment to provide tax relief where privately developed rental housing is sold to tenants and tenant rganizations with low and moderate incomes.

After you and your staff have had an opportunity to review the amendment, I would look forward to an opportunity to discuss it further with you and other members of the Committee.

Sincerely,

JOHN SPARKMAN.

EXPLANATION OF AMENDMENT TO TAX REFORM ACT TO PROMOTE PRIVATE DEVELOPMENT AND TENANT ORIENTED OWNERSHIP OF LOW AND MODERATE INCOME HOUSING

INTRODUCTION

The Tax Reform Act of 1969, H.R. 13270, proposes to modify substantially the present provisions of the Internal Revenue Code related to real estate. Although the bill recognizes a distinction between new housing and other real estate development, it threatens to jeopardize the government's effort to promote the private development of publicly assisted housing for low and moderate income families and the sale of such housing to tenants and tenant oriented organizations. That effort is built upon a combination of tax incentives and subsidies.

It is proposed that H.R. 13270 be amended to provide that upon the sale of a publicly assisted low or moderate income housing project to or for the benefit of persons of low and moderate income the seller would recognize gain for federal income tax purposes only to the extent that the amount realized on such sale exceeds the cost as determined under Section 1012 of the Internal Revenue Code. A draft of the proposed amendment is attached as Exhibit A.

This amendment would maintain or increase the continued interest of private enterprise in the development of publicly assisted low and moderate income housing without any significant loss of revenue and without disturbing the other goals sought to be achieved by the Tax Reform Act.

DISCUSSION

I. *National Housing Policy: To encourage private development of housing for low and moderate income occupants*

A major objective of national housing policy is to encourage private development of housing for low and moderate income families. To promote this policy Congress has established a number of federal assistance programs which are designed so that, when combined with existing tax incentives, they will stimulate private industry to develop housing that low and moderate income families can afford.

The Housing and Urban Development Act of 1968 extends national housing policy by enacting new provisions of law intended to facilitate home ownership on the part of low and moderate income families. For example, that statute added several provisions to the National Housing Act to permit the sale of publicly assisted, existing rental housing projects to tenants on a condominium basis, to tenant cooperatives, and to non-profit corporations and associations established exclusively for the purpose of developing and owning low and moderate income housing. Moreover, the Congress declared that to carry out the programs of the 1968 Act as well as other housing programs "there should be the fullest practicable utilization of the resources and capabilities of private enterprise."[1]

II. *Tax incentives basic to private participation in low and moderate housing: present incentives not adequate*

The President's Committee on Urban Housing has reviewed the combination of direct federal subsidy and tax incentives available to stimulate the participation of private enterprise in the development of low and moderate income housing and the extension of home ownership to the residents of such projects. Because federally assisted housing programs limit cash return, the Committee found that tax benefits, arising primarily from the use of accelerated depreciation, are a major incentive to private development and ownership of such housing. The Committee reported that the tax consequences of sale of such projects, particularly those providing for recapture of certain depreciation, seriously diminish the attractiveness of investment in this housing and impede efforts to facilitate purchase of projects by low and moderate income tenants or their organizations. Accordingly, the Committee suggested that various forms of tax relief, such as forgiveness of the tax on the gain on sale of such housing, be made available.[2]

Both the Congress and the Department of Housing and Urban Development have recognized the burden placed upon federally assisted low and moderate income housing by the tax imposed on sale. Although the Housing and Urban Development Act of 1968 (being a housing rather than a revenue measure) provided no tax relief. Section 236 of that Act authorized the Federal Housing Administration (FHA) to insure and subsidize a mortgage loan by a tenant cooperative or a tenant oriented non-profit organization in the amount of 100% of the purchase price determined by FHA not to exceed the fair market value of the property, thereby enabling the investor in selling to a tenant group to sell at a price that might enable the investor to recover its full equity investment after any taxes on the sale.

[1] Housing and Urban Development Act of 1968 § 2, 82 Stat. 476 (1968).

[2] See, *A Decent Home*, The Report of the President's Committee on Urban Housing, pp. 80–85 (1968).

In a letter dated January 18, 1969 to Edgar F. Kaiser, Chairman of the President's Committee on Urban Housing, the Department of Housing and Urban Development recognized that the inability of investors—because of taxes on sale—to recover their equity investment upon sale tended to discourage investments in low and moderate income housing. To move toward solving this problem, the Secretary of the Department of Housing and Urban Development advised that it would henceforth be the Department's policy, in accordance with the policy of Congress expressed in the 1968 Housing Act, to permit and to assist sale at a price that would enable: "the limited-dividend seller to realize a net amount out of the sales proceeds in many cases sufficient to recover its cash, land, and other investment and to retire the outstanding mortgage."

The solution contemplated by Section 236 and by the letter of the Secretary of HUD is now threatened, however, by the provisions of the Tax Reform Act of 1969 that would substantially increase the amount of gain "recaptured" at ordinary income rates upon sale of a project. The consequences of that change would be:

> (*a*) That even where a sale price permitting 100% after-tax recovery of the investor's capital is otherwise feasible (*i.e.*, within cost and fair value ceilings), the sale price needed to permit the investor to pay his taxes would impose an unnecessarily large burden on the tenant purchasers (who must service the debt incurred to pay such a price) and on available FHA mortgage guarantee funds; and
>
> (*b*) That, in many instances, it will not be possible to obtain a sales price recovering the original investment after taxes because such a price would result in an unduly long mortgage term if the tenant purchasers are to service the mortgage without an increase in monthly occupancy charges.

III. *Ways and Mean Committee suggests better incentive needed*

In its Report accompanying the Tax Reform Act of 1969, the Ways and Means Committee of the House of Representatives said:

> In the 1968 Housing Act, the Congress expressed its desire to stimulate construction in low- and middle-income housing to eliminate the shortage in this area. However, the present tax treatment of real estate does not efficiently stimulate investment in low- and middle-income housing.[3]

We believe that that statement implicitly recognizes the need for a new, specific incentive pointed directly at low and moderate income housing.

IV. *Proposed amendment would provide strong and direct incentive*

The proposed Amendment, which would implement a recommendation of the President's Committee on Urban Housing, would establish a new tax incentive which will be directly and meaningfully productive of low and moderate income housing.

Under the proposed Amendment, in the case of a "qualified" low and moderate income housing project, no tax would be paid on any gain from the sale of such project, unless the gain exceeded the cost of the project as determined under Section 1012 of the Internal Revenue Code. The amount of gain in excess of such cost would be taxed at capital gain rates.

The opportunity for profit upon the sale of federally assisted housing is restricted. Such sales must be approved by the FHA or other appropriate government agency. Present FHA regulations permit a maximum sale price, assuming value, sufficient after taxes to recover cash, land and other investment, and to retire the outstanding mortgage, provided that the project will continue to be used by low and moderate income families. Such limitations on sale price are intended to preserve a rent structure after sale within the means of low and moderate income families. To the extent that the present proposals of the Tax Reform Act of 1969 increase the tax on sale, they militate in favor of a higher sale price and work against the objectives of preserving such a rent structure and of promoting tenant or tenant oriented ownership.

The proposed Amendment is designed to function primarily in connection with the development of low and moderate income housing under the assisted programs of the federal government, such as the programs authorized under Section 23, Section 221(d)(3) Below Market Interest Rate, Section 236, and Section 202 of the National Housing Act. It would also be extended to such other federal, state, and local programs as the Secretary may by regulation from time to time determine.

[3] House Report 91–413 (Part 1) p. 166.

The federal housing programs use various subsidies to facilitate the construction or rehabilitation of low or moderate income housing. In the federal programs, admission to and sometimes continued occupancy in this subsidized housing is restricted to individuals and families whose incomes do not exceed those prescribed by statute and by the related regulatory provisions. Generally under these provisions, "low and moderate income" refers to individuals and families whose incomes range from $3,000 to $7,000 per year, depending on the location and the size of family. The standards of the following federal programs, under all of which "qualified housing projects" might be constructed or rehabilitated, serve to illustrate the income range of individuals and families considered to be eligible for low and moderate income housing.

Section 221(d)(3) below market interest rate (BMIR) program.—Under an administrative formula, the income necessary to support the rental of an average two-story, walk-up, two-bedroom unit, assuming that 20% of adjusted income is devoted to shelter, is determined. That is compared with the median income established by the Bureau of Labor Statistics for each locality, and the amount of the supporting income or the median income, whichever is higher, constitutes the maximum income eligible for occupancy in this program. The average income of a family of four residing in these projects during 1968 was approximately $6,000.

Public Housing Program—This program is open for initial and continued occupancy only to families of low income.

The statute defines such families as those who are in the lowest income group and who cannot afford to pay enough to cause private enterprise in their locality to build an adequate supply of decent, safe and sanitary units in substantial supply. The average income of a family of four residing in these projects during 1968 was approximately $3,000.

Section 236 Rental and Cooperative Housing Program.—To qualify for occupancy in this type of project, families must have incomes which are below an amount equal to 135% of the actual or permissible public housing income limits within the locality. The law provides an exception so that up to 20% of the periodic assistance payments can be used for families whose incomes are equal to 90% of the income limits for the Section 221(d)(3) BMIR program (see below). The average income of a family of four residing in these projects currently is approximately $4,500.

Section 221(d)(3) Rent Supplement Program.—Eligible families are those whose incomes upon occupancy do not exceed the maximum income for occupancy in low rent public housing in the area. The average income of a family of four residing in these projects during 1968 was approximately $3,000.

The proposed Amendment defines a "qualified housing project" as one which, in accordance with regulations prescribed by the Secretary of the Treasury or his delegate, has been constructed primarily to provide publicly assisted housing and related facilities for individuals or families of low and moderate income pursuant to the National Housing Act, as amended, or any other federal, state or local law of comparable purpose. That definition is intended to function primarily with the federally 'assisted programs established by the National Housing Act, such as those programs mentioned above, and comparable state and local programs. But the authority granted to the Secretary to promulgate regulations in this complicated and developing field will permit flexibility to keep abreast of changes and meet future needs.

An "approved disposition" under the proposed Amendment would be any sale or transfer of a qualified housing project which, in accordance with regulations prescribed by the Secretary of the Treasury or his delegate, is to or for the benefit of individuals or families of low and moderate income pursuant to the National Housing Act, as amended, or any other federal, state, or local law of comparable purpose. Such sales might be directly to low or moderate income occupants on a condominium basis, or to an organization such as a cooperative formed by low or moderated income occupants, or to a non-profit corporation or association created for the exclusive purpose of developing low and moderate income housing. Again, the regulations afford the Secretary flexibility to meet changing circumstances.

V. *Proposed amendment will not cause any major revenue loss*

Following a sale to the tenants or to a tenant oriented organization, there will be little or no loss of Treasury revenues on account of depreciation of the project or on account of interest on the purchaser's mortgage. If the sale is made to a non-profit organization, the organization will of course not take any income tax deductions. If a sale is made to tenants themselves, or to a tenant cooperative organization, no depreciation deductions will be allowable because the use of the property by the owner is for a residence. Interest deductions will be allowable, but tenants will be in sufficiently low income tax brackets so that even if they do not elect the standard deduction, the loss of revenue will be slight.

In the event that the proposed Amendment were adopted, it would be necessary to adopt a technical amendment to Section 1250 of the Internal Revenue Code providing that the "recapture" provisions shall not be applicable to a sale under Section 1131. It might also be necessary to make certain conforming technical amendments to the partnership sections of the Code.

CONCLUSION

Adoption of the proposed Amendment as a part of the Tax Reform Act of 1969 would stimulate the production of housing for low and moderate income families by strengthening the incentive for private development of such housing and would facilitate ownership by low and moderate income families without any significant adverse effect on revenues.[4]

[H.R. 13270, 91st Cong., first sess.]

[Amdt. No. 245]

AMENDMENT

Intended to be proposed by Mr. SPARKMAN to H.R. 13270, an Act to reform the income tax laws, viz: Page 310, after line 13, insert the following:

SEC. 522. TREATMENT OF GAIN ON CERTAIN DISPOSITIONS OF HOUSING PROJECTS.

(a) RECOGNITION OF GAIN.—Subchapter O of chapter 1 (relating to gain or loss on disposition of property) is amended by adding at the end thereof the following new part:

"PART X—DISPOSITIONS OF QUALIFIED HOUSING PROJECTS

"Sec. 1131. Approved dispositions of qualified housing projects.

"SEC. 1131. APPROVED DISPOSITIONS OF QUALIFIED HOUSING PROJECTS.

"(a) GENERAL RULE.—In the case of an approved disposition (as defined in subsection (c)) of a qualified housing project (as defined in subsection (b))—

"(1) any gain or loss recognized on such disposition shall be treated as gain or loss on the sale or exchange of property described in section 1231(b), and

"(2) gain shall be recognized only to the extent that the amount realized on such disposition exceeds the cost as determined under section 1012.

"(b) QUALIFIED HOUSING PROJECT.—For purposes of this section, the term 'qualified housing project' means buildings and other structures determined, in accordance with regulations prescribed by the Secretary or his delegate, to have been constructed or rehabilitated pursuant to the National Housing Act, as amended, or any other Federal, State, or local law of comparable purpose, primarily to provide publicly assisted housing and related facilities for individuals or families of low and moderate income, and the land underlying or appurtenant to such buildings and other structures.

"(c) APPROVED DISPOSITION.—For purposes of this section, the term 'approved disposition' means any sale or other disposition of a qualified housing project,

[4] The Ways and Means Committee of the House of Representatives (Report No. 91-413 (Part 1), p. 167) estimates that the present proposals of Section 521 of the Tax Reform Act to recapture depreciation will, when fully effective, produce a net increase in revenue of $125 million annually. Hence, it reasonably can be assumed that the revenue effect of the amendment proposed herein will be to give up only a small fraction of that net increase. We submit that the benefit to low and moderate income housing more than justifies that concession.

in accordance with regulations prescribed by the Secretary or his delegate, to or for the benefit of individuals or families of low or moderate income pursuant to the National Housing Act, as amended, or any other provision of Federal, State, or local law of comparable purpose."

(b) CONFORMING AMENDMENT.—The table of parts for subchapter O of chapter 1 is amended by adding at the end thereof the following new item:

"Part X. Dispositions of qualified housing projects."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales and other dispositions after the date of the enactment of this Act.

HOME OWNERSHIP AND THE INCOME TAX: A PROPOSED CHANGE* **

(By Richard W. Lindholm, Dean, Graduate School of Management and Business, University of Oregon)

This discussion of financing home ownership considers a portion of a major problem arising from not allowing those deductions in calculating taxable *personal* income that are allowable as expenses in calculating *business* income. It also demonstrates the stimulating effect that deductions have when the tax rate is high and advances a proposal to extend the allowable deductions for families.

The essence of the argument is that from the standpoint of allowable deductions arising from property ownership the individual taxpayer-homeowner is at an income tax disadvantage in comparison with a corporate landlord. Further, some of the deductions now allowable to a corporation could be extended to families and thereby provide an economic stimulus to home building and home buying. Briefly stated, the situation stems from the set of circumstances described below.

STATEMENT OF PROBLEM

The individual who borrows to build or buy a house is committed to make certain monthly payments: interest, insurance, and amounts applied to the indebtedness. If the home is owner occupied, only the interest portion of these payments is deductible as an expense from adjusted gross income in arriving at taxable income. Condominiums are treated in the same fashion.

If the home is in an apartment house owned by a corporation, none of the monthly payment is deductible in calculating the rent-payer's taxable income. The landlord corporation, on the other hand, can deduct from its taxable income the interest paid on the indebtedness, insurance and maintenance costs, and the portion of the payment on the indebtedness considered to be depreciation—which can be as much as 4 percent of the cost of the structure. If 4 percent is permitted, it amounts to a deduction from taxable income approximately equal to the debt reduction portion of the payments on a 25-year mortgage on a family home.

The benefit to a taxpayer of having an expenditure deductible from taxable income is not entirely measurable by whether or not it is deductible. The benefit varies depending on the tax rate applicable to the highest or last portion of taxable income of the taxpayer.

If an owner of a mortgaged home has a large family and a relatively low income, he may not have taxable income. To this family the deductibility of interest, insurance, or the debt retirement portion of the monthly payment is of no concern. Because the family is not an income-tax-paying family, it does not benefit even from the existing income tax treatment of monthly mortgage payments by homeowners. Most homeowners, however, are also income tax payers and would benefit from increased allowable deductions.

THE MONEY MARKET

A family wishing to borrow funds to build or purchase a home must compete in the money market with businesses, governments, and short-term consumer-borrowers. Therefore, it is important in the context of this analysis to consider the position of the acquirer of a family home relative to that of other fund seekers.

The money borrowed by the lowest income receiver who is considered an acceptable credit risk as well as the borrowings of the federal government and

*In all cases tax rates used are the marginal rates.

**To appear in the September, 1969, issue of the *Oregon Business Review*.

of the richest corporation come out of the same national pool of lendable savings. These funds are claimed by the various borrowers of the nation through the terms, including rate of interest, offered by the controllers of the lendable funds. This activity is centered in the money markets of the world. Because funds flow back and forth very easily between the various geographical areas of the United States, this country has a truly national money market which can be tapped nearly as readily in Portland, Oregon as in New York City.

It is also true that an international money market exists and that domestic United States lendable funds may be claimed for foreign use through the attractiveness of the proffered borrowing instrument, including, again, the rate of interest offered. In the case of foreign borrowing, the tax treatment of interest paid and interest received as income is of increased importance because of the considerable variation in national tax systems and because of the varying provisions for taxation of interest under the international tax treaties between the nations of the world.

CORPORATE BORROWING

When a corporation enters the money market to borrow funds, maybe through the sale of bonds, the interest rate it can afford to pay is determined by earnings expected from the new investment throughout its life. The cost of funds is the interest paid, plus some adjustment related to whether they are sold at, below, or above par, plus the cost of making the offering through the investment institution handling it. Currently a profitable corporation enters the money market with profits taxed at 52.8 percent, assuming annual profits are greater than $25,000. The first impact of the borrowing action is to increase deductions from taxable profits equal to all expenses and interest and later equal to depreciation deductions allowed.

The reduction of taxable profits by $100 results in a reduction of corporate income tax payments by $52.80 and a reduction of profits available for dividends or reinvestment in the business of $47.20. If the $100 of additional expense arose entirely from the payment of a 10 percent interest charge on a $1,000 bond, the federal government through reduced tax collections would be bearing $52.80 of the $100 interest cost, and the corporation would be bearing $47.20 of the interest cost. In the same manner, the corporation would be able to deduct all other costs of raising these funds, and, in addition, the allowable depreciation would also be deductible from taxable income.

Twelve-cent and 47-cent dollars

The impact of the income tax, both personal and corporate, when related to tax-deductible expenditures, has been considered important by business analysts for many years. During World War II and later during the Korean conflict when the 88 percent rate of the excess profits tax applied to some profits, it was said that businesses subject to these taxes had 12-cent dollars to spend, if the expenditure under Internal Revenue Service regulations was considered a deductible expense. It is also true now that profitable corporations spend 47-cent dollars. The federal government is a partner of the business firm and shares expenditures and the profits. As the new investment financed with the borrowing starts to become a source of profits, the federal government takes 52.8 cents of each dollar of profits and the business firm has for its use 47.2 cents.

Depreciation charges are deducted in arriving at profits, and therefore the business firm will regain the full amount of the investment, i.e., borrowing. The federal government partnership does not extend to its benefit from the firm's depreciation accumulations. So to this extent the business firm has a preferred position as a partner. On the other hand, losses in excess of amounts that can be deducted from three years of previous losses or from five years of future profits are borne entirely by the business firm. To this extent the government has a preferred position as a partner.

GOVERNMENT BORROWING

Both at the federal and at state and local levels, governments possess important borrowing advantages, in that they have the power to tax and a police power to back up this economic privilege. All other economic groups must find willing buyers of services or goods in order to acquire income to pay interest charges and retire debt.

Not only are governments able to utilize a forced exaction system not available to other economic groups, but also state and local government offer purchasers of their securities exemption from the federal income tax on interest received by the security owners. The federal government, through its power to "create" money, can make interest payments and retire debt directly through an increase of the money supply. These extensive rights and powers make governments very stiff competitors in the money market. In most instances they can offer greater certainty of repayment and prompt interest payments than even the most powerful corporation and certainly more than a family acquiring a home. Many families and corporations have acquired debt repayment power through federal mortgage insurance. This is very helpful, but does not overcome completely the disadvantages of competitive position to which they are subject vis-a-vis other borrowers.

FAMILY HOMEOWNER BORROWING

The highest income tax bracket applicable to the income of the typical $15,000 to $20,000 home purchaser is 17 to 20 percent plus the 10 percent surcharge. Because interest payments on the mortgage are deductible in arriving at taxable income, each dollar of interest paid is shared between the homeowner and the government. This makes the interest dollars paid by many homeowners 80-cent dollars. The dollars spent for insurance and mortgage reduction spending remain 100-cent dollars.

The howeowner thus competes in the money market with high-priced 80-cent and 100-cent dollars as against the cheap 47.2-cent dollars of the typical business corporation. To the typical family attempting to finance a new home, the offer of funds at an interest rate of 10 percent means a real interest cost of 8 percent, but to the typical business corporation the same nominal 10 percent means a real interest rate cost of 4.72 percent.

The substantial difference in the real interest rate cost of funds places the private homeowners at a serious disadvantage in his efforts to compete in the money market. Of course, the howeowner's position is directly somewhat better than that of the apartment or home renter, who cannot deduct any portion of the rent payment from taxable income. Indirectly, however, the homeowner's position is somewhat worse because the owner of rented structures is able to deduct all costs, including depreciation, in calculating taxable income. These deductions from taxable income by the owner of rented property should appear in lower rent payments required from tenants.

Taxation of imputed rent received

Sometimes the relative position of home renters and owners is expressed in term of utilities enjoyed or imputed rent rather than money outlays. The homeowner does not include, as a portion of taxable income, the income in kind enjoyed in ocupying the portion of the value of the home represented by the home's value in excess of the mortgage balance. Of course, if the homeowner had invested this equity in dollar-paying assets other than municipals, the income would be included as a poration of taxable income. So really the comparative economic position of the renter as compared with that of the owner varies depending on the value of the equity an owner holds in his homestead. If the equity is large, the homeowner's position gains relative to that of the renter. However, the investment risk inherent in concentrating savings in property ownership may outweigh the tax advantage of this sort of an investment program.

SUMMARY OF COMPETITION IN THE MONEY MARKET

The terms that bidders for funds for various uses are able to offer, including requests for financing individual home construction, are affected by tax treatment afforded interest payments from both the interest payer and payee sides. State and local governments are facilitated in attracting funds from the money market by being able to offer federal income tax exemption to the interest received by the lenders. The corporation is facilitated in the size of the bid it can make because the federal government covers 52.8 percent of the interest cost, as well as 52.8 percent of all costs related to the borrowing operations and, in addition, contributes 52.8 cents to each dollar that is set aside as depreciation of the facility financed with the loan. The average buyer of a family home benefits from government participation only by about 20 percent of his interest payments, with the federal government bearing none of the cost of negotiating the loan nor allowing annual deprication to be deducted from taxable income as it is from business taxable income.

The failure of the federal government to treat family homeowners as it does corporations and business generally is mitigated somewhat by a special capital gains privilege applicable to gains from the sale of a homestead. The gain from the sale of an old residence is not taxable to the extent that the amount received is invested in a new residence, and the gain is exempt up to the first $20,000 of sales price if the seller is 65 years of age or older and if the house has been the seller's principal residence for at least five of the last eight years. These considerations help to mitigate the problem but do not go to the core of the difficulty under consideration here.

A PROPOSED CHANGE

The ordinary family home buyer under current conditions does not compete on equal terms with corporate or government borrowers in his efforts to attract funds from the money market, but his competitive position can be equalized by a tax change just as his unequal position has been largely determined by federal government tax legislation. A simple method to equalize somewhat the ability of the family homeowner to attract funds from the money market would be to permit him to multiply by two his deductible interest payments for housing finance. If this change were made, the maximum effect of doubling should be limited to the tax deductibility enjoyed by corporations with annual taxable profits over $25,000. The initiation of this change would permit the taxpayer subject to a maximum rate of 17 percent to benefit from an interest deductibility equivalent to that which he would enjoy if the maximum tax rate applicable to his taxable income were 35 percent. The full doubling of interest rate payments on housing indebtedness would stop at the 22 percent rate, which is applicable to taxable income between $8,000 and $12,000. Even with such limitations, the housing industry would benefit from an increased money market competitiveness on the part of family borrowers interested in purchasing housing: the effects would extend to taxable incomes as high as $40,000 under the 1966 corporate and individual income tax rates.

As discussed above, the family homeowner is also disadvantaged because he cannot deduct depreciation year by year from taxable income, nor are the expenses of arranging borrowing deductible. These shortcomings are partially remedied through the special capital gains feature available to homeowners who sell their homes. In order to increase tax equality, borrowing expenses should be made deductible in calculating taxable income of individuals. Also, the homeowner should be permitted to deduct depreciation year by year from taxable income. At a 4 percent rate of depreciation, this would reduce taxable income of the owner of a $28,000 home by $1,120 a year and result in an annual tax saving of $224 at the 20 percent tax bracket.

When the house is sold, gain on the sale would, of course, be taxed at the lower rates applicable to capital gains. Also, if a loss is realized from the sale, it can be deducted from ordinary income up to $1,000 a year, with the loss unused in one year available for carryover into following years. In many cases the home is not sold and remains as a major portion of the estate and will be subject only to federal estate and state inheritance taxes. The federal estate tax allows a $60,000 exemption, and the rate after deduction of expenses is only 3 percent on the first $5,000 of taxable estate.

The gain to family homeowners in competitiveness in the money market, if they are treated about the same as businesses, would vary considerably depending on income level, length of time the home was owned, and the condition of the market for old homes. The overall effect of making the tax changes indicated would be progress toward increasing income tax equity while improving the homeowner's ability to compete for loanable funds, and should provide a stimulus to home building.

Amortization of pollution control facilities

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVE,
Washington, D.C. August 18, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: In connection with the Tax Reform Act currently pending before your Committee, I would like to call your attention to the need for a "human depletion allowance" for those who are willing to improve the quality of our environment.

I urge the Committee to give consideration to legislation to encourage motorists willing to incur the added expense and current inconvenience of non-internal combustion engine vehicles (ICE) and to induce the automobile industry to make low-pollution engines in large quantities by providing for a write-off or other form of tax relief for the additional cost of purchasing a non-ICE car or of converting production facilities to the construction of such cars.

I would urge as well, until an alternative to the ICE can be mass marketed, that the tax reform bill contain a write-off to cover the cost of conversion to nonleaded gas on the part of the consumer and oil company.

The House-passed version of H.R. 13270 contains an incentive for private industry to install pollution control equipment. This would come through the amortization of pollution control facilities authorized by Section 704 of the bill. While I support the intent of Section 704, I believe it totally ignores the fact that in urban areas over 90 percent of air pollution is caused by automobiles.

This fact was first brought out by the City of Los Angeles more than ten years ago when, after imposing and enforcing stringent industrial pollution emission standards, it found the level of air pollution little changed. The State of California found that the only way to make any significant impact on the level of air pollution was to regulate automotive emission. The first attempt to achieve this objective came through requiring pollution emission control devices on all automobiles. Almost all vehicles on the road today are, however, powered by the internal combustion engine. The experience with pollution emission control devices has demonstrated that such devices are unreliable as a long range solution to the air pollution program. This is because they can only partially reduce the level of pollution emitted by the internal combustion engine. According to projections developed by the Air Pollution Control Administration based on their 1970 standards, within ten years the mere increase in the number of vehicles on the road will begin to more than offset the decline in pollution achieved through these devices. In arriving at this conclusion, NAPCA ignored the failure of these devices to remain operative for the entire life of the vehicles.

The inevitable solution in the air pollution problem lies in the development of an alternative to the internal combustion engine. As the staff report prepared by the Senate Committee on Commerce, entitled "The Search for a Low Emission Vehicle," concluded, there are non-ICE engines, like the Rankine Cycle Propulsion System, available today which are "satisfactory alternative to the present internal combustion engine in terms of performance and far superior engines in terms of emissions."

The major problem pointed out in that report is the cost of conversion. Since steam engines are not readily available through mass production, purchase of such vehicles by individuals is expensive, and conversion by the automobile companies to alternative engines is high. This cost factor discourages individuals from purchasing steam engines and other powered vehicles and automobile companies from moving to mass produce such vehicles. Thus of the big four automobile companies, only American Motors is seriously working toward the mass production of alternative means of power to the internal combusion engine. The other three just don't see a market in it.

The level of pollution can be significantly reduced as well, although not as much as would be achieved by the elimination of the ICE, by substituting other additives for lead in gasoline or by using natural gas in place of refined gasoline in current internal combustion engine vehicles. But here too, while there is little if any problem with technological competence (American Oil Company makes a nonleaded gas and trucking firms have used Liquid Petroleum Gas for years), there is a cost factor with respect to conversion for both consumer and oil company.

It is ironic that a motorist concerned about the problem of air pollution has to pay more to buy a low-pollution car or to convert his car to steam or natural gas than the unconcerned person does. Through the application of the pollution abatement provision of the tax reform bill, we can begin to overcome this problem.

With kind regards, I am,

Sincerely yours,

LEONARD FARBSTEIN, *Member of Congress.*

STATEMENT OF HON. LEONARD FARBSTEIN, A U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman, it is a great pleasure to appear today before the distinguished membership of this Committee to recommend the establishment of a "human depletion allowance" for those who are willing to improve the quality of our environment.

I urge the Committee to give consideration to legislation to encourage the consumer willing to incur the added expense and current inconvenience of purchasing low pollution fuels or utilizing cars with low emission engines. Specifically, I recommend the enactment of a tax credit to stimulate use of low pollution fuels in place of refined gasoline. The credit would compensate motorists for the added cost of such fuels. In addition, I believe the Committee should undertake a study to determine how tax incentives might be used to stimulate the purchase of low pollution autos powered by non-internal combustion engines. Such vehicles are just now in the process of being developed and if a market can be developed, can be mass-produced in the next few years. The major obstacle to the development of market is the initial higher cost of such vehicles compared with conventional cars. A tax incentive to compensate for the added cost would serve to overcome this obstacle.

The House-passed version of the Tax Reform Bill, H.R. 13270, contains an incentive for private industry to install pollution control equipment. This would come through the amortization of pollution control facilities authorized by Section 704 of the bill. While I support the intent of Section 701, I believe it totally ignores the fact that over 50 percent of the air pollution in this country is caused by the automobile and up to 90 percent in urban areas.

This fact was first brought out by the City of Los Angeles more than a dozen years ago, when after imposing and enforcing stringent industrial pollution emission standards, it found the level of air pollution little changed.

I stand before this Committee today because I represent the city which the Public Health Service has ranked as the most polluted in the country. I represent a city which has sffered from inversions in the air, periods when the winds failed to blow away the carbon monoxide, the lead particles, the hydrocarbons, and the other deadly pollutants which were produced by the automobile with the result that many died.

Air pollution from automobiles aggravates or is the cause of pulmonary emphysema, chronic bronchitis, lung cancer, genetic mutation, degeneration of pulmonary functions, allergenic conditions, heart and respiratory diseases, other respiratory and circulatory diseases, and the common cold.

I come from a city where two million autos daily crowd, sprouting forth dirt and heavy smoke which corrodes every material with which it comes into touch.

I offer this recommendation because I want to do something about this situation.

Until now, most of the effort to combat auto-caused pollution has come through utilization of emission control devices attached to the crankcase or tailpipe. The use of such devices has brought a noticeable reduction in emissioin levels of certain auto pollutants. However, these devices can only partially reduce the level of pollution emission. As the National Air Pollution Control Administration projection of the level of auto pollution suggests, the increasing number of cars will begin to offset the decrease in pollution brought about by exhaust emissions control devices after 1980.

(See Table 1.)

TABLE 1.—POLLUTION LEVEL FROM AUTOMOBILES BASED ON 1970-71 PUBLIC HEALTH SERVICE STANDARDS

[In millions of tons per year]

	1968	1972	1975	1980	1990
Hydrocarbons:					
Urban	7.0	6.0	5.0	4.5	7.0
Total emissions, nationwide	12.0	10.0	8.5	7.0	10.0
Carbon monoxide:					
Urban	47.5	40.0	32.5	27.5	43.0
Total emissions, nationwide	68.0	55.0	45.0	37.5	58.0
Oxides of nitrogen:[1]					
Urban	3.0	4.0	4.5	6.0	10.5
Total emissions, nationwide	6.5	8.5	9.5	12.0	19.5

[1] There are no current Public Health Service emissions standards.

The primary source of pollution is the internal combustion engine. Since it cannot uniformily burn all of the gasoline it consumes, it inherently must produce a certain level of pollutant emission. Control devices can modify its output, but only to a limited degree. Use of alternative sources of fuel to refined gasoline can significantly reduce the level of emission and other types of propulsion systems are capable of being emission free. Available alternatives to current gasolines and engines can make the auto operate with little or no release of deadly pollutants into the atmosphere.

The obstacle to either is the initial extra cost that will result to the user, and the absence of a market large enough to permit use of economies of scale to bring the cost down. Authorizing a tax write-off for the extra cost of these alternatives would stimulate consumer interest and permit further development and refinement of these means of achieving a significant lower level of pollution emission from automobiles.

The resultant saving to the society in diminished material erosion and cleaning cost which would result from the lower level of pollution not to mention the health affect, would offset much of the loss in taxes.

Two substitutes for refined gasoline which can be used in current engines and bring about a significant lessing of emission levels are Liquid Petroleum Gas (LPG) and compressed natural gas. LPG, which has been used by the Florida Telephone Company in its trucks for more than ten years, was recently tested by the Air Pollution Control Administration on trucks in Detroit, and its low emission characteristics documented in the following test findings comparing LPG and refined gasoline.

(See Table 2.)

TABLE 2.—*Comparative truck emissions for gasoline and propane—Air Pollution Control Administration*

[In grams per mile]

Carbon monoxide:	
Gasoline	17.00
LPG (propane)	10.00
Hydrocarbons:	
Gasoline	28.80
LPG (propane)	8.00
Oxides of nitrogen:	
Gasoline	8.00
LPG (propane)	4.00
Lead:	
Gasoline	3.17
LPG (propane)	0

Methane in the compressed form is to be tested by the General Services Administration in an experiment involving its trucks in Los Angeles. As previous tests with a 1968 Ford Ranchero demonstrated, methane produced an even lower level of pollution emission than propane.

(See Table 3.)

TABLE 3.—*Comparative pollutant emission for gasoline and methane*

[In grams per mile]

Carbon monoxide:	
Gasoline	28.20
Methane	2.11
Hydrocarbons:	
Gasoline	2.56
Methane	1.41
Oxides of nitrogen:	
Gasoline	3.82
Methane	.51
Lead:	
Gasoline	3.17
Methane	0

GULF STATES PAPER CORP.
Tuscaloosa, Ala., September 3, 1969.

HON. JAMES B. ALLEN,
U.S. Senate,
Wasington, D.C.

DEAR SENATOR ALLEN: The Tax Reform Act of 1969 (H.R. 13270), which is now before the Senate Finance Committee, provides in section 704 for amortization of "pollution control facilities" over a sixty month period. We concur with the objective of section 704, which has been previously approved by the Committee on Finance, of providing an incentive to private industry for antipollution efforts and urge your support for this section. However, we are concerned that the definition of "pollution control facilities" as now contained in the act is not sufficiently broad as to include certain land improvements necessary to river and stream pollution control program; therefore, we ask that you propose or support a revision of the section to expand the definition of a "pollution control facility" as contained in the proposed act. We trust that the following comments will explain our position.

As presently proposed, the act allows a sixty month amortization of any "certified pollution control facility." The term "certified pollution control facility" is defined to mean a "new identifiable treatment facility" which is used to abate or control water or atmospheric pollution of contamination and which has met certain federal and state certification requirements. "New identifiable treatment facility" is defined to include "only tangible property (not including a building and its structural components, other than a building which is exclusively a treatment facility) which is of a character subject to the allowance for depreciation provided in section 167, which is identifiable as a treatment facility."

Under the present wording of section 704 there would be a question whether the costs of construction of effluent storage ponds would meet the definition of new identifiable treatment facilities. While these ponds are essential to proper prevention of pollution, they are also costly; it is doubtful whether industry could afford to bear the cost without the temporary financing assistance involved in the amortization provisions. Since the definition could be narrowly construed by the Internal Revenue Service, we suggest that it be broadened to include land which has been graded, excavated, or otherwise altered to make it a suitable component of a treatment facility.

This could be accomplished by expanding Internal Revenue Code section 168 (d)(4) as proposed by section 704 of the bill to read as follows:

"(4) NEW IDENTIFIABLE TREATMENT FACILITY.—For purposes of paragraph (1), the term "new identifiable treatment facility" includes all property, except a building or its structural components which is not used exclusively as a treatment facility, and costs of grading, excavating, or otherwise altering land which is identifiable as part of or in connection with a treatment facility, and which is property—* * *"

Even aside from the level of pollution emission, methane offers other benefits over leaded gasoline. It is cheaper to operate, does not clog spark plugs, dilute or contaminate the oil or corrode the exhaust pipes. Furthermore, it rates as safe as, if not safer than, gasoline by the insurance industry.

The major drawback of either of these fuels is that one cannot just pull up to the local gas station and fill up. There is an inconvenience and an initial capital cost necessary to adapt a vehicle to the fuel. In the case of compressed natural gas, "conversion kits" are available to adapt engines for both natural and regular gasoline. With the added expense of hooking into the home natural gas line to gain access to the fuel, the initial cost of converting to natural gas is approximately $550, or $400 for the engine and $150 for the gas line adaption. If a market can be created for this, the cost will obviously drop.

A similar picture emerges when one looks at alternative propulsion systems to the internal combustion engine. The General Steam Corporation of Newport Beach, California, has developed a closed steam engine propulsion system for less than $1 million for testing by the State of California in its highway patrol cars.

Lear Motor Company of Reno, Nevada, is also working on a steam engine which it expects to have in operation by next Spring. The President of Lear Motor Company, William Lear, who is the inventor of the Lear executive jet and numerous other inventions, hopes to work in conjunction with American Motors to produce a steam car in the next few years.

Other developers have come up with steam, turbine and electric motors.

I am informed that these existing steam engines could be mass produced for use in normal cars at a relatively low cost; although the cost would initially be greater than that of current engines. The material cost is low and most of the mechanisms for control of pressure and temperature are readily available. The major obstacle to mass projection is again consumer demand which is related to price.

A recent staff report of the Senate Commerce Committee reported that demand does not currently exist—that consumers are generally not looking for low-emission fuels or vehicles when they go to purchase a gasoline or automobile.

Although he is opposed to air pollution in general, he does not normally shop with an eye on pollution emissions himself. This is because of the extra cost of such systems. It goes on to say that because there is little consumer demand, the auto and oil industries have not moved at a dramatically fast pace to adopt cleaner fuels or engine systems.

It is ironic that a motorist concerned about the problem of air pollution has to pay more to buy a low-pollution car or to convert his car to steam or natural gas than the unconcerned person does. Through the application of the pollution abatement provision of this tax relief bill to the automobile consumer, we can begin to overcome this problem.

The amplification of the definition in the bill does not appear to conflict in any way with the published objectives of the House Ways and Means Committee. The Report of the Committee on Ways and Means to accompany H.R. 13270 contains the following comment:

"In view of the possible undesired effect on pollution control of repealing the investment credit and the increasing magnitude of the air and water pollution problem facing the Nation today, your committee believes it is appropriate to provide an incentive to private industry for antipollution efforts. However, it believes it is more appropriate to permit the rapid recovery of the costs involved, rather than to permit a return in excess of total costs. Accordingly, your committee's bill provides that the cost of new pollution control facilities (which are appropriately certified by the relevant State and Federal authorities) may be amortized over a 5-year period. Since quite often these facilities have a useful life of 10 to 20 years or more, the usual depreciation deduction each year is relatively small. The larger deduction provided by allowing the recovery of the taxpayer's cost over the shorter 5-year period will provide a greater incentive for the installation of effective pollution control equipment."

Our concern for the additional definition of property constituting a new identifiable treatment facility for purposes of the proposed act, can best be illustrated by providing you with a background of the proposed pollution control activities of Gulf States Paper Corporation which we feel are representative of those of other companies in the South as well as the rest of the Nation.

Gulf States Paper Corporation was the first large paper mill in the State of Alabama and it is the only major paper manufacturer maintaining its home office in the state. The Tuscaloosa plant includes one of the largest bag and sack manufacturing facilities in the world producing daily more than forty million bags and sacks in 250 different types and sizes. It has been located on the Black Warrior River since 1927 and has drawn its water supply from that river as well as returning effluent to it.

The first effluent control features, though crude by present standards, were installed in 1936. As better equipment became available, Gulf States Paper Corporation has replaced the old with the modern. The effects of the company's continuing policy to modernize its plant and reduce its pollution load to the river can be shown by the fact that, while production has increased by nearly 300% between 1934 and 1968, the gallons of effluent discharged in the river per day has increased by less than 24% and the gallons of effluent per ton of paper produced has actually decreased by 63%. However, in order to further reduce the volume of effluent flowing into the Black Warrior River and to comply with the standards set by the Alabama Water Improvement Commission, Gulf States plans to install the most effective treatment system made available by modern technology. This treatment facility will include a solids removal clarifier, a trickling tower, a secondary clarifier, and a *storage pond* of sufficient size to provide holding capacity for seventy-two hours of effluent. Diagrams illustrating the treatment facility are attached to this letter for your assistance in reviewing this matter.

The storage pond we propose to construct is necessary to allow an optimum matching of the discharge of treated effluent from the plant with the flow of the accepting river. It will have a maximum depth of fifty-five feet and will cost in the neighborhood of $1 million. As is true with the other planned pollution control facilities, the pond will not result in any increase in plant efficiency or profitability. If it were determined that the pond could not be amortized over the five-year period provided in the proposed act, it would seriously handicap financing efforts and might require the deferment of the pollution control project with the consequential cessation of our activities in Tuscaloosa. Since, in Tuscaloosa alone, the company employs over 1800 people and requires employment of an additional 1500 people in the area to maintain wood supplies, such a shutdown could have a severe economic effect on the area as well as the company. Accordingly, our concern for the proposed broader definition can be seen.

While we have illustrated the problem on a local basis, it will exist in connection with every type of plant facility having similar type effluent discharges and the same proximity to rivers and streams. Therefore, as you can see, our recommendation would have a broad national scope. Accordingly, we urge your cooperation in recommending these changes to the Senate Finance Committee.

We thank you for your consideration in this matter. If you feel that the testimony of company officials or our representatives at the Senate hearings would be of assistance, we would be honored to appear or to have our representatives to appear.

Yours very truly,

JACK W. WARNER.

STROOCK & STROOCK & LAVAN,
Washington, D.C., September 10, 1969.

Re Fast Amortization of Pollution Control Facilities—§ 704 of H.R. 13270 (*proposed new § 168, International Revenue Code*).

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: This letter supplements two letters dated July 15, 1969, and July 16, 1969 which were addressed to you by this firm on behalf of Fuel Desulphurization, Inc. of New York City. Those letters, which now appear at pages 468 and 470 of the printed hearings on H.R. 12290, were concerned with the rapid amortization provisions formerly contained in § 5 of H.R. 12290 as passed by the House of Representatives.

Substantially the same provisions are now incorporated in § 704 of the tax reform bill of H.R. 13270 (proposed new § 168, I.R.C.) as passed by the House of Representatives. Therefore, we had asked to present testimony concerning those provisions. However, in view of the announcement that the Committee on Finance would not receive new testimony concerning provisions in H R. 13270 which are similar to those previously in H.R. 12290, by this letter we would like to supplement the written views contained in our July 15 and 16 letters.

The minor amendments to proposed § 168 of the Internal Revenue Code which were adopted by the House of Representatives in the ecourse of passing H.R. 13270 have not materially changed that provision as it formerly appeared in H.R. 12290, nor have they obviated the concerns expressed in our earlier letters.

It remains true that, because of the exclusion of profit-making pollution abatement works found in clause (e)(2)(A) of proposed § 168 (lines 13 to 18 on page 344 of H.R. 13270), the bill would not allow the rapid amortization of single-purpose desulphurization facilities such as Fuel Desulphurization, Inc., has undertaken to construct in the New York City area at a cost estimated in excess of $80 million.

It also remains true that the particular wording of that exclusion could allow certain refiners of petroleum products to obtain the benefits of rapid amortization for their own desulphurization facilities within a new refinery complex, because no single element in such a complex is "profitmaking" by itself. Insofar as those amortization privileges would be available to refiners who are also proposing to desulphurize Western Hemisphere residual fuel oil in competition with Fuel Desulphurization, Inc. in order to supply the requirements of East Coast purchasers of such heavy fuel oil, proposed Code § 168 would give an unfair advantage to some desulphurizers as opposed to others. Insofar as those rapid amortization privileges would also be available to refiners of gasoline and other light products which must in any event be desulphurized before they can be used, the § 168 would provide a tax advantage which is truly a windfall because it is both unnecessary and unrelated to pollution control with respect to home heating fuels (No. 2 fuel oil) and industrial grade oils (Nos. 4, 5, and 6 fuel oils).

On the other hand, it is believed that fuel desulphurization and other primary pollution control facilities which concentrate on reducing sulphur in the No. 4 and No. 6 fuel oil grades should be exempt from the profit-making exclusion in clause (e)(2)(A) of proposed I.R.C. § 168 in furtherance of the purpose of that proposed section as explained on pages 15 and 16 of the Finance Committee's previous report on H.R. 12290 (Senate Report No. 91-321) and on pages 196 and 197 of the House Committee on Ways and Means' report on H.R. 13270 itself, i.e., "to provide an incentive to private industry for antipollution efforts."

In his May 22, 1969 letter to the House Committee on Ways and Means concerning the effect of repealing the investment credit on pollution control facilities the Secretary of Health, Education, and Welfare clearly indicated the reason why an amendment to § 168 of the bill is needed to include facilities that remove air pollution at the source. I refer to the following paragraph in Secretary Finch's letter which appears at page 130 of the printed May 20, 1969 House Committee hearings on H.R. 12290:

> Even more important, perhaps, is the likelihood that a tax credit which can be taken only with respect to the purchase of equipment will encourage private firms to rely on the use of hardware to control air pollution instead of seeking and applying more efficient methods. *Often, changes in fuel, raw materials, and processing are the most cost-effective means of controlling air pollution.* An investment tax credit that has the effect of subsidizing relatively inefficient techniques for the prevention and control of air pollution will, in the long run, do more harm than good. [Italics supplied.]

It should also be pointed out that clause (e)(2)(A) of proposed § 168 in its present form could be construed to allow rapid amortization of desulphurization equipment installed in an oil-refinery which, by the commonly used refinery process of "coking," produces from high-sulphur residual fuel oil only light products such as naphtha, gasoline, kerosene, jet fuel, and aromatics. This result is possible because the high-sulphur petroleum coke produced in such a process is a by-product material having a very low value which is inadequate to pay for the cost of "coking." The desulphurization facility used in connection with the "coker" may thus be considered a non-profitmaking facility *per se* under subparagraph (e) (2) of proposed § 168, because the facility is necessary to convert high-sulphur feeds into the very profitable light products of the refinery, for reasons which have nothing to do with air pollution control. That is, there is virtually no market for high-sulphur fuel oil, but there is a strong and profitable market for light products made from the destruction of such high-sulphur fuel oil.

Thus, depending on the value given to the high-sulphur feed, a "coker" might be construed as a "break-even" proposition, whereas in fact it would enhance the overall refinery profitability due to the additional light products derived or due to improved quality of the crude oil feedstock. In any event, the function of the "coker" as a pollution control facility is essentially secondary rather than primary; yet it could qualify for rapid depreciation under the present language of of the bill.

We presume that it was not the intention of the authors of the legislation to grant rapid amortization of desulphurization facilities designed to convert high-sulphur crude oil into light products and electrolytic (low-sulphur) coke, thus diminishing the potential supply of low-sulphur industrial fuel oil available for the market. Nevertheless, the language makes that possible and thus creates a preference for a standard refinery complex designed to manufacture gasoline and other high value petroleum products from high-sulphur crude oil vis-a-vis a fuel desulphurization facility as contemplated by § 26 of Oil Import Regulation No. 1. The preference arises from the fact that the residual fuel desulphurization facility designed and operated to remove sulphur from the heavy fuel oil which is burned on the Eastern Seabord uses desulphurizing equipment very similar to that which a refinery complex uses for making gasoline from a high-sulphur crude oil. The fuel desulphurizing facility of necessity produces some distillate as a by-product which can be further refined to make gasoline and kerosene.

Consequently, if the standard refinery which operates a "coker," using high-sulphur crude oil, is granted rapid amortization for its sulphur removal equipment, while the residual fuel desulphurization facility is not granted rapid amortization, the standard refinery has a cost advantage in the production of distillates which the fuel desulphurization facility does not have. The standard refinery, therefore, receives a competitive advantage over the fuel desulphurization facility constructed under § 26 of the Oil Import Regulations for the very purpose of preventing air pollution.

As was pointed out in our July 15, 1969 letter to you concerning the very similar language formerly appearing in H.R. 12290, the high competitive risks and capital costs of specialized fuel desulphurization facilities make the rapid amortization of such facilities an important incentive to prospective investors. Without such an incentive it will be difficult and very costly to finance the construction of such facilities within the United States and thus to insure a reliable supply of low-sulphur heavy grade fuel oil at reasonable prices. That, in turn, could deal a serious blow to one of the basic aims of the National Environmental Policy embodied in S. 1075 which the Senate passed on July 10. It is fully in keeping with the purposes of that bill to provide reasonable incentive to the construction of new primary air pollution control facilities.

We, therefore, respectfully urge that a correcting amendment be approved by the Finance Committee, in line with the stated purposes of the amortization provisions. For the Committee's convenience, I have appended such language, keyed to the text of H.R. 13270 as passed by the House, and I am also attaching the text of § 26 of Oil Import Regulation 1, as amended, and a copy of the Oil Import Administration's January 8, 1969 oil import allocation grant to Fuel Desulphurization, Inc.

Respectfully,

By JAMES H. HELLER.

PROPOSED AMENDMENT TO H.R. 13270

1. On page 342, after line 18, insert a new paragraph (2) of subsection (d), to read as follows:

"(2) PRIMARY AIR POLLUTION CONTROL FACILITY—

The term 'primary air pollution control facility' means a certified pollution control facility which is specifically designed and is operated to remove sulphur or other major atmospheric pollutants from combustible fuels before their delivery to the actual users of such fuels."

2. Renumber present paragraphs (2), (3), and (4) of subsection (d) as paragraphs (3), (4), and (5), respectively.

3. On page 344, in line 13, delete the word "The" and in lieu thereof insert the following: "Except in the case of a primary air pollution control facility, the."

TITLE 32A—NATIONAL DEFENSE, APPENDIX

CHAPTER X—OIL IMPORT ADMINISTRATION, DEPARTMENT OF THE INTERIOR

[Oil Import Reg. 1, Rev. 5, Amdt. 11]

OI REG. 1—OIL IMPORT REGULATION—ALLOCATION OF IMPORTS, UNFINISHED OILS, LOW SULPHUR RESIDUAL FUEL OIL—DISTRICTS I–IV

This amendment adds to Oil Import Regulation 1 a new section 26, the purpose of which is to permit residual fuel oil users on the East Coast to meet Federal, State, and local air pollution regulations and to encourage the construction, in Districts I–IV, of new facilities capable of producing sufficient quantities of low sulphur residual fuel oil for East Coast use. The new section 26 will provide for the making of allocations of imports into Districts I–IV of unfinished oils (in this instance to be confined to fuel oil and residual fuel oil), to persons with desulphurization facilities and to persons with planned desulphurization facilities who produce and who will produce and deliver in those districts low sulphur residual fuel oil to be used as fuel. The new section 26 is issued after careful consideration of comments received following the notice of proposed rule making published by the Administrator, Oil Import Administration, in the FEDERAL REGISTER for May 29, 1968 (33 F.R. 7822). Sixty-two comments on the proposals were received. There was considerable opposition to the proposal which provided for the making of additional allocations of imports of crude oil and unfinished oil equal to 50 percent of the amount in barrels of low sulphur residual fuel oil manufactured from crude oil. These comments served to confirm our tentative doubts regarding the effectiveness of such a proposal. Accordingly, this proposal has not been adopted. The other two proposals relating to desulphurization of residual fuel oil and the use of cutter stock for mechanical blending with high sulphur residual fuel oil have been slightly modified in the light of the comments received and in their present form should encourage the construction of facilities and the production of low sulphur residual fuel oil to be used as fuel to meet the air pollution requirements. As the purpose of this amendment is to further the control of air pollution, this amendment shall become effective immediately upon publication in the FEDERAL REGISTER.

A new section 26 reading as follows, is added to Oil Import Regulation 1 (Revision 5), as amended:

Sec. 26 Allocations of unfinished oils--Districts I–IV based on production of low sulphur residual fuel oil in Districts I–IV.

(a) As used in this section:

(1) "Low sulphur residual fuel oil" means residual fuel oil:

(i) Which is manufactured in Districts I–IV, and

(ii) Which contains not more than 1 percent of sulphur by weight, and

(iii) Which is delivered (either directly by the manufacturer or by others following its sale by him) to customers in Districts I–IV who must burn such fuel in order to comply with Federal, State, or local requirements:

(2) "Western Hemisphere" means North America, Central America, South America, and the West Indies;

(3) "Desulphurization facility" means a facility which includes equipment for removing sulphur or sulphur compounds from residual fuel oil and which produces low sulphur residual fuel oil.

(b) This section provides for the making of allocations of imports into Districts I–IV of residual fuel oil or fuel oil based upon the production or estimated production of low sulphur residual fuel oil. Allocations made by the Administrator under this section 26 shall be in addition to allocations made under other sections of this regulation, and the Administrator shall make allocations under this section without respect to the quantity of imports available for allocation in Districts I–IV for a particular allocation period under other sections of this regulation. To the extent that the provisions of this section are inconsistent with the provisions of other sections of this regulation, the provisions of this section shall be controlling.

(c) (1) A person who manufactures low sulphur residual fuel oil in a desulphurization facility by desulphurization of residual fuel oil containing at least 2 percent sulphur by weight which was derived from crude oil produced in the Western Hemisphere shall receive an allocation of imports of residual fuel oil equal to the amount in barrels of low sulphur residual fuel oil so manufactured. Residual fuel oil imported under such an allocation must be derived from crude oil produced in the Western Hemisphere and must be processed other than by blending by mechanical means either by the person to whom the allocation is made or by the person receiving the residual fuel oil under an exchange agreement.

(2) Upon a showing satisfactory to the Administrator that the construction of a desulphurization facility has been or is about to be completed, the person owning the facility shall be entitled to an initial allocation of imports of residual fuel oil on the basis of the quantity of low sulphur fuel oil which he estimates will be produced by the facility during a period of 90 days following the day the facility goes on stream. No license shall be issued under such an allocation earlier than 45 days prior to the date that the newly constructed desulphurization facility is scheduled to go on stream and in no event shall a license be issued under an allocation until an on-the-spot inspection of the new facility has been conducted by authorized representatives of the Oil Import Administration and a determination has been made that the newly constructed facility will have the operational potential which the applicant has certified to in his application, and that it appears that construction will be completed. The Administrator may make a second allocation based on the production estimated for the next succeeding period of 90 days. Residual fuel oil imported under such an allocation must be derived from crude oil produced in the Western Hemisphere and must be processed other than by blending by mechanical means either by the person to whom the allocation is made or by the person receiving the residual fuel oil under an exchange agreement.

(3) In order to encourage the construction of new desulphurization facilities in Districts I–IV the Secretary may make a general allocation to an applicant if the Secretary is satisfied that an applicant's proposal to construct a desulphurization facility in Districts I–IV constitutes a bona fide business venture and that the construction of such facility will be carried to completion within a reasonable time. Such a general allocation may provide that the applicant shall be entitled, for such a period of time as the Secretary may determine, to specific allocations of imports of residual fuel oil as provided in subparagraph (1) of this paragraph and to initial allocations as provided in subparagraph (2) of this paragraph.

(d) A person ,who produces low sulphur residual fuel oil by mechanically blending residual fuel oil to be used as fuel containing over 1.5 percent sulphur by weight derived from crude oil produced in the Western Hemisphere with fuel oil manufactured in his refinery capacity or desulphurization facility in Districts I–IV shall receive an allocation of imports of residual fuel oil or fuel oil equal to the amount in barrels of the fuel oil manufactured in his refinery capacity or desulphurization facility and used for blending in the production of low sulphur residual fuel oil. Residual fuel oil or fuel oil imported under such an allocation must be derived from crude oil produced in the Western Hemisphere and must be processed other than by blending by mechanical means either by the person to whom the allocation is made or by the person receiving the residual fuel oil or fuel oil under an exchange agreement.

(e) For the purpose of computing import allocations under sections 9, 10, and 25 of this regulation, neither residual fuel oil or fuel oil imported pursuant to an allocation made under this section 26 nor domestic oil received in exchange pursuant to the provisions of section 17 will qualify as either refinery inputs or petrochemical plant inputs. However, the person receiving the imported residual fuel oil or fuel oil under an exchange agreement pursuant to section 17 may count such oils as such inputs.

(f) The Administrator shall make an allocation under subparagraph (1) of paragraph (c) or paragraph (d) of this section only upon receipt from an applicant of a certification satisfactory to the Administrator with respect to the following matters pertaining to the production and delivery of the low sulphur residual fuel oil forming the basis of the application:

(1) Location of plant in which produced;

(2) Amount and sulphur content,

(3) Source of crude oil from which unfinished oils were produced,

(4) Source and disposition of unfinished oils,

(5) Delivery, either directly by applicant or by others following sale by applicant, to customers in Districts I–IV who are required to burn such fuel oil in order to comply with Federal, State or local requirements.

A similar certification as to prospective operations shall be made by an applicant for an allocation under subparagraphs (2) and (3) of paragraph (c). The Administrator may prescribe the form of certifications. An application for an allocation may be filed at any time. To apply for an allocation of imports under this section, an application must be filed with the Administrator in such form as he may prescribe. The Administrator may fix a period of time (not less than 180 days) for the expiration of licenses issued pursuant to specific allocations made under this section.

(g) No allocation made under this section shall be sold, assigned or otherwise transferred.

STEWART L. UDALL,
Secretary of the Interior.

December 5, 1968.

[F.R. Doc. 68-14786; Filed, Dec. 10, 1968; 8:40 a.m.]

TITLE 32A—NATIONAL DEFENSE, APPENDIX

CHAPTER X—OIL IMPORT ADMINISTRATION, DEPARTMENT OF THE INTERIOR

[Oil Import Reg. 1, Rev. 5, Amdt. 13]

OIL REG. 1—OIL IMPORT REGULATION—ALLOCATION OF IMPORTS, LOW SULPHUR RESIDUAL FUEL OIL—DISTRICTS I–IV

Section 20 of Oil Import Regultion 1 (Revision 5) provides for allocations of imports of residual fuel oil and fuel oil into Districts I–IV based on the production of low sulphur residual fuel oil. Section 26 is amended to provide for the issuance of licenses for testing and start up of new facilities, to include specific allocations under paragraph (d) within the scope of general allocations authorized by paragraph (c)(3), and to describe with more particularity the fuel oil which may be used for blending and which may be imported under allocations made pursuant to paragraph (d). As the purpose of this amendment is to further the control of air pollution, it would not be in the public interest either to provide notice and public procedure thereon or to delay its effective date. Accordingly, this amendment shall become effective immediately.

Subparagraphs (2) and (3) of paragraph (c), and paragraph (d) of section 26 of Oil Import Regulation 1 (Revision 5) (33 F.R. 18374) are amended to read as follows:

Sec. 26. Allocations of unfinished oils—Districts I–VI based on production of low sulphur residual fuel oil in Districts I–IV.

* * * * * * *

(c) * * *

(2) Upon a showing satisfactory to the Administrator that the construction of a desulphurization facility has been or is about to be completed, the person owning the facility shall be entitled to an initial specific allocation of imports of residual fuel oil on the basis of the quantity of low sulphur fuel oil which he estimates will be produced by the facility during a period of 90 days following the day the facility goes on stream. No license shall be issued under such an allocation earlier than 45 days prior to the date that the newly constructed desulphurization facility is scheduled to go on stream, except in such amounts as may be required for starting and testing the new desulphurization facility, and in no event shall a license be issued under such an allocation until an on-the-spot inspection of the new facility has been conducted by authorized representatives of the Oil Import Administration and a determination has been made that the newly constructed facility will have the operational potential which the applicant has certified to in his application, and that it appears that construction will be completed. The Administrator may make further specific allocations based on the production estimated for succeeding periods of 90 days each. Residual fuel oil imported under such an allocation must be derived from crude oil produced in the Western Hemisphere and must be processed other than by blending by mechanical means either by the person to whom the allocation is made or by the person receiving the residual fuel oil under an exchange agreement.

(3) In order to encourage the construction of new desulphurization facilities in Districts I–IV the Secretary may make a general allocation to an applicant if the Secretary is satisfied that an applicant's proposal to construct a desulphurization facility in Districts I–IV constitutes a bona fide business venture and that the construction of such facility will be carried to completion within a reasonable time. Such a general allocation may provide that the applicant shall be entitled, for such a period of time as the Secretary may determine, to specific allocations of imports of residual fuel oil as provided in subparagraph (1) of this paragraph and to initial allocations as provided in subparagraph (2) of this paragraph and to specific allocations s provided in paragraph (d) of this section.

(d) A person who produces low sulphur residual fuel oil by mechanically blending residual fuel oil to be used as fuel which has a viscosity not greater than 275 Saybolt Furol seconds at 122° F., which contains over 1.5 percent sulphur by weight, and which is derived from crude oil produced in the Western Hemisphere with distillate fuel oil which has a viscosity in the range of 22–40 Saybolt Universal seconds at 100° F. and which is manufactured in his refinery capacity or desulphurization facility in Districts I–IV shall receive an allocation of imports of fuel oil equal to the amount in barrels of the fuel oil which had a viscosity in the range of 22–40 Saybolt Universal seconds at 100° F. which was manufactured in his refinery capacity or desulphurization unit, and which was mechanically blended to produce low sulphur residual fuel oil. Fuel oil imported under such an allocation must have a viscosity within 2.0 Saybolt Universal seconds at 100° F., plus or minus, of the viscosity of the distillate fuel oil used for blending, must be derived from crude oil produced in the Western Hemisphere, and must be processed other than by blending by mechanical means either by the person to whom the allocation is made or by the person receiving the residual fuel oil or fuel oil under an exchange agreement.

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STEWART L. UDALL,
Secretary of the Interior.

JANUARY 8, 1969.

[F.R. Doc. 69-373; Filed, Jan. 8, 1969, 12:36 p.m.]

U.S. DEPARTMENT OF THE INTERIOR,
OFFICE OF THE SECRETARY,
Washington, D.C.

GENERAL ALLOCATION TO FUEL DESULPHURIZATION, INC. OF RESIDUAL FUEL OIL AND FUEL OIL INTO DISTRICTS I–IV

In accordance with subparagraph (3) of paragraph (c) of section 26 of Oil Import Regulation 1 (Revision 5) as amend by Amendment 13, a general allocation of up to 100,000 b/d of imports of residual fuel oil or fuel oil into Districts I–IV is made to Fuel Desulphurization, Inc. for use in a desulphurization facility to be constructed and operated by that company in these districts. This general allocation shall be effective as of the date on which it is signed by the Secretary of the Interior, shall remain in effect for a period of 10 years from the start up and operation of such facility as determined by the Administrator of the Oil Import Administration, and shall entitle Fuel Desulphurization, Inc. for that period of time to specific allocations as provided in subparagraphs (1) and (2) of paragraph (c), and as provided in paragraph (d), of section 26 as amended by Amendment 13. This general allocation is subject to the following conditions:

(a) Fuel Desulphurization, Inc. shall make such investments as are necessary to construct a new desulphurization facility in Districts I–IV which will be capable of producing up to 100,000 b/d per calendar year of low sulphur residual fuel oil.

(b) The new desulphurization facility shall be completed not less than thirty-six (36) months after the effective date of this allocation, unless the time is extended by the Secretary of the Interior by reason of delays due to unforeseeable causes without the fault or negligence of Fuel Desulphurization, Inc.

(c) Fuel Desulphurization, Inc. shall cooperate as fully as possible with the Department of Health, Education, and Welfare, the Department of the Interior, and state and local air pollution control authorities for the purpose of endeavoring to manufacture or produce low sulphur residual fuel oil of the type required to meet the air pollution control regulations and ordinances projected for future enforcement in New York City and other industrial population centers in Districts I–IV.

(d) Fuel Desulphurization, Inc. shall operate the new desulphurization facility to be constructed in such manner as to comply with Federal, state and local air pollution and environmental control regulations or requirements.

STEWART L. UDALL,
Secretary of the Interior.

Investment credit

STATEMENT OF JEROME R. GULAN, LEGISLATIVE DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

To: Senate Committee on Finance–September 18, 1969.
Subject: Tax Reforms and Small Business.

The National Federation of Independent Business thanks the Committee for the opportunity to submit this statement concerning tax reform measures and their importance to the 5 million small businesses throughout the United States.

The Federation now represents more than 270,000 small and independent business and professional people in the country, or approximately one out of every 20 businesses.

Few people today would question the importance of small business in our economic mainstream, or the wisdom of helping to maintain and strengthen its renewing influence in the economy.

One hundred years ago, we had only about 300,000 small businesses nationwide, serving a population of 29 million. Today, there are more than 5 million small businesses serving a population of more than 200 million. While our population has multiplied itself seven times, small business has done so sixteen times.

According to Federal Government statistics, small business accounts for roughly 95% of *total business population*! In construction, manufacturing, trade and services, we consider that small business represents from *90 to 99* per cent of the firms in each industry division.

We know that of a total labor force of 77 million people in this country, more than 40 million are employed by small business. Small business presently accounts for 73% of National retail sales, 73% of National wholesale sales, 82% of construction activity, 80% of service functions, and small business provides 34% of the manufactured value added to the economy each year.

This, then, is the posture of small business in our economy. The facts are quite impressive and would lead us to believe that small business is prospering and growing ever stronger as our Nation's econmy continues to grow.

However, such is not the case. Since 1952 there has been a noticeable slow down in small business growth in most categor'es, while at the same time we have experienced a sharp increase in business failures. In 1952, the failure rate was at 29 per 10,000 firms. Today the rate is above 50 per 10,000 firms. This trend towards increasing failures can be expected to continue unless the Federal Government's emphasis and efforts are more strongly directed to seeking ways and means of strengthening the position of existing firms and stimulating entry of new, small business concerns into the economic arena.

Foremost among the tools at the Government's disposal are its taxing policies.

The tax incentive approach has abundantly proven its worth as a stimulus to American business. Now that we find ourselves in an inflationary period, it is felt that such a stimulus is no longer necessary. This thinking might well have merit in the areas of corporate giantism where many millions of dollars are invested annually, providing correspondingly hugh drains on the Treasury. This is definitely not true in the case of small business!

While in the aggregate, small business users of the 7% investment credit have added but minimally to the Treasury drain, those selective users of the Credit have found the benefits derived therefrom of vital importance and necessity even in their continuing efforts to maintain their competitive position in the market place vis a vis their big business counterparts. We, therefore, request that if the 7% investment credit is to be repealed, a definite exemption of $25,000 to $50,000 of investments be permitted so that small business may continue those modernization and expansion efforts they find so necessary if they are to remain a viable factor in our Nation's economy.

Closely attuned to the 7% investment credit principle is one which would prove of invaluable assistance to that sector of the small business community which finds itself unable, by the very nature of its investments, to utilize the credit. We refer primarily to the non-manufacturing sector, the wholesalers, retailers, and service trades. These firms invest chiefly in inventories and receivables, and are, of all types of businesses, those most expected to be prime sources of employment and training for the unskilled.

This, then, brings into focus a tax proposal advanced more than ten years ago—the "plowback allowance".

Senator John Sparkman, as Chairman of the Senate Select Committee on Small Business, in a statement in 1960 described the plowback allowance as follows:

"Before leaving the subject of taxes and small business, I must mention one important objective that has not as yet been achieved. American small business needs desparately a form of tax relief which will provide an incentive and make it possible to reinvest a portion of profits in the business.

"Our economy is making such a headway today it is not enough just to own a small concern. The concern must be a going concern, and it must be going in the same direction as the national economy. For a small company to rest on its oars, just drifting from day to day, is to risk being swamped by the waves of competition.

"There must be forward motion. For this compelling reason, I have introduced and will continue to urge passage of my bill S. 59, which has carried over from the first session of the present Congress.

"The purpose of this measure is to help the owners of small companies to provide out of earnings money for expansion and modernization of their stores, plants, and equipment. This would be accomplished by the simple expedient of allowing a tax deduction of up to $30,000, or an amount equal to 20 percent of net income of the taxable year, for money plowed back into a business for additional investment in depreciable assets, inventory, and accounts receivable."

In a floor speech on January 6, 1961, Representative Frank Ikard of Texas, who had introduced a bill based on the plowback principle, stated that his proposal had the recommendation of the House Select Committee on Small

Business, the Senate Select Committee on Small Business, as well as active support and sponsorship of many Members of Congress. In 1967, Representative James Corman introduced a similar measure. During the current Congress, this same measure has been introduced by at least five members of the House, two of whom serve on the Committee on Ways and Means.

The Committee on Ways and Means, after extensive hearings, recognized the desirability of this legislation in meeting one of the greatest problems of small business. In a committee report in 1958, the committee stated:

"Your committee is convinced that one of the greatest problems confronting small- and medium-sized business is the acquisition of sufficient capital to modernize and maintain a rate of expansion experienced by their larger competitors. In this regard your committee is aware of the fact that small- and medium-sized businesses must rely to a very large extent upon retained earnings for modernization and expansion. Thus, there is a need to allow such businesses to retain more earnings after taxes to provide the funds necessary for growth. To aid in achieving this end your committee has investigated thoroughly various proposals to postpone, or to reduce, taxes, based upon "reinvestment in inventory and depreciable property and would have liked to have included a provision along these lines in this bill."

The House Ways and Means Committee concluded that budgetary considerations prohibited it from approving the measure at the time. In truth, the investment credit may be identified as a "blood-brother" of the plowback proposal, only coming as a credit after tax rather than a deduction from taxable income, and limited to depreciable assets.

A representative cross section of the Nation's entire small business community at the retail, wholesale, manufacturing servicing and professional occupational levels was polled on this measure, and three-fourths of them expressed an interest in enactment of such legislation.

We feel that extension of the seven percent investment credit principle to increases of investments in inventories and receivables is a vital necessity to a prosperous small business community. Since the seven percent investment credit has worked so well in encouraging expansion and in helping to provide additional jobs in the area for which it was particularly intended, extension of its principle to inventories and receivables, critically important in the retailing and service trades, no doubt would do much to stimulate job-producing expansion and modernizations in these areas.

CONCLUSION

The National Federation of Independent Business urgently recommends that:

1. Small business be allowed to continue using the 7% investment credit on capital investments up to $25,000 or $50,000 annually, and
2. The Congress enact into law the Plowback principle as described above in an effort to help the retail and service sector of the small business community.

Statement of the Aerospace Industries Association of America, Inc., Submitted by Concerning Proposed Repeal of 7-Percent Investment Tax Credit

The Aerospace Industries Association of America, Inc., representing 59 of the nation's principal manufacturers of aircraft, spacecraft, missiles, and components thereof, appreciates this opportunity to submit some additional comments on the proposed repeal of the seven-percent tax credit for investment.

DRAWBACKS TO REPEAL

The investment tax credit was designed to encourage American industry to acquire and maintain a modern, efficient productive capacity as a means of (1) protecting American employment from encroachment by foreign goods and services (many of which benefit from tax assistance in reducing prices), (2) providing more and better products and services at lower prices, and (3) improving the U.S. balance of payments by facilitating the production of goods and services for export. The credit has been a major factor in achieving these goals and providing a strong industrial base. Repeal of the credit will necessarily have adverse effects on each of these important national objectives.

The members of this Association are acutely aware of the need to maintain an up-to-date and efficient productive capacity. As principal suppliers of major defense and space systems and as producers of the aircraft and ground-base equipment used by the domestic and foreign air transportation industry, they are in the forefront of a world-wide technological advance which requires them to both utilize the most modern research and production facilities and to produce capital goods of the most advanced design for use by others. Because repeal of the investment tax credit would seriously inhibit the ability of many firms and entire industries to maintain necessary technological progress, we must recommend it be retained.

If repeal is intended to reduce inflationary pressures, we suggest that such action might well have a contrary effect. If inflation results when the supply of goods is not sufficient to meet the demands of purchasers, it would seem that an action designed to limit the expansion of productive capacity would be inflationary rather than deflationary.

Many of our companies, moreover, are committed to long-range production programs, and there is no way they can avoid acquiring the capital goods needed to discharge their obligations.

Furthermore, a number of the aerospace industry's customers, such as the airlines, are committed to long-term programs to enlarge and improve existing fleets so as to maintain American leadership in the vital air transport system. Acquisition of hundreds of millions of dollars worth of equipment in this area will be necessary regardless of the status of the tax credit. Repeal of the credit, however, would remove a source of cash needed by these companies to help finance these acquisitions, thereby forcing them to pay higher prices and borrow more heavily in an already tight money market (adding to inflationary pressures).

We believe that the long-range, lasting advantages of the investment credit to the United States economy more than outweigh any short-term advantages which might result from repeal. We urge, therefore, that the investment credit be continued.

IF REPEAL IS UNAVOIDABLE, EFFECTIVE DATE SHOULD BE EXTENDED

If repeal of the credit is deemed unavoidable, we believe that the effective date should be set somewhat beyond the original April 18, 1969. We submit that an action having adverse effects on business generally, upsetting the competitive balance within all segments of industry, should not be effected without ample notice to all concerned. The effect of repeal on a company which placed an order on Friday, April 18, while its competitor did not place his until Monday, April 21, could be to give a decided competitive advantage to the former. An extension of the effective date would do much to mitigate the inequities resulting from an abrupt termination on a date selected without prior notice to the public. We ask, therefore, that your Committee make the repeal effective on the date of enactment of the bill.

PROPOSED CHANGES IN TRANSITION RULES

The termination rules are designed to mitigate the effects of an abrupt termination of the investment credit. In general, the rules permit the industrial taxpayer to take the investment credit on property acquired after termination when its acquisition is necessitated by a commitment made prior to the termination date.

The rule of most general application is the Binding Contract Rule. It provides that anyone who entered into a binding contract prior to the termination date to acquire property then subject to the investment credit may take the credit even though the property is not delivered and paid for until after the date of termination. The other nine transition rules, though less general in their application, reflect the underlying theory that corporate taxpayers have made substantial economic commitments dependent, at least in part, on the availability of the investment credit, and that denial of the credit in such circumstances would be inequitable.

We believe that a rule of general application can be fashioned which will encompass all of the situations covered by rules 2 through 10 and any others of equal merit. Such a rule, which might be called the "Substantial Econmic Commitment Rule," could be generally applicable to all companies which had committed themselves prior to termination to carry out a project extending over a period of time and which had completed a substantial portion of the project prior to the termination date. We suggest that such a rule, with appropriate objective standards and safeguards, would not appreciably affect revenues and would apply equally to all companies in this situation.

If such an economic commitment rule of general application should not be considered feasible, however, we suggest the following amendments (to the House-passed Tax Reform Act of 1969):

Section 703(a) and 94(b)(5)—Certain Lease-Back Transactions, etc.

Put a period at the end of lire 9 on page 331 and strike out all of lines 10 through 18 on page 331.

This rule provides that if a party to a binding contract entered into before the termination date later transfers the contract to another party, such other party is entitled to the investment credit if the first party retains the right to use the property under a lease with the other party. However, if the lease is terminated before the expiration of the investment credit useful life of the property, the owner loses all or some of the credit. For example, if prior to the termination date *A* contracts to buy an article having a useful life of four years and, after the termination date, transfers the contract to *B* who buys the property and leases it to *A* for a term of four years, then *B* is entitled to an investment credit. But if A defaults on the lease and *B* repossesses the property, *B* loses the investment credit. This is so even though *B* puts the property to use either for himself or by leasing it to another party.

We see no rational reason for denying the investment credit to *B* merely because *A*'s lease had terminated, for whatever reason. Our proposed amendment would eliminate the part of the rule which would deny some or all of the credit to the owner-leasor if the lease terminates before the expiration of the useful life of the property for investment credit purposes.

Section 703(a) and 49(b)(10)—Certain New Design Products

Amend the parenthetical expression appearing in lines 7–9 on page 336 to read "(except for provisions for escalation in case of changes in prices of materials or in rates of pay)".

In line 10 on page 336 change "60" to "50."

This rule, like several others, recognizes the equity in allowing a firm to take an investment credit on property acquired to carry out a long-term project to which it had become committed well in advance of tthe repeal date. As in several other transition rules, the criteria for qualifying under this rule are stringent. Also similarly, the purpose here was to limit the application of the rule to those situations where the commitment is substantial and the terms were fixed well in advance of the repeal of the investment credit and relied upon availability of the credit. Although our proposed amendments would ease the criteria in two respects, their adoption wil not, in our judgment, violate the basic intent of the rule.

We suggest that a company should also be eligible under this rule if its fixed price contracts for the delivery of a new design product provide for a price adjustment due to increase in material costs as well as labor rates. It is a fairly standard practice in commerical contracts for the production of long lead-time items to provide that a price, which is otherwise firm and fixed, may be adjusted if there is a change in the cost of labor or materials during the production period. Such an escalation clause is desirable in contracts for the production of commercial aircraft, for instance, where several years elapse between the contract date and delivery of the planes—during which time there can be sharp increases in both labor costs and material costs. Therefore, we propose an amendment providing that a fixed price contract may contain an escalation clause for increases in both material prices and labor rates.

Section 49(b)(10)(A)(ii) of the bill says that the fixed price contracts entered into prior to April 18, 1969, must cover at least 60 percent of the new design product scheduled for delivery prior to January 1, 1973. The purpose here seems to be to assure that property acquired to produce products contracted for prior to the cut-off date is needed to produce a substantial portion of the item in the near term of the production schedule. Our second proposed amendment would reduce the required delivery percentage from 60 percent to 50 percent. We believe that this change, which is commensurate with other percentage requirements in the transition rules, will provide for a more equitable application of this rule among competing companies.

Section 703(a) and 49(d)—Rate of Credit Where Property is Placed in Service After 1970

Strike out all of lines 20 through 24 on page 337 and all of lines 1 through 4 on page 338.

This provision provides for a phase-out of the investment credit for property placed in service after December 31, 1970. The rate of decline in the investment credit is one-tenth of one percent per month beginning with January 1971, when the credit would be 0.9 percent and running to December 1974, when the credit would be 2.2 percent. After December 1974, no credit would be allowed. In our view this provision is particularly unfair to purchasers of long lead-time items.

For example, we are aware of one case in which several airlines contracted well before the repeal date to buy a new design aircraft, the first of which are to be delivered in late 1971 and the last in 1975. All of the aircraft are pre-termination property within the meaning of the binding contract rule, and ordinarily the purchaser would be entitled to a seven-percent investment credit. Because of the phase-out provisions of the proposed bill, however, the maximum credit will be about six percent for those receiving delivery in 1971, and those who take delivery in 1975 can claim no credit.

To elaborate, assume that on March 1, 1968, airline X entered into a contract with aircraft company Y to buy 10 commercial aircraft of the same kind at a fixed price per plane. And for simplicity of illustration, assume that the aircraft are to be delivered one at a time at six-month intervals, beginning in December 1970. Under these circumstances the following table shows the effect of the phase-out:

Delivery date:	*Percent of investment credit*
December 1970	7.0
June 1971	6.4
December 1971	5.8
June 1972	5.2
December 1972	4.6
June 1973	4.0
December 1973	3.4
June 1974	2.8
December 1974	2.2
June 1975	0

This seems particularly inequitable when one considers that all of the aircraft were contracted for at the same time, at the same price, more than a year before the repeal date of the investment credit—and in reliance on the availability of the credit in negotiating the price and in providing for the financing of the purchase. The disparate competitive position which can result from the happenstance of delivery dates to airlines buying the same plane should not be overlooked.

We urge the Committee to eliminate the phase-out provision of the bill and allow the full investment credit to be taken regardless of when an item of pre-termination property is placed in service.

Section 703 (b)—Limitations on Use of Carryovers and Carrybacks

Strike out all of lines 5 through 21 on page 338.

This section places a limit on the amount of investment credits which may be carried over. Under the proposal, the general 50 percent of tax liability limitation is retained and, in addition, a special limitation is provided to limit the allowable credit attributable to carryover in any year beginning after 1968 to 20 percent of the aggregate amount of unused credits which would otherwise have been available as carryovers to each such year after 1968 or any prior year following 1968.

Under this arrangement, a company could lose credit carryovers solely because of the 20 percent limitations, whereas such carryovers could be utilized under existing law. For instance, it would cause a company which had carried a credit forward from year to year for seven years to lose 80 percent of the credit in the seventh year although it might have been able to use the entire amount at that time.

Apparently this provision was inserted in the bill to minimize the economic effect of accumulated carryovers during the year following repeal. Secondly, the intention seems to be to avoid a situation in which a business might obtain a greater advantage from the carryover—in relation to competitors who lack same—than he would have had before repeal when some sort of credit was available to almost all companies.

Although some argument can be made for the limitation on the basis of the so-called "phantom" credit, the burden of record keeping (to say nothing of the problems of administering this further complexity) seems to greatly outweigh any need for precision.

None of these arguments seems to provide sufficient justification for prohibiting the right to use credits already earned. In addition, the final legislation should avoid saddling the business community with administrative and record-keeping burdens which vastly exceed the revenues they are supposed to protect.

This Association is grateful for your thoughtful consideration of these proposals.

RUBBER MANUFACTURERS ASSOCIATION,
Washington, D.C., October 24, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Old Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: The Rubber Manufacturers Association and its membership of some 190 domestic manufacturers of rubber products invites the Committee to consider its views on several specific elements in current tax proposals. Generally we wish to express our support of the views already presented to the Committee by the Chamber of Commerce and NAM.

The RMA is particularly concerned with those portions of the House Bill which offer serious obstacles to capital formation with a consequent adverse effect on future economic growth, especially as a result of the increase of the tax on corporate capital gains and repeal of the investment tax credit. The nature of rubber manufacturing is such that constantly changing technology requires substantial amounts of capital outlays. We believe that the need for adequate support of capital formation through the tax credit or ultimately through realistic depreciation allowances is essential for our industry's ability to maintain a progressive technology and to meet world competition.

RMA also urges that consideration be given to Secretary of the Treasury Kennedy's proposal that beginning in 1971 rates of corporate taxation be reduced. The overall increase of the tax burden on corporations contrasts to the proposed lightening of taxes on consumption and this again will delay the Nation's industrial progress. The year 1971 is suggested so that we can plan for the post-Vietnam period, when this country will be seeking solutions to domestic problems.

The RMA is also concerned with the House proposals that will reduce the incentives inherent in the present tax provisions on restricted property. We urge the retention of these provisions.

Finally, we would like to express our gratification for the constructive changes already introduced by your Committee on deferred compensation and certain capital gains, among other actions.

We would appreciate your making our views a part of the public record.

Sincerely,

W. J. SEARS, *Vice President.*

STATEMENT OF THE RUBBER MANUFACTURERS ASSOCIATION

The Rubber Manufacturers Association and its membership of some 190 domestic manufacturers of rubber products oppose that portion of the Tax Reform Act of 1969 which would repeal the now-existing 7% Investment Tax Credit. Such action at this time would not only jeopardize continuous growth and development of this industry, but might also prove to have serious consequences for our nation's economy.

The demand for all classes of rubber products is growing at such a rapid pace that the rubber manufacturing industry in America is faced with a twofold problem. First, this industry must attain levels of technology to such an extent that the needs of the large end users of our products are satisfactorily met. By its very nature rubber manufacturing can best be depicted as technologically based, and as such has the continuing problem of substantial capital outlay. This gives rise to the second problem, the availability and cost of capital itself.

In 1962 when the Investment Tax Credit was first enacted the Treasury Department also adopted certain depreciation reform. Such a move reflected the Federal government's willingness to give new impetus to the then-lagging level of investment in new plants and equipment. Both of these measures were adopted because it was at that time well recognized that this country had lagged behind the rest of the free world in permitting business to obtain tax relief for capital investment. This situation has not changed, American industry must compete with foreign production much of which has a far more liberal incentive to investment than the tax credit.

In 1966 the Investment Credit was suspended for five months, a move which proved unsuccessful and is still a nuisance for tax collectors and tax administrators alike. At the time of the Investment Credit, industry was assured that it would be a permanent measure together with depreciation reform and that in the future, industry could expect even greater allowances for depreciation and a more modern method for the recovery of investment in plant and equipment. Instead, the government suddenly proposes repeal of Investment Credit and at the same time, extends the surtax. Now the Congress must decide whether this investment inducement should be withdrawn at a time when business is most in need of funds for modernization of their plants.

The rubber industry of today must not only expand production of current products but must constantly improve and innovate. This industry must be able to cope with growing imports as well as to develop exports, two objectives which are vital to the strengthening of our balance of payments position. The mechanism of a tax credit has assured industry of a method to continue its efforts to maintain modern, safe and efficient plants. A repeal of this investment incentive available to American industry can only result in rising costs for the consumer and the eventuality of capital shortages when present plant and equipment re-placement comes due.

It seems incongruous, at best, to call the repeal of the tax credit a "Tax Reform" when in the long run the very individuals that such legislation is tailored to aid will invariably bear the brunt of rising costs and production lags. Plant modernization and expansion must continue if we are to attain our national goals and meet foreign competition.

The Investment Tax Credit has been a prime means toward these objectives for the rubber manufacturing industry. The Rubber Manufacturers Association strongly urges retention of the credit in the national interest and to assure the continued contribution of our industry to the economic progress of the nation.

Statement Submitted on Behalf of the National Automatic Merchandising Association, by Richard W. Funk, Counsel

VENDING INDUSTRY STATEMENT IN SUPPORT OF THE INVESTMENT TAX CREDIT

To Members of the Senate Finance Committee:

My name is Richard W. Funk and I am counsel for the National Automatic Merchandising Association, the national trade association of the merchandise and service vending machine industry. We represent over 2,000 companies who operate vending machines and provide food service to industry, government and other institutions, who manufacture vending machines and who supply the products sold through vending machines. These companies range in size from individual proprietorships to large publicly held national companies. We welcome this opportunity to submit this statement of position in support of the Investment Tax Credit.

The vending industry endorses the concept of a tax incentive to help encourage the improvement of plant and equipment designed to make American industry better able to provide services at home and to meet competition abroad. Since the establishment of the Investment Tax Credit in 1962, our industry has enjoyed the fruits of this far-ranging concept and believe it has made an important contribution to the success of our industry in improving its ability to provide goods and services to the American people.

Like other businesses, we have structured the economics of the industry on the premise that this concept would be a permanent part of the tax structure. We were disappointed when the credit was temporarily suspended and again welcomed its reinstitution. Over 80 per cent of the dollar volume of business done by the vending industry is the product of companies employing ten or less employees. Depending on the company, the Investment Tax Credit has made a contribution to industry net profits of between 10 and 20 per cent. A suspension of the tax credit or its complete abolition will have adverse economic consequences for our industry and its thousands of employees.

Although our association is committed to the principle that all tax incentives should be reviewed periodically to determine whether or not their need continues, we fee that the Investment Tax Credit should not be viewed as a fiscal policy tool. It was never the intent of the Kennedy administration nor of the Congress when this tax incentive was proposed to justify it on the basis of fiscal policy. On the contrary, its sole purpose was to update plant and equipment in America which had fallen into a state of disrepair resuting in the deterioration of this country's competitive position in world markets.

In conclusion, we urge that the Senate Finance Committee when examining the proposed repeal of the Investment Tax Credit, weigh the credit not for its immediate fiscal effect, but rather consider its purpose as a long--term investment in the modernization of American industry.

[Telegram]

WASHINGTON, *D.C., July 17, 1969.*

Senator RUSSELL LONG,
Chairman, Senate Committee on Finance, New Senate Office Building, Washington, D.C.:

The Transporation Association of America with broad membership comprised of transportation shippers and other users, investors, and for-higher airlines, freight forwarders, highway, oil pipeline, railroad, and water carriers urges continuation of investment tax credit for publicly regulated transportation modes. Tax credit incentive has enabled carriers to finance extensive technological advances which have expanded public services while holding down rates and fares, thereby restraining inflation. Industry is committeed to long-range program to enlarge and prove existing equipment with leadtimes far beyond immediate impact of inflation. Credit repeal will force more intensive competition with other more profitable business for capital funds to finance fleet expansion. This will increase capital costs. Regulated transportation lacks freedom to adjust rate and fare levels. It has become low-profit low-earnings industry and needs tax credit to keep pace with vast public need for expanded service. TAA also asserts that justification for credit repeal generally supporting House action does not apply to transportation industry. We urge Senate Finance Committee approval of credit extension for all modes of publicly regulated transportation. We request that this TAA recommendation be made a part of the official committee record.

HAROLD F. HAMMOND, *President.*

GREATER CHAMBER OF COMMERCE,
Boston, Mass., July 8, 1969.

Hon. RUSSELL B. LONG,
Chairman, U.S. Senate Finance Committee, New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: Since the high ratio of capital investment seems to be one of the most significant factors in the United States' position as a world leader in economic production, a continuation of a policy to stimulate and expand plant improvement should be encouraged to further economic growth and, in the long run, combat inflation. The Greater Boston Chamber of Commerce, therefore, urges the Senate, as it contemplates the repeal of investment credit recommended by the Administration, to give consideration to related matters bearing directly on the issue of economic expansion and equitable tax credit and liability.

Legislation modifying the investment credit should include a liberalization of the existing tax laws with regard to the deduction for depreciation and a specific provision for triple declining balance. Special consideration should be given to the air and rail commuter industries, including the possibility of retaining the investment credit for those industries.

If the Senate finds it necessary to make any changes in investment credit, the changes should include provisions for an orderly and fair transition. An abrupt retroactive repeal would disrupt the orderly flow of business—specifically in the capital goods industry and for many other small businesses.

Changes should be made on a gradual or prospective basis, perhaps on a schedule of decreasing percentages over a period of time, or timed to coincide with a reduction of the surcharge. Such action would allow for orderly planning and would minimize the imposition of any resulting hardships on certain classes of taxpayers.

We believe that no change should be undertaken in the method of utilizing presently existing or pre cut-off date carry-over. Changes in these provisions would have unconscionable discriminatory effect against those taxpayers who have made substantial capital expenditures but have not yet enjoyed sufficient earnings to enable them to use the full amount of the credit as compared with other taxpayers who have made expenditures at the same time, but have already realized the benefit of the credit.

We respectfully request that our views on the investment credit, as expressed in this letter, be made a part of the permanent record.

Sincerely,

HERBERT W. JARVIS,
Chairman, National Affairs Committee.

Retirement income

STATEMENT BY RAY M. PETERSON, FOR THE HEARINGS BEFORE THE SENATE COMMITTEE ON FINANCE, ON H.R. 13270—THE TAX REFORM ACT OF 1969

I am Ray M. Peterson, Fellow of the Society of Actuaries, and am presenting this statement as the views of a concerned individual representing only himself. I retired from the service of The Equitable Life Assurance Society of the United States in 1966 as Vice President and Associate Actuary after 43 years of service. Many of those years were devoted to the various aspects of old age retirement programs including acturial matters, plan design, administration and Federal regulation and income tax treatment.

I appreciate the consideration of the Chairman of your Committee, as conveyed by telegram from Tom Vail, Chief Counsel, in agreeing to accept a statement from me with the assurance that it "will be printed in record and be given same consideration as though delivered orally."

The purposes of this statement are (1) to provide the Committee and the Congress with information relating to what will be demonstrated as situations constituting *tax penalties on lifetime income spreading* preceded by a background discussion of the nature of retirement provisions and the pseudo-semantic setting that prevails, and (2) to make recommendations that will eliminate such tax penalties. It is believed that such recommendations are consonant with the avowed objectives of H.R. 13270, i.e., to achieve a higher order of equity in taxation.

Among the conclusions of a Task Force Report to the Senate Special Committee on Aging, dated March, 1969, entitled *Economics of Aging: Toward a Full Share in Abundance*, was the following:

Private group pensions and personal savings—tailored as they are to individual needs, pereferences, and financing ability—will continue to be essential supplements to basic social security benefits in the future. *The Government should explore and lend support to various methods of promoting and encouraging such supplementary sources of retirement income.* (Emph. added.)

In the spirit of this recommendation, this presentation is an exploration of methods by which Government can promote "supplementary sources of retirement income" in the private sector by, not encouraging, but merely ceasing to discourage the creation of legitimate retirement income provisions—discouragement that takes the form of a tax penalty on lifetime income spreading for millions of persons in our society.

NATURE OF LIFETIME INCOME SPREADING

Lifetime income spreading is the spreading of a part of income earned during productive years, together with investment earnings thereon, over the non-productive years of retirement. Under legitimate retirement programs, the taxation of the input—contributions from earned income and investment earnings on such contributions—instead of taxation of the output—income during retirement years—constitutes a ***tax penalty.***

Over twenty-five years ago, this truth was expressed by an eminent scholar and recognized tax authority, Dr. Erwin N. Griswold, Dean of Harvard University Law School from 1950 to 1967 and currently Solicitor General of the United States. Writing about the status of employee contributions under employer-instituted pension plans and the contributions set aside by individuals not covered by such a plan, he had the following to say:

> From the point of view of the employee, a true pension or retirement allowance is income in the year in which he receives the money. An individual knows that his productive capacity will decline before his life ends, if he lives a normal span of life, or longer. Therefore, a part of his activity in his productve years should in fairness and wisdom be attributed to his years of retirement . . . What the employee earns during his productive years must, for all practical purposes, be spread over the period of his life. *What he receives after his retirement is in reality his income then, for then is when it comes to him. To tax him on it at the top bracket of the graduated rates of his earnings years is an unfair failure to recognize the economic facts of life* . . . It is hard to find any substantial reason for making a distinction between amounts paid by the employer to provide future pensions and those withheld from the employee for the same purpose. In both cases, the employee's current productive capacity is being utilized to make provision for his retirement. Neither amount is received by the emplyoyee any more than the other, for he does not have any more right to obtain presently the amount withheld from his pay than to obtain the additional amount paid by the employer.
>
> . . . the tax statutes should be expressly amended so as to provide that amounts paid by an employee to provide bona fide pension benefits after retirement should be deductible from his current income. Such a deduction would have to be guarded to insure that it was available only for the purpose of providing true pension benefits . . . With such limitations, ***provision could also be made for the deduction of pension payments made by the self-employed, or by employees whose employers do not provide a pension plan.***
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> . . . Such a development would not only encourage employees to make provision for their retirement, but would be a recognition of the economic realities of providing for retirement under our present taxing system.[1] (Emphasis added.)

Provision has been made for the self-employed and their employees under the Self-Employed Individual Tax Retirement Act but two major areas of tax discrimination continue to exist: (1) employee contributions and associated investment income by individuals ***not covered*** by a qualified or other employer-instituted plan and (2) employee contributions under qualified or other employer-instituted plans. Note that the second category includes members of the Civil Service Retirement System and thus every member of the Congress participating in that System.

[1] ***The Tax Treatment of Employees' Contributions to Pension Plans.*** **E. N. Griswold, Harvard Law Review, Volume 57, p. 247 (1943).**

THE PSEUDO-SEMANTIC SETTING

It seems difficult to believe that no member of the Congress would fail to support the general proposition that *all persons* should have the opportunity, through legitimate retirement provisions, to spread the benefit of their productive years over their entire lifetime—and to do it without tax penalties. It is probable that the achievement of this order of tax equity has been unnecessarily obstructed by the language used in describing the income tax treatment of qualified plans. For example, deferred tax treatment is usually referred to as "favorable taxation" by government representatives and by many private pension practitioners. But an examination of the origin of the 1942 legislation will reveal that its objective was not to *create a new* status of favorable taxation but to impose tax penalties—unfavorable tax treatment—on nonqualified plans—plans or arrangements whose main purpose was tax avoidance. For bona fide retirement income programs, the deferred tax treatment should be described as "tax-penalty free" or "non-tax-penalized", not "tax-favored." The presence of a "tax incentive" is not enjoyed, rather the absence of a tax disincentive is experienced.

After a careful survey and analysis, this writer reached the following conclusion in a paper published by the Joint Economic Committee of the U.S. Congress:

> The present Federal income tax treatment of employer contributions and investment income for qualified plans, a long existing application of the principle of deferred taxation, is the natural method of treatment since—
>
> (i) There is no workable or equitable alternative for the vast majority of plans as they operate today;
>
> (ii) There are persuasive arguments that the treatment conforms to the general principles of tax law; and
>
> (iii) This treatment, as to the employee (in relation to employer contributions), has been accepted for many years, without question and without special legislation, for plans covering Government employees.[3]

Activists in the private pension field have probably contributed to this pseudo-semantic setting by strewing descriptive material and advertising with such terms and phrases as "A Tax Break for the Self-Employed", "Federal income tax benefits", "tax-savings advantages", "a tax shelter can be working for you during your entire business life", "a tax-shelter can be working for you during your entire business life", "a tax-sheltered fund", and "Tax Sheltered Annuities". Just as programs for the self-employe have been identified by the unemotional and non-descriptive term as "H.R. 10 Plans", the popularly called "Tax Sheltered Annuities" might better be identified as simply "403(b) plans or programs.

Thus, we have been sealed in the cement of a semantic facade; or, to change the figure of speech, we have been imprisoned by the perverting prism of parlance!

MAGNITUDE OF TAX PENALTIES

Very little published information has been found to show the magnitude of the effect of taxing the input of retirement provisions instead of taxing the output of such provisions. As indicated, one purpose of this statement is to provide extensive information and analysis of this tax penalty. It can have three sources: (1) taxation of investment income at time of input, (2) taxation of contributions at time of input and (3) taxation of input at the marginal tax rate at time of input instead of at the marginal tax rate at time of output.

To demonstrate the magnitude of such tax penalties, three situations are used: Case I—contributions and investment income taxable at time of input; Case II—contributions taxable at time of input but investment income taxable at time of output; and Case III—contributions and investment income taxable at time of output.

[3] *Old-Age Income Assurance by Lifetime Income Spreading with Deferred Taxation as the Natural Treatment.* Ray M. Peterson, F.S.A. A Compendium of Papers on Problems and Policy Issues in the Public and Private Pension System submitted to the Sub-Committee on Fiscal Policy of the Joint Economic Committee. Part III: Public Programs, p. 231.

Case I is exemplified by the individual who sets aside a part of his earned income by accumulating funds in a regular saving bank account, mutual fund or other facility, and then arranges for old age income either by purchasing an annuity at age 65 or otherwise providing for regular income payments.

Case II is exemplified by the present status of employee contributions under a qualified plan or additional voluntary contributions by the employee under such a plan.

Case III represents the status of employer contributions under a qualified plan or that of an individual who purchases a 403(b) deferred annuity.

The tax penalty for the individual not covered by an employer-instituted plan, i.e., Case I, is the percentage reduction in income that results from the *taxation of contributions and investment income* at time of input instead of at time of output, i.e., the excess of Case III income over Case I income divided by Case III income.

The tax penalty for the case represented by the status of employee contributions under a qualified plan, i.e., Case II, is the percentage reduction in retirement income that results from the *taxation of contributions* at time of input instead of at time of output, i.e., the Excess of Case III income over Case II income divided by Case III income.

In the Appendix hereof, Part I states the assumptions as to interest rates, marginal tax rates, contributions and mortality, Part II gives the mathematical formulas used and Part III displays the results of the calculations, including illustrations of the magnitude of the tax penalty for a wide range of circumstances.

Certain highlights of Tables (A) and (B) of Part III are noteworthy.

1. Although there is a common impression that the lower marginal tax rate that may prevail after retirement is the only factor that produces a difference in the net amount of retirement income that emerges, the fact is that *the effect, alone, of shifting the time of taxation from the input period to the output period is very substantial, indeed.* For example, consider an individual not covered by an employer-instituted plan (Case I) who invests each year beginning at age 45 in a savings facility that yields 5.5% interest, whose marginal income tax rate is 30% before and after retirement and who arranges to have his accumulated fund, after taxes, paid to him in equal monthly installments over a period corresponding to his expectation of life at age 65. His income, after taxes, will be *24.2% less* than that realized by an employee whose employer makes corresponding contributions with respect to him under a qualified plan (Case III).

Where the marginal tax rate is the same before and after retirement, the illustrations shown range from a *tax penalty of 9.4%* for contributions commencing at age 55, 4% interest and 20% marginal tax rate to *52.4* for contributions commencing at age 25, 7% interest and 40% marginal tax rate.

Expressed in another way, the Case III employee realizes *31.9%* more retirement income than the Case I employee from a given amount of contributions. For the range of illustrations, the Case III employees realize from *10.4% to 110.0%* more income than the Case I employee.

2. If in the individual case cited above, the *marginal tax rate after retirement is 20% instead of 30%*—a fairly typical situation—and the circumstances are otherwise the same, the Case I employee will realize 31:1% less income than the Case III employee.

For the range of illustrations with a 10% difference between pre- and post-retirement marginal tax rates, *the tax penalty* ranges from *17.0%* for contributions commencing at age 55, 4% interest and 20% pre-retirement marginal tax rate to *57.1%* for contributions commencing at age 25, 7% interest and a 40% pre-retirement marginal tax rate.

Viewed in another way, the Case III employee realizes *45.1% more* retirement income than the Case I employee from a given amount of contributions. For the range of illustrations, the Case III employees would receive *from 20.5% to 133.1% more income* than the Case I employees.

3. Although the effect of taxing the input of both contributions and investment income is very substantial, as just shown, *the effect of taxing the input of con-*

tributions alone is also of considerable magnitude. This is the situation that now exists with respect to employee contributions under employer-instituted plans.

To show the magnitude of this effect, consider a contributory plan where employees and the employer are making equal contributions on a "money purchase" basis similar to the plans of the Teachers Insurance and Annuity Association-College Retirement Equity Fund. Assume an employee, and his employer, start to contribute at age 45, interest earnings are at a 5.5% rate and the *marginal tax rate before and after retirement is 30%.* The retirement income derived from his contributions will be *18.6% less* than that produced by the employer's contributions.

Where the marginal tax rate is unchanged after retirement, the illustrations range from a *tax penalty* of *8.2%* for contributions commencing at age 55, 4% interest and a 20% marginal tax rate to *33.3%* for contributions commencing at age 25, 7% interest and 40% marginal tax rate.

Expressed in another way, the employer's contributions with respect to the individual case produce *22.9% more* income than the employee's contributions. For the range of illustrations, the employer's contributions produce from *8.9% to 49.9% more income.*

4. If in the individual case cited in item 3 above, *the marginal tax rate after retirement is 20% instead of 30%*—a fairly typical situation—and the circumstances are otherwise the same, the employee will realize *23.3% less income* from his own contributions than from the employer contributions.

For the range of illustrations with a 10% difference between pre- and post-retirement marginal tax rates, the *tax penalty* with respect to employee contributions ranges from *14.7%* for contributions commencing at age 55, 4% interest and 20% pre-retirement marginal tax rate to *35.7%* for contributions commencing at age 25, 7% interest and a 40% pre-retirement marginal tax rate.

Again, viewing another way, the income derived from employer contributions in the individual case will be *30.4% greater* than that derived from his own contributions. For the range of illustrations, employer contributions will produce from *17.2% to 55.5% more* income than that produced by employee contributions as a result of the difference in tax treatment.

5. Under the majority of contributory plans, the amount of retirement income is not a direct function of the amount of employee contributions but the employee contributes toward an overall formula of benefits (as under the Civil Service Retirement System.) In such cases, the tax penalty illustrated in items 3 and 4 as a lesser amount of income is borne by the employee in the form of increased taxes the value of which is represented by the value of the amount of income reduction occasioned by the tax penalty. Thus, the retirement income *could* be increased to the extent indicated if the employee were relieved of such taxes and corresponding amounts were channelled into retirement benefits.

6. The higher the marginal income tax rate, the greater the tax penalty.

7. The higher the rate of investment income, the greater the tax penalty.

8. Based on studies not shown, the tax penalty is about the same for men and women for a given retirement age; also, for a given commencing age, the tax penalty increases only moderately as the retirement age becomes older.

PREMATURE PAYOUT PENALTY

The tax penalties should be eliminated only with respect to legitimate or bona fide retirement provisions, i.e., programs under which accumulated contributions are either "locked-in" so they can be availed of only at retirement as income (or lump sum settlement) or are subject to a "premature payout penalty" if taken in cash before retirement.

The premature payout penalty should approximately offset the gain that would otherwise be enjoyed from taxing contributions and investment income, or investment income alone, as the case may be, at time of output instead of at time of input. In Tables (C) and (D) of Part III of the Appendix, an illustrative analysis of this gain is shown where contributions are made without interruption.

Where both contributions and investment income are involved, Table (C), the analysis supports a penalty of ½% or ⅔% for each year of contribution. Thus, for ten years of contribution, it would be 5% or 6⅔%. The uniform 10% increase in tax under H.R. 10 plans for "premature distributions" applicable to owner-employees amounts to 3% of the distribution for a 30% marginal tax rate, 4% for a 40% tax rate, and so on.

Where only investment income is involved, Table (D), the analysis supports a penalty, for each year of contribution, of ¼% of the excess of the amount withdrawn over the sum of contributions. Thus, for ten years of contribution, the penalty would be 2½% of such excess.

An interesting parallel to the tax treatment of investment income with respect to employee contributions under qualified plans is found in the deferred tax treatment of investment income under a "locked-in" arrangement offered for special savings accounts by at least one New York City bank and a Long Island Bank. *The tax deferment is based on the principle of constructive receipt and not on any special legislation such as applies to "qualified" plans.* Under this arrangement, interest on deposits is guaranteed by one bank for any selected period of years up to thirteen or so, subject to no right of withdrawal of capital or interest for the depositor but the bank could permit withdrawal in accordance with Section 217.4(d) of Regulation Q of the Board of Governors of the Federal Reserve System. This section is captioned: "Payments in emergencies." The bank has received an opinion form a qualified tax attorney that income tax on interest accumulations is not payable until the pre-selected maturity date. The opinion asserts that the interest is not constructively received, as defined by Treasury Regulation 1.451–2(a), since "the taxpayer's control of its receipt is subject to substantial limitations or restrictions." Also, accumulated interest on the deposit has no "cash equivalent" that would make it currently taxable.

RECOMMENDATIONS FOR TAX REFORM

In order to eliminate the tax penalties on lifetime income spreading identified in the foregoing pages, it is recommended that the Internal Revenue Code be amended to effect the following changes:

1. For employees not covered by an employer-instituted plan (or who are covered by a meager plan), *make contributions* from earned income that are applied to a bona fide retirement income arrangement *tax-deductible* and *defer tax on investment income* on such contributions until retirement benefits are received provided that the accumulated contributions are "locked-in" either absolutely or practically by a "premature payout penalty" if taken in cash before retirement, i.e., a condition similar to that which applies to owner-employees under H.R. 10 plans. (The Registered Retirement Savings Plan in Canada is a similar program.)

The following advantages would be gained by such a measure:

(i) The discrimination against employees not covered by an employer-instituted plan would be eliminated;

(ii) Such employees would have the opportunity to share in the growth of the economy through the purchase of variable annuity contracts or the use of other facilities for savings accumulations such as are now available to participants in H.R. 10 plans;

(iii) Such employees, who are paying taxes to provide pensions for public employees with tax deferment features, would have similar opportunity to provide for themselves without tax penalties;

(iv) By opening the door for the creation of non-tax-penalized programs for the millions who have not had the chance to participate in employer-instituted plans, an opportunity, at least and *at last*, would be provided to have *100% pension coverage in the private sector;* and

(v) Insurance companies, banks, mutual funds and other funding instrumentalities would be encouraged to extend their services by effective sales promotion activities to the "forgotten man"—the "man-in-the-street".

2. For employees who are contributing under an employer-instituted plan, *make such contributions tax-deductible* (including voluntary additional contributions),

provided such accumulated contributions are "locked-in" absolutely or practically by a "premature payout penalty" if withdrawn before retirement.

The following advantages would be gained by such a measure:

(i) Discrimination against employee contributions, vis-a-vis employer contributions, would be eliminated;

(ii) The present discouragement of contributory plans would be discontinued;

(iii) The prospect of greater benefits would be enhanced since the level of benefits for contributory plans is generally higher than that for non-contributory plans;

(iv) Vested benefits, derived from employer contributions, now frequently lost by withdrawal of employee contributions upon employment termination, would be preserved. (A good or, perhaps, disturbing example is the experience under the Civil Service Retirement System); and

(v) Contributing employees would have identifiable and fully vested equities that are in terms of dollars and that would properly be considered by employees as their personal savings for retirement purposes.

Associated with these two proposed amendments, it may be desirable to establish a reasonable limit on the aggregate amount of retirement income derived from all sources to which deferred taxation applies. It is suggested that consideration be given to a limit equal to 75% of the average earned income of the last five years of full employment and that a special income tax be imposed on any amount in excess of such limit.

CONCLUDING OBSERVATIONS

In the event of continued inflation, the taxation of the input of retirement provisions instead of the output at a later date—perhaps many years later—results in the payment of taxes of greater purchasing power and, in effect, an additional tax penalty that is not reflected in the figures here presented.

The recommended amendments will stimulate additional savings and thus increase the supply of capital in the years ahead. In such years, the prospect is that expanded welfare programs and social security benefits will produce spending rates that will have an inflationary potential since the marginal propensity to consume of the recipients will tend to be greater than that of those who pay the taxes to provide the funds for such purposes. Thus, the economic effect of these recommendations could be an important influence in combatting inflationary pressures.

As noted, the higher the marginal tax rate, the greater the tax penalty. But, recalling Dr. Griswold's words that "To tax him on it at the top bracket of the graduated rates of his earnings years is an unfair failure to recognize the economic facts of life," then, the higher the individual's top bracket, the more unfair the situation. It *is* a *fair* principle that the greater the injury, the greater the recompense deserved. Consequently, there is no justification for a demagogic declaration that elimination of the tax penalty constitutes favoritism to those in the higher income brackets.

Is it too much to say that if the magnitude of these tax penalties on legitimate old age savings provisions was generally known by the millions of employees not covered by employer-instituted plans but many whom are struggling with old-age provisions on their own, a new tidal wave of the tax revolt could engulf the Congress?

Is it too much to say that if the magnitude of the discrimination against employer-instituted plans where employees share the cost vis-a-vis plans where the employer pays all the cost was widely known, the new tidal wave of tax revolt could be reinforced by the protests of the millions of such contributing employees including participants under the Civil Service Retirement System?

May we hope that the truths here presented will produce actions resulting in tax justice? As Benjamin Disraeli said: "Justice is truth in action."

APPENDIX -- Part I

ASSUMPTIONS

Contributions

Attained Ages	Scales of Contribution (yearly amount)		
	A	B	C
25-29	$ 600	$ 750	$1,000
30-34	700	900	1,250
35-39	800	1,200	1,500
40-44	900	1,500	2,000
45-49	1,000	1,800	2,500
50-54	1,100	2,200	3,250
55-59	1,200	2,600	4,000
60-64	1,300	3,000	5,000

These may be taken as 10% of a yearly salary or earnings that is ten times the amount of the contribution. The different Scales are distinguished by the rate of increase and by the salary level and by the rate of increase.

Marginal Income Tax Rates

	Scale of Contributions		
	A	B	C
Pre-retirement	20 %	30 %	40 %
Post-retirement	20 %	30 %	40 %
	15 "	25 "	35 "
	10 "	20 "	30 "
	5 "	15 "	25 "

Interest Rates 4 %, 5.5 % and 7 %.

Retirement Age and Sex Males at Age 65.

Mortality After Retirement Ga 1951 Mortality Table (without projection)

APPENDIX -- Part II

FORMULAS

A. Annual Retirement Income

Definition of Symbols

RI(I), RI(II) and RI(III): annual retirement income, after tax, for Cases I, II and III, respectively.

t_a and t_r: pre-retirement and post-retirement marginal income tax rates, respectively.

i: annual rate of investment earnings before tax.

j: annual rate of investment earnings after tax,i.e., $(1-t_a)\cdot i$.

$C_r^{(i)}$ and $C_r^{(j)}$: accumulations of contributions to retirement age at rates i and j, respectively.

C_r: sum of contributions to retirement age, without interest.

$\bar{a}_m$: continuous life annuity value for retirement age m at interest rate i.

$\mathring{e}_m$: complete expectation of life for retirement age m.

Case I $$RI(I) = (1-t_a)\cdot C_r^{(j)}\cdot \left[\frac{(1-t_r)}{\bar{a}_m} + \frac{t_r}{\mathring{e}_m}\right]$$

If $t_r = t_a$,

$$RI(I) = (1-t_a)\cdot C_r^{(j)}\cdot \left[\frac{(1-t_a)}{\bar{a}_m} + \frac{t_a}{\mathring{e}_m}\right]$$

Case II $$RI(II) = (1-t_a)\cdot \left[\frac{(1-t_r)\cdot C_r^{(i)}}{\bar{a}_m} + \frac{t_r\cdot C_r}{\mathring{e}_m}\right]$$

If $t_r = t_a$,

$$RI(II) = (1-t_a)\cdot \left[\frac{(1-t_a)\cdot C_r^{(i)}}{\bar{a}_m} + \frac{t_a\cdot C_r}{\mathring{e}_m}\right]$$

Case III $$RI(III) = \frac{(1-t_r)\cdot C_r^{(i)}}{\bar{a}_m}$$

If $t_r = t_a$,

$$RI(III) = \frac{(1-t_a)\cdot C_r^{(i)}}{\bar{a}_m}$$

APPENDIX -- Part II (con.)

B. Amount of Accumulated Contributions for n Years, After Tax.

$C_n^{(i)}$ and $C_n^{(j)}$: accumulation of contributions for n years at rates i and j, respectively, where $j = (1-t_a)\cdot i$.

C_n: sum of contributions for n years without interest.

Case I	$(1-t_a)\cdot C_n^{(j)}$
Case II	$(1-t_a)\cdot \left[(1-t_a)\cdot C_n^{(i)} + t_a\cdot C_n\right]$
Case III	$(1-t_a)\cdot C_n^{(i)}$

C. Analysis of Effect of Lower Post-Retirement Marginal Tax Rate Than Pre-Retirement Marginal Tax Rate.

A lower post-retirement marginal tax rate produces additional income that can have three elements which are related to
(i) investment income earned during retirement years,
(ii) investment income earned prior to retirement, and
(iii) contributions.

In the following formulas,

I_r, II_r and III_r represent the retirement income for Cases I,II and III, respectively, where t_r is less than t_a.

I_a, II_a and III_a represent the retirement income for Cases I,II and III, respectively, where $t_r = t_a$.

$$\text{Item (i)} = (I_r - I_a) = (t_a - t_r)\cdot(1-t_a)\cdot\left[\frac{C_r^{(j)}}{\ddot{a}_n} - \frac{C_r^{(j)}}{\dot{a}_n}\right]$$

$$\text{Item (ii)} = (II_r - II_a) - (I_r - I_a)$$

$$= (t_a - t_r)\cdot(1-t_a)\cdot\left[\frac{C_r^{(i)} - C_r^{(j)}}{\ddot{a}_n} + \frac{C_r^{(j)} - C_r}{\dot{a}_n}\right]$$

$$\text{Item (iii)} = (III_r - III_a) - (II_r - II_a)$$

$$= (t_a - t_r)\cdot\left[\frac{t_a\cdot C_r^{(i)}}{\ddot{a}_n} + \frac{(1-t_a)\cdot C_r}{\dot{a}_n}\right]$$

The sum of Items (i), (ii) and (iii),i.e., $(III_r - III_a)$,

$$= (t_a - t_r)\cdot\frac{C_r^{(i)}}{\ddot{a}_n}$$

In comparing Cases I, II and III, only Items (ii) and (iii) become involved.

(iv)

APPENDIX -- Part III

Table (A)

TAX PENALTY Arising from Taxation of Contributions and Investment Income at Time of Input (instead of at Time of Output) for Employees Not Covered by an Employer-Institutes Plan.

Commencing Age	4.0% Interest Contribution Scale A	B	C	5.5% Interest Contribution Scale A	B	C	7.0% Interest Contribution Scale A	B	C
	Pre-Ret. Marg'l Tax Rate minus Post-Ret. Marg'l Tax Rate: 0%								
25	20.3%	26.7%	33.0%	27.3%	35.6%	43.2%	34.0%	43.7%	52.4%
35	16.8"	22.9"	28.5"	22.4"	30.3"	37.1"	27.7"	37.0"	44.8"
45	13.1"	18.6"	23.6"	17.3"	24.2"	30.5"	21.2"	29.4"	36.7"
55	9.4"	13.7"	17.9"	12.1"	17.7"	22.9"	14.6"	21.2"	27.3"
	Pre-Ret. Marg'l Tax Rate minus Post-Ret. Marg'l Tax Rate: 5%								
25	23.8%	30.6%	37.1%	30.3%	38.7%	46.5%	36.5%	46.2%	54.9%
35	20.5"	27.0"	32.9"	25.6"	33.6"	40.7"	30.4"	39.8"	47.8"
45	17.0"	22.8"	28.3"	20.6"	27.9"	34.5"	24.1"	32.5"	40.1"
55	13.5"	18.2"	23.0"	15.7"	21.6"	27.4"	17.8"	24.7"	31.2"
	Pre-Ret. Marg'l Tax Rate minus Post-Ret. Marg'l Tax Hate: 10%								
25	27.0%	33.9%	40.7%	32.9%	41.4%	49.3%	38.7%	48.4%	57.1%
35	23.8"	30.5"	36.8"	28.4"	36.6"	43.9"	32.8"	42.3"	50.4"
45	20.4"	26.5"	32.4"	23.6"	31.1"	38.0"	26.7"	35.3"	43.0"
55	17.0"	22.2"	27.4"	18.9"	25.1"	31.2"	20.7"	27.8"	34.6"
	Pre-Ret. Marg'l Tax Rate minus Post-Ret. Marg'l Tax Rate: 15%								
25	29.8%	36.9%	43.8%	35.3%	43.8%	51.8%	40.6%	50.4%	59.0%
35	26.8"	33.6"	40.1"	30.9"	39.2"	46.6"	35.0"	44.4"	52.6"
45	23.5"	29.8"	36.0"	26.3"	33.9"	41.0"	29.1"	37.7"	45.6"
55	20.2"	25.7"	31.2"	21.8"	28.2"	34.5"	23.2"	30.5"	37.5"

$$\text{Tax Penalty} = \frac{RI(III) - RI(I)}{RI(III)}$$

(v)

APPENDIX -- Part III (con.)

Table (B)

TAX PENALTY Arising from Taxation of Contributions of Employees at Time of Input (instead of at Time of Output) for Employees Covered by an Employer-Instituted Plan.

	4.0% Interest			5.5% Interest			7.0% Interest		
Com-mencing Age	Contribution Scale			Contribution Scale			Contribution Scale		
	A	B	C	A	B	C	A	B	C
	Pre-Ret. Marg'l Tax Rate minus Post-Ret. Marg'l Tax Rate: 0%								
25	13.4%	19.1%	25.0%	15.7%	22.7%	29.9%	17.3%	25.2%	33.3%
35	12.0"	17.5"	22.8"	14.4"	21.0"	27.5"	16.1"	23.6"	31.0"
45	10.4"	15.2"	20.0"	12.6"	18.6"	24.4"	14.3"	21.1"	27.9"
55	8.2"	12.3"	16.3"	10.2"	15.2"	20.2"	11.7"	17.6"	23.3"
	Pre-Ret. Marg'l Tax Rate minus Post-Ret. Marg'l Tax Rate: 5%								
25	15.3%	21.5%	27.9%	17.0%	24.4%	31.8%	18.1%	26.3%	34.6%
35	14.4"	20.3"	26.1"	16.0"	23.0"	29.9"	17.2"	25.0"	32.7"
45	13.2"	18.5"	23.8"	14.8"	21.1"	27.4"	16.0"	23.1"	30.2"
55	11.7"	16.3"	20.9"	13.1"	18.5"	24.0"	14.2"	20.3"	26.5"
	Pre-Ret. Marg'l Tax Rate minus Post-Ret. Marg'l Tax Rate: 10%								
25	17.1%	23.7%	30.4%	18.1%	25.8%	33.5%	18.8%	27.2%	35.7%
35	16.5"	22.7"	28.9"	17.5"	24.8"	32.0"	18.2"	26.3"	34.2"
45	15.7"	21.4"	27.1"	16.7"	23.3"	30.0"	17.4"	24.8"	32.2"
55	14.7"	19.7"	24.8"	15.7"	21.4"	27.3"	16.3"	22.7"	29.3"
	Pre-Ret. Marg'l Tax Rate minus Post-Ret. Marg'l Tax Rate: 15%								
25	18.6%	25.5%	32.5%	19.1%	27.0%	34.9%	19.4%	28.0%	36.6%
35	18.3"	24.8"	31.4"	18.8"	26.3"	33.8"	19.2"	27.4"	35.5"
45	18.0"	23.9"	30.0"	18.4"	25.3"	32.2"	18.8"	26.3"	33.9"
55	17.5"	22.7"	28.1"	17.9"	23.9"	30.1"	18.3"	24.9"	31.7"

$$\text{Tax Penalty} = \frac{RI(III) - RI(II)}{RI(III)}$$

APPENDIX -- Part III (con.)

Table (C)

GAIN from Taxing Contributions and Investment Income at One Time at End of Accumulation Period instead of Tax-at Time of Input, as Percentage of Gross Accumulation

(Ratio of (a) excess of after tax Case III accumulation over after tax Case I accumulation to (b) before tax Case III accumulation.)

Commencing Age	Period Contributions Made and Accumulated				
	5 yrs.	10 yrs.	20 yrs.	30 yrs.	40 yrs.
	Scale A Contributions (20% MTR)--5.5% Interest				
25	2.15%	4.25%	8.53%	12.93%	17.42%
35	2.15"	4.29"	8.67"	13.17"	
45	2.15"	4.31"	8.75"		
55	2.15"	4.32"			
	Scale B Contributions (30% MTR)--5.5% Interest				
25	2.81%	5.46%	10.25%	14.93%	19.53%
35	2.81"	5.41"	10.46"	15.37"	
45	2.81"	5.44"	10.64"		
55	2.80"	5.51"			
	Scale B Contributions (30% MTR)--7.0% Interest				
25	3.54%	6.92%	13.09%	19.13%	25.0%
35	3.54"	6.86"	13.41"	19.64"	
45	3.54"	6.89"	13.55"		
55	3.54"	6.98"			

Suggested Premature Payout Penalty

	Period Contributions Made and Accumulated				
	5 yrs.	10 yrs.	20 yrs.	30 yrs.	40 yrs.
1/2% for each year of contribution					
	2.50%	5.00%	10.00%.	15.00%	20.00%
or					
2/3% for each year of contribution					
	3.33%	6.67%	13.33%	20.00%	26.67%

to be applied to the total amount paid out.

(vii)

APPENDIX -- Part III (con.)

Table (D)

GAIN from Taxing Investment Income at One Time at End of Accumulation Period instead of Taxing at Time of Input, as Percentage of Excess of Gross Accumulation over Sum of Contributions

(Ratio of (a) excess of after tax Case II accumulation over after tax Case I accumulation to (b) excess of before tax Case III accumulation over sum of contributions without interest.)

Commencing Age	Period Contributions Made and Accumulated				
	5 yrs.	10 yrs.	20 yrs.	30 yrs.	40 yrs.
	Scale A Contributions (20% MTR) --5.5% Interest				
25	0.83%	2.01%	4.50%	7.18%	10.00%
35	0.83"	2.02"	4.55"	7.28"	
45	0.83"	2.02"	4.58"		
55	0.83"	2.03"			
	Scale B Contributions (30% MTR)--5.5% Interest				
25	0.94%	2.27%	4.89%	7.53%	10.21%
35	0.94"	2.26"	4.94"	7.67"	
45	0.94"	2.26"	4.98"		
55	0.90"	2.28"			
	Scale B Contributions (30% MTR)--7.0% Interest				
25	1.19%	2.90%	6.31%	9.02%	13.34%
35	1.19"	2.88"	6.51"	9.97"	
45	1.19"	2.89"	6.43"		
55	1.19"	2.92"			

Suggested Premature Payout Penalty

Period Contributions Made and Accumulated				
5 yrs.	10 yrs.	20 yrs.	30 yrs.	40 yrs.
1/4% for each year of contribution				
1.25%	2.50%	5.00%	7.50%	10.00%

to be applied to the excess of the total amount paid out over the sum of the contributions without interest.

Estate taxes

Statement of John C. Davis III on Behalf of the National Association of Wholesalers

SUMMARY

1. The Treasury Department proposal to impose a 25% capital gains tax on *unrealized* appreciation of assets at time of death would effectively limit small, closely-held, family-type wholesale distribution firms to one generation of existence, forcing many distress sales upon death of the owner or principal stockholder.

2. The Treasury proposals do not comprehend the fundamental difference between a "portfolio" of regularly traded and instantly marketable stock in public corporations and a "portfolio" consisting entirely of stock in one, closely-held, family-type wholesale distribution business. Part of the former can be liquidated to meet the demands of the tax collector without depreciating the value of the remainder of the "portfolio." Not so with a going distribution business—if you have to sell and not replenish inventory, your "out of business" and factoring of receivables inevitably leads to a "business embolism."

3. *Unrealized* capital asset appreciation in the wholesale distribution business produces business profits, and, as a basis for income tax revenue, should not be destroyed or impaired through forced liquidation to satisfy an income tax on "*unrealized income.*"

4. The Treasury proposal of a 100% marital exclusion would delay payment of transfer taxes until demise of a spouse, but would not permit transfer of our typical wholesale business to the next generation.

5. We recommend increasing the basic Estate Tax Exemption, which has remained at $60,000 for over 25 years, to $155,000 to fairly reflect a value comparable to $60,000 in 1940. However, this action *would not*, of itself, offset a capital gains levy on *unrealized* appreciation of capital assets, nor provide for perpetuation of small, closely-held, family-type businesses, from one generation to another.

STATEMENT

My name is John C. Davis, III, and I appear here today as a Past Chairman of the Board of the National Association of Wholesalers, and a member of its Executive Committee. NAW is a federation of 63 national commodity line wholesaler-distributor associations with approximately 16,500 member firms, representing over 23,000 merchant wholesale establishments or warehouse operations in the fifty states.

* * * * * * *

We are vitally concerned with Federal estate and gift taxes and State inheritance tax matters as we are predominantly small businesses. Of the 460,000 wholesale establishments enumerated by IRS in 1966, 61% are proprietorships, 6% partnerships and 33% corporations.

Of the $213 BILLION of business receipts reported by IRS for 1966 for those 460,000 wholesale businesses, the 151,000 corporations (33% of the total) had business receipts of $182 BILLION or 85%. Most of these businesses are what the Bureau of Census defines as "Merchant Wholesalers" who actually buy, break bulk, store, sell, deliver and extend credit to retailer-dealers and industrial, commercial, institutional and contractor business users, every conceivable type of product manufactured, mined or grown in the nation.

The number of wholesale firms listed on the major stock exchanges can be counted on the fingers of your two hands. A few others of the corporations have their stock traded over-the-counter on local stock exchanges but they, too, constitute a very few, certainly less than 1% of all corporations in our industry.

In other words, Mr. Chairman, most wholesale businesses are small, closely-held, family-type businesses. Many are in the second and third generation of family ownership and succession. We are thus very vitally concerned with the tax consequences of the death or physical incapacitation of an owner, partner or principal stockholder in our businesses, and how the tax will affect the chances of survival of that business.

Thus, lacking access to capital markets, we are primarily small, closely-held, family-type businesses. We are persuaded that the Treasury proposals in the estate and gift and capital gains tax areas would doom us to certain demise at the end of the first generation if they were enacted into law. We favor increased estate tax exclusion and are unilaterally opposed to taxation of unrealized capital gains as if the assets were sold the day of death of the owner.

A brief description of our type of business and business operation will illustrate the reasons for our deep concern that the Treasury proposals will cause the most common form of wholesaler-distributor organization, the closely-held, family owned business, to become extinct.

In 1966, 85% of the sales volume of wholesaler-distributors was handled by incorporated businesses. Their stock is owned principally by one or two family members—very seldom ten or more shareholders. The tens of thousands of first generation companies, founded since World War II, are presently owned and managed by the founders.

A business generation in wholesale distribution would average between twenty and thirty years—probably twenty-five years of continuous management by one person. A business generation in larger, publicly-held corporations, by comparison, would probably not exceed five to seven years—the period of actual Presidency or Chairmanship of one of a constantly changing line of professional managers.

Second generation wholesale companies, ie., those founded between World Wars I & II, are presently owned and managed by the sons or sons-in-law of the founders in the fortieth or fiftieth year of existence of the company. There are many tens of thousands of these companies now engaged in wholesale distribution. The balance of wholesaler-distributor firms were founded before World War I, some in the late 1800's.

Our economic function is to market the products of from a dozen to hundreds of manufacturing suppliers to hundreds of retailer-dealer or industrial, commercial, institutional and/or contractor and business users—the output of our nation's factories, mines and farms. In the performance of this vital economic function of giving time, place and possession utilities to products that have been given form utility by our factories, mines and farms, we add value to each product we handle. This "value added" by merchant wholesaler-distributors has been measured by the government, Bureau of the Census, as equal to $17.30 out of every $100 of goods handled or sold by us.

As we are the primary marketing arm of our suppliers, they are naturally vitally concerned about our managerial succession and viability. In 20 to 60 or more years of selling representation of our suppliers in our areas of primary market responsibility, we have demonstrated our ability to distribute their products for them more economically and efficiently than direct distribution systems of their own.

Their future is thus dependent upon our ability to survive and grow—grow faster than the built-in inflation of the economy, dollar wise, plus population growth, plus the growth in product proliferation of an affluent society. No business organization, be it publicly owned or closely-held, can surive in these times if it does not grow—at least keeping pace with growth in the economy as a whole.

The nation's merchant wholesaler-distributors are no exception. In fact, in the past decade, these small businesses have been growing at a rate almost double the growth in Gross National Product (GNP). The managerial know-how of these small business owner-managers is the key to their success and to the American low cost, fast distribution system which is the envy of the whole world.

With the best planning and training possible, of a succession management team, the death of a principle shareholder, owner-manager—even without drastic tax consequences to the survivors, individually and as a business often wreaks havoc and all too frequently leads to forced sale of distribution businesses. When the major shareholder is the owner- manager, the value of the business is drastically depreciated—diluted through the loss of an owner-manager. Our suppliers and larger customers, who are dependent upon our continued successful operation, are justifiably concerned about this.

It is the uncertainty and fear of these eventualities that is causing a rash of mergers and acquisitions in wholesale distribution in the 1960's and the tax consequences under present law are minimal when compared to what they would be under the Treasury Department Studies and Proposals in the capital gains, estate and gift tax areas.

As long ago as January, 1958, we wholesalers explained our tax and capital accumulation problems to the Congress and urged an increase in the Estate Tax Exemption to at least $120,000. We are now persuaded that $155,000 would be a more realistic figure as $60,000 in 1940, according to the Bureau of Labor

Statistics Index of the purchasing power of the dollar, translated in 1969 dollars would be $156,600.

We note that the Treasury Department Studies and Proposals do not contemplate any increase in the Estate Tax Exemption but rather propose a series of other changes, many of which we are very fearful would sound the death knell for small businesses such as those engaged in wholesale trade.

Philosophically, the Treasury proposal concludes that unrealized appreciation of capital assets, regardless of kind, is income and for tax purposes should be taxed as if realized. They propose to levy a tax on an assumed gain—an unrealized gain that may not actually exist or may quickly disappear. (Witness what has happened to publicly traded stocks in the last six months on the U.S. exchanges. The estate of anyone who died in January or early February would have been taxed on 25% to 30% of unrealized gain that doesn't exist today, a short tax months later.) Upon the death of an owner-manager a wholesale business could depreciate 50% or more, overnight.

The proposed tax is not on income but rather on property, solely because of its change in ownership. An unrealized increase in the value of an asset is not income, regardless of who holds it or why.

In wholesale distribution, between 80% and 85% of all our assets are inventory and accounts receivable. One of the intents of the Treasury proposals is to tax that portion of a decedent's appreciated assets "which have escaped income taxation", to use their language. Since 80% to 85% of our "appreciated" assets are inventory and accounts receivable, let us take a look at how they are accumulated.

In the average wholesaler-distributor firm, about 45% of the assets are accounts receivable and 40% is inventory—the ratio varies between commodity lines. Under current IRS regulations covering the creation of taxable income, beginning inventory, plus purchases, less closing inventory represents cost of goods sold. Net sales, less cost of goods sold becomes gross income from which cost of operation of the business are deducted to get net income for tax purposes.

Under this system of business tax accounting it could be argued that increases in the value of inventory, on the asset side of the balance sheet, come from before tax earnings. However, inventory has to be paid for, in most cases long before it is sold. Where does the money come from to pay for the increased level of inventory necessary to service a growing volume of sales? There are two sources only, other than current earnings, and they are new capital contributions or borrowings. New capital contributions are after-tax monies and borrowings must be paid back out of after tax earnings, only the interest is deductible.

For every dollar of increased sales in the typical wholesaler-distributor business, there must be a 20¢ increase in average investment in inventory and accounts receivable. In 1966, according to the latest available IRS Statistics of Income report, the average wholesaler-distributor business corporation made net profit BEFORE taxes of only 2.1% of sales. It can readily be seen that this level of earnings leaves little after tax earnings for reinvestment in the business. All increases in investment in accounts receivable MUST come from after tax earnings, either retained or newly invested.

Therefore, in our business, in a sustained period of inflations, we need increased investment every year to keep up with the inflationary spiral—to just stand still. If we are fortunate enough to expand our share of the market and thus experience absolute growth in excess of the inflationary growth that is taking place in the economy, as we have been doing recently, we must have heavy plowback of earnings as we lack access to outside capital markets.

I risk burdening the Committee with these industry problems, Mr. Chairman, to set the stage for what I have to say wih respect to our fears for the effect of the proposals of the Treasury Department on the future of our businesses. If you should accept the recommendations of the Treasury Department and (1) fail to increase the estate tax exemption, (2) tax unrealized appreciation of assets transferred at death or by gift even though you would reduce the effective estate tax rates by the 20% they propose—even though you leave the income and estate tax payment period in hardship cases for closely-held, family-type businesses at ten years and extend 100% exemption to spouses—in our opinion you would effectively eliminate the possibility of transfer of these types of businesses from one generation to another. You would force their sale or liquidation.

This is a most undesirable effect, in our opinion. We are absolutely persuaded that in the wholesale segment of the economy at least, you would multiply anticipatory mergers, a trend we have been watching closely and are very concerned about, under present law. In fact, Mr. Chairman, four years ago we became so concerned about the trend toward mergers and acquisitions of all types in our industry—vertical, horizontal and conglomerate—that we made a nation wide survey.

We undertook a study of merchant wholesaler-distributors' methods of stock valuation for estate tax purposes and the IRS attitudes and ruling as well as tax court cases. We have circulated almost 10,000 copies of this Wholesaler-Distributor Stock Valuation Study, a copy of which I would be glad to leave with you for the information of your staff and of the Committee.

The study documented the overwhelming difficulty of determining the decedent's "basis" when his assets were acquired 10, 20 or 30 or more years before, and determining, "fair market value" for assets in limited demand. If the Treasury proposal were to be enacted and everyone given a 1969 or 1970 basis as is proposed in the grandfather clause, the task of determining an equitable basis 10, 20 or 30 years from now seems hopeless, particularly when business records are required to be kept only seven years, barring litigation.

We are also persuaded, as a result of this study, that few small business wholesalers actually make adequate plans in advance for that "day certain", when the principal owner or stockholder dies. Even under present law, those who do study this problem are often persuaded that the best solution is to sell out of some publicly-held firm on a tax exempt exchange of stock basis. They do this to convert their own closely-held, unmarketable, illiquid stock into a liquid asset that will be taxed on appreciation as, if, or when the stock is sold—and for which there is always a ready market, in whole or in part, as the heirs may require.

We believe that taxing appreciation of assets at death, as if sold the day before death, would not only complicate this problem of economic concentration, but the statistics seem to indicate that the revenues that would result would be relatively small. We have never looked upon estate and gift taxes as revenue raising measures. We do not believe the Congress has done so in the past.

Being a drug wholesaler, Mr. Chairman, I would suggest that we have a look under the sugar coating in the Treasury pill and determine the long range effect. By sugar coating, I mean the forgiveness of taxation on all unrealized appreciation of assets that has taken place before the date of enactment of their proposals. Those of us in this business generation might say, "Fine", but our concern for the next generation, and the next, forbids this approach. Let me explain exactly what we believe would happen to an average wholesale firm in the next twenty-six years, under the Treasury proposals, based on what has happended to the average wholesale firm in the past twenty-six years.

Please keep in mind that our spouses are really not capable of managing our businesses after we are gone, as they do not possess the energy, ability, and business acumen to actively manage a going business. The 100% exemption to them merely delays the tax impact and may multiply the problems, we fear.

My family-owned wholesale drug business, if it is to be perpetuated, must be run by my son or my brother's son or our sons-in-law or nephews, not our wives or daughters. Despite the recent social trends in the United States, I believe we can all safely assume that the situation will be quite similar for at least the next twenty-six years, which I am using in the following examples.

My point is that the 100% spouse exclusion in no way helps solve the long-term problem of perpetuating the family-type business from one generation to the next. We have already witnessed the demise of the family farm. Not due wholly to tax problems, mind you, but because many of the sons left the farm. We are trying hard to persuade our sons to stay with our wholesale businesses but it isn't easy in view of our poor earnings record in past years, as you will see from our example.

Turning now to Exhibit I, appended to my statement. The average wholesale corporation, as reported in 1966 Preliminary Statistics of Income by IRS, has assets of $417,097. If we examine the Bureau of Labor Statistics Purchasing Power of the Dollar statistical series, we find that in terms of 1940 dollars this average wholesale corporation's assets would have been $175,104 in 1940 *IF* it had just kept up with devaluation of the dollar in the twenty-six year period, without any real appreciation in the value of its assets.

Now, let's suppose that the Treasury proposals are enacted into law in 1969 and that we have an asset base for a wholesale corporation of that same $175,104 and that the next twenty-six years will witness no greater rate of depreciation in the purchasing power of the dollar than the last twenty-six years. In other words, let us assume that the asset value of our corpoation will be $417,097 in 1995. What we want to know is, could our 1995 sons or grandsons take over the business on the death of the owner, under the Treasury proposals, pay the proposed capital gains tax at today's rates, the estate tax at the suggested rates of the Treasury proposals, and pay off the tax bill in ten years (IF the estate could qualify as a hardship case in the view of the Commissio.er) at the proposed new higher interest rate?

The capital appreciation would be $241,993 on which the capital gains tax would be $60,498.[1] This could be deducted by the estate, plus the $60,000 estate tax exemption from the $417,097 valuation for the estate tax base—which would leave $296,599 as the amount subject to the new Estate and Gift Transfer Tax. The recommended new Transfer Tax Rate on that size estate would be 25% or a tax liability of $74,150.

If we add the Capital Gains Tax of $60,498 to the Transfer Tax of $74,150, we have a total death tax liability arising against the estate of $134,648. If our heirs could prevail upon the Commissioner to agree that theirs was a hardship case (which few have been able to do in the past under the present payment plan, I might add) the estate could divide that amount into 10 equal payments, plus interest possibly at 6% (probably more) on the unpaid balance.

The first year's payment would then be $13,465 plus interest of $7,271 or $20,736. Now the average wholesaler-distributor business gets a three times turn over on assets, only, a very poor rate but these are the facts. This means that our average wholesale firm would have sales in 1995 of $1,251,291. The average net profit before taxes on sales of wholesale-distributor corporations in 1966, according to the IRS Statistics of Income, was 2.1% so, our 1955 corporation would earn $26,277 before taxes. At today's corporate rates, including the surtax, the income tax liability would be $6,724. If we deduct that from the earnings, there remains $19,553 net income after taxes available for distribution of shareholders (to the estate). The estate liability to the government is $20,736 for the first installment on death transfer taxes, plus interest, so the estate is faced with a $1,183 deficit, and, there had been no reinvestment to finance necessary growth, on the employment of $417,097 of assets to support $1,251,291 of sales. Moreover, the estate is also faced with paying income tax on the $19,553 it received as dividends from the business.

Can it survive? We think not.

Now, let us look at Exhibit II. This is a more typical wholesaler-distributor corporation, according to the 1966 IRS Statistics of Income of wholesale corporations. They separate the returns by asset size and the greatest percentage of total dollar sales fall into the $1 to $5 MILLION asset size corporation. We have chosen the mid-point in that asset size bracket, namely, $2,500,000.

Using the same set of assumptions our 1995 wholesale corporation with assets of $2,500,000 would be a 1966 corporation with $1,050,000 in assets.

The assumed appreciation subject to tax in 1995 in this case would be $1,450,000; the capital gains tax $362,500 and the taxable transfer base $2,077,500. The recommended rate for this size of estate would be 41% or $851,775. When the capital gains tax is added to the transfer tax, the total tax liability of this estate, when turned over to the sons, would be $1,214,275. Assuming again that they could convince the then Commissioner of Internal Revenue that they were a hardship case and he would permit them to pay the tax in ten equal yearly installments plus interest at 6% (or higher) on the unpaid balance, the first yearly installment, including interest, would be $186,999.

Our $2,500,000 asset corporation in the wholesale business would be having sales of $7,500,000 and at today's earning rate, net profit before taxes of $157,000. Its income tax liability would be $76,010. Take that amount off net profit before taxes and you have $81,490 income after taxes available for dividends to shareholders (the estate). BUT, the estate owes Uncle Sam $186,999 first year payment including interest. The estate faces a net deficit of $105,509—plus estate income tax on $81,490 on the dividends it received from operation of the business.

We submit, Mr. Chairman, that both the small, average wholesale corporation, and his larger, more typical counterpart would have to sell, at forced sale prices upon the death of the owner or principal stockholder, if the deceased is a widower father or a widowed mother under the proposals of the Treasury Department as we interpret them.

In both of the exhibits, I have assumed that the business only appreciated in value in an amount equal to the depreciation in the value of the dollar.

Our original premise was that no business can stand still. It either grows or fails. If these two example wholesaler-distributor business grew at all, in absolute dollars in assets and sales, their predicament would be that much worse.

The Treasury proposal promises to give some relief by permitting the accumulated earnings of the business after death to be used for stock redemption of the decedent's stock. However, if the business is already short of working capital, as most distribution businesses are today, or if there are no such earnings, then this solution is a nullity. The final nail in the coffin of the small business will be driven by the "adequate collateral to secure the payment of taxes" to the Treasury Department, as indicated at page 405. The Treasury Department would take a lien upon the business assets which would preclude the business from borrowing. Thus the lien would destroy the borrowing capacity and paralyze financial operations. In addition, it is stated at page 405 of the Treasury report that "the District Director is entitled to 90 days notice of sales of corporate assets of value greater than $1,000 (other than sales in the ordinary course of business), to notice of the declaration of a dividend, and to notice of any other action calculated to have a substantial effect upon the liquidating value of a firm, including changes in the salaries of officers or directors. Failure to furnish such notice will constitute a default, which will authorize the District Director to enforce his security interest." It is a certainty that the District Director will be either running or liquidating every small business within his district if this proposal is enacted.

In closing, we would urge again that (1) the present estate tax exemption, to spouses, orphans and sons or other heirs be increased to a more realistic figure—at least to a flat dollar amount that would represent at 1969 reflection of a $60,000 1942 exemption ($155,000), (2) that unrealized capital gains not be taxed at death but rather that the law should provide for the carry over to the heirs of the decedent's basis for property included in the estate, at least insofar as closely-held, family-type businesses that continue in operation are concerned, and (3) that the present 10 year extended payment period for estate taxes be retained and that the rules be relaxed, by law if deemed necessary, so that the Commissioner of Internal Revenue does not, in effect, become the financial manager of the business, to whom the heirs have to turn for approval every time they want to spend a few dollars for improvement in plant, equipment or additions to inventory, etc.

Indeed the Treasury study admits that the ten years payment period has not been taken advantage of by many taxpayers because of the stringent rules and regulations that are applied in such cases by the Commissioner.

It might also be desirable to increase the Federal Estate Tax credit for State inheritance and other death taxes, to ease the shock of death taxes on the Nation's smaller, independent businesses. We believe it is the genuine desire of this Committee and the Congress, yes AND the Administration, to perpetuate these businesses from one generation to another. Complete exemption for spouses will not do this.

The Treasury assertion that the 100% marital exclusion "will give the surviving spouse more time to plan for the disposition of an illiquid asset at the best possible price . . ." is fallacious. Disposition of our "illiquid assets", inventory and receivables, without replenishment in a like or greater amount means liquidation of the business, pure and simple.

The Treasury assertion that "Freezing of investment position (holding onto appreciated assets rather than selling them during lifetime) deprives the economy of the fruits of an unencumbered flow of capital toward areas of enterprise promising larger rewards" simply is not valid with respect to the perpetuation of closely-held, family-type wholesale distribution businesses. Our investment, frozen as it may be, is in a constantly changing, evergrowing group of products that are needed every day of the year by consumers to survive and other businesses to operate. If our investment is forced to be liquidated by tax law, to meet the demands of tax collectors, other, perhaps less efficient entrepreneurs will have to take our places with equal or greater amounts of capital investment to satisfy the insatiable appetites of American consumers and American business for food, clothing, shelter, raw materials, maintenance and repair and replacement parts and equipment. Of that your Committee may be sure, Mr. Chairman.

What the Treasury Studies and Proposals do not comprehend is the difference between a "portfolio" of regularly traded and instantly marketable stock in public corporations and a "portfolio" consisting entirely of stock in one, closely-held, family-type whole sale distribution business. Part of the former can be liquidated to meet the demands of the tax collector without depreciating the value of the remainder of the "portfolio". Not so with a going distribution business—if you have to sell and not replenish inventory, your "out of business" and factoring of receivables inevitably leads to a "business embolish".

We have not dealt with the gift tax proposals as the Treasury study reports that less than 10% of taxpayers with small estates ever use gifts in any way in their estate planning. We believe this is especially true in the wholesale industry.

We appreciate your kindness and attention, Mr. Chairman and Members of the Committee, in granting this opportunity to present these views. We are not experts in tax policy matters, I assure you, but we have developed some expertise in figuring the tax impact on our businesses, under the watchful eye and careful guidance of the Treasury Department and more particularly the IRS.

That concludes my remarks, Mr. Chairman, and with your permission I'd like to include my exhibits at this point in the record.

Senator WILLIAMS. Without objection.

EXHIBIT I

Example of effect of Treasury recommendations on assets and operations of an average wholesale distribution corporation

(Based on Statistics of Income 1966—Internal Revenue Service)

Assets of average wholesale corporation [1]	$417, 097
1940 basis [2]	175, 104
Appreciation	241, 993
Capital gains tax (25 percent)	60, 498
Assets	417, 097
Less capital gains tax	60, 498
Total	356, 599
Less overall exemption	60, 000
Taxable transfer	296, 599
Transfer tax (25 percent)[3]	74, 150
Capital gains tax	60, 498
Transfer tax	74, 150
Total taxes	134, 648
First installment of 10 year payment	13, 465
6 percent interest, first year	7, 271
Total first year payment by estate	20,736
Average business receipts equal 3X average assets [4]	1, 251, 291
Average net profit before taxes=2.1 percent [5] of business receipts	26, 277
Taxable income	26, 277
Corporate income tax (22 percent)	5, 500
(48 percent of remaining $1,277)	613
Surtax (10 percent)	611
Total corporate income tax	6,724
Net profit before taxes	26, 277
Less income tax	·6, 724
Net profit after income taxes	19, 553
Dividend to estate (assuming no retained earnings)	19, 553
1st year payment, including interest	20, 736
Deficit (not including estate income tax due on $19,553)	(1, 183)

[1] Total wholesale trade assets divided by the number of income tax returns. Source: p. 19, preliminary statistics of income, 1966, corporation income tax returns, Internal Revenue Service, U.S. Treasury Department.

[2] Purchasing price of the dollar (1957–59=$1) in 1940 $2.326 vs. 1966 $0.944. It would take $2.382 in 1966 dollars to equal the purchasing power of 1 1940 dollar, or, 1 1966 dollar is worth the equivalent of 42/100 1940 dollar. Thus, 1966 assets worth $417,097 would have been valued at 42/100 that amount ($175, 104) in 1940. Source: Bureau of Labor Statistics, U.S. Department of Labor.

[3] Proposed unified transfer tax rate from schedule on p. 356 of the joint publication, Committee of Ways and Means, pt. 3.

[4] Source: Same as 1. Total Assets $63,423,325,000 vs. total business receipts of $188,424,712,000 or, a ratio of 1 to 2.97.

[5] Source: Same as 1. Business receipts $188,424,712,000 vs. Income subject to tax $3,937,726,000 or, 2.089 percent.

Exhibit II

Example of Effect of Treasury Recommendations on Assets and Operations of A Typical Wholesale Distribution Corporation

(Based on Statistics of Income 1966—Internal Revenue Service)

Assets of typical wholesale corporation [1]	$2,500,000
1940 basis [2]	1,050,000
Appreciation	1,450,000
Capital gains tax (25 percent)	362,500
Assets	2,500,000
Less capital gains tax	362,500
	2,137,500
Less overall exemption	60,000
Taxable transfer	2,077,500
Transfer tax (41 percent) [3]	851,775
Capital gains tax	362,500
Transfer tax	851,775
Total taxes	1,214,275
First installment of 10 year payment	121,428
6 percent interest, 1st year	65,571
Total first year payment	186,999
Average business receipts equal 3× average assets [4]	7,500,000
Average net profit before taxes 2.1 percent [5] of business receipts	157,500
Taxable income	157,500
Corporate income tax (22 percent of 1st $25,000)	5,500
(48 percent of the remaining $131,500	63,600
Surtax (10 percent)	6,910
Total corporate income tax	76,010
Net profit before taxes	157,500
Less income tax	76,010
Net profit after income taxes	81,490
Dividend to estate (assuming no retained earnings)	81,490
1st year payment, including interest	186,999
Deficit (not including estate income tax due on $81,490	(105,509)

[1] Source: Preliminary Statistics of Income, 1966, Corporation Income Tax Returns, Internal Revenue Service, U.S. Treasury Department.

[2] Purchasing price of the dollar (1957–59=$1.00) in 1940 $2.326 vs. 1966 $0.944. It would take $2.382 in 1966 dollars to equal the purchasing power of 1 1940 dollar, or, 1 1966 dollar is worth the equivalent of 42/100 1940 dollar. Thus, 1966 assets worth $2,500,000 would have been valued at 42/100 that amount ($1,050,000) in 1940. Source: Bureau of Labor Statistics, U.S. Department of Labor.

[3] Proposed unified transfer tax rate from schedule on p. 356 of the joint publication, Committee on Ways and Means.

[4] Source: Same as 1. Total assets $63,423,325,000 vs. total business receipts of $188,424,712,000 or, a ratio of 1 to 2.97.

[5] Source: Same as 1. Business receipts $188,424,712,000 vs. Income subject to tax $3,937,726,000 or, 2.089 percent.

General

Statement of Marvin J. Miller, Executive Director, Major League Baseball Players Association, to the Finance Committee of the U.S. Senate

The Major League Baseball Players Association is the exclusive collective bargaining representative of all major league baseball players employed by the 24 major league baseball clubs which make up the American and National Leagues.

The players, as salaried employees, have a direct interest in the Tax Reform Act of 1969 currently under consideration by the United States Senate Finance Committee.

Certain conditions of employment of professional athletes are similar to those which relate to employment in other industries. However, several circumstances of their employment are unusual, and at least one is unique. It is the unique circumstance which has resulted in an inequitable application of the Internal Revenue Code by the Internal Revenue Service.

A major league player is required, as a condition of employment, to sign a contract containing a "reserve" clause which, in effect, provides that the player is the property of his club, that the employer club's option on his services has no termination date, that the player may be traded, sold, optioned or otherwise assigned to other employers at other locations at the will of the employer club, and that such assignments may be made without consultation or notice. Furthermore, there is no limit to the number of such assignments or reassignments and when they take place during a playing season, the player is obliged to report to the assignee club within 72 hours.

While relocation of employees is not unusual in American industry, there is no other field of endeavor outside of professional sports in which an employee is required to accept assignment of his contract to another employer in a different location or be barred from the entire industry and required to learn new skills in order to earn a living. This requirement means that a player at all times is subject to relocation of his place of employment and, in many cases, to one relocation after another.

The overwhelming majority of major league players maintain a permanent residence in one part of the country and a second home in the city in which his employer club of the moment is located. This second home, or "home-away-from-home", obviously entails certain living expenses. Such expenses are not reimbursed by the employer clubs. Despite the necessity and the obvious connection between such expenses and producing income through his salary as a player, such expenses are not considered as deductible for purposes of the Federal Income Tax unless certain other conditions relating to off-season employment and income are met. Even when income is earned off-season at the place of the player's permanent residence, Internal Revenue's decisions concerning the deductibility of his "home-away-from-home" expenses have been applied in a non-uniform fashion which has resulted in a great deal of confusion.

The Internal Revenue Service has recognized, in situations outside of professional sports, that it is appropriate to permit deduction of "home-away-from-home" expenses in situations where the wage or salary earner is required to live away from his permanent home in order to accept temporary employment. The underlying principle seems to be that when employment away from the taxpayer's home is on a temporary basis, it is unreasonable to expect him to relocate his family and, therefore, his extra living expenses necessitated by such employment are properly deductible.

Application of this principle to the circumstances of professional athletes in the major team sports of baseball, football, basketball and hockey seems eminently logical and equitable. Because of the reserve clause requirement, no player in these sports industries has anything but a temporary job with respect to any particular place of employment. At all times a player is subject to reassignment without notice. Almost inevitably each such assignment entails a change in the location of his employment to another city considerably beyond commuting distance.

In view of the clearly temporary nature of his employment, unreimbursed reasonable and necessary living expenses incident to the employment of professional athletes should be deductible expenses for Federal Income Tax purposes. It is urged that the Committee give favorable consideration to the following addition to Section 162(a) of the Internal Revenue Code of 1954:

> "For the purpose of this Section (§ 162(a)), the place of residence of a taxpayer shall be considered his home when his place of employment

> within the industry in which he is employed is determined exclusively by his employer who retains the right to assign his employment contract to another employer or for performance at another place."

In its consideration of the Tax Reform Act of 1969 the United States Senate Finance Committee reportedly has approved a more liberal "income averaging" provision than the current law provides, and has approved three new categories of moving expenses as deductible expenses. The Major League Baseball Players Association favors both of these actions. The income pattern of many professional athletes is very different from that of most taxpayers. As a result of the successful application of his skills and a number of other factors, a baseball player's major league starting salary of approximately $10,000 a year may advance rapidly over the next succeeding two, three or four years. However, since the average player does not even complete five years of major league service in his lifetime, the period during which he enjoys peak earnings is extremely short. (The top stars of the game who remain in the major leagues for 10, 15 and even more years are the exceptions.) Accordingly, the concept of income averaging which results in the application of a tax bracket more in keeping with the average annual income of a player over the period of his career is appropriate. Similarly, the Committee's action in recognizing certain categories of actual moving expenses as deductible is both realistic and equitable.

Under consideration by the Committee is an amendment relating to deferred compensation. Although deferred compensation agreements are not widespread in baseball, there has been a growing number of such contracts as more players attempt to plan ahead for the anticipated, precipitous decline in earnings at the relatively early ages of players when they become inactive as players. As noted, the peak earnings of professional athletes are compressed into a very few years. The attempt to defer a part of such income to a later period when the former athlete will face the necessity of embarking on a new career at an age somewhere between 32 and 39 seems to be constructive and socially useful. None of the deferred income contracts in baseball, to our knowledge, provide that the player receive any income which might be earned from the deferred salary during the period of its deferment. It is clear that if the tax laws required that the deferred salary be taxed as if such deferred salary had been paid in the year earned, it would result in the elimination of deferred salary agreements of the type generally found in professional sports. While the elimination of or limitation of deferred salary agreements would increase Federal tax revenues, it would seem to be desirable to permit significant salary deferrals (to be taxed in the years actually received) in the case of taxpayers whose peak earning years are composed into a small part of their working lives.

Finally, the Players Association urges that the Senate Finance Committee give consideration to a problem relating to player awards constituting gross income for purposes of the Federal Income Tax law. The United States Court of Appeals, 9th Circuit. (May 14, 1969) found that the Tax Court correctly held that the value of an automobile and the S. Rae Hickok belt awarded the taxpayer, a professional baseball player, constituted gross income in the years of receipt.

The Hickok belt was awarded to the player as the "outstanding professional athlete" in 1962.

It seems clear that, under certain conditions, prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary or civic achievement are excluded from gross income. However, the Circuit Court found that the taxpayer's award did not fall into one of these categories. In affirming the decision of the Tax Court, the Circuit Court noted:

> "The law as it presently exists requires the foregoing conclusion. We dislike it, for we are convinced it is an inequitable result. The next step would be for the International Revenue Service to tax the gold and silver in the medals awarded to Olympic Games' winners. Unfortunately for the taxpayer in this case, the court has no authority to legislate equities into the Internal Revenue Code or the Treasury Regulations. Both the problem and the remedy lie with the Congress, not with the courts."

The Major League Baseball Players Association respectfully requests that the Senate Finance Committee approve an amendment to the Internal Revenue Code which would exclude from gross income awards which are made in recognition of athletic achievement.

AMERICAN PUBLIC GAS ASSOCIATION,
Washington, D.C., October 7, 1969.

Hon. VANCE HARTKE,
Senate Committee on Finance, New Senate Office Building,
Washington, D.C.

DEAR SENATOR HARTKE: The American Public Gas Association, the national association of publicly owned gas distribution systems, held its Eighth Annual Convention at Gatlinburg, Tennessee, September 15–17, 1969, At that time, the members unanimously adopted 5 resolutions on various issues involved in the Tax Reform Act of 1969 (H.R. 13270) now before your Committee of vital interest to the members of the association. We are enclosing herein copies of these resolutions.

We respectfully request that these resolutions be made a part of the printed Senate Hearings relating to the Tax Reform Act of 1969.

We appreciate very much this opportunity to present our views to you and the Committee.

Respectfully submitted,

ROBERT H. KING, *President.*

RESOLUTION NO. 4.—THE TAX EXEMPT STATUS OF STATE AND LOCAL BONDS

Whereas, the interest from State, municipal and other public agency bonds has historically been exempt from Federal taxation under our dual system of government; and

Whereas, a Federal income tax on the obligations of States and their political subdivisions, or upon the interest they pay on these obligations, would be inconsistent with and contrary to the dual system of government contemplated by our Constitution; and

Whereas, the House of Representatives of the United States Congress has passed H.R. 13270, 91st Congress, 1st Session (also known as the Tax Reform Act of 1969) which bill would offer a Federal subsidy to State and local bond issues in exchange for their interest's being subject to Federal income taxation; and

Whereas, H.R. 13270 will have, and already has had, a seriously adverse impact on, and caused great uncertainty in the market for State and local obligations; and

Whereas, such a Federal subsidy would undermine the financial independence and integrity of State and local governments in carrying out their governmental responsibility of providing their citizens with essential public services including natural gas and would drive them to rely instead upon Federal assistance; and

Whereas, the issuance of tax exempt bonds bearing the lowest possible interest rate is essential for municipal and other publicly-owned gas utilities to have a means of financing needed facilities for the transmission and distribution of water, natural gas and electricity; and

Whereas, the limited tax preference provisions of H.R. 13270 provides a sufficient deterrent to tax abuse by holders of tax exempt State and local bonds; now, therefore, be it

Resolved, That the American Public Gas Association:

1. Reaffirm its opposition to any legislation which would abridge the tax exempt status of bonds issued by State or local governments to finance public services including natural gas; and

2. Opposes any legislation which would offer Federal subsidy as a substitution for the long-standing Constitutional and legislative tax exemption of interest on State and local bonds presently incorporated in Section 103 of the Internal Revenue Code of 1954.

RESOLUTION NO. 5.—TREATMENT OF LIBERALIZED DEPRECIATION AND ACCELERATED AMORTIZATION FOR RATE MAKING PURPOSES

Whereas, the "flow-through" principle for the treatment of liberalized depreciation under Section 167 and accelerated amortization under Section 168 of the Internal Revenue Code of 1954 results in substantial savings to the ratepayers who thereby pay only for the actual Federal taxes incurred by regulated natural gas companies as a part of their cost of service; and

Whereas, to the contrary, the "normalization" principle for the treatment of these matters results in the ratepayers paying for hypothetical "phantom" taxes which the regulated natural gas companies do not in fact pay to the Government and may never pay; and

Whereas, the Federal Power Commission has decided that the flow-through principle is the proper method for treating liberalized depreciation under Section 167 of the Internal Revenue Code, and has further decided that companies using liberalized depreciation may not change their depreciation method to avoid flowing through the resulting tax savings to the consumer, which decisions have been affirmed by a number of courts on appeals; and

Whereas, H.R. 13270, 91st Congress, 1st Session ("Tax Reform Act of 1969"), if enacted, would in effect "freeze" utility companies in the type of depreciation and amortization which they are now using by requiring (1) that if straight line depreciation is presently used, then no faster depreciation is to be permitted as to that property, (2) that if accelerated depreciation with normalization is presently used, the taxpayers must either switch to straight line or continue to normalize, and (3) that if accelerated depreciation with flow through is presently used, the taxpayer must continue to do so unless the appropriate regulatory agency permits a change as to that property; and

Whereas, the effect of these provisions of H.R. 13270 would be to inhibit the expanded use of accelerated depreciation (and flow through of the savings resulting therefrom) for ratemaking purposes, thereby arbitrarily discriminating against consumers in those areas of the country serviced by pipeline companies which have not as yet switched to accelerated depreciation; Now, therefore, be it

Resolved, That the American Public Gas Association opposes those provisions of H.R. 13270 which would change the present law relating to the use of accelerated depreciation and amortization by utility companies.

Resolution No. 6.—Oil and Gas Depletion Allowance and Intangible Drilling Expensfs

Whereas, the 27½% depletion allowance for oil and gas production has long been a greater benefit and incentive than is necessary for producers of oil and gas; and

Whereas, this allowance has in many instances permitted oil and gas companies to avoid bearing their fair share of our nation's tax burden; and

Whereas, the present tax provisions relating to intangible drilling expenses which permit an immediate write-off of the costs of drilling new wells provide sufficient incentive for such drilling; and

Whereas, H.R. 13270, 91st Congress, 1st Session ("Tax Reform Act of 1969"), if enacted, would cut the present 27½% depletion allowance on domestically produced oil and gas to 20% and would repeal entirely the 27½% depletion allowance for overseas production of oil and gas; and

Whereas, the provisions of H.R. 13270 would not affect the deductions permitted for intangible drilling expansion; and

Whereas, the effect of the above provisions of H.R. 13270 would be to reallocate the Federal income tax burden in a substantially more equitable manner than now exists and, through the maintenance of the present provisions relating to the deduction of intangible drilling costs, could result in a significant increase in the exploration for and development of domestic supplies of oil and gas through an incentive to increase the level of domestic drilling operation, which would result in substantial savings to consumers in the prices they would pay for oil and gas; and

Whereas, any changes in both the depletion allowance and the deduction for intangible drilling expenses might deter the development of new supplies of oil and gas and thereby result in an increase in the cost of oil and gas to the consumer; now, therefore, be it

Resolved, That the American Public Gas Association supports those provisions of H.R. 13270 which reduce the present 27½% depletion allowance on domestically produced oil and gas to 20% and which repeal entirely the depletion allowance for foreign production of oil and gas, but opposes any attempt to restrict the provisions of Section 263(c) of the Internal Revenue Code of 1954 regarding allowance of intangible drilling expenses for oil and gas wells.

Resolution No. 7.—Repeal of the Investment Tax Credit

Whereas, H.R. 13270, 91st Congress, 1st Session ("Tax Reform Act of 1969") would, if enacted, provide that the termination of the investment credit would not affect gas pipeline construction not yet begun but for which an application had been filed with the Federal Power Commission prior to April 19, 1969; and

Whereas, since 1964, the benefits derived by pipeline companies from the 7% investment tax credit have not been "flowed through" to the consumer to lower the rates he pays for gas, so that the consumers in effect, have been paying as though there were no investment tax credit; and

Whereas, this exception to the termination provisions (known also as the "pipeline sweetener") constitutes unwarranted special treatment for gas pipeline companies as the expense of the public; now, therefore, be it

Resolved, That the American Public Gas Association opposes anything short of uniform, across-the-board treatment of all businesses with respect to the termination of the investment tax credit.

RESOLUTION No. 8.—REDUCTION OF FOREIGN TAX CREDIT FOR OVERSEAS OIL AND GAS OPERATIONS

Whereas, it is desirable to encourage exploration for and development of domestic supplies of oil and natural gas; and

Whereas, it is in the interest of the nation and the consuming public to achieve a greater economy in the production of oil and natural gas through a proximity of the sources of these products to those who buy and consume them; and

Whereas, present tax law relating to foreign tax credits for overseas oil and gas operations encourages overseas production at the expense of domestic development; and

Whereas, present law has allowed some oil and gas companies to derive double tax benefits and to disguise royalty payments to foreign governments as "foreign taxes"; and

Whereas, provisions of H.R. 13270, 91st Congress, 1st Session ("Tax Reform Act of 1969") would, if enacted, correct this situation and encourage greater development of domestic oil and gas resources by reducing the foreign tax credits available for overseas oil and gas operations; now, therefore, be it

Resolved, That the American Public Gas Association supports the provisions of H.R. 13270 relating to reduction of the foreign tax credits available to overseas oil and gas operations.

Surtax

[Telegram]

JULY 10, 1969.

Mr. RUSSELL B. LONG,
Chairman, Senate Finance Committtee,
Senate Office Building, Washington, D.C.:

I wish to make known the opposition of our union to the extension of the 10 percent surtax which is an intolerable burden on wage earners in private industry who are caught in a squeeze between rising prices and rising taxes. We fully support tax reforms. The closing of loopholes in the present laws would more than make up.

ALBERT J. FITZGERALD,
General President,
United Electrical Radio and Machine Workers of America.

Railroad rolling stock

STATEMENT OF THE ASSOCIATION OF AMERICAN RAILROADS, SUBMITTED BY FRANCIS O. MCDERMOTT, TAX COUNSEL

SUMMARY RECOMMENDATION

The Association of American Railroads suggests:

(1) Modifying Section 705 of the House measure which provides 7 year amortization of certain railroad rolling stock by:

(*a*) Correcting the language to assure amortization treatment as intended by Committee on Ways and Means

(*b*) Reducing proposed amortization period from 7 to 5 years

(*c*) Expanding provision to include locomotives, and

(*d*) Broadening language to include private car lines and other taxpayers who own rolling stock

(2) Liberalizing present moving expenses by permitting:

(*a*) A new $2500 combined deduction for house-hunting trips, temporary living costs at new location, and commission for selling prior residence, (Section 231 of House Bill), and

(*b*) An employee to receive present nonrecognition of gain or capital gains treatment for sale of his prior residence where employer payments are involved

(3) Modifying the present foreign tax credit limitation by computing the limitation without regard to capital gains; and

(4) Expanding section 332(c), Internal Revenue Code of 1954, by:

(*a*) Extending nonrecognition of gain treatment to the parent in the case of subsidiary indebtedness to the parent, and

(*b*) Affording similar nonrecognition of gain treatment in such case when an insolvent subsidiary is liquidated.

STATEMENT

The Association of American Railroads, on behalf of the railroad industry, appreciates this opportunity to express its views regarding certain provisions of the tax reform bill presently before this committee.

The Association, usually referred to as the AAR, is a voluntary nonprofit, unincorporated association that includes in its membership the major, or Class I, railroads of the United States, plus numerous smaller U.S. roads and the major roads of Canada and Mexico. Our members operate about 94 percent of the railroad mileage in the United States.

1. AMORTIZATION OF RAILROAD ROLLING STOCK (SECTION 705 OF HOUSE BILL)

'The industry appreciates the recognition specifically given in H.R. 13270 by the Ways and Means Committee and the House of Representatives to the financial problems we face and our desire to modernize and up-grade our service to the public in general. Thus, the House bill contains a provision (Section 705) which provides a domestic common carrier railroad subject to regulation by the Interstate Commerce Commission to elect (under regulations prescribed by the Secretary) to amortize freight cars and passenger cars over a period of 84 months (7 years). This fast write-off is available to rolling stock (except locomotives) acquired by the tax payer after July 31, 1969. Also, as pointed out by the House Committee, rolling stock constituting pretermination property placed in service after July 31, 1969, qualifies for both rapid amortization and investment credit.

We are certainly in accord with the underlying reasons for this relief, particularly in view of imminent repeal of the investment credit. The record is eminently clear that since enactment of the tax credit our industry has been able to increase and invest in new equipment and facilities to a considerable degree. The dramatic result has been a substantial contribution to modernizing railroad equipment, increasing our efficiency, reducing freight car shortages during seasonal periods of critical need, and improving every railroad's ability to acquire new equipment, particularly rolling stock. With termination of the credit, our industry will be severely hit.

However, while we are in accord with the over all objective of the House provision, we submit that this amortization provision alone cannot be a true substitute for investment tax credit. In the first place, a basic difference is that a faster write-off period results only in a postponement of taxes rather than in a true tax saving. In contrast, the investment tax credit, as the term itself suggests, results in an actual reduction or saving in taxes. Thus, there is no way in which these two essentially different provisions can really be equated, either in the short or the long term. Also, the investment credit provides an immediate savings in cash which serves as a down-payment on equipment purchases. Moreover, for purposes of determining depreciation, investment credit does not have to be deducted from original cost.

Another aspect of the 7-year amortization provision is its delayed impact—it does not become fully operative until 1979—some ten years hence. The reason is that under present law by using the rapid write-off provided by Treasury Guidelines (double declining balance on a 14-year life for rolling stock), a railroad can recover two-thirds of the cost of the equipment in the first seven years of the equipment's life. The net effect of the 7-year amortization proposal merely gives us recovery of the extra one-third cost some three years earlier.

Furthermore, the provision would apply only to cars, not to locomotives nor to other facilities now eligible for the investment tax credit. Also, as presently written, it provides a faster write-off only for cars owned by carriers and not by "private" car owners such as carleasing companies, a distinction which does not apply under the existing investment tax credit. This would be a serious disadvantage to such owners, to the carriers which favorably lease cars from such owners, and to the cause of providing a fully adequate and modern car supply.

2. POSITION OF THE TREASURY

The Treasury Department, in testimony before the Finance Committee on September 4, 1969, opposed this provision on the basis that it provides relief only to a small number of profitable roads and would be of no financial assistance to the more depressed railroads; and, in contradiction to the House committee's conclusion, alleged that "it (Section 705) will not be an effective instrument in dealing with the specialized problems of seasonal shortages of general-purpose freight cars." They proposed no solution. We believe that the objections of the Treasury can simply be removed by adopting the industry's suggestions, especially that amortization be extended to include car leasing companies and other tax payers who own rolling stock. This particular extension will provide one of the prime advantages that the investment tax credit has afforded to our less provident railroads—the opportunity to favorable leases. Further, we wholeheartedly disagree with the conclusions of the Treasury, namely, the problem of seasonal shortages would not be helped in part by this provision. It is obvious that if the overall relief which the industry seeks is realized, greater incentive will exist to not only replace the present fleet but to expand and modernize it, especially when coupled with the rolling relief from invstment credit repeal.

3. SUGGESTED CHANGES IN SECTION 705

The American Railroads feel that the fast write-off provision of the House bill, if expanded, will go far in achieving the objective for which the House provision is designed; modernization of railroad equipment and increase in railroad efficiency. However, in order to provide our industry with its present level of equipment investment, which the House proposal intends to provide, we feel certain necessary improvements in the amortization provision must be made.

(a) *Amortization*

In the summary of H.R. 13270 prepared by the staffs of Joint Committee on Internal Revenue Taxation and the Finance Committee, it is correctly pointed out on page 99 that the bill *erroneously* provides for 7-year depreciation, instead of amortization. It is quite clear from the House Ways and Means Committee report, pages 200 and 201, that the House committee definitely intended that our industry be provided with the option to amortize certain of our railroad rolling stock over a 7-year period. In view of this, and without belaboring the point, this drafting error should be corrected and the language of the section redrafted to assure the industry of amortization election for its railroad rolling stock, in lieu of depreciation.

(b) *Five-year amortization in lieu of seven years*

Presently, the bill provides for an 84-month or 7-year period for amortization deductions. Regrettably, this period is far too long to supply the needed funds necessary to offset the permanent loss of the investment credit. This is particularly evidenced by the fact that use of a 7-year period as proposed, because of the present availability of double declining depreciation on a 14-year guideline life for rolling stock, will not produce any additional deductions in 1969. For several years, the additional deductions would be far short of currently available benefits arising from the investment credit and accelerated depreciation. Consequently, to provide meaningful assistance, it is essential that the amortization period be shortened to 5 years. This recommendation is made in full recognition that this Committee has seen fit, in view of the financial straits of the railroads and its need to have adequate equipment, to provide for a transitional phase-out of the investment credit for railroad rolling stock. The industry is grateful to the Committee for its help and feels that such Committee action is fully justifiable in view of the critical need for rolling stock now.

However, it must be recognized that the proposed relief provided in the investment credit repeal amendment of H.R. 7311, ordered favorably reported by the

Committee on Friday, September 19, is not a permanent answer and provides through 1974 only transitory assistance. This results from the fact that the phase-out credit provisions of the rolling stock proposal reduces the available investment credit at the rate of 1/10 of 1% a month beginning in January, 1971, until January, 1975, when the credit ends. Also, since the provision applies only to rolling stock, this cuts back our overall credit approximately 25 percent for 1969 and 1970, and even more when the phase-out reduction starts in 1971. This means less dollars, less cash flow for our equipment needs. However, coupled with a liberalized 5-year amortization allowance, as suggested, it should provide the railroad industry with a source of capital for its locomotive and car fleet and the continued modernization of the industry.

The 7-year amortization provides *no benefit* to the industry in 1970, a modest benefit in 1971, and some benefit in the three succeeding years, *provided* substantial equipment is added to the freight car fleet. On the other hand, the combination of the transitional investment tax credit for rolling stock, approved by this committee, and a five-year amortization of railroad rolling stock provision can go far in implementing the expressed Congressional intent to provide assistance to the railroad industry in meeting the needs of the country.

(c) *Inclusion of locomotives*

As drafted, the bill provides deductions for rolling stock except locomotives. Locomotives should be included in the rolling stock available for amortization in the same manner as the transitional phase-out provision which applies to all rolling stock. More efficient and modern locomotives will improve the use of car fleets generally. Obviously, adequate power is needed in order to move freight and passenger cars. Also, the industry is faced with the necessity of retiring large numbers of locomotives which can no longer do the job. Thus, failure to include locomotives in this provision would leave a great gap in our modernization plans. Further, without inclusion of locomotives, the amortization deductions will be far short of any investment credit benefits which they are intended to replace.

(d) *Availability to lessors*

Presently, Section 705 applies only to a railroad owning its own rolling stock. Since many of the finacially weak railroads lease rolling stock and since it is equally important to help these railroads acquire new rolling stock, the language should be broadened to include private car lines and other taxpayers which own rolling stock. This would be in line with the phase-out credit for rolling stock. As previously noted, one of the prime advantages of the investment credit to railroads and other companies is the right to transfer it to another party in a leasing arrangement. To those roads that have no taxable income or not enough to use their credits in full, transferability of the investment credit has been of substantial benefit. In the assignment arrangement to a lessor, a *quid pro quo* for assignment is the railroad's opportunity to obtain a significantly lower interest rate under the lease than that available in the going market. Consequently, over the years, the practice of acquiring equipment through investment credit leases has grown, and it now is a significant factor in modernizing our fleet. In view of this, it is recommended that the amortization provision be extended to all car owners—railroads, car leasing companies, and tax payer owners alike. This will guarantee that not only the tax paying railroads will benefit, but the less provident ones as well. Thus, the entire industry, and the public as well, will be helped.

(e) *Technical aspects*

Redrafting the bill on an amortization basis requires language to assure an election to terminate use of a 5-year amortization period should a tax payer so desire. A similar type of provision is in Section 168 of the Internal Revenue Code of 1954 premitting 5-year amortization of emergency facilities. In addition, since the investment credit is allowed on amortized rolling stock (as pre-termination property) a provision is necessary to make it clear that no reduction in the investment credit is made because of the use of a 5-year amortization period where the actual useful life of the equipment is in excess of the eight years required for full investment credit. Another aspect is that the enactment of this provision is not intended to afford capital gains treatment to what otherwise would be ordinary income. This has been called to the attention of the committee staffs and can be dealt with accordingly. Finally, it is requested that suitable language be inserted in the committee report or the bill, if necessary, which assures a railroad or other entity electing this amortization, that such action would not create any adverse effects on its depreciation accounts in application of the so-called reserve ratio test. It would be incongruous for a tax payer to elect the benefits of this provision and then be in a position of losing them because of the reserve ratio test.

(f) *Suggested proposal*

In order to achieve the purpose intended by the House, namely, to encourage continuation of the present level of our investment, and incorporating the necessary recommendations of the industry, the following language should be substituted for the present provisions of Section 705:

SECTION 705. AMORTIZATION OF RAILROAD ROLLING STOCK

(a) In General.—Part VI of subchapter B of Chapter 1 (relating to itemized deductions for individuals and corporations) is amended by inserting after section 182 the following new section:

"Sec. 183. Amortization of Railroad Rolling Stock.

"(a) Allowance of Deduction

A taxpayer may elect, in accordance with regulations prescribd by the Secretary or his delegate, to amortize any unit of railroad rolling stock—

"(1) the construction or reconstruction of which is completed by the taxpayer after July 31, 1969, and then only to that portion of the basis which is properly attributable to such construction or reconstruction after such date, or

"(2) which was acquired by the taxpayer after July 31, 1969, if the original use of such property commences with the taxpayer and commences after such date, over a period of 60 months. Such method shall be in lieu of any other method of computing the depreciation deduction under section 167."

"(b) Termination of Election

A taxpayer which has elected the amortization provided by subsection (a) may, at any time after making such election, discontinue the amortization with respect to the remainder of the amortization period for any rolling stock. The depreciation deduction under section 167 shall be allowed beginning with the first month as to which the amortization deduction does not apply, and the taxpayer shall not be entitled to any further amortization with respect to any rolling stock for which an election has been terminated.

"(c) Useful Life

In the case of rolling stock for which an election is made under this section, the taxpayer shall estimate the actual useful life of such rolling stock to compute the qualified investment under Section 46(c) (2)."

(b) Effective Date.—The amendments made by subsection (a) shall apply with respect to taxable years ending after July 31, 1969.

2. LIBERALIZATION OF MOVING EXPENSE RULES

A. *House bill provision (section 231) endorsed*

In general, the railroad industry endorses the further liberalization of the present moving expense rules proposed by Section 231 of the House Bill.[1]

The industry, in common with many other industries, finds itself asking a substantial number of its employees to move en masse to new job locations for the convenience of the employer. We believe that the reasons which support the current deductability by an employee of "direct" moving expenses should also support the exclusion from current income of certain "indirect" expenses necessitated by an employee's move for the convenience of his employer, and for which he is reimbursed by his employer. However, we feel the House provision does not go far enough.

B. *Further problem*

Employers requiring employees to transfer job locations have frequently sought to cushion the financial impact on the employee due to loss on the sale of his old residence in a depressed market by reimbursing the employee for any such loss. In *Otto Sorg Schairer*, 9 T.C. 549 (1947), an amount paid by an employer in reimbursement of a loss sustained on the sale of an employee's residence upon

[1] However, question is raised on the propriety of imposing withholding on deductible items since this action may prove too burdensome.

the employee's transfer to a different city was held to be part of the "amount realized" upon the sale and not taxable as compensation.

This was the law for sixteen years. But in *Harris. W. Bradley*, 39 T.C. 652 (1963), the Tax Court repudiated *Schairer*, holding that payment in reimbursement of an employee's loss on the sale of his residence in connection with his accepting employment at a new job location was taxable to the employee as incentive compensation.

Bradley has come to be the controlling judicial authority, and was most recently followed by the Tax Court in *William A. Lull, et al.*, 51 T.C. No. 83 (2/26/69). In that case, the taxpayers contended that payments by the employer with respect to IBM's "Home Guaranty" policy, i.e., reimbursement for loss on sale of the old residence, were part of the "amount realized" upon such sale. The taxpayers argued further that since they had purchased new residences at costs in excess of the adjusted sale prices of the old residences, no part of the payments were taxable pursuant to section 1034 (which provides for postponement of tax on the gain from the sale of a residence). Rejecting the taxpayers' contentions, the Court concluded that the amount paid to the employee in each case was not part of the "amount realized." The Court reasoned as follows:

"The amounts paid to the employee in such cases, and in the present cases, are not part of the 'amounts realized' upon the sale. They are not paid by the purchaser. *The employer does not purchase the house.* The payments are not made pursuant to the sales contract but pursuant to the employment contract. They are made to secure better services from the employee by relieving him of concern over the sale. Payments to secure better services represent compensation. *Commissioner* v. *LoBue* [56-2 USTC ¶ 9607] 351 U.S. 243, 247, (1956)."

The *Lull* case involved two individual taxpayers, and sales of three separate houses. In one sale the taxpayer received from an outside purchaser a net selling price in excess of his adjusted basis. Nonrecognition of this gain ($1,837.30) was allowed under section 1034, despite the receipt of $2,162.76 under the Home Guaranty policy, because the taxpayer purchased another residence in the same year for a greater price. But in the sales of the other two houses the net selling prices were less than the taxpayer's adjusted cost basis for each property, and the taxpayers' sustained losses. In all cases the amounts received by the taxpayers pursuant to the Home Guaranty policy were held taxable as compensation. In the case of two houses, sold at a loss, such losses nonetheless were held to be personal and nondeductible.

Even harsher and stranger results occurred in *Bradley*. In that case, the sales price of the residence, plus the $5,000 the employee received from his employer, was approximately $1,500 less than the employee's tax basis in the residence, so even after employer reimbursement the employee actually suffered a net loss on the disposition of his residence. Nonetheless, he was taxed on additional "compensation" of $5,000.

Since amounts paid to an employee by his employer as reimbursement for a loss realized by the employee on the sale of his residence are presently treated by the Revenue Service and the courts as taxable compensation, such amounts are ineligible for tax deferral under present tax law[3] even if such amounts are *reinvested* in a new residence. This treatment discriminates, particularly where the employee is guaranteed, under a union contract, receipt of the full appraised value of his home before it was affected by public notice of the move, as illustrated by the examples below:

	(a)	(b)	(c)
1. Appraised value	$35,000	$35,000	$35,000
2. Sales price	35,000	30,000	25.000
3. Reimbursement by employer (1)—(2)	0	5,000	10,000
4. Employee's tax basis (cost)	20,000	20,000	35,000
5. Gain or (loss) (2)—(4)	15,000	10,000	(10,000)
6. Taxable compensation (line (3))	0	5,000	10,000
7. Gain eligib'e for tax deferral under sec. 1034 (line 5)	15,000	10,000	0
8. Nondeductible (loss) (line 5)	0	0	10,000

[3] Sections 121 and 1034, Internal Revenue Code of 1954.

Needless to say, the tax inequities are most striking when a "mass move" is involved which depresses the sale price and increases reimbursement from employer to employee, i.e., taxable compensation to the employee as in example (c) above.

C. Suggested Proposal

It is recognized that the sale of a residence, with attendant loss where market value has declined below original cost, is conceptually different than out-of-pocket costs incurred by an employee in the course of moving. The loss on the sale of the residence is due to fluctuation in value, resulting, perhaps, from the transfer of a large number of employees by the same employer. Because of this difference we do not advocate the allowance of a deduction of the capital loss sustained by an employee on the sale of his old residence, but instead, enlargement of section 1034 to provide for postponement of tax with respect to employer payments incident to an employee's sale of his old residence when transferred by that employer to a new principal place of work as defined in section 217(c). It should be immaterial whether the employer payments are made as purchaser of the residence, or in reimbursement for loss sustained upon sale of the employee's old residence to a third party.

We suggest that a new paragraph (6) be added to section 1034(c) reading as follows:

(6) (A) If a taxpayer is required to change his "principal place of work," as defined in Section 217(c), as a condition to his continued employment, and sells his old residence to his employer, or to a nominee of his employer, to the extent that the taxpayer, within the period allowed by subsection (a) hereof, reinvests such proceeds in the purchase of a new residence, the proceeds of such sale shall not be treated as compensation received by the taxpoyer from his employer, and the determination of the amount of the taxpayer's taxable gain realized from such sale, shall be made under the provisions of this section or Section 121. If such a taxpayer is reimbursed by his employer for loss sustained upon the sale of the taxpayer's old residence to a third party and the taxpayer, within the period allowed by subsection (a) hereof, reinvests all or part of the proceeds of sale, including the amount received as reimbursement of loss, in the purchase of a new residence, to the extent that such proceeds of sale, including the reimbursement, are reinvested in a new residence, such proceeds shall not be treated as compensation received by the taxpayer from his employer and the determination of the amount of the taxpayer's taxable gain realized from such sale, shall be made under the provisions of this section or Section 121.

(B) To the extent that any taxable gain is recognized under this section or Section 121, to a taxpayer, resulting from a transaction described in subparagraph (A), upon the sale of his old residence to his employer, or a nominee, or by payment made to the taxpayer by the employer in reimbursement for loss sustained upon the sale of the taxpayer's residence to a third party, such gain shall be taxable to the taxpayer as ordinary income."

Where the employer is the purchaser of the employee's residence, loss on the subsequent sale thereof by the employer gives rise to an ordinary business expense deduction. As a corollary, should the employer realize gain on any sale of such residence, the gain should be taxable as ordinary income, for the gain would be a recapture of amounts previously deducted when paid to, or on behalf of, the employee. Of course an employer's reimbursement to an employee for loss in the sale of a residence to a third party gives rise to an ordinary business expense deduction.

Thus, under the proposed amendment employer reimbursement for losses incurred by employees on the sale of their homes, incident to a change in job location, would be treated, within certain limits, as part of the sales price of the employee's residence and accorded the present benefits of law. To the extent a taxpayer's gain is not reinvested in the purchase of a new residence, it would be taxed as ordinary income. This feature should provide both incentive to reinvest the funds and disincentive to abuse this provision as a vehicle for "disguised compensation."

The proposed amendment should have the following beneficial effects:

(1) It would settle any differences that may presently exist in tax treatment between sales to employers and reimbursement of employee losses by employers;

(2) It would alleviate hardships resulting from taxable reimbursements of the excessive losses experienced by employees involved in "mass moves" by allowing employees to reinvest and thereby defer tax on amounts received as reimbursement under Sections 1034 and 121;

(3) It should contribute to the adoption of uniform practices in handling this type of employee's moving expenses;

(4) It should eliminate pyramiding of tax by encouraging the abandonment of the current practice of paying the employee's tax, which is prevalent under the current rule;

(5) It should eliminate many of the troublesome problems of the employer associated with withholding of tax under the current rules;

(6) It should protect the revenue by providing that tax deferral be limited to the gain reinvested and that gain from the sale and reimbursement not reinvested be taxed at ordinary income rates.

D. *Attendant hardships require equity*

It is understood that the Treasury did not act with respect to reimbursement of loss on the sale of an employee's residence, incident to a change in job location, under section 217, because a workable rule could not be devised which would be applicable to the self-employed and to employees of an employer who had no policy of reimbursement. The thinking is reported to have been that employees who have their residences purchased or were reimbursed by their employer had enough to be thankful for and could be omitted from the remedial legislation. But are the equities so easily resolved?

Hardships giving rise to the reimbursement or purchase of employees' residences by employers at a figure in excess of current fair market value are usually the result of a mass move, which throws dozens or hundreds of homes on the market at the same time, thereby depressing current fair market value to as much as one-third or one-half the fair market value of the same residence two or three years earlier. If the employer's payment of the difference between current fair market value prior to public disclosure of the move is to be treated as compensation, as in the *Lull* case, the employer may consider paying the employee's tax if it is still worthwhile to make the move. But what of an employer with marginal or no profits which is financially unable to make such payments plus the tax thereon. It is submitted that such an employer, in many cases, will simply close up shop, lay off its help, hire new employees at the new location, and by so doing save both the cost of reimbursement *plus* the payment of income taxes for the employees.

The magnitude of the problem stems from the fact that current fair market value of a residence involved in a mass transfer will probably be reduced to the point where the employee is certain to sustain a loss (nondeductible) on the sale of his residence. Where such a move occurs in an area already economically depressed, the loss to employees can be calamitous. If the employee stays, he is out of work; if he moves, he starts out in the new job location with a substantial tax bill on "compensation" he doubtless will be forced to use to replace his former residence. Why should the Internal Revenue Code not allow him to defer this tax under section 1034?

A self-employed taxpayer, on the other hand, moves by his own decision, when and where he chooses. Customarily, he will not face a drastically depressed market in which to sell. He will have the benefit of sections 1034 and 121, if he otherwise qualifies. Moreover, were he to realize the same gain on the transaction as the employee, the self-employed taxpayer would not be faced with ordinary income tax rates, like the employee, but in most cases would pay the maximum rate of 25 percent on capital gain., i.e., if he chose to be taxed at all. The same inconsistency would apply to employees who received the purchase price for their residences from outside third parties.

Such inconsistency in the tax treatment of persons similarly situated can usually be justified by some compelling need to minimize the loss of revenue, the complexity of relief, etc. Here, at best, there is involved only the deferral, not absolution from tax. At worst, a tax situation is created that would dictate a lay-off of employees rather than preservation of their jobs at a different location. Moreover, nothing novel is required by this proposal, merely the extension of the coverage already available to most taxpayers with a penalty if the funds are not reinvested in purchasing a new residence.

3. MODIFICATION OF FOREIGN TAX CREDIT LIMITATION

A. Limitation on foreign tax credit

The foreign tax credit is provided in order to prevent double taxation. A limitation thereon is provided to prevent a taxpayer from saving more in U.S. tax than the amount properly attributable to his foreign source income. It is contended that by the same token, the amount of the foreign tax credit ought not to be *less* than the U.S. tax attributable to the inclusion of the foreign income. The present law frustrates this result, since the limitation is made to depend on the overall rate of tax, including the alternative tax on capital gains. Rather, limitation should be made to depend on the rate of U.S. tax applicable to the particular foreign source income included.

While a number of approaches might solve this problem, the solution here recommended is that the limitation be applied separately to capital gains and to other income, in the manner adopted for certain interest income in section 904(f).

B. Background and policy of limitation

The foreign tax credit was first provided by the Revenue Act of 1918, in order to prevent double taxation of income from foreign sources. The limitation thereon, which now appears in section 904 of the 1954 Code, first appeared in the 1921 Act. Its purpose is to insure that the taxpayer will not be able to reduce his tax on U.S. income by any portion of his foreign taxes, in cases where the foreign tax rate is higher than the U.S. rate. These conclusions were stated as follows in the committee report accompanying the Revenue Bill of 1939:

"The limitations on the allowance of a credit for taxes paid to foreign countries were placed in the law to make it certain that the Federal Government would receive its full tax on the income from the United States sources. It was not intended for the American tax to apply against the income from foreign sources unless the foreign tax rate was less than the tax rate imposed by the United States."[1]

C. Inadequacy of present limitation and reason therefor

As indicated by the quoted language, there should be no U.S. tax on foreign income unless the foreign rate is less than the U.S. rate. This equitable objective is defeated by the credit limitation in its present form.

The reason for this failure is that the amount of the limitation depends on the overall or effective rate of U.S. tax, including the lower alternative tax rate on capital gains, instead of matching the U.S. tax rate applicable to the particular foreign source income.

For example, assume the case of two corporations each having a taxable income of $1 million, of which $200,000 is ordinary income from the same foreign country. Assume further that both the foreign country and the U.S. apply a tax rate of 50 percent to such ordinary income. Assume finally, that one corporation has no net long-term capital gain, while the other has a net long-term capital gain of $200,000. Both corporations will pay a tax of $100,000 to the foreign country The first corporation will have a U.S. tax before credit of $500,000, of which one-fifth ($200,000 foreign income divided by $1 million of total income) can be allowed as a credit. Thus, the allowable credit of $100,000 equals the amount of foreign tax paid, and double taxation is completely avoided; this case properly reflects the fact that the U.S. tax rate and the foreign tax rate are exactly equal. The second corporation will have a U.S. tax of $450,000 (50 percent of $800,000 and 25 percent of $200,000) of which the same one-fifth can be allowed as a credit. Consequently, the limitation on the credit is $90,000. The second corporation is denied use of $10,000 foreign tax credit, because of the allowance of the alternative tax on capital gains. This has nothing to do with avoiding double taxation, and flies in the face of reality—namely, the two corporations are otherwise identically situated.

Research in past committee reports and in the texts and commentators discloses no policy reason for this effect of capital gains on the foreign tax credit limitation. Rather, it appears to be an unintended consequence of the particular mechanics adopted for computing the limitation.

D. Factual example

The Chesapeake and Ohio Railway Company operates a line of railroad between Detroit and Buffalo, passing through southern Ontario. The profits from

[1] H. Rept. No. 855, 76th Cong., 1st Sess., p. 5.

this operation are taxed as ordinary income by the Dominion of Canada, by the Province of Canada, and by the United States. The aggregate taxes payable to Canada and to Ontario are at the rate of 52 percent (except that the first $35,000 is taxed at 20 percent). The Internal Revenue Service has consistently recognized that the taxable income reported by C&O to Canada and Ontario is the correct measure of the foreign income for purposes of the foreign tax credit. One would expect that the company would have had a small unused credit in the years when the U.S. tax rate was 48 percent and would have come out exactly even in the years when the U.S. tax rate was 52 percent. The fact is, however, that in the five years 1963 through 1967 the taxpayer reported Canadian income of $9.4 million, on which it paid $4.9 million of tax to Canada and Ontario; while in that same period the amount of unused credit for U.S. tax purposes amounted to $1.1 million, or nearly 25 percent of the foreign tax paid. The reason was that the taxpayer's income from capital gains and section 1231 gains was a large proportion of its total taxable income. (The figures stated are subject to adjustment upon audit in both countries, but they fairly represent the nature of the problem and its magnitude.)

E. The other side of the coin

The present law does not operate only against taxpayers. It can operate equally with unfounded inequity against the government, where the taxpayer, with or without distortion of what would otherwise be normal business practices, realizes large capital gains in a foreign country at a low tax rate or none at all. In such a case the taxpayer's total foreign tax is not increased by the gain, but he can take credit for a larger share of his foreign taxes against his U.S. tax. The unfairness to the government is mitigated, however, by the fact that in no event can the credit exceed the amount of foreign tax payable; and moreover, there are many types of exempt or low-rate foreign income besides capital gains which operate to distort the application of the foreign tax credit.[3]

F. The proposed remedy

Any proposed remedy to cure the problem complained of must be ventured with some diffidence, in view of the complexity of foreign taxes and the wide diversity of operations conducted abroad by American taxpayers. It would seem, however, that the problem could best be solved by applying a separate limitation to capital gains, in much the same manner as has already been done for certain interest income from foreign sources. This could take the form of a new subsection (g) under section 904, as follows:

"(g) Application of Section in Cases of Certain Capital Gains—In any case where Section 1201 is applicable, the provisions of subsections (a), (c), (d), (e) and (f) of this section shall be applied separately with respect to—

(1) the excess of the net long-term capital gain over the net short-term capital loss, and

(2) taxable income computed without regard to the net long-term capital gain and the net short-term capital loss."

Suitable transitional rules, analogous to those in section 904(f)(4), would also be required.

G. Comments on proposed remedy

The problem could be solved very well from the viewpoint of taxpayers by providing a substraction formula; that is, the limitation on the foreign tax credit would be the difference in the U.S. tax as computed with and without the inclusion of the foreign source income. This is probably undesirable as a matter of policy, however, because as applied to individuals it would mean that the foreign tax rate was always compared with the top-bracket U.S. rate, and even as applied to corporations it would charge the entire effect of the surtax exemption against U.S. income instead of spreading it over all income as the present law does.

The problem could also be solved to the benefit of taxpayers by providing that "the tax against which such credit is taken" shall be computed without the application of section 1201 (alternative tax computation). The limitation rate applicable to foreign income would then be equal to the U.S. ordinary income rate. The objection is that such a solution would magnify, instead of reducing, the government's problem with respect to exempt and low-rate foreign income.

[3] See Chapman and de Kosmian, "The excess foreign tax credit: some solutions to the many problems," 22 J. Tax. 296 (May 1965).

Consideration may also be given to altering the terms of the fraction by which the limitation is now expressed (foreign income over entire income); for example, by excluding capital gains from the denominator or perhaps from both the numerator and the denominator. This approach simply will not yield rational results, however, for reasons rooted in the mathematical characteristics of fractions.

The separate limitation approach, as proposed, avoids the faults of the other approaches set forth above. It appears to be a complete solution to the instant problem, namely, the failure of the present law to give credit at the U.S. tax rate actually applicable to the particular foreign income. The only apparent drawback of the proposed approach is that it singles out foreign source capital gains for special treatment, and would deny taxpayers the advantage of foreign source capital gains while leaving the comparable advantage of other exempt or low-rate foreign income untouched. It would seem, however, that the separate limitation on certain foreign interest is ample precedent for the proposed approach, and that other shortcomings of the present limitation, whether adverse to the taxpayer or adverse to the revenue, should be dealt with specifically.

III. LIQUIDATIONS OF SUBSIDIARIES

A. Historical Background

Prior to the enactment of the 1954 Code, the Internal Revenue Service took the position that assets distributed to a parent corporation upon complete liquidation of a wholly owned subsidiary indebted to the parent must first be applied (at their fair market value) against the indebtedness to the parent.[3] If appreciated assets were so applied, the subsidiary realized taxable gain to the extent of appreciation. The nonrecognition of gain provisions of the predecessor to section 332(a) did not apply because they covered only distributions with respect to stock, not indebtedness.

Because of administrative difficulties in applying the concepts of I.T. 4109, such as deciding which assets should be applied against the debt where there was no designation by the parties, the Internal Revenue Service stated that it would not take the position that the subsidiary realizes gain on the liquidation by reason of the application of appreciated assets to its indebtedness, if the parent corporation would execute a closing agreement which provided that the basis of the subsidiary's assets in the hands of the parent would be the same as the basis of such assets in the hands of the subsidiary immediately prior to the liquidation.[4]

Section 332(c) of the Internal Revenue Code of 1954 overruled I.T. 4109, and when read together with the basis provisions of section 334(b)(1) reaches the same result as the closing agreements under Rev. Rul. 259.

B. Problems

While the enactment of the 1954 Code thus eliminated one vexatious problem by relieving the subsidiary of tax on the amount of any appreciation in property transferred by it in satisfaction of its indebtedness to its parent corporation, it did not afford any relief to the parent corporation from tax where it acquired an indebtedness of a solvent subsidiary at less than face value and when such indebtedness was satisfied at more than its basis in the hands of the distributee parent in a liquidation to which section 332 applies. Under the corresponding provision of the 1939 Code, the parent had been held to realize gain upon the liquidation measured by the difference between the basis of the indebtedness and the face amount thereof. *Houston Natural Gas Corp.* v. *Commissioner*, 173 F.2d 461 (5th Cir. 1949). The regulations under the 1954 Code take a similar position with respect to the application of the 1954 Code:

". . . For example, if the parent corporation purchased a subsidiary's bonds at a discount and upon liquidation of subsidiary the parent corporation receives payment for the face amount of such bonds, gain shall be recognized to the parent corporation. Such gain shall be measured by the difference between the cost or other basis of the bonds to the parent and the amount received in payment of the bonds." (Reg. § 1.332-7)

A further problem arising under section 332 stems from the fact that section 332(c) is applicable only if the liquidation qualifies under section 332(a), and the courts have ruled that section 332(a) applies only to solvent subsidiaries. Hence, even in its present posture, section 332(c) results in discriminatory treatment between solvent and insolvent subsidiaries.

[3] I.T. 4109, 1952-2 C.B. 138.

[4] Rev. Rul. 259, 1953-2 C.B. 55.

The problem of possible tax upon the parent company has prevented the liquidation of solvent subsidiaries in a number of instances, and exclusion of insolvent subsidiaries from the present provisions of section 332(c) has prevented the liquidation of still further subsidiaries. To avoid tax complications, subsidiaries which no longer serve any essential economic or business function are continued in existence. We submit it is unwise to have the revenue law operate in this fashion.

C. Proposal

Provision for the tax-free liquidation of 80 percent controlled subsidiaries was first introduced by the Revenue Act of 1935. This provision, as improved by the enactment of section 332(c) in 1954, has proved very beneficial, and has encouraged corporate simplification by liquidation of subsidiaries into parent companies. But the law requires further improvement to eliminate the remaining problems described above, namely, (1) taxability to the parent corporation where it acquiries an indebtedness of a solvent subsidiary at less than face value, and when such indebtedness is satisfied at more than its basis in the hands of the distributee parent, and (2) the inapplicability of section 332(c) to insolvent subsidiaries.

We recommend that section 332(c) be amended to eliminate these two problem areas. We suggest that, as amended, section 332(c) should read as follows:

(c) Special rule for indebtedness of subsidiary to parent—If—

(1) a corporation is liquidated and subsection (a) applies to such liquidation, or would apply except for the fact that such corporation is insolvent, and

(2) on the date of the adoption of the plan of liquidation such corporation was indebted to the corporation which meets the 80% stock ownership requirements specified in subsection (b),

then no gain or loss shall be recognized to the corporation so indebted because of the transfer of properly in partial or full satisfaction of such indebtedness, and no gain or loss shall be recognized to the corporation meeting such 80% stock ownership requirements upon the receipt by it of property in satisfaction of indebtedness.

D. Advisory Group Report

The 1958 revised report on corporate distributions by the Advisory Group on Subchapter C took a similar position by asserting it would be more appropriate not to recognize gain or loss to the parent corporation when outstanding indebtedness of a subsidiary which the parent had acquired at a discount is satisfied in the course of liquidation. The Advisory Group, however, suggested that there be basis adjustments to property received by an amount equivalent to the gain or loss the parent realized. We doubt the suitability of such an automatic basis adjustment provision.

The provisions of Reg. 1.332–7 and the holding of the *Houston Natural Gas Corp.* case incorporated therein must be read in the light of the concepts on which they are premised and then applied accordingly. We believe a purely mechanical basis adjustment approach such as recommended by the Advisory Group would produce improper results in many cases. The *Houston Natural Gas Corp.* case rests on the principles of *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, and *Helvering* v. *American Chicle*, 291 U.S. 426. These cases involved the repurchase from outsiders of bonds issued by the taxpayers at a price less than their issue price or face value. It was this excess of issuing price or face value over repurchase price which was taxable income. These cases, and a number more, upholding regulations comparable to the present Reg. 1.61–12(c)(1) make sense, because there has been meaningful economic accretion to the taxpayer by reason of and at the time of the bond repurchase. We do not believe there is any meaningful economic accretion upon liquidation in the typical situation where an 80 percent subsidiary is liquidated into the parent.

Further, a review of the cases on the sort of question involved in *Kirby Lumber* and *American Chicle* discloses a number of circumstances under which the principles of these cases are inapplicable, or where their applicability has only a reduced effect. Thus, if there is a donative intent in the reduction by a creditor of indebtedness, no income results because gifts are excluded from income by statute. And the rule of section 111 that gross income does not include the recovery of certain amounts which a taxpayer had previously deducted without thereby reducing his taxes has been applied to cancellation of indebtedness situations. Other situations excepted from the general rule have included cancellation of indebtedness representing a reduction of purchase price, or the lack of realized income in value of assets, or the net effect of the whole transaction when completed producing no gain.

If basis adjustment rules are to be considered, any legislation should limit them to situations falling within the *Kirby Lumber* type of situation, and they should not detract from the existing exceptions to the rule therein.

The 1958 Subchapter C Advisory Group revised report declined to make any recommendations with respect to insolvent subsidiaries. We recognize the problems which would be presented in any attempt to make full application of section 332 to the liquidation of insolvent subsidiaries. Thus, we do not urge the full application of section 332, but only that section 332(c) be enlarged to insulate both the insolvent subsidiary and its parent from tax in situations where the subsidiary transfers properly in satisfaction of indebtedness owed the parent. Consequently, the liquidation of an insolvent subsidiary would fall outside the tax-free category spelled out in section 332(a), and the parent corporation would in appropriate situations still have a bad debt deduction and a stock loss. However, the insolvent subsidiary should be protected under an enlarged section 332(c) in satisfying indebtedness owing to its parent by the transfer of property in a course of liquidation. It does not make sense to protect the solvent subsidiary and leave the insolvent subsidiary taxable on fictitious gain (arising out of the happenstance that property theoretically applied in the satisfaction of a debt had a fair market value in excess of the adjusted basis). On the other side of the picture the parent of either a solvent or insolvent subsidiary should be protected against gain under section 332(c) where indebtedness held at a discount is satisfied by the transfer of property in the course of liquidation.

E. Effective Date

We would recommend that these amendments to section 332(c) be effective as of June 22, 1954.

Accumulation trusts

ARTHUR ANDERSEN, & CO.,
Chicago, Ill., September 12, 1969.

Re statement regarding H.R. 13270
Tax Reform Act of 1969—Accumulation Trusts.

Mr. TOM VAIL,
Chief Counsel, Committee on Finance,
2227 New Senate Office Building, Washington, D.C.

DEAR MR. VAIL: We agree with the position of the Treasury that the unlimited "throwback" rule should be applied only to distributions of income accumulated in taxable years beginning after April 22, 1969, to avoid undesirable retroactivity.

SUMMARY

The foregoing comment is not intended to indicate an approval or disapproval of the remaining portions of the Act. This statement is submitted as part of a series of letters, each dealing with a particular area of the proposed legislation. It is intended that the comments and suggestions contained herein be made a part of the record of testimony relative to the legislative changes contemplated for accumulation trusts. We shall be pleased to discuss these matters further with you or the Committee, either in person or by telephone. Please call us collect at 312-346-6262 if necessary.

Very truly yours,

JOHN MENDENHALL,
Director of Taxes.

STATEMENT OF PHILIP P. MARTIN, JR.

Mr. Chairman—and members of the committee, my name is Philip P. Martin, Jr. I appear before your Committee today to testify on the subject of accumulating and multiple trusts. I am a California attorney, and have been engaged in tax work, in particular tax work concerning trusts, since 1948. I have been teaching Tax Law and Estate Planning at the University of San Diego School of Law since 1956. I am Vice President and Trust Counsel for the Southern California First

National Bank, and I am currently Chairman of the Legislative Committee, Trust Division, of the California Bankers Association.

However, I am appearing here as an individual law professor who has extensive practical experience, as well as theoretical background.

I teach the 5-year throw-back rule in my classes at law School. The preparation of a throw-back computation is quite complicated and whenever there is a throw-back computation, it costs a considerable sum of money in accountant's and attorney's fees. Fortunately, the well-thought out exceptions which Congress created in 1954 now cause comparatively few throw-back computations. If you do away with the exceptions completely, as proposed by the House bill, you will be doing a great injustice to millions of trust beneficiaries, who are typically widows and orphans, to cure comparatively few abuses. The accountant's and attorney's fees will be more than the taxes involved in many cases.

It is true there have been illustrations of abuses where an individual is beneficiary of several trusts. The real area of abuse concerns the 9-year termination exception. It is theoretically possible to set up many trusts for the same beneficiary, and if they all terminate at least 9 years from the last transfer into the trust, a large amount of tax can be avoided. This is not common, but apparently has been done by a few which causes our present crisis.

In a normal situation, a beneficiary may receive one accumulation distribution during his lifetime. I would propose that, to cure the above described abuse, you give an election to a beneficiary to use the 9-year termination exception once in his lifetime. This would cure any abuses from multiple trusts for the same beneficiary whether created by one person or several persons. In particular, my proposal would add to Section 665(b)(4) of the Internal Revenue Code language similar to the following:

"The latter exception is at the election of the beneficiary and can be used only once in his lifetime, effective as to any accumulation distributions after May 22, 1969."

There are other provisions of the Internal Revenue Code where elections can be made only once in a lifetime. The same provision could be added to Section 665(b)(2) concerning emergency needs of such beneficiary if it is felt there is any abuse of this exception.

The only other exception with respect to instruments created after January 1, 1954, concerns amounts accumulated before a beneficiary attains the age of 21. I suggest that this exception be left intact as it is not in an area subject to abuse. In fact, Section 2503(c) of the Internal Revenue Code encourages accumulation trusts for minors. The practical problems concerning the minor's past income, many of whom do have small amounts of income but do not file a return because their gross is under $600, would be tremendous.

Trustees have storage problems and normally do not keep returns available for over a 5-year period, nor do most beneficiaries because of the three-year Statute of Limitations. The proposed unlimited throw-back would cause an horrendous burden to trustees. The 5-year throw-back rule, with the above mentioned changes, would cure the real abuses, and would be sufficient to take care of any problem in this area. There is no need to complicate all accumulation distributions because of a few abuses which can be cured as mentioned above.

The House proposal is a completely new proposal as of this year, the first publication coming with the tax reform studies of the outgoing, or old Treasury. There have not been sufficient hearings and study concerning it. It goes far beyond anything advisory groups, or others, have suggested to cure abuses in the multiple trust area. The reason there has not been an outcry from the widows and orphans is that they do not understand it. Instead of the wholesale change suggested by the House, I would suggest the above-mentioned changes, which will take care of the problems in this area. Or even better, I would suggest that this proposal be pulled out of the bill for study next year along with other proposals concerning trusts, including estate and gift tax problems of trusts.

STATEMENT SUBMITTED BY GEORGE J. GANSEL, A VICE PRESIDENT, ON BEHALF OF THE CHASE MANHATTAN BANK, N.A.

SUMMARY

1. Accumulation trusts (bill section 341)

It is the position of The Chase Manhattan Bank (National Association) that the proposed "unlimited throwback" rules of Bill Section 341, combined with the elimination of all exceptions to the existing "five-year throwback," would serve neither simplification nor equity. In order to prevent the abuses of a very few taxpayers, this Section would move in almost punitive fashion against thousands of trusts and their beneficiaries, subjecting them to highly complex and voluminous tax computations, substantial new record-keeping requirements and, of course, needless added expenses.

We recommend to your Committee that Section 341 be stricken from the Bill. Alternatively, we recommend the retention of the present exceptions to the "throwback" rule. Any new legislation should be applied only to trusts created after the enactment of H.R. 13270.

2. Limit on tax preferences and allocation of expenses (personal trusts and estates) (bill sections 301 and 302)

It is the position of The Chase Manhattan Bank (National Association) that the proposed application of the LTP rules to personal trusts and estates would create substantial compliance and, possibly, equity problems. Bill Sections 301 and 302 are obviously designed for individual taxpayers and little thought, if any, was given to fiduciary tax aspects. This serious deficiency could lead to complete confusion in the area of fiduciary taxation. As we have explained in our detailed comments, with few exceptions we can see no reasonable basis for subjecting trusts and estates to the minimum tax rules or for requiring the complex special allocation of fiduciary deductions. In our opinion, the effect of these Sections on tax revenues derived from fiduciary taxpayers would be negligible.

We recommend to your Committee that Section 301 and 302 be amended, so as to make them applicable only to individual taxpayers. Alternatively, we recommend that these Sections (and the affected Sections of Subchapter J of the Internal Revenue Code) be rewritten to clearly define the application of the LTP rules to personal trusts and estates.

DETAILED DISCUSSION

As a large corporate fiduciary, administering more than 5,500 personal trusts for which fiduciary income tax returns are required and further administering several hundred estates of decedents, we have reviewed the 1969 Tax Reform Bill (H.R. 13270) which was passed by the House of Representatives on August 7, 1969. We have also carefully studied the Report of the House Ways and Means Committee (dated August 2nd) and the Supplemental Report (dated August 4th), with particular emphasis upon the effect of this proposed legislation upon accumulation trusts, and trusts and estates subject to the "Limit of Tax Preferences" (LTP) rules.

It is our conclusion that the Bill would have a substantial impact on many existing trusts and estates and that it would, likewise, materially affect future trusts and estates. Apart from the proposed reductions in the tax rate, many of the provisions pertaining to trusts and estates would tend to increase the tax burden of these taxpayers; substantially increase the administrative burden and the resulting costs; inhibit the creation of *bona fide* personal trusts; and make grantors, testators, beneficiaries and fiduciaries ever more reliant upon highly specialized professional tax assistance.

Some of the new restrictions will, in practice, affect only few fiduciaries and we believe that little opposition can be expected on account of

(1) the repeal of Code Section 673(b), to disallow two-year charitable trusts (fewer than ¼ of 1% of all trusts administered by us fall into this category);

(2) the amendment of Code Section 677, to disallow tax-favored accumulations of trusts income for the grantor's spouse (again, the proportion of trusts falling into this category, in our experience, is negligible); and

(3) the addition of Code Section 1001(e), to tax the full proceeds from the sale of certain life estates or trust income interests.

Other restrictions will cause considerable compliance or equity problems. We understand that other interested parties will appear before your Committee on the subject of deductions for charitable contributions by trust donors and by the trusts (and estates) themselves. We merely wish to add our comment that numerous long-established charitable remainder trusts (the grantors of which are deceased or have no interest whatever in these trust), under the proposed changes of Code Section 642(c), would become fully taxable and that these additional income taxes would generally have to be borne by corpus of these trusts which is subsequently distributed to qualified charitable organizations.

Accumulation trusts (bill section 331)

We are particularly concerned with the proposed taxation of accumulation trusts and their beneficiaries. Under existing law, only income accumulated during the preceding five years is taken into account in the special computation of the beneficiary's current income tax on trust distributions. Furthermore, Code Section 665(b) excludes from the application of the so-called throwback rule income accumulated during the minority of the beneficiary, emergency distributions, certain distributions of pre-1954 trusts, amounts distributed upon termination of a trust (if no transfers were made to the trust during the preceding nine years), and amounts not in excess of $2,000.

It has been our experience in filing a total of about 80,000 Federal fiduciary income tax returns since the enactment of the 1954 Internal Revenue Code, that the existing accumulation trust rules for domestic trusts are workable (despite the technical nature of the required computations) and equitable. Fiduciaries and beneficiaries have been able to cope with Code Sections 665 through 668 because the statutory exceptions limited their application to a relatively few trusts.

We have found Code Sections 665 through 669 sufficiently restrictive to discourage tax abuses or the creation of accumulation trusts solely or primarily because of income tax considerations. (We estimate that fewer than 10% of the personal trusts administered by us are accumulation trusts, and their beneficiaries are mostly minors. The proportion of accumulation trusts for adult beneficiaries is very small.)

It is well known that there have been a few cases of attempted flagrant abuse of these provisions through the creation of large numbers of identical or nearly identical trusts. One grantor created 90 identical trusts, and the court had no difficulty in treating the trusts as one. Declaring that subsance must prevail over form, the court found the entire scheme to be "a mockery of our tax laws." (*Boyce v. U.S.*, 190 F. Supp. 950, aff'd 296 F. (2d) 731).

In another case a taxpayer created 19 trusts for his grandson. The court consolidated the trusts and taxed them as one trust since the taxpayer didn't "adequately maintain the trusts as separate from each other and from himself." The court said it was unnecessary to determine whether the obvious tax avoidance purpose required treating the trusts as one since the trusts weren't actually maintained as separate and distinct entities. (*Ray R. Sence, Tr. v. U.S.*, 394 F. 842).

Of course, we also realize that in another instance the creation of 10 trusts each by husband and wife for the primary benefit of their son and the son's wife succeeded. (*Estelle Morris Trusts*, 51 T.C. 20).

The proposed unlimited "throwback" and the elimination of *all* exceptions will bring tens of thousands of trusts, many of them quite small, within the scope of very complex tax provisions, whereas the existing rules affect the administration of only a limited group of trusts. Thus, because of the requisite added recordkeeping and the highly technical nature of the special computations for taxing accumulation distributions, both the beneficiary and the fiduciary would be subjected to substantial and costly burdens. The beneficiary would have to depend upon the services of an experienced tax practitioner specializing in fiduciary taxation, and the fiduciary's administrative costs would rise considerably. Many beneficiaries of limited means will not be able to properly comply with a staute of such complexity because they cannot afford the services of tax attorneys or other tax practitioners, and many individual trustees will not have the requisite expertise to properly compute and report accumulation distributions. (We estimate that fewer than 30% of all personal trusts administered by us generate annual income in excess of $10,000).

H.R. 13270 recognizes these complexities, at least with respect to the beneficiary, and it attempts to provide limited relief in the form of the so-called shortcut method for computing the beneficiary's income tax. Instead of hypothetically recomputing the taxes he has paid on his personal returns for all preceding years affected by the throwback (if he still has copies of all these returns), he may average the accumulation generally over three years, i.e., the current year and the two preceding years. This shortcut method eliminates the need for copies of the beneficiary's returns filed more than two years ago, but it does not really simplify the beneficiary's special computation, nor is it equitable because it will often result in a tax greater than that computed under the "exact" method. In other words, the wealthy beneficiary who has complete tax records and the assistance of a tax attorney will be able to make alternative computations to determine the lowest possible tax liability, while the less fortunate beneficiary will frequently pay a higher tax because he doesn't understand this complex law. The beneficiary of more limited means, out of ignorance or out of desperation, may include the entire accumulation in his current year's income and pay the full tax thereon, possibly even without taking credit for the fiduciary income taxes already paid on the accumulations.

The complexities of the unlimited throwback provisions are further compounded by the concurrent application of other new provisions such as the Limit on Tax Preferences. The LTP concept, as it affects the minimum tax and the special allocation of personal expenses, is to be made applicable not only to individuals but also to trusts and estates. It would be possible for both the bneficiary and his trust to be subject to LTP for years affected by the throwback provisions, in combination wih tax preference carryovers, capital loss carryovers and/or net operating loss carrybacks and carryovers. We doubt that any tax practitioner, let alone any average taxpayer, is brave enough to give assurances that he will be able to properly make all the computations and recomputations which the proposed law would require. In fact, we wonder whether proper compliance in some of these cases would be possible at all.

It is apparent that the proposed changes of Code Sections 665 through 669 would not serve the needed simplication of our tax laws, nor would they achieve substantial equity. Section 341 of the Bill would move in almost punitive fashion against thousands upon thousands of trusts and their beneficiaries (who have no opportunity to change the dispositive provisions of the trust instruments), in order to stop the abuses by a very few taxpayers.

In our opinion Section 341 should be deleted from the Bill and other methods should be considered to eliminate the isolated abuses in this area. If your Committee feels that it is necessary to adopt the unlimited throwback rule, then we recommend that the existing five exceptions contained in Code Section 665(b) be retained without change and, furthermore, that the unlimited throwback rule be applied only to trusts created after the enactment of this Bill. We do not object to Section 342 of the Bill which amends Code Section 677.

Limit on Tax References and Allocation of Deductions (Personal Trusts and Estates) (Bill Sections 301 and 302)

We are also very much concerned about Bill Sections 301 and 302 dealing with the limit on tax preferences and the special allocation of deductions, particularly with regard to compliance and equity aspects.

The title of Section 301 indicates its applicability to trusts and estates, yet no reference whatever is made in the body of the Section to trusts or estates (except for one ambiguous reference to Code Section 642(c)). The House Ways and Means Committee Report mentions estates and trusts once (p. 78), while it frequently refers to "individuals." The Supplemental Report doesn't refer to trusts and estates at all. We find it strange and incomprehensible that the House considered it necessary to include unique taxable entities such as estates and trusts among the taxpayers subject to LTP, while it found no need for specifying how the new rules are to be applied. Perhaps the authors of this proposed legislation failed to recognize the substantial compliance and equity problems the Bill would create.

In order to understand some of the difficulties, one should recognize that trusts and estates are essentially conduits which collect income and pay it over to their beneficiaries. Generally, an income tax liability arises only if income or gains are accumulated or set aside for future distribution to the beneficiaries. Thus, where the entire income is currently distributable or distributed, the "taxable income" (absent capital gains realized in corpus) of the trust or estate is zero, even though the "gross income" includes the items allocable to the beneficiary.

In this connection it is interesting to note that the "Limit on Tax Preferences" would be computed by reference to "Adjusted Gross Income." AGI is a term peculiar to individual taxpayers and apparently has no application to trusts and estates. The proposed law fails to specify how the LTP for estates and trusts is to be determined.

We are also intrigued by the designation as an item of tax preference of the Section 642(c) deduction for contributions of appreciated property to charity. We find it extremely difficult to visualize a situation where such a deduction would ever arise, either under the existing or under the proposed law. Under present law the charitable deduction is allowed with respect to any amount of gross income of an estate or trust which is paid or permanently set aside for charity, and it matters little whether the actual distribution consists of cash, depreciated assets, or appreciated assets. Under the proposed new law, the trust or estate would be either fully exempt or entitled to a Section 642(c) deduction for items of gross income currently distributed to charity.

The voluntary contribution of trust assets to charity would not be a distribution of "gross income" and, hence, there would be no Section 642(c) deduction. Even if the fiduciary substituted appreciated securities for income payable to charities, the Section 642(c) deduction would not reflect the appreciation which, if considered at all, would be taxable to the trust or estate entity as capital gain

If the purpose of Bill Section 301 is the imposition of a minimum tax, why make it applicable to trusts and estates having no "taxable income" by reason of the "distribution deduction" allowed by Code Section 651 and 661 (which are not amended in any way by the 1969 Tax Reform Bill)? Even if the fiduciary goes through the motions of including in "gross income" any disallowed tax preferences, the trust or estate still would have no "taxable income" because the entire income has been allocated to the beneficiary. It would seem to us that the law should be aimed at the beneficiary as the actual recipient and ultimate taxpayer, not at the trust or estate entity, even if this approach would require the furnishing by the fiduciary of additional income tax data to the beneficiary so that he can make the necessary computations.

The Bill also fails to specify how the proposed Code Section 84 applies in the case of trusts and estates whose income is only partly distributed during the taxable year (the balance being accumulated for later distribution). Are disallowed tax preferences to be allocated between the beneficiary and the fiduciary entity or are they allocable entirely to the trust or estate? Since the gross income, as explained above, includes the distributed income, and since disallowed tax preferences are added to "gross income," would all disallowed tax preferences be includible in the "Distributable Net Income," as defined in Code Section 643(a)?

Where the entire trust income is accumulated, the "minimum tax" rules of Bill Section 301 would apply, even though Bill Section 331 would require the inclusion of the accumulated income in the beneficiary's tax base upon receipt of this income by him. It is unclear how disallowed tax preferences of the accumulation trust would be treated in case of an accumulation distribution, *i.e.*, whether the income and expenses would retain their original character or whether the disallowed tax preferences would pass to the beneficiary as taxable income. Assuming that the trust items retain their original character, we cannot understand why the tax administration of the trust should be made more complicated and costly without, in the final analysis, producing any net increase in tax revenues because of the credit which the beneficiary may claim for the tax paid by the trust.

Another problem is the treatment of the trusts or estate's LTP carryover. Will the carryover enter into the computation of the "Distributable Net Income" of subsequent years? This is a very important question since DNI measures the amount of trust or estate income reportable by the beneficiary and deductible by the trust or estate.

Where the ordinary income is fully distributed but the trust or estate has realized capital gains during the taxable year (which are retained in corpus), the "taxable income" of the trust or estate will consist entirely of net capital gains, while the "Distributable Net Income" (allocable to the beneficiary) will be comprised of all ordinary income, reduced by the fiduciary expenses. The commingling of DNI items and capital gains, for purposes of Section 84, could conceivably result in gross distortions. For example, assume a trust with a DNI of $9,000 consisting of tax-exempt interest, and $20,000 long-term capital gains (100%) which are not includible in DNI. On an overall basis the tax preferences would amount to $19,000, and the 50% LTP limit would have been exceeded. Yet both the beneficiary and the trust entity, *separately*, would meet the $10,000 test. If, under these circumstances, the tax liability of the beneficiary or that of the trust entity is increased under the minimum tax rules (the proposed law is sufficiently unclear to leave this point in doubt), we contend that the law would be inequitable because the income of one taxpayer would adversely affect the tax liability of another taxpayer.

Further substantial technical questions would arise with respect to the application of these provisions to fully and partially revocable or "substantial owner" trusts subject to the provisions of Code Section 671 through 678.

In our opinion Bill Section 301 could be reasonably applied only in the case of a decedent's estate which made no distributions during the taxable year. The throwback rules would be inapplicable, and there would be no conflict between the beneficiaries and the estate entity. However, inasmuch as the administration of an average estate is usually completed within 2 to 4 years, or even sooner, there are relatively few estates which don't make at least partial income or corpus distributions during the period of administration. It would seem that little purpose would be served by the extension of the elaborate rules of Bill Section 301 to this small group of taxpayers, especially since the creation of the estate entity obviously is without tax motivations.

Bill Section 302 is equally confusing when considered in the context of fiduciary income taxation. There is no mention at all of trusts and estates (except for an inconsequential change, among the technical amendments, of a cross-reference having to do with tax-exempt income of a foreign trust), not even in the Section title. The House Ways and Means Committee Reports mention trusts and estates once, but without any discussion. Thus, it must be assumed that the Section covers trusts and estates because it is applicable to "a taxpayer (other than a corporation). . . ."

As we pointed out above, the LTP rules obviously are designed for individuals and are unworkable when applied to most trusts and estates. This comment is equally pertinent for purposes of Bill Section 302. While Section 301 used the concept of "adjusted gross income" in fixing the "Limit on Tax Preferences," Section 302 creates the term "modified adjusted gross income," for purposes of the "Section 277 Fraction." The latter is defined as "taxable income (determined without regard to this section) plus allocable expenses, but in no case shall modified adjusted gross income be less than zero." There is no definition in Section 277 of "taxable income plus allocable expenses" of a trust or an estate and, as explained above, the term "adjusted gross income" is inapplicable to trusts and estates.

The "taxable income" of the fiduciary is computed by deducting from gross income the fiduciary expenses, the "Distribution Deduction" for income allocable to the beneficiary, the Section 642(c) Deduction for income allocable to charity, the Section 1202 Deduction for one-half of the long-term capital gains, and various other items such as the fiduciary's share of the Section 691(c) Deduction (pertaining to estate tax paid on "income in respect of a decedent"), the dividend exclusion deduction, and the fiduciary personal exemption. Are the "allocable expenses" those items which did not reduce the Distribution Deduction or the Charitable Deduction? If so, how can expenses be traced to particular items of income, especially in view of the fact that, under present law and Regulations, the fiduciary may allocate the deductible portion of general expenses to any class of taxable income includible in Distributable Net Income? In fact, practically all expenses enter into the DNI computation and there is no direct apportionment of expenses between the trust or estate entity and the beneficiary.

Or are "allocable expenses" the total expenses, before the computations of DNI, the Distribution Deduction and the Charitable Deduction? In the latter case the tax liability of the beneficiary could increase because of tax preferences attributable to the trust entity. (For example, the trust's long-term capital gains could result in a disallowance of deductions otherwise allowable in computing the DNI and, thus, increase the beneficiary's taxable income, even though the beneficiary has absolutely nothing to do with the trust's gains.) This result would be grossly inequitable.

We conclude that the inclusion of personal trusts and estates among the taxpayers to whom Bill Sections 301 and 302 apply was ill-advised. The proposed legislation could, in the area of fiduciary taxation, cause complete confusion and serious compliance and enforcement problems, and lead to a breakdown of our "self-assessment" system, while achieving neither reform nor simplification.

We submit that both Sections should be amended to exclude personal trusts and estates from their scope. If your Committee finds that such exclusion is not appropriate, we recommend that these Sections (and the affected Sections of Subchapter J of the Internal Revenue Code) be rewritten to clearly define their application to trusts and estates.

Statement of Cornelius C. Bond, Easton, Md.

SUMMARY

A. Accumulation Trusts do constitute a loop-hole which should be closed
B. But—retroactive taxing unfair and discriminatory
C. So—only trusts established after April 22, 1969 should be taxed not distributions from trusts established in prior years in compliance with the law.

STATEMENT

Mr. Chairman and members of the Senate Finance Committee, my name is Cornelius C. Bond, formerly President of Knox Metal Products Co. of Knoxville, Tennessee now semi-retired doing some industrial consulting work and investing in small businesses.

I am very much concerned with many of the provisions of the tax bill you have under consideration but will confine my remarks to the section dealing with accumulation trusts. My remarks will necessarily be brief as I am not a lawyer nor an accountant and I find the language of this section to be rather complicated so that I cannot say that I understand it completely.

First of all let me say that I am very definitely in favor of closing all loopholes and the fact that income can be accumulated in a trust and taxed at a lower rate than the individual beneficiary would be subject to is certainly a loophole, in my opinion.

Taking advantage of a loophole, however, is not evading taxes, it is simply asserting the right of any citizen to minimize his and his family's taxes to the extent permitted by the tax laws. Insofar as his family is concerned certainly he would be derelict in his duty if he did not do so. I feel sure that those of you who are lawyers would so advise your clients. I repeat, I do not object to closing this and all other loopholes. What I do object to however, and object to it strenuously, is the retroactive feature in the bill as passed by the House.

To the best of my knowledge there has never been a change in the tax laws that carried retroactivity to such an extent. Moreover, other changes in this proposed tax bill are not retroactive so that in the case of accumulation trusts we have a plain case of discrimination.

When a man, in good faith, complies with the tax laws and regulations in existence in any given year it is clearly unfair to penalize him by reaching back and changing the rules on him. This is what this bill would do as now written and if allowed to become law it will constitute a penalty that appears to be no less than outright confiscation. This seems especially true when you consider that in many cases the individual beneficiary may well be subject to a higher tax rate than if he had not had the accumulation trust. This is so because it is extremely unlikely that any individual would keep his income tax return data for, say twenty years or more, so that his retroactive taxes could be computed on the so-called "exact method" Paragraph (1)(A) of amended section 668b).

In conclusion I would like to suggest that the retroactive feature be eliminated by changing the wording that provides, in substance, for applying the tax to *distributions* made after April 22, 1969 to make it apply only to trusts *established* after that date (or the effective date of the new tax law).

I appreciate this opportunity to express myself on this subject and hope that the members of the Senate Finance Committee will give my idea favorable consideration.

STATEMENT OF PROFESSOR DAVID WESTFALL, LAW SCHOOL OF HARVARD UNIVERSITY

Income Taxation of Trusts

SUMMARY

1. Section 341 of the House bill would be more effective in reducing the present use of trusts for tax avoidance purposes if Section 643(a) (3) and (4) of the Code were revised to include capital gains and all dividends in distributable net income.
2. Section 342 of the House bill should be revised to apply to existing trusts. Any grentor who is taxable on trust income as a result should be given a right of reimbursement from the trust for a pro rata part of his tax.

STATEMENT

Section 341 of the House bill

Section 341 is sound in proposing an expanded application of the throwback rule. However, without a change in the present definition of distributable net income, the rule would remain inapplicable to capital gains in most cases, as well as some dividends. Thus the bill would not prevent the use of trusts to accumulate capital gains at low rates for ultimate distribution to high-bracket beneficiaries, free of any further tax.

To remedy this, Section 613(a) (3) and (4) of the Code should be amended to included capital gains and all dividends in distributable net income. This would affect current distributions as well as distributions of accumulated income and would reduce the extent to which trust income is taxed to the trust instead of to a beneficiary.

Section 342 of the House bill

Although Section 341 of the House bill applies its changes in the throwback rule to existing trusts, Section 342, dealing with trusts which accumulate income for the grantor's spouse, does not. In effect, this exception would give a limited group of taxpayers a continuing and unjustified reduction in effective tax rates. Moreover, the presence of such "grandfather clauses" unnecessarily complicates Code provisions.

No significant hardship would result from applying Section 342 to all trusts, whenever created, if a grantor who is taxable on trust income as a result were given a right of reimbursement from the trust for a pro rata part of the tax. The proposed changes merely affect tax rates, applying the grantor's marginal rates instead of separate rates for the trust as another taxpayer. Rate changes ordinarily are applied to taxpayers generally. To create exceptions discriminates unfairly between different taxpayers with the same incomes.

Deferred compensation

AUGUST 29, 1969.

Re H.R. 13270—The Tax Reform Act of 1969.
Subject: Section 331—Deferred compensation.

COMMITTEE ON FINANCE,
U.S. Senate,
New Senate Office Building,
Washington, D.C.

GENTLEMEN: Chrysler Corporation ("Chrysler") welcomes the opportunity afforded by your Committee to submit a written statement presenting its views with respect to those provisions of H.R. 13270 (the Tax Reform Act of 1969) dealing with deferred compensation (Section 331). The principal points discussed may be summarized as follows:

I. Bonus payments received by an employee within the first 2½ months of the year following the year in which the qualifying services are rendered should be excluded from the definition of deferred compensation. In addition, payments excluded from the application of the bill should not be taxed as deferred compensation merely because of payment subsequent to the death or retirement of the employee.

II. Deferred compensation payments should be included within the meaning of "earned income" for purposes of applying the 50% maximum rate limitation on earned taxable income provided in Section 802 of the bill.

I. DEFINITION OF "DEFERRED COMPENSATION"

Many employers pay incentive compensation under plans whereby the exact amount of the payment cannot be determined until the company's auditors have determined its net income after the close of the taxable year in which such bonuses were earned. It is unclear whether Section 331 of H.R. 13270, as presently written, would treat such bonus payments as deferred compensation. It is believed, however, that such bonus payments represent "current pay for current services" and should continue to be recognized as such and not taxed as deferred compensation (see *Rev. Rul. 55-446,* 1955-2 C.B. 531). Accordingly, it is requested that proposed Subsection 1354(f) of the Code, as incorporated in Section 331 of the bill, be revised to except such bonus payments from the proposed rules governing deferred compensation payments. Attached is suggested language which would accomplish this result.

II. EARNED INCOME

If deferred compensation payments are to be characterized as "earned income" for purposes of determining the minimum tax imposed by Section 331 of the bill, then such payments should be characterized as "earned income" for all purposes, including the 50% maximum rate limitation on earned taxable income provided in Section 802 of the bill. Accordingly, the phrase "or any deferred compensation payment" should be deleted from proposed Section 1348(b)(1) of the Code.

Yours very truly,

CHRYSLER CORP.,
BRIAN T. O'KEEFE,
Assistant Comptroller.

SECTION 331—DEFERRED COMPENSATION

(f) Applicability of Section.—

1. This section shall not apply to any deferred compensation payments made under a written plan—

(A)
(B) Same as (1), (2) and (3) of proposed bill
(C)

2. This section shall not apply to any payment made under a written plan which identifies the employees (or class of employees) eligible to receive payments thereunder and which is approved by the stockholders of the employer corporation or is communicated to employees of non-corporate employers and which—

(A) requires the employee to perform services for the employer in the year immediately preceding the year in which such payment is made; and

(B) requires the employer to make payment within 2½ months after the close of the employer's taxable year in which the employee's interest in such payment vests.

3. This section shall not apply to any payment made subsequent to an employee's retirement, death or acceptance of public service under a written plan which—

(A) meets all of the requirements, except for service in the immediately preceding year, as provided in paragraph (2) above;

(B) provides that any and all such payments to the retired or former employee, or his designated beneficiary, are required (except in the case of earlier need due to financial hardship) to be made at the same time and in the same amount as would have been made to the employee had he continued employment; and

(C) requires that any such payment be made no later than the end of the third calendar year following the year after the year in which employment is so discontinued.

To the Members of the Senate Finance Committee:

In 1958 this Company adopted an Executive Incentive Profit-Sharing Plan which provided that awards made thereunder would be paid partly in the current year and the balance deferred until death, termination of employment, or retirement. Consequently, for eleven years a part of our compensation has been deferred, and we have all looked upon this as being a supplement to our eventual retirement benefit.

The proposed bill, dealing with deferred compensation, seems inequitable and unfair because the tax rate on deferred compensation when paid is retroactive to the year in which the deferred compensation was earned. This is really penalizing thrift, and unquestionably, plans will be changed to have all incentive awards paid currently since there is no incentive to save for the rainy day.

You might also consider that the resulting increased compensation to many individuals will be inflationary since it is likely that people will spend money that is put into their hands which otherwise would have been deferred.

We urge you to amend the proposed bill so that its provisions are not retroactive, as well as to consider whether its provisions are actually beneficial for the economy.

Very truly yours,

CHESEBROUGH-POND'S INC.
F. J. MCGROATY, *Secretary.*

FEDERATED DEPARTMENT STORES, INC.,
Cincinnati, Ohio, September 16, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: I know that you and your committee are currently involved in the task of drafting legislation to achieve meaningful tax reform. There is, however, one item in the bill passed by The House of Representatives that I would like to call to your attention.

Section 331 would change the rules on taxing deferred compensation. We feel that this provision was included in the reform package without sufficient study or adequate consideration of all the factors involved.

Attached to my letter is a short memo outlining five sound reasons why the tax treatment of deferred compensation should not be changed. We sincerely believe that these reasons merit your attention.

Cordially,

RALPH LAZARUS.

FIVE SOUND REASONS WHY THE TAX TREATMENT OF DEFERRED COMPENSATION SHOULD NOT BE CHANGED

1. Discontinuance of Deferred compensation plans would result in a revenue loss to Treasury

(a) Current compensation would be taxed at no more than 50% rate and the average would be less than the deduction the corporation would get at the 48% rate.

(b) Pensioin plans would be improved to offset loss of deferred compensation plans with the result that employer contributions to pension trusts would be increased (a revenue loss), but the employee is not taxed until he receives the pension.

2. Burden on widows and children

In many instances the employee dies before receiving the deferred compensation. When the money is needed most, the new law would require the widow or children to pay tax on deferred compensatoin at the high rates applicable to the breadwinner's most productive years.

3. Deferred compensation is not a tax gimmick

(a) No income escapes tax and no capital gain is involved.

(b) Payments are *ordinary* income in year of receipt.

(c) Timing & amount of corporation's deduction coincide with individual's realization of income.

(d) Any tax saving merely results from leveling of income

4. DEFERRED COMPENSATION SERVES MANY PURPOSES

(a) Enables corporations to attract and retain capable people.

(b) Deferred compensation can be expressed in terms of shares of the corporation's stock, giving the employee an incentive to improve the corporation's profitability.

(c) A flexible means of giving employees an appropriate level of income after retirement.

5. NEW LAW UNDULY COMPLEX

In *each* year a payment was received, the tax liabilities for *all* years in the period over which the deferred compensation was earned would have to be separately recomputed.

COMMENTS OF MR. WILLIAM R. JUDY ON BEHALF OF REID AND RIEGE

DEFERRED COMPENSATION

We would like to comment on Section 331 of the bill dealing with *Deferred Compensation*. The proposal would impose a minimum tax on deferred compensation exceeding $10,000 in the taxable year. Please note that qualified pension plans may not discriminate in favor of supervisory employees, the very people corporations want to lure into a particular business position. Present deferred compensation arrangements allow a corporation to give extra benefits to personnel that are crucial to its business success. Diminish the attractiveness of deferred compensation by imposition of a "minimum tax" and revenue will be increased, but only at the expense of American business generally which thrives and grows on key personnel spurred to greater achievements by incentives such as deferred compensation arangements.

In giving its reasons for the proposed change, the Committee places emphasis on the fact that it should make no diffedence taxwise whether deferred compensation arangements are funded or nonfunded since the promises of large, financially sound corporations to pay retirement income are just as secure as a funded trust. Once again, this attitude neglects the key employee in the small corporation. The small business may be quite successful now, but when retirement age arrives for the key employee, the unsecured promise to pay by the corporation may be worthless due to business reverses. Meanwhile, the employee has been paying a minimum tax on funds he never actually receives.

We strongly agree with the Administration position that this provision should be deleted from the bill as explained in the comments of the Assistant Secretary of the Treasury for Tax Policy, Mr. Edwin S. Cohen, before the House Committee on September 4, 1969. We are confident that after study, the Treasury Department will conclude that the proposed changes in tax treatment for deferred compensation are impractical and would also do great harm to the competitive powers of the small corporation as it battles for competent key personnel with the large corporation.

GENERAL ELECTRIC CO.,
New York, N.Y., September 17, 1969.

HON. RUSSELL B. LONG,
Chairman, Committee on Finance,
Washington, D.C.

DEAR MR. CHAIRMAN: The General Electric Company is pleased to have the opportunity to submit to the Committee on Finance of the Senate its views on the provisions of H.R. 13270, Tax Reform Act of 1969, which relate to Other Deferred Compensation. Nothing in this letter relates to restricted stock plans or the changes which the section of the House bill dealing with Restricted Property would make in the tax treatment of such plans.

I would appreciate it if you would arrange for this letter to be included in the printed record under Other Deferred Compensation.

SUMMARY

Deferred compensation is a well-established and vital part of many compensation programs for managerial and professional personnel. It serves many corporate purposes and its use should not be discouraged.

Deferred compensation is not a "tax loophole." All payments are taxed in full as ordinary income in the year of receipt. No income escapes tax, and no income is taxed as capital gain. The corporation obtains a deduction only in the year in which the individual receives the payment, and the amount of the deduction is the same as the amount of income taxed to the individual.

The principal objective of deferred compensation plans is to provide continuity of income after retirement. Any tax reduction results merely from leveling of the individual's income over his working and retirement years.

Whereas the bill provides a 50% *maximum* on the tax rates on earned income, thus treating it more favorably than under present law, it would penalize deferred compensation, which by any rational definition must be earned income, both by imposing a *minimum* tax (Section 331) and by excluding it from the proposed statutory definition of earned income (Section 802). The inconsistency and unfairness of these provisions is readily apparent.

If deferred compensation plans were abandoned, current compensation payments would be increased and higher pensions would be provided to managerial and professional personnel under qualified plans. The result would probably be a net current revenue loss to the Treasury.

Section 331 would greatly complicate the tax computation process by requiring in *each* year in which a payment was received a recomputation of the taxes for *all* years in the period over which the deferred compensation was earned. Thus, the income and the tax for any single year in which deferred compensation was originally allotted might have to be recomputed as many as twenty or thirty times; and in any single year in which a payment of deferred compensation was received, a recomputation of taxes for as many as twenty or thirty prior years might be required.

The proposed treatment of deferred compensation would alter fundamental tax concepts of long standing (cash method of accounting and annual accounting period). No satisfactory case has been made for such a change, and it would weaken, rather than strengthen, our taxing system.

Section 331 should be eliminated from the bill in its entirety, and Section 802 should be amended to delete the exclusion of deferred compensation from the definition of "earned income."

Deferred compensation is a natural product of the bargaining which goes on between employer and employee on compensation and other conditions of employment under our free enterprise system. Union-represented employees do this bargaining through their elected representatives, and one of the results has been a continuing improvement in the level of pensions payable under funded, qualified plans.

These pensions, together with social security, comprise virtually the entire retiremnt income of most of these employees, and the combination of the two generally provides them with satisfactory continuity of income through their retirement years.

Both the pensions and the social security are forms of deferred compensation. They exist only because both the employer and his employees are willing to set funds aside during an employee's working years to provide him with a continuing income after his retirement.

Other employees, including managerial and professional personnel, bargain individually with their employer in matters involving compensation and other conditions of employment. While they receive a salary and the usual employee benefits and are included under social security and qualified pension programs, they may also negotiate or be offered other incentive arrangements, including bonuses tied to profits, stock options, and supplemental deferred compensation arrangements. There is nothing unusual about this. In fact, our free enterprise system could not exist without appropriate incentive arrangements for the individuals who assume positions of high responsibility in the nation's industrial economy.

The provisions of the bill relating to deferred compensation appear to be designed to discourage its use. They would tax it more heavily by providing for a minimum tax (Section 331) and by excluding it from the statutory definition of "earned income" for purposes of the 50% limitation on the tax rates on such income (Section 802 of the bill—proposed Section 1348(b) (1) of the Code).

Deferred compensation is not a "tax loophole." All payments are taxed in full as ordinary income in the year of receipt. No income escapes tax, and no income is taxed as capital gain. The corporation obtains a deduction only in the year in which the individual receives the payment, and the amount of the deduction is the same as the amount of income taxed to the individual. Therefore, it is difficult to understand why the Ways and Means Committee of the House concluded that "reform" in this area is necessary.

Inherent in the proposed provisions is the philosophy that deferred compensation arrangements which are "non-discriminatory," as that term is defined for purposes of "qualified" plans, are acceptable. There can be no quarrel with this premise, but only with the conclusion apparently drawn therefrom that any arrangement outside the "qualified" category is ipso facto not acceptable. For the fact is that the two types of arrangements are not comparable. The reason for the "non-discrimination" requirements applicaple to qualified plans is to justify the current deduction by the employer of compensation which will be taxable to the recipient only when received, perhaps many years later. Since this favorable disparity between time of deduction and time of taxation does not obtain and is not sought in the case of deferred compensation arrangements to which the proposed provisions are intended to apply, it is clear that the "non-discrimination" guideline is totally irrelevant.

One attempt at justification in the Ways and Means Committee's report was to compare the present tax treatment of unfunded deferred compensation (taxed in full at time of receipt) with that which applies when an amount to be deferred on a nonforfeitable basis is placed in trust under a nonqualified plan (taxed in full when placed in trust). This comparison is hardly a valid one, because nonqualified trusteed arrangements are not used to any appreciable extent. The reason for this is that the individual would actually receive no funds with which to pay the tax due on an amount placed in trust on a nonforfeitable basis, and if his right to the amount is made forfeitable in order that he will not be taxed until he actually receives the amount from the trust, the income tax regulations provide that his employer will never be allowed a deduction for the payment.

The other attempt at justification was to state that the possibility of shifting income to taxable years after retirement when the marginal tax bracket is expected to be lower should not be available to employees who are in a position to bargain for deferred compensation and to rely on the unsecured obligation of their employers, when such benefits are not available to other employees. As pointed out above, all employees are in a position to bargain for deferred compensation, either directly or through their union representatives. Although most of this deferred compensation is in the form of benefits under qualified plans, it would be a serious mistake to enact taxing statutes which would have the effect of compelling *all* deferred compensation arrangements, even though they do not receive the favored tax treatment accorded qualified plans, to be provided through plans which must meet rigid requirements for qualification. If compensation plans for managerial and professional personnel are to be effective, flexibility in their design must be allowed. Unfunded deferred compensation plans offer this flexibility, and they are therefore of great value to the companies which have adopted them. Furthermore, it is possible through these plans to provide key employees with a strong incentive to improve the company's performance (which is beneficial to all of the company's employees and share owners) by awarding the deferred amounts in terms of shares of the company's stock. Section 331 would seriously impair a company's ability to accomplish these extremely important objectives.

Even laying aside the fact that deferred compensation arrangements serve legitimate and necessary corporate purposes, it makes sense to allow the impact of taxes to be tempered through the deferral of income, particularly when the payor's tax deduction is also deferred. One of the imperfections in our present taxing system is that the progressive rate structure is applied to a taxpayer's income on an annual basis, whereas his income may fluctuate widely from year to year. The present income averaging provisions of the Code represent an attempt to mitigate the harshness of this feature of the system, and Section 311 of the present bill would move another step in this direction by liberalizing these provisions. Income leveling through deferral of compensation accomplishes a similar result by forward-averaging. To treat a taxpayer as though his income were bunched into a few high-earning years (as Section 331 would do) in order to apply high progressive tax rates to the income, when actually it was received more or less uniformly over a more extended period, would be inconsistent with the income averaging principle and would represent a backward step in the evolution of a fairer taxing system.

There is a further inconsistency within the bill itself with respect to deferred compensation. Section 802 provides for a limitation of 50% on the tax rates applicable to earned income, thus treating such income more favorably than under present law. However, Section 802 also provides that the term "earned income" shall not include any deferred compensation payment. Deferred compensation is clearly earned income, and as such it should be subject to the 50% ceiling on rates. One is led to conclude, therefore, that the real purpose of the two provisions of the bill is to place such a severe tax penalty on the use of deferred compensation as to discourage its use. If such is the case, it is indeed regrettable, for reasons mentioned heretofore.

The Ways and Means Committee report on the bill estimates that enactment of Section 331 would result in a revenue increase of $5 million in 1972, $10 million in 1974, and $25 million in 1979. However, even these small amounts appear to be based on the assumption that deferred compensation plans will be continued, whereas the apparent purpose of the new provision is to discourage the future use of such plans. If deferred compensation plans were abandoned, companies would be forced to pay higher current compensation to their managerial and professional employees. This would result in higher pensions for these individuals under qualified plans, because pension benefits are related to nondeferred compensation. The combination of higher current compensation payments and higher employer contributions to qualified pension plans could result in a current net revenue loss to the Treasury, because the loss of revenue from the higher corporate tax deduction would probably not be fully offset by the higher current tax payments by the individuals. This would result partially from the fact that the deductible corporate pension contributions would not be taxed to the individuals at the time they were made. In addition, with the 50% limit included in the bill on individual tax rates on earned income, the average tax rate of the recipients of the additional current compensation would probably be lower than the average tax rate of the corporations making the payments. I think it is a fair conclusion that enactment of the proposed provisions relating to deferred compensation would result in a loss of revenue to the Federal Government—hardly the result to be expected from the closing of a "loophole."

The "minimum tax" computations required by Section 331 are complex and burdensome. If enacted they would represent an affront to any taxpayer who is expected to comply conscientiously with the provisions of our voluntary, self-assessment taxing system. They require the taxpayer to recompute, in *each* year in which a deferred compensation payment is received, the taxes for *all* of the years in the period over which the deferred compensation is deemed to have been earned. The earning period would be the entire period of employment (as many as 40 years or more) unless under regulations to be prescribed by the Secretary the deferred compensation is deemed to have been earned over some shorter period. It takes only a little imagination to visualize a 40-column spread sheet and a foot-high pile of tax returns for prior years which would have to be resurrected and reworked each year a deferred payment was received. Presumably this would involve keeping a record of, and using, the various tax rates which happened to have been in effect in each year of the earning period, including any surcharges which applied. Furthermore, the spread-back calculation would produce a higher minimum tax each year from the operation of the progressive rate structure as amounts were successively added to the taxable income for each year in the earning period.

Although Section 331 contains a less complicated alternative under which the taxpayer may elect to calculate the minimum tax each year a payment is received by recomputing his taxes for the three years of the last ten in the earning period in which his taxable income was the *highest* and multiplying the average increase in tax by the number of years in the earning period, this alternative would be available to him only at the expense of a considerable amount of additional tax.

In addition to being burdensome from a record keeping and computational standpoint, the minimum tax proposal can result in an unfairly high tax in two respects. First, because of the successivly higher tax each year under the spread-back computation, the "minimum tax" can start out lower and end up higher than the tax calculated on the deferred compensation on the basis of including it in income in the year of receipt. But each year the taxpayer has to pay the higher of the two amounts. Therefore, in total, he can end up paying more than he would have if he had used either the spread-back in all years or the current inclusion in income in all years. Second, if the tax rate structure is higher during the payout period than it was during the earning period, this alone may cause him to pay a higher tax on the deferred compensation. However, if the tax rate structure is lower during the payout period, he may not get the benefit of the reduction because of the "minimum tax" under the spread-back provision.

It should be evident that Section 331 would detract from, rather than enhance, the fairness of our taxing system.

In conclusion, it should be pointed out that the proposed treatment of deferred compensation would alter fundamental tax concepts of long standing. Cash basis taxpayers are required to report their income in the year of receipt, and this would not be changed. However, the tax is payable as a general rule at the rates in effect in the year of receipt. Any exceptions to this rule have been in the direction of mitigating an unfairly high tax which would result from its application. Thus, there are income averaging provisions in the present Code, and the bill would liberalize these and add others. There is the provision relating to repayment of an amount held under a claim of right, which allows the taxpayer the greater of the tax benefits which would result from claiming the amount repaid as a deduction in the year of repayment or eliminating it from income in the year of original receipt. To introduce a provision which would increase the tax over that which would otherwise apply, by aggregating the income with that of other taxable years and applying rates applicable to those years, would depart from the fundamental concepts of the cash method of accounting and the annual accounting period at the expense of equity, instead of in the direction of equity. This would weaken, rather than strengthen, our taxing system.

We strongly recommend that Section 331 be eliminated from the bill in its entirety and that Section 802 be amended to delete the exclusion of deferred compensation from the definition of "earned income."

Our Company greatly appreciates the opportunity to present its views on these provisions of the bill.

Very truly yours,

REGINALD H. JONES.

STATEMENT OF A. B. HEILIG, ON BEHALF OF THE CAMPBELL SOUP CO.

This statement is submitted on behalf of Campbell Soup Company in opposition to the enactment of Section 331 of H.B. 13270 relating to taxation of deferred compensation.

Section 331 of this bill would in cases where deferred compensation exceeds $10,000 in any taxable year require the recipient to pay taxes in accordance with an unwieldly formula. Tax calculation would shift from the date on which the deferred compensation is actually received and enjoyed to the date of award.

Campbell Soup Company opposes this provision not only because of its inherent complexity in calculation and administration, but also because the imposition of such a tax penalty on deferred compensation would seriously impair our existing employee benefit structure. When, as is our case, deferred payments are given in the form of shares of the Company's stock, the employee-recipient is furnished with an added incentive to make his company successful. The Company views its existing system of deferred compensation as an important tool in attracting and retaining valuable employees and their continuing contributions to our business.

The proposal raises many questions quite apart from its adverse effect on acquiring and retaining outstanding personnel. The change does not jibe with the announced intention of closing loopholes and achieving certainty and simplification in the tax law and tax returns. Changing the law relative to deferred compensation does not plug tax "loopholes" since all income received is taxed and at ordinary income rates. Moreover, the proposed treatment of deferred compensation seems inconsistent with the proposal to afford generally more favorable treatment of earned income under H.B. 13270, which would substantially lower the maximum tax rate on earned income to 50%. Since deferred compensation is a form of earned income, it is suggested that H.B. 13270 is conceptually inconsistent in attempting to increase taxes on deferred compensation, while at the same time taxes on other forms of earned income are lowered. The proposal introduces many uncertainties. For example, the tax rate applicable at the time the deferred compensation is actually received may or may not be greater than that applicable at the time of the award by reason of changes in level of income or the sources of income or an intervening change in the federal income tax rates.

In terms of the individual taxpayer, to the extent that present tax reform focuses on high income individuals with little or no tax liability, Section 331 completely misses the mark. The income received by individuals under deferred compensation plans comes to them and is taxed at a point of time, usually during retirement, when their income is drastically reduced.

Campbell Soup Company respectfully requests that this Committee delete Section 331 from the Tax Reform Act of 1969 since its inclusion accomplishes no real reform purpose, confuses rather than simplifies the law in this area, does not produce substantial revenue, and impairs the ability to obtain and retain outstanding personnel.

ELECTRONIC INDUSTRIES ASSOCIATION,
Washington, D.C., September 24, 1969.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate of the United States,
Washington, D.C.

DEAR SENATOR LONG: The Electronic Industries Association, with a membership of approximately three hundred companies representing all major sectors of the electronics industry, respectfully submits the following comments regarding certain proposals of H.R. 13270, "The Tax Reform Act of 1969".

In response to the proposed change to the present tax treatment of deferred compensation, other than restricted stock, Title III, Subtitle D, "Other Deferred Compensation", Section 331, "Deferred Compensation":

1. The concept of taxing income realized in one year at rates applicable in another year and to a potentially different taxpayer, where a beneficiary receives the payments, is an extreme departure from accepted tax principles.

2. No public purpose would be served by adoption of the proposal. It would tend to be harmful to our member companies and their employees, as many companies have had incentive programs and plans for many years.

3. A revenue loss to the Treasury would logically result from probable improvements in executive pension plans to compensate employees for the loss of deferred compensation.

4. Deferred compensation is not a "tax loophole", since no income escapes tax. These payments are treated as ordinary income in the year after receipt.

5. No capital gain is involved.

6. Some arguments pointed out to us by individual members of our industry for retaining the present tax treatment of deferred compensation are:

a. Qualified pension plans are designed primarily for employees under the executive level. Many plans provide inadequate retirement income to higher level employees for various reasons. For example, a plan may be a career-average earnings type which specifically does not include incentive compensation. Deferred compensation has been the answer to this disparity.

b. Deferred compensation may contain forfeiture conditions which encourage employees to remain with their company.

c. Deferred payments are sometimes shares of corporate stock which give the employee incentive to improve profitability, the goal of the organization.

d. Industry must attract capable people and keep them motivated. Deferred compensation as it is now treated succeeds in this important area. Employees are increasingly looking for an appropriate level of income after retirement, and deferred compensation is an established means to this end.

e. The proposed change would have a greater effect on tax liabilities of individuals in middle income ranges than on those in higher income ranges because rate progressions are steeper in the middle income ranges.

f. The proposed change would introduce more complexity into the tax computation process for the reason that in each year in which a payment was received, the tax liabilities for all years in the earning period would have to be separately recomputed.

We conclude that the ability of the electronics industry to attract, retain, and motivate executive personnel would be seriously impaired by the adoption of this proposal.

In regard to the proposal to change the tax rate from long term capital gains to ordinary income, on lump sum distributions from savings and profit sharing distributions from savings plans, Title V, Subtitle B "Capital Gains and Losses", Sections 511–516:

1. The proposed change will have an adverse effect on all employee-members of savings and profit sharing plans. These plans cover a broad spectrum of employee groups and are not limited to highly compensated executives. In fact, savings plans frequently limit amounts that can be contributed for higher paid personnel.

2. Lump sum payments made at retirement come at a time when employees' future income possibilities are limited. They should not be burdened with an additional tax at that time.

3. The establishment and growth of savings plans has contributed to improved employer-employee relations. This should not be discouraged.

4. Thousands of savers will lose confidence in their employers as the company will not be able to live up to announced policies for such savings plans.

We conclude that changing the tax rate, as proposed, on lump sum distribution from savings and profit sharing plans would be highly undesirable from an employee, employer, and government administration standpoint.

We respectfully request that this statement be considered by your Committee and included in the record of the hearings currently before your Committee.

Respectfully,

L. K. WALLEY,
Compensation and Benefit Practices Committee,
Industrial Relations Department.

A. M. WARNER,
Director, Industrial Relations Department.

EASTMAN KODAK CO.,
Rochester, N.Y., September 24, 1969.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: One of the provisions in the Tax Reform Act of 1969 now being considered by your Committee is Section 331. This would amend the tax law to provide a minimum tax on "deferred compensation." Under this provision, the minimum tax payable by an individual who receives compensation for services performed in a prior year would be a tax computed as though the payment was received in the year in which it was "deemed to have been earned." In effect, this provision would tax an individual in the amount of the greater of either the tax in the year the income is received or the year in which the income is "deemed to have been earned."

We believe that this section would add an unnecessary complication to the tax law. We know of no testimony that indicates that there is any serious abuse of the present procedure of taxing such deferred income in the year in which it is received and at the tax rates in effect for such year. While the proposed section contains no definition of "deferred compensation," this change would apparently apply to many types of arrangements where payment for services is made in a period succeeding that in which the employee's services were performed. In addition to the type of pay plans customarily known as "deferred compensation," this provision would apply to supplemental pension plans, termination pay arrangements, and any plan in which the receipt of compensation is, for no matter what reason, deferred.

Under the present procedure the employer receives a deduction, and the employee pays tax on the amount received in the same year. Thus, there is no distortion of tax revenue to the government because of this method of timing compensation payments.

This bill would vastly complicate the method of computing tax, without any justifying effect on tax revenues. It would be intolerable for many older taxpayers to make these complex computations of revised tax for all of the prior years in which the income would be "deemed to have been earned." There is no justification for this additional computational burden.

For many reasons, it may be desirable or necessary to defer payment of compensation to a later year. Such compensation plans are flexible and may be arranged to fit particular situations. We are particularly concerned about the effect of this change on supplemental retirement pay plans. While the $10,000 annual exclusion from the provision would eliminate the effect on most employees, these provisions would apply to many supplemental pension payments which for one reason or another cannot be paid under qualified pension plans. We believe that there is no reason why the supplemental pension payments should not be permitted, and payments thereunder taxed to the employee in the year when the compensation is received.

We hope that after your Committee has reviewed this provision you will agree with us that it should be deleted from the tax bill.

Very truly yours,

HARMAR BRERETON,
Vice President and General Counsel.

COMMENTS OF THE MOTION PICTURE AND TELEVISION TAX INSTITUTE ON SECTIONS 331 AND 802 OF H.R. 13270, PRESENTED BY, GERALD J. MEHLMAN, CHAIRMAN

The Motion Picture and Television Tax Institute is an association of independent motion picture and television producers and their respective professional representatives. A committee of the Institute has reviewed the above cited sections of H.R. 13270, the Tax Reform Bill of 1969, as passed by the House of Representatives. Consideration of Sections 331 and 802 was made in the context of how they relate to the motion picture and television industry.

SECTION 331

Section 331 of the Bill which adds a new Section 1354 to the Code changes present law by providing that nonqualified deferred compensation shall be taxed at minimum rates applicable to when such compensation is deemed earned, while delaying payment of the tax until actual receipt. This proposed change of law qualifies the cash method of reporting income for cash basis taxpayers as to deferred compensation. By doing so it represents a policy determination that the right of individual taxpayers to defer receipt of their current compensation until later years when they presumably will be in a lower bracket should be narrowed.

For the reasons hereinafter stated the Institute recommends deletion of Section 331 from H.R. 13270 by the Senate Finance Committee. Section 331 of the Bill will result in unintended hardships to persons in the motion picture and television industry. Artist and other individuals in the industry need the opportunity to forward average their earnings to afford security. If they individually do not level out their income over their productive careers they have no protection against years when their career drops off and work may be unavailable. This is not tax avoidance. Artists and other in the entertainment industry need the opportunity to protect against lean years without the penalty of increased taxes.

Even accepting Section 331 in its present form, certain new problems would be created. Generally, individuals in this industry have high expenses which are directly related to the production of their income, such as commissions to agents. These expenses typically are paid when the income is received. The Bill fails to permit the proper matching of income and expense by making no provision for reducing the deferred compensation payment by related expenses before making the new minimum tax computations (proposed Sections 1354(a)(1) and (2)).

An additional factor to be considered is that Section 331 would increase the complexity of the tax law by imposing additional record-keeping requirements and adding complicated tax computations without necessarily creating greater tax equity. Two of the state purposes of the legislation are to increase tax equity and simplify the tax system.

Finally, Section 331, as applied to the motion picture and television industry, fails to recognize important nontax practical business considerations motivating deferred compensation plans. Frequently it is the producer of a motion picture or television series who insists on the deferred compensation arrangement. The industry is a high risk industry. Substantial capital is required to produce motion pictures and television series and maintain the plants necessary for the production of films. The industry is depressed and indication are for further cutbacks in production. Producers and studios face economic uncertainty and financial difficulty as the cost of financing remains high.

Deferred compensation arrangements benefit producers by reducing the immediate capital outlays for salaries. This in turn facilitates the financing and production of pictures. The economic health of the motion picture and television industry will be adversely affected if artists and others are inhibited from aiding in the financing of pictures by accepting deferred compensation arrangements.

In conclusion, we strongly recommend for the foregoing reasons that Section 331 of the Bill not be enacted. In the event Section 331 is retained as part of the Bill, we believe that it should be modified to provide for the treatment of directly related expenses paid in the year the deferred compensation payment is received. In these cases, such payments should be first offset against the deferred compensation payment.

SECTION 802

I. Section 802 of the Bill provides for a 50% maximum rate on "earnea income." Section 802 represents a policy decision to reduce rates on earned income to reasonable levels in order to encourage incentive and discourage tax avoidance. Yet these purposes are undermined by excluding deferred compensation because the incentive remains to avoid excessive rates.

It is apparently the view of the House Ways and Means Committee that the maximum 50% marginal rate must be denied deferred compensation in order to implement Section 331. The Institute recomends deletion of Section 331 from the Bill for the reasons previously stated. It is submitted that even if Section 331 is retained, it is preferable from a policy standpoint to apply the maximum marginal tax under Section 802 to each year during which a deferred compensation payment is deemed earned under proposed Section 1354(b), rather than to penalize deferred income as is presently proposed.

On policy grounds it is difficult to distinguish between current and deferred earned income insofar as applying a maximum marginal rate is concerned. The present distinction penalizes taxpayers deriving deferred compensation, even though it is the same income merely delayed in time, and even though the taxpayer may have had no choice in the matter. In fact, these payments receive harsher tax treatment than the proposed treatment of periodic payments received from qualified employee pension and profit sharing plans, although each is a form of deferred compensation. We therefore urge that deferred compensation payments be included in the definition of earned income for purposes of the maximum fifty-percent tax rate on earned income under Section 802(a).

II. Section 802 of the Bill (proposed Section 1348 (b)(1)) does not define the term "deferred compensation."

One of the common methods of compensating artists, producers, and the like in the motion picture and television industry is to grant to them, as part of their compensation, a percentage interest in the future net profits or gross proceeds of the motion picture or television series in which they render services. (We are referring only to the situation where such percentage payments are payable to the artist in the year in which they are realized, i.e., not to a situation where the payment is deferred, by agreement, to a year subsequent to the year in which the profits or proceeds are realized.) It is believed that the term "deferred compensation" was not intended to apply to this type of situation, but rather to funded or unfunded plans whereby an employee and an employer arrange to defer a portion of the agreed compensation of the employee, the amount of which has become fixed by the performance of services. Similar to the case of the artists in the entertainment field would be the case of an employed inventor or writer who agreed that his compensation would be measured by a percentage of the future sales of an invention or a copyrighted work.

In order to avoid creating a serious doubt in this area, we earnestly request that, if these proposed statutory changes are retained in the Tax Reform Bill, there be included in the Report of the Senate Finance Committee an explanatory statement along the following lines:

"The term 'deferred compensation' is intended to include compensation paid to an employee under a funded or unfunded plan, attributable to services performed in a prior year. This term is not intended to include compensation in the form of percentage payments out of the profits or proceeds of a motion picture or television series in which the employee has rendered services during a prior year, compensation in the form of a percentage interest in sales proceeds under a patent or copyright with respect to which the employee has performed services, or similar compensation in connection with the sale or exploitation of a product in connection with which the employee performed services in a prior year. Such compensation would constitute earned income for the taxable year in which the payments are received."

We would be pleased to provide any elaboration of these remarks which you consider necessary.

Accrual of vacation pay

CHRYSLER CORP.,
September 2, 1969.

Re H.R. 13270—The Tax Reform Act of 1969.

COMMITTEE ON FINANCE,
U. S. Senate,
New Senate Office Building,
Washington, D.C.

Subject: Proposed Modifications to Section 367 of the Internal Revenue Code; and Accrual of Vacation Pay or Payments in Lieu of Vacation.

GENTLEMEN: Chrysler Corporation ("Chrysler") is taking this opportunity to submit a statement with respect to two subjects of concern to Chrysler which have not been included in H.R. 13270, and which may be summarized as follows:

I. Section 97 of the Technical Amendment Act of 1958 (dealing with vacation pay accruals) should be extended to taxable years ending after December 31, 1968.

II. H.R. 13270 should include a provision repealing the applicability of section 367 with respect to selected foreign transactions which do not afford an opportunity for the avoidance of U.S. tax.

I. ACCRUAL OF VACATION PAY OR PAYMENTS IN LIEU OF VACATION

Rev. Rul. 54-608, 1954-2 CB8, disallowing the accrual of vacation pay or payments in lieu of vacation in certain circumstances, was made inapplicable to taxable years ending before January 1, 1969 by Section 97 of the Technical Amendments Act of 1958, as amended. It is recommended that a provision similar to that contained in H.R. 12936 (91st Congress, 1st Session), extending the inapplicability of *Rev. Rul. 54-608* to taxable years ending after December 31, 1968, be enacted as part of the Tax Reform Act of 1969.

II. PROPOSED MODIFICATIONS TO SECTION 367 OF THE INTERNAL REVENUE CODE

Any tax reform bill enacted by Congress should include a provision amending Section 367 so as to make it inapplicable to selected foreign transactions which generally do not afford an opportunity for the avoidance of U.S. tax.

Section 367 *requires* a U.S. taxpayr to obtain an *advance* tax ruling that avoidance of U.S. tax is not a principal purpose of the proposed exchange or distribution resulting from the organization, reorganization or liquidation of one or more foreign corporations. A ruling is required for many transactions where there is little or no opportunity for the avoidance of U.S. taxes.

It is requested that consideration be given to limiting the applicability of Section 367 by (i) designating the existing language of Section 367 as subsection (a) and (ii) enacting a new subsection (b) which enumerates specific transactions to which subsection (a) would not apply.

There is justification today for repealing or curtailing Section 367 e.g., relatively new Code provisions Subparts F and G and Section 1248; more stringent regulations under Section 482; expanded compliance activities of the OIO Division; enactment of reporting requirements under Section 6038 and 6046, etc. Selective curtailment of Section 367 would allow taxpayers to consummate a business transaction in a more expeditious manner and would also ease the administrative burden of the Internal Revenue Service as well as taxpayers. These objectives could be accomplished without undermining the compliance responsibilities of the Treasury Department.

The attachment to this letter reflects suggested changes which ought to be made to Section 367.

Yours very truly,

E. A. SIGLER,
Manager, Income Tax Department.

Attachment.

PROPOSED AMENDMENT TO SECTION 367

SEC. 367. FOREIGN CORPORATIONS.

(a) General rule—except as provided in subsection (b).

(b) *Exceptions.*—Subsection (a) shall not apply, and a foreign corporation shall be treated as a corporation, in any of the following exchanges:

(1) An exchange described in section 332 where a foreign corporation is liquidated into another foreign corporation;

(2) A transfer described in section 351 where property, other than stock of a foreign corporation, is transferred from one foreign corporation to another foreign corporation;

(3) An exchange described in one or more of sections 354, 355, 356 and 361 where—

(A) The assets of a controlled foreign corporation are acquired by another controlled foreign corporation or the stock of a controlled foreign corporation is exchanged (or treated as exchanged under section 355) or acquired in exchange for the stock of another controlled foreign corporation and the acquiring corporation is controlled (within the meaning of section 951(d)(3)) by a person or persons who immediately prior to such acquisition or exchange controlled the acquired corporation; and

(i) The foreign corporations which are parties to the transaction are created or organized under the laws of the same foreign country, and

(ii) The acquired corporation had a substantial part of its assets used in its trade or business located in such same foreign country, and

(iii) Both the acquiring corporation and the acquired corporation have earnings and profits or both such corporations have a deficit in earnings and profits. For purposes of this subparagraph the earnings and profits of any foreign corporation for any taxable year shall be determined according to rules substantially similar to those applicable under section 1248 to foreign corporations under regulations prescribed by the secretary or his delegate, or

(B) The stock of a foreign corporation is acquired by a domestic corporation, or

(C) The Exchange involves the mere recapitalization of a foreign corporation.

Repeal of alternative capital gains tax for individuals

MARSHALL, BRATTER, GREENE, ALLISON & TUCKER,
New York, N.Y., September 12, 1969.

Re section 511(c) of H.R. 13270.

Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR MR. VAIL: Paragraph (c) of Section 511 of H.R. 13270 provides that the alternative tax computation for capital gains transactions in Section 1201(b) of the Internal Revenue Code of 1954, as amended, is repealed in respect of "sales and other dispositions after July 25, 1969." It is respectfully submitted that there is neither historical precedent nor adequate cause for such effective date provisions.

In general, prior Revenue Acts have set forth "taxable year" effective date provisions when capital gains tax rates were changed. For example, the Revenue Act of 1951 became law on October 20, 1951 but with respect to the change in the capital gains tax rate it was effective for taxable years beginning after October 31, 1951 and before November 1, 1953. Similarly, the Revenue Act of 1934, which became law on May 10, 1934, was effective with respect to the change in capital gains tax rates for taxable years beginning after December 31, 1933. Finally, the Revenue Act of 1921, which became law on November 23, 1921, was effective with respect to the new rate imposed on capital gains transactions to sales or exchanges consummated after December 31, 1921. Although the effective date of the Revenue Act of 1921 applies to sales and exchanges after a certain date, the effective date was the last day of the taxable year for most taxpayers.

Instead of providing a "taxable year" approach, Section 511(c) of H.R. 13270 adopts a transactional approach which falls in the middle of the natural taxable year for most taxpayers. The most plausible explanation for the July 25, 1969 cut-off date is that any subsequent cut-off date would stimulate unusually heavy stock market transactions and abnormally and possibly adversely affect the economy. It is respectfully submitted that even if such explanation represents sufficient reason to depart from historical precedent, such reason is not factually relevant. As you are no doubt aware, various circumstances, such as the Vietnam War, high interest rates, and anti-inflationary measures, have spawned an extremely depressed stock market. Consequently, every reliable barometer of stock prices is significantly lower for the 1969 year as compared to the 1968 year. Such being the case, and without any meaningful indication that the present bear market will turn around, it is very unlikely that taxpayers who are burdened with loss positions will rush to dispose of their stocks or securities in the event the higher effective rate of capital gains taxes provided in the House Bill is made effective with respect to taxable years beginning after December 31, 1969.

Indeed, if the House of Representatives is apprehensive of abnormal stock market transactions, the effective date provisions in paragraph (d) of Section 514, relating to the lengthening of the six month holding period to a twelve month holding period, will abet the result sought to be avoided. The effective date set forth in Section 514(d) is with respect to "taxable years beginning after July 25, 1969." Thus, since the calendar year is the taxable year for most taxpayers, there may be abnormally high stock market transactions after July 25, 1969 but before December 31, 1969 in those situations where a taxpayer is "long" stock or securities for more than six months but less than twelve months. However, as noted above, even though the philosophy of the effective date provisions in Sections 511 and 514 are internally inconsistent, it is respectfully submitted that the concept is not valid because of the present lengthy and uninterrupted bear market.

As additional reason for the July 25, 1969 effective date provision may be that a taxpayer may not quarrel with a rate change which is not made prospective. If this is true, then the provisions set forth in Section 331 of H.R. 13270 are inconsistent with such approach. In general, such provisions provide that deferred compensation payments shall be subject to the rate of tax imposed in the year the compensation is earned rather than the year in which the compensation is paid. Although the effective date provisions of Section 331(c) makes such Section applicable "with respect to taxable years ending after June 30, 1969" the transitional rule set forth in paragraph (g) of Section 331 states that "the minimum tax imposed by Subsection (a) shall not apply to the returnable portion of any deferred compensation payment attributable to a taxable year (1) beginning before January 1, 1970.

In view of the above, it is respectfully submitted that there exists neither historical precedent nor adequate reason to impose an artificial July 25, 1969 effective date provision with respect to the repeal of the alternative capital gains tax. In lieu of the present effective date provision, it is urged that the amendment relate to sales or other dispositions occurring for taxable years beginning after either July 25, 1969 or December 31, 1969.

What is specifically shocking about the July 25, 1969 cut-off date is that whenever H.R. 13270 provides a transactional effective date provision it makes an exception for legally binding contracts entered into before such date. Section 511(c), however, does not set forth any "grandfather" exception.

Again, Section 331(g) of H.R. 13270 has a "grandfather" clause with respect to deferred compensation payments attributable to a taxable year "(2) beginning before January 1, 1974 if paid or made available pursuant to an obligation which was, on July 11, 1969 and at all times thereafter, binding (without regard to the effect of any possibility of forfeiture by the employee)."

On March 20, 1969, my client entered into a legally binding contract for the disposition of all the stock of a corporation the business of which had been operated by my client for more than 30 years. Closing of the contract is conditioned on the purchaser having a public offering of its stock. If such public offering occurs, my client may not be released from his contractual liability to consummate the transaction. It is anticipated that the contract will close within the next couple of months.

It is respectfully submitted that the effective date provisions of Section 511(c) make for an extremely inequitable and harsh result if there is no "grandfather" exception. Although, arguably, inequitable results are bound to occur in far reaching tax legislation, it is respectfully submitted that when an equitable result is caused by an effective date provision which is (i) internally inconsistent with other provisions of the legislation, and (ii) is without historical precedent or present reason, such effective date provision should be changed.

Very truly yours,

DAVID N. HURWITZ.

Maximum tax on earned income

ARTHUR ANDERSEN & CO.,
Chicago, Ill., September 18, 1969.

Re Statement Regarding H.R. 13270 Tax Reform Act of 1969—Maximum Tax on Earned Income.

MR. TOM VAIL
Chief Counsel, Committee on Finance,
New Senate Office Building, Washington, D.C.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

(1) The reference to the Section 911 definition of "earned income" in New Section 1348(b) should be deleted, and a separate, less arbitrary, definition of earned income should be made for computing the maximum tax.

(2) There is no reason for excluding deferred compensation payments from "earned income."

BASIS FOR COMMENTS

(1) *Definition of Earned Income*

DEAR MR. VAIL: In defining "earned income," reference is made to a present definition in Section 911, a section which is limited to taxpayers having activities abroad. We realize that revision of Section 911 is not within the scope of this discussion, and we have not reviewed the propriety of Section 911 within the context of the sections dealing with taxation of foreign income. However, since the scope of new Section 1348 is much broader than 911, it seems prudent to consider the appropiateness of the Section 911 definition to the instant matter. Section 911 provides that, where capital is determined to be a material income-producing factor, no more than 30 per cent of the income from the taxpayer's trade or business is to be considered as earned income. Such an allocation is completely arbitrary and will have no relation to the facts in a given case except by sheer accident.

A much more reasonable standard for determining earned income should be developed, without having to resort to this arbitrary mechanical test. Similar requirements for allocation of income of a business between capital sources and services have been contained in other sections of the Code and Regulations, in the case of family partnerships (Section 704(e)(2), Reg. 1.704-1(e)) and family groups which control Subchapter S corporations (Section 1375(c), Reg. 1.1375-3). In each instance, the regulations provide for a consideration of the particular facts to determine a reasonable allowance for earned income. If for some reason a mechanical test is required, a reasonable pre-tax rate of return on invested capital could be specified in the Code, with the remaining income assumed to be "earned."

(2) *Deferred Compensation—Earned Income*

There is no logical reason for excluding deferred compensation payments from "earned income." Such payments are similar in nature to other earnings, the only difference being a matter of timing. To create the possibility of taxing payments such as these, at higher rates than current compensation is taxed, does not seem justified or desirable, the only purpose served would be to completely eliminate such arrangements, even if their existence could be otherwise justified for good business reasons.

SUMMARY

This statement is submitted as part of a series of letters, each dealing with a particular area of the proposed legislation. It is intended that the comments and recommendations contained herein be made part of the record of testimony relative to the legislative changes contemplated for maximum tax. We shall be pleased to discuss these matters further with you or the Committee, either in person or by telephone. Please call us collect at 312-346-6262 if necessary.

Very truly yours,

JOHN MENDENHALL, *Director of Taxes.*

ARTHUR ANDERSEN & CO.,
Chicago, Ill., September 19, 1969.

Re Statement Regarding H.R. 13270 Tax Reform Act of 1969—Other Deferred Compensation.

MR. TOM VAIL,
Chief Counsel, Committee on Finance,
New Senate Office Building, Washington, D.C.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

The provisions of the Bill dealing with "other deferred compensation" should be deleted.

BASIS FOR COMMENTS

(1) *Complex Computations and Recordkeeping Requirements*

DEAR MR. VAIL: An employee is to be provided with alternatives for computing the tax on deferred compensation, one of which is to furnish sufficient data to compute the tax as if the deferred income was received in the year earned. The employee apparently will have to verify the period in which such income was earned, and the employee will be required to retain and have readily available tax returns for 15, 20 or 25 years in some cases. This does not seem to be a reasonable alternative. If this alternative is not chosen, then the taxpayer must compute a tax under an averaging formula, roughly equivalent to computations necessary under normal income averaging. In this instance, however, the taxpayer is required to average for a higher tax.

Further, in a year in which normal income averaging is available, and a deferred compensation payment is received, two averaging computations will have to be made independently, one to arrive at the highest tax, and one at the lowest. Presently, there is no provision in either Section for reconciling this conflict.

(2) *Conflict With Business Purpose and the Intent of Other Sections*

Other sections of the Bill, namely income averaging and the maximum tax on earned income, have as their purposes:

(a) The elimination of "peaks and valleys" in a taxpayer's year to year income, and

(b) Reduction of the top marginal rates on earned income. Even in Section 802, deferred compensation is held not to be earned income and thus is presently excluded from the protection provided by the maximum tax provisions (which we have commented upon at length in another statement). Further, the provisions of Section 331 controvert the principle of cash basis accounting, which has been firmly established as an acceptable accounting method for tax purposes. If some contracts should constitute constructive receipt in the year the compensation is earned, that question should be dealt with independently and not solved in the manner proposed in the Bill.

CONCLUSION

This statement is submitted as part of a series of letters, each dealing with a particular area of the proposed legislation. It is intended that the comments and recommendations contained herein be made part of the record of testimony relative to the legislative changes contemplated for other deferred compensation. We shall be pleased to discurss these matters further with you or the Commitee, either in person or by telephone. Please call us collect at 312-346-6262 if necessary.

Very truly yours,

JOHN MENDENHALL, *Director of Taxes.*

Foundations

AMERICAN ASSOCIATION OF LAW LIBRARIES,
Los Angeles, Calif., October 1, 1969.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR LONG: Being cognizant of H.R. 13270 and the serious effect which it would have on law libraries throughout the country, I am writing you in my capacity as President of the American Association of Law Libraries with the request that your Committee give its consideration to suggestions for the modification of H.R. 13270, as set forth below.

While I enclose an Attachment with certain details concerning the purposes of our Association and the importance of grants of philanthropic foundations for our work, it may suffice here to state that the American Association of Law Libraries is representative of law libraries and law librarians in the United States. Our Association is a non-profit organization and its work has resulted, inter alia, in continuing publications which are deemed to benefit all facets of the legal profession and large segments of the general public in our law-oriented society. One of the primary purposes of our Association is concerned with the education, and with the continuing education, of law librarians. From time to time, our Association has been entrusted with projects which are pioneering in technical fields of law librarianship.

None of these Association enterprises could have been undertaken by us successfully without the receipt of donations and grants from philanthropic foundations. Also, the quality of some of our outstanding law libraries is largely due to gifts and grants received. If philanthropic foundations were restricted in the free use of their funds through taxation or otherwise and if incentives for making educational and scientific contributions were removed from donors, Associations such as ours, and law libraries most of which already strain their budgets to the limit, would be innocent sufferers, and the public interest would be affected adversely.

For the preceding reasons, I would like to urge your Committee to consider:

(1) Bona fide philanthropic foundations should not be taxed, nor inhibited in making direct grants to libraries and individuals who work in the public interest, nor be inhibited in making grants to educational, scientific and scholarly associations.

(2) The incentives provided under the present law to donors of books, collections of papers, and works of art to libraries, and to donors of funds for library facilities, should be retained;

(3) The working of H.R. 13720 should be clarified so as to exclude from the definition of private foundations specifically independent, non-profit, learned and professional associations whose functions are primarily aimed at the conduct of educational, research and scholarly activities in general, and the conduct of educational, research and scholarly activities relating to libraries and library services in particular.

The third request, above, is based on our concern that under the present text of H.R. 13720 the American Association of Law Libraries might possibly be defined as a private foundation and thus be affected by tax and other burdens which the projected legislation might impose on private foundations.

In conclusion, I respectfully request that (a) the American Association of Law Libraries be given an opportunity to present its views concerning the language which your Committee may formulate so that the work of our non-profit educational, scientific and scholarly Association will not be affected and (b) that this memorandum and its Attachment be incorporated into the record of your Committee.

Very truly yours,

WILLIAM B. STERN,
President.

ATTACHMENT

The American Association of Law Libraries was established in 1906 and incorporated in the District of Columbia as a non-profit organization in 1935. Under its Certificate of Incorporation, the particular object of the Association is "to develop and increase the usefulness and efficiency of law libraries." Under its Constitution, the Association "is established for educational and scientific purposes. It shall be conducted as a non-profit corporation to promote librarianship, to develop and increase the usefulness of law libraries, to cultivate the science of law librarianship and to foster a spirit of cooperation among the members of the profession" (Art. II). The membership of the Association represents most or all of the nearly 1,000 law libraries in the United States and their librarians, regardless of the size of the law library involved, thus including the professional staff of the Law Library of Congress and the largest university law libraries on the one hand, and many small city and county law libraries on the other hand. The membership represents public law libraries, legislative libraries, law school libraries, bar association libraries, court libraries, etc. One of the aims of the Association is to improve law library service, for the benefit of the legal profession—including attorneys, judges, legislators, members of the teaching and research staff and students of law schools—and for the benefit of the large sector of the general public which is increasingly interested in law. This aim is based on the premise that the quality of legal research and thus the quality of law depend to a large extent on the quality of available research and reference materials and the personal services offered by experienced law librarians. The Association works in close cooperation with law and library associations.

Publications of the Association include the Law Library Journal, an educational and scholarly journal, now in its 61st year of publication; the Index to Legal Periodicals (published since 1906; originally as an Association enterprise and in recent years as a commercial publication in cooperation with, but without profit to the Association); and the Index to Foreign Legal Periodicals (published since 1960).

The Association has been engaged in various projects relating to technical innovations and modern aspects in the field of librarianship in general and law librarianship in particular.

None of the foregoing Association activities could have been started or undertaken without the support of philanthropic foundation. In its everyday activities, the Association is aided by private donations.

The Association is concerned with the education for law librarianship and sponsors annual Institutes which in part are financed by private gifts made for the support of Institute participants.

The various projects of the Association are in the hands of the approximately 40 Committees of the Association.

SEPTEMBER 15, 1969.

Hon. PAUL FANNIN,
U.S. Senate,
Washington, D.C.

DEAR PAUL: The Lincoln Foundation is engaged in teaching and research in the fields of economics and taxation, with emphasis on land. Some contemplated provisions in the new Tax Reform Bill would work to the detriment of Foundations such as ours. We do not believe it is the intent of Congress to so restrict these Foundations. Enclosed is a memo from Norm Sugarman outlining the specific circumstances we have in mind and suggesting some wording that would remedy the situation. Norm is now Secretary of the Lincoln Foundation.

I hope you are able to keep these suggestions in mind as hearings on the bill progress and thank you for your attention to this matter.

I hope things are going well with you.

Sincerely,

DAVID C. LINCOLN,
President.
FRANK L. SNELL,
Treasurer.

SEPTEMBER 12, 1969.

Memo to: David C. Lincoln.
From: Norman A. Sugarman.
Subject: Lincoln Foundation, Inc.

BACKGROUND

The Lincoln Foundation was founded in 1947 and has since operated continuously as a foundation which is tax exempt under the Internal Revenue laws. It devotes substantially all of its funds to educational purposes in the form of grants to educational institutions. The principal institutions to which the Foundation has made grants in recent years are Claremont College, in California, The University of Hartford, in Connecticut, and the Henry George School of Social Science, in New York City.

The Lincoln Foundation is managed by a Board of Directors of ten persons of which only three are related to the decreased principal donor of the Foundation, John C. Lincoln. The other seven directors are unrelated to the Lincoln family and consist of notable public figures, such as Raymond Moley, professors of economics and other persons who have an educational and public interest in the principal education field to which the Foundation is devoted.

THE TAX BILL

Under the Tax Reform Bill a special tax and other restrictions are imposed on "private foundations". Foundations which are not "private foundations" are not so affected. Under Section 509(a) of the Bill there are four categories of foundations that are not "private foundations". The three colleges or universities with which the Foundation is associated are, of course, recognized as exempt public institutions under the Internal Revenue Code, and fall in the first category of organizations which under Section 509(a)(1) in the Bill are regarded as public organizations as distinguished from "private foundations".

Section 509(a)(3) exempts another category of organizations from the definition of "private foundation" because they operate for the benefit of and are connected with public charitable organizations and are not controlled by the creator of or principal donor to the foundation. The Lincoln Foundation fits the concept of Section 509(a)(3) (even though not all of its literal requirements) and on the same principle as is expressed in Section 509(a)(3), should not be regarded as a "private foundation".

ANALYSIS OF TAX BILL PROVISION

A copy of Section 509(a) as presently contained in the Bill is attached; paragraph (3) thereof begins on line 7 of the second page. There is certain language in the provision of Section 509(a)(3) which may exclude the Lincoln Foundation from its provisions, purposefully or inadevertently. For example, the provision seems to apply (in (A)) only to an organization which is "organized and at all times thereafter is operated exclusively for the benefit of" colleges and universities and similar public organizations. The Lincoln Foundation is operating for the benefit of colleges and universities by reason of its grants to them, and the provision should be broad enough to permit an existing organization to qualify by operating for the benefit of such institutions even though it may not have been originally so organized. It should not be important to the policy of the Congress that the original documents of a foundation drafted many years ago did not foresee the current provisions of the Tax Bill; and an existing organization should be able to be treated as other than a "private foundation" by adapting its current operations to the support of educational institutions. Certainly Congress does not intend to reduce the financial aid to colleges and universities, which will be the effect unless this provision is broadened.

Another provision of this Section of the Bill which seems to be unduly restrictive is that contained in (B), which makes the provision applicable only to an organization which is operated "in connection with one organization" such as a college or university or similar public institution. This restriction makes it impossible for the Foundation to qualify because it is making grants to more than one college or university. The provision should be broadened so as to permit the Foundation to be operated in connection with more than one college or university, or, if, for some reason, it is important that the foundation be connected at any one time with only one school, then the foundation should be permitted to shift its alliance to another educational institution if there is good reason to make the shift (such as the failure of the first educational organization properly to use the funds made available to it).

Basically, the Lincoln Foundation should not be treated as a "private foundation", in the sense that is commonly given to that term, because it is not controlled by any one family or group and because its funds are devoted primarily to colleges and universities and similar public institutions. (In this connection, it is far different from the Ford Foundation, which spends a substantial part of its funds for projects which are outside of publicly supported institutions).

SUGGESTED REVISION OF THE BILL

There are a number of ways in which the present provisions of the Bill could be modified in order that foundations, such as the Lincoln Foundation, would be exempt from classification as a "private foundation". It should be pointed out that the situation of the Lincoln Foundation is very similar to that of other foundations which have developed in this country for the support of colleges, universities, symphony orchestras, art museums, etc., where there is no private control by any one individual or family and the funds are distributed solely for the support of such public institutions. There is attached a suggested revision of Section 509(a)(3) which would permit the Lincoln Foundation and similar meritorious organizations to be exempt from the definition of private foundations.

SECTION 509(a) AS PROPOSED TO BE ADDED TO THE INTERNAL REVENUE CODE BY SECTION 101(a) OF THE TAX REFORM BILL OF 1969 AS PASSED BY THE HOUSE OF REPRESENTATIVES

"SEC. 509. PRIVATE FOUNDATION DEFINED.

"(a) GENERAL RULE.—For purposes of this title, the term 'private foundation' means an organization described in section 501(c)(3) other than—

"(1) an organization described in section 170(b)(1)(B);

"(2) an organization which—

"(A) normally receives more than one-third of its support in each taxable year from any combination of—

"(i) gifts, grants, contributions, or membership fees, or

"(ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business (within the meaning of section 513), not including such receipts from any person in any taxable year which are in excess of 1 percent of the organization's support in such taxable year,

from any person other than a disqualified person (as defined in section 4946) with respect to the organization, or from any organization described in section 170(b)(1)(B), and

"(B) normally receives not more than one-third of its support in each taxable year from gross investment income (as defined in section 506(b)(2));

"(3) an organization which—

"(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more organizations described in paragraph (1) or (2),

"(B) is operated, supervised, or controlled by one or more organizations, or in connection with one organization described in paragraph (1) or (2), and

"(C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2); and

"(4) an organization which is organized and operated exclusively for testing for public safety.

Suggested revision of paragraph (3) of Section 509(a):

(3) an organization which—

(A) distributes substantially all of its income to, is operated for the benefit of, to perform the functions of, or to carry out the purposes of one or more organizations described in paragraph (1) or (2).

(B) is operated, supervised, or controlled by or in connection with one or more organizations described in paragraph (1) or (2), and

(C) is not controlled through 50% or greater vote by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2); and

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Tax relief for the handicapped

SUMMARY OF STATEMENT BY UNITED CEREBRAL PALSY ASSOCIATIONS, INC.

I. IDENTIFICATION OF ORGANIZATION

II. NEED FOR ENACTMENT OF LEGISLATION TO PROVIDE TAX BREAKS FOR THE HANDICAPPED

In our statement we will discuss our concern for failure to provide tax breaks in the form of deduction for transportation expenses and an additional exemption for handicapped or disabled persons, a group of taxpayers who need them urgently.

III. CONCLUSION—RECOMMENDATIONS

STATEMENT

1. IDENTIFICATION OF ORGANIZATION

United Cerebral Palsy Associations, Inc. is a nonprofit voluntary agency, organized in 1948, the only National organization devoted exclusively to a united attack on cerebral palsy. Cerebral palsy is a condition caused by damage to the human brain, usually at birth.

Cerebral Palsy is the general term applied to a group of disabilities resulting from damage to the developing brain. It is the result of damage to the brain's motor control centers. It means impaired motor functions. It also means other problems. About two-thirds of the individuals with cerebral palsy are mentally retarded; about one-half have speech defects; about one-third have visual difficulties; about one-half have hearing difficulties. An undetermined number have learning problems associated with perceptual and conceptual difficulties.

There are 45 state and 250 United Cerebral Palsy local affiliates that provide care, treatment and training services cerebral palsy individuals need to achieve relatively independent, productive lives. Many United Cerebral Palsy groups offer family supportive services designed to ease the burden of raising a multiple disabled child.

In addition, local and state affiliates support national programs of research and training whose purpose is to discover the causes of cerebral palsy and means of prevention, and to increase the numbers of highly skilled professional personnel who can work with the multihandicapped.

II. NEED FOR ENACTMENT OF LEGISLATION TO PROVIDE TAX BREAKS FOR THE HANDICAPPED

A. *Deduction of transportation expenses by the disabled—an incentive to work for economic independence*

H.R. 424 and S. 1069 introduced respectively by Congressman Wilbur D. Mills and Senator Jacob K. Javits, would permit both the blind and the disabled to deduct up to $600 for transportation expenses incurred in going to and from work.

According to a report of the Intergovernmental Ad Hoc Committee on Transportation of the Advisory Council of the President's Committee on Employment of the Handicapped, in the United States there are nearly four million persons of working age who are handicapped by physical or mental disabilities, and who are prevented from getting or holding jobs or pursuing normal daily activities.

Last year, some 700,000 persons received vocational rehabilitation services through federal and state resources and more than 208,000 were returned to employment.

Preparing the handicapped for employment, no doubt, solves a big problem. Getting to a place of employment presents an even greater barrier to many of the disabled. Transortation systems, unfortunately, are not adapted for use by the handicapped. For this reason the handicapped are concerned not only about the availability of transportation facilities, accessibility and usability of transportation systems, but also about the excessive costs of private transportation which they must use when they cannot utilize public facilities.

An analysis of a pilot study entitled "Transportation for the Handicapped" conducted since July 1, 1968, was reported at a Symposium on March 18, 1969, at the Center for Transportation Studies, Eagleton Institute of Politics, Rutgers University, New Brunswick, New Jersey.

The Center found that the primary solutions to the problems faced by handicapped individuals were government aid in the form of a tax deduction for travel expenses, government provided transportation facilities between home and work and direct payments of transportation costs incurred in the work trip. Further research indicated that solutions to transportation problems most frequently cited were government provided transportation facilities and a tax deduction for travel expenses.

Further analysis initiated as a result of this meeting concerns comparison of travel patterns of the handicapped and the general population. It showed that the handicapped individual's peak travel periods begin earlier than that of the general population, i.e., handicapped travellers try to avoid the most heavily travelled hours of the day.

The Center also investigated federal legislation concerning transportation aid to the handicapped. Of the 942 total analyzed responses from handicapped persons to a questionnaire (from New Jersey and Pennsylvania), 160 indicated the need for government aid in the form of a tax deduction for travel expenses. This represents about 17% of the handicapped population surveyed or about 1 handicapped person out of 6 considered. If this percentage holds true on a national basis, the urgency to pass such legislation becomes imperative.

The need for some form of tax break is revealed in the following cases:

> Rosalie lives on the upper west side in New York City. She has been employed by the State Civil Service Commission and was having problems getting to her job because she could get around only in a wheel chair. She tried taxicabs, but this ate up 75 percent of her income. She appealed to private agencies for transportation, but they had to give it up because it tied up vehicles they need for transporting groups. So Rosalie is out of a job.
>
> George has had 11 years of training in a sheltered workshop in Nassau County and has become proficient in clerical duties. He has a nice personality and manner and gets along well with everybody on the staff. He could hold a job in outside industry. Yet he cannot use public transportation to get to work because he is confined to a wheel chair.

The handicapped are productive citizens and contribute to the economy of the Nation. If we are at all concerned with removing them from welfare rolls and giving them the dignity and self-respect which can come from gainful employment, some incentive should be provided so that they can become financially independent. Deduction of extraordinary transportation expenses would provide one of the necessary incentives. Other categories of wage earners or the self-employed are permitted to deduct certain expenses incurred as essential to their income producing activities. Why not the severely handicapped and disabled?

B. *Failure to provide additional exemption for the disabled is discriminatory*

Hon. Wilbur D. Mills, Chairman of the Ways and Means Committee of the House of Representatives had introduced in the 90th and 91st Congresses H.R. 424, which, among other things, would provide an additional tax exemption of $600 for a disabled taxpayer and his spouse. Senator Jacob K. Javits introduced a companion bill in the Senate, S. 1069.

For the past thirteen years many bills have been introduced to obtain this form of tax relief for the handicapped—each time without success. Perhaps this year, as this Committee considers the subject of tax reform, we can also achieve this measure of reform for the Nation's handicapped citizens.

In his remarks when Senator Javits introduced his bill on February 18, 1969, he indicated that an estimated 300,000 disabled persons would qualify under the propsed legislation at a maximum cost to the Government of $130 each or $10,000,000 per year, a small sum indeed when we are made aware of the fact that the average cost of rehabilitating a disabled person averages from $479 to $544 per year. If we are seriously concerned about alleviating the frustrations that a handicapped person must feel in trying to get to work, the added burden of discriminatory taxation should be removed. The handicapped or disabled person should at least be placed on a parity with other persons who are blind or over the age of 65 and who are allowed the additional exemption of $600. The amount involved would be insignificant perhaps to most of us, but to the disabled it will mean the use of much needed dollars. Most important of all, it will help them to become productive citizens and attain their goal of independent living.

III. CONCLUSION—RECOMMENDATIONS

We recommend amendment of the Internal Revenue Code to provide an additional exemption of $600 for the disabled taxpayer and his spouse and the deduction of transportation expenses of up to $600 incurred in going to and from work. The additional exemption of $600 would eliminate the inequity existing between the handicapped or disabled taxpayers and the blind and persons over 65 years of age. The deduction of transportation expenses of up to $600 would provide the needed incentive to help them gain economic self-sufficiency by providing them with a few more dollars to meet the added expenses incurred because of their handicapping or disabling condition.

It is further recommended that the Federal Government undertake improvements to transportation systems for the handicapped and that the highest priority should be given to the removal of architectural barriers on buses and trains.

OCTOBER 3, 1969.

SUMMARY OF H.R. 13270 AS REPORTED BY THE COMMITTEE ON FINANCE

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A. Private Foundations

1. Limitation on Life of Foundations

Present law.—Under present law, there is no limitation on the period for which a private foundation or other exempt organization may be exempt from income tax.

Problem.—Questions have been raised as to whether private foundations should have a permanent exemption from income tax. In part, the problem here is that if foundations have a permanent life, their economic power may increase to such an extent that they have an undue influence on the private economy and on governmental decisions as well. Secondly, since income (or estate or gift tax) exemptions were granted for amounts given to these foundations and the basis for this deduction is that these funds would be used for educational, charitable, religious, etc., purposes, questions have been raised as to why, after some period of time, the donated funds themselves should not actually be so used, rather than merely the income from these funds.

Finance Committee decision.—To deal with the problems described above, the Finance Committee adopted an amendment limiting the period of the income tax exemption for private (nonoperating) foundations to 40 years.

In the case of existing foundations, this 40-year period would begin with January 1, 1970. For foundations created in the future, the 40-year period begins with their creation or initial treatment as a tax-exempt private foundation.

A private foundation remaining in existence as a nonoperating foundation after 40 years (whether or not consecutive) is to be taxed in the same manner as an ordinary taxpayer (except that if the combination of the audit-fee tax and the unrelated business income tax is higher, these taxes would continue to be paid), but in addition is to remain subject to all of the provisions relating to foundations (self-dealing, distribution of income, etc.). Contributions to such an organization will not be deductible after the 40 years. A private foundation could escape taxation as a regular corporation after the end of the 40 years by being converted into an operating foundation or a publicly supported educational, charitable, or religious organization, or by distributing all of its assets to one or more operating foundations or a publicly supported educational, charitable, or religious organization.

The House bill contains no comparable provision.

2. Audit-Fee Tax

Present law.—Although present law subjects many exempt organizations to taxation on unrelated business income, their investment income is specifically excepted from this tax.

Problem.—Questions have been raised as to why private foundations should not pay some of the cost of government, especially the funds needed for more extensive and vigorous enforcement of the tax laws relating to exempt organizations.

Finance Committee decision.—The Finance Committee decided to deal with this problem by imposing on private foundations an audit-fee tax of ⅕ of 1 percent (based upon the fair market value of the assets held by the foundation), or $100, whichever is the greater. The assets used by a foundation in the active conduct of its exempt functions would not be included in the base for this audit-fee tax. The assets would be valued and averaged in the same manner as is provided for determining the base upon which the minimum investment return is calculated. The committee views this tax as a supervisory fee and as an indication of the amount of the funds needed by the Internal Revenue Service for the administration of the Internal Revenue Code provisions relating to private foundations and other exempt organizations.

The House bill would have imposed a tax equal to 7½ percent of investment income. That tax in the average case would have represented approximately twice as heavy a tax burden as the audit-fee tax provided by the Finance Committee amendments.

3. Prohibitions on Self-Dealing

Present law.—Under present law, no part of the net earnings of private foundations and other charitable organizations are permitted to inure to the benefit of private shareholders or individuals, Also, arm's length standards are imposed with regard to loans, payments of compensation, preferential availability of services, substantial purchases or sales, and substantial diversions of income or corpus to (or from, as the case may be) creators (of trusts) and substantial donors and their families and controlled corporations. The sanctions provided are loss of exemption for a minimum of one taxable year and loss of charitable contributions deductions under certain circumstances.

Problem.—Arm's-length standards have proved to require disproportionately large enforcement efforts, resulting in sporadic and uncertain effectiveness of the provisions. Moreover, the subjectivity involved in applying such standards has occasionally resulted in the courts refusing to uphold sanctions, especially when they are severe in relation to the offense. In other cases, the sanctions have practically no deterrent or punitive effect even where there is vigorous enforcement. Also, many benefits may be derived by those who control a private foundation even though they deal at arm's length.

Finance Committee decision.—The Finance Committee amendments, like the House bill, replace the arms-length standards with a list of specific transactions which constitute prohibited self-dealing when engaged in between the foundation and disqualified persons. Self-dealing transactions, as in the House bill, include the sale or exchange or leasing of property between the private foundation and a disqualified person, the lending of money or other extension of credit between such persons, the furnishing of goods, services, or facilities between such persons, the payment of compensation by a private foundation to disqualified persons, the transfer to or use by, or for the benefit of, disqualified persons of the income or assets of a private foundation, the payment of money or other property to a government official, and the payment by a private foundation of a tax imposed on a disqualified person as a result of these new provisions. Except for the last item in this list, which was added by the Finance Committee, the provisions are the same as under the House bill. The Finance Committee, however, also clarified the self-dealing provisions to make it clear that where a private foundation sells stock to a disqualified person in order to comply with the divestiture rules (described subsequently), this is not to constitute self-dealing even though the sales price is reduced by sales commissions which would have been paid had the stock been sold in the open market. The committee also made it clear that self-dealing may occur even without the transfer of money or property between the foundation and the disqualified person. This can occur, for example, where the stock is bought or sold by the foundation in order to manipulate the price of the stock for the benefit of the disqualified person.

A special rule was applied by the Finance Committee in the case of leases and loans outstanding on October 9, 1969, and also where, under arrangements in existence before that date, goods, services, or facilities were shared by a private foundation and a disqualified person. In all such cases where the foundation receives terms at least as favorable as terms offered to third parties in arms-length transactions, the existing arrangement (under the same or a new lease, loan, etc.) can continue for a period of up to 10 years.

Under the House and Finance Committee version of the bill, a violation of the self-dealing provisions results in an annual tax on the self-dealer of 5 percent of the amount involved in the violation. If the self-dealing is not corrected within an appropriate time, then a tax of 200 percent of the amount involved is imposed on the self-dealer. If the foundation manager is knowingly involved in the self-dealing, a tax of 2½ percent initially is imposed upon him (subject to a maximum of $10,000). Where the foundation manager refuses to agree to the correction of the initial transaction, a tax of 50 percent of the amount involved is imposed. In the case of repeated or willful violations, the tax imposed on the self-dealer or foundation managers may be doubled. A third level of tax may also be assessed as described below in "Change of Status." The Finance Committee provided that the tax on a foundation manager who "knowingly" participates in the self-dealing will not apply unless the violation is willful and is not due to reasonable cause. In addition, the burden of proof that a violation is knowing in such a case is to be upon the Internal Revenue Service to the same extent as in the case of civil fraud under present law.

Both the House and the Finance Committee version of the bill require that the foundation's governing instrument prohibit it from engaging in self-dealing transactions described in the Code.

The Finance Committee added an amendment to the House bill providing for abatement of the additional (second level) self-dealing taxes on private foundations if the State Attorney General takes action to assure that the assets of the private foundation are to be devoted to charitable purposes and the Treasury Department finds that the action of the State Attorney General corrects the violation and generally satisfies the requirements of the bill.

A disqualified person for purposes of the self-dealing provisions (and the other provisions which follow) includes substantial contributors, foundation managers, the families of either of the foregoing, businesses controlled by any of the above, and, for "self-dealing" purposes only, government officials at policymaking levels. The Finance Committee modified the House definition of "family" in determining who is a "disqualified person" by excluding brothers and sisters (and their descendants). It also excludes from the definition of a disqualified person general partners of substantial contributors where the partner's interest in the partnership is less than 20 percent.

A "substantial contributor" as defined by the Finance Committee amendments is an individual, corporation, or other entity that has in total contributed to a foundation more than 2 percent of the contributions made up to any given time, but in no event less than $5,000. (Contributions for this purpose would be valued at fair market value at the time of the contribution.) In the case of existing foundations, the calculations would be made as though all contributions made before October 9, 1969, were made as of that time. (A husband and wife are to be treated as one for purposes of these calculations.) Once a person becomes a substantial contributor he remains in that status even though he makes no further contributions.

4. Distributions of Income

Present law.—A private foundation loses its exemption if its aggregate accumulated income is unreasonable in amount or duration for its charitable purposes.

Problem.—Under present law, if a private foundation invests in assets that produce no current income, then it need make no distributions for charitable purposes, even though the donor has received full deductions for the value of the nonincome-producing property he has contributed. Also, current distributions are not required until the accumulated income becomes "unreasonable". Finally, the sanctions under present law (as described above under "self-dealing") tend to be either largely ineffective or else unduly harsh.

Finance Committee decision.—The Finance Committee amendments, like the House bill, provide that a private foundation must distribute all of its income currently and further provide that in no event may it distribute less than 5 percent of the value of its assets (other than those assets currently being used in the active conduct of the foundation's exempt activities). Operating foundations are governed by separate expenditure requirements and do not have to meet those imposed by this section.

An extended transition rule is provided before the 5-percent minimum payout rule goes into effect for existing foundations. First, under both the House bill and the Finance Committee amendments, the 5-percent minimum payout requirement does not apply for 1970 and 1971 (although during these two years a foundation is still required to pay out any income actually received). In addition, the Finance Committee amendments provide that in 1972 the minimum payout requirement is to be 3½ percent, 4 percent in 1973, 4½ percent in 1974, and 5 percent in 1975 and subsequent years. Under both the House bill and the committee's amendments, the 5-percent payout is not a fixed figure but is an indication of the amount which the House and the Finance Committee believed should be paid out, given present money rates and stock yields. Should these rates and yields change, the Secretary of the Treasury is authorized to modify the 5 percent payout (either upward or downward) to take into account such changes.

Under both the House bill and Finance Committee amendments, graduated sanctions are imposed in the event of a failure to make timely distributions. Under the House bill and the committee's amendments, a tax of 15 percent of the undistributed amount is imposed where there has been a failure to distribute by the end of the taxable year after the income was earned (unless one of the exceptions described below applies). If the distribution of the remaining amount is not made during the "correction period," then a tax of 100 percent of the amount which should be distributed is imposed.

Both the Committee and the House provisions permit income to be set aside for later distribution in certain limited circumstances and also to carry forward "excess" distributions from one year to another. Income may be set aside for up to five years if approval is obtained in advance from the Internal Revenue Service, by establishing that such an arrangement is needed in order to better assure that the purpose for which the funds are to be spent will be carried out. This could be true, for example, in the case of grants for continuing research or as a part of a matching grant program.

Qualifying distributions for purposes of this provision include distributions to educational and religious organizations, to public charities, and to private operating foundations. However, except as described below, a distribution to a controlled organization does not qualify even if the donee organization is a public charity, etc. Qualifying distributions also include direct expenditures for charitable purposes by the foundation and expenditures by it for assets to be used for charitable purposes.

The Finance Committee made a series of perfecting amendments in determining what constitute qualifying distributions. They are as follows:

(1) The committee's amendments allow foundations to make deficiency distributions (along the lines of the deficiency dividend procedure at present followed by personal holding companies) if failure to distribute is because of failure to properly value the assets and is not willful but is due to reasonable cause.

(2) The committee amendments treat as a qualifying distribution a distribution by one private foundation to another private foundation or to a controlled organization which is exempt under section 501(c)(3) (including either private foundations or private operating foundations) but only if the funds are spent or used by that foundation or controlled organization for charitable purposes within one year of their receipt. This expenditure by the receiving organization is in addition to minimum expenditure requirements otherwise applicable to it. Moreover, the donee organization is not to be permitted to pass the grant through to another private nonoperating foundation or to a controlled organization.

(3) In determining the income which must be distributed currently, the Finance Committee allows as deductions both the audit-fee tax and any tax on unrelated business income. In addition, the committee made it clear that reasonable administrative expenses in operating a private foundation are also to be treated as qualifying distributions.

(4) Under the House bill, a distribution is not a qualifying distribution if made to a controlled organization even though the controlled

organization is an operating foundation (point No. 2 above, however, would modify this in the case of distributions passed on through such organizations within one year). The committee made it clear that an organization is to be considered as "controlled" when persons who are "disqualified persons" with respect to the granting foundation may, by aggregating their votes or positions of authority, require the organization to make a distribution, or prevent the organization from making a distribution.

(5) Loans to individuals which are related to the exempt purpose for which the organization was established—for example, student loans—have generally been considered as qualified distributions at the time of the loan. The committee decided that this was appropriate and that the loans when repaid (or receipts from the sale of assets previously used for charitable purposes) should be treated as income for purposes of the minimum distribution requirement, to the extent the foundation has previously treated the amounts as expenditures which are qualifying distributions. This rule also applies where it is determined that an amount previously set aside (and treated as a qualifying distribution at that time) is no longer needed for the purpose for which it was set aside.

(6) The committee agreed that where written commitments have been made before October 9, 1969, by one private foundation to a second private foundation (even though the second foundation is not an operating foundation), the grants made under such commitments by the end of 1974, are to be treated as grants to an operating foundation (and therefore allowed as qualifying distributions and not subject to the expenditure responsibility limits described below in *Limitations as to Activities of Foundations*) if the foundation to which the distributions are made is not controlled by the granting foundation. However, for the grant to be so treated, it must be made for the charitable, educational, or other purpose or function constituting the basis for the organization's exemption. This is a transition rule intended to provide for already outstanding commitments.

5. Stock Ownership Limitation

Present law.—Present law does not deal directly with foundation ownership of business interests, although some cases have held that business involvement can become so great as to result in loss of exempt status.

Problem.—The use of foundations to maintain control of businesses appears to be increasing. Whether or not the foundation management is independent of donor control, incentive to control a business enterprise frequently detracts from incentive to produce and use funds for charitable purposes. Temptations are frequently difficult to measure and sanctions presently are applied only in rare cases.

Finance Committee decision.—Both the House bill and the Finance Committee's amendments as a general rule limit to 20 percent the combined ownership of a corporation's voting stock which may be held by a foundation and all disqualified persons. However, if someone else can be shown to have control of the business, the 20-percent limit is raised to 35 percent.

Excess holdings acquired by gift or bequest in the future under both the House bill and the committee's amendments generally must be disposed of within five years.

In the case of existing holdings, the Finance Committee provided that the combined holdings of a private foundation and all disqualified persons in any one business (if at present in excess of 50 percent) must generally be reduced to 50 percent by the end of 10 years after the date of enactment of the bill. However, where the combined holdings now exceed 75 percent, an additional 5 years is allowed before the 50-percent limit must be reached. (This test must be met both as to the combined voting power of stock and also as to the combined value of all classes of stock taken together.) Present holdings in excess of 20 percent but less than 50 percent need not be decreased but they are not permitted to be increased. This is a substitute for the House provision which would have required the meeting of the 20 percent limit, or the 35 percent limit, in the case of existing holdings within a period of 10 years. In addition, the House bill would have provided certain interim requirements calling for progressive partial dispositions at the end of two years and at the end of five years. The Finance Committee amendments delete both of these requirements except, with modifications, in the case of excessive land holdings, as described below.

The Finance Committee also adopted an amendment which would apply to future purchases of business holdings by private foundations. If a foundation buys voting stock of a business, such stock will not be treated as permitted holdings if the foundation votes more than half of the shares so purchased. This limitation will not apply to stock acquired by gift or bequest nor to stock presently held by foundations.

The Finance Committee also made it clear that the excess business holdings requirements do not apply to certain types of investments. First, they do not apply in the case of investments which are related to the exempt program of the organization involved. For example, holdings would not be considered as excess business holdings if they are investments in small businesses in central cities, or in corporations to assist in neighborhood renovation, where these are a part of the charitable program of the organization involved. However, in these cases the making of a profit by the foundation could not be one of the major purposes of the investment and the principal purpose of the organization in making the investment would have to be charitable. Second, the Finance Committee made it clear that passive income sources are not required to be disposed of under this provision. For example, the holding of a bond issue would not constitute an excess business holding nor would the holding of the stock of a company which itself derives essentially passive income in the nature of a royalty be treated as a business holding for purposes of the bill.

In cases where a foundation owns stock in a holding company, the foundation is to be treated as owning its proportionate share of the investments and business holdings held by the holding company in addition to any stock it holds separately from the holding company. If this total exceeds the limitation permitted under the bill, then either the holding company must dispose of some of its investments or the foundation would have to dispose of some of its stock in the holding company if sanctions are not to apply.

Under a committee amendment, property acquired by a foundation in the future under the terms of a will executed before October 9, 1969, or under a trust instrument which was irrevocable at all times since

October 9, 1969, is to be treated under the same rules as property now held by the foundation. In such cases, however, the 10- or 15-year periods are to run from the date the foundation obtains the stock from the trust or the estate.

Both the House bill and the Finance Committee's amendments permit sales of excess business holdings at a fair price to be made by the foundation to disqualified persons (for example, the stock can be redeemed by the corporation issuing it). The Finance Committee amendments also provide that the redemption of stock by a closely held corporation from a foundation to comply with these provisions is not to result in the imposition of the accumulated earnings tax with respect to that corporation, nor is it to give rise to dividend treatment to the foundation or to other shareholders of the corporation. These rules apply only in the case of stock already held by a foundation or acquired by it under existing wills or trusts.

The committee also decided to make the divestiture provisions inapplicable in two types of cases. The first is where the following conditions exist:

(1) The foundation on October 9, 1969, owned 95 percent or more of the voting stock of the corporation.

(2) The stock was acquired by the foundation solely by gift, devise, or bequest before December 31, 1956.

(3) No member of the governing body of the foundation is a substantial contributor or members of his family at any time on or after December 31, 1956.

(4) The business of the corporation was, on October 9, 1969, and continues to be of substantially the same character as the enterprise which was conducted at the time of the last gift of the stock by the donor.

(5) The corporation in 3 of the last 5 years and in every year in the future distributes to its shareholders at least 40 percent of its income after taxes and the foundation distributes or uses substantially all of its income for its tax-exempt purposes.

(6) The corporation does not in the future acquire any stock in another business enterprise which would represent excess business holdings. A business holding owned by a private foundation through a holding company, all the voting stock of which was owned by the foundation on all the critical dates, is treated as being owned directly by the foundation for these purposes.

The second type of case where the committee decided to make the stock divestitute requirements inapplicable is in the case of foundations incorporated before January 1, 1951, where substantially all of the assets of the foundation on October 9, 1969, consisted of more than 90 percent of the stock of an incorporated business enterprise which is licensed and regulated, the sales and contracts of which are regulated, and the professional representatives of which are licensed, by State regulatory agencies in at least 10 States and the foundation received its stock solely by gift, devise, or bequest. Stock of a company placed in trust with provision for the charitable remainder to go to the foundation upon the death of the life beneficiary also is treated as coming under this provision if the foundation holds on October 9, 1969, without regard to this trust, more than 20 percent of the stock of the enterprise. Such a foundation also must not acquire in the future any stock in another business enterprise which would represent excess business holdings and must distribute or use substantially all of its income for its tax-exempt purposes.

In both of these types of cases, the business holdings referred to are only those actually owned by the foundation on the relevant dates, except in the case of ownership through a holding company in the first type of case (where the foundation must have actually owned all the holding company's voting stock on the relevant dates) and the limited case of the trust holding described in the second type of case.

The committee also decided that where a corporation owns more than 10 percent of the land area of any major political subdivision in in the United States (any county, or a city with a population of more than 100,000) and a foundation and disqualified persons together have excess holdings of 75 percent or more of the stock of such a corporation, 10 percent of the excess holdings must be disposed of within two years, 25 percent within five years, 50 percent within ten years, and the remainder by the 15th year.

6. Limitations on Use of Assets

Present law.—A private foundation loses its exemption if its accumulated income is invested in such a manner as to jeopardize the carrying out of charitable purposes. No similar specific limitations apply to investment of assets.

Problem.—Under present law a private foundation manager may invest the assets (other than accumulated income) in warrants, commodity futures, and options, or may purchase on margin or otherwise risk the entire corpus of the foundation without being subject to any sanctions. (In one case a court held that a consistent practice of such investments constituted an operation of the foundation for a substantial non-exempt purpose, but the only sanction was loss of tax exemption, which did not really improve the status of charity.)

Finance Committee decision.—Both the House bill and the Finance Committee amendments impose upon all assets of a foundation the same limitations presently applicable only to accumulated income. As a result, under this provision, a foundation must not invest its corpus in a manner which would jeopardize the carrying out of its exempt purposes.

The sanction provided by the House bill where investments are made in a manner which jeopardizes the carrying out of the organization's exempt function is a tax of 100 percent of the amount so invested. The Finance Committee amendments provide an initial sanction on private foundations of 5 percent of the amount involved, and an initial tax on the foundation manager, where he knowingly jeopardizes the carrying out of the foundation's exempt purposes, of 5 percent (up to a maximum of $5,000). They also modify the second level sanction, where the jeopardy situation is not corrected, by providing a 25 percent tax on the foundation and a 5 percent tax on the foundation manager who refuses to take action to correct the situation (in the case of the foundation manager, this sanction may not exceed $10,000).

The committee amendments also provide that before the second stage sanctions are imposed the State Attorney General is to be given an opportunity to intervene in the case to exercise whatever powers he has to correct the situation. Where the Treasury Department finds the situation is corrected, the second level sanctions are not to be imposed.

The committee's amendments make it clear that a program-related investment—such as low-interest or interest-free loans to needy students, high-risk investments in low-income housing, and loans to small businesses where commercial sources of funds are unavilable—is to be considered as a charitable expenditure and not as an investment which might jeopardize the foundation's carrying out of its exempt purposes. To qualify as a program-related investment, the investment must be primarily for charitable purposes and not have as one of its major purposes that of deriving a profit for the foundation.

The committee also decided to make it clear that the determination of whether investments jeopardize the carrying out of the foundation's charitable purposes is to be made as of the time of the investment, in accordance with a "prudent trustee" approach, and not subsequently, on the basis of hindsight after a loss occurs.

7. Limitations as to Activities of Foundations

Present law.—Present law requires that no substantial part of the activities of a private foundation may consist of carrying on propaganda or otherwise attempting to influence legislation. It further provides that no such organization may "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office." The corresponding charitable contributions deduction provision prohibits substantial propaganda activities but does not deal specifically with the electioneering activities. Another provision prohibits the use of accumulated income to a substantial degree for nonexempt purposes.

Problem.—Under the present law's substantial lobbying provision, a large organization may safely engage in far more lobbying than a small organization. Also, many organizations make their views clear as to which candidates for public office ought to be supported, with confidence that the drastic remedy of loss of exemption will not be imposed. Heavily endowed organizations may engage in lobbying or electioneering and, if exempt status is lost, may continue to avoid tax on investment income by becoming exempt under other provisions of the law. The individual grant device is increasingly being used as a method for funding certain political viewpoints. Organizations that have been called to task for engaging in such activities have claimed that they have no responsibility for how their money is used once a grant has been made.

Finance Committee decision.—Both the House bill and the Finance Committee amendments provide sanctions where private foundations spend money on certain activities, primarily lobbying and electioneering. The definitions in the Finance Committee amendments as to lobbying, however, are somewhat less stringent. First, the House bill prohibits expenditures representing attempts to influence legislation through attempts to affect the opinion of the general public. The committee amendment taxes expenditures where attempts are made to influence legislation by attempting to cause members of the general public to propose, support, or oppose legislation. This is not intended to prevent the examination of broad problems of the type the government could be expected to deal with ultimately, but it would not permit lobbying on matters which have been proposed for legislative action.

Second, the House bill would tax attempts to influence legislation through private communications with persons who participate in the formulation of legislation, other than through making available the results of nonpartisan analysis or research (except that private foundations could communicate with respect to their own tax status). The committee amendment would tax attempts to influence legislation through communications with government personnel who may participate in the formulation of legislation, except in the case of technical advice or assistance provided to a governmental body in response to a written request by such body or person. In addition, an exception is provided where the activity consists of making available the results of nonpartisan analysis, study, or research (an exception is also provided for communications with respect to the tax-exempt status of the foundation itself).

The committee indicated that where noncommercial educational television and radio stations adhere to the FCC regulations and the "fairness doctrine" (requiring balanced, fair, and objective presentations of issues, and forbidding editorializing), this is to constitute compliance with the first of the two rules specified above. Under this rule, a private foundation would be able to make grants to these television and radio stations without sanctions being applied under this provision, such grants to be tested under the "fairness doctrine" on a grant-by-grant basis.

The House bill provided that voter registration drives would be permitted under this provision where conducted on a nonpartisan basis by broadly supported organizations active in at least five States, provided that contributions to the operating foundations carrying on such activity are not geographically limited as to use. The Finance Committee decided to delete the portion of the bill which would permit private foundation funds to be used for voter registration drives.

The House bill also prohibits expenditures to influence the outcome of any public election. The committee modified this to prohibit expenditures for the purpose of influencing the outcome of any specific election, because it is arguable that almost any statement or study or general educational activity may become at a future date an issue in an election depending upon the desires of the candidates at that time. Limiting this to "specific" elections would still prohibit the preparation of any materials that were designed to favcr or hinder any particular candidate for public office or any particular viewpoint in the case of a referendum.

The House bill also imposes sanctions upon the making of grants to individuals by private foundations unless the grantees are chosen in open competition or on some other objective and nondiscriminatory programmatic basis, in accordance with procedures approved in advance by the Internal Revenue Service. Grants may also be made in the form of scholarships or fellowships for specific purposes. Among the permitted purposes for which grants may be made where approval of the program has been obtained in advance are grants for the improvement or enhancement of "a literary, artistic, musical, scientific or other similar capacity, skill or talent." The committee amendments also permit individual grants for the enhancement or improvement of "teaching skills." In addition, the committee amendments provide that private foundations may make grants to individuals in the form of prizes or awards if the individuals are selected from the general public on the basis of merit or unusual achievement.

Grants to organizations other than public charities are also prohibited under this provision unless the granting organization becomes responsible for how the money is spent and for providing information to the Internal Revenue Service regarding the expenditures. This expenditure responsibility under the committee amendments is not to be interpreted as making the granting foundation an insurer of the activity of the organization to which it makes a grant, so long as it uses reasonable efforts and establishes adequate procedures so that the funds will be used for proper charitable purposes. In effect, "prudent man" standards are required in such cases. For example, if the organization to whom the grant was made supplied a certified audit as to the purpose of the expenditures, this would appear to meet this requirement.

Under the House bill there is one sanction in the case of expenditures for activities under this category. It is a tax equal to 100 percent of the amount improperly spent plus a tax on the foundation manager who knowingly made the improper expenditure of 50 percent of that amount. The committee amendments provide an initial sanction of 10 percent of the amount improperly spent (plus a tax of 2½ percent up to a maximum of $5,000 on the foundation manager who knowingly made the improper expenditure). The heavier sanction would apply later only if the foundation refused to correct the earlier improper action to the extent possible. The heavier sanction on the manager (to a maximum of $10,000) would apply later only if he refused to agree to the correction.

8. Disclosure and Publicity Requirements

Present law.—Under present law, an exempt organization must file annual information returns describing its gross income, expenses, disbursements for its exempt purposes, accumulations, balance sheets, and the total amount of contributions and gifts received by it during the year. This requirement applies only to exempt organizations other than: religious organizations (and certain of their affiliates); schools and colleges; publicly supported charitable organizations; certain fraternal beneficial societies; and federally owned, congressionally chartered exempt organizations. These information returns are in addition to the unrelated business income tax returns required to be filed in certain cases.

No specific sanctions are provided for failure to file an exempt organization information return. However, certain criminal provisions may apply in extreme cases.

Existing law also provides that the information required to be furnished on exempt organization information returns is to be open to the public.

Problem.—The present information return requirements are essentially the same as those provided by the 1950 amendments to the charitable organization provisions of the code. The primary purpose of these requirements is to provide the Internal Revenue Service with the information needed to enforce the tax laws. The House and the Finance Committee concluded that experience of the past two decades indicates that more information is needed on a more current basis for more organizations and that this information should be made more readily available to the public, including State officials.

Finance Committee decision.—The House bill makes several changes in the present provisions.

First, the House bill provides that every exempt organization, whether or not a private foundation, must file an annual information return except where the Treasury Department determines that this is unnecessary for efficient tax administration. The Finance Committee provided two exceptions to this provision. First, it exempted churches and their integrated auxiliary organizations and associations or conventions of churches from the requirement of filing this annual information return (where the church or its auxiliary organization, etc., is engaged in an unrelated business, however, it would still be required to file an unrelated business income tax return). The integrated auxiliary organizations to which this applies include the church's religious school, youth group, and men's and women's clubs. The committee also exempted from the requirement for filing this annual information return any organization that normally has gross receipts of $5,000 or less where the organization is of a type not required to file an information return under present law. In addition to these two exempt categories, the Treasury Department can exempt other types of organizations (such as religious orders) from the filing requirements if it concludes that the information is not of significant value.

A second change in present law made by the House bill is to require that there be shown on each information return the names and addresses of all substantial contributors, directors, trustees, and other management officials (all of whom are "disqualified persons" for purposes of several of the new provisions), and of highly compensated employees. Compensation and other payments to managers and highly compensated employees also must be shown. The Finance Committee is in accord with these changes except that it decided not to require that the names and addresses of substantial contributors be disclosed to the public in the case of exempt organizations other than private foundations (such organizations would, however, be required to disclose these names to the Internal Revenue Service).

A third change in present law made by both the House bill and the committee's amendments provides that the failure to file a timely exempt organization information return (unless reasonable cause is shown) is to result in a sanction of $10 per day, up to a maximum of $5,000 as to any one return, imposed upon the foundation. Failure to file after a reasonable demand by the Internal Revenue Service (unless reasonable cause is shown) is to result in an additional sanction of $10 a day up to a maximum of $5,000 as to any one return. This sanction is imposed on the exempt organization official or employee who fails to file the information return.

The fourth change made by the House bill and the committee amendments directs the Internal Revenue Service to notify State officials of any refusal by the Service to recognize the exempt status of an organization previously exempt or that in the future applies for exempt status, any violation by an organization of the requirements of its exemption, and any mailing of a notice of deficiency regarding any of the new taxes imposed by this bill with respect to private foundations. In addition, the Service is to make available information about the items previously referred to that are relevant to any determination under State law.

9. Change of Status

Present law.—Under present law, an organization is exempt if it meets the requirements of the code, whether or not it has obtained an "exemption certificate" from the Internal Revenue Service.

If an organization does not continue to meet the requirements for exemption, if it commits certain specifically prohibited acts (sec. 503) or if it deals in certain prohibited ways with its accumulated earnings (sec. 504), it loses its exempt status. This loss of exempt status may relate back to the time the organization first violated the code's requirements. However, if the violation occurred after the contributions had been made to the organization, no deductions are disallowed to such contributors. Also, the organization's income tax exemption is not disturbed for years before the organization's first violation.

Problem.—The House and the Finance Committee believe that the Internal Revenue Service has been handicapped in evaluating and administering existing law by the lack of information with respect to many existing organizations.

In addition, they are concerned that in many cases under existing law the loss of exempt status will impose only a light burden on many existing foundations. This is true in those circumstances, for example, where the foundation has already received sufficient charitable contributions to provide its endowment and where the foundation could retain its exemption as to its current income by qualifying for exemption under an exemption category other than section 501(c)(3).

Finance Committee decision.—With respect to the first problem outlined above, the House bill provided that new exempt organizations must notify the Internal Revenue Service if they claim exempt status under section 501(c)(3). It also required that they, and existing organizations, notify the Service if they claim to be other than private foundations. The bill provides that the Treasury Department may exempt from either or both of these notification requirements:

(1) churches (or conventions or associations of churches);
(2) schools and colleges; and
(3) any other class of organization where the Treasury determines that full compliance with these provisions is not necessary to efficient administration.

The Finance Committee concluded that churches, their integrated auxiliaries, and conventions or associations of churches, whether or not the Treasury acts, should not be required to claim exempt status in order to be exempt from tax nor should they be required to file with the Internal Revenue Service to avoid classification as private foundations. The committee also decided to exclude from these requirements those educational or public charitable organizations whose gross receipts normally are $5,000 or less. As under the House bill, the Treasury Department still will be able to exercise its discretion in exempting other classes of organizations (such as religious orders) where this is consistent with efficient administration.

With respect to the second problem outlined above, the House bill provides that an organization which was a private foundation for its last taxable year ending before May 27, 1969, or become one on a subsequent date, may not change its status unless it repays to the government the aggregate tax benefits (with interest) which have resulted from its exempt status. (This tax may be abated, however, as described below.) The Treasury Department may also assess this tax in any case where the private foundation has willfully engaged in flagrant or repeated acts (or failures to act) giving rise to tax liability under the other provisions relating to private foundations.

The tax benefits to be repaid in these cases are the increases in income, estate, and gift taxes which would have been imposed upon the organization and all substantial contributors if the organization had been liable for income taxes and if its contributors had not received deductions for contributions to the organization.

If a private foundation is required to pay this tax or volunteers to pay this tax to change its status, the Internal Revenue Service may then abate any part of the tax which has not been paid if (1) the foundation distributes all of its net assets to organizations which have been public charities, or (2) itself has operated as an organization which is not a private foundation for at least five years.

The Finance Committee accepted the House provision described above except that it provided that where a private foundation volunteers to change its status by acting in all respects as a public charity for at least five consecutive years the foundation is to be classified as a public charity *during* the five-year period. Should the organization fail to act as a public charity during that period, it would lose its status as of that time as a public charity. However, it would during the 5-year period continue to be treated as the same private foundation subject to the same change of status rules if it engages in willful, flagrant, or repeated violations. Also, if an organization that was a private foundation for its last taxable year ending before October 9, 1969, changes into a "public" charity in its first taxable year beginning after December 31, 1969, it need not go through the processes required by this "Change of Status" provision.

The committee's amendments provide that the tax on change of status, discussed above, may also be abated if the Service is satisfied that corrective action to preserve the foundation's assets for charity has been completed by the State Attorney General or other appropriate State official under the supervision of the appropriate courts.

10. Definition of Private Foundation

Present law.—"Private foundation", a term not found in present law, is often used to describe an organization, contributions to which may be deducted only up to 20 percent of an individual donor's adjusted gross income. Deductions of up to 30 percent of a donor's income may be taken for contributions to (1) churches, (2) schools, (3) hospitals, (4) fund-raisers for schools, (5) States and subdivisions, and (6) publicly supported charities.

Problem.—In general, the problems that gave rise to the statutory provisions of the bill discussed above appear to be especially prevalent in the case of organizations presently in the 20-percent group. However, it appears that certain organizations presently in the 20-percent category generally do not give rise to the problems which have led to the restrictions and limitations described above.

Finance Committee decision.—The House bill provides that private foundations subject to the provisions described in the first 9 parts of this summary are organizations referred to in section 501(c)(3) of the code *other than:*

(1) organizations, contributions to which may be deducted to the extent of 30 percent (50 percent under the bill) of an individual's income (for list of six categories of organizations, see *Present law*, above);

(2) certain types of broadly, publicly supported organizations (described below);

(3) organizations organized and operated exclusively for the benefit of one or more organizations described in (1) or (2) above which are controlled by one or more of these organizations or are operated in connection with one of these organizations and are not controlled by disqualified persons (other than foundation managers, disqualified only as such, and organizations described in (1) or (2) above); and

(4) organizations which are organized and operated exclusively for testing for public safety.

The first and fourth categories are essentially the same as in present law. The second category provides that private foundation treatment is not to apply in the case of an organization (including a membership organization) which normally receives no more than one-third of its support in each year from investment income, if at least one-third of its support comes from the public (in the form of gifts, grants, contributions, membership fees, and gross receipts from admissions) not taking into account amounts received from disqualified persons. This requirement is designed to insure that the organization is responsive to the general public. The remainder of the organization's support may come from substantial contributors and other disqualified persons but no more than one-third of its support may come from investment income.

The committee in general accepted this definition but made the following modifications or clarifications in it:

(a) It provided a definition of support for purposes of this provision. In this regard it adopted the definition contained in the current regulations modified to include in support amounts received from the exercise or performance by an organization of its exempt purpose or function.

(b) In defining the one-third of the organization's support which must come from the public, the bill includes gross receipts from activities by the organization which are not unrelated trade or business activities. This, however, does not include receipts in the year from any persons which are in excess of 1 percent of the organization's support or (under the committee's amendment) $5,000, whichever is greater.

The term "person" as used in the Internal Revenue Code does not include governmental units, so that under the House bill an organization which has only one contributor whose support comes from government contract work might avoid classification as a private foundation (or, depending upon the interpretation, might be regarded as being a private foundation even though its governmental support really was broadly based). The committee provided that amounts received from government contracts (on a contract-by-contract basis) would be included in the qualifying activity income only to the extent they do not exceed 1 percent of the organization's support, or $5,000, whichever is the greater.

(c) The committee provided that an organization which would meet all of the tests of the third category described above except that it is operated in connection with two or more specific schools nevertheless may qualify where all the beneficiaries are educational organizations.

(d) The committee provided that an organization which is formed outside the United States, if it meets the definition of a private foundation, is to be treated as such despite the place of its organization. A gift by a domestic private foundation to a foreign nonoperating private foundation generally will not be a qualifying distribution; a gift to a foreign operating foundation will qualify under the same circumstances that a gift to a domestic operating foundation would qualify.[1]

(e) The committee provided that a foundation which is run in conjunction with an organization exempt under paragraphs (4), (5), or (6) of section 501(c) (such as a social welfare organization, labor or agricultural organization, business league, real estate board, etc.) which is publicly supported is to be treated as meeting the public support test for purposes of being a public charity rather than a private foundation.

11. Private Operating Foundation Definition

Present law.—The term "operating foundation" is not in present law but is sometimes used to describe the type of organization contributions to which qualify for the unlimited charitable contribution deduction even though they do not qualify for the 30-percent deduction provision of present law. Essentially these are organizations which, although lacking general public support, devote most of their earnings and much of their assets directly to the conduct of their educational, charitable, and religious purposes, as distinct from merely making grants to other organizations for these purposes. More specifically, in order to qualify for this treatment under present law, substantially more than half of the organization's assets and substantially all of its income must be used or expended directly for its exempt purposes or function.

Problem.—A definition of an operating foundation is needed under the House bill and the committee's amendments, first, because an operating foundation (as distinct from private foundations generally) can be the recipient of grants from a private foundation without having to spend the funds so received currently within one year with the funds nevertheless qualifying as expenditures of income by the donating private foundation. Second, insofar as the committee amendments are concerned, an operating foundation (as distinct from a nonoperating private foundation) is not limited to a 40-year life as an exempt organization. Third, under the committee amendments, charitable contribution donations to operating foundations are eligible for the 50-percent charitable contribution deduction. Fourth, while operating foundations are required to spend or use "substantially all

[1] The committee provided a series of modifications of the private foundations rules to take account of the fact that some of the rules could not easily be applied in practice to foreign organizations. The audit-fee tax will be 2 percent of the gross income received from sources within the United States. The requirements regarding change of status, governing instruments, self-dealing, minimum distributions, excess business holdings, jeopardy investments, and limitations on activities will not apply to foreign private foundations if no significant part of their normal support (other than investment income) comes from the United States. However, in general, such a foreign private foundation loses its exemption under the Internal Revenue Code if it engages in any of the acts that would have justified a doubling of the taxes imposed upon the organization had it been a domestic organization engaging in those same acts. Also, no income, gift, or estate tax deductions would be allowed to an organization that has lost its exempt status under these circumstances. In effect, such an organization would be treated as a taxable nonresident alien.

of their income" for their educational or charitable purposes, they are not subject to the 5-percent minimum payout requirement nor required to expend their entire income.

Finance Committee decision.—The House bill and the committee amendments provide that an operating foundation is a private foundation substantially all of whose income is spent directly for the active conduct of its activities representing the purpose or function for which it is organized and operated. Under the House bill, it must also meet one of two other tests. Under the committee's amendment, it may meet either one of the same tests or a third test. The first of these alternative tests under both versions of the bill requires that substantially more than half of the assets of the foundation must be devoted directly to the activities for which it is organized or to functionally related businesses. (This alternative is essentially the same as present law.) The second alternative under both versions of the bill covers cases where the organization normally receives substantially all of its support (other than gross investment income) from 5 or more exempt organizations and from the general public. However, in this case not more than 25 percent of the foundation's support may be received from any one of these exempt organizations and, under a committee amendment, not more than half of its support may come from its investment income. The third alternative provided by the committee is where an organization's endowment (plus any other assets not devoted directly to the active conduct of the activities for which it is organized), based upon a 4-percent rate of return, is no more than adequate to meet its current operating expenses. (The 4-percent rate will vary in accordance with any changes made by the Secretary of the Treasury in the 5-percent minimum payout requirement.)

12. Hospitals

Present law.—Hospitals qualify for exempt status and may receive deductible charitable contributions as "charitable" organizations.

Problem.—It has been contended by some revenue agents that hospitals (unlike educational organizations, churches, and others) must provide some significant amount of charitable services without charge or below cost in order to be exempt as "charitable" organizations.

The Internal Revenue Service has issued a ruling indicating that hospitals, if they meet all the other requirements of section 501(c)(3), are exempt under that provision, whether or not they provide charitable services on a no-cost or low-cost basis.

Finance Committee decision.—The committee deleted from the bill those provisions which would have conformed the code to the result reached by the ruling. The committee decided to reexamine this matter in connection with pending legislation on Medicare and Medicaid.

13. Effective Dates

The provisions described above generally apply to taxable years beginning after December 31, 1969.

Finance Committee decision.—The committee generally adopted the effective dates in the House bill with the following exceptions:

(1) Foundations whose governing instruments cannot be changed to comply with the income distribution rules or with business ownership

rules are not to be affected by these rules until the instruments can be changed. Similar provisions already appear in the bill with regard to accumulations and with regard to the provision requiring existing private foundations to reform their governing instruments in accordance with the language of the bill.

(2) The House bill provides that the self-dealing rules are not to apply to fair price sales to disqualified persons in the case of property held by the foundation on May 26, 1969, if the foundation is required to dispose of the property in order to meet the business holding requirements. The committee changed the date to October 9, 1969, and extended this treatment to exchanges and other dispositions where the foundation receives in return amounts equal to or in excess of the fair market value of the property which was exchanged. The committee also agreed that this rule as to the sales of business holdings is also to apply to later acquired property received under wills executed before October 9, 1969, or where the property was received under the mandatory provisions of trusts or documents transferring property in trust if such provisions were irrevocable on October 9, 1969, and at all times thereafter.

B. OTHER TAX-EXEMPT ORGANIZATIONS

1. The "Clay Brown" Provision or Debt-Financed Property

Present law.—Under present law, charities and some of the other types of exempt organizations are subject to tax on rental income from real property to the extent the property was acquired with borrowed money. However, this provision does not apply to all tax-exempt organizations and there is an important exception which excludes rental income from a lease of 5 years or less. Nor does the tax apply to income from the leasing by a tax-exempt organization of assets constituting a going business.

Problem.—During the past several years weaknesses in the present provision relating to debt-financed property have been exploited in several different respects. As a result a large number of tax-exempt organizations have used their tax-exempt privileges to buy businesses and investments on credit, frequently at what is more than the market price, while contributing little or nothing themselves to the transaction other than their tax exemption.

In a typical *Clay Brown* situation a corporate business is sold to a charitable or educational foundation, which makes a small or no down payment and agrees to pay the balance of the purchase price out of profits from the property. The charitable or educational foundation liquidates the corporation, leases the business assets back to the seller, who forms a new corporation to operate the business. The newly formed corporation pays a large portion of its business profits as "rent" to the foundation, which then pays most of these receipts back to the original owner as installment payments on the initial purchase price.

In this manner in the *Clay Brown* case (1965 Supreme Court case), a business was able to realize increased after-tax income, and the exempt organization acquired the ownership of a business valued at $1.3 million, without the investment of its own funds. In the recent (1969) *University Hill Foundation* case, the Tax Court upheld the acquisition of 24 businesses by the University Hill Foundation in the period 1945 to 1954. Other variants of the debt-financed property problem have also been used.

Finance Committee decision.—Both the House bill and the committee amendments provide that all exempt organizations' income from "debt-financed" property, which is unrelated to their charitable function, is to be subject to tax in the proportion in which the property is financed by the debt. Thus, for example, if a business or investment property is acquired subject to an 80 percent mortgage, 80 percent of the income and 80 percent of the deductions are to be taken into account for tax purposes. As the mortgage is paid off, the percentage taken into account diminishes. Capital gains on the sale of debt-financed property also are taxed. The provision makes exceptions for property to be used for an exempt purpose of the organization involved within a reasonable time and also for property acquired by gift or inheritance under certain conditions. Special exceptions are also provided for the sale of annuities and for debts insurea by the Federal Housing Administration to finance low and moderate-income housing. The provision is generally effective for 1970 and later years, but for years before 1972 only indebtedness incurred on or after June 28, 1966, is to be taken into account.

The Finance Committee and House versions of the bill are the same except for the following modifications:

(1) It is to be made clear in the committee report that property acquired under life income contracts is not to be treated as debt-financed property except where payments received by any of the life beneficiaries are treated for tax purposes as the proceeds of a sale.

(2) Where a debt-financed building is operated by an exempt holding company (or other exempt organization) for the benefit of an affiliated exempt organization, the committee amendments specify that the property of the holding company (or other exempt organization) is not to be classified as debt-financed property to the extent it is used by the related exempt organization (whether or not a section 501(c)(3) organization) in the performance of its exempt functions.

(3) The House bill exempts from the classification of debt-financed property, property where "all" of the property is used for the exempt purpose of the organization. The committee amendments specify that this exclusion also is to include cases where "substantially all" of the property is used for the organization's exempt purposes. In addition, if less than substantially all of the property's use is related to the exempt purpose of the organization, to the extent that the property is so used it is not to be considered as debt-financed property.

(4) Generally, an acquisition indebtedness would exist with respect to any property whenever the indebtedness was incurred in acquiring or improving the property or would not have been incurred "but for" the acquisition or improvement of the property. Thus, for example, where a church has a portfolio of investment with no debt, and subsequently acquires a debt to construct a church-related building, such as a seminary, such debt will not be considered acquisition indebtedness with respect to the investment portfolio.

2. Extension of Unrelated Business Income Tax to All Exempt Organizations

Present law.—Under present law the tax on unrelated business income applies only to certain tax-exempt organizations. These include:

(a) Charitable, educational, and religious organizations (other than churches or conventions of churches);

(b) Labor and agricultural organizations;

(c) Chambers of commerce, business leagues, real estate boards, and similar organizations;

(d) Mutual organizations which insure deposits in building and loan associations and mutual savings banks; and

(e) Employees' profit sharing trusts and trusts formed to pay (nondiscriminatory) supplemental unemployment compensation.

Problem.—In recent years, many of the exempt organizations not now subject to the unrelated business income tax—such as churches, social clubs, fraternal beneficiary societies, etc.—have begun to engage in substantial commercial activity. Some churches, for example, are engaged in operating publishing houses, hotels, factories, radio and TV stations, parking lots, newspapers, bakeries, restaurants, etc. Furthermore, it is difficult to justify taxing a university or hospital which runs a public restaurant or hotel or other business and not taxing a country club or lodge engaged in similar activities.

Finance Committee decision.—The House bill and the Finance Committee amendments extend the unrelated business income tax to all exempt organizations (except United States instrumentalities). The organizations which will newly be made subject to this tax include churches and conventions or associations of churches, social welfare organizations, social clubs, fraternal beneficiary societies, employees' beneficiary associations,. teachers' retirement fund associations, cemetery companies, credit unions, mutual insurance companies, and farmers' cooperatives formed to finance crop operations.

As under present law, this tax does not apply unless the business is "regularly" carried on and, therefore, does not apply, for example, in cases where income is derived from an annual athletic exhibition. In the case of membership organizations, income resulting from charges to members for goods, facilities, and services supplied in carrying out the exempt function is not subject to tax.

The bill contains several administrative provisions including one providing that no audit of a church, its integrated auxiliaries, or convention or association of churches is to be made unless the principal internal revenue officer for the region believes the church may be engaged in a taxable activity. Churches will not be subject to tax for 6 years on businesses they now own.

The Finance Committee amendments differ from the House provisions only in the following respects:

(1) Present law, in distinguishing between passive income which is free of tax and active business income which is subject to tax, provides an exclusion from the unrelated business income tax for all rents from real property and personal property leased with the real property. The committee amendments modify this to limit the exclusion for rents of

personal property to cases where the personal property is incidental to the lease of the real property. Further, in any case, rents from real property would be taxed where such property is leased with personal property, if 50 percent or more of the rent is attributable to the personal property. In addition, the committee amendments tax as unrelated business income property rentals of both real and personal property where the rentals are measured by reference to the net income from the property.

(2) The committee amendments will make it clear that related income includes income received from members for providing goods, facilities, or services not only to guests but also to members' dependents.

(3) Under the committee amendments, the $1,000 specific deduction allowed in present law in computing the unrelated business income tax is to be available for each parish, individual church, district, or other local unit in the case of a diocese, province of a religious order or convention or association of churches, to the extent that each such local unit has such income.

(4) Under present law, a voluntary employees' beneficiary association (exempt under sec. 501(c)(9)) must derive 85 percent or more of its income from its members. With the imposition of the tax on unrelated business income on organizations in this category (and also the investment income tax referred to subsequently), the House concluded that the 85 percent income test was no longer necessary. As a result, the voluntary employees' beneficiary associations, under the House bill, generally are to be exempt whether or not they meet the 85 percent test in the same manner as is now the case where the members are United States Government employees (sec. 501(c)(10)). For this reason, the committee amendments combine these two categories. In addition, the committee amendments specify that those voluntary employees' beneficiary associations which provide pension and retirement benefits for their members and are taxed under special life insurance company provisions, will be restored to an exempt category under section 501(c) (as was previously the case) but will be subject to the unrelated business income tax.

(5) In defining what constitutes related business income, the committee amendments provide that when an exempt holding company and a tax-exempt organization to which it is related file a consolidated return, the holding company is to be treated as organized and operated for the same purposes as the exempt organization. This means that the income of the holding company will be classified as related business income if it is related to the exempt functions of the exempt organization.

(6) In the case of churches, it will be made clear in the committee report that the term "related business income" includes the operation and maintenance of cemeteries, the conduct of charitable institutions, the sale of religious articles and the printing, distribution and sale of religious pamphlets, tracts, calendars, papers, books and magazines with a substantial religious content, as long as these activities are carried on in connection with the church.

(7) The committee amendments provide that the unrelated business income tax is not to apply to a religious order or to an educational institution maintained by such religious order that has held unrelated businesses, which provide services under licenses issued by a Federal

regulatory agency, for 10 years or more, if the unrelated business distributes not less than 90 percent of its earnings each year and it is established to the satisfaction of the Secretary, or his delegate, that rates, and other charges and services provided by such a business are fully competitive with and do not exploit similar businesses operating in the same general area.

(8) The committee report is to make it clear that when organizations send out inexpensive articles incidental to the solicitation of charitable contributions, the amounts received are not to be considered as being in exchange for the inexpensive articles where it is clear that the contributions, less a reasonable administrative cost, fully accrue to the exempt organization.

(9) Under present law, the unrelated business income tax does not apply to a business in which substantially all the work in carrying on the business is performed for the organization without compensation or to a business (such as a thrift shop) which sells merchandise, substantially all of which is received by the organizations as gifts or contributions. These exceptions do not apply, however, unless the business is run for the benefit of a single exempt organization. The committee amendments extend these exceptions to cases where such a business is run for the benefit of more than one exempt organization and also where it is run as a separate corporation.

3. Taxation of Investment Income of Social, Fraternal, and Similar Organizations

Present law.—Under present law, the investment income of social clubs, fraternal beneficiary societies, and employees' beneficiary associations are exempt from income tax.

Problem.—Since the tax exemption for social clubs and other groups is designed, at least in part, to allow individuals to join together to provide recreational or social facilities without tax consequences, the tax exemption operates properly only where the sources of income of the organization are limited to receipts from the membership. Where an organization receives income from sources outside the membership, such as income from investments, upon which no tax is paid, the membership receives a benefit from the tax-exempt funds used to provide pleasure or recreational facilities.

Finance Committee decision.—The House bill provides for the taxation (at regular corporate rates) of the investment income of social clubs, fraternal beneficiary associations and employees' beneficiary associations. This does not apply under the House bill, however, to the income of fraternal beneficiary associations and employees' beneficiary associations to the extent the income is set aside to be used only for the exempt insurance function of these organizations or for charitable purposes. If in any year, an amount is taken out of the set-aside and used for any other purpose, however, this amount will be subject to tax at that time.

The Finance Committee amendments modify the House bill by excluding fraternal beneficiary associations from the tax on investment income. In addition, a new category of exemption for fraternal beneficiary associations is set forth which applies to fraternal organizations operating under the lodge system (such as the Masons) where the fraternal activities are largely religious, charitable or educational in nature but where no insurance is provided for the members.

The committee amendments also extend the exemption from the investment income tax available in the House bill for fraternal beneficiary associations and employees' beneficiary associations in the case of amounts set aside for charitable purposes to the other types of organizations to which the investment income tax is to apply. In doing so, it intends in the case of national organizations of college fraternities and sororities that amounts set aside for scholarships, for student loans or loans on local chapter housing, leadership and citizenship schools and services, and similar activities be classified as amounts used for educational or charitable purposes under this provision. This exception would also extend to any other educational or charitable activities of these or other exempt organizations.

The committee amendments also provide that amounts set aside for the reasonable cost of administration of benefit programs, as well as the payment of benefits themselves, constitutes use for educational, charitable, etc. purposes.

In addition, the committee amendments provide that the tax on investment income is not to apply to the gain on the sale of assets used by the organizations in the performance of their exempt functions to the extent the proceeds are reinvested in assets used for such purposes within a period beginning one year before the date of sale and ending three years after that date.

4. Interest, Rent, and Royalties From Controlled Corporations

Present law.—Under present law, rent, interest, and royalty expenses are deductible in computing the income of a business. On the other hand, receipt of such income by tax-exempt organizations generally is not subject to tax.

Problem.—Some exempt organizations "rent" their physical plant to a wholly owned taxable corporation for 80 percent or 90 percent of all the net profits (before taxes and before the rent deduction). This arrangement enables the taxable corporation to escape nearly all of its income taxes because of the large "rent" deduction. While courts have occasionally disallowed some, or all, of the rent deductions, the issue is a difficult one for the Internal Revenue Service.

Finance Committee decision.—The House bill and the Finance Committee amendments amend the Code to provide that where a tax-exempt organization owns more than 80 percent of a taxable subsidiary, interest, annuities, royalties and rents received by it are to be treated as "unrelated business income" and subject to tax. The deductions connected with the production of this income are allowed.

The committee amendments modify this provision by providing that where the subsidiary is also an exempt organization it is to apply only to the extent the income is unrelated business income to the subsidiary. As a result, the payments received from the subsidiary would not be subject to tax to the extent the facilities rented or the money borrowed is used by the exempt organization in the performance of its exempt function. Where the operation of the controlled corporation is "functionally related" to the exempt purposes of the controlling exempt organization, these types of income from the taxable subsidiary would be "related" income and would not be subject to tax.

5. Limitation on Deductions of Nonexempt Membership Organizations

Present law.—Some courts have held that taxable membership organizations cannot create a "loss" by supplying their members services at less than cost so that the resulting loss on membership activities reduces income earned from investments or other activities. Other courts have held instead that such a "loss" is permissible, that the expenses of providing such services at less than cost will offset from taxation additional income earned by the organization from investments or other activities.

Problem.—In some cases membership organizations, which also have business or investment income, serve their members at less than cost and offset this book loss against their business or investment income and as a result pay no income tax. In an important decision the courts held that a non-exempt water company was not subject to tax when the "losses" in supplying its members water offset its investment income. Other courts have held to the contrary.

Finance Committee decision.—The House bill provides that in the case of a taxable membership organization the deduction for expenses incurred in supplying services, facilities or goods to the members is to be allowed only to the extent of the income received from these members. The purpose was to prevent membership organizations from escaping tax on business or investment income by using this income to serve its members at less than cost and then deducting the book "loss."

The Finance Committee amendments accept this provision in general but provide the following modifications:

(1) The provision is not to apply in certain situations where there is no attempt to subsidize services to members with income from nonmembership sources, such as in the case of the American Automobile Association which receives prepaid dues income as consideration for services to be rendered in competition with the charges made by other automobile clubs which are operated as loss leaders for profit organizations.

(2) The provision is not to apply to securities and commodities exchanges organized on a membership basis.

(3) Where the cost of furnishing services, facilities or goods to members exceeds the income from members, the excess deductions are to be available as carryovers to succeeding years as offsets against income derived from members in those years.

(4) The committee amendments postponed the effective date of this provision for one year or until 1971. In addition, the committee report is to make it clear that the adoption of this provision is not to be taken as any inference as to the allowability of a deduction for the excess of such costs over income from members under existing law.

6. Income From Advertising, Etc.

Present law.—Late in 1967 the Treasury promulgated regulations under which the income from advertising was treated as "unrelated business income" even though such advertising appeared, for example, in a periodical related to the educational or other exempt purpose of the organization.

Problem.—While it was concluded that the regulations reached an appropriate result in specifying that in carrying on an advertising business in competition with other taxpaying advertising businesses a tax should be paid, nevertheless, the statutory language on which the regulations were based was sufficiently unclear so that substantial litigation could have resulted from these regulations.

Finance Committee decision.—The House bill provides that the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. It further indicates that for this purpose an activity does not lose its identity as a trade or business merely because it is carried on within a larger aggregate of similar activities which may, or may not, be related to the exempt purpose of the organization.

The Finance Committee amendments approve the intent of the House provision but provide for a restructuring of the language so that it will have application only in the areas to which the regulations had application; in the case of advertising and certain other profit-making activities carried on within a larger aggregate of activities, namely, a sale by a hospital pharmacy of drugs to persons other than hospital patients and the operation of a race track by an exempt organization. Under both the House and committee versions of the bill, an organization which publishes more than one magazine, periodical, etc., may treat any of these on a consolidated basis in determining its unrelated trade or business income so long as each such periodical, etc., is "carried on for the production of income."

C. CHARITABLE CONTRIBUTIONS

1. 50 Percent Charitable Contribution Deduction

Present law.—Under present law, the charitable contributions deductions allowed individuals generally is limited to 30 percent of a taxpayer's adjusted gross income. In the case of gifts to certain private foundations, however, the deduction is limited to 20 percent of a taxpayer's adjusted gross income. (In addition, in limited circumstances. a taxpayer is allowed an unlimited charitable contributions deduction.)

Problem.—It has been suggested that it would be desirable to strengthen the incentive for charitable giving by increasing the present 30 percent limitation on the charitable contribution deduction. Moreover, it was hoped that an increase would offset any decreased incentive resulting from the repeal of the unlimited charitable contributions deduction (see No. 2 below).

Finance Committee decision.—The House bill increases the general 30 percent limitation on an individual's charitable contribution deductions to 50 percent. The 20 percent charitable contribution deduction limitation is retained in the case of gifts to private foundations. Also contributions of appreciated propert, continue to be subject to the present 30 percent limitation.

The Finance Committee amendments, while retaining the general House rules, modify them in two respects. First, they provide that private operating foundations, and also private nonoperating foundations, which within one year distribute the contributions they receive to religious, educational, or public charities, or private operating foundations, are to qualify for the 50 percent limitation in the same manner as other contributions. Second, the committee amendments provide that the 30 percent limit is to apply only to the appreciation portion of the value of a gift of appreciated capital gain property (to which the separate appreciated property rules do not apply). Thus, the basis portion of the value of the property would be eligible for the 50 percent limit before applying the 30 percent limit to the appreciation portion.

The House bill provides that the contribution base to which the percentage limitation is to be applied is adjusted gross income plus the amount of tax preferences not included in the tax base. The committee amendments restore existing law which bases the percentage upon adjusted gross income.

2. Repeal of the Unlimited Charitable Deduction

Present law.—The charitable contributions deduction for individuals generally is limited to 30 percent of the taxpayer's adjusted gross income. An exception to the 30 percent general limitation allows a taxpayer an unlimited charitable contributions deduction, if in 8 out of the 10 preceding taxable years the total of the taxpayer's charitable contributions plus income taxes paid exceeded 90 percent of his taxable income.

Problem.—It has been pointed out that the unlimited charitable contributions deduction has permitted a number of high-income persons to pay little or no tax on their income. It appears that the charitable contributions deduction is one of the two most important itemized deductions used by high-income persons, who pay little or no income tax, to reduce their tax liability.

Finance Committee decision.—The unlimited charitable contribution deduction under both the House bill and committee amendments is to be eliminated for years beginning after 1974. During the interim period, an increasing limitation is to be placed on the amount by which the deduction may reduce the individual's taxable income. For taxable years beginning in 1970, the total charitable deduction (for those qualifying under this provision) is not to be allowed to reduce an individual's taxable income to less than 20 percent of his adjusted gross income. This percentage is increased by six percentage points a year for the years 1971 through 1974. The percentage of the taxpayer's taxable income which must be given to charity (or paid in income taxes) in 8 out of the 10 preceding taxable years in order to qualify for the extra charitable deduction during this interim period is reduced to 80 percent in 1970, and then is reduced by six percentage points a year for each of the years 1971 through 1974.

The committee amendments, while in accord with the rules set forth above, specify that during the interim period through 1974 the 30 percent limit on gifts of appreciated property and the appreciated property rule which in some cases takes the appreciation into account for tax purposes are not to apply in the case of a person qualifying for the extra charitable contribution deduction in the interim period in the case of property which would give rise to a long-term capital gain if sold.

3. Charitable Contributions of Appreciated Property

Present law.—A taxpayer who contributes property which has appreciated in value to charity generally is allowed a charitable contributions deduction for the fair market value of the property at the time of contribution. Further, no income tax is imposed on the appreciation in value of the property at the time of the gift. In addition, if property is sold to a charity at a price below its fair market value--a so-called bargain sale—the proceeds of the sale are considered to be a return of the cost and are not required to be allocated between the cost basis of the "sale" part of the transaction and the "gift" part of the transaction. The seller is allowed a charitable contributions deduction for the difference between the fair market value of the property and the selling price (often at his cost or other basis).

Problem.—The combined effect of not taxing the appreciation in value and at the same time allowing a charitable contributions deduction for the fair market value of the property given is to produce tax benefits significantly greater than those available with respect to cash contributions. The tax saving which results from not taxing the appreciation in the case of gifts of long-term capital assets is the capital gains tax which would have been paid if the asset were sold. In the case of ordinary income type assets, however, this tax saving is at the taxpayer's top marginal tax rate. In either case, the tax saving from not taxing the appreciation in value is combined with the tax saving of the charitable deduction at the taxpayer's top marginal rate. As a result, in some cases it is possible for a taxpayer to realize a greater after-tax profit by making a gift of appreciated property than by selling the property, paying the tax on the gain, and keeping the proceeds.

Finance Committee decision.—The House bill, in the case of charitable contributions of appreciated property, takes this appreciation into account for tax purposes in five types of situations. The committee amendments retain two of these provisions.

Both the House bill and the Finance Committee amendments provide that appreciation is to be taken into account for tax purposes in the case of gifts to a private foundation, other than an operating foundation and other than a private foundation which within one year distributes an amount equivalent to the gift to public charitable organizations or private operating foundations. In addition, both the House bill and the committee amendments take into account appreciation in value in the case of property (such as inventory or works of the donor) which would give rise to ordinary income if sold.

In the cases where the appreciation is taken into account for tax purposes, the committee amendments provide that the charitable deduction otherwise available is to be reduced by the amount of appreciation in value in the case of assets which if sold would result in ordinary income, or in the case of assets which if sold would result in capital gain, by one-half the amount of this appreciation in value. The House bill would have given the taxpayer the option of reducing his charitable deduction to the amount of his cost or other basis for the property, or of including the appreciation in value of the property in his income (as ordinary income or capital gains income as the case may be) at the time of taking the charitable contribution deduction and deducting the full fair market value of the property as a charitable contribution.

The House bill would also have taken appreciation in value into account in the case of gifts of tangible personal property (such as paintings, art objects and books not created by the donor) and in the case of future interests in property. The Finance Committee amendments do not include these two provisions. In addition, in the case of so-called bargain sales to charities—where a taxpayer sells property to a charitable organization for less than its fair market value (usually at its cost basis)—the House bill provided that the cost or other basis of the property was to be allocated between the portion of the property "sold" and the portion of the property "given" to the charity on the basis of the fair market value of each portion. This provision is deleted by the committee amendments.

The committee amendments are generally effective for contributions paid after December 31, 1969 (as under the House bill). However, in the case of a contribution of a letter or memorandum, or similar property, the committee's amendments apply to such contributions paid after December 31, 1968.

4. Two-Year Charitable Trust

Present law.—Under present law, an individual may establish a trust for two years or more with the income from property placed in the trust being payable to charity. In such a case, although the trust instrument provides that after the designated period of time the property is to be returned to him, the income from the trust property is not taxed to the individual. However, the individual does not receive a charitable contributions deduction in such a case.

Problem.—The special two-year charitable trust rule has the effect of permitting charitable contributions deductions in excess of the generally applicable percentage limitations on such deductions. For example, with the 50 percent limitation on such deductions contained in the House bill, the maximum deductible contribution that could generally be made each year by an individual who had $100,000 of dividend income (but no other income) would be $50,000. However, if the individual transferred 60 percent of his stock to a trust with directions to pay the annual income ($60,000) to charity for two years and then return the property to him, the taxpayer would exclude the $60,000 from his own income each year. In effect, then, the individual has received a charitable contributions deduction equal to 60 percent of his income.

Finance Committee decision.—Both the House bill and the committee amendments eliminate the rule under which an individual is not taxed on the income from property which he transfers to a trust to pay the income to charity for a period of at least two years. This provision applies to transfers after April 22, 1969. As a result, a person who establishes a trust with charity as the income beneficiary will be taxable on the income where he retains a reversionary interest which may be expected to take effect within ten years from the time the trust is created.

5. Gifts of the Use of Property

Present law.—Under existing law a taxpayer may claim a charitable deduction for the fair-rental value of property which he owns and gives to a charity to use for a specified time. In addition, he may exclude from his income the income which he would have received and been required to include in his tax base had the property been rented to other parties.

Problem.—By giving a charity the right to use property which he owns for a given period of time a taxpayer achieves a double benefit. For example, if an individual owns an office building, he may donate the use of 10 percent of its rental space to a charity for one year. He then reports for tax purposes only 90 percent of the income which he would otherwise have been required to report if the building were fully rented, and he claims a charitable deduction (equal to 10 percent of the rental value of the building) which offsets his already reduced rental income.

Finance Committee decision.—The House bill generally provides that the charitable deduction is not to be allowed for contributions to charities of less than a taxpayer's entire interest in property except to the extent a deduction would be allowed had the interest been transferred in trust. Therefore, no deduction would be allowed where a contribution is made of the right to use property for a period of time. In such a case, however, a taxpayer is able to continue to exclude from his income the value of the right to use property so contributed.

The Finance Committee retains the basic provision but modifies it so that it will not result in the denial of a deduction for an outright gift of a fractional (e.g. one-fourth) interest in the entire property. This is accomplished by limiting the application of the rule subjecting outright gifts to the treatment accorded gifts in trust to charitable contributions of either (a) a terminable interest in property (e.g. the use of property for a period of years), (b) the income from property for a period of years), or (c) a future interest in property.

6. Charitable Contributions by, and Stock Holdings of, Estates and Trusts

Present law.—Present law allows a nonexempt trust (or estate) a full deduction for any amount of gross income which it permanently sets aside for charitable purposes. There is no limitation on the amount of this deduction. Also, there are no limitations on the proportions of the stock of a company which may be held by a nonexempt trust or estate.

Problem.—To retain the deduction allowed by present law for nonexempt trusts for amounts set aside for charity (rather than paid to charity) would appear inconsistent with the requirements in the bill requiring foundations and charitable trusts to distribute all of their income. Not to subject these trusts generally to the same requirements and restrictions as those imposed on private foundations would present an easy means of avoiding these restrictions by setting amounts aside for charity in nonexempt trusts but not distributing these amounts for extended periods of time. Problems also arise as to the extent it is appropriate to apply the stock diversification requirements of foundations to the nonexempt trusts.

Finance Committee decision.—Neither the House bill nor the committee amendments impose the current income distribution requirements, generally applicable to foundations, to nonexempt trusts. Instead, much the same result is achieved by generally denying a deduction to nonexempt trusts for the amount of their current income set aside for charity. In other words, to obtain a deduction for a charitable distribution, a nonexempt trust with charitable income beneficiaries must pay out its income currently to charity, in much the same manner as a private foundation is required to do.

In the case of a charitable remainder trust (i.e. a trust which provides that the income is to be paid to a noncharitable beneficiary for a period of time and the remainder interest is to go to charity), both versions of the bill provide that if specified requirements are met the trust is to be tax exempt. The requirements limit the trusts accorded tax-exempt status to annuity trusts (where the noncharitable beneficiary receives a fixed dollar amount each year) and unitrusts (where the noncharitable beneficiary receives a stated percentage of the assets each year). In these cases the value of the income going to the noncharitable beneficiaries is taxed to them currently. The amount going to charity (because of a rule set forth subsequently) is deductible to the donor only to the extent of the remainder interest and not with respect to any income interest.

In the case of estates, the House bill also denied charitable contribution deductions to the estate for income set aside for charity. The committee amendments, however, restore the set-aside deduction for income of estates set aside for charity.

In addition to restoring the set-aside deduction in the case of estates, the Finance Committee amendments restore this deduction in the case of pool arrangements under which a person transfers property to a public charity, which places the property in an investment pool and then pays the donor (or perhaps another person) the income attributable to the property for his life. In such cases, the committee amendments restore the set-aside deduction to the extent that the pool accumulates capital gains for the benefit of charity. These pool arrangements qualify the donor for a charitable contribution deduction.

The committee amendments also restore the set- aside deduction in the case of trusts established before October 9, 1969, with an irrevocable charitable remainder. In addition, the committee amendments restore the set aside deduction for trusts established pursuant to a will in existence on October 9, 1969 which may not be changed under State law prior to the person's death because of his incompetency or other disability. A third transitional category where the committee amendments restore the set aside deduction is where the trust is provided for in a will in existence on October 9, 1969, and the person involved dies within three years of that date.

The committee amendments provide that the elimination of the set-aside deduction except as indicated above is to become effective with respect to taxable years beginning in 1970.

The committee amendments make it clear that the limitations on business holdings and the speculative investment limitations applicable to foundations are not to apply in the case of certain split-interest trusts. Thus they will not apply where charity is the income beneficiary and the value of the income interest does not exceed 60 percent of the value of the trust property. They also will not apply in the case of a charitable remainder trust until such time as the charity comes into the remainder interest if none of the income interest in the trust is held by or for charitable interests. At that time, the 5-year period for stock diversification would be available.

7. Charitable Remainder Trusts

Present law.—Under present law an individual may make an indirect charitable contribution by transferring property to a trust and providing that the trust income is to be paid to private persons for a period of time with the remainder to go to a charity. Generally, a charitable contribution deduction is allowed for the remainder interest given to charity. The amount of the deduction is based on the present value of the remainder interest which is determined by using actuarial life expectancy tables and an assumed interest rate of 3½ percent.

Problem.—Present rules allow a taxpayer to receive a charitable contribution deduction for a gift to charity of a remainder interest in trust which is substantially in excess of the amount the charity may ultimately receive. This is because the assumptions used in calculating the value of the remainder interest may bear little relation to the actual investment policies of the trust. For example, the trust assets may be invested in high-income, high-risk assets. This enhances the value of the income interest but decreases the value of the charity's remainder interest. This factor, however, is not taken into account in computing the amount of the charitable contribution deduction.

Finance Committee decision.—The House bill limits the availability of the charitable contribution deduction for income, estate and gift tax purposes in the case of a charitable gift of a remainder interest in trust to situations where there is a close correlation between the amount to be received by the charity and the amount of the deduction allowed the donor on the creation of the trust. In general a deduction is allowed only where the trust specifies the annual amount which is to be paid to the noncharitable income beneficiary in dollar terms (annuity trust) or as a fixed percentage of the value of the trust's assets as determined each year (unitrust).

The amount of the deduction allowed on the creation of the charitable remainder interest in trust thus would be computed on the basis of the actual relative interests of the noncharitable income and the charitable remainder beneficiaries in the trust property.

The Finance Committee amendments retain the treatment described above with the following modifications:

(1) Where a person transfers property to a charity which places the property in a pool or fund and then pays a share of the pool's income to the person for his life, the life of his spouse or that of another person, a charitable contribution deduction would be allowed to the donor determined by reference to the highest rate of return from the particular pool or fund in which the investment is placed during the three years prior to the contribution.

(2) The committee amendments make the new rules inapplicable in the case of a gift of real property to charity where the donor (and/or his spouse) reserves the right to live on, or receive the income from, the property for his (or their) life. In determining the value of the gift in such a case, straight line depreciation or cost depletion is to be taken into account with respect to the property. In addition, the rate of return based on today's money rates and stock returns should be computed on a 6 percent basis with the Secretary of the Treasury varying this amount as money rates and investment returns change.

(3) The committee amendments modify the unitrust and annuity trust rules of the House bill by providing that the trust instrument need not require the full distribution of the stated amount (i.e., the unitrust percentage amount or the annuity amount) to the income beneficiary so long as a distribution of the full current income (other than capital gains) is required. For this purpose, distributions of income in excess of the stated amount could be made to the extent that

distributions of income in earlier years were less than such amount. However, the value of the charitable remainder would be determined by reference to the stated amount. Further, such value would be determined on the basis of a 5 percent payout to the income beneficiary if 5 percent is higher than the stated amount.

(4) The definitions of annuity trust and unitrust are modified under the committee amendments to make it clear that the provision may apply to trusts with more than one noncharitable income beneficiary (either concurrently or successively).

(5) The charitable remainder trust rules under the committee amendments are to be effective only in the case of transfers in trust after October 9, 1969.

(6) The committee amendments make the charitable remainder trust requirements inapplicable for estate tax purposes in the case of trusts created before October 9, 1969, with an irrevocable charitable remainder.

(7) The committee amendments make the charitable remainder trust rules inapplicable for estate tax purposes with respect to wills in existence on October 9, 1969, if the person involved dies within three years, or if the will could not be changed under State law prior to the person's death because of his incompetency or other disability.

8. Charitable Income Trust With Noncharitable Remainders

Present law.—Under present law, a taxpayer who transfers property to a trust to pay the income to a charity for a period of years with the remainder to go to a noncharitable beneficiary, such as a friend or member of his family, is allowed a charitable contribution deduction for the value of the income interest given to charity. In addition, neither he nor the trust is taxed on the income earned by the trust which is given to charity.

Problem.—A taxpayer receives a double tax benefit where he is allowed a charitable deduction for the value of an income interest in trust given to charity and also is not taxed on the income earned by the trust.

Finance Committee decision.—The House bill and the Finance Committee amendments generally provide that a charitable contribution deduction for income tax purposes is not to be allowed where a person gives an income interest to charity in trust unless he is taxable on the trust income. Moreover, even in this case the charitable deduct'on will not be allowed unless the charity's income interest is in the form of a guaranteed annuity or is a fixed percentage (payable annually) of the value of the trust property (as determined each year).

Under the House bill, the charitable deduction for gift tax purposes is subject to the above rules. In addition, a charitable deduction for estate tax purposes also is denied for gifts of income interests in trust.

The Finance Committee amendments make the rules described above (other than the requirement that the gift take the form of a guaranteed annuity or fixed percentage payout) inapplicable for gift and estate tax purposes.

The committee amendments make these rules applicable for purposes of income tax charitable deductions to transfers in trust after October 9, 1969.

D. FARM LOSSES

1. Limitation on Deductions Attributable to Farming

Present law.—Under present law, income and losses from farming may be computed under more liberal accounting rules than those generally applicable to other types of businesses. A cash method of accounting under which costs are deducted currently may be used, rather than an accrual method of accounting and inventories under which the deduction of costs would be postponed. In addition, a taxpayer in the business of farming may deduct expenditures for developing business assets (such as raising a breeding herd or developing a fruit orchard) which other taxpayers would have to capitalize. In addition, capital gains treatment quite often is available on the sale of farm assets.

Problem.—Although the special farm accounting rules were adopted to relieve farmers of bookkeeping burdens, these rules have been used by some high-income taxpayers who are not primarily engaged in farming to obtain a tax, but not an economic, loss which is then deducted from their high-bracket, nonfarm income. In addition, when these high-income taxpayers sell their farm investment, they often receive capital gains treatment on the sale. The combination of the current deduction against ordinary income for farm expenses of a capital nature and the capital gains treatment available on the sale of farm assets produces significant tax advantages and tax savings for these high-income taxpayers.

Finance Committee decisions.—The Finance Committee adopted a substitute in lieu of the House provision which provides that farm losses may be offset against nonfarm income only to the extent of 50 percent. The remaining half of the farm deductions may be taken in subsequent years to the extent that ordinary farm income exceeds farm deductions. In the case of individuals the deduction of farm losses against nonfarm income is limited in the manner described above only if the taxpayer has more than $50,000 of nonfarm income for the year and, in addition, only to the extent the farm loss for the year exceeds $25,000.

The current deduction limitation rules described above do not apply if the taxpayer elects to follow generally applicable business accounting rules (i.e., uses inventories and capitalizes capital expenses).

The House provision for which the above is a substitute would, in effect, have converted capital gains into ordinary income to the extent a taxpayer's farm losses (above limitations) had been offset against nonfarm income. Under the House bill a taxpayer would be required to maintain an "excess deductions account" to record his farm losses. In the case of individuals, farm losses would be added to EDA only if the taxpayer had more than $50,000 of nonfarm income for the year and only to the extent the farm loss for the year exceeded $25,000.

The amount of farm losses which would have been recaptured on the sale of farm land would be limited to the deductions in the current and four prior years with respect to amounts spent for soil and water conservation and land clearing. To the extent of the gain on farm property which would be treated under these rules as ordinary income, there would be a reduction in the taxpayer's excess deductions account. As under the Finance Committee substitute, these rules would have been applicable both to corporations and individuals. Also as under the Finance Committee substitute the recapture rules provided by the House bill would not apply if the taxpayer elected to follow generally applicable business accounting rules.

The Finance Committee substitute and the House provision would apply to farm losses in years beginning after 1969.

2. Depreciation Recapture

Present law.—Present law provides that when a taxpayer sells personal property used in a business, there is a recapture of the depreciation claimed on the property. In other words, the gain on the sale of the property is treated as ordinary income, rather than capital gain, to the extent of the depreciation previously claimed. These rules do not apply, however, to livestock.

Problem.—The effect of the exclusion of livestock from the depreciation recapture rule is to allow a taxpayer to convert ordinary income into capital gain with substantial tax savings. This occurs because the depreciation is deducted currently from ordinary income taxed at the regulaı rates, but the gain on the sale of the livestock is taxed only at the lower capital gains rates.

Finance Committee decision.—Both the House bill and the Finance Committee amendments eliminate the exception for livestock from the depreciation recapture rules. As a result gain on the sale of livestock is to be treated as ordinary income, rather than as capital gain, to the extent of the previous depreciation deductions.

This provision applies to years after 1969 but only to the extent of depreciation taken after 1969.

3. Holding Period for Livestock

Present law.—Present law allows gain on the sale of livestock held for draft, breeding, or dairy purposes to be treated as a capital gain, if the animal has been held by the taxpayer for one year or more.

Problem.—A one-year holding period allows taxpayers to make short-term, tax-motivated investments in livestock. For example, a taxpayer can go into the livestock business to build up a breeding herd over a short period of time, currently deduct the expenses of raising the animals against his other income which is taxed in the high bracket, and then sell the entire herd at the lower capital gains rates.

Finance Committee decision.—The committee adopted an amendment which provides that in order for any gain upon the sale of horses and cattle to result in capital gain, where the animals are held for draft, dairy, breeding or sporting purposes (such as horse racing), the animals must have been held for at least 2 years. The gain on the sale of other types of livestock held for one of these purposes, however, would continue to be subject to the 1-year holding period presently in existing law.

The House bill provided that livestock, in order to be eligible for capital gains treatment upon sale (in the case of animals held for draft, dairy, breeding or sporting purposes), must have been held by the taxpayer for at least 1 year after the animals would normally have been used for draft, dairy, breeding or sporting purposes.

Both the Finance Committee amendment and the House provision would apply to livestock acquired after 1969.

4. Hobby Losses

Present law.—Present law contains a so-called hobby loss provision which limits to $50,000 per year the amount of losses from a "business" carried on by an individual that he can use to offset his other income. This limitation only applies, however, if the losses from the business exceed $50,000 a year for at least five consecutive years. Moreover, certain specially treated deductions are disregarded in computing the size of the loss for this purpose.

Problem.—This hobby loss provision generally has been of limited application because it usually is possible to break the required string of five loss years. In addition, where the provision has applied to disallow the deduction of a loss, the taxpayer has been faced in one year with a combined additional tax attributable to a five-year period.

Finance Committee decision.—The House bill would replace the present hobby loss provision with a rule which disallows the deduction of losses from an activity carried on by the taxpayer where the activity is not carried on with "a reasonable expectation of profit." An activity would be presumed to have been carried on without this expectation of profit where the losses from the activity were greater than $25,000 in three out of five years.

The Finance Committee amendments make a series of modifications in this provision, as follows:

(1) In lieu of the test of "a reasonable expectation of profit" provided by the House bill, the committee amendments substitute the test of "not engaged in for profit." This differs from the House approach in that there would no longer need to be a reasonable expectation of profit so long as the facts and circumstances (without regard to the taxpayer's subjective intent) indicate that the taxpayer engaged in the activity, or continued the activity, with the objective of making a profit.

(2) In lieu of the presumption in the House provision to the effect that the activity constitutes a hobby, where there are losses of $25,000 or more in three out of five years, the committee amendments substitute a presumption that the taxpayer is not engaged in carrying on the activity as a hobby if he has profits in two out of five years.

(3) The Treasury Department has indicated its willingness to establish two advisory groups drawn from the cattle and horse industries (one concerned with the cattle industry and one with the horse industry) to assist the Commissioner of Internal Revenue in establishing standards for application of these rules to achieve reasonable results and to resolve policy questions in their application from time to time. This action should help limit the disallowance by the Internal Revenue Service of the deduction of losses under this provision to cases where it is generally recognized that this is appropriate.

(4) The committee amendments provide that deductions will in no event be disallowed under this provision for items which presently may be deducted without regard to whether the taxpayer incurs them in a trade or business or for the production of income. This is true, for example, in the case of the capital gains deduction and the deduction for interest and certain State and local taxes.

(5) The Finance Committee amendments allow deductions in the case of an activity not engaged in for profit to the extent income is earned from such an activity. A deduction would be allowed for

expenses to the extent they do not exceed the income realized from the activity in question after the deduction of the expenses which are allowed in any event (those referred to in item 4 above).

(6) The committee amendments restrict the applicability of the hobby loss provision to individual taxpayers and subchapter S corporations .

5. Crop Insurance Proceeds

Present Law.—Under present law a cash-basis farmer whose crops have been destroyed and who receives crop insurance proceeds in compensation for his loss reports the proceeds as income in the year received.

Problem.—A problem arises in that the crops which have been destroyed might not, under normal circumstances, have been reported as income until the following year. As a result, the reporting of the insurance proceeds in the earlier year may result in a doubling up of income in that year (since the farmer may in the forepart of that year also be reporting the income from the sale of crops from the prior year). In the next year, since the farmer has only deductions and no income to report, he is likely to have a net operating loss which may be carried back and offset against income in the year in which the double amount was reported. However, the problem which arises is that the farmer in such cases is faced with the advance payment of tax and also may lose the benefit of exemptions and personal deductions in the year of the loss.

Finance Committee decision.—The committee added a new provision to the House bill which provides that, at his election, a cash-basis farmer whose crops have been destroyed and who receives crop insurance proceeds in compensation for his loss may elect to defer the reporting of these proceeds for Federal income tax purposes until the year following the year of destruction if this is the year in which he normally would have reported the income from the sale of the crops had they not been destroyed.

6. Exchange of Livestock of Different Sexes

Present law.—Present law provides that property held for productive use in a trade or business or held for investment may be exchanged tax-free for property of a like-kind.

Problem.—There appears to be some confusion at present as to whether an exchange of male calves for female calves qualifies as a tax-free, like-kind exchange. If this can be done, a breeding herd of females could be built up more quickly without tax consequences. Although the Revenue Service does not consider this to be a like-kind exchange, it has not taken a published position.

Finance Committee decision.—The committee added a new provision to the House bill which provides that for purposes of applying the tax-free, like-kind exchange rule of present law, livestock of different sexes are not property of a like-kind. Although this provision was not included in the House bill, the House Ways and Means Committee in its report on the bill stated that it believed this to be the proper interpretation of present law.

7. Gain From Disposition of Farm Land.

Present Law.—Under present law, a taxpayer may elect to currently deduct expenditures for soil and water conservation purposes and land clearing expenditures from ordinary income. Under normal accounting rules these expenditures would be added to the basis of the farm property and, thus, would reduce the amount of capital gain realized on the sale of the property.

Problem.—The current deduction allowed for soil and water conservation expenditures and land clearing expenditures with respect to farm land, combined with the capital gains treatment allowed on the sale of the farmland allows high income taxpapers to convert ordinary income into capital gain income. These taxpayers may purchase farm land, deduct these expenditures from their high bracket nonfarm income, and then receive capital gain treatment on the sale of the farm land.

Finance Committee decision.—The Finance Committee added an amendment to the bill which provides for the recapture of soil and water conservation expenditures and land clearing expenditures made with respect to farm land. Thus, gain on the sale of farm land would be treated as ordinary income, rather than as a capital gain, to the extent of these expenditures incurred during the taxable year in which the sale occurred or the 5 preceding taxable years. There is full recapture of these expenditures as ordinary income if the property is sold within 5 years of the time the soil and water expenditures or land clearing expenditures occurred. If the sale occurs from 6 up to 10 years after the expenditures occurred, the amount recaptured is reduced by 20 percent a year, with no recapture in the tenth and subsequent years.

The House bill, to a limited extent, dealt with this problem by treating gain on the sale of farm property as ordinary income to the extent of the amounts in the taxpayer's excess deductions account, or, if less, to the extent of the deductions for these expenditures in the year of sale and the prior 4 years.

E. MOVING EXPENSES

Present law.—A deduction from gross income is allowed for certain moving expenses related to job-relocation or moving to a first job. The deductible expenses are those of transporting the taxpayer, members of his household and their belongings from the old residence to the new residence, including meals and lodging en route.

Two conditions must be satisfied for a deduction to be available. First, the taxpayer's new principal place of work must be located at least 20 miles farther from his former residence than his former principal place of work (or, if the taxpayer had no former place of work, then at least 20 miles from his former residence). Second, the taxpayer must be employed full time during at least 39 weeks of the 52 weeks immediately following his arrival at the new principal place of work.

Generally, the courts have held that reimbursements for moving expenses other than those which may be deducted are includible in gross income.

Problem.—Job-related moves often entail considerable expense in addition to the direct costs of moving the taxpayer, his family, and personal effects to the new job location. These additional expenses include certain costs of selling and purchasing residences, househunting trips to the new job location, and temporary living expenses at the new location while permanent housing is obtained.

Finance Committee decision.—Both the House bill and the committee amendments extend the present moving expense deduction to cover three additional types of job-related moving expenses: (1) travel, meals, and lodging expenses for premove house-hunting trips; (2) expenses for meals and lodging in the general location of the new job location for a period of up to 30 days after obtaining employment; and (3) various expenses incident to the sale of a residence or a settlement of a lease at the old job location or to the purchase of a residence or the acquisition of a lease at the new job location. A limitation of $2,500 is placed on the deduction allowed for these three additional categories of moving expenses. In addition, expenses for the house-hunting trips and temporary living expenses may not account for more than $1,000 of the $2,500.

Both versions of the bill provide that the 39-week test is to be waived if the taxpayer is unable to satisfy it due to circumstances beyond his control. In addition, both versions of the bill require that reimbursements of moving expenses be included in gross income.

The House bill provides that the taxpayer's new principal place of work must be located at least 50 miles (instead of 20 miles as under present law) farther from his former residence than his former place of work. This modification of present law is not accepted by the Finance Committee amendments. The Finance Committee amendments continue the 20-mile test.

The committee amendments also extend the availability of the moving expense deduction (both the categories which are deductible under present law and those made deductible by this bill) to self-employed persons. However, because moves of self-employed persons are more likely to be voluntary than in the case of employees, the amendments provide that the period of time the person is required to work at the new location is extended from 39 weeks to 78 weeks in the case of self-employed persons.

A further modification made by the committee limits the moving expense deduction which may be claimed by a husband and wife, both of whom work, to the amount which could be claimed if only one were employed.

This change applies to taxable years beginning after 1969.

F. MINIMUM TAXES AND ALLOCATION OF DEDUCTIONS

Present law.—Under present law, many individuals and corporations do not pay tax on a substantial part of their economic income as a result of the receipt of various kinds of tax-exempt income or special deductions. In addition, under present law, an individual is permitted to charge his personal or itemized tax deductions entirely against his taxable income, without charging any part of these deductions to his tax-free income.

Problem.—The present treatment imposes no limit on the amount of income which an individual or corporation may exclude from tax as the result of various tax preferences. Individuals with large interest deductions on funds borrowed to carry growth stock, for example, may offset practically all their income in this manner and, as a result, pay little or no tax. Similarly, individuals may pay tax on only a fraction of their economic income, if they enjoy the benefits of accelerated depreciation on real estate, percentage depletion deductions or intangible drilling expenses. Corporations also may escape tax on all, or a large part of their economic income if they can take advantage of the deductions already referred to, or others which apply only in the case of corporations. As a result, there are large variations in the tax burdens placed on individuals or corporations, with similar economic incomes depending upon the size of the preference income they may have. In general, those individual or corporate taxpayers who receive the bulk of their income from personal services and manufacturing corporations, are taxed at relatively higher tax rates than others. On the other hand, individuals or corporations which receive the bulk of their income from such sources as capital gains or are in a position to benefit from net lease arrangements, from accelerated depreciation on real estate, from percentage depletion, or from other tax-preferred activities tend to pay relatively low rates of tax. In fact, individuals with high incomes who can benefit from these provisions may pay lower effective rates of tax than many individuals with modest incomes. In extreme cases, individuals may enjoy large economic incomes without paying any tax at all. This was true for example in the case of at least 154 returns in 1966 with adjusted gross incomes of $200,000 a year (apart from those with income exclusions which do not show on the returns filed). Similarly, large corporations may pay either no tax at all or taxes which represent lower effective rates on their income than Congress has provided for small corporations. Here, too, there are numerous examples where either no tax was paid or the effective rates of tax on economic income was very low.

A problem also arises from the fact that an individual who receives tax-free income or special deductions can charge the entire amount of his personal deductions to his taxable income. This, in effect, gives him a special tax benefit. He not only excludes the tax-free income from his tax base but also, by charging all his personal deductions against his taxable income, reduces his tax payments on this taxable income. As a result, individuals with substantial tax-free income or special deductions and who also have large personal deductions can wipe out much, or all, of their tax liability on substantial amounts of otherwise taxable income.

Finance Committee decision.—The House bill sought to require individuals with substantial amounts of otherwise tax-free income to pay significant amounts of tax through the use of two basic provisions: the first of these is a limit on tax preferences which required the individual taxpayer to aggregate his taxable income and his tax-free income and to include at least one-half of this amount in his tax base; the second of these provisions required the individual taxpayer to allocate his personal expenses between taxable and nontaxable income, disallowing those deductions attributable to the nontaxable income. Neither of these provisions applied to corporations.

The House bill used both provisions because, if the limit on tax preferences had been used alone, an individual could have nontaxable income amounting to as much as one-half his total economic income and yet not be affected by the provision. Moreover, the half of his income subject to tax, were it not for the allocation of deductions, could be largely, or entirely, offset by the individual's itemized deductions. The House provisions, working hand in hand, result in significant tax increases for individuals with substantial amounts of tax preference income, but have the effect of adding complexities to the preparation of tax returns for those to whom they apply. In addition, the limit on tax preference does not lend itself well to application with respect to corporate income. This is because a corporation with sufficient tax preferences to be affected often can arrange to escape the impact of these provisions by merging with other corporations with relatively small amounts of tax preference income. This has the effect of averaging the tax preference income over a larger amount of taxable income.

The Finance Committee amendments substitute for the two House provisions a minimum tax on preference income which is made equally applicable to individuals and corporations. This alternative is much simpler than the LTP and allocation of deductions, in part because it is separate from the regular income tax computations. Under the committee approach, tax preference income is subject to a special 5 percent tax payable in addition to the regular income tax. This does not have the effect of treating differently two individuals or corporations with the same amount of tax preference income merely because they have different amounts of taxable income.

The minimum tax of 5 percent provided by the committee amendments applies to the sum of every individual's or corporation's (or estate's or trust's) tax preferences, to the extent they exceed $30,000. This tax base may in some cases be reduced for net operating losses. Generally, of course, it would be preferable to use a net operating loss carryover against regular income, rather than to reduce the tax preferences subject to the 5 percent tax. The bill achieves this effect by allowing the deferral of the 5 percent tax in such cases until it is clear that the net operating losses will be available for offset against regular income during the 5-year carryforward period. Should the net operating losses not be usable in this manner, the tax base for the 5 percent minimum tax is decreased by the unused net operating loss.

The items of tax preference included in the base of the 5 percent tax under the committee amendment are as follows:

(1) Excess investment interest.—This is the excess of investment interest over net investment income (except for financial institutions). Investment income consists of gross income from interest, dividends (other than dividends from foreign subsidiaries), rents and royalties, net short-term capital gain from property held for investment purposes, and amounts treated as ordinary income under the recapture rules (secs. 1245 and 1250) to the extent this is attributable to gain from the sale or exchange of property held for investment purposes. Investment income does not include income from property subject to a net lease entered into before October 10, 1969. Investment expenses for this purpose include State and local property taxes, bad debts, straight-line depreciation, the dividends received deduction, amortizable bond premium, cost depletion, and other deductions attributable to the production of income to the extent these expenses are directly attributable to the production of such investment income. Investment interest expense, as distinguished from other interest expense, is interest on indebtedness incurred or continued to purchase or carry property held for investment purposes.

(2) Accelerated depreciation on personal property subject to a net lease.—This is the accelerated depreciation in excess of the straight-line depreciation. Net leases for this purpose involve those situations where the lessor is either guaranteed a specific return or is guaranteed in whole or in part against the loss of income. Net leases also include those situations where the trade or business expense deductions are less than 15 percent of the rental income produced by the property.

(3) Accelerated depreciation on real property.—This is the excess of the fast depreciation allowed over straight-line depreciation.

(4) Amortization of rehabilitation expenditures to the extent the amortization deduction exceeds straight-line depreciation.

(5) Amortization of certified pollution control facilities.—This is the excess of the amortization deduction over accelerated depreciation.

(6) Amortization of railroad rolling stock.—This is the excess of the amortization deduction over the accelerated depreciation.

(7) Tax benefits from stock options.—In the case of qualified stock options (or restricted stock options), this is the excess of the fair market value of the stock at the time of the receipt of the stock pursuant to the exercise of the option over the option price of the stock.

(8) Bad debt deductions of financial institutions.—In the case of a bank, saving and loan association, mutual saving bank or other financial institution, this is the amount by which the bad debt reserve deduction exceeds the amount which would be allowable to the bank or other institution had it maintained its bad debt reserve on the basis of its own actual bad debt loss experience.

(9) Depletion and intangible drilling and development costs.—This is the sum of two items: the deduction for intangible drilling and development costs (other than those incurred in drilling a nonproductive well) and the excess of the depletion deduction allowance taken for the year over the capitalized cost of the property reduced for depletion taken in prior years. In this case the intangible drilling and development costs, since they are treated directly as a preference item, are treated as a part of the recoverable cost in determining the depletion perference.

(10) Capital gains.—In the case of individuals, one-half of the net long-term capital gain, to the extent it exceeds the net short-term capital loss. In the case of corporations, the tax preference is the excess of the net long-term capital gain over the net short-term capital loss, multiplied by a ratio in which the denominator is the regular corporate rate (48 percent) and the numerator is the regular corporate rate, minus the rate applicable to capital gains in the case of corporations (28¼ percent in 1970 and 30 percent thereafter). In other words, the corporate capital gains are included among the tax preferences in the ratio of the difference between their special tax rate and the general corporate tax rate to the general corporate tax rate.

Stock options and capital gains (items (7) and (10) above) which are derived from sources outside the United States, are subject to the minimum tax only if the foreign country taxes them at a preferential rate. The remaining items of tax preference as set forth above include preferences attributable to income derived from sources outside the United States only to the extent that these items result in foreign losses which reduce taxable income derived from sources within the United States. The amount of tax preferences so included is not to exceed the amount of such foreign losses. The foreign tax credit is not to be allowed against the 5-percent minimum tax.

Special rules are provided in order to cover the following situations:

(1) In the case of estates or trusts, the items of tax preference are attributed to the estate or trust and the beneficiaries in the same ratio as the income of the estate or trust. The exemption available to the trust or estate is reduced in similar proportions.

(2) In the case of members of a controlled group of corporations, the $30,000 exemption is to be apportioned equally among the members of the group unless they agree to share the exemption in some other way.

(3) In the case of subchapter S corporations (where the income is taxed to the shareholders), items of tax preference are to be apportioned among the shareholders in the manner consistent with the manner in which a net operating loss is apportioned among the shareholders. However, where capital gains are taxed to both the subchapter S corporation and the shareholder under section 1378 of the code, the capital gains tax preference is subject to the minimum tax at both the corporate and individual levels.

(4) Regulated investment companies are not to be subject to the minimum tax to the extent they pass through to shareholders amounts attributable to tax preferences. However, their shareholders are to be subject to minimum tax on capital gains tax preferences passed through to them. In addition, the shareholders will be deemed for purposes of the minimum tax to have received the other tax preferences of the regulated investment company in proportion to the amounts that are distributed to them by the regulated investment company.

(5) In the case of a husband and wife filing separate returns, who each have tax preferences, the $30,000 exemption is to be $15,000 for each spouse.

This provision applies for the calendar year 1970 and subsequent years.

G. INCOME AVERAGING

Present law.—Under present law, income averaging permits a taxpayer to mitigate the effect of progressive tax rates on sharp increases in income. His taxable income in excess of 133⅓ percent of his average taxable income for the prior 4 years generally can be averaged and taxed at lower bracket rates than would otherwise apply. Certain types of income such as long-term capital gains, wagering income, and income from gifts are not eligible for averaging.

Problem.—The 133⅓ percent requirement denies the benefit of averaging to taxpayers with a substantial increase in income and reduces the benefits of averaging for those who are eligible.

Finance Committee decision.—The House bill extends income averaging to long-term capital gains, income from wagering, and income from gifts. The Finance Committee amendments do not accept this change.

Both the House bill and the committee amendments, however, lower the percentage by which an individual's income must increase before the averaging provision is available from 33⅓ percent to 20 percent. This change applies to taxable years beginning after 1969.

The committee amendments also exclude accumulation distributions by trusts from the averaging rule since the tax on such amounts is computed under special rules contained in other provisions of the bill.

H. RESTRICTED PROPERTY

Present law.—Present law does not contain any specific rules governing the tax treatment of restricted stock plans. Existing Treasury regulations generally provide that no tax is imposed when the employee receives the restricted stock. Tax is deferred until the time the restrictions lapse; at that time, only the value of the stock, determined at the time of transfer to the employee, is treated as compensation, provided the stock has increased in value. If the stock has decreased in value, then the lower amount at the time the restrictions lapse is considered to be compensation. Thus, under present regulations there is a deferral of tax with respect to this type of compensation and any increase in the value in the stock between the time it is granted and the time when the restrictions lapse is not treated as compensation.

Problem.—The present tax treatment of restricted stock plans is significantly more generous than the treatment specifically provided in the law for similar types of deferred compensation arrangements. An example of this disparity can be seen by comparing the situation where stock is placed in an employee's trust rather than given directly to the employee subject to restrictions. In the employee trust situation, if an employer transfers stock to a trust for an employee and the trust provides that the employee will receive the stock at the end of 5 years if he is alive at that time, the employee is treated as receiving, and is taxed on the compensation in the amount of the value of the stock at the time of the transfer. However, if the employer, instead of contributing the stock to the trust, gives the stock directly to the employee subject to the restriction that it cannot be sold for 5 years, then the employee's tax is deferred until the end of the 5-year period. In the latter situation, the employee actually possesses the stock, can vote it and receives the dividends, yet his tax is deferred. In the case of the trust, he has none of these benefits, yet he is taxed at the time the stock is transferred to the trust.

Finance Committee decision.—Both the House bill and the committee amendments provide that a person who receives compensation in the form of property, such as stock, which is subject to a restriction generally is to be subject to tax on the value of the property at the time of its receipt unless his interest is subject to a substantial risk of forfeiture. In this latter case, he is to be taxed on the value of the property at the time the risk of forfeiture is removed. The restrictions on the property are not taken into account in determining its value except in cases where the restriction, by its terms, will never lapse. Generally, this provision applies to property transferred after June 30, 1969.

The Finance Committee, while accepting the general format of the House provision, in its amendments provided the following modifications and refinements:

(1) Where an employee transfers (by gift or upon death) property which is subject to forfeiture, the House provision was unclear as to the effect if the property was transferable subject to the forfeiture condition and as to the effect at the time of transfer. The committee amendments provide that the employee is not to be treated as realizing income at the time of such a transfer if the person to whom the property is given remains subject to the forfeitable condition. However, under the committee amendments, the employee (and not the donee) is to be taxed on the value of the property at the time it becomes nonforfeitable.

(2) The committee amendments provide that an interest in property is not to be considered as being forfeitable unless the employer can compel the employee or other holder of the property to return the identical property upon the happening of certain events. Where property is forefeitable under the committee amendments the employee is to be treated as realizing income if he sells or exchanges the property, even though this occurs before the property becomes nonforfeitable.

(3) The committee amendments permit employees receiving property subject to forefeitable restrictions to treat the receipt of the property under these conditions as the receipt of property not subject to forfeitable conditions, and pay tax on the basis of the unrestricted value of the property at that time. If, subsequently, however, the employee's right to the property is forfeited, he would not, if he elects this option, be eligible for a refund for the tax previously paid or receive any deduction for the amount forfeited.

(4) The committee amendments provide that if restricted stock (or other property) is exchanged in a tax-free exchange for other stock or property subject to substantially the same restrictions, the exchange will not cause the holder of the stock to become taxable, and the stock received in the exchange will be treated as restricted property. The same principal applies where stock not subject to the restricted property provision because of the effective date is exchanged in a tax-free exchange. The stock received in the exchange is not to be treated as subject to the new restricted property rules if it is subject to substantially the same restrictions as the stock given up.

(5) The committee amendments provide for the deductions for the employer with respect to restricted property to be in the statute rather than merel provided for by Treasury regulations. The deduction will be allow at the same time as, and the same amount as, the income is taxed to the recipient.

(6) The committee mendments provide that the restricted property rules are not to apply to premiums paid by an employer under nontrusteed annuity plans for an employee who meets the qualification requirements for tax exemption (under section 401(a)). They also provide that the restricted property rules are not to apply to amounts

excluded from gross income (under section 403(b)) in the case of annuities purchased for an employee by an educational or charitable organization (exempt under section 501(c)(3)).

(7) The committee amendments make clear that the amount subject to tax in the case of nonexempt trusts and nonqualified annuities when the employee's interest becomes nonforfeitable is the value at that time of its interest in the trust (or the then value of the annuity contract). The value of amounts subsequently contributed by the employer to the trust (or premiums subsequently paid) are to be included in the income of the employee when contributed or paid to the trust (or insurer).

(8) The committee amendments provide that in the case of nonexempt trusts, the employer is to be allowed a deduction at the time the amounts are taxed to the employee. (Under present regulations, no deduction is ever allowed in these cases where taxation of the income to the recipient is deferred.)

(9) The general effective date of the restricted property—namely, property transferred after June 30, 1969—under the House bill does not apply where property is transferred before February 1, 1970, pursuant to a written plan adopted and approved before July 1, 1969. The committee amendments allow additional time up to May 1, 1970, for the transfer of property in these cases.

(10) The House bill provides that the new restricted property provision is not to apply in the case of property transferred after June 30, 1969, where the property is transferred pursuant to a binding written contract entered into before April 22, 1969. The committee amendments also provide an exception for binding contracts with a third party to pay key employees a determinable amount of stock until a fixed number of shares has been transferred. In this latter case, the committee's amendments provide that the new rule is not to apply to property transferred before January 1, 1973.

I. ACCUMULATION TRUSTS, MULTIPLE TRUSTS, ETC.

Present law.—A trust that distributes all its income currently to its beneficiaries is not taxed on this income; instead the beneficiaries include these distributions in their income for tax purposes.

An accumulation trust (a trust where the trustee is either required, or is given discretion to accumulate income for future distributions to beneficiaries), however, is taxed on its accumulated income at individual rates. When this accumulated income is distributed to the beneficiaries, they are in some cases taxed on the distributions under a so-called throwback rule. The throwback rule treats the income for tax purposes as if it had been received by the beneficiary in the year in which it was received by the trust. This throwback rule, however, only applies with respect to the part of the distribution of accumulated income which represents income earned by the trust in the 5 years immediately prior to the distribution. In addition to this limitation, the throwback rule does not apply to distributions of accumulations prior to the beneficiaries attaining age 21, distributions to meet a beneficiary's emergency needs, a distribution of accumulated income which is a final distribution (made more than 9 years after the last transfer to the trust), distributions not in excess of $2,000, and certain other periodic mandatory distributions under trusts created before 1954.

Problem.—The progressive tax rate structure for individuals is avoided when a grantor creates trusts which accumulate income taxed at low rates, and the income in turn is distributed at a future date with little or no additional tax being paid by the beneficiary. This result occurs because the trust itself is taxed on the accumulated income rather than the grantor or the beneficiary. This means that the income in question, instead of being added on top of the beneficiary's other income and taxed at his marginal tax rate, is taxed to the trust at the starting tax rate. The throwback rule theoretically prevents this result, but the 5-year limitation and the numerous exceptions substantially limit the effectiveness of the rule.

This avoidance device is compounded by the use of multiple trusts—the creation of more than one accumulation trust by the same grantor for the same beneficiary.

Finance Committee decision.—The House bill and the Finance Committee amendments provide that in the case of accumulation trusts (including multiple trusts), the beneficiaries are to be taxed on the distributions of accumulated income in substantially the same manner as if the income had been distributed to the beneficiaries when it was earned by the trust. The taxes paid by the trust on the income, in effect, are to be considered as paid by the beneficiary for this purpose. A shortcut method of computing the tax on the accumulated income is provided under which the tax attributable to the distribution, in effect, is averaged over the number of years in which the income was earned by the trust.

The Finance Committee and House versions of the bill are generally the same except for the following modifications:

(1) The House provision would have applied to income accumulated by a trust (other than a foreign trust created by a United States person) in years ending after April 22, 1964, where the accumulated income was distributed to the beneficiaries after April 22, 1969. The committee amendments modify this to apply the new provision only to accumulations in taxable years beginning after December 31, 1968, with respect to distributions made after that date. Income accumulated in prior years, regardless of when distributed, is to continue to be subject to the law in effect at the time the income was accumulated except for the fact that the $2,000 de minimis exemption is made inapplicable to any distributions after December 31, 1968.

(2) The committee amendments provide an interest charge to cover the tax payments by the income beneficiaries which are deferred (to the extent their taxes may exceed those paid by the trust) by the use of accumulation trusts. This charge is to be the equivalent of what in the average case would be a 6-percent rate: namely, a 3 percent rate which may not be taken as an income tax deduction. It is based on the amount of tax payable by the beneficiary over and above the tax which was paid in the earlier years by the trust. The charge is based on simple interest computed for the number of years of tax deferral involved (a simpler method of computation is available where the shortcut method is used). Where the payments by the trust exceed the aggregate tax due with respect to any year, these payments may offset amounts payable by the same beneficiary with respect to other years and may reduce or eliminate interest charges to him with respect to other years.

(3) Except in the case of "simple trusts" (or until the first year other trusts become accumulation trusts) capital gains, even though allocated by the trustees to the corpus of the trust, are to be taken into account separately in determining the additional tax payable by the beneficiary (over and above the tax previously paid by the trust) with respect to the distribution made to such beneficiary.

(4) In the case of the so-called "shortcut" method for the computation of any additional tax payable by the beneficiary upon the distribution of accumulated income, the committee amendments provide that the 3 years to be taken into account in determining the base for the income computation are the 3 years immediately prior to the current year (rather than the 2 immediately prior years plus the current year). The committee amendments provide that the "shortcut method" is not to be available to the taxpayer if, during any of the preceding taxable years in which an accumulation distribution was deemed made, prior accumulation distributions were also deemed to have been made by two or more other trusts to the taxpayer. The committee amendments also provide that the so-called exact method (as well as the short cut method) of computation is to be available with respect to accumulations of income in years prior to the time the beneficiary was in existence.

J. MULTIPLE CORPORATIONS

Present law.—There are several provisions in the code which are designed to aid small corporations. The most important of these provisions is the surtax exemption. As the result of the surtax exemption corporations are taxed at only 22 percent, instead of at 48 percent on the first $25,000 of taxable income.

Present law permits a controlled group of corporations to each obtain a $25,000 surtax exemption if each of the corporations pays an additional 6 percent tax on the first $25,000 of taxable income.[1] This generally reduces the tax savings of the surtax exemption from $6,500 to $5,000.

Other provisions in the code designed to aid small corporations include: (1) the provision which allows a corporation to accumulate $100,000 of earnings without being subject to the penalty tax on earnings unreasonably accumulated to avoid the dividend tax on shareholders; and (2) the provision which allows an additional first year depreciation deduction equal to 20 percent of the cost of the property (limited to $10,000 per year).

Problem.—Large corporate organizations have been able to obtain substantial benefits from these provisions by dividing income among a number of related corporations. Since these are not in reality "small businesses" it is difficult to see why they should receive tax benefits intended primarily for small business, whether or not they have incorporated the businesses separately for business, as distinct from tax, reasons.

Finance Committee decision.—The House bill and the Finance Committee amendments provide that a group of controlled corporations may have only one of each of a series of special provisions designed to aid small corporations. The most important of these is the surtax

[1] The election to take multiple surtax exemptions and to pay the additional 6 percent tax is generally desirable where the group has a combined income of about $32,500 or more. Below this figure the allocation of a single surtax generally produces a lower tax.

exemption and the accumulated earnings credit. A controlled group of corporations is limited to one $25,000 surtax exemption and one $100,000 accumulated earnings credit after a transition period.

The House bill provides an 8-year transition period, reducing the additional surtax exemptions in excess of one by $3,125 in each of the years 1969 through 1976. The committee amendments reduce this transition period to 5 years but commence it with the year 1970. Thus, under the committee amendments the additional surtax exemptions in excess of one are to be reduced by $5,000 in each of the years 1970 through 1974.

Both the House and the Senate amendments modify the present definition of a brother-sister controlled group—i.e., two or more corporations, 80 percent or more of the stock of which is owned by one individual, estate, or trust. Both versions expand this definition to include two or more corporations which are owned 80 percent or more by five or fewer persons, provided these five or fewer persons own more than 50 percent of each corporation identically. For example, a person who owns 70 percent of one corporation and 30 percent of another is treated as owning only 30 percent of each corporation identically.

The Finance Committee amendments make the following modifications in the House provisions:

(1) Under the House bill the dividends received deduction is increased gradually from 85 percent to 100 percent over the transition period in the same proportion as the denial of the multiple surtax exemptions. The committee amendments also increase the deduction gradually over the transition period; in this case by 3 percentage points a year.

(2) Under the present consolidated return regulations, preconsolidation losses for a corporation in a group claiming multiple surtax exemptions may be carried over after the consolidation only against the income of the corporation which sustained the losses. The House bill would have modified these regulations to permit net operating losses for 1969 and subsequent years to be taken as a deduction against the income of other members of the group in the same proportion as the reduction in the additional surtax exemptions for the group. The Finance Committee amendments do not permit any preconsolidation net operating losses during the transition period to be carried over and used against the income of other members of the group. The consolidation of the income and losses is only to be allowed for years after the end of the transition period. However, the committee amendments permit corporations which have used multiple surtax exemptions for past years to elect to change over immediately to a consolidated return basis (foregoing any part of the multiple exemptions during the transition period). They provide that corporations which do so may use net operating loss carryovers to offset income of other corporations in the consolidated group, if the group agrees to give up multiple surtax exemptions for any prior years in which a loss was sustained which is offset against income of another corporation in the group.

(3) The committee amendments delete from the House bill a provision limiting the tax benefits of controlled groups of mutual insurance companies. This provision is deleted since it is understood that there are no such groups.

K. CORPORATE MERGERS, ETC.

1. Disallowance of Interest Deduction in Certain Cases

Present law.—Under present law a corporation is allowed to deduct interest paid by it on its debt but is not allowed a deduction for dividends paid on its stock or equity.

Problem.—It is a difficult task to draw an appropriate distinction between dividends and interest, or equity and debt. Although this problem is a long-standing one in the tax laws, it has become of increasing significance in recent years because of the increased level of corporate merger activities and the increasing use of debt for corporate acquisitions purposes.

There are a number of factors which make the use of debt for corporate acquisition purposes desirable, including the fact that the acquiring company may deduct the interest on the debt but cannot deduct dividends on stock. Various characteristics tend to make a bond or debenture more nearly like equity than debt. For example, the fact that a bond is convertible into stock tends to make it more attractive since the convertibility feature will allow the bondholder to participate in the future growth of the company. The fact that debt is subordinated to other creditors of the corporation makes it more attractive to the corporation since it does not impair its general credit position.

Although it is possible to substitute debt for equity without a merger, this is much easier to bring about at the time of the merger. This is because, although stockholders ordinarily would not be willing to substitute debt for their stockholdings, they may be willing to do so pursuant to a corporate acquisition where they are exchanging their holdings in one company for debt in another (the acquiring) company.

In summary, in many cases the characteristics of an obligation issued in connection with a corporate acquisition make the interest in the corporation which it represents more nearly like a stockholder's interest than a creditor's interest, although the obligation is labeled as debt.

Finance Committee decision.—In general, the House bill and Finance Committee amendments disallow a deduction for interest on bonds issued in connection with the acquisition of a corporation where the bonds have specified characteristics which make them more closely akin to equity.

The disallowance rule under both versions of the bill only applies to bonds or debentures issued by a corporation to acquire stock in another corporation or to acquire at least two-thirds of the assets of another corporation. In addition, the disallowance rule only applies to bonds or debentures which have three characteristics. Two of these characteristics are substantially the same in the House bill and the committee amendments. They provide that the interest disallowance rule is to apply where the bonds are subordinated to the corporation's trade creditors and also are either convertible into stock, or are issued as an investment unit including warrants.

The House bill provides that the interest disallowance rule is to only apply where the ratio of debt to equity of the acquiring corporation (including affiliated corporations) is more than 2 to 1, or where the annual interest expense on its indebtedness is not covered at least three times over by its earnings. The Finance Committee amendments apply the interest disallowance rule in this respect in the same general manner as the House provision. However, under the committee amendments, for the interest disallowance rule to apply, the ratio of debt to equity must exceed 4 to 1 or the annual interest expense on the indebtedness of the corporation must not be covered as much as two times over by its earnings.

The House bill provides an exception from the rule described above for up to $5 million a year of interest on obligations to which the interest disallowance rule would otherwise apply. The amount of this exception is reduced by interest on debt used for acquisition purposes which is not subject to the disallowance rule. The committee amendments retain this provision but for this purpose take into account only interest on obligations issued after December 31, 1967.

Neither the House bill nor the committee amendments apply to debt issued in tax-free acquisitions of stock of newly formed or existing subsidiaries or in connection with acquisitions of foreign corporations if substantially all of the income of the foreign corporation is from foreign sources.

In addition to the committee amendments described above the following modifications or refinements are also made in the House bill:

(1) The committee amendments provide that the subordination test referred to above is to include any obligation which, by its terms (other than by operation of law), is subordinated in right of payment to any substantial amount of the corporation's indebtedness.

(2) The committee amendments provide that the debt equity and interest coverage test, in the case of a corporation engaged in the lending, finance, or banking business, are to be applied by reducing its indebtedness (and the interest thereon) by amounts owed to the corporation with respect to its lending, finance, or banking business (and the interest thereon).

(3) The committee amendments provide that the interest disallowance rule is no longer to apply after a corporation for a period of at least 3 consecutive years has brought itself down below the 4-to-1 debt equity ratio and the interest charges over the 3-year period are covered more than two times by the earnings of the corporation.

(4) The committee amendments provide that the interest disallowance rule is to apply where a corporation acquires at least two-thirds of the "operating assets" (excluding cash) rather than where it acquires two-thirds of a company's "total" assets.

(5) The committee amendments provide that the bill is not to apply to acquisitions of stock of a corporation where the total interest of the acquiring corporation in the other corporation does not exceed 5 percent.

(6) The committee amendments make this provision applicable to indebtedness incurred after October 9, 1969 (rather than May 27, 1969, as in the House bill). They also make the provision inapplicable where stock or assets of a corporation were acquired pursuant to a binding contract entered into before this effective date.

(7) The committee amendments make this provision inapplicable where a corporation has on or before October 9, 1969, acquired at least 50 percent of the stock of a corporation, to the extent the corporation subsequently acquires the additional stock necessary to provide control for tax purposes (80 percent).

The committee amendments also provide a statutory provision authorizing the Internal Revenue Service to issue regulations distinguishing between debt and equity. Statutory guidelines are provided for this purpose and the delineation is for all purposes under the Internal Revenue Code. This grant of authority is not limited to cases involving acquisitions.

2. Limitation on Installment Sales Provision

Present law.—Under present law, a taxpayer may elect the installment method of reporting a gain on a sale of real property, or a casual sale of personal property where the price is in excess of $1,000. The installment method, however, is available only if the payments received by the seller in the year of sale (not counting debt obligations of the purchaser) do not exceed 30 percent of the sales price.

Although the Internal Revenue Service has not ruled as to whether the installment method of reporting gain is available where the seller receives debentures, it is understood that some tax counsel have advised that the method is so available.

Problem.—The allowance of the installment method of reporting where readily marketable debentures or securities are received by the seller of property is not consistent with the purpose for which the installment provision was adopted. This method presumably was initially made available because of the view that where a seller received a debt obligation he did not have cash, or the equivalent of cash, on hand which would provide him with funds to pay the tax due on the gain. This problem, however, does not exist where the seller receives readily marketable securities.

Finance Committee decision.—The House bill and the Finance Committee amendments provide that where bonds have interest coupons attached, are in registered form or have other features which make them readily tradeable in the market, these bonds are to be considered as payments in the year of the sale for purposes of the installment sales provision relating to sales of real property and casual sales of personal property (including the rule which denies the installment method on a transaction where more than 30 percent of the sales price is received in the first year). The committee amendments add obligations which are payable on demand to the category of bonds that are to be treated as payments in the year of sale. The committee amendments, however, exclude from the category of bonds or debentures in registered form (which otherwise would be considered as payments received in the year of sale) bonds or debentures which are nontransferable except by operation of law or which otherwise are not readily tradeable on an established securities market.

The House provision would have applied to sales occurring after May 27, 1969. The committee amendments make the new rules effective with respect to sales occurring after October 9, 1969. In addition, the amendments provide that the new rules are not to apply to a sale made pursuant to a binding contract entered into before October 9, 1969.

The House bill in addition to the provision described above would have denied the use of the installment method unless the payment of the principal of the loan, or the payment of the principal of the loan and the interest taken together, were spread relatively evenly over the installment period. This requirement would have been satisfied if at least 5 percent of the principal was paid by the end of the first quarter of the installment period, 15 percent was paid by the end of the second quarter and 40 percent by the end of the third quarter. The committee amendments delete this provision from the bill.

3. Original Issue Discount

Present law.—Under present law, original issue discount arises when a corporation issues a bond for a price less than its face amount. (The amount of the discount is the difference between the issue price and the face amount of the bond.) The owner of the bond is not taxed on the original issue discount until the bond is redeemed or until he sells it, whichever occurs earlier. In addition, only that portion of the gain on the sale of the bond equal to the part of the original issue discount attributable to the period the taxpayer has held the bond is taxed at ordinary income rates.

The corporation issuing the bond, on the other hand, is allowed to deduct the original issue discount over the life of the bond.

Problem.—Present law results in a nonparallel treatment of original issue discount between the issuing corporation and the bondholder. The corporation deducts a part of the discount each year. On the other hand, the bondholder is not required to report any of the discount as income until he disposes of the bond. Although it is likely that the discount will be deducted by the corporation, it is probable that much of the ordinary income is not being reported by the bondholders.

Finance Committee decision.—The House bill and the committee amendments provide that the bondholder and issuing corporation are generally to be treated in a consistent manner with respect to original issue discount. Bondholders are to include the original issue discount in income ratably over the life of the bond. This rule applies to both the original bondholder and subsequent bondholders. (Issuing corporations already take deductions ratably over this period.) Corporations issuing bonds in registered form are to be required to furnish the bondholder and the Government with an annual information return indicating the amount of original issue discount to be included in income for the year.

The committee amendments provide an exception to the rule specified above to the effect that original issue discount must be included in the bondholder's income ratably over the life of the bond. The exception applies in the case of life insurance companies which already accrue discount under the Internal Revenue Code on a basis which produces essentially the same result as a ratable accrual.

The House provision would have been effective with respect to bonds issued on or after May 28, 1969. The committee amendments make these rules applicable to debt obligations issued after October 9, 1969. In addition, the new rules are made inapplicable to debt obligations issued after this effective date which are issued pursuant to a binding contract entered into before this date.

4. Convertible Indebtedness Repurchase Premiums

Present law.—Under present law, there is a question as to whether a corporation which repurchases its convertible indebtedness at a premium may deduct the entire difference between the stated redemption price at maturity and the actual repurchase price. The Internal Revenue Service takes the position that the deduction is limited to an amount which represents a true interest expense (i.e., the cost of borrowing) and does not include the amount of the premium attributable to the conversion feature. This part of the repurchase is viewed by the Revenue Service as a capital transaction analogous to a corporation's repurchase of its own stock for which no deduction is allowable. There is, however, at least one court case which holds to the contrary in that it allowed the deduction of the entire premium. In addition, there are several pending court cases which have been filed by taxpayers to test the validity of the Service's position on this matter.

Problem.—A corporation which repurchases its convertible indebtedness is, in part, repurchasing the right to convert the bonds into its stock. Since a corporation may not deduct the costs of purchasing its stock as a business expense, it would appear that the purchase of what, in effect, is the right to purchase its stock should be treated in the same manner.

Finance Committee decision.—The House bill and Finance Committee amendments provide that a corporation which repurchases its convertible indebtedness at a premium may deduct only that part of the premium which represents the cost of borrowing and not that portion attributable to the conversion feature. Generally, the deduction is to be limited to the normal call premium for nonconvertible corporate debt except where the corporation can satisfactorily demonstrate that a larger amount of the premium is related to the cost of the borrowing.

The provision in the House bill would have applied to repurchases of convertible indebtedness after April 22, 1969. The committee amendments change this effective date so that it will apply to repurchases of convertible indebtedness after October 9, 1969

L. STOCK DIVIDENDS

Present law.—In its simplest form, a stock dividend is commonly thought of as a mere readjustment of the stockholder's interest, and not as income. For example, if a corporation with only common stock outstanding issues more common stock as a dividend, no basic change is made in the position of the corporation and its stockholders. No corporate assets are paid out, and the distribution merely gives each stockholder more pieces of paper to represent the same interest in the corporation.

On the other hand, stock dividends may also be used in a way that alters the interests of the stockholders. For example, if a corporation with only common stock outstanding declares a dividend payable at the election of each stockholder, either in additional common stock or in cash, the stockholder who receives a stock dividend is in the same position as if he received a taxable cash dividend and purchased additional stock with the proceeds. His interest in the corporation is increased relative to the interests of stockholders who took dividends in cash. Under present law, the recipient of a stock dividend under these conditions is taxed as if he had received cash.

Problem.—In recent years, considerable ingenuity has been used in developing methods of capitalizing corporations in such a way that shareholders can be given the equivalent of an election to receive cash or stock, but at the same time permitting stockholders who choose stock dividends to receive them tax free. Typically, these methods involve the use of two classes of common stock, one paying cash dividends and the other stock dividends. Sometimes, by means of such devices as convertible securities with changing conversion ratios, or systematic redemptions, the effect of an election to receive cash or stock can be achieved without any actual distribution of stock dividends, and therefore without any current tax to the stockholders whose interests in the corporation are increased. In addition, some of these plans have the effect of satisfying the claim of the preferred stockholders to dividends with stock distributions, year after year.

Finance Committee decision.—The House bill and the committee amendments provide that a stock dividend is to be taxable if one group of shareholders receives a distribution in cash and there is an increase in the proportionate interest of other shareholders in the corporation. In addition, the distribution of convertible preferred stock is to be taxable unless it does not cause such a result.

To counter the various devices by which the effect of a distribution of stock can be disguised, both versions of the bill give the Treasury Department regulatory authority to treat as distributions changes in conversion ratios, systematic redemptions, and other transactions which have the effect of creating disproportionate distributions.

The two versions of the bill also deal with the related problem of stock dividends paid on preferred stock. Since preferred stock characteristically pays specified cash dividends, stock dividends on preferred stock (except antidilution distributions on convertible preferred stock) are a substitute for cash dividends and therefore all stock distributions on preferred stock (except for antidilution purposes) are taxable under both versions of the bill. An antidulution distribution occurs where the conversion ratio of the preferred stock is increased to take into account a stock dividend (or stock split) with respect to the stock into which it can be converted.

The committee intends to make it clear that isolated redemptions of stock are not to be considered as resulting in taxable distributions to stockholders whose stock is not redeemed.

The committee amendments provide a de minimis rule where the disproportionate distribution rules are not to apply. If a distribution which results in an increase in the proportionate interests of other shareholders is made but if this distribution and all prior distributions of this type to the same class of shareholders made during the last 36 months does not have the effect of increasing the proportionate interest of other shareholders in the assets or earnings and of the corporation by more than 1/10th of 1 percent, the distribution is not to result in a stock dividend being taxable. This test is applied on a distribution by distribution basis, always taking into account any prior distributions in the prior 36 months (including distributions before the effective date of this act).

Generally, under the House bill and the committee amendments the provisions apply (subject to certain transitional rules) to distributions made after January 10, 1969 (or in those cases where the new rules in the bill do not follow the regulations previously published, after April 22, 1969). The House bill contains a transitional rule for stock dividends paid on stock that was outstanding on the effective date. This provision was intended to apply only where the corporation's dividend policy and capital structure on the effective date were such that stock dividends paid by it would be taxable under the bill. To prevent avoidance of the House provision, the committee amendments provide that where a corporation had two classes of stock outstanding before the effective date but had not prior to the effective date used them in a way which would have given rise to tax under the new rule, the corporation cannot begin after the effective date making disproportionate distributions of the kind covered by the bill (without payment of tax).

If the transitional rule applies where two classes of stock were in existence before the effective date, one convertible into the other and one paying cash dividends and the other paying stock dividends, it is unclear under the House provision whether additional issues of the cash dividend paying stock after the effective date could be made. The committee report implies they could not. Further, the House provision does not permit the issuance of the stock dividend paying stock in such a situation. The committee amendments provide that a corporation which qualifies for the transitional rule is to be able to continue issuing one class of stock, but the stock which may be issued in such a case is to be the larger of the two classes. (This would usually be common stock of the corporation.)

M. FINANCIAL INSTITUTIONS

1. Commercial Banks—Reserves for Losses on Loans

Present law.—Commercial banks, as a result of Revenue Ruling 65-92 (C.B. 1965-1, 112), now have the privilege of building up a bad debt reserve equal to 2.4 percent of outstanding loans not insured by the Federal Government. Alternatively, their reserve may be based on their actual loss experience. The 2.4-percent figure used for this purpose is roughly three times the annual bad-debt loss of commercial banks during the period 1928-47. In 1968, Revenue Ruling 68-630 (C.B. 1968-2, 84) clarified the loan base used for computing the allowable bad-debt reserve generally to include only those loans on which banks can suffer an economic loss.

Problem.—By allowing commercial banks to build up bad-debt reserves equal to 2.4 percent of uninsured outstanding loans, present law gives them more favorable treatment than most other taxpayers. Section 166(c) of the Internal Revenue Code permits business taxpayers to take a deduction for a reasonable addition to a reserve for bad debts. Most taxpayers accumulate a bad-debt reserve equal to the ratio of the average year's losses to accounts receivable. The average loss is computed on the basis of losses for the current year and the 5 preceding years.

Finance Committee decision.—The Finance Committee amendments provide that in the future the deduction allowed commercial banks for additions to bad-debt reserves is to be limited to 1.8 percent of eligible loans, or the amount called for on the basis of their own experience as indicated by losses for the current year and the 5 preceding years. Banks presently below the 1.8-percent reserve will be permitted to bring their reserves up to this level over a 5-year period. Banks with bad-debt reserves in excess of 1.8 percent of eligible loans are not to be permitted to add to these reserves unless additions are justified on the basis of their own experience. However, these banks will not be required to reduce their existing level of reserves. Moreover, they will be allowed in any event to deduct their actual bad debt losses during the year.

The House bill differs from the committee amendments in that it would, in the future, have limited the deduction allowed commercial banks for additions to bad-debt reserves to the amount called for on the basis of their own bad debt loss experience. In addition, the House provision would have provided banks with net operating loss carrybacks for 10 years instead of the 3 provided under present law.

The committee amendments apply to taxable years beginning after July 11, 1969. This is the same effective date as in the House bill.

2. Small Business Investment Companies and Business Development Corporations

Present law.—In the past, small business investment companies have been allowed to build up a bad-debt reserve amounting to 10 percent of their outstanding loans. This was a temporary revenue ruling designed to provide a basis for computing the reserve in the absence of experience or experience of any comparable industry. Presently, however, small business investment companies and also business development corporations must base additions to their bad-debt reserves on their own experience in the current year and the 5 preceding years.

Problem.—Requiring a small business investment company or a business development corporation to base its bad-debt deductions upon its own experience has created problems for new companies which have been in existence for only a few years. Such companies, although they may subsequently realize losses, initially are unlikely to have much if any losses.

Finance Committee decision.—The Finance Committee amendments provide that a new small business investment company, or a new business development corporation, may during the first 10 years of its experience base its bad-debt reserves upon the industry average. This adopts identical provisions of the House bill with respect to these two types of organizations.

3. Mutual Savings Banks, Savings and Loan Associations, etc.

Present law.—Mutual savings banks, savings and loan associations, and cooperative banks are permitted to compute additions to their bad-debt reserves on the basis of their actual experience or under one of two alternative formulas (specified by the 1962 Revenue Act), whichever produces the greatest addition to the reserve. The two alternative formulas provide for the deduction of (1) 60 percent of taxable income, or (2) 3 percent of qualifying real property loans. Under the first method, a mutual institution is permitted to deduct each year an amount equal to 60 percent of its taxable income (computed before any bad-debt deduction). Under the second method, an institution is permitted to deduct an amount sufficient to bring the balance of the reserve for losses on qualifying real property loans to 3 percent of such loans outstanding at the close of the taxable year, plus an amount sufficient to bring the balance of the reserve for losses on other loans to a "reasonable" amount.

A savings and loan association and a cooperative bank are entitled to use these special reserve methods only if they meet a comprehensive set of investment standards, which were established by Congress in the 1962 act to insure that the tax benefits are available only to those institutions primarily engaged in the business of home mortgage financing. Mutual savings banks, however, are not subject to any investment standards under these tax provisions and may use the special reserve methods regardless of the amount of their investments in home mortgage financing.

Problem.—In 1952 Congress repealed the exemption of these institutions from Federal income tax and subjected them to the regular corporate income tax. At that time, however, these institutions were allowed a special deduction for additions to bad-debt reserves which proved to be so large that they remained virtually tax exempt. In the Revenue Act of 1962, Congress sought to end this virtual tax exemption by providing the special alternative methods for these institutions in the computation of their bad-debt reserve. Although these methods are more restrictive than prior law, they still provide highly favorable treatment for the bad-debt reserves of these institutions.

It was expected that most of these institutions would compute their deduction under the 60-percent method, which requires the payment of some tax, while the 3-percent method would be an alternative primarily benefiting a limited number of new or rapidly growing institutions. In practice, about 90 percent of the savings and loan associations use the 60-percent method, but most mutual savings banks use the 3-percent method and as a result have been able to avoid substantially all Federal income taxes.

Finance Committee decision.—Both the House bill and the committee amendments revise the tax treatment of mutual savings banks, cooperative banks and savings and loan associations in a number of ways. Both amend the special bad-debt reserve provisions by eliminating the 3-percent method and reducing the present 60-percent method. The House bill would have reduced this 60 percent to 30 percent gradually over a 10-year period. The committee amendments reduce this to 50 percent over a 4-year period. In both cases the balance of this reserve for losses on qualifying real property loans (as under present law) may not exceed 6 percent of these loans outstanding at any time.

Both the House bill and the committee amendments also revise the present investment standards applicable to savings and loan associations by liberalizing the composition of the qualifying assets. In addition, these liberalized standards are applied to mutual savings banks. The new investment standard is a flexible one which reduces the percentage (applied against taxable income, with certain adjustments, to compute the bad-debt reserve deduction) depending upon the percentage of investments in the qualifying assets—residential real property loans, liquid reserves, and certain other assets. The full percentage (50 percent at the end of a 4-year period under the committee amendments, or 30 percent at the end of a 10-year period under the House bill) is to be allowed generally only if the institution has a prescribed percentage—82 percent for savings and loan associations and cooperative banks and 72 percent for mutual savings banks—of its investments in qualifying assets. The percentage is reduced by 1 percent for every 1 percent that a savings and loan institution's qualifying assets are less than the prescribed percentage of total assets (or by 1.5 percentage points for every 1 percent in the case of mutual savings banks since they are only required to meet the 72-percent test on qualified assets). However, if less than 60 percent of the institution's funds are in qualifying assets (50 percent for mutual savings banks during the transition period), the percentage deduction method may not be used. Both versions of the bill also allow these institutions to compute their bad-debt reserves on the basis of the 6-year moving average of their own experience rather than on the basis of the percentage deduction method.

The committee amendments also deal with the interrelationship of the 50-percent deduction with the intercorporate dividends received deduction in the case of mutual savings banks and savings and loan associations (the latter, however, under their Federal or State supervision are not permitted to have any appreciable investments in corporate stock). Under present law the income on which the 60-percent (50 percent under the committee amendments) deduction is computed includes net capital gain from the sale of stock and Government obligations and also dividend income qualifying for the intercorporate dividends received deduction. The House bill, however, excludes from the base on which the bad-debt deduction is computed net capital gain from the sale of corporate stock or Government obligations, three-eighths of the net long-term capital gain from the sale of other property (the extent of the preferential capital gains rate for corporations) and the dividend income qualifying for the intercorporate dividends received deduction. The committee amendments continue the same treatment for capital gains as provided by the House bill.

In the case of the intercorporate dividends received deduction, however, the committee amendments allocated the deduction between the portion of the income subject to tax and the portion which is allowed as a bad-debt reserve deduction. As under the House bill the income from corporate securities remaining after the dividends received deduction (the 15 percent remaining after deducting the 85 percent) is not to be taken into account in the base in determining the bad-debt deduction. This can be illustrated as follows: assume a mutual savings bank has $200,000 of interest income and $100,000 of dividend income. In this case, $85,000 of the dividend income under present law would not be included in the savings banks tax base as a result of the dividend received deduction. However, as a result of the allocation, the allowable dividend received deduction is reduced by one-half, or to $42,500. Also, to prevent overlap with the bad-debt deduction, one-half of this $42,500 would be deducted toward the bad-debt reserve in the case of an institution eligible to deduct 50 percent of its taxable income for this purpose. (As under the House bill, the $15,000, to which the intercorporate dividends received deduction did not apply, would not be taken into account in determining the 50-percent deduction.)

Thus, the 50-percent deduction would be computed on the basis of the $200,000 of interest income plus $42,500 of corporate income. The 50-percent bad-debt deduction in this case would be $121,250 leaving a like amount which, together with the $15,000 of security income remaining after the dividends received deduction indicates a tax base in this case of $136,250.

The committee amendments also modify somewhat the types of loans which are taken into account in determining whether a mutual institution qualifies under the 82- or 72-percent asset requirement which must be met for the 50-percent deduction to be available. Under the House bill the following investments were included in qualifying assets for this purpose:

(1) Loans for residential real property, including real property primarily used for church purposes, facilities in residential developments dedicated to public use (e.g., schools and libraries), and

property used on a nonprofit basis by residents (e.g., swimming pools, etc.) and mobile homes not used on a transient basis.

(2) Loans for the improvement of commercial or residential property in an urban renewal area or in an area eligible for assistance under the Demonstration Cities and Metropolitan Development Act.

(3) Loans for educational, health and welfare institutions or facilities including facilities primarily for students, residents, etc.

(4) Property acquired through the liquidation of any of the prior three categories.

(5) Student loans.

(6) Property used by the mutual institution in its business.

The committee amendments have modified the above categories to include loans secured by an interest in real property located in an urban renewal area to be developed for predominantly residential use under an urban renewal plan or located in a predominantly residential area covered by a program under the Demonstration Cities and Metropolitan Development Act. Loans for residential purposes are also defined as including loans secured by redeemable ground rents and it is made clear that real property loans include loans to finance the acquisition or development of land which is to become residential property if there is assurance that the building will actually occur within a period of 3 years. The committee amendments also make it clear that an apartment building with a few commercial establishments in it qualifies as residential property for this purpose if 80 percent of the usable space in the building is residential space.

The committee's provision also gives mutual savings banks and savings and loan institutions the option of computing their bad debt reserves under the commercial bank formula (1.8 percent of eligible outstanding loans) in lieu of the bad debt reserves outlined above. Institutions availing themselves of this option will not be permitted to derive undue advantage from switching from one method of computing bad debt reserves to another. This is because the committee's bill requires such institutions to establish bad debt reserves for each method of computing reserves so that in any year an institution switches to another reserve method it will generally be able to add to that reserve only the amount that would have been permitted had it been consistently on that reserve method throughout the years.

These amendments under both the House bill and the committee amendments are effective for taxable years beginning after July 11, 1969.

4. Treatment of Bonds Held by Financial Institutions

Present law.—Commercial banks and mutual savings institutions receive special tax treatment in regard to their transactions in bonds and other corporate and governmental evidences of indebtedness. Like other taxpayers, they can treat long-term gains from such transactions as long-term capital gains for tax purposes. However, unlike other taxpayers, they can treat capital losses from such transactions as ordinary losses and may deduct such losses without limit from ordinary income.

Problem.—The present nonparallel treatment of gains and losses on bond transactions by financial institutions appears to have inequitable results.

Transactions of financial institutions in corporate and government bonds and other evidences of indebtedness do not appear to be true capital transactions; they are more akin to transactions in inventory or stock in view of the size of the bank holdings of these items and the extent of their transactions in them. Moreover, financial institutions now maximize their tax advantages by arranging their transactions in bonds in the light c' existing market conditions in order to realize gains in selected years and losses in other years. This enables them to report their gains as capital gains for tax purposes and their losses as ordinary losses chargeable against regular income. The result is to permit financial institutions to reduce their taxable liability and to receive preferential treatment over other taxpayers.

Finance Committee decision.—Both the House bill and the committee amendments provide parallel treatment for gains and losses derived by financial institutions on transactions in corporate and governmental bonds and other evidences of indebtedness. Under both versions of the bill, financial institutions are to treat net gains from these transactions as ordinary income, instead of as capital gains, and they are to continue to treat net losses from such transactions as ordinary losses in the same manner as under present law.

The House provision would have applied to bonds which are sold or exchanged in taxable years beginning after July 11, 1969. The committee amendments provide the same rule for indebtedness acquired after July 11, 1969. However, in the case of indebtedness held by the financial institutions on or before that date, this indebtedness, if sold at a gain, is to continue to receive capital gains treatment if the gain is realized within 5 years, but only if it is a net capital gain, taking into consideration transactions on all securities in any year.

Under present law, the capital gains and ordinary loss treatment for bonds and other forms of indebtedness is available only in the case of commercial banks and, in limited circumstances, for small business investment companies. Under the bill, this treatment also is to be available in the case of small business investment companies and business development corporations. Under present law, these financial institutions presently receive capital gain and capital loss treatment with respect to the sale or exchange of indebtedness. Under the committee amendments, these institutions are to receive ordinary gain and ordinary loss treatment in all cases after the 5-year transitional period. In the transition period, however, they may continue to receive capital gain and capital loss treatment for the sale or exchange of these various forms of indebtedness if they so elect for the entire transition period.

5. Mergers of Savings and Loan Associations

Present law.—Under present law a taxpayer which has previously deducted additions to its bad debt reserve for tax purposes must restore the reserve to income when the need for the reserve ceases. An example of a situation where a taxpayer's need for a bad debt reserve ceases is where the taxpayer sells all of its assets including its accounts receivable.

In general, where there is a tax-free merger or reorganization the need for the bad debt reserve is considered to continue and, accordingly, the acquired corporation is not required to restore the reserve to income and it is carried over the acquiring company. On the other hand, where a transaction is a purchase of assets or is treated as a purchase of assets (i.e., where a corporation purchases the stock of another corporation which it then liquidates under sec. 334(b)(2)), the need for the reserve is considered to cease and, accordingly, it must be restored to income.

In the case of mergers or reorganizations of savings and loan associations, the status of the reserves for losses on loans (sec. 593) also depends on whether for tax purposes the merger is characterized as a tax-free reorganization or as a taxable sale. In general, if the merger or reorganization is tax-free, then the bad-debt reserve of the acquired association is carried over; however, if the merger is not tax-free, then the bad-debt reserve is restored to income and taxed (sec. 593(f)).

Problem.—Where there is a merger of savings and loan associations which is treated under present law as a tax-free reorganization (or liquidation), present law has been interpreted as not requiring the acquired association to restore its bad debt reserve to income. However, since present law is not explicit on this point, it is usually necessary for the associations to obtain a ruling on this point from the Internal Revenue Service. The delay involved in this may be detrimental in the case of supervisory mergers. (A supervisory merger is one encouraged or instituted in the public interest by the Federal Savings and Loan Insurance Corporation and the Federal Home Loan Bank Board involving one or more savings and loan associations with financial or managerial problems.) There does not appear to be any necessity to require the association to acquire a ruling in these cases.

Finance committee decision.—The committee amendments provide that in those cases where section 381 applies (relating to carryovers in certain corporate acquisitions which qualify as tax-free reorganizations or liquidations), the bad-debt reserves would not have to be restored to income (i.e., the provisions of sec. 593(f) are not applicable). This amendment is intended merely to be declaratory of existing law where the bad-debt reserve is carried over to the acquiring corporation (under sec. 381). There is no comparable provision in the House bill.

6. Foreign Deposits in U.S. Banks

Present law.—Present law provides special rules, for purposes of the income tax and the estate tax, for the treatment of U.S. bank deposits, and the interest thereon, of foreign persons.

In general the effect of these special rules is to exempt this type of interest income received by foreign persons from U.S. tax and to exempt the deposits from the estate tax. Under present law the special bank deposit rules are to cease to apply at the end of 1972. In other words, after 1972 the interest on these bank deposits otherwise would be subject to income tax and the bank deposits themselves would be subject to the estate tax.

Problem.—Congress provided, in 1966, that the special treatment accorded U.S. bank deposits of foreign persons should be terminated. It was believed, however, that an immediate elimination of the special rules might have a substantial adverse effect on the balance of payments. Accordingly, it was decided to postpone the elimination of the special rules until the end of 1972. In view of the continuing deficit in the balance of payments, it appears that our balance-of-payments situation might be adversely affected to a substantial degree if the special treatment were removed at the end of 1972.

Finance Committee decision.—Both the House bill and the committee amendments provide that in the case of deposits in U.S. banks the special income and estate tax rules regarding U.S. bank deposits (including deposits with savings and loan associations and certain amounts held by insurance companies) of foreign persons are to continue to apply until the end of 1975. As a result, income from deposits in the United States by nonresident alien individuals which is not effectively connected with a U.S. business will be exempt from U.S. income tax until the end of 1975 under both versions of the bill.

The committee amendments revise the treatment of U.S. bank deposits of foreign persons to provide the same treatment for deposits in U.S. branches of a foreign bank as now exists in the case of deposits in U.S. banks.

N. DEPRECIATION ALLOWED REGULATED INDUSTRIES

Present law.—Regulated industries may make the same elections as other taxpayers regarding depreciation of their business property. About half the regulatory agencies require utilities that use accelerated depreciation to "flow through" the resulting reduction in Federal income taxes currently to income. (Where the utility is earning the maximum allowed by law or regulations, this results in flowing through the tax reduction to the utility's current customers.) Other agencies permit the utilities they regulate to "normalize" the deferred tax liabilities resulting from accelerated depreciation. (This involves the utility retaining the current tax reduction and using this money in lieu of capital that would otherwise have to be obtained from equity investments or borrowing.) Some agencies insist that utilities subject to their jurisdiction use accelerated depreciation for tax purposes and, in a few rate cases, such agencies have treated the utilities they regulate as though they used accelerated depreciation (and flowed through the resulting tax reduction), even though the utilities may have in fact used straight line depreciation.

Problem.—The trends of recent years are shifts from straight line to accelerated depreciation and shifts from normalization to flow through, often against the will of the taxpayer utilities. In general, flow through to customers doubles the revenue loss involved in shifting from straight line to accelerated depreciation. It is understood that continuation of these trends would shortly lead to revenue losses of approximately $1.5 billion. Consideration of legislative action in this area is complicated by the fact that many utilities do not have effective monopolies while others do; many utilities are in growing industries while others are losing ground; many utilities compete (to the extent they face any competition) only with other regulated utilities while others compete with businesses not subject to governmental rate regulation.

Finance Committee decision.—Both the House bill and the committee amendments provide that in the case of existing property the following rules are to apply:

(1) If straight line depreciation is presently being taken, then no faster depreciation is to be permitted as to that property.

(2) If the taxpayer is taking accelerated depreciation and is "normalizing" its deferred taxes, then it must shift to the straight line method unless it continues to normalize as to that property.

(3) If the taxpayer is taking accelerated depreciation and flowing through to its customers the benefits of the deferred taxes, then the

taxpayer would continue to do so (except under the committee amendments as provided below), unless the appropriate regulatory agency permits a change as to that property.[1]

Both versions of the bill in the case of new property provide that if the taxpayer presently flows through to its customers the benefits of deferred taxation, then it would stay on accelerated depreciation and flow through unless the regulatory agency permits it to change (or unless the exception under the committee amendments pointed out below applies). In all other cases, accelerated depreciation is to be permitted only if the utility normalizes the deferred income taxes. The taxpayer is permitted to elect straight line depreciation as to this new property. If the taxpayer seeks to use accelerated depreciation, the regulatory agency may permit it to normalize; if the regulatory agency does not, the taxpayer must use straight line depreciation.

The bill does not change the power of the regulatory agencies in the case of normalization to exclude the normalization reserve from the base upon which the agency computes the company's rate of return.

Both the House bill and the committee amendments provide that the rules set forth above apply to property used predominantly in the trade or business of the furnishing or sale of—

(1) Electrical energy;
(2) Water;
(3) Sewage disposal services;
(4) Gas through a local distribution system;
(5) Telephone services; or
(6) Transportation of gas by pipeline.

In all of the above cases, the rules of the bill apply if the rates are regulated by a utilities commission or similar agency.

The committee amendments, while in most respects the same as the House provisions, differ in one principal area: The amendments permit an election to be made within 180 days after the date of enactment of the bill for a utility in one of the regulated industries covered by this provision to shift from the flow-through to the straight line method, with or without the permission of the appropriate regulatory agency, or to permit it to shift to the normalization method with the permission of the regulatory agency. This election applies only to new property. To provide time for the regulatory agency to authorize a change from flow through to normalization (if it wishes to), the election would not take effect until 1971. Since the utility could no longer use accelerated depreciation unless the regulatory agency permits it to normalize, the agency would not be able to impute accelerated depreciation and flow it through.

A number of other changes of lesser importance are also made by the committee amendments. They are as follows:

(1) Oil pipelines are removed from the category of industries covered by the bill and regulated steam producers are included in the categories covered. In addition, COMSAT, which was specifically excluded under the House bill, is included in the industries covered by the provision.

(2) In some jurisdictions, the purpose and effect of normalizing is accomplished by additions to a reserve for depreciation. The committee amendments permit such a definition of normalization and do

[1] That is, the bill does not require the taxpayer to flow through, but it also does not affect any power the regulatory agency might have to require the taxpayer to flow through.

not require that additions be to a separate account described as a "reserve for deferred taxes."

(3) The committee amendments provide that the requirement of normalizing is not met by simply normalizing on the regulated books of account of the utility if these books of account may be ignored by the regulatory agency in setting rates. Under the committee amendments, while the regulated books of account are to be used as the basic source of information, these books are not to control if the current rates of the utility are set by reference to the flow-through method. This prevents a revenue loss which would occur if rates are set based on the flow-through method.

(4) The committee amendments provide that a taxpayer is not to be treated as normalizing unless the entire deferral of taxes resulting from the difference between (a) the depreciation method used in the regulated books of account and (b) the accelerated depreciation method used on the return is normalized. In other words, differences resulting from different useful lives ("guideline" versus "engineering") or capitalizing some items on the books while expensing them on the return, need not be normalized. However, differences such as those between 200-percent (or 150-percent) declining balance and straight line must be normalized. However, this rule is to be applied for the future only.

(5) Under the committee amendments, the status of a company as to whether it is on straight line, normalizing or flow through is to be determined as of August 1, 1969 (instead of July 22, 1969, as under the House bill).

(6) Under the committee amendments, the new rules are to apply to all taxable years for which a return has not been filed before August 1, 1969, even though those years may have ended before that date.

(7) Under the committee amendments, the status of a company is not necessarily to be determined only by the method of depreciation used on its tax return. Utilities that have used accelerated depreciation (with flow through) in computing their tax expenses on their regulated books of account for the latest monthly period ending on or before August 1, 1969, are to be permitted to elect accelerated depreciation (with flow through) for such property and for future acquisitions. In addition, the committee amendments provide that a utility which has filed a request with the Internal Revenue Service for permission to change from straight line to accelerated depreciation is to be permitted to make that change for such property and for future acquisitions. Also, in certain limited circumstances involving regulatory agency hearings that began before April 22, 1969, a utility might be permitted to change to flow through. All of these involve situations where the utility had committed itself to a change in its dealings with the Internal Revenue Service or with the appropriate regulatory agency.

O. TREATMENT OF DEPRECIATION FOR EARNINGS AND PROFITS

Present law.—A dividend is defined under present law as a distribution of property by a corporation to its shareholders out of earnings and profits. If a distribution exceeds the corporation's earnings and profits, then the excess is a "tax-free dividend" (not currently taxable to the shareholder) which reduces his cost basis in the stock (increasing capital gain or reducing capital loss if the stock is sold by him). Earnings and profits generally are computed by reference to the method of depreciation used in computing the corporation's taxable income and so are reduced by the amount of depreciation deducted by the corporation on its return.

Problem.—Tax-free dividends (in effect, resulting in current avoidance of tax at ordinary income rates in exchange for possible postponed tax at long-term capital gains rates) appear to be increasing in a number of industries. Especially among utilities, a number of companies are regularly making such distributions. It was indicated that in 1968 private power companies alone made such tax-free distributions totaling approximately $260 million. Statistical information is not readily available in the real estate industry on this point, but it is understood that substantial amounts of corporate distributions in this industry are also tax-free. Availability of these tax benefits is generally unrelated to the purposes of accelerated depreciation and is of greatest value to individual stockholders in high tax brackets.

Finance Committee decision.—The House bill and the committee amendments provide that for purposes of computing its earnings and profits, a corporation is to deduct depreciation on the straight-line method or on a similar method providing for ratable deductions of depreciation over the useful life of the asset. This provision does not affect the amount of depreciation that can be deducted in determining the corporation's Federal income tax.

The committee amendments provide that this rule as to the method of computing earnings and profits is not to apply in the case of a foreign corporation. Thus, for example, the amount of the foreign tax credit allowed a company receiving dividends from a foreign corporation will be computed as under existing law and will not be affected by the provisions of this bill.

This provision applies to earnings and profits for taxable years beginning after June 30, 1972.

P. NATURAL RESOURCES

1. Percentage Depletion

Present law.—At present, percentage depletion is granted to a wide range of minerals. The depletion rates are 27½ percent for oil and gas wells; 23 percent for sulfur, uranium, and an extended list of minerals; 15 percent for metal mines, rock asphalt, vermiculite, and certain types of clay; 10 percent for coal and a limited group of other minerals; 7½ percent for clay, shale, and slate used for specified purposes; and 5 percent for such items as gravel, peat, and sand, and certain minerals from brine wells. In addition, a 15-percent rate applies to a final category which contains an extended series of minerals and also includes all other minerals unless sold for riprap, ballast road material, rubble, concrete aggregates, or for similar purposes. Percentage depletion is not granted in the case of soil, sod, dirt, turf, water, or mosses or minerals from sea water, the air, or similar inexhaustible sources.

Percentage depletion generally applies to the specified items regardless of whether the pertinent property is located in the United States or abroad. However, except for sulfur and uranium, the 23-percent percentage depletion rate applies only to deposits in the United States, and foreign deposits of the other minerals in this category are eligible for percentage depletion at the 15-percent rate.

The percentage depletion allowance is limited to a maximum of 50 percent of the taxable income from the property, computed before any allowance for depletion. In any case where depletion based upon cost is higher than percentage depletion, the higher amount is allowed as a deduction.

Problem.—Percentage depletion was adopted in 1926 when the prior allowances based on discovery value in the case of oil and gas proved difficult to administer and produced varying results. At that time, it was recognized that percentage depletion could permit taxpayers to recover amounts in excess of their investments. However, this was deemed justified on the ground it would have the beneficial effect of stimulating exploration for, and discovery of, new reserves of vitally needed oil and gas.

It has been argued that if percentage depletion rates are viewed as a needed stimulant at the present time, they are higher than is needed to achieve the desired increase in reserves.

Finance Committee decision.—The Finance Committee amendments provide that the percentage depletion rate for oil and gas wells is to be reduced from the present rate of 27½ percent to 23 percent. As under present law, percentage depletion is to apply to both domestic and foreign oil and gas wells. In addition, the committee amendments provide that in the case of oil and gas producers with less than $3 million of gross income from oil and gas production, the "net income" limitation on the allowance for depletion is to be increased from 50 percent to 65 percent of the net income from the property.

The House bill would have decreased the percentage depletion rate for oil and gas from 27½ percent to 20 percent. It also would have made percentage depletion unavailable in the case of foreign production of oil and gas. No changes were made in the House bill with respect to the net income limitation.

In the case of other minerals, the committee amendments provide that the percentage depletion rates of existing law are to continue to apply. The House bill would have generally reduced these rates by about 25 percent (except for gold, silver, oil shale, copper, and iron ore, which were left at the present rate of 15 percent). The percentage depletion rates under present law (which are retained by the committee) and the rates under the House bill in the case of these other minerals are as follows:

[In percent]

	Present rate (and committee bill)	Rate provided by House bill
Sulfur and uranium, and specified minerals from domestic deposits	23	17
Gold, silver, oil shale, copper, and iron ore from domestic deposits	15	15
Remaining minerals now at 15 percent	15	11
Asbestos, coal, sodium chloride, etc	10	7
Clay, shale, and slate for specified uses	7½	5
Gravel, sand, and other minerals now at 5 percent	5	4

The committee amendments also made certain other changes with respect to the depletion allowance for other minerals. In the case of gold, silver, and copper, they increase the 50-percent net income limitation to 70 percent. In addition, the committee amendments clarify the treatment for percentage depletion purposes of minerals extracted from saline lakes within the United States. Under present law, the Internal Revenue Service has held that percentage depletion is not available with respect to minerals extracted from the Great Salt Lake because it is considered to be an inexhaustible source. The committee amendments provide that, except for salt and water, the various depletion rates will be allowed for minerals extracted from the Great Salt Lake and other perennial saline lakes in the United States.

2. Mineral Production Payments

Present law.—A mineral production payment is a right to a specified share of the production from a mineral property (or a sum of money in place of the production) when that production occurs. Depending on how a production payment is created, it may be classified as a carved-out production payment, or it may constitute a retained production payment which may then be used in a so-called A-B-C transaction.

A carved-out production payment is created when the owner of a mineral property sells—or carves out—a portion of his future production. A carved-out production payment is usually sold for cash and, quite often, to a financial institution. Under present law, the amount received by the seller of the carved-out production payment generally is considered ordinary income subject to depletion in the year in which received. The purchaser of the production payment treats the payments received as income subject to the allowance for depletion (almost always cost depletion) and thus generally pays no tax on those amounts (except for that portion of the payments which is in the nature of interest). The amounts utilized to pay the production payment are excluded from income by the owner of the property during the payout period, but the expenses attributable to producing the income are deducted by him in the year they are incurred.

A retained production payment is created when the owner of a mineral interest sells the working interest, but reserves a production payment for himself. Under present law, the owner of the retained production payment receives income for which percentage depletion may be taken during the payout period, or the period during which he receives a part of the production (or a payment based on production). The purchaser of the working interest excludes the amounts used to satisfy the production payment during the payout period, but (until recently) deducted the cost of producing the minerals subject to the production payment.

The so-called A–B–C transaction is the same as a retained production payment case, except that after selling the working interest, the initial owner then sells the "retained production payment." Thus, in an A–B–C transaction, the owner of the mineral property, A, sells it to a second person, B, and reserves a production payment (bearing interest) for a major portion of the purchase price. He then sells the production payment to a third party, C, which is usually a financial institution, or, perhaps, a tax-exempt organization.

Problem.—The use of carved-out production payments constitutes a problem because they are being employed to circumvent the limitations on the depletion deduction and the foreign tax credit and to distort the benefits that the net operating loss provisions were designed to provide. In addition, in A–B–C transactions, taxpayers are able to pay off what is essentially a purchase money mortgage with before-tax dollars rather than after-tax dollars.

Finance Committee decision.—Both the House bill and the Finance Committee amendments provide, in general, that carved-out production payments and retained payments (including ABC transactions) are to be treated as a loan by the owner of the production payment to the owner of the mineral property. In the case of a carved-out production payment, both versions of the bill provide that the payment is to be treated as mortgage loan on the mineral property (rather than as an economic interest in the property). Thus, the proceeds received by the seller upon a sale of a production payment are not to be taxable to him. However, as income is derived from the property subject to the carve-out, that income, including the portion used to satisfy the production payment, is taxable to the owner of the property, subject to the depletion allowance. The cost of producing minerals used to satisfy carved-out production payments is to be deductible when incurred.

This treatment is not to apply to a production payment carved out for exploration or development of a mineral property if, under existing law, gross income is not realized by the person creating the production payment.

In the case of retained production payments (that is, the sale of mineral property subject to a production payment), both versions of the bill provide that the production payment is to be treated as a purchase money mortgage loan (rather than as an economic interest in the mineral property). As a result, the income derived from the property which is used to satisfy the payment is to be taxable to the owner of the mineral property subject to the allowance for depletion. In addition, the production costs attributable to producing the minerals used to satisfy the production payment are to be deductible by the owner of the working interest in the year incurred.

Under the House bill, these rules would have applied to mineral production payments created on or after April 22, 1969, other than production payments created before January 1, 1971, pursuant to a binding contract entered into before April 22, 1969. The committee amendments advance the April 22, 1969, date in both of these cases to October 9, 1969.

The committee amendments also provide two transition rules. First, they permit taxpayers to elect to apply the new rules with respect to carved-out production payments to such payments which were sold after December 31, 1967 (in the case of a calendar year taxpayer). As a result, where this election is made these payments will be treated as a loan rather than as a sale. Any refunds paid as a result of this provision are to be paid without interest. The second transition rule provided by the committee amendments is a modification of a House bill transition rule. The rule under the House bill would have allowed payments to be carved out during the part of a taxable year on or after April 22, 1969, to the extent of drilling or development costs incurred during the portion of the taxable year occurring before April 22, 1969. The amount carved out in this manner could be used under the House provision only to reduce or offset such costs. It could not be used to increase a percentage depletion deduction or foreign tax credit. The committee amendments modify this rule to provide that the new rules with respect to carved-out production payments are not to apply except for percentage depletion and foreign tax credit purposes to payments sold during the part of the taxpayer's year which occurs after October 9, 1969, to the extent the production payments offset a net operating loss which would have occurred in the taxable year in the absence of the carved-out production payments. In no event, however, are the amount of the carved-out production payments qualifying for this treatment plus the amount of payments sold by the taxpayer in the prior part of his taxable year to exceed the amount of carved-out payments sold by the taxpayer during his preceding taxable year.

3. Mining Exploration Expenditures

Present law.—Present law allows a taxpayer to elect to deduct, without dollar limitation, mining exploration expenditures (that is, exploration expenditures for any ore or mineral other than oil or gas) which are made prior to the development stage of the mine. The availability of this deduction is limited to mines located in the United States or on the Outer Continental Shelf. When a mine reaches the producing stage, the exploration expenditures previously deducted are recaptured, generally by disallowing the depletion deduction with respect to the mine.

A taxpayer who does not elect this unlimited mining exploration expenditure deduction is allowed a limited deduction for exploration expenditures (whether on domestic or foreign mines) without the recapture rules applying. The total deduction under this limited provision for all years may not exceed $400,000.

Problem.—The allowance of a current deduction for exploration expenditures without applying the recapture rules under the limited deduction provision is not justified in view of the recapture rule applicable to the unlimited deduction.

Finance Committee decision.—The House bill and the committee amendments amend existing law to provide that insofar as future mining exploration expenditures are concerned, the general recapture rules are to apply in all cases. Taxpayers may still continue to deduct expenditures for foreign (and oceanographic) explorations to the extent permitted under present law (generally up to a maximum of $400,000).

The committee amendments also provide that taxpayers who have elected to deduct mining exploration expenditures under the limited provisions of present law are to be deemed (unless the taxpayer notifies the Treasury to the contrary) to have made an election with respect to expenditures made after the effective date of this provision to deduct the expenditures under the unlimited provision. The committee also wants to clarify its intent as to the treatment (under existing law as well as under the bill) of expenditures which are incurred during the development or producing stage of a mine. It is the intent of the committee that expenditures on a mine after the development stage has been reached are to be treated as deductible development expenditures or operating expenses unless the expenditures are made for the purpose of discovering a new mine. That is, if a mine is in the development or productive stage, exploratory expenditures (drilling, crosscutting, etc.) to determine the location, extent, or quality of a known deposit in the mine, or to locate or find other veins of ore in the mine, are deductible without recapture. However, if the exploration project is for the discovery of a new mine, even though conducted from underground workings of an existing mine, the expenditures would be subject to section 617. For example, if the operator of an existing mine enters into an agreement with the owner of adjacent land to drive crosscuts from the bottom of the existing mine into the adjacent lands to find out whether there are deposits of ore which would "make a mine," the exploration expenditures would be subject to section 617 even though the agreement provides that the operator of the existing mine, if the exploration project is successful, will have a share in the new mine when it is developed.

The House provision applied to mining exploration expenditures made after July 22, 1969. The committee amendments apply to exploration expenditures made after December 31, 1969.

4. Treatment Processes in the Case of Oil Shale

Present law.—The depletion allowance for oil shale under present law is applicable only to the value of the rock itself after extraction and crushing—which has little value. Liquid oil from wells, on the other hand, has considerable value.

Problem.—Existing levels of technology do not permit oil shale to be produced on a basis competitive with oil produced from wells. Percentage depletion does not operate effectively as an incentive to improvements in oil shale technology because percentage depletion on oil produced from oil shale is substantially less than percentage depletion on oil produced from wells.

Finance Committee decision.—The House bill and Finance Committee amendments extend the point at which percentage depletion is computed in the case of oil shale until after extraction from the ground, through crushing, loading into the retort and retorting. However, this is to be before hydrogenation or any refining process or any other process subsequent to retorting.

5. Continental Shelf Areas

Present law.—It is not clear under present law whether for purposes of the exploration for, or exploitation of, mineral resources in the continental shelf area of a country over which it exercises tax jurisdiction under the principles of international law, that area is considered for U.S. tax purposes as a part of the country.

Problem.—The development of natural resources in the continental shelf areas of the world makes the status of these areas for tax purposes of increasing importance. This status is important, for example, in determining the source of income from mining activities conducted on a continental shelf area and in the application of the foreign tax credit with respect to this income.

Finance Committee decision.—The House bill did not deal with this subject. The Finance Committee amendments provide that for purposes of applying the income tax provisions with respect to natural resources, the term "United States" includes the seabed and subsoil of the submarine areas adjacent to the territorial waters of the United States over which the United States has exclusive rights in accordance with international law with respect to the exploration and exploitation of natural resources. A similar definition of "foreign country" also is provided. This does not mean, however, that a foreign country will by reason of this be treated as a country which is contiguous to the United States.

Q. CAPITAL GAINS AND LOSSES

1. Alternative Tax Rate for Individuals

Present law.—One-half of an individual's net long-term capital gains are included in taxable income and, accordingly, are taxed at regular tax rates. However, the alternative tax—a maximum of 25 percent on net long-term capital gains—is available and is more favorable to use when an individual's marginal tax rate exceeds 50 percent. For married couples filing a joint return, the alternative tax is more favorable when taxable income is greater than $52,000. For single persons, the alternative tax is more favorable when taxable income exceeds $26,000.

Problem.—In recent years, many high-income taxpayers have planned to take advantage of the lower 25-percent alternative capital gains tax and have revised their investment strategies to convert as much as possible of their income into capital gains. For these taxpayers, the alternative rate operates as an exclusion which varies with the taxpayer's marginal rate. A taxpayer with a 70-percent marginal rate, for example, in effect includes only 36 percent of his net long-term capital gain in his income. As a result, the portion of a taxpayer's capital gain income subject to tax varies according to his marginal tax rate—the higher the tax rate, the smaller the portion of the gain which is taxed. The alternative capital gains rate, therefore, appears to be at variance with the intent of the progressive rate structure to tax individuals according to their ability to pay. The effect of the alternative capital gains tax on the effective rate of tax is shown in the table presented below in which the returns are classified by adjusted gross income in the case of those which are estimated to use the alternative capital gains tax in 1969.

This table also indicates the rates which would apply in each adjusted gross income category if the alternative capital gains rate were not available (the House bill) and under the Finance Committee cut back.

RETURNS WITH ALTERNATIVE CAPITAL GAINS TAX, ESTIMATED 1969

	Income tax liability as a percent of AGI plus the excluded one-half of long-term gains		
AGI class	Present law	Without the alternative rate (House bill)	Finance committee bill
Under $20,000			
$20,000 to $50,000	30.4	30.6	30.6
$50,000 to $100,000	30.2	30.5	30.4
$100,000 to $200,000	31.6	33.1	32.7
$200,000 to $500,000	30.9	34.7	34.4
$500,000 to $1,000,000	29.9	35.7	35.5
$1,000,000 and over	28.5	35.6	35.5
Total	30.5	33.2	32.9

Finance Committee decision.—The House bill would have repealed the alternative capital gains rate for noncorporate taxpayers effective with respect to sales and other dispositions after July 25, 1969. As a result, after that date noncorporate taxpayers would have included one-half of their net long-term capital gains in income without regard to their tax rate bracket. Given the rate schedules in the House bill and the committee amendments, this would have meant a top alternative capital gains rate of 32½ percent in 1972 and subsequent years for those in the top bracket rate of 65 percent.

The committee amendments generally are in accord with the objectives of the House bill in repealing the present 25-percent alternative rate on capital gains. However, it was thought that taxpayers with relatively small amounts of capital gain should continue to be eligible for this 25-percent alternative rate. Accordingly, the committee amendments provide that single persons and married couples filing joint returns may continue to apply this alternative rate in the case of gains up to $140,000 ($70,000 for a married person filing a separate return) provided they do not have tax preference income (other than capital gains) greater than $10,000. The tax preferences referred to here are the same as those provided in the case of the minimum tax except for the exclusion of the capital gains.

The committee amendments also change the effective date of the provisions to apply to years beginning after December 31, 1969 (in lieu of applying the changes to sales or other dispositions after July 25, 1969, under the House bill). They also phase in the higher rates over a 3-year period. The present rate of 27½-percent in 1969 (including the surtax) is increased as follows:

	Percent
1970 (before applying the surtax)	28¾
1971	31
1972	32½

The committee amendments also provide that the present 25-percent capital gains tax rate (plus any surcharge) is to continue to apply in the case of binding contracts which were in effect on or before October 9, 1969. (This does not apply, however, in the case of gain from the sale of timber, or coal or iron ore royalties taxed as a capital gain under section 631 or amounts received with respect to patents under section 1235 of the code.)

In the case of installment payments received after 1969 which relate to sales made on or before October 9, 1969, the present maximum alternate rate of 25 percent, plus any surcharge, is to continue to apply to those installments received in the future. Similarly, the 25-percent rate, plus any surcharge, will continue to apply to distributions from corporations pursuant to plans of liquidation adopted prior to October 9, 1969, under which the corporation will sell its assets and distribute the proceeds to shareholders.

2. Alternative Tax Rate for Corporations

Present law.—Corporations that have an excess of net long-term capital gains over net short-term capital losses may use the "alternative tax," which taxes the entire excess net long-term capital gain at 25 percent. Since the corporate tax structure is not graduated (as is the case for individuals) but is computed on the basis of a normal tax of 22 percent of taxable income and a surtax of 26 percent of that part of the taxable income which exceeds $25,000, usually only those corporations with taxable incomes in excess of $25,000 (on which the tax rate would be 48 percent, apart from the effect of the surcharge) use the alternative tax.

Problem.—The committee amendments reduce the availability of the alternative tax for many individuals, thereby raising their maximum capital gain rates. Accordingly, it appears appropriate to raise the corporate alternative tax rate to a greater percentage of the regular corporate tax rate. In addition, since corporations are not subject to graduated tax rates, they usually do not encounter the problem of having bunched income, which has accrued over more than a one year period and which is taxed in one year at steeply graduated rates. This, of course, is one of the reasons for providing special tax treatment for capital gains.

Finance Committee decision.—Both the House bill and the committee amendments increase the alternative capital gains rate which is applied to a corporation's net long-term capital gains from the present 27½ percent (including the surcharge) to 30 percent.

The House bill would have made this change effective with respect to sales and other dispositions occurring after July 31, 1969. The committee amendments continue the present 27½-percent rate (including the surcharge) for the entire calendar year 1969. They provide, however, that the full 30-percent rate is not to be effective until 1971. In 1970 a special rate (halfway between the 27½ percent and the 30 percent) is to be effective; namely, a rate of 28¾ percent (including the surcharge).

The committee amendments provide that the 25-percent capital gains tax rate (plus any surcharge) is to continue to apply in the case of binding contracts which were in effect on or before October 9, 1969. (This does not apply, however, in the case of gain from the sale of timber or coal or iron ore royalties taxed as capital gain under section 631 or amounts received with respect to patents under section 1235 of the code).

In the case of installment payments received after 1969 which relate to sales made on or before October 9, 1969, the alternative rate of 25 percent (plus any surcharge) is to continue to apply to these installments received in the future.

3. Capital Losses of Individuals

Present law.—Under present law, both individual and corporate taxpayers may deduct capital losses to the extent of their capital gains. In addition, if an individual's capital losses exceed his capital gains, he may deduct up to $1,000 of the excess loss against his ordinary income. (On the other hand, where an individual has a net long-term capital gain rather than a net capital loss, a maximum of only one-half of the net long-term capital gain is subject to tax.)

When a husband and wife each have capital transactions and a joint return is filed, their respective gains and losses are treated as though they had been realized by only one taxpayer and are offset against each other. On the other hand, when both spouses have capital losses and file separate returns, each spouse is allowed to deduct up to $1,000 of net capital losses from ordinary income.

Problem.—The present treatment of long-term capital losses is inconsistent in the case of individuals with the treatment of their long-term capital gains. Although a maximum of 50 cents of each $1 of long-term capital gains is subject to ordinary tax, when capital losses exceed capital gains, the excess loss is deductible dollar-for-dollar against ordinary income (up to a maximum of $1,000).

In addition, when it is more advantageous to them, married couples can file separate returns, be treated as two separate taxpayers, and be allowed to deduct up to $1,000 of capital losses from ordinary income. This treatment is permitted even though married couples are generally treated as one taxpayer. This treatment of losses tends to provide an advantage for people living in community property States because all gains and losses from community property are attributable in equal amounts to each of the spouses by operation of community property law and, therefore, they are automatically eligible for the benefit of the double deduction. On the other hand, spouses living in noncommunity property States must have separate losses in order to claim this advantage—hence, they must either sell assets held in their joint names or each must sell his own assets. (In addition, they must have equal incomes or the loss offset may be more than offset by a difference in tax from loss of the joint return benefit as a result of this variation in income.)

Finance Committee decision.—Both the House bill and the committee amendments provide that only 50 percent of an individual's long-term capital losses may be offset against his ordinary income up to the $1,000 limit. Thus, $2,000 of losses will be required to obtain the full $1,000 deduction. (Short-term capital losses, however, will continue to be fully deductible.) In addition, both versions of the bill provide that the deduction of capital losses against ordinary income for married persons filing separate returns is to be limited to $500 for each spouse (in place of the $1,000 allowed under present law).

The House bill would have applied these provisions in taxable years beginning after July 25, 1969. The committee amendments advance this date to taxable years beginning after December 31, 1969.

4. Capital Loss Carrybacks for Corporations.

Present Law.—Under present law, both corporations and individuals may carry net operating losses back 3 years and forward 5 years. In the case of capital losses, however, an unlimited loss carryover is available in the case of individuals and a 5-year capital loss carryover is available in the case of corporations. No carrybacks are available either in the case of individuals or in the case of corporations. Capital losses which are carried to other years first are offset against capital gains realized in those years. In the case of individuals, any remaining losses may be offset against ordinary income generally to the extent of $1,000 a year. In the case of corporations, however, capital losses may only be offset against capital gains.

Problem.—In the case of regular operating losses, Congress has found in the past that a carryback of a loss was often more beneficial to a corporation than a carry forward.

A carryback results in the immediate refund of tax paid in prior years, whereas a carry forward of a loss merely holds out the prospect of a lesser tax at some time in the future. The carryback, therefore, makes cash available at the time the loss occurs and often helps to offset the disadvantages of the incurring of the loss. A similar situation exists in the case of capital losses for corporations. The committee sees no reason why capital losses should be treated any differently in this respect in the case of corporations than net operating losses. The problem is different in the case of individuals, however, since here the capital loss in part is allowed against ordinary income.

Finance Committee decision.—The committee amendments provide a 3-year capital loss carryback for corporations. This is not available, however, for foreign expropriation capital losses for which a special 10-year carry forward (in lieu of the regular 5-year carry forward) is available under present law or for losses incurred by subchapter S corporations. Present law provides that taxpayers filing for refunds with respect to net operating loss carrybacks may obtain a so-called "quickie" refund under which the refund is made to them after only a preliminary check on the appropriateness of the refund. Subsequently, a full examination is made of the refund under the regular auditing processes. The "quickie" refund in this case is permitted before review by the Joint Committee on Internal Revenue Taxation of the refund, but a subsequent review is made in the same manner as in the case of other refunds of over $100,000. The committee amendments apply this same "quickie" refund procedure in the case of the 3-year capital loss carrybacks in the same manner as in the case of net operating loss carrybacks.

This amendment applies to capital losses sustained in taxable years beginning after December 31, 1969.

There is no comparable provision in the House bill.

5. Collections of Letters, Memorandums, Etc.

Present law.—Present law excludes copyrights and literary, musical, or artistic compositions (or similar property) from the definition of a capital asset, if they are held by the person whose efforts created the property (or by a person who acquired the property as a gift from the person who created it). Thus, gain arising from the sale of such a book, artistic work, or similar property is treated as ordinary income, rather than as capital gain. However, since collections of letters, memorandums, etc. (including those prepared for the individual) are not excluded from the definition of a capital asset, gains from the sale of such property are accorded capital gains treatment.

Problem.—The rationale underlying the present law treatment of artistic works and similar property in the hands of the person who created them, in effect, is that the person is engaged in the business of creating the artistic work or similar property. In view of this, the gain arising from the sale of the property is treated as ordinary income, rather than as a gain from the sale of a capital asset.

It is difficult to see why this treatment should not extend to collections of letters, memorandums, etc., created by the person or prepared for or given to him. In the one case, a person who writes a book and then sells it is treated as receiving ordinary income on the sale of the product of his personal efforts; in the other case, one who sells a letter or memorandum written by, or for, him is treated as receiving capital gain on the sale even though the product he is selling is, in effect, the result of his personal efforts.

Finance Committee decision.—Both the House bill and the committee amendments provide that letters, memorandums, and similar property (or collections thereof) are not to be treated as capital assets, if they are held by the taxpayer whose personal efforts created the property or for whom the property was prepared or produced (or by a person who received the property as a gift from such a taxpayer). For this purpose, letters and memorandums addressed to an individual are considered as prepared for him. Gains from the sale of these letters and memorandums, accordingly, are to be taxed as ordinary income rather than capital gains. This also means, as a result of other changes in the bill in the charitable contributions deductions, that where such letters, memorandums or similar property are given to charitable organizations and a deduction claimed, the appreciation in value of these letters, etc., will be excluded from the amount of the deduction.

The House bill would have made this amendment effective with respect to sales and other dispositions of property occurring after July 25, 1969. The committee amendments make this provision applicable to sales or other dispositions of these papers occurring on or after January 1, 1969.

6. Holding Period of Capital Assets

Present law.—Capital gains on assets held longer than 6 months are considered long-term gains. In the case of individuals, 50 percent of the excess of net long-term capital gains over net short-term capital losses is included in income. In the case of corporations, the excess is taxed at a maximum rate of 25 percent (30 percent under the bill) rather than at the regular 48-percent corporate rate.

Problem.—The House felt that a better line of demarcation between gains for investment and speculative gains would be a 12-month holding period rather than the 6-month holding period of existing law. The committee, however, was concerned (as also was the Treasury Department), as to the impact this might have on the willingness of investors to take risks and thus on capital investments and on revenues.

Finance Committee decision.—The Finance Committee restored the 6-month holding period of present law.

7. Total Distributions From Qualified Pension, Etc., Plans

Present law.—An employer who establishes a qualified employee pension, profit-sharing, stock-bonus, or annuity plan is allowed to deduct contributions to the trust, or if annuities are purchased, may deduct the premiums. The employer contributions to, and the earnings of, a tax-exempt trust generally are not taxed to the employee until the amount credited to his account are distributed or "made available" to him. Retirement benefits generally are taxed as ordinary income under the annuity rules when the amounts are distributed, to the extent they exceed the amounts contributed by the employee. Thus, employee contributions to a pension, etc., fund are not taxed when received since these amounts were contributed from after-tax dollars of the employee.

An exception to the general rule of ordinary income treatment of pension benefits, however, provides that if an employee (not including self-employed persons) receives his total accrued benefits in a distribution within 1 taxable year on account of separation from service or death, the distribution is taxed as a capital gain, rather than ordinary income.

If part or all of this total distribution consists of employer securities, the employee is not taxed on the net unrealized appreciation in the securities at the time of distribution, but instead only when the stock is subsequently sold by the employee. The employee is taxed at the time of distribution only on the portion of the employer securities attributable to the employer's cost at the time of the contribution to the trust. Furthermore, this portion is taxed at the long-term capital gains rate, rather than at ordinary income rates.

Problem.—The capital gains treatment of lump-sum pension distributions was originally enacted in the Revenue Act of 1942 as a solution to the so-called bunched-income problem of receiving an amount in 1 taxable year which had accrued over several years.

The capital gains treatment afforded lump-sum distributions from qualified pension plans allows employees to receive substantial amounts of deferred compensation at a much more favorable tax rate than other compensation received for services rendered. Moreover, it appears that the more significant benefits accrue to taxpayers with adjusted gross incomes in excess of $50,000, and that a number of lump-sum distributions of $800,000 and over have been made.

Finance Committee decision.—The House bill limits the extent to which capital gains treatment is to be allowed for lump-sum distributions from qualified employees' trusts. Capital gains treatment under the House bill is limited to the taxable portion of the distribution in excess of employer contributions which accrued during plan years beginning after 1969. The effect of this is to treat as ordinary income the amounts attributable to these employer contributions accruing after 1969. This treatment applies to employer contributions of employer's securities as well as where other amounts are contributed by the employer to the plan. The committee amendments adopt this portion of the House provision.

The House bill also would have provided a special 5-year "forward" averaging with respect to the amounts to be treated as ordinary income. Under this procedure, the taxpayer would compute the increase in tax resulting from including one-fifth of the portion of the distribution to which ordinary income tax is to apply in his gross income for the year in which the distribution is made. The tax on this one-fifth is then multiplied by 5 to obtain his tax liability on the entire ordinary income portion. The House bill would have further provided that the taxpayer could receive a partial refund of his tax on the ordinary income portion at the end of the 5-year period by adding one-fifth of the ordinary income portion into gross income in each of the 5 taxable years. If the tax determined in this manner resulted in a lower tax than that previously paid, the taxpayer would be entitled to a refund.

To simplify the computations involved for the taxpayers, the committee amendments provide a substitute for the 5-year "forward" averaging provision. Under the committee amendments, there would be one determination of the tax on the ordinary income portion of the distribution with no subsequent recomputations or refunds. In this computation, the taxpayer would not take into account any compensation received from his employer during the year of the lump-sum distribution in determining the tax on the one-fifth. In addition, in determining this tax on the one-fifth, the capital gains portion of the lump-sum distribution also would not be taken into account These two provisions avoid placing the taxpayer in a higher tax bracket in the year of receipt because of the lump-sum distribution and salary income received during his final year of employment. This avoids the need for a refund procedure to recompute the tax liability on the ordinary income portion after 5 years.

8. Sales of Life Estates, Etc.

Present law.—Under present law, when a life estate and remainder interest in property are acquired by gift, by bequest, or through inheritance, the basis of the property is divided between the life estate and the remainder. The owner of the life interest is not permitted to deduct any portion of his basis over the life of his interest and thereby to reduce for tax purposes the amount of income he receives from his interest. However, where the life tenant sells his right to receive future income, his basis in the property may be used to reduce the gain he receives on the sale. The purchaser of the life estate is allowed to amortize his basis (his purchase price) and, therefore, is able to offset it against the income he receives from it.

Problem.—This treatment of life estates has the effect of allowing a large portion, and in some cases, almost all of the income from a life estate or similar interest to avoid taxation in those situations where the life tenant sells his interest. This is because the life tenant is not taxed on his income to the extent of his basis and, in addition, the purchaser of this interest is not taxed on most of the income from it because he is allowed to reduce that income by amortization deductions for the purchase price which he pays for the interest. In addition, in some cases the seller's basis has exceeded the amount he received upon its sale, and he has been permitted to take a deductible loss.

Finance Committee decision.—The House bill and the committee amendments provide that the entire amount received on the sale or other disposition of a life (or term of years) interest in property or an income interest in a trust (which was acquired by gift, bequest, inheritance or a transfer in trust), is to be taxable, rather than only the excess of the amount received over the seller's basis for his interest.

Neither version of the bill, however, changes present law where a life interest is disposed of as a part of a single transaction in which the entire fee interest is transferred to any other persons. This occurs, for example, where a life tenant and remainderman join in the sale of the entire property interest. In such a case the gain realized by the life tenant is to be measured by the excess of the proceeds received on the sale over his basis for his interest.

The House bill would apply to sales or other dispositions after July 25, 1969. The committee amendment moves this effective date up to October 9, 1969.

9. Certain Casualty Losses Under Section 1231

Present law.—Generally, under present law (sec. 1231(a) of the code), if the gains on the disposition of certain types of property exceed the losses on this same type of property, in effect, the excess is treated as long-term capital gain. On the other hand, if the losses exceed the gains, then the net loss is treated as an ordinary loss. The types of property subject to this provision generally are depreciable property and real estate used in a trade or business.

An exception to this general provision is provided for uninsured losses resulting from casualty or theft in the case of property used in a trade or business (or capital assets held for the production of income). These uninsured losses are deductible in full against ordinary income rather than being required to be netted with other gains and losses under section 1231.

Problem.—The exception to the general section 1231 rule has led to anomalous results. A business taxpayer with a casualty loss on two similar business properties, one of which is insured and one of which is not, is allowed to deduct the uninsured loss in full against ordinary income and at the same time is allowed to treat the gain on the insured property (the excess of the amount of insurance received over his adjusted basis in the property) as a capital gain. In other words, the gain and loss do not have to be netted under section 1231. On the other hand, the netting is required where the business taxpayer only partially (perhaps 5 percent) insures a business property.

Finance Committee decision.—The House bill and the committee amendments modify the treatment of casualty losses and casualty gains (under sec. 1231) to provide that casualty (or theft) losses on depreciable property and real estate used in a trade or business and on capital assets held for the production of income are to be consolidated with casualty (or theft) gains on this type of property. If the casualty losses exceed the casualty gains, the net loss is to be treated as an ordinary loss (without regard to whether there may be noncasualty gains coming under section 1231). On the other hand, if the casualty gains exceed the casualty losses then the net gain is to be treated as a section 1231 gain which must then be consolidated with other gains and losses under section 1231.

Under the bill, the rule described above applies where the casualty property is uninsured, partially insured, or totally insured. Although the House intended that casualty losses and casualty gains on capital assets which are personal assets (such as a personal residence or a nonbusiness automobile) were to be subject to this special rule, they were unintentionally omitted. The committee amendments specifically include personal assets in this netting of casualty gains and casualty losses.

Both versions of the bill also clarify the fact that uninsured casualty losses on personal assets are subject to the basic section 1231 provisions.

The House provision would have applied to taxable years beginning after July 25, 1969. The committee amendments move this effective date up to December 31, 1969.

10. Transfers of Franchises, Trademarks, and Trade Names

Present law.—Questions have arisen under present law as to whether the transfer of a franchise is to be treated as an outright sale or as a mere license, and whether the franchisors are selling franchises in the ordinary course of business. Depending upon how these questions are resolved, the franchisor will receive ordinary income or capital gains treatment on the gain he realizes on the transfer of a franchise. A similar situation exists in the case of trademarks and trade names. At present, these problems must be resolved under general tax principles, and this has produced different results; i.e., capital gains in some situations and ordinary income treatment in others, despite factual similarities in the interests in the franchises (or trademarks or trade names) transferred.

Problem.—On several occasions the Tax Court has held that the transfer of franchises was not a sale for tax purposes and that all gains therefrom were to be taxed as ordinary income. This position of the Tax Court has been accepted generally by two circuit courts of appeals; however, three other circuit courts have found sales to exist in similar transactions and have allowed franchisors capital gains treatment. Since present law does not specifically deal with the tax treatment of the transfer of a franchise, and since this has resulted in a considerable diversity of opinion among the courts as to whether the transfer of a franchise constitutes a license or a sale (and whether part or all of a sale of a franchise constitutes the sale of a capital asset) there appears to be a need for legislation in this area. A similar situation exists in the transfer of trademarks and trade names.

Finance Committee decision.—The House bill and the committee amendments deny a franchisor capital gains treatment on the transfer of a franchise if he retains any significant power, right or continuing interest with respect to the subject matter of the franchise. In the event the franchise agreement includes significant rights or restrictions which are subject to the franchisor's approval on a continuing basis, this power to exercise continuing active operational control over the franchise constitutes the franchisor's retention of a significant power, right, or continuing interest. Moreover, if the franchisor's conduct constitutes participation in the commercial or economic activities of the franchise then this too will be regarded as a retention of a significant power, right or continuing interest.

The Finance Committee amendments made more specific the rules of the House bill by providing the following:

(1) The committee amendments provide that included in the concept of retaining a "significant power, right, or continuing interest" (i.e., rights having the effect of giving the franchisor effective control of the operations of the franchise) are situations where the franchisor can require the franchisee to sell or advertise only the product or the services of the franchisor, the right to set the standards of quality of the products used or sold and of the equipment and facilities used, and a requirement that the franchisee purchase substantially all of its products or equipment from the franchisor. These conditions would not include, however, rights which can be justified as reasonably necessary for the protection of the franchisor (e.g., a security interest, the right to terminate for nonperformance, and the right to inspect the franchisee's books).

(2) Franchise agreements frequently provide for the franchisee to pay the franchisor an initial payment (a lump sum or fixed amount payable in installments) as well as additional payments contingent upon the use, disposition, or productivity of the subject matter of the franchise. (These contingent payments are customarily measured by the franchisee's gross sales or are based upon some form of sales unit.) The payment by a franchisee to a franchisor of a lump sum or a fixed amount, taken by itself, suggests a capital transaction. On the other hand, a transaction providing only for contingent payments suggests the retention by the franchisor of a significant power, right, or continuing interest in the subject matter of the franchise. To resolve the problem where there is a combined method of payment—an initial lump-sum payment or installment payments plus contingent payments—the committee amendments provide that the term "significant power, right, or continuing interest" (in determining whether the transfer of the franchise is a sale of a capital asset or a license arrangement) is to include a right to contingent payments where they constitute a substantial element under the parties' agreement. Even where the contingent payments are small, however, they are to be treated as ordinary income to the franchisor. In such cases, the franchisee would be allowed to deduct these contingent payments currently.

(3) The committee amendments also provide rules with respect to initial payments (including a lump sum or fixed amount payable in installments) made by a franchisee to a franchisor, determining the treatment to be accorded these payments based upon whether the agreement constitutes a sale or a license. Where the transfer constitutes a sale, the franchisor is to continue to treat an initial payment as proceeds from a sale; that is, the transfer is to give rise to a capital transaction (except in the case of a dealer). In such a case, the franchisee, if he has purchased an intangible asset without an ascertainable useful life, is to continue to be treated as under present law, and thereby not to be entitled to depreciation or amortization deductions for the payment made to the franchisor. Where the franchise agreement constitutes a license, however, the franchisor is to treat an initial payment as

ordinary income and the franchisee is to treat it as a deductible expense over the period to which the payment is attributable but, in no event, over more than 10 years.

The committee decided to exclude transfers of a franchise to engage in professional sports from the application of this provision.

The rule provided by the House version of the bill would not apply with respect to amount received or accrued in connection with the transfer of a franchise which is attributable to the transfer of all substantial rights of a patent, trademark, or trade name, to the extent the amounts separately identified are reasonable in amount. The committee amendments, however, deleted these exceptions, since patents are treated specifically in section 1235 of the code and the committee amendments also apply the general franchise rules to transfers of trademarks and trade names.

The House provision would apply to transfers made after July 25, 1969. The committee amendments move this date up to December 31, 1969, except that transferees may elect to treat payments made by them in taxable years ending after December 31, 1969, pursuant to transfers before that date, as subject to the new rules for deduction purposes only.

R. REAL ESTATE DEPRECIATION

Present law.—Under present law, the first user may take depreciation allowances for real property under the double-declining-balance method or the sum-of-the-years-digits method. These rapid depreciation methods generally permit large portions of an asset's total basis to be deducted in the early years of the asset's useful life. A subsequent owner is permitted to use the 150-percent declining-balance-method, which also provides more rapid depreciation than straight line in the early years.

Net gains on sales of real property used in a trade or business are, with certain exceptions, taxed as capital gains and losses are treated as ordinary losses. Gain on the sale of buildings is taxed as ordinary income to the extent of depreciation taken on that property after December 31, 1963, if the property has been held not more than 12 months. If the property has been held over 12 months, the excess depreciation over straight line depreciation is "recaptured" as ordinary income and that amount is reduced after 20 months, at the rate of 1 percent per month, until 120 months, after which nothing is recaptured.

Problem.—The present tax treatment of real estate has been used by some high-income individuals as a tax shelter to escape payment of tax on substantial portions of their economic income. The rapid depreciation methods now allowed make it possible for taxpayers to deduct amounts in excess of those required to service the mortgage during the early life of the property. Moreover, because accelerated depreciation usually produces a deduction in excess of the actual decline in the usefulness of property, economically profitable real estate operations are normally converted into substantial tax losses, sheltering from income tax such economic profits and permitting avoidance of income tax on the owner's other ordinary income, such as salary and dividends. Later, the property can be sold and the excess of the sale price over the remaining basis can be treated as a capital gain to the extent that the recapture provisions do not apply. By holding the property for 10 years before sale, moreover, the taxpayer can arrange to have all the gain resulting from excess depreciation (which was offset against ordinary income) taxed as a capital gain without the recapture provisions coming into play. The tax advantages from such operations increase as a taxpayer's income moves into the higher tax brackets.

Because of the present tax situation, when investment is solicited in a real estate venture it has become the practice to promise a prospective investor substantial tax losses which can be used to diminish the tax on his income from other sources. Thus, there is, in effect, substantial dealing in "tax losses" produced by depreciable real property.

In addition to the tax shelter aspect of the present depreciation allowances in the case of individuals, problems have also been raised as to whether the present allowance constitutes an undue incentive for commercial and industrial construction.

Finance Committee decision.—The House bill and committee amendments revise real estate depreciation allowances to limit the opportunities to use the present treatment as a tax shelter and yet, at the same time, to maintain tax incentives to build housing where the need is great.

Under the bill and committee amendments, the most accelerated methods of real estate depreciation (the 200-percent declining balance and sum-of-the-years digit methods) are limited to new residential housing. To qualify for this accelerated depreciation, at least 80 percent of the income from the building must be derived from rentals of residential units.

Other new real estate, including commercial and industrial buildings, under both the House bill and committee amendments, is to be limited to the 150-percent declining balance depreciation method.

In the case of used buildings (including housing), depreciation on future acquisitions is to be limited to straight line depreciation.

A special 5-year amortization deduction is provided in the case of expenditures in the future for the rehabilitation of buildings for low-cost rental housing. This rapid amortization is to be available only for low-income rental housing where the dwelling units are held for occupancy by families and individuals of low or moderate income as determined in a manner consistent with the policies of the Housing and Urban Development Act of 1968. To qualify for this treatment, the aggregate rehabilitation as to any housing may not exceed $15,000 per dwelling unit and the sum of the rehabilitation expenditures (over a 2-year period) must exceed $3,000 per dwelling unit. The committee amendments provide that the special 5-year amortization deduction for rehabilitation expenditures is to apply only with respect to such expenditures made before December 31, 1974. This termination date is designed to give Congress an opportunity at that time to evaluate the effectiveness of the program in achieving its objective.

The House bill and the committee amendments also provide that where depreciable real estate is sold in the future accelerated depreciation taken in the future in excess of allowable straight-line depreciation is to be recaptured as ordinary income to the extent of the gain occurring upon the sale. The committee, while accepting this provision, modified it to provide that in the case of sale of new residential housing there is to be a percentage reduction in the amount of excess depreciation recaptured. Under the committee amendments, the full excess of accelerated over straight-line depreciation is to be recaptured on the sales of such property within the first 10 years. After the first

10 years, the percentage reduction in this excess depreciation subject to recapture is to be 1 percent a month. This means that if the property is sold after the fourth month of the 19th year of the taxpayer's holding period, there is to be no recapture of excess depreciation in the case of the sale of new residential housing under the committee amendments.

The committee amendments provide that the recapture rules described above are not to apply in the case of federally assisted projects (such as the so-called FHA 221(d)(3) and FHA 236 programs) or to other publicly assisted housing programs under which the return to the investor is limited on a comparable basis. These Federal programs presently provide only a 6-percent rate of return to investors and, therefore, the favorable tax treatment presently provided accounts for much of the attractiveness of these programs. The present recapture rules in the case of these projects provide for a recapture of the excess depreciation in full only if the sale occurs in the first 20 months. If the sale occurs after that time, the excess depreciation over straight line which is recaptured is reduced by 1 percent a month until 120 months after which no recapture applies. The committee amendments continue these present rules but provide that these more generous recapture rules are to apply only in respect to property constructed, reconstructed, or acquired before January 1, 1975. This is designed to give the Congress an opportunity at that time to evaluate the effectiveness of this tax-incentive provision.

The committee also modified the House bill to allow accelerated depreciation with respect to a building yet to be constructed providing that the taxpayer had filed with the appropriate local government authority, before July 25, 1969, an initial application for permission to construct, and if construction of such property is begun within one year after the date the initial application was filed.

In the case of U.S. persons deriving income from real estate abroad which nevertheless may be subject to U.S. tax, the committee decided that the fast depreciation methods described above are to be available in these cases for housing for purposes of the computation of U.S. tax in any situations where the foreign country also allows a comparable fast depreciation method but only to the extent of the accelerated rates under U.S. law or under the laws of the foreign country, whichever is the lesser.

The changes in depreciation methods as to both new and used property with respect to residential housing and other construction are not to apply to construction which began before July 25, 1969, or where there was a written contract to construct or sell the building before that date. The House bill would have applied the binding contract rule only in the case of new construction. In addition, the House bill would have applied the new recapture rules to all depreciation attributable to periods after July 24, 1969. The committee amendments apply the new recapture rules to depreciation attributable to periods after December 31, 1969. In addition, the existing recapture rules are to be applied where the sale of the property was subject to a binding contract in existence prior to October 9, 1969, even though the transfer takes place after this date.

S. SUBCHAPTER S CORPORATIONS

Present law.—Subchapter S of the Internal Revenue Code was enacted in 1958 to provide tax relief for small business corporations (those with 10 or fewer shareholders) by allowing them to elect not to be taxed as a corporation, but instead to have the income or loss of the corporation taxed directly to the shareholders in a pattern roughly similar to that of partnership taxation. These provisions do not deal with employee retirement plans; consequently, subchapter S corporations may establish corporate retirement plans which are no different from plans established by other corporations and thus may include employees who are also shareholders of the corporation.

Prior to 1962, self-employed persons (proprietors and partners) were not able to establish such plans to benefit themselves. In 1962, however, Congress enacted the Self-Employed Individuals Retirement Act (H.R. 10), permitting self-employed persons to be treated as employees of the businesses they conduct so that they may be covered under qualified employees retirement plans in much the same manner as their employees. These provisions, though, contain certain specific requirements as to proprietors and partners which limit contributions to 10 percent of the proprietor's or partner's earned income, or $2,500, whichever is less.

Problem.—The H.R. 10 limitations on retirement income plans described above do not apply to corporations and so may be avoided by a proprietor or the partners of a partnership by forming a corporation, electing subchapter S treatment, and then becoming employees of the corporation while at the same time retaining many of the benefits of tax treatment as a partnership. By the same token, a business that had incorporated without contemplating a subchapter S election can avoid the burden of the corporate tax while retaining its broad corporate retirement plans.

Finance Committee decision.—Both the House bill and the committee amendments provide limitations similar to those contained in the retirement plans for individuals (the so-called H.R. 10 type plans) with respect to contributions made by subchapter S corporations to the retirement plans for individuals who are "shareholder employees"; that is, employees or officers who own more than 5 percent of the corporation's stock. Under both versions of the bill, a shareholder-employee must include in his income the contributions made by the corporation under a qualified plan on his behalf to the extent contributions exceed 10 percent of his salary or $2,500, whichever is less.

This provision applies to taxable years of subchapter S corporations beginning after 1969.

T. TAX TREATMENT OF STATE AND MUNICIPAL BONDS

1. Election to Issue Taxable Bonds With Interest Subsidy

Present law.—Interest payments on obligations of State and local governments generally are exempt from Federal income tax, an exemption that has been provided ever since the Federal income tax was adopted in 1913.

Problem.—It is understood that the tax savings for individuals and corporations from the purchase of tax-exempt bonds generally is greater than the differential between the interest yields on tax exempt and taxable bonds. As a result, it has been estimated that the interest savings to State and local governments was $1.3 billion in 1968, but the tax revenue loss of the Federal Government was $1.8 billion. However, because of concern that any action with respect to State and municipal bonds can have a deleterious effect on the market for these bonds and, because of the high interest costs which are now being paid on new issues of such bonds, the committee concluded that any action having an impact on State and local government bond prices would be particularly unfortunate in the present circumstances.

Finance Committee decision.—The House bill provided that States and local governments could voluntarily relinquish the privilege of tax exemption with respect to given debt-security issues and in these cases the Secretary of the Treasury would pay a fixed percentage of the interest yield on each such issue. Under the House bill, the fixed percentage to be paid by the United States could vary with respect to the debt securities issued in any calendar quarter within a range of from 25 to 40 percent of the interest yield. Up to 1975, however, the range was to be from 30 to 40 percent of the interest yield. The amounts were to be paid out of permanent Federal appropriations.

This provision would have applied to obligations issued in calendar quarters beginning after the date of enactment of the bill.

The Finance Committee amendments deleted this provision from the bill. However, the committee bill requires that every person who receives or accrues interest on tax-exempt State and local government bonds is to make a return setting forth these amounts and any other information with respect to these bonds which the Treasury Department prescribes by regulations. The return is to be made in the time and manner prescribed by the Treasury Department, but, insofar as practicable, the regulations are to require the return to be made in connection with the regular individual and corporate income tax returns.

Failure to file this return (unless the failure is due to reasonable cause) is to result in a penalty of $10 or an amount equal to 5 percent of the interest received or accrued during the year, whichever is the larger, except that the penalty in no event is to exceed $1,000.

This provision is to apply to taxable years beginning after December 31, 1969.

2. Arbitrage Bonds

Present law.—Arbitrage bonds generally are obligations issued to acquire other securities where the rate of return of the other securities produces a higher yield than the interest cost on the initial bond issue. Present law does not specifically preclude the issuance of bonds for such purposes by State or local governments. However, questions have been raised in such cases as to whether such bonds in reality are obligations of a State or local government where the proceeds from the securities acquired secure the payments under the initial bonds. As a result, in recent years the Internal Revenue Service has refused to rule as to whether or not bonds issued in such circumstances constitute tax-exempt State or local government bonds.

Problem.—Some State and local governments have misused their tax exemption privilege by engaging in arbitrage transactions in which the funds from the tax-exempt issues are employed to purchase higher yielding Federal or other obligations the interest on which is not taxed in their hands. In such cases, it would appear that the State or local bonds were issued to derive arbitrage income from the investment of funds and not to carry on a governmental function.

Finance Committee decision.—The House bill made provision for the taxation of arbitrage bonds issued by State or local governments. The bill provided that, under regulations prescribed by the Secretary of the Treasury or his delegate, any arbitrage obligation was not to be treated as a tax-exempt State or local government bond. It was contemplated that the regulations issued by the Secretary of the Treasury would provide rules for the temporary investment of proceeds from the State or local government obligation pending their expenditure for the governmental purpose which gave rise to the issue. This provision was to apply to obligations issued after July 11, 1969.

The committee amendments also provide that arbitrage bonds are not to be treated as tax-exempt State or local government issues. However, under the committee amendments, arbitrage bonds are defined. They are in general defined as obligations issued where all or a major part of the proceeds can be reasonably expected to be used (directly or indirectly) to acquire securities or obligations which may be reasonably expected, at the time of the issuance of the State or local obligation, to produce a yield which is materially higher than the yield on the State or local governmental bond issue. Arbitrage bonds are also defined as including obligations issued to replace funds which were used to acquire (directly or indirectly) the type of securities or obligations referred to above.

The definition of arbitrage bonds for purposes of this provision is not to include issues where part or all of the proceeds of the issue are reasonably expected to be used to provide permanent financing for real property used, or to be used, for residential purposes (or to replace funds so used) where the yield on the State or local government obligations at the time of issue is not expected to be substantially lower than the yield on the permanent financing. (This exception does not apply to State or local government obligations held by a person who is a substantial user of property financed by the proceeds of the issue or by a member of his family.)

In addition, an obligation is not to be treated as an arbitrage bond solely because the proceeds of the issue may for a temporary period be invested in securities or other obligations until the proceeds are needed for the purpose for which the State or local government bonds were issued. Nor are obligations to be classified as arbitrage bonds where the proceeds of the State or local government issue may be invested in securities or other obligations which are part of a reasonably required reserve or replacement fund. The amount of the proceeds invested in securities or obligations which are part of a required reserve or replacement fund may not exceed 15 percent of the total proceeds of the issue unless the issuer establishes to the satisfaction of the Treasury Department that a higher amount is necessary.

The committee amendments are effective with respect to obligations issued after October 9, 1969.

U. EXTENSION OF TAX SURCHARGE AND EXCISE TAXES

1. Extension of Tax Surcharge at 5-Percent Annual Rate for First Half of 1970.

Present law.—The Revenue and Expenditure Control Act of 1968 adopted a 10-percent surcharge on the tax liabilities of individuals and business corporations in order to dampen inflationary pressures and keep the economy under control. The 10-percent surcharge initially would have expired as of June 30, 1969, but in H.R. 9951 the 10-percent surcharge was extended for the period from July 1, 1969, through December 31, 1969.

Problem.—The extension of the surcharge until the end of calendar year 1969 provided by H.R. 9951 will help combat the inflationary pressures which have remained strong. However, these inflationary pressures are still such that the committee believes an extension of the surcharge (at a lower rate) through the first half of 1970 is necessary in order to finish the job of bringing the economy under control. The gross national product is still rising; the consumer price index and the wholesale price index have risen at annual rates of 5.6 and 3.6 percent, respectively, since the end of last year; and our financial and money markets are showing marked signs of strain.

Finance Committee decision.—Both the House bill and the committee amendments, in effect, provide that the surcharge on the tax liabilities of individuals and corporations which, under present law, is scheduled to expire on December 31, 1969, is to be continued at a 5 percent annual rate for the period from January 1, 1970, until June 30, 1970. For a calendar year taxpayer, the surcharge is applied for the entire year rather than for one-half the year which means that insofar as tax returns are concerned those for calendar 1970 will show a 2½-percent surcharge.[1] For withholding tax purposes, however, the surcharge is to be taken into account at a 5-percent rate with respect to wages and salaries paid in the first half of the calendar year. In the second half of the year, insofar as withholding is concerned, no surcharge is to be imposed.

A conforming amendment is also made which relates to the required amount of minimum distributions which a domestic corporation must receive from its foreign subsidiaries in order to avoid including undistributed earnings of the foreign subsidiaries in its own income.

The above provisions under the House bill and the committee amendments apply to taxable years ending after December 31, 1969, and beginning before July 1, 1970.

2. Continuation of Excise Taxes on Communication Services and Automobiles

Present law.—The excise tax on passenger automobiles presently is 7 percent and the excise tax on local and toll telephone services and teletypewriter exchange services presently is 10 percent. Both rates are scheduled to decline to 5 percent on January 1, 1970, 3 percent on January 1, 1971, 1 percent on January 1, 1972, and to be repealed on January 1, 1973.

[1] In the case of a fiscal year taxpayer the surcharge is at an annual rate of 10 percent for the period ending December 31, 1969, and at an annual rate of 5 percent for the period beginning January 1, 1970, and ending June 30, 1970. The rate for any fiscal year, only a part of which is in the 10 percent or 5 percent surcharge period, is to be determined by a proration of the two periods on a daily basis.

Problem.—It appears inappropriate to reduce these excise taxes during a period of continuing inflationary pressures when the Federal Government has imposed an income tax surcharge and is applying other forms of fiscal and monetary restraints to control the inflationary pressures.

Finance Committee decision.—The House bill and the committee amendments postpone for one year the scheduled reduction in the excise taxes on passenger automobiles and communications services. Accordingly, both versions of the bill provide that the current rates are to continue through 1970, and each subsequent scheduled reduction is to be postponed one year. Under both versions of the bill the scheduled rates for the excise taxes on passenger automobiles and communications services are as follows:

Year	Rate (percent)	
	Automobiles	Communications services
1970	7	10
1971	5	5
1972	3	3
1973	1	1
1974	[1]	[1]

[1] Tax is repealed.

These provisions become effective on January 1, 1970.

V. REPEAL OF THE INVESTMENT CREDIT

Present law.—Present law provides a 7-percent tax credit (3 percent for public utility property) for qualified investment in: (1) tangible personal property; (2) other property (not including buildings and structural components) which is an integral part of a manufacturing or production or research or storage facility; and (3) elevators and escalators.

To qualify, the property must be depreciable and have a useful life of four years or more. New property fully qualifies for the credit. Up to $50,000 of used property can be taken into account in any year.

Property with a useful life of from four to six years qualifies for the credit to the extent of one-third of its cost. Property with a useful life of six to eight years qualifies to the extent of two-thirds of the investment. If the property has a useful life of eight years or more, the full amount qualifies.

The amount of the investment credit taken in any year may not exceed the first $25,000 of tax liability plus 50 percent of the tax liability in excess of $25,000. Investment credits which, because of this limitation, cannot be used in the current year may be carried back to the three prior years and carried forward to the succeeding 7 taxable years.

Problem.—The investment credit does not appear to be suited to present conditions. The credit was designed to provide a tax inducement for businessmen to modernize their equipment and expand productive capacity. Since 1962, business has invested $400 billion in new plant and equipment, and it would appear that there is no reason to grant a tax inducement for new investment now.

The current outlook is that plant and equipment expenditures will reach record levels in 1969. Such expenditures have risen from $64.1 billion in 1968 to $70.9 billion in 1969 and now are expected to rise another 8.3 percent in 1970. Much of this investment has resulted from the inflationary psychology which induces businessmen to increase plant and equipment spending beyond normal levels in an attempt to avoid higher costs in later years. In such a situation, business investment should not be stimulated. Instead, such investment should be moderated in order to contain an overactive economy and reduce inflationary pressures.

The investment credit cannot be turned on and off quickly to adjust to current economic conditions. In 1966, the credit was suspended temporarily in order to reduce the inflationary impact of large investment expenditures; but the investment credit continued to have an expansionary impact on some investments beyond the cutoff date as a result of transition provisions and carryovers of unused credits. In other cases, there was distortion in the investment process because businessmen postponed normal investments in anticipation of the time when the credit would be restored.

Finance Committee decision.—Both the House bill and the committee amendments provide that the investment credit is not to be available with respect to property the physical construction, reconstruction or erection of which is begun after April 18, 1969, or which is acquired by the taxpayer after that date. The two versions of the bill provide certain exceptions to this general rule, however, where the investment credit is to be available in the case of property constructed, reconstructed, erected or acquired under a binding contract entered into before April 19, 1969, or in certain other transitional situations which are discussed briefly below.

The House provision would have phased out investment credits available in 1971 through 1974 (generally those which result from binding contracts or other transition rules) by reducing the rate of the investment credit by 1/10th of one percentage point a month during this period. Under the committee amendments, however, investment credits are to be allowable in the future (where they arose from binding contracts in the past or from the application of the other transition rules) at the full 7 percent rate if the property is placed in service before 1979. No investment credits would be allowed for property placed in service after that time.

Both the House bill and the committee amendments limit the amount of unused credits from prior years which may be carried over and used in 1969 and subsequent years. Under both versions of the bill the amount of unused credits which a taxpayer can claim as a carryover to any year after 1968 cannot exceed 20 percent of the carryovers available at the end of 1968 (or any higher level of carryovers available in any subsequent year).

The 20 percent limitation on the use of carryovers is in addition to the general 50 porcent limitation (the extent to which the investment credit can reduce tax liability). In determining the years in which the carryovers of investment credits are available, the House bill would have retained the present length of the carryover period, namely, three years back and seven years forward. The committee amendments, however, provide an additional three-year carryforward period for unused investment credits to the extent these unused credits cannot be used in a year solely because of the special 20 percent limitation.

As indicated above, the investment credit continues to be available under the House bill, and under the committee amendments, not only where the construction commenced, or the acquisition occurred, before April 19, 1969, but also where property is constructed (reconstructed or erected) or acquired after that date but pursuant to a contract which was binding on the taxpayer on April 18, and at all times thereafter. This applies only to contracts where the construction or acquisition of property is itself the subject matter of the contract and does not apply to contracts with persons other than a builder or supplier where the taxpayer becomes obligated to construct or acquire property; to some extent third-party situations are covered under a provision described below.

In addition to the binding contract rule, the House bill and the committee amendments contain a series of other transitional rules under which the investment credit will continue to be available although the actual construction or acquisition occurred after that date. These rules are summarized as follows:

(1) Both versions of the bill contain an "equipped building rule" which provides that where construction of a building began before April 19, 1969, and the cost of the building plus machinery and equipment which had been ordered for it before that date represents more than half of the entire cost of the building and planned equipment, the entire equipped building project and incidental appurtenances are to be eligible for the investment credit. The equipped building rule covers not only machinery and equipment to be used in the building but also incidental machinery, equipment and structures adjacent to the building and necessary to the planned use of the building. This rule applies where the entire project was planned before April 19, 1969, and more than 50 percent of the cost of the building, equipment and machinery was attributable to property on which construction began before April 19 or which was acquired or under contract binding before that time.

(2) A plant facility rule (covering cases where the facility is not housed in a building) is also provided in both versions of the bill. This provides that the investment credit is to be available where under a plan in existence on April 18, the taxpayer constructed a plant facility and more than 50 percent of the cost of the facility is attributable to property the construction of which began before April 19 or tc property which was acquired by the taxpayer before that date. In such cases the investment credit is to be available with respect to the entire plant facility. Under the plant facility rule, the investment credit is also available where construction on the facility began before April 19, at the site of the plant facility. In addition, where a certificate of convenience and necessity was issued before April 19 by a Federal regulatory agency with respect to what would otherwise be two or more plant facilities, these may, under the rule set forth above, be treated as a single facility. For this treatment to apply, 50 percent of the cost of the property making up the facilities must be attributable to property the construction of which began before April 19 or to property acquired before that date.

(3) A special machinery and equipment rule makes the investment credit available where machinery and equipment was only partially

on order or under construction on April 18. Under this rule, the investment credit will continue to be available in the case of machinery and equipment where more than 50 percent of the parts or components were on hand on April 18 or are acquired under a binding contract in effect on that date.

(4) Under the bill and committee amendments, an investment credit is also available where a person who has a pre-April 19 binding contract for property sells the property to a third person and leases it back. Under the bill and committee amendments, the credit is available where the binding contract was entered into before April 19, the property (or contract rights) involved is transferred to a third person, and a person who is a party to the binding contract retains the right to use the property under a lease. In this case, the other person succeeds to the position of the transferor with respect to the binding contract and the property. The lease can be for any term unless the lessor decides not to exercise his election to permit the lessee to claim the investment credit. In this latter case, the lease must be for a term of at least one year. Under the House bill, if the lessor retained the right to use the credit and the lessee subsequently lost the right to use the property, this would be treated as a disposition of the property by the lessor and would result in a recapture of the investment credit previously allowed to the lessor (where this occurs prior to the end of the useful life of the property used in determining the amount of the credit allowed). Under the committee amendments (which are substantially identical to the rule in the 1966 legislation temporarily suspending the investment tax credit), the application of this special recapture rule contained in the House bill is limited to situations which do not involve long-term leases. The committee amendments also extend this sale and lease back rule to situations where the property sold continues to qualify for the credit under the machinery and equipment rule rather than the binding contract rule. In addition, the committee amendments provide that a corporation which is affiliated with the seller of the property may lease the property back.

(5) The House bill and committee amendments also provide for situations where binding contracts or leases entered into before April 19 require the construction of machinery or equipment under the terms of the lease or contract arrangement even though these do not qualify under the binding contract rule summarized above. Under both versions of the bill where a binding lease or contract is in effect on April 18, the investment credit is to continue to be available in the case of this property. Where a project includes property in addition to that covered by a specific lease arrangement, this rule is to apply to the other property only if binding leases and contracts in effect on April 18 covered real property representing at least one-quarter of the entire project. The bill and committee amendments also cover cases of pre-April 19 binding contracts involving the construction or acquisition of property specified in an order of a Federal regulatory commission for which an application was filed before April 19. In these cases, the property must be used for the purpose of transporting one or more products to be purchased or sold under the contract, and one or more parties to the contract must have had commitments in existence on April 18 which in the aggregate require the taking or providing of more than 50 percent of the products to be transported over a substantial portion of the useful life of the property.

(6) The House bill and committee amendments provide that in

determining whether property is to be treated as acquired under a binding contract before April 19, certain transfers are to be disregarded. The type to be disregarded are transfers where it is appropriate for the transferee to "step into the shoes" of the transferor. These include cases where there is a transfer at death, a transfer to a corporation upon the liquidation of a subsidiary, a transfer to a controlled corporation, a transfer as a result of a tax-free corporate reorganization, a transfer to a partnership by a partner in exchange for an interest in the partnership, and a transfer by a partnership to a partner.

(7) Both versions of the bill make the investment credit available where property is acquired by a corporation which is a member of an affiliated group from another member of the group in whose hands it would qualify for the credit because of the construction, acquisition, or binding contract rules. In such a case, the property may be transfered to another member of the same group without losing the investment credit, even though that occurs after the effective date. The House bill also provides that a contract between members of an affiliated group is not to be treated as a binding contract even though it was entered into prior to April 19, 1969. The committee amendments accept this as a general rule but provide that the rule is not to apply if at all times after June 30, 1969 (and prior to the completion of the contract) the corporations no longer are members of the same affiliated group.

(8) Both versions of the bill also make the investment credit available where an ocean-going vessel (known as a mother ship) is eligible for the investment credit because of the binding contract rule (or otherwise) and this mother ship is designed to carry barges. In such cases, the House bill provides the barges are to be eligible for the investment credit, but not in a greater number than the number specified in the binding contracts with the Maritime Administration. The committee amendments modify this House provision somewhat. In the case of subsidized carriers, the credit is to be allowed for the number of barges specified in a pre-April 19 application for mortgage or construction loan insurance filed with the Secretary of Commerce. The investment credit is also to be available in the case of barges used by unsubsidized carriers where more than 50 percent of the barges the carrier plans to use otherwisc qualify under the binding contract or other transition rules.

(9) The House bill makes available the investment credit for certain new design projects where certain conditions are met. In these cases, under the House bill, the taxpayer must have undertaken before April 19 a project to produce a product of a new design, the binding contracts involved must be fixed price contracts (except for price escalation provisions relating to changes in pay rates) and the binding contracts must cover more than 60 percent of the entire production of the new design product to be delivered before 1973. This provision is applicable only where before April 19 more than 50 percent of all depreciable property required to be constructed or acquired to carry out the binding contracts either was under construction by the taxpayer, had been acquired by him, or was under a binding contract for construction or acquisition. (In applying this 50 percent test, productive items such as jigs, dies, and templates specifically designed for and only suitable for use in the manufacture

of the new design product are to be considered as property under a binding contract if they were described in written engineering and internal financial plans of the taxpayer in existence on that date.) The committee amendments modify this transition rule to provide that the fixed price binding contracts may allow for price changes due to material costs in addition to those due to pay increases, and by reducing from 60 percent to 50 percent the amount of the production of the new design products (to be delivered before 1973) which must be covered by binding contracts.

(10) The committee amendments (but not the House bill) provide an additional transitional rule under which the credit is to continue to be available in the case of property which a taxpayer must construct or acquire in order to carry out a pre-April 19, 1969, contract with a person who must take substantially all of the production from the property over its useful life. For this rule to apply, the property must be specified in a binding contract or must be extractive property with respect to which a series of special requirements are satisfied.

(11) The committee amendments (but not the House bill) provide that where a corporation purchases substantially all of another corporation's assets pursuant to a pre-April 19 binding contract, the purchasing corporation can "step into the shoes" of the other corporation for purposes of obtaining an investment credit with respect to its property and contracts.

(12) The committee amendments (but not the House bill) also include cases where under a binding lease or contract to lease entered into before April 19, a lessor or lessee is obligated to construct or acquire property specified in documents related to the lease or contract which were filed with a Federal regulatory agency before April 19. The property constructed or acquired by the lessor or lessee in such a case is to be eligible for the investment credit. A lease which is treated as a financing arrangement for other tax purposes will continue to be treated as a lease for purposes of this amendment.

(13) The committee amendments (but not the House bill) also make the investment credit available where the site of a plant facility was acquired before April 19 for the purpose of constructing a refinery and substantial expenditures for the acquisition of a pipeline in connection with the refinery occurred before April 19 and within one year after the date of acquisition of the plant site, the taxpayer commenced construction of the refinery. The investment credit is made available in such a case by considering the date of acquisition of the plant site as the date on which the construction or erection of the refinery commenced.

Other amendments made by the committee provide that recapture of investment credit upon early disposition of property is not to occur to the extent that the taxpayer replaces such property within a 6-month period after the disposition. An investment credit is not allowed in such circumstances, however, with respect to the replacement property. Relief from interest and penalties on payment of estimated tax is allowed where this results from understatement of tax because of the repeal of the credit.

W. AMORTIZATION OF POLLUTION CONTROL FACILITIES

Present law.—Under present law, a taxpayer may claim an investment credit with respect to pollution control facilities to the extent they involve property of a type generally eligible for the investment credit.

Problem.—There is a present need for industry to install facilities that will remove pollutants and contaminants from air and water discharged after use in production processes. Since termination of the investment credit will remove to some extent the financial offsets to the costs of these facilities, an alternative form of incentive may be viewed as desirable.

Finance Committee decision.—Under the House bill, a taxpayer would be allowed to amortize any certified pollution control facility over a period of 60 months. The amortization deduction would replace the depreciation deduction, but the additional first-year 20 percent depreciation allowance would still be available.

The committee amendments continue the concept of the House bill but limit the amortization deduction to pollution control facilities added to plants which were in operation on December 31, 1968. Thus, the special amortization provision is not to be available in the case of facilities included in new plants built in the future. The committee amendments further limit the 5-year amortization deduction by allowing it only for the proportion of the cost of the property attributable to the first 15 years of its normal useful life. Where a property has a normal useful life of more than 15 years, the taxpayer would in effect treat his facility as if it were two separate facilities. One facility (representing the portion of the total cost attributable to the first 15 years of useful life) would be eligible for the 5-year amortization. The other facility (the remaining cost) would receive regular depreciation based upon the entire normal useful life of the property. If the property has a normal useful life of 15 years or less, the total cost of the property would be eligible for the 5-year amortization.

Under the House bill, certified pollution control facilities generally are defined as that part of any depreciable property which is a separate identifiable treatment facility used to abate or control water or atmospheric pollution or contamination by removing, altering, disposing or storing of pollutants, contaminants, waste or heat and which is appropriately certified. The committee amendments provide that the definition of an eligible pollution control facility is to exclude facilities which serve any function other than pollution abatement. Moreover, they are not to include facilities that only diffuse the pollution as distinct from abating pollution. Thus, the amortization treatment will only be available in the case of installations which prevent or minimize the direct release of pollutants into the air or water in the course of manufacturing operations. Facilities which remove elements from fuel that would be released as pollutants when the fuel is burned would not be eligible for the amortization deductions.

Under the House bill and the committee amendments the amortization deduction is to be available only with respect to pollution control facilities which are certified by the appropriate State and Federal authorities. Under this requirement, it is necessary for the State authority to certify to the Federal authority that the facility has been constructed or acquired in conformity with a State program or requirements regarding the abatement or control of water or air pollution or contamination. Under the House provision, it is also necessary for the Federal authority to certify to the Treasury Department that the facility meets minimum performance standards (which must be promulgated by the Federal authority from time to time and which must take technological advances into account and specify the tolerance for such pollutants and contaminants as is appropriate); that it was in compliance with the applicable regulations of the Federal agencies; and that its operation was in furtherance of the general policies of the United States for cooperation with the States in the prevention and abatement of water and air pollution. Under the committee amendments, the Federal certifying authorities are not to establish national effluent standards for water or emission standards for air but rather are to set general guidelines for the standards to be specified by the States.

The committee provided that the 5-year amortization deduction for air and water pollution control facilities is only to apply to those placed in service before January 1, 1975.

The amendments made by this provision under both the House bill and the committee amendments apply to taxable years ending after 1968.

X. AMORTIZATION OF CERTAIN RAILROAD ROLLING STOCK, ETC.

Present law.—An investment credit is generally allowable with respect to railroad rolling stock. Under present depreciation guidelines, the useful life of rolling stock is 14 years.

Problem.—Since the enactment of the investment credit, the railroads have been able to increase their investment in new equipment and facilities to a considerable degree. The result has been a substantial contribution to modernizing railroad equipment, increasing railroad efficiency, reducing freight car shortages during seasonal periods of critical need, and improving the ability of railroads to finance acquisitions of new equipment.

Repeal of the investment credit may affect the ability of the railroads to continue their present investment programs at the same pace. Because of the importance to the economy of a healthy railroad industry and the existence of the present shortage of freight cars, it appears that an alternative form of incentive to encourage continuation of the present level of investment is needed. It is more appropriate to permit a rapid recovery of the costs involved, however, than to permit a return of more than total costs.

Finance Committee decision.—The House bill would have provided that a domestic common carrier railroad, subject to regulation by the Interstate Commerce Commission, could elect to amortize its rolling stock (other than locomotives) over a 7-year period. This treatment was to be available in the case of rolling stock acquired after July 31, 1969 (where its original use commenced with the taxpayer after that date). Rolling stock constructed by the taxpayer after that date also was to be eligible for the 7-year amortization provision.

The committee amendments substitute a broader provision for the provision contained in the House bill. Instead of 7-year amortization of new rolling stock, and in lieu of any special exception from the repeal of the investment credit, the committee amendments provide for 5-year amortization of new rolling stock including locomotives. This applies to rolling stock acquired (or constructed) after January 1, 1970. In addition, rolling stock acquired (or constructed) during 1969 is to be eligible for 4-year amortization to the extent of any unrecovered costs as of January 1, 1970. On January 1, 1973, the Secretary of the Treasury is to issue regulations indicating particular classes of cars or locomotives which are not in short supply. Rolling stock in these specific classes of cars or locomotives which is placed in service from that time on will not be eligible for the 5-year amortization writeoff.

The 5-year (or 4-year) amortization referred to above is to be available with respect to the rolling stock of all railroads, switching and terminal companies all of whose stock is owned by railroads and rolling stock of lessors who lease to railroads. This would include, for example, the Pacific Fruit Express and Fruit Growers Express Companies. The 5- (or 4-) year amortization provision is not available, however, in the case of rolling stock owned and used by companies other than railroads or rolling stock leased to companies other than railroads.

In addition, for purposes of the amortization provision, property placed in service at any time during 1970 is to be presumed to be placed in service on December 31, 1969. For subsequent years, the question of when the rolling stock is placed in service will depend upon the depreciation convention generally followed by the taxpayer.

The 5-year amortization provision under the committee amendments is to apply to qualified rolling stock placed in service before January 1, 1975. This will give Congress an opportunity at that time to review this amortization provision to see what, if any, changes or modifications may then appear desirable.

In the absence of action to the contrary, the fact that railroad rolling stock was amortized rather than subject to depreciation (with a 14-year life) would have an adverse effect on the extent to which railroads were considered as meeting the so-called reserve ratio test under the present Treasury regulations with respect to depreciation. To overcome this adverse effect, it is understood that the Treasury Department for 1969 and later years will take into account, for reserve ratio purposes, the acquisitions of rolling stock with respect to which the amortization election has been made. In other words, the amortization base will be considered as if it were in the appropriate depreciation schedule (in the absence of amortization) and the guideline reserve ratio test will be applied by including in the depreciation reserve a simulated amount reflecting the accumulated depreciation on such equipment if it had been depreciated on the basis of the guideline lives.

It is further understood that to the extent the 5-year (or 4-year) amortization deductions result in larger deductions than would be available under the depreciation schedules previously in effect, the railroads are expected to maintain a level of investment in, or maintenance of, rolling stock and other transportation facilities equal to the level of these larger deductions. Thus, the larger deductions are being allowed on the basis that they represent a larger annual level of replacement need for equipment necessary in order to sustain and improve railroad service to the public. The extent to which this level is achieved and maintained will be pertinent in deciding whether this provision should be extended at its expiration date on December 31, 1974.

This does not imply that there would be any specific tracing of funds or that the amount invested in transportation equipment need necessarily represent an increase over prior transportation equipment purchases but rather that railroads should, in general, attempt to see to it that their expenditures for purchases or maintenance of rolling stock and other transportation equipment facilities would, over a period of years, at least equal the level of deductions obtained as a result of the amortization deductions.

Rolling stock which, because of acquisition or construction before April 19, 1969 or because of the binding contract or other transition rules, is eligible for the investment credit in 1969, 1970 or later years is nevertheless to be eligible for the 5-year (or 4-year) amortization deduction writeoff. The useful life of the rolling stock for purposes of the investment credit is to be determined on the basis of the rolling stock's actual useful life and is not to be based upon the 5- (or 4-) year amortization period over which it is written off.

Recently, upon audit by the Internal Revenue Service, questions have been raised as to the treatment of repairs in the case of railroad rolling stock. It has been contended by some agents that repair of the rolling stock represents a capital improvement extending the 14-year guideline life of the rolling stock. To prevent this result in the case of railroad rolling stock, the committee amendments will treat the cost of repairs as an expense in all cases where such costs in any 12-month period do not exceed 20 percent of the unadjusted basis of the unit involved. This is not to be considered as a guideline, however, with respect to the repair of any other types of transportation equipment of other transportation companies or of other equipment generally. Nor will it constitute a limit on repair deductions for railroads; if amounts would otherwise be deductible as repairs, they will continue to be deductible even though the amount exceeds this limit.

The committee amendments also provide railroads with the option to amortize railroad gradings and tunnel bores on the basis of a 50-year life. Under present law, railroads capitalize these costs but have not been able to depreciate them because of uncertainties as to the length of their useful life. The railroad property which would be amortizable includes only improvements resulting from excavating (including tunneling), constructing embankments, clearing, diverting of roads and streams, sodding of slopes, and all similar work necessary to provide, construct, reconstruct, alter, protect, improve, replace, or restore a roadbed or right-of-way for railroad track.

The investment to be amortized in this case is the adjusted basis for determining gain. If the property was acquired before 1913, its basis for this purpose will be its value as of March 1, 1913. This value will be presumed to be the valuation made by the Interstate Commerce Commission or a comparable State regulatory body where appropriate. Either the railroad or the Internal Revenue Service may demonstrate that the March 1, 1913, value was different from such valuation, but the burden of proof will be on the party seeking to establish the different amount. Property purchased or constructed after February 28, 1913, would be amortized on the basis of the taxpayer's cost.

The amortization for railroad grading and tunnel bores is to begin with taxable years beginning on or after January 1, 1970.

Y. ADJUSTMENT OF TAX BURDEN FOR INDIVIDUALS

1. Increase in Standard Deduction

Present law.—Under present law, a taxpayer in computing taxable income may itemize his deductions, or may take the larger of the minimum standard deduction or the 10 percent standard deduction. The minimum standard deduction is $200 plus $100 for each exemption, and the regular standard deduction is 10 percent of adjusted gross income. Both forms of the standard deduction are limited to $1,000 ($500 in the case of a married individual filing a separate return).

Problem.—The 10 percent standard deduction was introduced in 1944 to reduce the complexity of the income tax for the vast majority of taxpayers. Instead of keeping records of deductible personal expenditures and itemizing deductions on their tax returns, more than 82 percent ot taxpayers were able to use the simpler standard deduction when it was first introduced. Since that time, higher medical costs, higher interest rates, higher State and local taxes, increased homeownership, and more expensive homes have encouraged more and more taxpayers to itemize their deductions. In addition, itemization has been encouraged by rising incomes which have moved more and more taxpayers beyond the $10,000 income level where the $1,000 standard deduction ceiling first becomes applicable. The effect of higher incomes and increased expenses has been to decrease the proportion of returns using the standard deduction from 82 to 58 percent.

Finance Committee decision.—Both the House bill and the committee amendments increase the present 10 percent standard deduction with a $1,000 ceiling to a 15 percent standard deduction with a $2,000 ceiling. Both versions of the bill provide that the standard deduction is to be 13 percent with a $1,400 ceiling in 1970, 14 percent with a $1,700 ceiling in 1971, and finally 15 percent with a $2,000 ceiling in 1972 and for subsequent years.

Nearly 34 million returns will benefit as a result of this increase in the standard deduction. This constitutes slightly more than half of all taxable returns. As a result of this change alone, some 8.7 million taxpayers presently itemizing their deductions or 27 percent of the total can be expected to shift to the standard deduction, raising the proportion of taxpayers using this deduction from 58 percent to nearly 70 percent. This is without regard to the impact of the low-income allowance described below.

2. Low-Income Allowance

Present law.—The minimum standard deduction is $200 plus $100 for each personal exemption up to a total of $1,000.

Problem.—Inflationary price increases have had their most severe impact in the erosion of the already inadequate purchasing power of the poor. In addition, recent studies of the economic conditions of the poor by the Department of Health, Education, and Welfare have indicated that, even with the present minimum standard deduction, many persons with incomes below the poverty level are subject to tax and in addition, substantial tax burdens are imposed on those with incomes immediately above the poverty levels. At the present time there still are some 5.2 million taxable returns at or below the recognized poverty levels.

Finance Committee decision.—Over a period of three years (two years in the House bill), the committee amendments revise the present minimum standard deduction of $200 plus $100 for each exemption (with a total of up to $1,000) to a flat $1,100 minimum standard deduction for all returns (except that this amount is to be $550 in the case of a husband and wife filing separate returns).

The new minimum standard deduction or low-income allowance consists of a "basic allowance" (the former minimum standard deduction) and an "additional allowance". The basic allowance amounts to $200 plus $100 for each personal exemption up to a total of $1,100.

The "additional allowance" for 1970 (and 1971 under the committee amendments) adds a sufficient amount to the basic allowance (in the case of families with 8 or fewer exemptions) so that the total tax-free income level apart from personal exemptions in the case of each family is $1,100. In the case of a single person, this means that there is a $300 basic allowance plus an $800 additional allowance; in the case of a family unit of 2 members, the amount added to the $400 basic allowance is $700. As the amount of the basic allowance increases (by $100 for each exemption) the additional allowance added by the bill, in order to maintain a uniform $1,100 of tax-free income per family unit, decreases by $100. As a result, the differentiation as to starting tax levels for different size family units is to be based entirely on the difference in number of $600 exemptions available to a family unit. This is approximately in accord with the analysis of poverty levels for families of different sizes made by HEW which indicates that the poverty level increases by approximately $600 above a base $1,100 amount for each additional person in a family unit.

For 1970 (and 1971 under the committee amendments), the additional allowance provided by the bill is "phased out" as the income of the taxpayer increases. In 1970, for each $2 of additional adjusted gross income above the nontaxed poverty level ($1,100 plus $600 for each exemption), the additional allowance is decreased by $1. Thus, the $800 additional allowance made available in the case of single persons gradually is eliminated as income rises above $1,700 and terminates at an income level of $3,300 (an income span of $1,600). In 1971, under the committee amendments (but not under the House bill), the additional allowance is decreased by $1 for every $15 of additional income above the non-taxable level. Thus, for a single person the reduction of the additional allowance begins at $1,700 and ends at $5,872 (above that level he would find the 14-percent standard deduction available in that year worth more than the remaining low-income allowance). In 1972 under the committee amendments and in 1971 under the House bill the phaseout no longer applies.

Both versions of the bill provide that married couples filing separate returns in 1970 and 1971 generally are not to have the benefit of the additional allowance provided by the bill. However, to provide for the case of a family abandoned by one of the parents both versions of the bill specify that a married individual, under certain conditions, may obtain the full low income allowance even though not filing a joint return. In addition, such an individual when electing the percentage standard deduction may deduct an amount up to the full ceiling rather than only up the ceiling provided for married individuals filing separately and may also use the tax rates for head of household. This result is obtained by treating such an individual as if she or he were a "head of household". To qualify for this status the individual must not file a joint return, but must maintain a household which is the principal place of abode of one or more dependents. The dependent in question must be a son or daughter (or step-son or step-daughter) for which the individual is entitled to a dependency exemption. The individual must furnish more than half the cost of maintaining the household and during the entire taxable year the individual's spouse must not be a member of the household in question.

Approximately 11.8 million returns will benefit in 1970 from the low income allowance and 5.2 million will become nontaxable. In 1972, when the phaseout is no longer applicable, 36.8 million taxpayers are expected to benefit from the $1,100 minimum standard deduction of which 5.5 million are expected to become nontaxable over the period. In addition, 5.7 million are expected to shift from itemized deductions to the standard deduction, in response to the low income allowance.

The low income allowance with the $1 for $2 phaseout is to be effective for both the House bill and the committee amendments for taxable years beginning after December 31, 1969. Under the committee amendments, the low income allowance with the $1 for $15 phaseout is to be effective for taxable years beginning after December 31, 1970 and the low income allowance (or minimum standard deduction) without the phaseout is to become fully effective for taxable years beginning after December 31, 1971. Under the House bill the phaseout would have been completely eliminated one y:ar earlier at the end of 1970.

3. Tax Treatment of Single Persons

Present law.—Since the Revenue Act of 1948, married couples filing joint returns have had the option of being taxed under the split- income provision. This, in effect, taxes a married couple as if it were composed of two single individuals each with one-half the couple's combined income. This 50–50 split of income between the spouses for tax purposes generally produces a lower tax than any other division of income since the application of the graduated tax rates separately to each of the two equal parts comprising the couple's income keeps the total income in lower tax brackets.

Single people generally do not have a comparable income splitting privilege. As a result they pay higher taxes than married couples at the same income levels.

In 1951, a head-of-household provision was enacted to grant partial income-splitting to widows, widowers, and single persons with dependents in their households. Individuals who qualify under this provision are allowed approximately one-half of the income-splitting benefits given to married couples. These heads of household use a different tax rate schedule which, at any given level of income, produces a tax liability about halfway between the tax paid by a married couple filing a joint return and a single individual.

Beginning in 1954 surviving spouses with dependent children were permitted to use the joint return tax rates with full income splitting for two taxable years following the year of death of the husband or wife.

Problem.—Under present law, the tax rates imposed on single persons are quite heavy relative to those imposed on married couples at the same income level; a single person's tax is as much as 40.9 percent higher than the tax paid on a joint return with the same amount of taxable income. Some difference between the rate of tax paid by single persons and joint returns appears appropriate to reflect the additional living expenses of married taxpayers but the existing differential of as much as 41 percent (the result of income splitting) cannot be justified on this basis.

Finance Committee decision.—The Finance Committee amendments provide a new, lower, rate schedule for single persons (as well as a new regular schedule and head-of-household rate schedule). This rate schedule is designed to provide tax liability for single persons which is 17 to 20 percent above that for married couples for taxable incomes of between $14,000 and $100,000, with the maximum differential of 20 percent being reached for an income level at $20,000. (At present the difference can be as great as 40 percent.) Below $14,000, where income splitting is less beneficial the excess of single persons' rates over those of married couples gradually decrease. This is also true above $100,000 again where the benefits of income splitting become less significant. A new rate schedule is also provided for heads-of-households which is one-half way between the new rate schedule for single persons and the rate schedule for married couples. The present rate schedule for single persons is maintained for married couples filing separate returns and for estates and trusts.

The new rate schedule for single persons is a different type of approach than that taken in the House bill. Under the House bill, widows and widowers, regardless of age, and single persons age 35 and over were permitted to use the head-of-household rate schedule which provides tax liability half-way between that of the regular rate schedule used by single persons and the joint return schedule.

The House bill also would have extended the joint return privilege for surviving spouses as long as they had dependent children under age 19 or attending school or college. Under present law, they have the benefits of full income splitting only for the first two years after the death of the spouse. Under the committee amendments, they will use the head-of-household rate schedule after their joint return privilege expires (two years after the year of the spouse's death) as long as they continue to support a dependent.

The new rate schedule for single persons is effective in two stages with approximately one-third of the rate reductions taking place in 1971 and the remaining two-thirds in 1972 (as is also the case with the general rate reduction).

4. Individual Income Tax Rates

Present law.—Present law tax rates range from 14 percent to 70 percent on taxable income in excess of $100,000 for a single taxpayer and $200,000 for a joint return (see the rate schedule below).

Problem.—The present tax rates are considered by many to be too high. They take a large portion of the income from those subject to the full impact of the rates. Such high rates also encourage many taxpayers to shelter their income from the top rates by using tax avoidance techniques which have frequently developed into tax loopholes.

Finance Committee decision.—The House bill and committee amendments provide the same rate reductions, applicable in 1972. The tax rates are reduced by at least one percentage point in all brackets, the reduction varying in the different brackets so as to produce a reduction of tax of 5 percent or more in all brackets. Thus, for example, the top rate is reduced from 70 percent to 65 percent.

Both the House bill and the committee amendments provide that the rate reduction is to take place in two stages in 1971 and 1972. The committee amendments, however, in order to reduce the fiscal impact of the large revenue loss in 1971, provide a lesser rate reduction in that year than does the House bill. The House bill provides the rate reduction evenly between 1971 and 1972. The committee amendments provide for approximately ⅓ of the rate reduction to occur in 1971 and the remaining ⅔ of it to occur in 1972. The rate schedule, under present law, under the House and Finance committee bill for 1971 and the rate schedule under both bills for 1972 is shown in the table below:

INDIVIDUAL INCOME TAX RATE SCHEDULE FOR MARRIED TAXPAYERS UNDER PRESENT LAW, UNDER HOUSE AND SENATE FINANCE COMMITTEE BILLS FOR CALENDAR YEARS 1971 AND 1972

Taxable income bracket		Tax rate (percent)			
			1971		1972
Married (separate)	Married (joint)	Present law	House bill	Senate Finance Committee bill	House and Senate Finance Committee bill
$0 to $500	$0 to $1,000	14	13.5	13.6	13
$500 to $1,000	$1,000 to $2,000	15	14.5	14.6	14
$1,000 to $1,500	$2,000 to $3,000	16	15.5	15.6	15
$1,500 to $2,000	$3,000 to $4,000	17	16.5	16.6	16
$2,000 to $4,000	$4,000 to $8,000	19	18.5	18.6	18
$4,000 to $6,000	$8,000 to $12,000	22	21.5	21.7	21
$6,000 to $8,000	$12,000 to $16,000	25	24	24.4	23
$8,000 to $10,000	$16,000 to $20,000	28	27.5	27.6	27
$10,000 to $12,000	$20,000 to $24,000	32	31	31.3	30
$12,000 to $14,000	$24,000 to $28,000	36	35	35.3	34
$14,000 to $16,000	$28,000 to $32,000	39	38	38.3	37
$16,000 to $18,000	$32,000 to $36,000	42	41	41.3	40
$18,000 to $20,000	$36,000 to $40,000	45	43.5	43.9	42
$20,000 to $22,000	$40,000 to $44,000	48	46	46.5	44
$22,000 to $26,000	$44,000 to $52,000	50	48.5	48.9	47
$26,000 to $32,000	$52,000 to $64,000	53	51	51.5	49
$32,000 to $38,000	$64,000 to $76,000	55	52.5	53.1	50
$38,000 to $44,000	$76,000 to $88,000	58	55	55.8	52
$44,000 to $50,000	$88,000 to $100,000	60	57	57.8	54
$50,000 to $60,000	$100,000 to $120,000	62	60	60.5	58
$60,000 to $70,000	$120,000 to $140,000	64	62	62.5	60
$70,000 to $80,000	$140,000 to $160,000	66	63	63.8	60
$80,000 to $90,000	$160,000 to $180,000	68	64.5	65.4	61
$90,000 to $100,000	$180,000 to $200,000	69	65	66.0	61
$100,000 to $120,000	$200,000 to $240,000	70	66	67.0	62
$120,000 to $150,000	$240,000 to $300,000	70	66.5	67.4	63
$150,000 to $200,000	$300,000 to $400,000	70	67	67.8	64
$200,000 and over	$400,000 and over	70	67.5	68.1	65

Note: Under present law the taxable income brackets and rates shown for married taxpayers filing seperate returns are also applicable to single persons.

The first stage of the rate reduction under both the House bill and the committee amendments is applicable for taxable years beginning after December 31, 1970, and the full reduction is made applicable for taxable years beginning after December 31, 1971. In the case of fiscal years straddling these two dates the proration formula generally applicable to rate reductions applies.

5. Collection of Income Tax at Source on Wages

Present law.—Present law provides withholding tables and a percentage withholding method which incorporates the $600 personal exemption, the minimum standard deduction, the 10 percent standard deduction, and the tax rates.

Finance Committee decision.—The House bill requires the Internal Revenue Service to prescribe, and the committee amendments include in the bill, new withholding rates and tables incorporating: the low income allowance (with the phaseout) and the 13 percent standard deduction (with the $1,400 ceiling) for 1970; the low income allowance (with the phaseout), the 14 percent standard deduction (with a $1,700 ceiling) and the new tax rates for 1971; and the low income allowance (without the phaseout), the 15 percent standard deduction (with the $2,000 ceiling) and the fully reduced tax rates for 1972.

There are no comparable provisions in the House bill.

These provisions apply to wages paid after December 31, 1969, or the 15th day after enactment, whichever is later.

6. Provision for Flexibility in Withholding Procedures

Present law.—Under present law employers are limited in methods of computing wage withholding to the withholding tables or percentage methods specified in the code or essentially equivalent methods. They are permitted to withhold on the basis of average wages paid within a calendar quarter but present law does not permit them to use average wages over a longer period.

Problem.—Employers in some cases have devised withholding methods, frequently in conjunction with computerized payroll operations, which produce approximately the same amount of withholding as the regular methods but are substantially easier for employers to administer. The Internal Revenue Service has no authority to permit employers to use such methods. There also are a number of types of employment situations where the existing permissible withholding methods do not accurately match tax liability and tax withheld. This is true, for example, where wage payments vary significantly in size from one pay period to another.

Finance Committee decision.—The committee amendments permit employers to use any withholding method which results in substantially the same amount of withholding as the regular methods. The amendments also permit the employers to "annualize" wage payments for withholding purposes. In addition, the bill provides that where wage payments are quite irregular, withholding can be provided on the basis of cumulative wages and cumulative withholding.

This provision is to apply for wages paid after December 31, 1969.

7. Additional Withholding Allowances for Excess Itemized Deductions

Present law.—Under present law taxpayers with estimated itemized deductions which exceed the level of deductions on which withholding is based may claim additional exemptions for withholding tax purposes for each $700 of itemized deductions above a threshold level (10 percent of the first $7,500 of estimated wages plus 17 percent of any remainder). The estimated itemized deductions in this case may be no larger than the actual itemized deductions for the prior year.

Problem.—The requirement that the estimated itemized deductions be no larger than actual deductions for the preceding year prevents the provision from operating in the first year in which a taxpayer has excess itemized deductions although their existence is clear. Problems also arise where the itemized deductions exceed the threshold level by less than $700 but nevertheless give rise to overwithholding. Moreover, with the increase in the standard deduction percentage from 10 to 15 percent, the 10 percent threshold level needs to be increased.

Finance Committee decision.—The committee's amendments eliminate the prior year's requirement for excess itemized deductions in cases where the excess itemized deductions are substantiated by a court order (such as one providing for payment of alimony) or by other evidence clearly verifying their existence. The amendments also provide that an additional withholding allowance is to be permitted for excess itemized deductions of more than $300. In addition, the amendments raise the percentage threshold for determining excess itemized deductions to conform to the higher standard deduction provided by both versions of the bill. The 10 percent applicable to the first $7,500 is increased to 15 percent and this is applied to all estimated wages and not merely the first $7,500.

There is no comparable House provision.

This provision is to be effective for taxable years beginning after December 31, 1969.

8. Certification of Nontaxability for Withholding Tax Purposes

Present law.—Present law does not excuse employees from withholding on their wages or salaries if their incomes during the period of their employment are above specified levels even though they know, for other reasons, that they will have no tax liability for the year.

Problem.—The difficulty with the present withholding system is that individuals who work only part of a year have tax withheld on their wages even though they may have no tax liability for the entire year. This requires these employees to file a tax return and claim a refund for this excess withholding. This represents a problem, especially for students who work part time during the summer but whose income falls below the new levels at which tax begins. This is a substantially higher level than under present law because of the low income allowance. In addition, the withholding rates and tables are based on the assumption that the taxpayer does not have large itemized deductions (except for a special provision discussed below). As a result some taxpayers with large deductions also find themselves in a nontaxable status even though there may have been significant withholding in their cases.

Finance Committee decision.—The committee amendments provide that an individual is not to be subjected to withholding of income tax if he certifies to his employer that he expects to have no Federal income tax liability for the current year and, in fact, had no income tax liability in the prior year.

This certification provision could relieve as many as 10 million persons from overwithholding and having to file a return only for the purpose of obtaining a refund. No comparable provision is in the House bill.

This provision will apply after April 30, 1970.

9. Withholding on Supplemental Unemployment Benefits

Present law.—Under present law supplemental unemployment benefits are not subject to withholding because they do not constitute wages or remuneration for services.

Problem.—Supplemental unemployment compensation benefits (SUB) paid by employers are generally taxable to the recipient. As a result in the absence of witholding these benefits may require a significant tax payment by the recipient.

Finance Committee decision.—The committee amendments require the payor of taxable supplemental compensation benefits to withhold Federal income tax from these payments. These are benefits paid to an employee, under a plan to which the employer is a party, which are paid because of the employee's involuntary separation from employment as a result of a reduction in force, the discontinuance of a plant or operation or similar conditions. This provision was not in the House bill.

This provision applies to such payments made after June 30, 1970.

10. Voluntary Withholding on Payments Not Defined as Wages

Present law.—Present law specifically excludes certain types of remuneration from the definition of wages and makes no provision for withholding in such cases. Voluntary withholding is unavailable under present law in such cases even though the payments are received from a person constituting an employer and both the employer and employee agree to the additional withholding. Moreover, withholding is not authorized in the case of annuities and other non-wage type payments even though withholding would be desirable in many cases.

Problem.—The inability of a person to have tax withheld on the remuneration he receives means that he may have a substantial and possibly burdensome final tax payment. This often occurs, for example, in the case of persons receiving retirement income or income from annuities and also in the case of earnings of farm and domestic workers. Where the recipient of the payment desires to have tax withheld, it is difficult to see why this should not be done.

Finance Committee decision.—The committee amendments direct the Secretary of the Treasury to issue regulations which prescribe rules for employer withholding on payments for pensions and annuities when an employee or recipient requests such withholding. If an employee or other recipient requests withholding on these payments the employer or payor would be required to comply with the request. In the case of other payments an employer or payor would be permitted to withhold where both the employer and employee (or payor and payee) agree to such withholding.

No such provision is in the House bill.

This provision applies to such payments made after June 30, 1970.

Z. MISCELLANEOUS INCOME TAX PROVISIONS

1. Qualified Pension, Etc., Plans of Professional Corporations

Present law.—Under present law, the amounts which self-employed individuals can set aside annually on a tax-free basis for pensions in a qualified plan is limited to 10 percent of the individual's earned income not to exceed $2,500. These are the limitations imposed with respect to the so-called H.R. 10 type pension plans. In the case of employees in a corporation, however, there are no specific limitations as to the amounts which may be set aside to fund their pensions under qualified plans which do not discriminate as to benefits and coverage in favor of high-paid employees, shareholders or officers of the company.

Generally, lawyers, doctors, accountants and certain other professional groups in the past have been unable to carry on their professions through the form of corporations because of the personal nature of their responsibility or liability for the work performed for a client or patient. In recent years, however, most States have adopted special incorporation laws which provide for what are generally known as "professional corporations." These have been used increasingly by groups of professional persons, primarily to obtain the more favorable tax treatment for pensions generally available to corporate employees. The Treasury Department in the so-called Kintner regulations held that professional corporations were not taxable as corporations partly because of the personalized responsibility or liability maintained in the case of shareholders with respect to their clients or patients. Recent court cases, however, have overturned the regulations and the Service has now acquiesced and generally recognizes these professional corporations as corporations for income tax purposes.

Problem.—Congress, in passing the H.R. 10 pension legislation, made it clear that it intended to impose limitations as to the amount which may be set aside on a tax-free basis for subsequent pension payments to self-employed persons. The formation of professional corporations, while maintaining the personal relationship between the shareholder-employee and the patient or client, has had the effect of indirectly overcoming the limitations Congress intended to impose with respect to deductible amounts which may be set aside for pensions in these cases. It is recognized that there are disparities in the treatment of self-employed individuals and corporate employees with respect to pension plans, and that this problem needs attention. These disparities are being studied and the Treasury and staffs are expected to report back with suggestions on these problems. In the meanwhile, however, it would appear inappropriate to permit what are essentially, in most respects, self-employed persons to avoid the pension limitations prescribed by Congress.

Finance Committee decision.—The committee amendments provide that shareholder-employees of a professional service organization are to include in their gross income the amounts of contributions paid on their behalf which are deductible under qualified pension, profit-sharing and stock bonus plans under the Internal Revenue Code (sec. 404(a)(1), (2) or (3)), to the extent that these amounts exceed 10 percent of the compensation received by the shareholder-employee from the organization, or $2,500, whichever is less. In addition, forfeitures allocated to the shareholder-employees' account under stock bonus or profit-sharing plans are required to be included in gross income. Where an individual is covered by plans of more than one organization, the Secretary of the Treasury or his delegate, by regulations, is to aggregate the contributions paid on his behalf in making the computations referred to above.

The amounts included in the shareholder-employee's gross income under this provision are to be treated as a part of his consideration or cost for the pension, profit-sharing or stock bonus plan when the plan benefits are subsequently received by him so that the same amounts will not be taxed twice. If the rights of the shareholder-employee, under a plan to which this provision applies, terminate before he receives sufficient payments to cover the amounts which he previously included in gross income, he is permitted to deduct these amounts in the year in which his rights under the plan terminate.

The term "professional service organization" under this provision means any corporation or association in which the beneficial ownership, or control, is limited under State or local law, or rules of professional ethics, to individuals who are required to be licensed or otherwise authorized under State or local law to perform professional services necessary to carry on the trade or business in which the corporation or association is engaged. This provision also covers the executor or administrator of a person described above. A shareholder-employee is an employee of a professional service organization who owns a beneficial interest in such an organization.

There is no comparable House provision.

This provision applies to taxable years beginning after December 31, 1969.

2. Amounts Received Under Insurance Contracts for Certain Living Expenses

Present law.—Under present law, a person whose residence is damaged or destroyed by fire, storm, or other casualty, and who must temporarily find another residence while his home is being repaired must declare any insurance payments received to cover the additional living expenses as taxable income.

Problem.—In the type of situation described above, few if any persons regard the insurance payments received as "income," since the payments merely reimburse the taxpayer for a period of time for the loss of the use of property he had. In addition, taxing the insured on the reimbursement in this case means that he has had a net loss on the overall transaction.

Finance Committee decision.—The committee amendments in the case of an individual whose residence is damaged or destroyed by fire, storm or other casualty, provide that gross income does not include amounts received under an insurance contract for reimbursement for living expenses incurred by him and members of his household as the result of the loss of use or occupancy of a residence.

The amendments allow the exclusion only to the extent that the amounts received do not exceed the excess of the actual living expenses incurred by the taxpayer (for himself and members of his household) resulting from the loss of the use of the residence over the normal living expenses which would have been incurred by the taxpayer (for himself and members of his household) during this period.

No comparable provision is contained in the House bill.

This provision applies to amounts received on or after January 1, 1969.

3. Deductibility of Treble Damage Payments, Fines, Penalties, etc.

Present law.—At present, there is no statutory provision setting forth a general "public policy" basis for denying deductions which are "ordinary and necessary" business deductions. Nevertheless, a number of business expenses have been disallowed on the grounds that the allowance of these deductions would be contrary to Federal, State or other clearly defined "public policy." This has been true, for example, in the case of certain fines.

Questions have been raised as to whether deductions should be allowed for damages paid to a private party in a cause of action in which the successful party is entitled to damages in a greater amount than the economic loss demonstrated by him. Under section 4 of the Clayton Act, for example, a person injured by an an antitrust violation may sue for damages and recover three times the amount of economic loss established. The Internal Revenue Service has held that amounts paid or incurred in satisfaction of treble damage claims under that Act are deductible as ordinary and necessary business expenses.

Problem.—The question as to whether antitrust treble damage payments should be deductible must be viewed from the standpoint of antitrust policy and from the standpoint of tax policy. From the standpoint of antitrust policy, the basic issue is the extent to which the extra damage amounts are designed to constitute a penalty on the violator. Denying a deduction is one way of assuring that the treble damage penalties with respect to violations of the antitrust laws are not diluted by permitting them to reduce taxes otherwise paid.

From the standpoint of tax policy, there generally has been a reluctance to deny a deduction for business expenses on the grounds that this departs from the concept of a tax imposed on actual net business income. There still remains, however, the question as to what is an ordinary and necessary business expense. The Supreme Court in the *Tank Truck Rental* case, for example, in holding that the payment of fines could not be considered as ordinary and necessary, stated:

> A finding of "necessity" cannot be made, however, if allowance of the deduction would frustrate sharply defined national or State policies proscribing the particular types of conduct evidenced by some governmental declaration thereof.

On the same grounds, it appears appropriate to deny deductions for bribes, illegal kickbacks, and the penalty portion of antitrust treble damage payments. A 1958 amendment to the Internal Revenue Code applicable to bribes of foreign officials already suggests such a Congressional policy. At present, no deduction may be taken for payments to officials or employees of a foreign government, if in the United States such payments would be unlawful.

Finance Committee decision.—The Finance Committee bill codifies the court position that deductions are not to be allowed for fines or similar penalties paid to a government for the violation of any law.

The bill also denies deductions for three other types of expenditures: treble damage payments under the antitrust laws, deductions for bribes of public officials (whether or not foreign officials), and other unlawful bribes or "kickbacks." The codification of the rule denying deductions for payments in these situations which are deemed to violate public policy is designed to be all-inclusive. Thus, public policy generally will not be deemed to be sufficiently clearly defined in other circumstances to justify disallowance of deductions. The bill does not deal with lobbying expenditures which are already covered by an Internal Revenue Code provision (sec. 162(e)) added by section 3 of the Revenue Act of 1962.

In the case of two of the new categories, amounts are to be denied as deductions only when the expenditure or an associated expenditure arises out of a conviction in a criminal proceeding. Under the committee amendment, there would have to be a conviction in a criminal prosecution (or a plea of guilty or nolo contendere) before deductions would be denied for treble damage payments under the antitrust laws. This is also true of the provisions relating to bribes and kickbacks of other than public officials. Denial of the deduction for the payments in these cases can be justified on the grounds that the deduction would clearly frustrate a sharply defined public policy.

In addition to denying a deduction in the case of antitrust payments and bribes and kickbacks, the amendments also cover other related payments. They also cover, for example, situations where only a few out of a series of related actions give rise to specific indictments. This policy of covering only those cases where there is a criminal conviction in a related case means that the denial of deduction will only occur in the case of "hard-core violations" where intent has been clearly proved in a criminal proceeding. It is believed, however, that illegal bribes and kickbacks with respect to public officials are in a different category and that these in all events should be denied as deductions. Such treatment is by statute already accorded bribes of or kickbacks to foreign governmental officials or employees.

In the case of treble damage payments under the antitrust laws, the denial of the deduction is limited to two-thirds of the amount paid or incurred. The remaining one-third would continue to be deductible on the grounds that it represents a restoration of the amount already owing to the other party. The denial of the deduction in this case applies not only to judgments for damages against the taxpayer under the antitrust laws but also for settlements of any actions brought under these laws.

The amendments are made applicable only with respect to amounts paid or incurred after December 31, 1969. In addition, in all cases where nondeductibility depends upon a criminal conviction, only criminal convictions after 1969 are to be taken into account. A conviction following a trial occurring after December 31, 1969, is to be treated as occurring before that date if the trial follows an appeal which resulted from a conviction following an earlier trial concluded before that date.

4. Deductibility of Accrued Vacation Pay

Present law.—Taxpayers on the accrual basis generally deduct vacation pay in the year of the accrual. Under present rules, vacation pay is considered to be accruable only after liability to a specific person has been clearly established, the amount of liability can be computed with reasonable accuracy and the accrued amount will not be forfeited by termination of employment or other cause. A taxpayer may not change his method of handling vacation pay without first obtaining the Treasury Department's approval since such a change would constitute a change of accounting methods.

The ruling setting forth the Treasury policy outlined above was initially made applicable to taxable years ending on or before June 30, 1955. Subsequently, the effective date of this ruling was postponed until January 1, 1959. Congress since that time has by successive actions postponed the application of this ruling for years up to taxable years ending before January 1, 1969.

Problem.—The implementation of Revenue Ruling 54–608 requires the denial of a deduction in any year where the accrual of vacation pay has not been clearly fixed with respect to specific employees. Nevertheless, it would place some taxpayers in a hardship position. The problem arises with respect to those taxpayers who have been accruing vacation pay under plans which do not meet the requirements of the strict accrual rules set forth in this ruling. For such taxpayers to elect the ruling to go into effect would mean one year in which they receive no deduction for vacation pay (since the current year's vacation pay deductions were accrued in the prior year and the next year's vacation pay does not meet the tests of accrual of this ruling). Congress has asked that this problem be studied and that permanent legislation be prepared. For this an additional 2-year period is needed.

Finance Committee decisions.—The committee's amendments postpone for two years the effective date of Revenue Ruling 54-608. As a result, deductions for accrued vacation pay, if computed by an accounting method consistently followed by the taxpayer, will not be denied for any taxable year ending before January 1, 1971 solely because the liability to a specific person for vacation pay cannot be clearly estimated or the amount computed with reasonable accuracy.

No comparable provision is contained in the House bill.

This provision is applicable for taxable years ending before January 1, 1971.

5. Banks for Cooperatives

Present law.—Under present law the thirteen existing banks fo- cooperatives are not allowed the same bad debt reserve deduction as commercial banks because they do not receive deposits and, therefore, are not treated as banks under Internal Revenue Service rulings, nor are these banks allowed any different net operating loss carrybacks than regular corporations. In other words, they are allowed a 3-year carryback of net operating losses and a 5-year carryforward.

Problem.—The problem in giving the banks for cooperatives the bad debt reserve treatment available for commercial banks is that to date they apparently have had no bad debts, since their customers, the cooperatives, have apparently met all their payments. On the other hand, it is, of course, possible that in the case of a downturn in the economy at some future time, substantial losses might occur. Such situations could be provided for by a 10-year net operating loss carryback for these banks. This would appear to provide adequately for any bad debts which these banks might sustain.

Finance Committee decision.—The committee amendments provide that banks for cooperatives are to have a 10-year net operating loss carryback, in addition to the 5-year carryforward now available in the case of operating losses.

No such provision is contained in the House bill.

This amendment applies to taxable years beginning after the date of enactment of this bill.

6. Deduction of Recoveries of Antitrust Damages, etc.

Present law.—Taxpayers sometimes recover substantial damages due to a patent infringement, a breach of fiduciary duty, or an antitrust injury to which section 4 of the Clayton Act applies many years after the injury was sustained. The damages are at that time includible in taxable income.

Problem.—Difficulty arises from the fact that the original losses may have resulted in no income tax benefit because, due to insufficient income from other sources, the net operating loss carryovers expired before it was possible to offset them against other income. As a result, in some cases taxpayers are required to include damages in income although the losses which they replace may not have resulted in a tax benefit.

Finance Committee decision.—The committee amendments provide that in the case of losses resulting from a patent infringement, a breach of contract, a breach of fiduciary duty, or an antitrust injury for which there is a recovery under section 4 of the Clayton Act, a special deduction is to be allowed which has the effect of reducing the amounts required to be included in income to the extent that the losses to which they relate did not give rise to a tax benefit. This result is accomplished by providing, in effect, that the amount includible in gross income is to be the compensatory amount reduced by the amount of the unrecovered losses sustained as a result of the compensable injury.

The compensatory amount as used here means the amount of the award, settlement, or recovery reduced by the amounts paid or incurred in securing it. The unrecovered losses are the net operating losses for the year to the extent the losses are attributable to the compensable injury, reduced by the net operating losses which are allowed as offsets against income in other years. Where a net operating loss is only partially attributable to a compensable injury sustained during a year, the compensable injury portion is to be considered the portion of the loss which is last used as an offset against income in other years.

The provision applies only to recoveries for actual economic injury and not for additional amounts. In the case of treble damage recoveries under section 4 of the Clayton Act, for example, the provision applies to the ⅓ of the recovery which represents the economic injury and not to the other ⅔ of the recovery which are punitive in nature.

There is no comparable provision in the House bill.

The committee amendments apply to compensatory amounts received in taxable years beginning after December 31, 1968.

7. Corporations Using Appreciated Property to Redeem their Own Stock

Present law.—Present law (sec. 311 of the code) provides that with few exceptions gain or loss is not recognized to a corporation if it distributes property with respect to its stock either when the distribution is a dividend (sec. 301) or when it is in redemption of stock (sec. 302, 303 or 304).

Problem.—Recently, large corporations have redeemed very substantial amounts of their own stock with appreciated property and in this manner have disposed of appreciated property for a corporate purpose to much the same effect as if the property had been sold and the stock had been redeemed with the cash proceeds of the sale.

This device has been used extensively by insurance companies which have large investment portfolios of stock of other companies acquired some time ago at prices appreciably below present values. They have been buying back their own stock through a general offer to their shareholders to exchange stock for their portfolios investments. The Internal Revenue Service has ruled such exchanges to be tax free to the insurance company. The insurance companies then retire the stock they have purchased back, thereby increasing their per-share earnings, or instead of retiring stock may later use it to acquire stock of other companies.

Finance Committee decision.—The committee amendments provide that if a corporation distributes property to a shareholder in redemption of part or all of his stock and the property distributed to him has appreciated in value in the hands of the distributing corporation, then gain is to be recognized to it to the extent of this appreciation. This provision applies whether or not the redemption is classified as a dividend but it does not apply to redemptions in complete or partial liquidation of the corporation.

There is no comparable provision in the House bill.

This amendment applies to distributions after October 9, 1969, in taxable years ending after that date.

8. Reasonable Accumulations by Corporations

Present law.—Under present law, a special tax is imposed on accumulated taxable earnings of a corporation when the earnings are accumulated to save individual shareholders from the tax on dividends which would have been incurred if the earnings had been distributed. A corporation is not subject to this tax, however, to the extent the earnings are accumulated to meet the reasonable needs of the business, including the reasonably anticipated needs of the business.

Elsewhere in present law (sec. 303) provision is made for the redemption by a corporation of stock included in the estate of a deceased shareholder to the extent the amount used in such a redemption is not greater than the estate tax plus the funeral and administrative expenses. The provision applies, however, only if the stock of the corporation in question constitutes more than 35 percent of the gross estate or more than 50 percent of the taxable estate. (The section also applies in some cases where the percentage requirements are met by the stock of two or more corporations.)

In addition, this bill adds a provision to the effect that a private foundation must dispose of all the stock it owns in excess of "permitted holdings." In the case of foundations which now own substantial amounts of stock in a corporation, permitted holdings are defined as 50 percent of the stock of the corporation reduced by the percentage of stock owned by related parties. In addition, the bill provides that although generally there can be no dealings between a foundation and a corporation in which related parties have substantial interests, over a transition period stock can be redeemed in the type of case described above without this being classified as prohibited self-dealing.

Problem.—Where there is a redemption of stock from a shareholder (whether or not to pay death taxes), the question arises as to whether the money accumulated to pay for the stock was accumulated for the reasonable needs of the corporation's business. If it was not so accumulated, the corporation becomes subject to the accumulated earnings tax. It would appear that the same question will arise when a corporation redeems stock from a foundation in order to help the foundation bring its holdings down below the amount specified by the statute.

It would appear that amounts accumulated in the year of death and in later years to redeem stock to pay death taxes, or to redeem stock which a foundation must dispose of, should not be considered unreasonable accumulations. To consider them so defeats the purpose of these two redemption provisions of the statute.

Finance Committee decision.—The committee amendments provide (sec. 537 of the code) that the reasonable needs of the business are to include the amount needed (or reasonably anticipated to be needed) in the year of death and in later years to make a section 303 redemption. The provision gives protection from the special tax on accumulated earnings (sec. 531) with respect to amounts redeemed to pay death taxes. The committee amendments also provide that reasonable needs of the business include the amounts needed, or reasonably anticipated to be needed, to redeem from private foundations stock it held on October 9, 1969 (or received pursuant to a will or irrevocable trust treated as binding on October 9, 1969) which constituted excess business holdings. Both the amount of the accumulation and the time it is held must be reasonable under the circumstances.

The bill also provides that if funds are used to redeem stock to pay death taxes or to redeem excess holdings of private foundations, no inference is to be drawn from this, where amounts have been accumulated by the corporation in prior years, that such amounts represented unreasonable accumulations. Such a determination, if it is to be made, must be made without considering that the funds are used for these types of redemptions.

There is no comparable provision in the House bill.

This provision is effective with respect to the tax on accumulated earnings in taxable years ending after October 9, 1969. No inference is to be drawn from the enactment of this provision that such accumulations would not have been for the reasonable needs of the business in the absence of any such provision.

9. Special Contingency Reserves of Insurance Companies

Present Law.—Under present law, amounts set aside by a life insurance company in policyholder reserves are deductible in computing the income of the insurance company subject to tax. The amounts deductible include not only additions to life insurance reserves but also interest paid on indebtedness and amounts in the nature of interest. Present law also specifies that these deductible amounts include interest on special contingency reserves established under the Federal Employees Group Life Insurance Act of 1954.

Problem.—The question which arises is whether deductions for interest paid on indebtedness and amounts in the nature of interest include interest paid on so-called special contingency reserves under group life and group accident and health insurance contracts. One type of these reserves is used to fund over the employee's working life the cost of providing him group term life and group health and accident insurance after retirement. The second type of reserve is used for premium stabilization purposes, that is, to meet unusually large current claims which would otherwise require an increase in premium payments by employers for the insurance coverage provided for employees. In some cases, the reserve is a combination of both types.

When this matter was considered in connection with the Life Insurance Company Income Tax Act of 1959, the Finance Committee Report, the floor manager's statement on the finance committee amendments, and the floor manager's explanation of the conference committee action all contained language based upon the assumption that special contingency reserves in general were covered by the deduction for interest paid on indebtedness, and amounts in the nature of interest, and that the specific reference to contingency reserves on Federal employees group life insurance was adopted merely to "make it clear" that a deduction was available to insurance companies for interest credited on this type of special contingency reserve. Moreover, these special contingency reserves are of the same nature as other reserves held for policyholders, the interest on and additions to which are deductible in arriving at the amount of income of the life insurance company subject to tax. There appears to be no reason for a difference in tax treatment for these special contingency reserves. Despite the congressional intent, the Internal Revenue Service does not feel that it can so interpret present law.

Finance Committee decision.—The committee amendments provide specifically that in computing the taxable income of a life insurance company a deduction is to be allowed for interest paid on special contingency reserves under contracts of group term life insurance or group health and accident insurance which are established and maintained for the provision for insurance on retired lives, for premium stabilization, or for a combination of the two. A similar amendment is also made to the life insurance company provisions relating to the items taken into account as reserves for purposes of the so-called "Phase II" tax imposed on life insurance company income (i.e., the tax on gains from operations other than investment income).

There is no comparable provision in the House bill.

This provision, on the basis that it is declaratory of congressional intent, is made effective as of the effective date of the Life Insurance Company Income Tax Act of 1959; namely, taxable years beginning after December 31, 1957.

10. Spinoffs of Life Insurance Companies.

Present law.—Life insurance companies presently are taxable on their investment income plus 50 percent of their remaining gains from operations. The remaining portion of a company's gain from operations is taxed to the company only when, and if, this amount is distributed to shareholders. The portion of an insurance company's income which is taxed currently is, for accounting purposes, placed in a "shareholders surplus account" which is the first amount considered as distributed to shareholders.

The portion of the insurance company's gain from operations not taxed currently is placed in an account called a "policyholders surplus account." Distributions from this account are considered as made only after any balance in the shareholders surplus account is exhausted. Distributions out of the policyholders account give rise to the so-called Phase III tax on life insurance companies; that is, the deferred tax becomes due when the amount is distributed to the shareholder. Included in distributions which may give rise to this tax are distributions in redemption of stock, distributions in partial liquidation and distributions in a "spinoff" (a distribution of a subsidiary's stock to the shareholders of the life insurance company) which is tax free to the shareholders receiving the stock.

Problem.—In the past, three exceptions have been made to the rule that there would be phase III tax consequences in the cases of a spinoff to shareholders of the stock of a subsidiary of the life insurance company: The spinoff of stock of a controlled fire and casualty insurance subsidiary company, if acquired before January 1, 1963, in a tax-free stock-for-stock reorganization; the spinoff of stock of a controlled fire and casualty insurance company subsidiary, without regard to the type of corporate reorganization in which the parent gained control of the subsidiary company, where the parent owned 80 percent or more of the stock of the subsidiary before January 1, 1958 (the effective date of the Insurance Company Act of 1959); and the spinoff of the stock of a subsidiary corporation which is also a life insurance company, if the spinoff is to a holding company which owns at least 80 percent of the stock of the "first tier" life insurance company subsidiary which, in turn, owns (and has owned since December 31, 1957) at least 80 percent of the stock of the "second tier" life insurance company. The absence of the phase III tax, however, only applies to the extent there were no contributions to the capital of the second tier company after December 31, 1957 (the effective date of the Life Insurance Company Act of 1959).

Another case has come to the attention of the committee which differs from the third situation described above only in that the second tier subsidiary is an ordinary corporation subject to the general corporate tax provisions rather than a life insurance company. In this situation the life insurance company wants to spin off the stock of the ordinary business subsidiary to the parent holding company in order to simplify the operations of the group of corporations along functional lines. Moreover, certain States are considering legislation directed against continuing ownership by life insurance companies of noninsurance business interests.

The problem which exists here is that the removal of any assets from the possible application of the phase III tax (as would happen if the regular corporation could be spun off without any tax consequences) does lessen the certainty of the ultimate payment of the phase III tax by the life insurance company. This is particularly important where it is other than a life insurance company which is being spun off, since in such cases the assets cannot be expected to be held for use in an insurance company and could generally be sold or distributed to shareholders without the application of a phase III tax.

Finance Committee decision.—The committee amendments permit the spinoff of a second tier ordinary business subsidiary to the parent holding company without the application of phase III tax consequences at that time, but in a manner designed to preserve the potential application of a phase III tax. To accomplish this result, the amendment provides that the phase III tax is to continue to apply in such a case to the full extent and in the same manner as if the spinoff had not been made, and as if distributions to the holding company by the ordinary business corporation were channelled through the life insurance company. The sale or other disposition of the stock of the ordinary business subsidiary by the holding company also is to be treated as reducing the shareholders surplus account or policyholders surplus account of the life insurance company. These effects are limited to the amount of the fair market value of the stock of the ordinary business corporation at the time of the spinoff.

This amendment applies only where a life insurance company has, at all times since December 31, 1957, owned all of the stock of the business subsidiary which is spun off to the parent holding company. In such cases the phase III tax is not to apply (except to the extent of any post-1957 contributions to capital of the business subsidiary) at the time of the spinoff but, as is indicated above, the phase III tax consequences will continue to apply to distributions by (or the sale of stock of) the ordinary business subsidiary.

There is no comparable provision in the House bill.

This amendment applies to taxable years beginning after December 31, 1968.

11. Loss Carryover of Insurance Company on Change of Form of Organization or Nature of Insurance Business

Present Law.—Under present law, the rules governing the income tax treatment of insurance companies differ somewhat, depending upon whether the company is a stock or mutual company and also depending upon the nature of the insurance company's business (life, casualty, etc.). An insurance company which incurs losses during periods when it is subject to tax under one set of rules, in the past, has not been able to carry these losses forward and deduct them (as it could if its status had not changed) during periods in which the company is subject to tax in a different status.

Problem.—The limitation on the use of losses by insurance companies has been provided in the past primarily because a loss of one type of organization carried over to a period when it is taxed as another type might result in too generous treatment. (For instance, until 1962 mutual casualty companies were not taxed on their underwriting income and their losses were not taken into account for Federal tax purposes.) There appears to be no reason for this, however, if a company in changing its form of organization or the nature of its insurance business does not receive more favorable operating loss carryforwards than it would receive in the case of either type of organization.

Finance Committee decision.—The committee amendments permit an insurance company to carry over and deduct a net operating loss when the company, as a result of a change in its form of organization or the nature of its insurance business, becomes subject to a different type of insurance company taxation. However, this provision forestalls any tax advantage in such a case by limiting the net operating loss which may be carried over to the lesser of the loss carryover as computed under the rules applicable to the company before the change or the loss carryover as computed under the rules which apply to the company after the change.

There is no comparable House provision.

This provision applies to the carryforward of losses incurred by insurance companies in periods beginning on or after January 1, 1963, but does not permit a deduction to be taken for any taxable year beginning before January 1, 1967.

12. Unit Investment Trusts

Present law.—A mutual fund plan sponsor is an underwriter who sponsors a periodic payment plan for the accumulation of mutual fund shares by small investors. Under present law, the Internal Revenue Service treats a group of periodic payment investors subscribing to a plan as "an association taxable as a corporation" because the bank serving as custodian is regarded as having power to invest their funds, thus giving the arrangement the corporate characteristics of centralized management.

Problem.—In fact, the bank custodian does not exercise managerial discretion but performs only ministerial functions in much the same manner as a brokerage office holding securities in its own name for a particular customer. As a result of treating the plan as a corporation, if an investor asks for his stock to be delivered to him, gain or loss is recognized on this transaction although the investor has merely taken down his own shares.

Finance Committee decision.—The committee amendments add a provision to the regulated investment company provisions providing that certain periodic payment plans are not to be treated as a corporation, partnership or trust and the mutual fund shares are to be treated as owned directly by the investors through the bank custodian as a nominee. The committee amendments apply to unit investment trusts registered under the Investment Act of 1940 which issues periodic payment plan certificates and meet certain other conditions.

The new provision does not apply in the case of a unit investment trust which is a separate asset account under the insurance laws or regulations of a State. For purposes of the security laws these separate asset accounts may in some cases be classified as either a unit investment trust type of investment company. In addition, the provision added by the committee amendments will not apply to other unit investment trusts sponsored by life insurance companies which are treated as a part of the assets of the sponsoring life insurance company for purposes of State insurance laws and for which a separate asset account also must be maintained. Under present law, trusts of this latter type may in some cases for Federal tax purposes be treated as part of the insurance company and in other cases as associations taxable separate from the life insurance company. In the latter case, such trusts may elect to be taxed as regulated investment companies. These unit investment trusts will continue to be taxed as associations.

There is no comparable House provision.

This provision is effective with respect to taxable years of unit investment trusts ending after December 31, 1968, and to taxable years of holders of interest in these trusts ending with or within the taxable years of these trusts.

13. Exclusion for Income Earned Abroad

Present law.—Present law provides an exclusion from income for purposes of U.S. tax for income earned from sources without the United States in the case of either a U.S. citizen who is a bona fide resident of a foreign country or a U.S. citizen who is present in a foreign country for at least 17 out of 18 consecutive months. The exclusion under present law is $25,000 a year in the case of a bona fide resident of a foreign country who has been such for a period of at least 3 years. In all other cases the exclusion under present law is $20,000.

Problem.—The problem which arises is that it is difficult to see why the U.S. citizen living abroad should have an appreciably lower tax rate than citizens living in the United States. While there are some services which may not be provided to the same extent for U.S. citizens living abroad as for those living at home, there are other services which in many cases are used more by citizens living abroad. Moreover, the citizen living abroad is likely to come back to the United States upon retirement and at that time receive many of the services provided domestically at a time when he is paying little or no Federal income tax. Sometimes it is argued that citizens living abroad should not be taxed by the United States since their income is likely to be taxed by the foreign country in which they reside. However, to the extent this is true the foreign tax credit prevents the doubling up of tax on such income. Moreover, there are cases where the foreign country, although it taxes such income when received in the foreign country, does not tax it where arrangements are made for the citizen to have the funds deposited for him in the United States.

Finance Committee decision.—The Finance Committee amendments reduce from $20,000 or $25,000 (in this latter case where the individual is a bona fide resident of the foreign country for more than 3 years) to $6,000 the amount of earned income received from abroad which a U.S. citizen who is a bona fide resident of a foreign country or who is abroad for 17 out of 18 months may exclude from income in computing his U.S. income tax. There is no comparable provision in the House bill.

This amendment applies to taxable years beginning after the date of enactment of this bill.

14. Foreign Base Company Income

Present law.—Under present law, U.S. shareholders of controlled foreign corporations are taxed currently on certain income earned abroad by the corporation including what is termed "foreign base company income." Foreign base company income includes foreign personal holding company income, foreign base company sales income (generally income from the sale of property produced in one foreign country by one corporation and sold by a related corporation in another foreign country for use outside that country) and foreign base company services income. Basically, this provision is designed to prevent the avoidance of tax by arranging sales between related parties so that sales take place in a country which imposes little or no tax on this type of income where the production or other effort in connection with the property and the use of the property does not occur in that country. Present law provides an exception from this provision where it is established to the satisfaction of the Treasury Department that the creation or organization of the controlled foreign corporation in the foreign country in which it is incorporated does not have the effect of a substantial reduction of income or similar taxes.

Problem.—Cases have come to the attention of the committee where controlled foreign corporations have substantial investments in foreign countries which in practical terms they must dispose of because of the operation of the laws of the foreign country relative to permissible investments of foreigners. If that foreign country imposes little or no capital gains tax, then the exception in present law is not available with respect to the gain on the sale of the investments since there is a reduction of income taxes (relative to the tax which would have been paid in the United States were the transaction to occur here). This is true even though the corporation was not created to reduce taxes and the purpose of the sale is to comply with foreign laws and not to reduce taxes.

Finance Committee decision.—The Finance Committee amendments deal with the type of problem described above by amending existing law (sec. 954(b)(4)) to provide that the exception from the tax imposed with respect to foreign base company income is to apply, if the Treasury Department is satisfied that neither the creation nor organization (or acquisition) of the controlled foreign corporation in the particular foreign country nor the transaction giving rise to the income in question has as one of its significant purposes a substantial reduction of income or similar taxes.

This amendment applies to taxable years ending after October 9, 1969.

15. Deferral of Gain Upon the Sale of Certain Low- and Middle-Income Housing

Present law.—Under present law, where an individual sells his personal residence to the extent he reinvests the proceeds from this sale within a certain specified time in another personal residence, no gain is recognized on the sale of the first residence Instead, the basis of the second residence is considered to be that of the first residence (plus any additional funds added) with the result that if the second residence is resold without the funds being reinvested in a third residence, the gain is generally realized at that time. Present law also provides for the nonrecognition of gain on a similar basis in the case of involuntary conversions of property and also in the case of "like-kind" exchanges. No deferral of the recognition of gain is available, however, under present law in the case of the sale of low- and moderate-income housing held as rental property.

Problem.—In the case of federally assisted housing projects (where the return to the investor is limited to approximately 6 percent), the Government is interested in encouraging the sale of these Government-assisted housing projects to the low- or middle-income occupant or to a tax-exempt organization which manages the property on their behalf (such as cooperatives and condominiums). The maximum sales price permitted under these programs under present law is the amount the individual has invested in the property, an amount necessary to retire the outstanding mortgage liability, and the taxes payable as a result of the sale. By providing that no gain is to be recognized in these cases, it would be possible to decrease the sales price to the occupants or tax-exempt organizations managing these properties. This should enable them to make purchases they otherwise could not make.

Finance Committee decision.—In order to obtain a more favorable price for Government-assisted housing units where they are sold to the occupant or a tax-exempt organization managing the property, the committee amendments provide that no gain is to be recognized to the initial investor where the properties are sold in this manner but only to the extent that the investor reinvests the proceeds from the sale in other similar Government-assisted housing. In this case, the taxpayer's basis for the project is carried over and becomes part or all of his basis for the new project in which the funds are invested (depending upon whether or not he also invests additional funds in the second project). The holding period of the first property is taken into account in determining how long the second property is held in this case, but only to the extent the proceeds of sale of the old project are reinvested in the new project.

There is no comparable provision in the House bill.

This provision is effective with respect to sales made after October 9, 1969.

16. Cooperative Per-Unit Retain Allocations Paid in Cash

Present law.—Under present law, patronage dividends paid in money, qualified allocations or other property may be paid to the patron within 8½ months after the end of the year in which the earnings to which they relate arise. Where this occurs the cooperative is not taxed but the patron is taxed on this amount. Patronage dividends are amounts determined by reference to the net earnings of the cooperative from business done with, or for, its patrons.

Per-unit retain allocations, if paid in qualified per-unit retain certificates, also may be paid to the patron within 8½ months after the end of the year, with the cooperative receiving a deduction for such amounts and the patron reporting these amounts as taxable income. However, this treatment is not available in the case of per-unit retain allocations paid in money or other property. Per-unit retain allocations are payments to patrons with respect to products marketed for them where the amount is fixed without reference to the net earnings of the organization. Usually the per-unit retain allocation is fixed on the basis of the number of units marketed with the cooperative.

Problem.—Problems have arisen under present law where cooperatives desire to make cash payments to patrons with respect to cooperative pools, but cannot make them before the end of the year because their accounting records are not closed at that time. These payments cannot be made during the 8½ month period as cash patronage dividends because they cannot be paid with respect to net earnings. The net earnings of the pool cannot be determined until the pool is closed, which may occur much later. Moreover, the payments can be made as per unit retain allocations only if they are paid as a qualified per unit retain certificates. There seems to be no reason why a cooperative should be able to deduct per unit retain allocations paid as qualified certificates during the 8½ month period following the close of the taxable year, but not per unit retain allocations paid in money during the same period.

Finance Committee decision.—The Finance Committee amendments provide that a cooperative can deduct or exclude from gross income per unit retain allocations whether they are paid in money (or other property) or in qualified per unit retain certificates.

No such provision is contained in the House bill.

This amendment applies to per-unit retain allocations made after October 9, 1969.

AA. MISCELLANEOUS EXCISE TAX PROVISIONS

1. Application of Excise Taxes on Trucks to Concrete Mixers

Present law.—Until 1967, the 10 percent excise tax on the manufacture of automobile trucks was not applied in the case of concrete mixers where the actual mixing of the concrete occurred in the tank mounted on a truck chassis. The truck chassis in such a case, however, was subject to the excise tax. In 1967 the Internal Revenue Service reversed its position with respect to concrete mixers mounted on truck chassis. At that time it concluded that these concrete mixers were not designed and adapted by the manufacturer for purposes predominantly other than the transportation of property on the highway.

Problem.—Apparently, the change in ruling policy stemmed from an exemption for seed, feed, and fertilizer spreaders added by Congress in 1965. In the committee report on that provision reference was made to the fact that these would not be taxable even though incidental highway use occurred. It was not the intent of Congress when it provided an exemption from the excise tax on automobile trucks for these purposes, that the language used in connection with the provision for the exemption would result in the review of existing items not subject to tax, and the reclassification of them into a taxable status. Moreover, "incidental" in such a case was not intended to tax equipment where its highway transportation use was functionally incidental or subordinate to some nonhighway use—in this case, the mixing of concrete.

Finance Committee decision.—The committee amendments provide an exemption from the manufacturer's excise tax on trucks in the case of articles designed to be mounted on automobile truck trailer or semi-trailer chassis which are designed to be used primarily to process or prepare concrete. In addition, an exemption is provided for parts and accessories designed primarily to be used in connection with the use of these concrete mixers.

No comparable provision appears in the House bill.

This amendment applies to articles sold after June 30, 1969.

2. Constructive Sales Price

Present law.—Present law (sec. 4216(b)) provides for a constructive sales price (as a substitute for the actual sales price) as a base for the various ad valorem manufacturers' excise taxes in several different types of situations. One of these involves the situation where the article is sold at less than the fair market price if the transaction is not at arm's length. Sales between related companies are examples of sales which are not considered to be at arm's length. As a result, in the case of a sale by a manufacturer or importer to its selling affiliate, a determination must be made as to whether the sale is at less than "fair market price," and where this is true, the appropriate constructive price must be determined by general standards. If industry data are available, the determination should properly be made by reference to the prices for which others in the same industry at the same level of distribution sell similar articles. Because of difficulties in obtaining what it considers to be adequate information as to selling practices and prices of various companies within an industry, the Internal Revenue Service has generally not made determinations of constructive sales prices by reference to sales by other companies.

In 1962, however, the Internal Revenue Service published a ruling providing for a constructive sales price where a manufacturer or importer (the party liable for the excise tax) sells his products to a wholly owned sales subsidiary and the subsidiary resells to one or more independent wholesale distributors (Rev. Rul. 62–68). This provided that the taxpayer could elect to treat the constructive sales price as being 95 percent of the lowest price for which the sales subsidiary resold the article to independent or unrelated wholesale distributors. The Service has also held that where a manufacturer or importer makes sales to a wholly owned selling subsidiary at a price less than the fair market price, and the wholly owned selling subsidiary resells the articles to independent retailers but does not regularly sell to wholesale distributors, the constructive sales price is to be 90 percent of the selling subsidiary's lowest price to independent retailers.

Problem.—In those industries where the pricing policies of competitors on any broad basis are difficult to determine with certainty, the ruling policy of the Internal Revenue Service has been of help. It acknowledges that the price at which the selling company sells, either to wholesalers or to retailers, overstates the price at which the affiliated manufacturer or importer could be expected to sell to the selling company. However, where information as to the selling prices of others in an industry can be obtained, this information may well indicate that where most sales are to retailers, the 10 percent markdown is inadequate.

Finance Committee decision.—The Finance Committee's amendment adds two constructive price rules to the tax laws dealing with situations where a manufacturer or importer regularly sells an article subject to excise tax to an affiliated corporation and that corporation regularly sells these articles to independent retailers but does not regularly sell to wholesale distributors. The first of these rules is essentially the private ruling practice of the Internal Revenue Service. The second rule provides a method for determining the fair market price in the case of such sales to a selling affiliate, by reference to the markups of others in the same industry who normally sell to independent distributors.

The first rule provides that the fair market price of the article is to be 90 percent of the lowest price for which the subsidiary corporation regularly sells the article in arms length transactions to independent retailers. The second rule provides that where the distributor regularly sells only to retailers and the normal method of sales in the industry is by arm's length transactions to distributors, then the fair market price of the article is to be the price at which the article is sold to retailers by the affiliated distributor, reduced by a percentage equal to the markup used by independent distributors in that industry.

This latter rule, in effect, allows a manufacturer to establish a fair market price on its products with the opportunity for the Service to comment on the adequacy of this determination under the guidelines set forth.

This amendment does not attempt to cover all situations where a manufacturer or importer sells to an affiliated company but only to codify and clarify present law with respect to the more common situations discussed above. In other situations, such as a sale by a wholly owned manufacturing corporation to its parent corporation which, in turn, resells to independent wholesale distributors (or, perhaps, at retail) the fair market price would continue to be determined under the existing constructive price provisions.

In computing a sales subsidiary's lowest price to independent parties, this price should be determined in the same manner as if the price were in a taxable sale. This price should be, for example, the net price to the purchaser after taking into account trade discounts given by the seller as a result of contractual arrangements existing at the time of the sale. Also, it is not required that the sales subsidiary make any given percentage of its sales at a particular price in order for these to be the lowest price so long as the sales are bona fide arm's length transactions to unrelated parties. Moreover, where sales are made both including and excluding transportation charges, the lowest price would be the price excluding the transportation charge.

There is no comparable provision in the House bill.

These amendments apply to articles sold after January 1, 1969.

BB. MISCELLANEOUS ADMINISTRATIVE PROVISIONS

1. Filing Requirement for Individuals

Present law.—Under present law an individual is required to file a tax return if his gross income is $600 or more unless he is age 65 or over, in which case he is required to file a tax return if his income is $1,200 or more.

Problem.—With the introduction of a low income allowance which raises the nontaxable level for a single person to $1,700 and for a married couple to $2,300 the existing filing requirements would result in a substantial amount of unnecessary filing of returns by those not subject to tax. This would cause an appreciable amount of paper work both for the taxpayers and for the Internal Revenue Service.

Finance Committee decision.—The committee amendments raise the income level at which a tax return must be filed to $1,700 for a single taxpayer, $2,300 for a married couple (or single person age 65 or over), $2,900 in the case of a married couple where one spouse is age 65 or over, and $3,500 in the case of a married couple where both spouses are age 65 or over. For married couples these higher filing levels are applicable only if they are living together at the end of the year. The filing requirement would remain at $600 for a married couple filing separate returns and those living apart. The House bill contained no comparable provision.

These changes apply to taxable years beginning after December 31, 1969.

2. Computation of Tax by Internal Revenue Service

Present law.—Presently taxpayers may request the Internal Revenue Service to compute their tax if their gross income is less than $5,000, they take the standard deduction, use the optional tax table and do not have nonwage income in excess of $100. The tax in this case does not take into account whether the taxpayer is a head-of-household or surviving spouse and does not take into account the retirement income credit.

Problem.—The present limitations on the type of taxpayer who may elect to have his tax computed by the Internal Revenue Service appear to be unduly restrictive.

Finance Committee decision.—The committee's amendments raise from $5,000 to $7,500 the income level up to which Internal Revenue Service will compute income tax (this amount may subsequently be raised to $10,000 if the Internal Revenue Service finds this practical). In addition, the Internal Revenue Service is to be permitted to issue regulations (without regard to the amount or the source of adjusted gross income, marital status, whether the taxpayer itemizes or takes a standard deduction, or the type of tax credits he claims) outlining the conditions under which the taxpayer may request the Internal Revenue Service to compute his tax.

This provision applies to taxable years beginning after December 31, 1969.

3. Penalties for Failure to Pay Tax and Make Deposits

Present law.—Under present law, in the case of a failure to pay income tax when due, simple interest at 6 percent, payable annually, must be paid on the unpaid amount. Present law also provides a 5 percent per month penalty up to a maximum of 25 percent, if a taxpayer fails to file a return on the date it is due, unless the failure is due to reasonable cause and not to willful neglect.

Problem.—Since the current cost of borrowing money is substantially in excess of the 6 percent interest rate provided by the Internal Revenue Code, it is to the advantage of taxpayers in many cases to file a return on the due date but not to pay the tax shown as owing on the return. For the period the tax remains unpaid the taxpayer is, in effect, borrowing from the Government the amount of the tax at a 6 percent rate of interest. Although full information is not available, borrowings of this type may be occurring on a substantial scale.

Finance Committee decision.—The committee amendments provide a penalty for failure to pay income tax when due. As in the case of failures to file returns, under present law, the penalty is to be 5 percent of the amount of the tax if the failure is for not more than one month, with an additional 5 percent for each additional month, or fraction thereof, while the failure continues, not exceeding 25 percent in all. The penalty in this case is imposed on the net amount due after taking into account amounts which have been withheld, estimated payments and other applicable credits. This penalty is not to be imposed if it is shown that the failure to pay the tax is due to reasonable cause and not to willful neglect.

The penalty applies to the tax due at the time of the filing of a return and also, in the case of a late-filed return only, to the amount of any deficiency subsequently determined to be payable. In addition, the 5 percent per month penalty applies to failures of withholding agents to pay over withholding tax when due.

There is no comparable House provision.

This provision applies to amounts payable on and after January 1, 1970.

4. Reporting of Medical Payments

Present time.—Present law provides that every person making payment in the course of his trade or business to another person of rent, salaries, and a variety of other fixed or determinable gains, profits and income amounting to $600, or more, in a year must file an information return showing the amounts paid and the name and address and identification number of the recipient.

At the time the committee ordered this bill reported, the Internal Revenue Service did not require reporting of payments to doctors and other suppliers of health care services when payments were made to them by insurance companies and other organizations (including the Federal Government through the Medicare program and the Federal and State Governments through the Medicaid program and the Maternal and Child Health program). Since this bill has been ordered reported, however, the Service has ruled that insurance and other companies paying $600 or more a year to a doctor or other person rendering service under health plans must file annual information returns. The reporting requirement applies to payments made during 1969, but organizations not equipped to immediately provide the data may start filing returns as of January 1, 1970. The reporting requirement does not apply to cases where a patient submits a claim to the insurance company for a bill he has paid and is reimbursed by the insurance organization.

Problem.—It appears appropriate to require information returns with respect to payments in excess of $600 to suppliers of medical goods and services whether the payments are made to the supplier, to the patient or to others in reimbursement for payments or amounts payable to the supplier. The recent Internal Revenue Service requirement that information returns be provided with respect to payments to doctors does not fill the need for obtaining information where payments are made to patients for doctor bills. To omit this type of payment could well encourage doctors, dentists, etc., to seek the indirect, rather than the direct, type of reimbursement in order to avoid having their payments reported to the Federal tax collector.

Finance Committee decision.—The committee amendments require the filing of information returns for payments of $600 or more to a supplier of medical goods and services, including doctors and dentists.

The information return requirement also applies to payments to doctors, dentists, etc., which are reimbursed by the insurance company or other organizations to the patient. All payments made to the doctors, dentists, etc., whether directly or through reimbursement, are to be aggregated in determining the amounts paid during a year.

The following exceptions are provided:

(1) The reporting requirements apply only in the case of payments made in the course of a trade or business and, therefore, do not, for example, apply to payments by the patient who pays a doctor bill.

(2) The reporting requirements do not apply to payments of wages subject to withholding, to payments to a tax-exempt organization, or to payments to a governmental unit or agency.

(3) The reporting requirements do not apply to goods and services supplied by noninstitutional pharmacists.

(4) The reporting requirements do not apply to payments to an individual by his attorney or agent.

(5) In the case of a settlement of a claim which includes reimbursements for amounts paid to a doctor, dentist, etc., reporting is required only to the extent these payments are separately identified by the person making the payment.

The amounts reported as payments to suppliers which are actually payments to other persons in reimbursement of the amounts billed by doctors, dentists, etc., will not always accurately reflect the actual income of the doctor, dentist, etc. Nevertheless, the amounts reported will be helpful to the Internal Revenue Service in selecting returns for audit, but the reports will not be used as evidence (in themselves) of income received by the doctor, dentist, etc.

The Secretary of Health, Education, and Welfare is also required to provide similar reporting to that outlined above with respect to Medicare and Medicaid. Moreover, he is also required to keep records showing the identity of each person who receives payments under Medicare and Medicaid programs and under programs for maternal, child health, and crippled childrens' services and the aggregate amounts paid to individuals under each program. The doctors, dentists, etc. are to be identified by the identifying number required to be included in the information return.

In addition, the Secretary of HEW is to submit to the Senate Finance Committee and the House Ways and Means Committee an annual report identifying each person paid $25,000 or more during the preceding year under Medicare and Medicaid programs or programs for maternal, child health and crippled childrens' services.

No comparable provision is contained in the House bill.

The provisions requiring reporting with respect to Medicare, Medicaid and other Federal program payments either by the Secretary of

HEW or by private carriers or other organizations are to be effective for calendar years beginning after 1968. With respect to other payments the bill applies to payments made on or after January 1, 1970.

CC. ARTICLE I STATUS FOR TAX COURT AND PROVISION FOR SMALL CLAIMS CASES

Present law.—The Tax Court is at present an independent agency in the executive branch, where taxpayers may take income, estate, and gift tax cases for redetermination of deficiencies (including a determination that there not only is no deficiency but that there is an overpayment) before paying the taxes. The judges of the Tax Court are appointed by the President with the advice and consent of the Senate for 12-year terms. (An appointment to fill a vacancy in an existing term is onlv for the remaining period of the vacancy.) The Court does not have the power to punish for contempt, even in the case of violations of subpoenas it is authorized to issue. The Court provides its own rules of procedure but must abide by the rules of evidence applicable to nonjury cases in the District Court of the District of Columbia.

Judges must retire upon reaching age 70 if they have completed 10 years of service; they may retire after 18 years of service at any age. A noncontributory pension is available which entitles a judge to retire at full pay after 24 years on the court or at proportionately lesser amounts where retirement occurs earlier. A judge who elects this noncontributory pension is not entitled to receive a Civil Service pension even though rights to the pension may have accrued before he became a judge. Also he may not receive back his Civil Service contributions if he elects the Tax Court pension.

Problem.—Two problems have arisen in connection with the Tax Court: the first is the need for special procedures for handling small claims, and the second is the status of the Tax Court itself.

Often taxpayers with small claims believe that there is no inexpensive practical way for them to present their claims before an impartial tribunal and, therefore, they conclude they must abide by the decisions of the Internal Revenue Service. While the Tax Court procedures are less complicated in many respects than those of other courts, they remain formal in nature because the Court and the Internal Revenue Service must consider not just the amount involved in any particular case but also the precedent that it may provide for future cases.

In addition, since decisions in these cases are subject to review in the appropriate Court of Appeals, and then, perhaps in the Supreme Court, a complete record of the proceedings must be prepared of the proceedings in each case and the findings of fact and the opinion must be sufficiently detailed to permit a proper review. Although the Tax Court has instituted simplified procedures in small cases, formal rules of evidence often constitute a difficult barrier to the taxpayer who represents himself.

Since the Tax Court has only judicial duties it appears anomalous to classify it with quasi-judicial executive agencies that have rule making and investigatory functions. Its constitutional status as an executive agency, no matter how independent, raises questions in the minds of some as to whether it is appropriate for one executive agency to be sitting in judgment on the determinations of another executive agency.

Also it seems inappropriate that the Tax Court is required to look to the District Courts to enforce its own authority.

Because a Tax Court judge, under present law, is first appointed for the remainder of his predecessor's term, his first appointment may well be for only 2 or 3 years or possibly only several months. It would appear appropriate that Tax Court judges have longer, more uniform terms.

The Tax Court retirement provisions also are defective in several respects. For example, they do not authorize retirement for disability although this is available to District Court judges. Moreover, Tax Court judges are not permitted to collect Civil Service retirement pensions if they elect Tax Court retirement, nor are they permitted to receive back their contributions to the Civil Service retirement fund. District Court judges, however, are permitted to collect Civil Service retirement pensions in addition to their pensions as judges. Also, District Court pensions are more favorable as a proportion of salary than those available to Tax Court judges. Finally, the present provisions severely restrict the occasions when a Tax Court judge may apply for survivor benefits.

Finance Committee decision.—The committee amendments provide for a small claims procedure, where neither the disputed amount of the deficiency nor the claimed overpayment exceeds $1,000 as to any year, or where the amount in an estate tax matter does not exceed $1,000, a simplified and relatively informal procedure is to be available to the taxpayer.

In such a case the decision is to be based upon a brief summary opinion instead of formal findings of fact; the decision is not to be a precedent for future cases and is not to be reviewable upon appeal. In addition, the Court is to be given discretion as to rules of evidence and procedure with the expectation that the Court would follow relatively informal rules whenever possible. The use of the small claims procedure would be optional with the taxpayer except that the Tax Court (presumably upon the request of the Internal Revenue Service) can decide before the hearing that the case involves an important tax policy which should be heard under normal procedures and should be subject to appeal. Where it becomes evident to the Court during, or at the end of, the trial of a case that the deficiency or overpayment should be increased to an amount in excess of $1,000, then the Court has the discretion to shift the case to the regular procedures for Tax Court cases. This discretion is expected to be exercised only in unusual cases, where the Court deems it appropriate, taking into account all considerations bearing on the fairness of the change, including the costs involved for all parties. Commissioners can be used by the Tax Court in these cases as well as in regular cases and are to be paid at the same rate as commissioners of the Court of Claims.

The committee amendments also establish the Tax Court as a court under Article I of the Constitution, dealing with the legislative branch. At the present time the Court of Military Appeals is the only other Article I court. Other courts, however, have enjoyed this status in the past, including the Court of Claims. The Tax Court is given the same powers regarding contempt that Congress has previously given to the District Courts.

The method of appointment of the judges to the Court (by the President with the advice and consent of the Senate) is not changed by the bill. However, the term of office is established as 15 years from the date the judge takes office. A judge may not be appointed for the first time after reaching age 65.

The provisions regarding retirement are revised to require retirement at age 70 whether or not the judge has completed 10 years of service at that time. (The bill, however, does not change the provision of existing law authorizing the recall of retired judges to relieve heavy case loads.) As in the case of the District Court, the bill also permits a judge to retire at age 65 if he has served 15 years. He may retire at a younger age with 15 years of service if he is available for reappointment at the conclusion of his term but is not reappointed. The bill also requires a Tax Court judge to retire if he is permanently disabled. Generally, retirement under these provisions is to be at the full pay of the office except that if a judge has served less than 10 years then his pension is apportioned in accordance with the number of years served (if he retires for disability and has served less than 10 years his pension is half the salary of the office).

The bill retains the provision to the effect that a Tax Court judge may not receive both Civil Service retirement and Tax Court retirement pensions, but the judge is permitted to receive back any contributions he made to the Civil Service retirement fund if he elects the Tax Court pension.

In addition, minor amendments are made to conform the statute to the terminology and time period (90 days instead of 3 months) applicable to appeals from trial courts under the Federal Rules of Appellate Procedure.

There are no comparable provisions in the House bill.

The provision dealing with the treatment of small tax cases is to be effective 1 year after the bill's enactment. The other provisions are generally effective on date of enactment except that in the case of judges who are now members of the Court transition rules are provided with respect to their status for retirement purposes.

DD. HOUSE PROVISIONS DELETED BY COMMITTEE

1. Limitation on Deduction of Interest

Present law.—Present law allows individual taxpayers an itemized deduction, without limitation, for all interest paid or accrued during the taxable year.

Problem.—The present deduction for interest allows taxpayers to voluntarily incur a substantial interest expense on funds borrowed to purchase growth stocks (or other investments initially producing low income) and to then use the interest deduction to shelter other income from taxation. Where a taxpayer's investment produces little or no current income, the effect of allowing a current deduction for interest on funds used to make the investment is to allow the interest deduction to offset other ordinary income while the income finally obtained from the investments results in capital gains.

Finance Committee decision.—The House bill would have limited the deduction allowed individuals for interest on funds borrowed for investment purposes (but not interest incurred in a trade or business). Under the provision, a taxpayer's deduction for investment interest would have been limited to the amount of his net investment income (dividends, interest, rents, etc.), plus the amount of his long-term capital gains, plus $25,000.

Under the House bill investment interest in excess of $25,000 would first have been offset against net investment income and then would have been offset against long-term capital gain income (before the 50 percent capital gains deduction). A carryover of disallowed interest would have been allowed so that the disallowed interest could have been used to offset investment income (and capital gains) in subsequent years.

The Finance Committee amendments delete this provision. However, interest expense in excess of investment income is an item included in the base for the minimum tax.

2. Other Deferred Compensation

Present law.—In 1960, the Internal Revenue Service issued a comprehensive ruling (Revenue Ruling 60–31) describing various types of arrangements in which tax deferral was available. In general, the basis for the ruling was that the employee did not have the right to receive the compensation immediately and, therefore, the employee had not constructively received the additional compensation. This treatment is available only with respect to unfunded arrangements. In the case of funded arrangements, the employee is taxed currently on the contribution (if his rights are nonforfeitable) even though he may not immediately receive the compensation. The following example is typical of the tax deferral arrangements covered by the Revenue Ruling: The employer and employee enter into a 5-year employment contract which provides for a specified amount of current compensation and an additional specified amount of nonforfeitable deferred compensation. The deferred compensation is credited to a reserve account on the company's books and is accumulated and paid out in equal annual installments in the first 10 years after the employee's retirement.

Problem.—The present treatment of deferred compensation under the Internal Revenue Service ruling provides employers and employees with the opportunity of shifting income from high tax years during employment to retirement years when the marginal tax bracket can be expected to be substantially lower. This tax treatment is not available when the amount to be deferred is placed in trust but is available when the amount is accumulated on the books of the employer corporation and represents a promise to pay on its behalf. As a result, key employees who are in a position to enter into deferred compensation arrangements with employers can avoid the graduation in the present tax structure intended to be generally applicable.

Finance Committee decision.—The House provision continued to tax the deferred compensation in the situations described above when it was received, but to the extent the deferred compensation exceeded $10,000 a year, it would have taxed the income at rates which would have been applicable had the income been received when earned. This result would be accomplished by determining the tax which would have applied had the income been received over the employee's entire period of service with the employer, or over the period to which the deferred compensation is properly attributable. An alternative method bases the tax on the average compensation for the three highest years during the last 10 years of the earning period.

The committee amendments delete this provision. The Treasury Department informed the committee that this provision is too complicated and requires further study. A group has been established by the Treasury Department to carry on this work.

3. Foreign Tax Credit

Present law.—Under present law a U.S. taxpayer is allowed a foreign tax credit against his U.S. tax liability on foreign income. Generally, the amount of the credit is limited to the amount of U.S. tax on the foreign income.

There are two alternative formulations of the limitation on the foreign tax credit: the "per country" limitation and the "overall" limitation. Under the per country limitation, foreign taxes and income are considered on a country-by-country basis. Under the overall limitation, on the other hand, all foreign taxes and foreign income are aggregated. Thus, under this latter limitation, foreign taxes in one country, in effect, can be averaged with lower foreign taxes in another foreign country.

Problem.—Since the per country limitation is computed separately for each foreign country, losses which occur in one country reduce U.S. tax on domestic income, rather than reducing the credit for taxes paid to other foreign countries (as would occur under the overall limitation). However, when the business operation in the loss country becomes profitable, the income, in effect, is likely not to be taxed by the United States because the foreign country is likely to impose a tax equal to the U.S. tax and, as a result, a foreign tax credit is likely to be allowed with respect to that income.

Another problem which may arise (primarily where the overall limitation is used) is the difficulty of distinguishing royalty payments from tax payments. This problem is likely to arise in cases where the taxing authority in a foreign country is also the owner of mineral rights in that country. Since royalty payments may not be credited against U.S. taxes, the allowance of a foreign tax credit for a payment which, although called a tax, is, in fact, a royalty, allows a taxpayer a larger reduction in U.S. tax than would occur than if a deduction (instead of the credit) were available. Where the credit exceeds the U.S. tax on the income from the mineral production in the foreign country, the excess credit may be used to offset U.S. tax on income from other operations in that country, or on income from other foreign countries.

Finance Committee decision.—The House bill would have provided that a taxpayer who uses the per country limitation, and who reduces his U.S. tax on U.S. income by reason of a loss from a foreign country, is to have the resulting tax benefit recaptured when income is subsequently derived from the foreign country involved. The House bill also would have provided a separate foreign tax credit limitation in the case of foreign mineral income so that excess credits from this source could not be used to reduce U.S. tax on other foreign income. In other words, the foreign tax credit allowed on mineral income from a foreign country would have been limited to the amount of U.S. tax on that income. Excess credits could have been carried over under normal foreign tax credit carryover rules and credited against U.S. tax in other years on the foreign mineral income.

The Finance Committee has deleted these two provisions of the House bill and requested that they be given further study.

4. Cooperatives: Payment of Patronage Allocations

Present law.—In determining taxable income under present law, cooperatives are permitted a deduction (or exclusion) for patronage dividends paid in money or in qualified patronage allocations. They also are permitted a deduction (or exclusion) for qualified per-unit retain certificates (that is, certificates issued to patrons to reflect the retention by the cooperative of a portion of the proceeds of the marketing of products for the patrons).

A patronage allocation, or per-unit retain certificate, is qualified—and therefore not taken into account by the cooperative—only if the patron consents to take it into account currently as income (or as a reduction in price in the case of purchases from the cooperative). Thus, in general, a cooperative is not taxed on patronage allocations or per-unit retains only if they are taxable to patrons. In the case of qualified patronage dividends, present law requires that 20 percent must be paid in money so that the patron will have all or part of the money to pay the tax.

Problem.—Generally, qualified patronage allocations and qualified per-unit retains are considered as amounts distributed by cooperatives to their patrons and reinvested in the cooperatives as capital. However, some attach significance to the fact that a patron on an individual basis normally does not have an independent choice between reinvesting the funds in the cooperative or retaining them for his own use. This choice is generally made by the members of the cooperative as a group. Despite this, it is pointed out that in most cases the patron is taxed as though he had full dominion and control over the patronage allocation or per-unit retain. The concern in this regard is that while most cooperatives revolve out these funds—on which the patron has already paid the tax—within 4 to 15 years, some cooperatives may retain the funds indefinitely.

Since the funds are taxed to the patron at the present time and since this change would not require any tax payment at the cooperative level but only the ultimate distribution of the funds to the patron over a shorter period than has sometimes been the case, the committee does not believe that the House provisions represent a revenue problem. The committee has asked the staff, however, to study problems as to the tax treatment of cooperatives, particularly as to whether cooperatives engage in activities which are unrelated to the purposes for which special tax treatment is given, and it has asked that a report be made back to it on this subject.

Finance Committee decision.—The House bill would have required cooperatives to revolve out patronage dividends and per unit retains within 15 years from the time the written notice of allocation was made or the per-unit retain certificate was issued. In addition, the percentage of patronage allocations which would have had to be paid out currently in cash or by qualified check was increased from 20 percent to 50 percent. The additional 30 percent would have had to have been paid with respect to the current allocations or in redemption of prior allocations. The increase in the required payout would have been phased in ratably over a 10-year period. These provisions were to apply to taxable years beginning after 1969.

The Finance Committee amendments delete these provisions.

5. Maximum Tax on Earned Income

Present law.—Under present law, the individual income tax rates reach a maximum of 70 percent for taxable income in excess of $100,000 for single persons and $200,000 for joint returns. The 70 percent rate is applicable to all taxable income other than capital gains subject to the alternative rate of 25 percent.

Finance Committee decision.—The House bill provided that the maximum marginal tax rate applicable to an individual's earned income was not to exceed 50 percent (although the rates on other income were to reach 65 percent in 1972 and later years). The committee amendments delete this provision.

EE. REVENUE ESTIMATES AND BURDEN TABLES

TABLE 1.—BALANCING OF TAX REFORM AND TAX RELIEF UNDER H.R. 13270—CALENDAR YEAR TAX LIABILITY

[In millions of dollars]

A. AS APPROVED BY THE SENATE COMMITTEE ON FINANCE

	1970	1971	1972	1974	1979
Tax reform program under Finance Committee bill	+1,400	+1,655	+1,880	+2,440	+3,335
Repeal of investment credit	+2,500	+2,990	+2,990	+3,090	+3,270
Tax reform and repeal of investment credit	+3,900	+4,645	+4,870	+5,530	+6,605
Income tax relief under Finance Committee bill	[1] −1,712	−5,144	−8,968	−8,968	−8,968
Balance between reform (+) and relief (−) under Finance Committee bill [1]	+2,188	−499	−4,098	−3,438	−2,363

B. AS PASSED BY THE HOUSE OF REPRESENTATIVES

	1970	1971	1972	1974	1979
Tax reform program under House bill [1]	+1,665	+2,080	+2,215	+2,650	+3,570
Repeal of investment credit	+2,500	+3,000	+3,000	+3,100	+3,300
Tax reform and repeal of investment credit [1]	+4,165	+5,080	+5,215	+5,750	+6,870
Income tax relief under House bill	[1] −1,912	[1] −6,568	−9,273	−9,273	−9,273
Balance between reform (+) and relief (−) under House bill [1]	+2,253	−1,488	−4,058	−3,523	−2,403

[1] Revised.

Note: The tax surcharge extension ($3,100,000,000 liability for 1970) and the excise tax extension ($1,170,000,000, $900,000,000, $800,000,000, and $400,000,000 for 1970 through 1973, respectively) are not included because of their impermanent character.

TABLE 2.—BALANCING OF TAX REFORM AND TAX RELIEF UNDER H.R. 13270—CALENDAR YEAR LIABILITY

[In millions of dollars]

A. AS APPROVED BY THE SENATE COMMITTEE ON FINANCE

	1970	1971	1972	1974	1979
Tax reform program under Finance Committee bill	+1,400	+1,655	+1,880	+2,440	+3,335
Repeal of investment credit	+2,500	+2,990	+2,990	+3,090	+3,270
Tax reform and repeal of investment credit	+3,900	+4,645	+4,870	+5,530	+6,605
Income tax relief:					
Low-income allowance	−625	−625	−625	−625	−625
Change in phaseout on low income allowance		−1,062	−2,027	−2,027	−2,027
Increase in standard deduction [1]	[2] −1,087	−1,325	−1,373	−1,373	−1,373
Rate reduction		−1,687	−4,498	−4,498	−4,498
Tax treatment of single persons		−445	−445	−445	−445
Total tax relief under Finance Committee bill	[2] −1,712	−5,144	−8,968	−8,968	−8,968
Balance between reform (+) and relief (−) under Finance Committee bill	+2,188	−499	−4,098	−3,438	−2,363

B. AS PASSED BY THE HOUSE OF REPRESENTATIVES

	1970	1971	1972	1974	1979
Tax reform program under House bill [2]	+1,665	+2,080	+2,215	+2,650	+3,570
Repeal of investment credit	+2,500	+3,000	+3,000	+3,100	+3,300
Tax reform and repeal of investment credit [2]	+4,165	+5,080	+5,215	+5,750	+6,870
Income tax relief:					
Low-income allowance	−625	−625	−625	−625	−625
Removal of phaseout on low income allowance		−2,027	−2,027	−2,027	−2,027
Increase in standard deduction [1]	[2] −1,087	[2] −867	−1,373	−1,373	−1,373
Rate reduction		−2,249	−4,498	−4,498	−4,498
Maximum 50-percent rate on earned income	−200	−150	−100	−100	−100
Intermediate tax treatment for certain single persons, etc		−650	−650	−650	−650
Total tax relief under House bill	[2] −1,912	[1] −6,568	−9,273	−9,273	−9,273
Balance between reform (+) and relief (−)under House bill [2]	+2,253	−1,488	−4,058	−3,523	−2,403

[1] 1970: 13 percent, $1,400 ceiling; 1971: 14 percent, $1,700 ceiling; 1972: 15 percent, $2,000 ceiling.

[2] Revised.

Note: The tax surcharge extension ($3,100,000,000 liability for 1970) and the excise tax extension ($1,170,000,000, $800,000,000, $800,000,000 and $400,000,000, for 1970 through 1973, respectively) are not included above because of their impermanent character.

TABLE 3.—INDIVIDUAL INCOME TAX LIABILITY—TAX UNDER PRESENT LAW AND AMOUNT AND PERCENTAGE OF CHANGE UNDER REFORM AND RELIEF PROVISIONS UNDER H.R. 13270 WHEN FULLY EFFECTIVE

A. AS APPROVED BY THE SENATE COMMITTEE ON FINANCE

Adjusted gross income class	Tax under present law [1] (millions)	Increase (+) decrease (−) from reform and relief provisions	
		Amount (millions)	Percentage
0 to $3,000	$1,169	−$773	−66.1
$3,000 to $5,000	3,320	−1,007	−30.3
$5,000 to $7,000	5,591	−948	−17.0
$7,000 to $10,000	11,792	−1,291	−10.9
$10,000 to $15,000	18,494	−1,907	−10.3
$15,000 to $20,000	9,184	−790	−8.6
$20,000 to $50,000	13,998	−1,013	−7.2
$50,000 to $100,000	6,650	−318	−4.8
$100,000 and over	7,686	+203	+2.6
Total	77,884	−7,843	−10.1

B. AS PASSED BY THE HOUSE OF REPRESENTATIVES

Adjusted gross income class	Tax under present law [1] (millions)	Increase (+) decrease (−) from reform and relief provisions	
		Amount (millions)	Percentage
0 to $3,000	$1,169	−$775	−66.3
$3,000 to $5,000	3,320	−1,049	−31.6
$5,000 to $7,000	5,591	−996	−17.8
$7,000 to $10,000	11,792	−1,349	−11.4
$10,000 to $15,000	18,494	−1,932	−10.4
$15,000 to $20,000	9,184	−775	−8.4
$20,000 to $50,000	13,998	−976	−7.0
$50,000 to $100,000	6,650	−365	−5.5
$100,000 and over	7,686	+324	+4.2
Total	77,884	−7,893	−10.1

[1] Exclusive of tax surcharge.

TABLE 4.—TAX RELIEF PROVISIONS UNDER H.R. 13270 AFFECTING INDIVIDUALS AND TOTAL FOR ALL REFORM AND RELIEF PROVISIONS AFFECTING INDIVIDUALS, WHEN FULLY EFFECTIVE, BY ADJUSTED GROSS INCOME CLASS, 1969 LEVELS

A. AS APPROVED BY THE SENATE COMMITTEE ON FINANCE

		Relief provisions						
Adjusted gross income class	Reform provisions	Low income allowance	Elimination of phaseout	15 percent, $2,000 standard deduction	General rate reduction	Tax treatment of single persons	Total relief provisions	Total, all provisions
				millions				
0 to $3,000	+$8	−$552	−$202		−$27		−$781	−$773
$3,000 to $5,000	−6	−72	−788		−141		−1,001	−1,007
$5,000 to $7,000	−4	−1	−594		−329	−$20	−944	−948
$7,000 to $10,000	−5		−335	−$228	−663	−60	−1,286	−1,291
$10,000 to $15,000	+15		−83	−789	−975	−75	−1,922	−1,907
$15,000 to $20,000	+17		−16	−231	−496	−63	−806	−789
$20,000 to $50,000	+94		−8	−117	−806	−176	−1,107	−1,013
$50,000 to $100,000	+146		−1	−7	−420	−36	−464	−318
$100,000 and over	+860			−1	−641	−15	−657	+203
Total	+1,125	−625	−2,027	−1,373	−4,498	−445	−8,968	−7,843

B. AS PASSED BY THE HOUSE OF REPRESENTATIVES

		Relief provisions							
Adjusted gross income class	Reform provisions	Low income allowance	Elimination of phaseout	15-percent $2,000 standard deduction	General rate reduction	Maximum tax on earned income	Intermediate tax treatment	Total relief provisions	Total, all provisions
					millions				
0 to $3,000	+$16	−$552	−$202		−$27		−$10	−$791	−$775
$3,000 to $5,000	−3	−72	−788		−141		−45	−1,046	−1,049
$5,000 to $7,000	+3	−1	−594		−329		−75	−999	−996
$7,000 to $10,000	+7		−335	−$228	−663		−130	−1,356	−1,349
$10,000 to $15,000	+26		−83	−789	−975		−111	−1,958	−1,932
$15,000 to $20,000	+23		−16	−231	−496		−55	−798	−775
$20,000 to $50,000	+90		−8	−117	−806		−135	−1,066	−976
$50,000 to $100,000	+137		−1	−7	−420	−$20	−54	−502	−365
$100,000 and over	+1,081			−1	−641	−80	−35	−757	+324
Total	+1,380	−625	−2,027	−1,373	−4,498	−100	−650	−9,273	−7,893

TABLE 5.—TAX REFORM PROVISIONS UNDER H.R. 13270 AFFECTING INDIVIDUALS, FULL-YEAR EFFECT—BY ADJUSTED GROSS INCOME CLASS

A. AS APPROVED BY THE SENATE COMMITTEE ON FINANCE

Adjusted gross income class	Change alternative tax on long-term gains [1]	Capital loss limitation	Pension plan provision	Life estates provision	Averaging at 120 percent	Charitable deductions	Reduce percentage depletion	Accumulation trusts	Moving expenses	Foreign income	Farm losses	Real estate	Tax free dividends	Tax on preference income	Total
							millions								
0 to $3,000	----------	+$5	(2)	----------	(2)	----------	(2)	(2)	−1	----------	----------	(2)	(2)	+$4	+$8
$3,000 to $5,000	----------	+3	+$1	----------	(2)	----------	+$1	+$1	−$12	----------	----------	(2)	(2)	(2)	−6
$5,000 to $7,000	----------	+5	+2	----------	(2)	----------	+1	+1	−14	(2)	----------	(2)	+$1	(2)	−4
$7,000 to $10,000	----------	+9	+2	----------	(2)	----------	+1	+1	−26	+$1	----------	+$5	+2	(2)	−5
$10,000 to $15,000	----------	+15	+7	----------	−$5	----------	+2	+5	−32	+3	----------	+10	+3	+7	+15
$15,000 to $20,000	----------	+8	+5	----------	−20	----------	+2	+6	−11	+10	----------	+10	+3	+4	+17
$20,000 to $50,000	+$1	+16	+13	(2)	−45	----------	+8	+30	−12	+10	----------	+45	+17	+11	+94
$50,000 to $100,000	+10	+4	+8	+$5	−30	----------	+5	+32	−2	+1	+$5	+50	+19	+38	+146
$100,000 and over	+319	(2)	+17	+5	−10	+$20	+10	+54	(2)	(2)	+20	+135	+35	+255	+860
Total	+330	+65	[3] +55	+10	−110	+20	+30	+130	−110	+25	+25	+255	+80	+320	+1,125

B. AS PASSED BY THE HOUSE OF REPRESENTATIVES

Adjusted gross income class	Eliminate alternative tax rate on long-term gains [1]	6- to 12-month gains included at 100 percent [1]	Capital loss limitation	Pension plan provision	Life estates provision	Averaging including capital gains and 120 percent	Deferred compensation	Charitable deductions	Interest deduction	Reduce percentage depletion	Accumulation trusts	Moving expenses	Farm losses	Real estate	Tax-free dividends	Limited tax preference	Allocation	Total
								millions										
0 to $3,000	----------	+$1	+$5	(2)	----------	(2)	(2)	----------	----------	+$1	(2)	−$1	----------	(2)	(2)	+$10	(2)	+$16
$3,000 to $5,000	----------	+2	+3	+$1	----------	(2)	(2)	----------	----------	+1	(2)	−11	----------	(2)	(2)	+1	(2)	−3
$5,000 to $7,000	----------	+2	+5	+2	----------	(2)	(2)	----------	----------	+2	+$1	−13	----------	(2)	+$1	+3	(2)	+3
$7,000 to $10,000	----------	+5	+9	+3	----------	(2)	(2)	----------	----------	+2	+1	−23	----------	+$5	+2	+3	(2)	+7
$10,000 to $15,000	----------	+10	+15	+9	----------	−$5	(2)	----------	----------	+5	+3	−29	----------	+10	+3	+3	+$2	+26
$15,000 to $20,000	----------	+10	+8	+6	----------	−30	(2)	----------	----------	+5	+3	−10	----------	+10	+3	+15	+3	+23
$20,000 to $50,000	+$1	+35	+16	+17	(2)	−110	(2)	----------	----------	+19	+16	−11	----------	+45	+17	+10	+35	+90
$50,000 to $100,000	+11	+30	+4	+10	+$5	−105	+$5	----------	----------	+13	+17	−2	+$5	+50	+19	+10	+65	+137
$100,000 and over	+348	+55	(2)	+22	+5	−50	+20	+$20	+$20	+22	+29	(2)	+20	+140	+35	+30	+365	+1,081
Total	+360	+150	+65	[3] +70	+10	−300	+25	+20	+20	+70	+70	−100	[3] +25	+260	+80	+85	[3] +470	+1,380

[1] Assumes ½ of effect as compared with no change in realization.

[2] Less than $500,000.

[3] These full year effect estimates exceed the estimates for 1979 in Table 6.

TABLE 6.—REVENUE ESTIMATES, TAX REFORM UNDER H.R. 13270, CALENDAR YEAR LIABILITY[1]

[In millions of dollars]

Provision	As approved by the Senate Committee on Finance					As passed by the House of Representatives				
	1970	1971	1972	1974	1979	1970	1971	1972	1974	1979
Corporate capital gains	140	175	175	175	175	175	175	175	175	175
Foundations	40	45	45	50	55	65	70	75	85	100
Unrelated business income	5	5	5	5	20	5	5	5	5	20
Contributions	5	10	20	20	20	5	10	20	20	20
Farm losses	25	25	25	25	25	(3)	5	10	10	[8] 20
Moving expenses	−110	−110	−110	−110	−110	−100	−100	−100	−100	−100
Railroad amortization	−125	−115	−160	−180	−105	(3)	−5	−[4] 15	−[4] 60	−[4] 85
Amortization of pollution facilities[5]	−15	−40	−70	−115	−120	−40	−130	−230	−300	−400
Corporate mergers, etc	(3)	(3)	(3)	(3)	(3)	10	20	25	40	70
Multiple corporations	30	70	120	235	235	[4] 45	[4] 75	[4] 105	[4] 175	235
Accumulation trusts	10	25	35	80	130	50	70	70	70	70
Income averaging	−110	−110	−110	−110	−110	−300	−300	−300	−300	−300
Deferred compensation:										
Restricted stock	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)
Other deferred compensation						(3)	(3)	5	10	25
Stock dividends	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)
Subchapter S	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)
Tax-free dividends				80	80				80	80
Financial institutions:										
Commercial bank:										
Reserve	225	150	125	100	100	250	250	250	250	250
Capital gain	(3)	5	5	10	50	50	50	50	50	50
Mutual thrift reserves:										
Savings and loan associations	10	20	30	40	40	10	25	35	60	125
Mutual savings banks	20	25	30	35	35	(3)	5	10	15	35
Tax-exempt interest						(3)	(3)	(3)	(3)	(3)
Individual capital gains:										
Capital loss provisions	50	50	55	60	65	50	50	55	60	65
6 months–1 year holding period[6]						100	150	150	150	150
Pension plans	(3)	5	10	20	[8] 40	(3)	5	10	25	[8] 50
Casualty loss	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)
Sale of papers	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)
Life estates	10	10	10	10	10	10	10	10	10	10
Franchises	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)
Alternative rate provision[6]	200	265	330	330	330	300	300	300	300	300
Natural resources:										
Production payment	100	110	125	150	200	100	110	125	150	200
Percentage depletion	155	155	155	155	155	400	400	400	400	400
Foreign depletion						25	10	(3)	(3)	(3)

Foreign income:										
Loss carryover						35	35	35	35	35
Restriction on mineral credits						30	30	30	30	30
Reduced exclusion	25	25	25	25	25					
Individual interest deduction						20	20	20	20	20
Regulated utilities [5]	60	140	185	260	310	60	140	185	260	310
Cooperatives						(2)	(2)	(2)	(2)	(2)
Limit on tax preference						40	50	60	70	85
Allocation						205	420	425	440	[3] 460
Tax on preference income	650	655	665	690	700					
Real estate:										
Used property [5]	15	40	65	150	250	15	40	65	150	250
New nonhousing [5]	(2)	60	170	435	960	(2)	60	170	435	960
Capital gain, recapture	(2)	10	20	40	100	5	15	25	50	125
Rehabilitation [5]	−15	−50	−100	−200	−330	−15	−50	−100	−200	−330
Total tax reform	1,400	1,655	1,880	2,440	3,335	[4] 1,665	[4] 2,080	[4] 2,215	[4] 2,650	[4] 3,570
Plus investment credit	2,500	2,990	2,990	3,090	3,270	2,500	3,000	3,000	3,100	3,300
Total	3,900	4,645	4,870	5,530	6,605	[4] 4,165	[4] 5,080	[4] 5,215	[4] 5,750	[4] 6,870

[1] Except as indicated these estimates are all at current levels, the time differences being solely to show the phasein.

[2] Less than $2,500,000.

[3] Full year effect: farm losses $25,000,000; pension plans, $55,000,000 under Senate Finance Committee and $70,000,000 under House bill; and allocation, $470,000,000. See Table 5.

[4] Revised.

[5] Assumes growth.

[6] Assumes ½ of effect as compared with no change in realization.

Note: Calendar year 1969 estimates, not shown above, are as follows: under the Finance Committee bill and the House bill, repeal of the investment credit $800,000,000; under the House bill, corporate capital gains $75,000,000, multiple corporations $20,000,000, accumulation trusts $20,000,000 and individual capital gains $175,000,000.

TABLE 7.—TAXABLE RETURNS UNDER PRESENT LAW, NUMBER MADE NONTAXABLE BY RELIEF PROVISIONS AND NUMBER BENEFITING FROM RATE REDUCTION UNDER H.R. 13270[1] BOTH AS APPROVED BY THE SENATE COMMITTEE ON FINANCE AND AS PASSED BY THE HOUSE OF REPRESENTATIVES

[Number of returns in thousands]

Adjusted gross income class	Returns taxable under present law	Returns made nontaxable by low-income allowance and 15 percent $2,000 standard deduction [2]	Returns remaining taxable—benefiting from rate reduction [2]
0 to $3,000	10,053	5,149	4,904
$3,000 to $5,000	9,562	405	9,157
$5,000 to $7,000	9,779	24	9,755
$7,000 to $10,000	13,815	8	13,807
$10,000 to $15,000	13,062	4	13,058
$15,000 to $20,000	3,852	2	3,850
$20,000 to $50,000	2,594		2,594
$50,000 to $100,000	340		340
$100,000 and over	95		95
Total	63,152	5,592	57,560

[1] Provisions effective for tax year 1972 and thereafter.
[2] Revised.

TABLE 8.—TAX BURDEN ON THE SINGLE PERSON UNDER PRESENT LAW [1] AND UNDER H.R. 13270 [2] AS APPROVED BY THE SENATE COMMITTEE ON FINANCE AND AS PASSED BY THE HOUSE OF REPRESENTATIVES (ASSUMES NONBUSINESS DEDUCTIONS OF 10 PERCENT OF INCOME)

A. AS APPROVED BY THE SENATE COMMITTEE ON FINANCE

TAX BURDEN ON SINGLE PERSONS

Adjusted gross income (wages and salaries)	Tax under present law	Tax under H.R. 13270 as approved by Finance Committee	Tax decrease	
			Amount	Percentage
$900	0	0	0	0
$1,700	$115	0	$115	100.0
$3,000	329	$180	149	45.3
$3,500	415	258	157	37.8
$4,000	500	344	156	31.2
$5,000	671	524	147	21.9
$7,500	1,168	1,005	163	14.0
$10,000	1,742	1,468	274	15.7
$12,500	2,398	1,977	421	17.6
$15,000	3,154	2,602	552	17.5
$17,500	3,999	3,320	679	17.0
$20,000	4,918	4,098	820	16.7
$25,000	6,982	5,635	1,347	19.3

B. AS PASSED BY THE HOUSE OF REPRESENTATIVES

1. TAX BURDEN ON SINGLE PERSONS UNDER 35 (OTHER THAN WIDOWS AND WIDOWERS)

Adjusted gross income (wages and salaries)	Tax under present law	Tax under H.R. 13270 as passed by House	Tax decrease	
			Amount	Percentage
$900	0	0	0	0
$1,700	$115	0	$115	100.0
$3,000	329	$180	149	45.3
$3,500	415	258	157	37.8
$4,000	500	344	156	31.2
$5,000	671	524	147	21.9
$7,500	1,168	1,023	145	12.4
$10,000	1,742	1,507	235	13.5
$12,500	2,398	2,078	320	13.3
$15,000	3,154	2,806	348	11.0
$17,500	3,999	3,683	316	7.9
$20,000	4,918	4,650	268	5.4
$25,000	6,982	6,566	416	6.0

2. TAX BURDEN ON SINGLE PERSONS 35 AND OVER (AND WIDOWS AND WIDOWERS AT ANY AGE)

Adjusted gross income (wages and salaries)	Tax under present law	Tax under H.R. 13270 as passed by House	Tax decrease	
			Amount	Percentage
$900	0	0	0	0
$1,700	$115	0	$115	100.0
$3,000	329	$175	154	46.0
$3,500	415	250	165	39.8
$4,000	500	331	169	33.8
$5,000	671	501	170	25.3
$7,500	1,168	957	211	18.1
$10,000	1,742	1,399	343	19.7
$12,500	2,398	1,907	491	20.5
$15,000	3,154	2,532	622	19.7
$17,500	3,999	3,250	749	18.7
$20,000	4,918	4,042	876	17.8
$25,000	6,982	5,643	1,339	19.2

[1] Exclusive of tax surcharge.

[2] Provisions effective for tax year 1972 and thereafter.

TABLE 9.—TAX BURDEN ON THE MARRIED COUPLE WITH NO DEPENDENTS UNDER PRESENT LAW[1] AND UNDER H.R. 13270[2] AS APPROVED BY THE SENATE COMMITTEE ON FINANCE AND AS PASSED BY THE HOUSE OF REPRESENTATIVES (ASSUMES NONBUSINESS DEDUCTIONS OF 10 PERCENT OF INCOME)

Adjusted gross income (wages and salaries)	Tax under present law	Tax under H.R. 13270 as approved by Finance Committee and passed by House of Representatives	Tax decrease	
			Amount	Percentage
$1,600	0	0	0	0
$2,300	$98	0	$98	100.0
$3,000	200	$91	109	54.5
$3,500	275	158	117	42.5
$4,000	354	228	126	35.6
$5,000	501	375	126	25.1
$7,500	915	792	123	13.4
$10,000	1,342	1,174	168	12.5
$12,500	1,831	1,599	232	12.7
$15,000	2,335	2,098	237	10.1
$17,500	2,898	2,669	229	7.9
$20,000	3,484	3,276	208	6.0
$25,000	4,796	4,530	266	5.5

[1] Exclusive of tax surcharge.
[2] Provisions effective for tax year 1972 and thereafter.

TABLE 10.—TAX BURDEN ON THE MARRIED COUPLE WITH TWO DEPENDENTS UNDER PRESENT LAW[1] AND UNDER H.R. 13270[2] AS APPROVED BY THE SENATE COMMITTEE ON FINANCE AND AS PASSED BY THE HOUSE OF REPRESENTATIVES (ASSUMES NONBUSINESS DEDUCTIONS OF 10 PERCENT OF INCOME)

Adjusted gross income (wages and salaries)	Tax under present law	Tax under H.R. 13270 as approved by Finance Committee and passed by House of Representatives	Tax decrease	
			Amount	Percentage
$3,000	0	0	0	0
$3,500	$70	0	$70	100.0
$4,000	140	$65	75	53.6
$5,000	290	200	90	31.0
$7,500	687	576	111	16.2
$10,000	1,114	958	156	14.0
$12,500	1,567	1,347	220	14.0
$15,000	2,062	1,846	216	10.5
$17,500	2,598	2,393	205	7.9
$20,000	3,160	2,968	192	6.1
$25,000	4,412	4,170	242	5.5

[1] Exclusive of tax surcharge.
[2] Provisions effective for tax year 1972 and thereafter.

TABLE 11.—EFFECT OF H.R. 13270 AS APPROVED BY THE SENATE COMMITTEE ON FINANCE AND AS PASSED BY THE HOUSE OF REPRESENTATIVES ON FISCAL YEAR RECEIPTS, 1970 AND 1971

[In billions]

As approved by the Senate Committee on Finance			As passed by the House of Representatives		
	Fiscal year			Fiscal year	
Provision	1970	1971	Provision	1970	1971
Tax reform provisions (+):			Tax reform provisions (+):		
Corporation[1]	+$0.3	+$0.8	Corporation	+$0.4	+$1.0
Individual[2]	+([3])	+.5	Individual	+.3	+.6
Total, tax reform provisions	+.3	+1.3	Total, tax reform provisions	+.7	+1.6
Tax relief provisions (−):			Tax relief provisions (−):		
Individual	[4]−.7	−3.0	Individual	−.7	−3.6
Other provisions (+):			Other provisions (+):		
Repeal of investment credit:			Repeal of investment credit:		
Corporation	+.9	+1.9	Corporation	+.9	+1.9
Individual	+.4	+.6	Individual	+.4	+.6
Total, repeal of investment credit	+1.3	+2.5	Total, repeal of investment credit	+1.3	+2.5
Extension of tax surcharge:			Extension of tax surcharge:		
Corporation	+.3	+.7	Corporation	+.3	+.7
Individual	+1.7	+.4	Individual	+1.7	+.4
Total, surcharge extension	+2.0	+1.1	Total, surcharge extension	+2.0	+1.1
Extension of excise taxes	+.5	+1.1	Extension of excise taxes	+.5	+1.1
Total, other provisions	+3.8	+4.7	Total, other provisions	+3.8	+4.7
Total, all provisions	+3.4	+3.0	Total, all provisions	+3.8	+2.7

[1] Does not reflect the substantial, but immeasurable, increase in tax receipts resulting from the imposition of increased penalties for failure to pay tax and make deposits when due.

[2] Does not reflect the substantial, but immeasurable, increase in tax receipts resulting from the imposition of increased penalties for failure to pay tax and make deposits when due; nor the increase in receipts resulting from the provisions regarding the reporting of medical payments and regarding the limitations on pension plans of professional service corporations, for which data are not available.

[3] Less than $50,000,000.

[4] Does not reflect $200,000,000 reduction in receipts resulting from certification of nontaxability for withholding tax purposes.

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SUBJECT INDEX TO ORAL AND WRITTEN TESTIMONY RECEIVED ON H.R. 13270

(This index is not exhaustive, rather it is intended as a quick reference to the subject matter)

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