PRIVATE FOUNDATIONS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FOUNDATIONS

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-THIRD CONGRESS

FIRST SESSION

ON

THE ROLE OF PRIVATE FOUNDATIONS IN TODAY'S SOCIETY AND A REVIEW OF THE IMPACT OF CHARITABLE PROVISIONS OF THE TAX REFORM ACT OF 1969 ON THE SUPPORT AND OPERATION OF PRIVATE FOUNDATIONS

OCTOBER 1 AND 2, 1973

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PRIVATE FOUNDATIONS

MONDAY, OCTOBER 1, 1973

U.S. SENATE,
SUBCOMMITTEE ON FOUNDATIONS,
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2221, Dirksen Office Building, Washington, D.C., Senator Vance Hartke (chairman of the subcommittee) presiding.

Present: Senators Hartke, Curtis, Fannin, and Hansen.

Senator HARTKE. The committee will come to order.

This is the first meeting of the Subcommittee on Foundations of the Senate Finance Committee.

Foundations have played an important part in American life since colonial days. Today, there are more than 31,000 foundations with grants totaling around $2.2 billion in 1972 alone.

Traditionally, American foundations have been concerned with meeting important human needs. The early foundations set the tone for this concern by their involvement in education and social welfare. Foundations are much more than a means for the wealthy to divest themselves of surplus money painlessly. They are a means whereby those with surplus money can turn that money to uses which benefit the public.

It is because of the importance of foundations to American society that this subcommittee has been formed. The human needs which gave rise to many foundations in the past will increase, rather than diminish, in the coming years.

This change will heighten the importance of foundations and lend greater importance to the need to examine their operations and look to their future.

The problems of students and schools, the young and the old, the scientist and the engineer, and the poor, the hungry and the sick—these have been the traditional concerns of foundations in the United States and they are likely, with various changes in emphasis, to be the concerns of foundations in the future. This subcommittee must examine the extent to which such private philanthropy can and should be encouraged so that important human needs can continue to be met.

The Tax Reform Act of 1969 established a whole new set of rules applicable to charitable contributions and to the operation of charitable organizations. That legislation was designed to insure that tax benefits conferred on private foundations result in adequate public benefit. We will look into the question of whether any areas of foundation abuse remain and the extent to which the 1969 legislation was more restric-

tive than necessary in order to accomplish the objective of assuring that public benefits accrue from the tax benefits given to foundations.

Our session today marks the opening of a series of panel discussions and formal hearings which will explore what foundations are doing today, the effect of the 1969 Tax Reform Act on foundations, the role and the value of foundations in our soceity today, the regulations of foundations in the United States, the relationship between grant-making Government agencies and foundations, and the future of foundations.

The participants in our session today will provide the subcommittee with a general overview of foundations in the United States today. They will also discuss the utility of foundations and whether there is a continuing need for private uses thereof. Our session tomorrow will focus on the effects of the 1969 Tax Act on foundations and the experience which other countries have had with the regulation of foundations.

Despite the importance which foundations have had throughout the history of the United States, the public knows very little of the contributions which they have made to our society. In 1969, there was public recognition of the abuses of some foundations. This recognition was translated into the restrictive provisions of the Tax Reform Act.

It is now time that Congress helped chart a path to a new understanding of foundations. I look forward to today's discussions as the beginning of a dialog which will lead to greater public awareness of the nature of private foundations and an improved working relationship between them and the Federal Government.

Senator Curtis.

Senator CURTIS. Thank you, Mr. Chairman.

Foundations are a very important part of our society; they do a vast amount of good.

I want to welcome those who have come here to testify today so that we on this committee may have on the record current facts, problems and observations as well as a report from the foundations represented.

I have no further statement but I am delighted to have the opportunity to hear these panelists.

Senator HARTKE. Thank you.

Each of the participants in today's session has prepared a formal statement which will be submitted for the record in its entirety and in the interest of time I would hope each participant would confine their oral presentations to this subcommittee to a summary of his or her formal statement, if that is possible. Without objection, the hearing record will remain open for no more than 2 weeks in order that members of the subcommittee and participants in the first two sessions may add additional and relevant material to the record.

[The press release of the Subcommittee on Foundations announcing these hearings, follows:]

PRESS RELEASE

FOR IMMEDIATE RELEASE
September 25, 1973

FINANCE SUBCOMMITTEE ON FOUNDATIONS
2227 Dirksen Senate Office Bldg.

Finance Subcommittee on Foundations Announces Panel Discussions To Study The Role of Foundations Today and the Effect of the Tax Reform Act of 1969 upon Foundations

Senator Vance Hartke, Chairman of the Finance Subcommittee on Foundations, announced today that the Subcommittee will hold two days of panel discussions on October 1 and 2 on selected issues affecting private foundations. The panel discussions are designed to present a full and objective review of the role of private foundations to today's society and a review of the impact of the charitable provisions of the Tax Reform Act of 1969 on the support and operation of private foundations. Public hearings on this and other subjects affecting private foundations will be scheduled at a later date, and persons who wish to submit written testimony will have an opportunity to do so at that time.

The sessions will be held in Room 2221, Dirksen Senate Office Building, beginning at 9:30 A.M. on both October 1 and 2, 1973.

Following is a list of the panelists and the subjects to be covered on the particular days.

October 1

There will be two panels on this day. The first panel will consider the activities of private foundations today, areas given priority attention in the past and today, the experience of grant recipients, the relationship between foundations in grant-making, the involvement of the public in grant-making decisions, publicity given foundation activities, and the activities of foundations in monitoring the application of their grants. The second panel will consider the role of foundations in American society, how useful they are, the functions they perform, the importance of cost effectiveness in measuring functions carried on by foundations which could be performed by government, the role of wealthy individuals in connection with foundations, and the question of a limited life for foundations as opposed to existence in perpetuity.

The panelists for the first discussion will be:

DR. ROBERT F. GOHEEN: Retired in 1972 as President of Princeton. Served as a trustee of various foundations, elected in fall of 1972 as Chairman and Chief Executive Officer of the Council on Foundations.

LANDRUM BOLLING: Former President of Earlham College, Richmond, Indiana. Chosen as head of Lilly Foundation (Indiana) in 1972.

DAVID FREEMAN: President of the Council on Foundations since March 1968. President of the Southern Educational Foundation. Prior to 1968 he served for 10 years on the staff of the Rockefeller Brothers Foundation and later as treasurer of the Fund for the Republic.

ROBERT GUENZEL: President of the Lincoln Community Foundation in Lincoln, Nebraska from 1969 to 1972 and is presently a member of its board. He is an attorney in Lincoln and teaches at the University of Nebraska's College of Business Administration.

RAYMOND WIEBOLDT: Director of the Wieboldt Foundation in Chicago; former director of the Chicago Lighthouse for the Blind; director of Welfare Council of Metropolitan Chicago; businessman.

The panelists for the second discussion will be:

MERRIMON CUNINGGIM: Author of Private Money and Public Giving, Advisor of Ford Foundation. From 1960 to 1972 he was president of the Danforth Foundation of St. Louis (9th largest in country). He was Dean of the School of Theology at Stouther Methodist University, and was a Rhodes Scholar and holds a Ph.D. from Yale.

FRITZ HEIMANN: Author, The Future of Foundations, Associate Corporate Counsel of the General Electric Company. Served from 1969-70 as associate director then executive director of the Peterson Commission on Foundations and Private Philanthropy.

M. CARL HOLMAN: President of Urban Coalition. Former Deputy Staff Director of the U.S. Commission on Civil Rights; Professor, Clark College, Atlanta, Georgia; former Editor of Atlanta Inquirer; Member of the Board of Directors of the Field Foundation.

October 2

There will be two panels on this day also. The first panel will discuss the effects of the Tax Reform Act of 1969 on the operation and support of private foundations, including consideration of whether any areas of abuse remain and the extent to which the legislation was more restrictive than necessary in order to accomplish the objective of assuring public benefit from the tax incentives granted. The second panel will be concerned with a comparative analysis of foundations in other countries, their experience and regulation.

The panelists for the first discussion will be:

HOWARD DRESSNER: Secretary and General Counsel of the Ford Foundation; formerly Assistant to the Vice-President of the Ford Foundation for domestic programs. Formerly on Administrative staff of New York University.

RUSSELL MAWBY: President of Kellogg Foundation since May of 1970. Ph.D. from Michigan State and associated with that University as Director of its Division of Agriculture until 1965 when he joined Kellogg.

JOHN HOLT MYERS: Member of Washington law firm, Williams, Myers & Quiggle. Associate professor George Washington Law School. Participant in various seminars concerned with charitable foundations, and contributor to various legal periodicals.

JOHN SIMON: Professor at Yale Law School and President of the Taconic Foundation. Trustee of the Public Education Association. Member of the Board of the Council on Foundations and the Foundation Center.

MALCOLM STEIN: New York Lawyer. During the first Nixon administration, attorney-adviser in the office of the Assistant Secretary of the Treasury for Tax Policy.

GEORGE D. WEBSTER: Member of Washington law firm of Webster & Kilcullen; Member Advisory Group, Commissioner of Internal Revenue; former member Council, Section of Taxation, American Bar Association; Program Chairman, Annual Conference on Federal Tax and Other Problems of Non-Profit Organizations, since its establishment in 1964.

The panelists for the second discussion will be:

SHELDON COHEN: Washington attorney; Chief Counsel, Internal Revenue Service, during the administration of President Kennedy; Commissioner of IRS during administration of President Johnson

MARION FREMONT-SMITH: A practicing lawyer in Boston and the author of two books on philanthropy. She is a former Assistant Attorney General in Massachusetts and recently participated in the International Conference on Philanthropy in Ditchley, England.

ALAN PIFER: President of the Carnegie Corporation of New York and the Carnegie Foundation for the Advancement of Teaching. He has been with the various Carnegie Foundations since 1953. Prior to this he was executive secretary for the organization which administers the Fulbright Scholarship Program in England. (Was also chairman of President Nixon's Task Force on Education in 1968 and is currently chairman of the Mayor's Advisory Committee on Higher Education in New York).

NATHANIEL SPEAR III: Has been with the Foundation Center in New York since 1969 and is currently its International Specialist. He has taught English in Bogota, Colombia and French and Spanish in New York.

Senator HARTKE. Our first witness today will be Dr. Robert F. Goheen, chairman of the board of directors of the Council of Foundations.

STATEMENT OF ROBERT F. GOHEEN, CHAIRMAN, COUNCIL ON FOUNDATIONS, ACCOMPANIED BY THOMAS TROYER, CAPLIN AND DRYSDALE

Mr. GOHEEN. Mr. Chairman, Senator Curtis, I am Robert F. Goheen, chairman of the Council on Foundations. With me is Mr. Thomas Troyer of the firm of Caplin and Drysdale, our legal counsel. We welcome this opportunity to appear before this committee to speak about the state of the grantmaking foundations and the effects of the 1969 Tax Reform Act on them.

For that purpose I have submitted to the subcommittee a fairly extensive written testimony. This oral statement necessarily is confined to highlights.

The Council on Foundations which we represent is a membership association of grantmaking foundations which currently has 650 members, some with large assets and some with small, located in all parts of the country. The members include 105 community foundations, 62 company foundations, and over 450 independent family and general purpose foundations. In 1973, 65 percent or more of all estimated assets in the hands of grantmaking foundations are administered by council members.

The chief function of the council is to advance effective and responsible performance throughout the foundation field.

When the 1969 Tax Reform Act was passed, some saw it as a deathknell for private grantmaking foundations—or if not that, at least as setting restrictions that would severely inhibit their ability to serve as effective charitable agents. I am happy to say that those doomsayers were wrong. Illustrative of their error are 367 grants of over $5,000 each and totaling nearly $25 million made during 1972 and 1973 in the five States represented by the subcommittee members.

City governments, children's homes, local health centers, programs combating racism, programs fostering ecumenical member cooperation, 4–H Clubs, Girl Scouts, YMCA's, American Indian Schools, public television, children with learning disorders, drug addiction, and deaf adults were among the beneficiaries, alongside colleges, hospitals, museums and churches.

As the chairman and members of this subcommittee doubtless know, philanthropic foundations are of several kinds and vary greatly in size, structure, chosen areas of activity, and modes of operation.

Under classifications established by the Tax Reform Act of 1969, as many as 37,000 foundations may exist today in this country. Of that total, according to the most recent IRS reports, slightly over 700 are private operating foundations. That is, they are primarily involved in conducting charitable activities with their own personnel or facilities, rather than through grants to other institutions or agencies.

Then there are the community foundations or trusts, numbering about 240 at latest count. They are marked by a local or regional

focus, relatively broad funding from the local or regional sources, and boards of directors that are also broadly based.

Finally, there are the so-called private nonoperating foundations. These, too, are of several kinds and encompass great differences in purpose, scale, and method. They include, for example, somewhere between 1,200 and 1,400 company-sponsored foundations established by business corporations to help them institute and carry out systematic programs of charitable giving. Far the most numerous of the private foundations, however, are the independent family and general purpose foundations.

According to most recent reports from the IRS, organizations classified as private, grantmaking foundations number today in the neighborhood of 31,000.

Altogether, by estimate of the Foundation Center the private, grantmaking foundations hold $28 to $30 billion of assets at market value. But only about 2,000 foundations are worth more than $1 million each, while about 350 hold assets worth over $10 million. Foundations known to have assets over $100 million—market value—numbered 46 in 1972.

Of all the private giving in the United States—some $23 billion in 1972—foundation grants accounted for about 10 percent, or $2.2 billion. That percentage surprises most people. They assume the foundations are bigger than they are. Those who worry that foundations exercise excessive financial power should compare $2.2 billion disbursed by 31,000-or-so separate entities with the over $25 billion in annual program outlays of the Department of Health, Education, and Welfare over and above social security payments.

In comparisons of size such as those offered, foundations are Davids to Goliaths. But as that analogy reminds us, small assets well directed can produce important results. That is the primary significance of foundations. Foundations can be more objective, more searching, more systematic, and have a longer eye to the future than the giving of individuals tends to be. They can also be more flexible, more adaptable to specific situations and to specific institutional potentials, less bureaucratically constrained, than governmental appropriations and governmental agencies generally can be. In other words, the organized foundation, devoting time and care to the choices that confront it, is in position to make its dollars have a maximum charitable impact.

I wish to turn now more specifically to the 1969 act and its consequences for foundations.

As you know, the act put many restrictions on the foundations, including a ban on self-dealing, a required high level of annual payout, better public reporting, phased divesture of substantial interest in companies, prohibition of speculative investments, new controls over grants to individuals and certain other types of grantees, stringent restrictions on the funding of voter registration drives and on activities that might influence legislation, and, finally, a 4-percent excise tax on net investment income.

These rigorous provisions of the 1969 act have been accompanied by a marked extension and intensification of the supervision of foundation performance by the Internal Revenue Service.

Moreover, the 1969 act recognized the difficulties involved in compliance with some of its new requirements by providing transition

periods. Consequently some of the reforms that Congress enacted in 1969 remain to be fully implemented. Nonetheless, as the act's substantive provisions come into full effect, these situations will be corrected, and in all parts of the country we observe foundation managers and trustees taking their responsibilities very seriously doing all that they can to meet the requirements and complexities of the new law.

The 1969 act on the whole, then, seems to us to have brought necessary and beneficial regulation to the foundation field. There are, however, several features of the act which are troublesome, particularly in their impact on the actual or potential beneficiaries of foundations activities.

We believe that these features of the act merit further consideration by the Congress.

First, there is the 4-percent excise tax on the net investment income of foundations. The excess revenue raised by this tax beyond the amounts needed for proper auditing and supervision of foundations represents a serious loss to the activities supported by foundations. In 1972, $40 million that would have been available to various operating charities was denied to them by the 4-percent tax.

So, we urge, sir, that the tax be set at a level closer to the actual auditing and supervisory costs, that it be earmarked for those purposes and that it be redesignated as an auditing fee. Such changes would be in accord with the provisions voted by the Finance Committee and the Senate in 1969 which were later altered in the Conference Committee to give us the current 4-percent tax.

Second, two aspects of the 1969 act taken together appear to bear adversely on the future ability of foundations to continue their support of the country's various medical, educational, cultural, and other charitable services.

One element is the high level set in the act for the required annual payout. The Council on Foundations has from the start strongly supported the principle of a substantial annual payout requirement, but we are concerned that the 6-percent rate set as a norm by the act is somewhat too high. Analysis of data on the productivity of investment funds, the rate of inflation, and the rate of growth of costs and charitable operations leads us to conclude that a moderate reduction of the payout personally is desirable My written testimony deals with this set of problems at some length and we shall be glad to furnish additional data if requested.

Second, the effect of the high payout requirement in reducing the support power of foundation assets over time needs to be considered, we believe, in relation to several other parts of the 1969 act that discourage the establishment of new foundations and the augmentation of old ones. Of particular concern here are differences in the deductibility rules affecting contributions to private foundations as compared to public charities, especially with respect to the deduction for gifts of appreciated securities. Administrative complexity and the 4-percent tax are other deterrents.

Because we firmly believe that foundations have made important contributions to the educational, cultured, medical, and other charitable services available to our people, and because we are convinced that comparable contributions remain important for the future, we are

concerned about these long-term consequences of the Tax Reform Act as presently constituted. We, therefore, hope that these two matters, the level of the required annual payout and the reduced incentives, can in conjunction be reexamined by the Congress in order to secure both a reasonable annual current return to charity with due regard for the needs that lie ahead.

In summary, Mr. Chairman, we wish to suggest that the task of so regulating foundations that they necessarily must serve the general good of the Nation has been accomplished, and, on the whole, accomplished well. For this reason, we submit, a new climate of opinion is now merited, one which recognizes the capacity of foundations to help meet important human needs. Congress, we believe, can properly, and should, take a hand in establishing such a new climate of opinion. Never, indeed, have foundations been more needed than today. With many difficult social problems calling for added effort and fresh approaches to solutions, with severe cutbacks in the availability of Federal funding, with private sector educational, medical, and social welfare institutions in deep financial trouble, the initiatives and resources which foundations can provide are desperately required.

No longer should they be regarded as marginal institutions operating in a twilight zone of official disappropriation. It must be made clear to them, we submit, that they enjoy the confidence of the Nation's highest legislative body and that superior performance is needed and expected from them. For their part foundations, we believe, will respond to such an approach and will give their best.

We, therefore, sir, particularly welcome the interest of this subcommittee, as stated by the chairman and by Mr. Curtis. We hope that this subcommittee may take a lead in strengthening the charitable sector and the role of foundations in that sector. We thank you for the opportunity to express our views.

Senator HARTKE. Thank you, Dr. Goheen.

That is a rather conclusive statement and a good one.

One of the problems that concerns me in this whole field, which I think is one which is becoming so socially aware in the Nation today, is just where America is going. Can you give me any indication if there is a sort of philosophical approach foundations have, as differentiated from a pragmatic approach.

Mr. GOHEEN. Well, I could not say that foundations as a whole have a single philosophic approach. In their points of view, the trustees and directors of foundations span the range of American opinion—of the differences in American opinion—and if they have any single commitment, it is a commitment to the vitality and importance of pluralism in the American society—the cultivation of many points of initiative, concern, and energy to be brought to bear on the problems of our society, including the questions of the future of our society.

Senator HARTKE. I understand that, but that does not direct itself to the problem that I'm talking about. If I can take you to the field of politics for a moment, which is not necessarily a bad field but sometimes looked upon with a great deal of apprehension in these days—it seems to be one of the declining arts in the American society. A prominent politician named George Wallace said there is not a dime's worth of difference between the Democratic Party and the Republi-

can Party, and, as one observer in the political scene, I can say too often I find that is true, too much true to suit me. When I ask people in my own political organization, for example, what is the philosophy of the Democratic Party and why is it different from the Republican Party, I find them stuttering and stammering and they go back to the traditional "grandfather was a Democrat and great grandfather was a Democrat and, therefore, I am a Democrat."

What I am asking you in regard to foundations is that same basic question, Is there a philosophical approach that foundations use, not the fact they are interested in philanthropy, not interested in representing diverse views, but just what is the common thread which binds all foundations and which guides their endeavors?

One of the real criticisms I find of the National Government today is the fact that we are program oriented and we have more programs than we have problems. The fact is we have a program-oriented Nation today rather than a philosophical-oriented Nation. When you come, therefore, to defend our system of Government against a highly philosophical system such as communism, we find ourselves hard pressed. Maybe that is so because, in an open society, there is such a variety of interpretations of what the system is.

Having said all of that, let me rephrase the question again. Is there such a thing as a basic philosophical approach to foundations or is it simply program oriented on an ad hoc basis?

Mr. GOHEEN. I would have to say, sir, as far as I know there is no basic philosophy in foundations other than an often tacit commitment—a very important tacit commitment—to the values and institutions of the society which permit things like foundations to function. They are not going to function in a totalitarian society obviously. But I would add this: The foundations, as I see them, are not trying to tell anybody what the philosophy of the Nation should be. Instead, they are encouraging and helping a whole lot of people in universities and elsewhere who are trying to analyze and study political and economic and philosophical issues that are very germane.

Senator HARTKE. Are you saying in substance, instead of developing a philosophy, they are hoping to expand the horizon so that the philosophy of the Nation has a chance to move in different directions?

Mr. GOHEEN. Not necessarily a different direction but so that the best thought, the best minds, can be given a chance to play and operate on serious issues without anybody telling anybody that you have to think this way or that way.

Senator HARTKE. Let me give you one for a moment. Three A's, acid, abortion, the Republicans created this—acid, abortion, and amnesty. All right, these are all controversial items now, in American society. Is it the job of the foundation to explore those and present the diversity of ideas or is the job of the foundations to refuse to be involved in those? Is it the job of the foundations if they become involved in those to direct the attention of the Nation in the way in which it should go or should they just explore the possibility and lay the cards on the table and let somebody else in a different sphere come on and pick up the pieces?

Mr. GOHEEN. I think it is very clearly the job of foundations not to advocate solutions to any of these three A's but rather to encourage

and enable serious thought and investigation to be conducted with respect to them.

The Drug Abuse Council which has been established with support from four major foundations is a very important example, illustrating an effort to set up a group which in a thoroughly objective, nonideological way will try to bring together and make known the best available information on the drug abuse problem and also to support significant further research on this problem.

Senator HARTKE. Well, you say it is not their job to advocate solutions if they come up with facts. Why shouldn't they advocate, why should they stop? What I am trying to find out is what is the role of the institutions? The press is not here at this time. So you can speak your mind freely.

Mr. GOHEEN. We worry, sir, also about the absence of the press today.

As you know, it is entirely right for foundations to support study and analysis which can lead to published conclusions. The foundations do this with respect to their own activities as well. An important and impressive document was the Ford Foundation report on 10 years of funding public school systems. They laid it out on the table, the things they did not accomplish, which were many, and the lessons learned. This is valuable knowledge for public educational systems all over the country.

Senator HARTKE. All right, once having come above that, wasn't it their job to see that this material did not go in file 13?

Mr. GOHEEN. Well, they have distributed that report very widely around the country.

Senator HARTKE. That is a point. Is that their responsibility, is that their role? I am not saying it is or isn't at the moment.

Mr. GOHEEN. I think foundation people are concerned to ameliorate the human condition and to help to get at the roots of some of our persistant ills. You can't do that by getting knowledge and sitting there; you have to get it out; yes, sir.

Senator HARTKE. Well, is there a role in the foundation to make a distribution of the areas in which they move? The information I have, and I don't say this is necessarily right, that the breakdown of the giving in 1971 showed 40 percent went to religious institutions, 16 percent to health, 15 percent to education, 7 percent to social welfare, 6.6 percent into civil and cultural affairs, and 13 percent to others.

Now, am I wrong on that?

Mr. GOHEEN. Yes, sir, those are the figures for all philanthrophic giving.

Senator HARTKE. That is not for the foundation?

Mr. GOHEEN. In my written testimony are the last available breakdowns of foundation giving, and for the last 2 years, 1971, 1972, according to records of the foundation center, we have education receiving 30 percent, welfare 16¾ percent, health 15 percent, science and technology 13 percent, international activities 11 percent, humanities 9 percent, and religion 5 percent. So in terms of individual giving, religion is very high, but not in terms of foundation giving.

Senator HARTKE. Education is first, right?

Mr. GOHEEN. Yes, sir.

Senator HARTKE. I would say that is the right place to put the emphasis.

Senator CURTIS. What was the percentage on education?

Mr. GOHEEN. Thirty percent for the last 2 years.

Senator HARTKE. Well let me ask you another question. What about the distribution of the funds geographically in the Nation? Is there a distribution in relation to the geographic areas? Then, secondarily, is a distribution in relation to the population areas?

Mr. GOHEEN. I can't really respond in relation to population, sir, I just don't have that. Certainly there are foundations in all parts of the country. It is true that many of the large ones tend to be located in the Northeast, but there are some large ones in the Midwest and Far West as well.

It was interesting to me, looking at the composition of this subcommittee, to see that in Indiana as a heavily industrialized State with major urban centers foundation activities over the last 2 years were much heavier than in the other States represented on the subcommittee. But there is significant foundation activity in all of the five States.

Senator HARTKE. Who do I look to? What is the song——

Mr. GOHEEN. Yes.

Senator HARTKE. Who do I turn to for this information?

Is that our job, your job, whose job is that?

Mr. GOHEEN. We can put together from the incomplete data available, sir, relationships between foundation giving and the population distribution of the country. We shall do that and submit it to you. But may I here, as in my written testimony, call your attention to the difficulties we all face when we seek complete and systematic data about foundations. It is anomalous that although philanthropy since the late sixties has been posing serious issues for national tax policy; yet, it remains very difficult to get up-to-date information from Treasury about philanthrophic giving, and when you get it, it comes in large aggregated terms that don't answer the kinds of questions you have raised.

Senator HARTKE. Is there any reason why that information should not be available to the committee?

Mr. GOHEEN. No, sir, no reason at all.

Senator HARTKE. Would you object if we moved in that direction, for any reason? We are at the edge of such an unknown we are sort of like looking at the Moon for the first time and we are not sure what the rocks are going to be.

Mr. GOHEEN. Speaking for the council, and I believe also for many of the so-called public charities with whom I have conferred, university people and college people, they would welcome a more up to date and comprehensive reporting from Treasury on these items. We think it is very desirable.

Senator HARTKE. In other words, you don't feel this would be an unreasonable intrusion into the privacy of the foundation?

Mr. GOHEEN. No, sir, we are asking here for hard data on assets and areas of giving. I think that should be public information.

Senator HARTKE. Let me say to you, and I think I can speak without any fear of contradiction by the committee, any information you can supply to the committee, not necessarily at this time but even after the

record is closed on this hearing, we certainly would appreciate it.

Mr. GOHEEN. Fine.*

Senator HARTKE. And in that regard, I would hope we could work in a cooperative spirit so that we don't come up with some material which leaves the wrong impression on statistical background, which it can, as you well know.

Mr. GOHEEN. Yes, sir.

Senator HARTKE. An article you wrote in the summer of 1972 in the Education Record you said that "one cannot but be struck by the recurrent emphasis of foundations on innovations, experimentation, exploration, and other manipulative forms of change."

Now, how does this contention justify the involvement of foundations in areas where large amounts of money already are expended by either the local, State or Federal Governments?

Mr. GOHEEN. Well, may I answer that in two parts?

First with respect to the article. I was particularly putting attention to be very heavy in innovative claims and exhortations, but if you look at where foundation money is actually going, much of it is going to support traditional institutions, agencies, and activities.

Second, I think that one important function for foundations, especially staffed foundations, is to try to help organizations experiment and develop new lines of activity. They can often do this faster and on a smaller scale than a Government agency can manage. If the privately supported experiment proves bad, Government can learn from that. If it proves good, Goverment can learn from that.

To give you an example. The Upward Bound programs dealing with minority group young people in high schools were first designed by a number of private universities with support from a couple of foundations. Having proved themselves, the concept and methods were taken on by the Government.

Senator HARTKE. Now, I have some more questions but in deference to my other colleagues.

Senator Curtis.

Senator CURTIS. Thank you, Mr. Chairman.

Isn't it true that whatever is deductible as a gift determines the program and philosophy of the foundation in a sense?

Mr. GOHEEN. I don't quite understand the question, Mr. Curtis.

Senator CURTIS. Well, my chairman asked you for the philosophy of foundations. It seems to me, and I will just state this as a proposition, if you don't care to comment. It seems to me that a purpose of foundations is to do good and to distribute charity.

Now, whatever is deductible under our tax laws determines the scope and operation of their activity, I would think, and that is something determined by Congress?

Mr. GOHEEN. Yes, sir.

Senator CURTIS. I have always had the view that if Congress was of the opinion that certain activities of a few foundations were not in the public interest, that it could be reached through a determination, through the statute on what is deductible in the way of a gift, rather than clamping down, so to speak, on all foundations, because in my opinion the tax that we imposed and the payout and the divestiture

*See p. 86 for the response of Dr. Goheen.

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in the 1969 act have been quite hard on many foundations, particularly some of the smaller and new ones.

You cited a figure of 31,000 foundations. How was that figure arrived at?

Mr. GOHEEN. This was a figure secured from the Internal Revenue Service about 2 weeks ago, sir.

Senator CURTIS. Were there that many that paid a tax?

Mr. GOHEEN. They would all have had to pay a tax.

I might say, as the written testimony indicates, that there are apparently between 10,000 and 12,000 other private institutions awaiting tax classification, so that when I said there may be 37,000 foundations, I was suggesting that out of that pool 5,000 or 6,000 more may be added to the known 31,000.

Senator CURTIS. Well, there are always a few foundations that in their beginning years just exist on paper, isn't that true? Someone will set up a foundation expecting in the future to utilize it as a channel for their giving, but at any given time there is quite a number of them that really have no assets of any consequence.

Mr. GOHEEN. Some of them would be very, very small or maybe have no assets.

Senator CURTIS. What is your definition of a nonoperating foundation?

Mr. GOHEEN. A nonoperating foundation is one which functions by making grants to other agencies or institutions which are carrying out recognized charitable purposes.

Mr. TROYER. I might add to that. I am Tom Troyer, of the law firm of Caplin & Drysdale, legal counsel for the Council on Foundations.

The 1969 act provides a definition of what an operating foundation is and gives certain more liberal rules for operating foundations. The definition is rather complex. The essential part of it, however, depends upon expenditures by a foundation, in the language of the statute, "directly for the active conduct" of its charitable operations. An organization which makes expenditures of a certain level of magnitude directly for the active conduct of its operations, is an operating foundation. All other private foundations are nonoperating foundations.

Senator CURTIS. In other words, if here is a foundation that their trustees or managers look after the investment and make their gifts direct to established hospitals, colleges, and other beneficiaries, they are under the statute a nonoperating.

Mr. TROYER. That is right.

Senator CURTIS. But when a foundation has its own activities in research, education, and demonstration, and possibly even administering charity to individuals, then it becomes an operating foundation?

Mr. TROYER. That is correct.

Senator CURTIS. Was the $40 million collected by the tax, the gross amount the Treasury reports?

Mr. GOHEEN. No, sir. As indicated here, Treasury collected $56 million in 1972.

Senator CURTIS. How much do they say they have spent?

Mr. GOHEEN. And they spent $12.9 million on auditing the foundations. Allowing a few million dollars for leeway, I said over $40 million

was not required for auditing and supervision and that amount would have been otherwise available to charitable activities.

Senator CURTIS. Now, the payout provided in the 1969 act will go as high as 6 percent?

Mr. GOHEEN. In 1975, according to the statute.

Senator CURTIS. Do you think that most foundations can pay that out of earnings?

Mr. GOHEEN. Not on the long term, sir, they can't. If they put all of their money into high-interest bonds for a short time, they could, but as indicated in my statement, in a more long-range view one cannot expect them to earn enough to pay out that amount and keep up with the inflation of costs in the kind of things foundations support. That is unrealistic, we believe.

Senator CURTIS. I think so.

Now, is this a particular discouragement to individuals who want to start a foundation?

Mr. GOHEEN. I can't answer that. I believe that there are other more pressing discouragements. The limitation on the amount that can be left, the tax on appreciated securities if given to a foundation, and so on.

Senator CURTIS. How many new foundations have been created since the 1969 act?

Mr. GOHEEN. We are unable to answer that question in detail. I believe that Prof. John Simon testifying tomorrow will be speaking particularly to this question of the birth rate and death rate of foundations. He has recently collected some information on the matter with help from our office, but I don't have it in hand at the moment.

Senator CURTIS. I have been told that there have been very few created since the 1969 act.

Mr. GOHEEN. There are clear evidences of that, except for some that stem from estates written before 1969. There is lots of evidence that some law firms have been discouraging people from founding new foundations, but we can't put hard numbers to that.

Senator CURTIS. That is a source of my information, and that there has been a marked decline in foundations created either by inter vivos gifts or testamentary gifts, I mean confining it to those actions taken since the act, not predating.

Mr. GOHEEN. This is our conviction also, and we think there is a good deal of evidence for it. Moreover, now that foundations are properly regulated, or are regulated very substantially, we think that is unfortunate. It's a different situation than when these things were springing up like topsy all around, often without as much attention to charitable purpose as might have been desirable.

Senator CURTIS. I think that is true. And isn't it also true that there is a long, long list of foundations that have done a great deal of good, that started out as small foundations under a plan where they accumulated income for a number of years until they reached a point where they could accomplish the objective of the donor? Isn't that correct?

Mr. GOHEEN. Yes, sir.

Senator CURTIS. It seems to me that the 1969 act in addition to maybe causing the death of some foundations, I am not so sure of that, but certainly have discouraged new ones, has also deprived the individ-

ual of modest wealth from doing that which has been done through the years, of taking a relatively small amount, setting it aside and letting it accumulate until it can carry on a program of good work more or less in perpetuity.

There is a great deal of misunderstanding about the operation of foundations. I think this even prevails here in the Congress. There are those who feel that assets in the hands of foundations are sort of removed from our economy. Well, that isn't true at all, is it?

Mr. GOHEEN. I don't believe it is true at all.

Senator CURTIS. The assets of a foundation are invested in stocks and other evidences of ownership and they play just as important a part in making our economy go and providing jobs and business turnover as if those same assets were held by an individual, isn't that true?

Mr. GOHEEN. I believe so.

Senator CURTIS. I will not take too long here to propound questions at this point. I am interested in the reporting requirements of the 1969 law that was put in there at my suggestion. I felt that it would be in the public interested to know what foundations are doing. I also felt so strongly that foundations generally were good for our country that there ought to be a place where their activities were reported and where this information would be fed to the computers and where writers and others could go to it and find out what is going on and tell the American public.

If in the course of these hearings or at any time you or any of your colleagues who will testify later have any suggestions on how to make that report more effective, less burdensome on the foundations, and still more informative, I would be very happy to have it.

Mr. GOHEEN. All right.

Senator CURTIS. Because it was not my purpose that this would be a burden or a restriction on foundations but merely that it just would be a simple factual way of letting everyone who was concerned know what they got in return for the tax treatment given to foundations.

Mr. GOHEEN. Sir, we believe that is an excellent provision; indeed, we think that it is a minimal provision. We would like foundations to be reporting more fully and more often than is required by law.

Senator CURTIS. Of course the law sets a minimum requirement, it does not stop a foundation from——

Mr. GOHEEN. We think it excellent. Attached to my written testimony as exhibit 1 is a statement of principle by the council on the importance of public reporting for the foundation field as we see it. We believe that the public is entitled to accurate information about foundations, and we believe the public will understand foundations better if it can know more about them.

Senator CURTIS. It is your recommendation that the 4 percent tax ought to be reduced?

Mr. GOHEEN. We think it ought to be redesignated as an auditing fee and pegged in amount to the actual cost of auditing and supervision.

Senator CURTIS. Because as it stands now it lessens the amount the beneficiaries receive.

Mr. GOHEEN. Very substantially.

Senator CURTIS. Yes. In fact they are the ones that carry the burden.

Mr. GOHEEN. That is right; it is not really a tax on the foundation, it is a tax on the beneficiaries.

Senator CURTIS. Do you also feel that the mandatory payout requirements need an adjustment downward if they are to be continued?

Mr. GOHEEN. We believe so, sir, and we believe so especially when they are looked at in conjunction with the disincentives to the augmentation of the field. When you put those two things together, the high payout, as it were, evaporates the total pool of foundation assets. If then no fresh springs flow into the pool, that pool is going progressively to dry up.

Senator CURTIS. When an individual starts a foundation, he gives that which he has, doesn't he, and that is usually stock in his own company.

We cannot expect a high payout in every instance and we cannot expect instant diversification of his portfolio, all of which in my opinion were brought about by the mistaken opinion that if the donor's securities were held by the foundation that per se that meant something wrong, either mismanagement of the funds or tax evasion or something of that sort, and I do not buy that at all.

Mr. GOHEEN. It seems to me, sir, very anomalous that for foundations established before 1969 realistic periods of transition for divestiture are provided but for those established after the act the period is very short, as you know. It appears inequitable and unrealistic unless it is intended to cut down on foundation assets.

Senator CURTIS. Well, I know of few instances where a requirement of a divestiture by a foundation would mean the liquidation of the business and the only possible purchaser would be one or two monopoly competitors. I was totally out of sympathy with the entire act, but particularly the divestiture, the forced payout and tax, I think it went by far beyond what the public interest requires, and I think it was brought about by a misunderstanding of the operation of foundations and what is the proper approach. If the Congress arrives at conclusions that a particular activity should not be funded by foundations, they have a remedy in determining what gifts are deductible and what are not. But I shall not take any more time at this time.

Mr. TROYER. I might add that there is another provision of the act that has the effect that you are talking about. It is quite important, and it has the effect of constricting the birth of foundations, the creation of new foundations. That is the set of special restrictions on gifts of appreciated property to private foundations. When one gives a stock of a closely held business or other appreciated property to a public charity or to an operating foundation one gets a deduction for the total current fair market value. That is not true after the 1969 act for an endowment gift to a private nonoperating foundation. That is a very significant discouragement to the creation of the new nonoperating foundation with business interests or other appreciated assets of that kind.

Senator CURTIS. Yes, I did not include that, but it is certainly very important and I think a change should be made in that and I also hope a change can be made in the divestiture requirements because it serves

no good purpose, and it certainly is hampering some excellent operations.

Sometimes the notion prevails that foundations are created because somebody wants to escape taxes. I think most foundations are created under a desire to do good. I know of one foundation whose gifts run into millions and millions of dollars that has been very, very helpful to a long list of educational institutions, and I happen to know why it was created. The man came to the conclusion that his sons were going to inherit more money than they should inherit and he wanted to do good with it. It was not motivated by anything else.

I thank you, Mr. Chairman.

Senator HARTKE. Senator Hansen.

Senator HANSEN. Dr. Goheen, of the various types of activities carried on or supported by private foundations, which do you regard as the more important or more appropriate activities? If you could just identify areas briefly for me I would be grateful.

Mr. GOHEEN. I don't feel competent to do that. It seems to me that the range of human needs in our society and the world scene is very great and demanding. Foundations are engaged over the vast spectrum of these needs, and rightly so. I could not say that education should get more than health or anything of that sort.

Senator HANSEN. In your prepared statement you say in summary, "Never, indeed, have foundations been more needed than today. With many grievous social problems calling for new, experimental approaches at solution, with severe cutbacks in the availability of Federal funds, with private sector educational, medical, and social welfare institutions in deep financial trouble, the initiative and resources foundations can provide are desperately required. No longer should they be regarded as marginal institutions operating in a twilight zone of official disapprobation * * *."

Does this imply that even a minor but still significant share of the financial backing that I assume you conclude is required can be provided by foundations and not through tax dollars?

Mr. GOHEEN. I think a significant proportion, sir, and it is often a portion that gives the institution the flexibility and the ability to do something which it wants very much to do but otherwise can't do.

If you look at the universities today, about which I know something, they have been through a period of very stringent belt tightening to get their budgets back in order. One of the great problems is: How do you meet the needs of a changing society when you are reducing volume of your expenditures? How, for example, do you do more in environmental studies when that is needed? Foundation money can often come in and give that little bit of leverage.

On the other hand, a welfare-type institution that can make its case to a local foundation and pick up, let's say, $2,000 often finds that $2,000 invaluable in the local situation. They could not do the job without it. Also, foundations are reporting to us that, with the financial problems hitting the charitable agencies and with the change in the mode of Federal response, the appeals they are receiving have grown immensely in recent months.

Senator HANSEN. Are there any activities that you would care to identify that you think have been traded on or supported by private

foundations in the past and may be continuing as of today that you feel would be no longer appropriate for private charity? I mean are there any activities that you think in the past have been supported by foundations that you would like—you would now say ought no longer be supported?

Mr. GOHEEN. Well in terms of humanitarian, educational, medical services, that kind of thing, I really can't think of anything. Foundation responses in these areas change as techniques change and new problems come in focus. But your question gives me an opportunity to say, sir, that prior to 1969—and perhaps one reason for some of the provisions of the 1969 act—there were instances when foundations were thought to have engaged in political activities or to have supported direct political activity. The Congress in the 1969 act has put down very specific prohibitions against that, and I think it is important to recognize the fact.

The most recent national publicity that has come to foundations came in the Watergate hearings last week, during Mr. Buchanan's testimony in which he made a number of allegations about foundations which were, on the whole, out of date and in great measure incomplete. It is too bad that through that televised testimony, without adequate rejoinder, the impression was given out that some foundations continue to be invloved in partisan political activity when that is not so.

Senator CURTIS. May I say right there you have some company in that regard. There are a number of people that have been maligned by those hearings and no opportunity to rejoin or cross-examine.

Senator HANSEN. What is your personal view as to the wisdom of financing political campaigns since you brought up this issue? I was not going to raise it but you have. How do you feel about the bill to have all campaign funds provided at taxpayers' expense?

Mr. GOHEEN. My personal view, sir, is that some realistic system of public financing greatly needs to be developed. I think it will strengthen and improve and restore public confidence on our political system.

Senator HANSEN. Doesn't the recognition of the validity of foundations tend to limit or restrict the tax fund that otherwise would be available to Government for all of its purposes?

Mr. GOHEEN. Well, the fact that these funds are in the hands of 31,000 foundations means that some substantial party that $28–$30 billion was not taken into the tax system at some point, although there is no way of telling where the funds would have gone if they had not been given to foundations. As between foundations and Government, I guess it comes down to who one believes can better provide the services and meet the human needs. Are not at least some of these services and needs being better handled through the involvement and concern of foundation trustees and managers year by year? I think the public is gaining, not losing. Moreover, I believe that much of the essence of this country—one would hope in its future as well as in its past, to pick up the chairman's first question—lies in our pluralism, in our capacity to have multiple points of thought, energy, and concern playing roles in the well-being of the country.

Senator HANSEN. Do you believe it is important, Dr. Goheen, that individuals, if they feel strongly about a particular issue, program, problem or candidate, ought not to be denied the opportunity to put their money where their mouth is, so to speak, using the foundations as a vehicle?

Mr. GOHEEN. I would think they should not use the foundations as a vehicle to support a particular candidate or a particular piece of legislation. In my personal view, the prohibitions enacted in the 1969 act on that score are desirable. I think foundations, misunderstood as they often are, will be better understood and be able to do their primary humanitarian jobs better if they don't get too caught up in the political process. That is my view about foundations. I believe individuals obviously should be able to support issues and causes and people of their choice—though in terms of campaign legislation, such as we were talking about before, some dollar limit would have to be set unless we are going to have the same problems we now have.

Senator HANSEN. Well, there are many questions that that response suggests to me. I won't go into them but I would ask you this.

If a foundation believes through its trustees that it has identified serious major significant problems, would you say that it is appropriate only to pursue those goals within a clearly defined structure of foundation activity or do you think that it might be appropriate to bring to bear whatever sort of campaign, so long as there is nothing illegal, immoral or without precedent about it, that might be pursued in anticipation that the objective more shortly would be realized?

Mr. GOHEEN. Yes, as long as it is not illegal or immoral I would quite agree with that.

Senator HANSEN. Well, I gather that, considering your dedication and your commitment to foundations, you should speak as you have, if you did not say what I understand you to say, you would not be worthy of your hire.

I happen to believe that if a person is employed by a group that he ought to speak for them, he ought to believe what he says, and I am certain that you do. I don't mean at all to depreciate your loyalty, I commend you for it.

But you think then that there are certain things particularly in the political arena that we would be better off to deny individuals. You spoke about how we might finance political campaigns as an example and if I understood you correctly, you looked with some favor upon legislation which would make the financing of political campaigns more a Federal tax function than to leave it as it has been in the past, an individual decisionmaking responsibility. That part was right?

Mr. GOHEEN. Yes, I think that is right. I am not a political scientist but I would offer this analogy. I think we found in many others aspects of American life that when people are in control of substantial assets without regulation and supervision there are going to be some who will abuse, seriously abuse, that privilege for personal gain. So, the insurance companies had to be regulated and the banks had to be regulated and finally the foundations had to be regulated. I think that we may have come to the point, I think we have come to the point where in terms of political campaigns individuals need to

be regulated more than they have been, or curbed more than they have been, in the use of economic power, not in other respects.

Senator HANSEN. Now, if we finance political campaigns with public tax funds, who is responsible—if there is to be any responsibility, in determining who indeed are the real honest to goodness candidates? How do you make certain that a person who does have some deep commitment toward bettering society is given a share of funds sufficient to assure that he may wage a successful campaign or have a chance for it? If four or five others who are really very uninterested candidates, but conceivably could be put into a race to dilute the support away from a challenger, and I have particularly in mind the problem that I think arises from the fact that despite any kind of law we may write, whatever kind of campaign law is written, is going to be an incumbent bill because it written by people who are now in office and if you would agree with me, that the visibility and name recognition probably that goes with being in office does give some advantage to someone in office. How are we, if we turn it over to public financing, going to give an honest sincere dedicated challenger, a man without very much statewide or district visibility, a chance to effectively challenge an incumbent?

Mr. GOHEEN. Senator, you got me out of my depth. I am an amateur in this area.

It seems to me, however, there are two things that might be done. One is that there should be a certain amount that a candidate should provide from private sources before he would qualify for public subsidy.

Senator HANSEN. You say he should? Say that again.

Mr. GOHEEN. I am suggesting that in order to keep just anybody without any support at all from declaring himself as a candidate and, therefore, gaining public funds, there might be a point up to which private support would not only be desirable but necessary. Let's say you have to be able to show that you have $50,000 worth of support in order to run for *x* office; if you had that, then it would be matched by Federal funds. But let me repeat that I am talking as an amateur.

Senator HANSEN. Then would it follow that a rich man as contrasted to a poor opponent would have a built in advantage, would you say?

Mr. GOHEEN. He certainly might. He has today.

Senator HANSEN. Does that square with your political ethic?

Mr. GOHEEN. It would reduce his advantage very substantially, but I am out of my depth in this area and would like to get out of it if I might.

Senator HANSEN. The only reason I am asking these questions is that a lot of people are asking them of foundations and foundations have been criticized in the past. I have had a lot of letters from constituents who find foundations at times seemingly going against public purposes or at least administrative purposes in the area of foreign affairs and many other areas. I am not being critical, I wanted to get some answers from you in order that I might better understand what the picture is and respond more intelligently to those who say: "You were on the Finance Committee in 1969 when you passed this tax reform law, how do you justify this?" And very often I am like you are

now, excepting I suspect I have had this experience more times than you have had, I don't know what the answers are.

Mr. GOHEEN. On the other question, getting away from the campaign business, to what foundations support, it seems to me right that we should have foundations supporting a whole range of different points of view and lines of inquiry, whether popular or not, in our society. That is one of the contributions they can help to make. If some foundations tend to be "liberal" in their assistance, there are others that are very "conservative" in theirs, and most fall in between. I think that is healthy and properly reflects the American society.

Senator HANSEN. Just to give you an example, our distinguished chairman is cosponsor of the Burke-Hartke bill. I am sure you have heard of it, and there are a lot of laboring people——

Senator HARTKE. Let me say at this point on an objective analysis it is the best trade bill in the field.

Senator HANSEN. I was hoping you might allow me to make that observation, Mr. Chairman, but I am happy to have you make it.

I was going to say that there are lots of people in this country who don't agree with multinational corporations, who are weary of foreign aid, and who believe that the profits that are made in this country ought to go to increasing the standard of living of all Americans, and that ought to be almost to an exclusive objective. As a consequence, not everyone feels that the funds which have been accumulated through activities in which there is mass participation, I am thinking of big corporations and so forth, ought to be used as much as in the past in support of international efforts of one kind or another, whether it is relief for India or grain for Pakistan, or hurricane relief for some other country. These are just things that come along and positions that are taken and I would like to know how we answer that sort of criticism in the context of the activities of a foundation, especially if they seem to go contra to clearly delineated administrative purpose.

Mr. GOHEEN. Well, sir, it would be my view that one of the functions of foundations is to see to it that members of different points of view and lines of argument on important issues like this can be fomulated and can be heard so that the public discourse will thereby be enriched and enlightened. I think it would be very unfortunate if the public policies of a given administration were to dictate—or a given session of Congress, for that matter, were to dictate—what could be advanced and what could not be advanced as significant thought. I think this would be terribly unfortunate.

Senator HANSEN. Mr. Chairman. Thank you. I have taken more than my share of time. I appreciate your responses.

Senator HARTKE. Dr. Goheen, I want to return now to the question of philosophy. Since you have raised the issue of Watergate, that basically is where I was headed anyway, you might as well know. Let me give you some preliminaries on this situation. I was asking what the basic philosophy of foundations is or what it should be, or if it should have a philosophy. I was really dealing with the historical context of what happens in a society where people happen to somehow come into additional funds beyond those of the ordinary people.

In other words, the wealthy people historically have been looked upon as having a responsibility in society, especially in democratic so-

cities—the wealthy people have been looked upon as having a responsibility to society to perform two things; to either reform the system itself or provide for some type of assistance to those less fortunate, in other words to the poor. That is nothing new, it is a historical context.

In line with that it appears to me that there is a basic split inside foundations, and this is in broad categories, and that is the responsibility of foundations to do first one thing or to do another. The first one is: is it the responsibility of the foundation to support existing institutions, or is it the responsibility of the foundation to provide for innovations and for the change or the conflict or the controvery in society.

Now, having once made that distinction between the two general approaches, then two questions immediately arise as far as the Government is concerned. Can our tax structure afford either one of those philosophical approaches, or both, and, No. 2, should it?

You see, Mr. Buchanan does raise, in my opinion, a very substantial question, which is in the mind of the public, and the mere fact that he happens to be a Republican and happened to be in front of the Watergate Committee does not in any way in my opinion either give additional merit to it nor detract from it. But he does raise a fundamental question for foundations and I think he does raise in terms of the ordinary individual a discussion about so-called liberal foundations and conservative foundations.

Now, the question was asked of Mr. Buchanan, "In the course of your duties during the Presidential campaign of 1972 and also your duties at the White House, were you of the view that a number of tax-exempt foundations were unfriendly to the President or to the Republican Party, and indeed helpful to the Democratic Party." That was the question. And I think you are well aware of the answer, that he indicated in substance that he thought they were there at that time but especially had been more so prior to that time, and he specifically then indicated that he thought the Ford Foundation was guilty, in his opinion, of being wrong, in his opinion, as to their approach. I think that is a fair interpretation of what he said. I am not trying at this moment to go ahead and use his exact phraseology, but his general thrust and theme.

He said the Brookings Institution was considered to be a liberal organization. Then he indicated also that at times that after people had been involved in the 1964 campaign, with Barry Goldwater, who also were involved I suppose, with foundations. Mr. Buchanan charged that that foundation found itself in serious trouble with the taxing authorities and was threatened at that time with losing its tax-exempt status.

Now, his statement was, that the administration of the Internal Revenue Service "requires a strong fellow running the Internal Revenue Division, especially a friendly fellow with a friendly staff in the tax-exempt office."

Now, with all that preliminary, I leave you again with the question I asked in the first analysis. Is it the responsibility of the Government to provide tax funds to promote either one or two of those basic propositions which I indicated and, secondarily, can it afford to do so? The two basic propositions are, again, whether foundations should

promote and help existing institutions or, involve themselves in the controversy of whether or not existing institutions are functioning for the benefit and common good?

Mr. GOHEEN. Sir, it seems to me that it is appropriate for foundations to be——

Senator HARTKE. Let me ask the question for the people in the back of the room, can you hear?

Mr. GOHEEN. It seems to me it is appropriate for foundations to be concerned with both of these two basic missions as you enunciated them. Some foundations do both things. Some choose to emphasize innovation and social change, others choose to emphasize support to established institutions.

It also intrigues me that some people think that support to a university—I think here of Mr. Neilson's book—is necessarily support to the status quo. Often the most far out new thinking comes out of the universities. In other words a foundation can support an established institution and still, through it be supporting lines of forward thought and change.

Attached to the written statement as exhibit 2 is a statement of guidelines and principle put together by the directors of the council. It states, as I said to Senator Hansen, that it is not only appropriate but right that there should be foundations of different interests and persuasions operating within the American society; that some should be more conservative and others less conservative; that some should be concerned more with innovation and others more with the root well-being of the institutions of our society.

As to whether the Government can afford this, I am not an economist, but I would say that it can.

Senator HARTKE. Do you agree with the contention that foundations now presently avoiding paying taxes in the amount of $610 million?

Mr. GOHEEN. I beg your pardon.?

Senator HARTKE. Foundations avoided paying taxes in the amount of $610 million last year. Is that a fair statement?

Mr. GOHEEN. I can't answer that.

Mr. TROYER. I don't know where that revenue statement comes from.

Senator HARTKE. It is a very rough staff estimate.

Mr. GOHEEN. If we put beside that again the fact that in 1972 $2.2 billion of foundation giving went into various charitable institutions, and 30 percent of that $2.2 billion went into colleges and universities, you get the other side of the coin.

Senator HARTKE. Look, I did not say that in any way to depreciate from the value of foundations. We have some technical things which we are going to have to agree upon here ultimately, although we are——

Mr. GOHEEN. I had not heard——

Senator HARTKE. I was saying in answer to the question whether or not the Government can afford to do this, as distinguished whether it should do it, you have to ultimately say how much money are you avoiding in paying taxes.

Mr. GOHEEN. May I say the other side of the coin is that if the foundations had been paying that tax then much of the $2.2 billion of foundation giving would not be available to go to recognized charities that need support and might otherwise become tax burdens.

Senator HARTKE. I am not arguing that fact, I am trying to establish facts not argue them.

Go right ahead then.

Mr. GOHEEN. Well, I think that is a lot of tax dollars.

Senator HARTKE. I really don't want to move in that direction, I want to come back to the basic question of philosophy and the question which Buchanan raised in the Watergate hearings, which I think is a legitimate question.

Mr. GOHEEN. Mr. Buchanan's objection was that he thought that certain lines of "liberal thought" advanced in places like the Brookings Institution got a disproportionate amount of foundation support and he would like to have had a few big Republican foundations, Republican spirited foundations which were supporting equivalent studies but coming at issues from a different point of view, I understand he even drafted a memorandum for the establishment of such a foundation. I think it might be very good if there were more of the conservative foundations supporting serious academic research, research in depth, than seems to be the case. They have generally chosen to put their funds in different kinds of things. I don't think it should be an either or proposition. I think we want both of them.

Senator HARTKE. A lot of foundations make contributions to organizations and educational institutions primarily, let me say organizations generally which have deficits in their operating budgets. Is this a proper function of foundations?

In other words, just to pick up the deficit of an organization which in and of itself would probably fail to exist without that type of support? Is that a proper function of the foundation in view of the fact that it is using American tax dollars?

Mr. GOHEEN. If it is a question of keeping alive an institution which otherwise could not exist for any length of time, I would think that was a waste of foundation money. More often it is the question of this deficit representing the difference between an institution performing well or not performing at all or performing badly, and if you look at the record of foundation giving to many of the small liberal arts colleges you will see that $5,000 here and $10,000 there is helping them with student aid programs, faculty study leaves, and so on that they simply could not otherwise fund. These things have to do with the quality of the institution, not its bare survival.

Senator HARTKE. In our society is it the responsibility of foundations to keep going an operation which somehow cannot finance itself?

Mr. GOHEEN. In our society we have been doing that for many, many years. We believe in voluntary efforts and we have encouraged them. We have known they were never going to make a profit, that they were always going to have hard times. That is why we have these big fundraising drives. Why do we have United Fund?

Senator HARTKE. I might even question some of the United Fund activities in my own concept. But on the other hand, I am not saying at this moment it is a bad thing, I am just asking the question because I am going to ask you the other side of the question right now.

Mr. GOHEEN. I was asking a rhetorical question to illustrate the point.

Senator HARTKE. I am going to ask the other side of the same question. In the field of attempting to effectuate social change, is that a proper function really of the foundations? Would that social function be of such a nature to eliminate foundations themselves or what if the social change would say in substance it would eliminate the whole doctrine that is presently there, and say take you down the road toward, let me put it in blunt terms, a Communist society in which there is no room for private giving because there is no such thing as private property.

Mr. GOHEEN. Sir, earlier on, you remember, I said that if there was a philosophy governing foundations I thought it had to be a commitment to an open and free society, with the kinds of values and institutions that permit foundations to exist. In my own conception of such a society and in the kind of society which we largely though not perfectly have, it is proper that there should be people thinking far out thoughts and arguing even the destruction of the society because that sets up challenges against which other people, the rest of us, can argue and sharpen our thoughts and maybe improve our society. At least, I believe in such openness, and I think that foundations in their diversity depend on it.

Senator HARTKE. Let me repeat again, that the question of open end society again is a subjective decision and even Senator Curtis, for example, expressed his apprehensions today about the Watergate hearings, that they were not really in effect an open-end hearing, and I am not going to pass judgment on that, I am just saying to you that the question of what is an open-end society and what is an open-end hearing and what really isn't is always subject to a great deal of discussion. But the point I am making is, do the foundations have at the moment any public awareness? It is in this field that there has been a criticism directed at them for being engaged in the sixties in political activities, isn't that fair?

Mr. GOHEEN. Yes.

Senator HARTKE. I am asking you now, you have to say yes or no.

Mr. GOHEEN. Yes, sir. I was waiting for you to stop.

As I said earlier, I thought it was too bad Mr. Buchanan raked up pre-1969 activities in some instances. Then I read the Buchanan testimony and questioning last night. It seems to me what he said beyond that was that just as there is Brookings Institution, which he described as liberal——

Senator HARTKE. Liberal?

Mr. GOHEEN. Liberal. Just as there is Brookings, which he described as funded by the Ford Foundation, he would like to have had something like a MacArthur Institute funded to look at things from an ideologically conservative position. He emphasized that he didn't want Brookings' tax exemption taken away, I think that is fine, I don't see anything wrong with that.

Senator HARTKE. I am not on that point; you are talking about whether that is fine. I am talking about what it is ultimately going to do and whether it is a proper function of utilization of tax money. Are you saying it's a proper utilization?

Mr. GOHEEN. I said——

Senator HARTKE. Because I am going to take you to another proposition in a moment.

Mr. GOHEEN. I tried to say earlier, Mr. Senator, that I thought that foundations should not get involved in specific legislative issues and take partisan political positions with respect to those isues—that they should try to assure that the research they support is nonpartisan, objective, scholarly sound. I would repeat that. I also happen to believe that the diversity of points of view in the American society is a wonderfully precious thing. The class and interplay of conflicting views is part of the life and vitality of our society and I think foundations should not back off from controversy as long as they stay away from partisan politics.

Senator HARTKE. But, you see, Mr. Buchanan did not give you that type of commendatory endorsement. What he said in substance was that there was actual political activity involved in the utilization of tax funds by the foundations. That was the substance of his charge.

What I am saying to you is very simply the controversy of foundation involvement in political activities. The registration people, the registration of minority groups especially, was being criticized.

Now, isn't that same type of criticism going to be leveled at the institutions in the secondary field if they become involved in the whole question of social innovations and reform in the seventies?

And, let me ask you, if they are criticized for such operations, is that a legitimate reason for the Government to eliminate their tax-exempt status?

Do you understand what I am saying?

Mr. GOHEEN. Yes, sir, you throw a great deal at me at once.

Senator HARTKE. I understand. I am really coming back to the heart of this whole hearing.

Mr. GOHEEN. Let me just say with respect to the public opinion and Mr. Buchanan's statement, I would agree with you. I merely meant to say I thought it was unfortunate that no recognition was given that the 1969 act rules out a whole lot of kinds of things he was referring to. ~~Second,~~ with respect to questions of social change, whether they have to do with integration or low-income housing, things of this sort, these are controversial matters in the public mind and——

Senator HARTKE. Let me ask you this.

Low-income housing is one thing, but that is not controversial in the nature of the three A's a while ago. Let me ask you specifically, I want to ask you about acid, amnesty, and abortion, this is a problem you are faced with in the seventies.

If you get involved in those things, are you prepared to go ahead and defend the actions of the foundations in relationship to their tax-exempt status?

Mr. GOHEEN. I think that the foundations are doing what they should with respect to these problems—at least many are—namely, supporting serious in-depth studies of them. That is proper. Foundations should not stay away from questions simply because they are controversial. That is what I thought I said earlier.

Senator HARTKE. All right.

Mr. ~~TROYER.~~ Let me simply add a footnote, Senator, because I think we may be tending to lose sight of an important point here.

In Mr. Buchanan's criticism of foundations there are two aspects: one directed at foundation involvement in politics, and one directed at foundation involvement in the making of the laws that govern our society. The Finance Committee looked very carefully, very directly, very closely at both of those points in 1969, and it adopted some very tough rules on both. It applied severe penalty taxes to any foundation involvement in—and I am quoting the Internal Revenue Code now—"influencing the outcome of any public election." Also, the 1969 act established some very elaborate and very specific restrictions for voter registration activities. Beyond that, the act goes to the subject of foundation involvement in legislative activities, and again puts some very tough, severe penalties on foundation activities designed to influence legislation. It defines that term very broadly.

The language of the Internal Revenue Code here, which triggers these penalty taxes, is "any foundation expenditure for any attempt to influence any legislation through any attempt to affect the opinion of the general public, any segment thereof, any attempt to influence legislation through communication with any member, employee of a legislative body, or any other governmental official or employee, who may participate in the formulation of legislation."

So the Finance Committee looked at these problems in 1969, and now we have some tough rules that keep foundations out of both of the areas that Mr. Buchanan is talking about.

Senator HARTKE. Is this a good rule or bad rule, is that a good law or bad law?

Mr. TROYER. I think the first half of it no one would quarrel with. The attempt to keep foundations out of politics, out of direct interference in political campaigns, as Mr. Goheen has said, is clearly right and the foundations themselves have not argued to the contrary. We supported that legislation in 1969, and we think it is a good rule.

As experience develops under the second rule—that is, the very broad restriction on activities which may influence decisions of legislative bodies—it may be that the Congress would want to rethink its decision.

Mr. GOHEEN. May I suggest, if your question was leading up to whether there should or should not be equivalent regulation of foundations on issues of social concern—such as amnesty, acid, and whatever the other one was, or low-cost housing, busing, and so on—my strong belief would be that it would be very unfortunate if Congress were to legislate what should or should not be investigated and studied in these areas. We must hope that will not occur.

Senator HARTKE. Let me give you two as a thought.

One of them you mentioned, busing, that is a controversial issue in Indianapolis, Ind., at the moment. There is at this time a group which wants to have a constitutional amendment in regard to busing. Is it proper for the foundations to use tax money in order to get involved in a situation which ultimately would be effecting problems, not only legislative changes and legislative actions, but also ultimately would even effect constitutional changes, whether the organization was pro or anti?

Mr. GOHEEN. Under the law foundations could not support things designed to take a position one way or the other on that piece of legis-

lation, a constitutional amendment, but they could be supporting studies, in say, the University of Michigan on the basic issue.

Senator HARTKE. Let me do the other side of the coin, the other item which Senator Hansen raised, and the question of public financing of political campaigns. Is it a proper and legitimate operation of the foundation to become involved in the study and to the ultimate recommendation as to whether or not political campaigns should be financed out of the Public Treasury?

Mr. GOHEEN. I would believe so.

Senator HARTKE. You would think it would be a proper study?

Mr. GOHEEN. Yes.

Senator HARTKE. Wouldn't that be an attempt to influence legislation which presently is before the Congress?

Mr. GOHEEN. No, sir; not if it is done as a serious and analytical study of the pros and the cons.

Senator HARTKE. Every study I have made has been serious and what was the other word you used?

Mr. GOHEEN. And analytical.

Senator HARTKE. Serious and analytical. And everything my opponents have made has been scurrilous—that is very simple.

Let me go back to Senator Fannin who has not had a chance to ask questions.

Senator FANNIN. Thank you.

Dr. Goheen, I appreciate the opportunity to question you because I am vitally interested in what you have had to say. I regret that I was not here from the very start.

You give a few examples, you say, of grant-making foundations doing their job, which primarily is to assist organizations, both the public and private, to serve the myriad needs of people. I have witnessed what has been done in my State and around the Nation in medical research, safety programs, research not assumed by industry because of no opportunity for financial return. I can praise the work of foundations in many respects. But I am very concerned, Doctor, because foundations funded by a business or executive, former executive business or present executive business, seem to feel that they should show their independence by being antibusiness. An example is the Ford Foundation.

What is your thought in this regard? That is one example.

Mr. GOHEEN. I know of no instance of the Ford Foundation being antibusiness that I can recall. Maybe you could refresh my recollection.

Senator FANNIN. I think fostering some of the strikes that have been in progress, they might say indirectly, but Ceasar Chavez is an example.

Mr. GOHEEN. I have no evidence of that at all, sir. Maybe if you could tell me. Is it in fact known——

Senator FANNIN. That is why I am asking you, indirectly, that is what I understand had taken place, and I have been very concerned about it.

Mr. GOHEEN. Mr. Dressner from the Ford Foundation will be testifying to this committee tomorrow morning.

Senator FANNIN. Fine. We will address that question to him then.

I am very proud of some of the programs that have been sponsored in my own State, and the colleges you refer to. I happen to be very active

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in the school you referred to and very pleased with what they are doing. When the school was faltering the foundation did to a great extent come to their rescue. I have been told, I put this in a question, what are the stipulations that are attached to the contribution of funds? For instance, are you familiar with what happened?

Mr. GOHEEN. No, sir; I am not familiar with any detail other than having read the reports of a number of foundations and some press stories.

To answer your question not in the general terms in which you first put it, the normal situation is that an agency or institution like the community college draws up a proposal describing something it wants to do and for which it needs support. It submits that proposal to a foundation or foundations which review it. If a foundation approves it and has the funds, it will give the institution financial aid for the purpose requested. Later the foundation normally wants to know whether the purposes for which the money was given were in fact the purposes served and how did it go.

Generally, foundations do not like to give support that is going to tie them down into the basic funding of the institution over a long, long period of time.

Senator FANNIN. Well, the reason I did ask you this question was that I have been told that some of the foundation money was contributed with the understanding, and understand I don't know whether the ones you refer to are involved in any respect, but with the understanding that this would bring students from other States around the Nation, non-Indian students on to campus. They did have certain goals in that respect, maybe they were good goals, integration, I don't know what the goals were, but I know they had considerable trouble and almost rebellion on the campus at one time because they did bring in some malcontents and it caused considerable, as I said, difficulty.

I am wondering, I was wondering if you had any knowledge.

Mr. GOHEEN. Not of that specific thing. I knew there had been some tensions but I did not know, and do not know who initiated that idea, whether that was an idea of the college administrators or an idea of some foundation person.

Senator FANNIN. They should be interested in, when they are funding a particular project, and you, I think, stated that they should be interested in showing all sides of a particular issue. Is the way that you feel money should be handled in this regard is to foster all different types of programs, conservatives, liberal, moderate programs?

Mr. GOHEEN. May I make a distinction, sir? I believe that research and study funded by a foundation should endeavor to be as objective and fair and honest as it can be, and should not in any way be guided by strictly partisan concerns.

Ordinarily in this country humans are entitled to differences in basic points of view. Therefore, the second part of my answer is that there should be some foundations which are inclined to support more liberal things and others more conservative things. In the general mix of our society that seems to me to be healthy.

Senator FANNIN. Shouldn't they be interested in what is right and beneficial to the people of the Nation, are you saying——

Mr. GOHEEN. Yes; I think that is absolutely the first thing—is of the essence—but if I may use the term, a liberal Democrat and a conservative Democrat may have quite different points of view, at the same time that both are deeply devoted to the well-being of the Nation.

Senator FANNIN. I don't exactly follow you. I am just wondering if you feel, I realize you do not feel the foundations should foster dissent or controversy. Aren't many of these programs we are discussing doing exactly that, fostering dissension and controversy?

Mr. GOHEEN. Sir, I would not agree with that. I think we are in a time when there are great strains in the American society and stresses between element and element of it. As foundations work within the totality of the society, as it were, they are going to be interpreted by some one way and others another way. In a given circumstance, what looks controversial to one person may not be controversial to another. I don't think it is correct to say that foundations are inciting the dissent and the controversy.

Senator FANNIN. Do you feel that they should promote patriotism?

Mr. GOHEEN. Well, I certainly do. But patriotism again is a matter which can be defined in a variety of ways.

Senator FANNIN. That is my concern, because of the manner in which it has been considered by foundations in some respects. I feel very keenly that we are benefiting our young people greatly by some of the programs that are being fostered by foundations, I am also vitally concerned when patriotism is attacked by some groups I feel are being also funded by foundations. I am not in a position—I recall when we were discussing this matter back in 1969, before the 1969 legislation, we had a great number of illustrations in that respect, and I still feel that we have some problems in that regard. I don't believe they are as serious as they were at that time, we are not having the problems around the country, thankfully, that we were then, and so perhaps that is not true a this time, but I am vitally concerned that this does not happen. I appreciate the answers you have given and I just regret that I was not here to hear your full testimony.

Mr. GOHEEN. Thank you, Senator.

Senator HARTKE. Dr. Goheen, we are taking a lot of time but I am still going to ask you a few questions.

Mentioning colleges and universities, there has been a sharp cutback in the amount of aid available to students in most universities and colleges. As a former president of a great university itself, what is the proper role, first, of the Federal Government in aiding students in the school, and shouldn't that aid also be given to both private and public schools, or should it be directed toward public schools?

Mr. GOHEEN. I believe, sir, that if we are to maintain our plural system of higher education, which I believe to have shown itself to be greatly valuable, it is important that Federal aid be available to private institutions as well as to the State institutions.

I, myself, believe that if there is to be general aid, it is best attached to aid to students, to needy students, as was done in the education amendments passed, I guess, 2 years ago but never adequately funded. I also think it is of great importance that there again be more Federal attention to the education of graduate students who are the future faculty and research personnel of the country. Most universities are

having a very, very difficult time adequately funding the graduate programs today.

Senator HARTKE. You said in your statement on page 11 that public accountability is not the instinctive disposition of some particular foundations.

Mr. GOHEEN. That is right.

Senator HARTKE. Why is there this reluctance on the part of the foundations to open up their activities to public scrutiny?

Mr. GOHEEN. At its most pure it goes back to a good old Judaeo-Christian ethical principal: you do your good works quietly and don't parade your virtue to your fellow man. Let God reward you later if He sees fit.

Senator HARTKE. To open them up to scrutiny is one thing and parading them to the public—I don't think Jesus, when He was doing good work, went around and said that He wasn't supposed to let others know about them.

Senator CURTIS. There were several instances where He warned people not to tell anybody.

Mr. GOHEEN. That is a really very honorable——

Senator HARTKE. And they proposed to immediately tell everyone, right?

Mr. GOHEEN. Having been brought up in a Calvinist home, this old and noble tradition is one I learned early. It appeals to me. I don't think it is unimportant. But a more general reason is that people of wealth who establish foundations with which they are still associated in their lifetimes are concerned that too much knowledge about their foundations will greatly augment the number of requests that come in.

Senator HARTKE. Greatly what?

Mr. GOHEEN. Augment the number of requests that come to them. Already they can't meet all the demands that come to them. Why invite any more?

Senator HARTKE. I wouldn't find that a very serious problem.

Mr. GOHEEN. I don't find it so either.

Senator HARTKE. If nothing else, maybe you could employ a clearinghouse for these requests.

Mr. GOHEEN. We would be——

Senator HARTKE. Excessive?

Mr. GOHEEN. We would be swamped.

Senator HARTKE. What is the real reason that the public should not have a good look?

Mr. GOHEEN. Look, there is no reason. Attached to my written statement as exhibit I, is a policy statement from the council that emphasizes the importance of the obligation of public accountability; we believe in that totally. You asked me why and that is a different question.

Senator HARTKE. In other words, you really are saying that the council's statement is that there should be more——

Mr. GOHEEN. Yes, sir.

Senator HARTKE. I want to insert in the record at this time a list of the 100 largest U.S. foundations, including Community Corporate and other private foundations, ranked by grants.

I want to put that in the record.

[The material referred to by Senator Hartke follows:]

100 LARGEST U.S. FOUNDATIONS RANKED BY GRANTS

Rank and foundation	Total grants	Year	Rank by assets
1. The Ford Foundation (New York)	$187,820,519	1972	1
2. Longwood Foundation, Inc. (Delaware)	67,535,078	1971	23
3. The Rockefeller Foundation (New York)	43,900,000	1972	8
4. The Andrew Mellon Foundation (Pennsylvania)	31,800,000	1972	4
5. Emily and Ernest Woodruff Foundation (Georgia)	28,426,000	1971	15
6. Charles Stewart Mott Foundation (Michigan)	24,507,330	1971	7
7. The Duke Endowment (New York)	19,503,665	1972	18
8. W. K. Kellogg Foundation (Michigan)	18,610,512	1972	5
9. Carnegie Corporation of New York (New York)	13,787,483	1972	9
10. Alfred P. Sloan Foundation (New York)	13,542,346	1972	13
11. John A. Hartford Foundation, Inc. (New York)	13,475,225	1971	14
12. Edna McConnell Clark Foundations (New York)	12,494,086	1971	29
13. Danforth Foundation (Missouri)	11,947,420	1972	51
14. Houston Endowment, Inc. (Texas)	11,641,064	1972	12
15. Rockefeller Brothers Fund (New York)	10,287,498	1972	10
16. Lilly Endowment, Inc. (Indiana)	9,886,600	1972	3
17. DeWitt Wallace Fund, Inc. (New York)	9,343,726	1970	....
18. The Vincent Astor Foundation (New York)	8,989,506	1972	26
19. The Kresge Foundation (Michigan)	8,801,812	1972	19
20. Ford Motor Company Fund (Michigan)	7,727,220	1972	....
21. The Cleveland Foundation and Greater Cleveland Assd. Foundation (Ohio)	7,572,981	1972	21
22. DeRancé, Inc. (Wisconsin)	7,219,916	1972	35
23. New York Community Trust—Community Funds, Inc. (New York)	6,930,576	1972	22
24. The Commonwealth Fund (New York)	6,878,783	1972	40
25. The Moody Foundation (Texas)	6,179,589	1972	24
26. San Francisco Foundation (California)	6,088,783	1972	8
27. Sid W. Richardson Foundation (Texas)	5,993,235	1970	53
28. Exxon Education Foundation (New York)	5,354,370	1972	....
29. Charles E. Merrill Trust (New York)	5,242,313	1970	....
30. Research Corporation (New York)	5,230,000	1972	41
31. The Seely G. Mudd Fund (California)	5,186,998	1972	....
32. Callaway Foundation, Inc. (Georgia)	5,175,286	1972	55
33. The Haas Community Fund (Pennsylvania)	5,141,934	1972	17
34. The Bush Foundation (Minnesota)	4,888,403	1971	20
35. El Pomar Foundation (Colorado)	4,812,915	1972	45
36. The Robert A. Welch Foundation (Texas)	4,716,557	1971	60
37. The Wm. R. Kenan, Jr. Charitable Trust (New York)	4,655,000	1971	38
38. Richard King Mellon Foundation (Pennsylvania)	4,643,180	1971	11
39. Sarah Mellon Scaife Foundation, Inc. (Pennsylvania)	4,509,584	1971	30
40. The Surdna Foundation (New York)	4,419,000	1971	36
41. The Grant Foundation (New York)	4,418,835	1972	59
42. The Pew Memorial Trust (Pennsylvania)	4,359,000	1971	6
43. Max C. Fleischmann Foundation (Nevada)	4,295,140	1972	37
44. Sears-Roebuck Foundation, Inc. (Illinois)	4,172,000	1972	....
45. Z. Smith Reynolds Foundation, Inc. (North Carolina)	4,124,900	1971	39
46. John Simon Guggenheim Memorial Foundation (New York)	4,089,000	1972	27
47. Mary Flagler Cary Charitable Trust (New York)	3,996,448	1971	57
48. United States Steel Foundation, Inc. (Pennsylvania)	3,956,860	1972	....
49. W. Clement & Jessie V. Stone Foundation (Illinois)	3,721,000	1972	....
50. Louis W. & Maude Hill Family Foundation (Minnesota)	3,697,203	1972	34
51. Charles Hayden Foundation (New York)	3,658,201	1972	54
52. Elliott White Springs Foundation, Inc. (South Carolina)	3,631,559	1972	107
53. Gulf Oil Foundation (Texas)	3,436,294	1972	180
54. Charles F. Kettering Foundation (Oregon)	3,430,976	1972	32
55. Amoco Foundation (Illinois)	3,410,000	1972	84
56. Alcoa Foundation (Pennsylvania)	3,351,595	1971	25
57. The Robert Wood Johnson Foundation (New Jersey)	3,315,623	1971	2
58. The Henry J. Kaiser Family Foundation (California)	3,277,140	1970	48
59. The Charles A. Dana Foundation, Inc. (Connecticut)	3,025,000	1971	85
60. The Louis D. Beaumont Foundation, Inc. (Oregon)	2,857,744	1970	159
61. Sarah Mellon Scaife Foundation, Inc. (Pennsylvania)	2,789,788	1972	39
62. Frank E. Gannett Newspaper Foundation, Inc. (New York)	2,786,170	1972	16
63. Boettcher Foundation (Colorado)	2,756,084	1972	71
64. The Field Foundation, Inc. (New York)	2,721,000	1971	113
65. Exxon Educational Foundation (New York)	2,620,932	1972	....
66. China Medical Board of New York, Inc. (New York)	2,614,551	1972	66
67. Claude Worthington Benedum Foundation, Inc. (Pennsylvania)	2,526,418	1972	52
68. Mobil Foundation, Inc. (New York)	2,498,566	1971	....
69. Mary Reynolds Babcock Foundation (North Carolina)	2,481,522	1972	127
70. General Electric Foundation (New York)	2,431,877	1972	125
71. Amon G. Carter Foundation (Texas)	2,383,259	1971	62
72. The James Irvine Foundation (California)	2,381,000	1972	28
73. The Louis Calder Foundation (New York)	2,233,752	1972	63
74. Humble Companies Charitable Trust (Texas)	2,233,427	1971	241
75. Helene Fuld Health Trust (New York)	2,203,830	1972	68
76. The Herbert H. & Grace A. Dow Foundation (Michigan)	2,196,662	1970	74
77. Booth Ferris Foundation (New York)	2,155,700	1972	44
78. The George Gund Foundation (Ohio)	2,130,709	1972	97
79. M. D. Anderson Foundation (Texas)	2,103,854	1972	70
80. W. Alton Jones Foundation, Inc (New York)	2,025,595	1971	90

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100 LARGEST U.S. FOUNDATIONS RANKED BY GRANTS—Continued

Rank and foundation	Total grants	Year	Rank by assets
81. Burlington Industries Foundation (North Carolina)	$2,014,630	1971	256
82. Allegheny Foundation (Pennsylvania)	2,012,154	1971	253
83. Kate B. Reynolds Health Care Trust (North Carolina)	1,941,404	1972	
84. Chrysler Corporation Fund (Michigan)	1,844,977	1972	
85. Fannie E. Rippel Foundation (New Jersey)	1,837,184	1972	103
86. Arthur V. Davis Foundation (Florida)	1,800,000	1972	79
87. Russell Sage Foundation (New York)	1,781,726	1972	81
88. Samuel S. Fels Fund (Pennsylvania)	1,776,680	1972	
89. Hoblitzelle Foundation (Texas)	1,681,189	1971	92
90. The John & Mary R. Markle Foundation (New York)	1,655,284	1972	94
91. The Henry Luce Foundation (New York)	1,607,000	1972	93
92. The Joseph & Helen Regenstein Foundation (Illinois)	1,578,550	1972	89
93. The Jessie Smith Noyes Foundation (New York)	1,558,900	1972	
94. Victoria Foundation, Inc. (New Jersey)	1,557,500	1972	75
95. Benwood Foundation, Inc. (Tennessee)	1,530,528	1970	
96. Turrell Fund (New Jersey)	1,520,452	1971	95
97. Murry & Leonie Guggenheim Foundation (New York)	1,500,000	1971	177
98. Walter E. Heller Foundation (Illinois)	1,498,829	1971	
99. The Teagle Foundation, Inc. (New York)	1,476,130	1972	98
100. Bank of America Foundation (California)	1,473,100	1971	

Senator HARTKE. As I said before, and you indicated you could not help me, this also indicates the location of the foundations, but it does not indicate the geographic area in which those grants were made, and all I am going to ask you now for the record, is to fill that information in, too. All right?

Mr. GOHEEN. Yes, sir.*

Senator HARTKE. In line with that you have indicated you thought most of the operations are going to the northeastern part of the United States.

Mr. GOHEEN. No. I said most of the big foundations happen to have their headquarters there.

Senator HARTKE. Where their headquarters are is rather immaterial, except the investment of the assets.

Mr. GOHEEN. Where the charities have been supported.

Senator HARTKE. Do you think you can have any better coordination between the foundations, is that part of your function?

Mr. GOHEEN. Yes; it is something that the council works on every day.

Senator HARTKE. What about helping the smaller organizations, smaller groups which don't have the expertise and advice, is that a part of your responsibility?

Mr. GOHEEN. Yes; it is. We do this often by running conferences that bring foundation people together in geographical regions to share experience and hear from experts in the different fields. We also publish a magazine and we do a lot of individual consulting of this sort.

Senator HARTKE. You indicated in your statement that you thought this committee should go into the broader span of representation from foundation recipients.

Mr. GOHEEN. Yes.

Senator HARTKE. And what type of organization do you think should testify here?

Mr. GOHEEN. Well, I would like to see some universities and colleges, public universities as well as private ones, tell you what foundation support has meant and does mean to them. I would like to see some

*See p. 38.

people in here from welfare agencies of various kinds, from public libraries, and the various other charitable institutions with whom foundations are working, because that is really where the foundations come in contact with the society.

Senator HARTKE. Does the council, your council, keep in touch with these recipients?

Mr. GOHEEN. We try to.

Senator HARTKE. Do you know of any recipients who are dissatisfied with their relationship with the grantors?

Mr. GOHEEN. One of the really——

Senator HARTKE. That is a nice question to put out.

Mr. GOHEEN. Yes.

Senator HARTKE. There are some, and you think some may be legitimate while some may not be legitimate complaints?

Mr. GOHEEN. I do.

The commonest complaint is over no support or inadequate support. One is daily up against the fact that the needs far outbalance the foundation resources available.

Senator HARTKE. I have no further questions.

Senator CURTIS. I won't take any more time, but I don't want to name foundations by name, but we will assume there are about 31,000 of them. How many of them do you know of have been broadly criticized for the programs they have carried on?

Mr. GOHEEN. I certainly know of one. I would think probably not more than four or five.

Senator CURTIS. Do they fall in the category of the operating or nonoperating?

Mr. GOHEEN. The ones I was thinking of are the grantmaking nonoperating, sir.

Senator CURTIS. Nonoperating?

Mr. GOHEEN. Nonoperating. There is at least one of which I know has drawn some adverse criticism.

Senator CURTIS. That is all.

Senator FANNIN. There have been considerable pressures to allow certain tax-exempt organizations the right to lobby for legislation. This is partially justified, because the corporations can lobby and takea business expense deduction. What are your thoughts on this issue?

Mr. GOHEEN. With respect to foundations or with respect to charitable organizations?

certain tax-exempt organizations the right to lobby for legislation.
the foundation to lobby for legislation.

Mr. GOHEEN. You are speaking just about foundation? My personal view, I don't speak for the council, my personal view is it is best for foundations not to get into lobbying at all or into legislative activity at all.

Avoiding that, indeed, may protect their freedom to support controversial studies which don't tie directly to legislation.

Senator FANNIN. Very good.

Mr. GOHEEN. That is my answer.

Senator FANNIN. I agree with you, and I thank you for your remarks in that regard.

Senator HANSEN. I have no further questions.

Senator HARTKE. Thank you, Doctor.

[Mr. Goheen's prepared statement and supplementary comments and responses to questions raised, follows. Hearing continues on page 72.]

Hon. VANCE HARTKE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR HARTKE: During my testimony before your Subcommittee on Foundations October 1, you asked us to provide (1) information on the geographic distribution of foundation giving, with some reference to the division between industrialized and rural areas and (2) information on the geographic distribution of the activities supported by the 50 foundations listed in the February 1973 issue of *Non-Profit Report* as the largest givers in any one of the last 3 years.

With the assistance of The Foundation Center and the cooperation of various individual foundations, we have done our best to put together useful information responding to these two inquiries and we are pleased to be able to present it herewith.

Permit me first, however, to point out some of the difficulties in the way of getting complete information on these matters and, hence, some of the limitations of the data we are submitting.

As I indicated in both my written and oral testimony it is both anomalous and frustrating that at a time when foundations and other forms of philanthropic giving are recurrently involved in issues of tax policy—as has been the case since 1969 and seems certain to continue—there seems to be so little interest in the Treasury Department in developing and making available up-to-date and useful information about philanthropy. We are forced to rely instead on very incomplete data available to private agencies, such as The American Association of Fund-Raising Counsel and The Foundation Center, both of which, I hasten to say, seem to me to do a remarkably good job, given the limitation of having to work largely with volunteered information.

Thus with reference to the questions you have posed, the IRS reporting forms (990-AR) covering the foundation activities in 1972 are not yet available from the IRS. If they were, the information on them would not be so arranged as to permit ready response to your inquiries. Even for just the 50 large foundations to which you referred, it would take many, many hours to extract the desired information from the individual 990-ARs. Consequently, in trying to develop useful responses to your questions we have had to rely mainly on the information collected and recorded by The Foundation Center in its computerized data bank from reports submitted to The Center on a volunteer basis by individual foundations and through a culling of press reports.

The Center's data bank for the year 1972 includes grants of $10,000 and more by 817 out of the some 31,000 private non-operating foundations that exist. While thus incomplete, we believe that the evidence we have been able to bring together out of this partial record is probably a reasonably good indication of the distribution of foundation giving generally. And while commenting on The Center, I am pleased to be able to report that it has developed plans, and is currently seeking funding, that will permit it henceforth to record information on all grants shown in the IRS reporting forms for foundations with assets of over $1 million.

Now, in more specific response to your questions, there are attached three breakdowns showing:

(1) The distribution by states of the 1972 giving of foundations on record in The Foundation Center.

(2) The distribution of this giving between the nation's 25 major industrial centers and other areas.

(3) The geographic distribution of the 50 largest foundations (as listed in *Non-Profit Report*) in terms of giving and program activities.

As you will see, these data evidence a very broad distribution of foundation giving in all regions of the country. But as was to be expected, foundation giving is considerably greater to institutions and agencies located in the nation's most heavily populated centers than to other parts of the country. Thus there is nearly an even split in foundation giving between the rest of the country and the 25 largest metropolitan area (as defined in the 1970 Census), although only

slightly more than one-third (75,699,686) of the national population is located in the latter areas.

When one looks at the distribution of foundation giving among the 50 states, there are marked concentrations in the Middle Atlantic States, which include New York City, and in the South Atlantic States, which include the District of Columbia. These concentrations are to be explained in part by the large number of national non-profit service organizations headquartered in New York and Washington. Grants to these national organizations are recorded at the location of the national headquarters, but in most cases they are supporting activities throughout the entire United States. (In illustration we include, as Attachment #4, examples drawn from the 1972 annual reports of the W. K. Kellogg Foundation, the Kresge Foundation, and the A. W. Mellon Foundation, where over $4 million was given to organizations headquartered in either Washington or New York but conducting nation-wide programs.) This same phenomenon of course is also reflected in the totals shown in Attachment #2.

Sincerely,

ROBERT F. GOHEEN.

DISTRIBUTION BY STATES AND REGIONS OF FOUNDATION GRANTS ON RECORD IN THE FOUNDATION CENTER—1972

	Total grants paid 1972	Number of grants
New England (population 11,842,000):[1]		
Maine	$1,768,063	33
New Hampshire	4,568,195	61
Vermont	2,816,761	61
Massachusetts	76,528,001	1,042
Rhode Island	3,017,168	66
Connecticut	24,416,099	333
Total	113,114,287	1,596
Middle Atlantic (population 37,199,000):		
New York	285,448,222	3,163
New Jersey	30,968,443	705
Pennsylvania	68,336,715	1,335
Total	384,753,380	5,203
East North-central (population 40,253,000):		
Ohio	40,713,731	778
Indiana	18,105,989	286
Illinois	48,706,350	767
Michigan	32,530,816	377
Wisconsin	12,426,139	172
Total	152,483,025	2,380
West North-central (population 16,320,000):		
Minnesota	18,823,033	214
Iowa	3,760,690	38
Missouri	17,469,723	172
North Dakota	648,190	14
South Dakota	363,523	9
Nebraska	2,037,650	52
Kansas	1,244,848	34
Total	44,347,657	533
South Atlantic (population 30,671,000):		
Delaware	1,057,870	10
Maryland	16,750,252	132
District of Columbia	136,845,301	910
Virginia	10,746,625	132
West Virginia	2,517,590	37
North Carolina	47,333,767	520
South Carolina	6,329,975	118
Georgia	16,393,319	160
Florida	9,968,665	149
Total	247,943,364	2,168
East South-Central (population 12,804,000):		
Kentucky	5,738,930	75
Tennessee	13,774,509	130
Alabama	3,333,190	50
Mississippi	3,229,310	55
Total	26,075,939	310

[1] U.S. Census of population, 1970.

DISTRIBUTION BY STATES AND REGIONS OF FOUNDATION GRANTS ON RECORD IN THE FOUNDATION CENTER—1972—Continued

	Total grants paid 1972	Number of grants
Mountain (population 8,281,000):		
Montana	$914,258	9
Idaho	785,809	10
Wyoming	171,800	4
Colorado	15,272,826	217
New Mexico	2,535,012	43
Arizona	5,647,341	49
Utah	2,809,907	25
Nevada	7,132,158	43
Total	35,269,111	400
West South-central (population 19,320,000):		
Arkansas	1,304,601	12
Louisiana	5,042,304	78
Oklahoma	2,773,400	36
Texas	43,718,375	540
Total	52,838,680	666
Pacific (population 26,522,000):		
Washington	4,276,931	61
Oregon	4,124,640	60
California	92,980,437	1,110
Hawaii	2,753,666	116
Alaska	1,666,275	13
Total	105,801,949	1,360
Total, all grants	1,162,627,392	14,616
Total, foreign grants	86,732,425	788

PROPORTION OF FOUNDATION GRANTS TO PROPORTION OF POPULATION BY MAJOR GEOGRAPHIC AREAS

	Percent of number of grants	Percent of total grants	Percent of population
New England	10	10	6
Middle Atlantic	36	33	18
East North-central	16	13	20
West North-central	4	4	8
South Atlantic	15	21	15
East South-central	2	2	6
Mountain	3	3	4
West South-central	5	5	10
Pacific	9	9	13

1972 foundation grants to 25 standard metropolitan statistical areas (SMSA) as defined by the Bureau of the Budget (1970 Census)

	Amount
1. New York, N.Y. (Includes the 5 boroughs, Nassau, Suffolk, and Westchester Counties where available), population 11,528,649	$150,668,931
2. Los Angeles-Long Beach, Calif. (Includes Los Angeles County, Orange County, and other areas where available), population 7,032,075	25,761,758
3. Chicago, Ill. (Includes Cook County and other areas where available), population 6,978,947	30,294,446
4. Philadelphia, Pa. (Includes city plus suburban areas where available), population 4,817,914	17,571,852

1972 foundation grants to 25 standard metropolitan statistical areas (SMSA) as defined by the Bureau of the Budget (1970 Census)—Continued

	Amount
5. Detroit, Mich. (Includes city plus suburban areas where available), population 4,199,931	$12,272,210
6. San Francisco-Oakland, Calif., (Includes Bay Area where available), population 3,109,519	22,494,678
7. Washington, D.C. (Includes surrounding areas of Maryland and Virginia where available), population 2,861,123	136,845,301
8. Boston, Mass. (Includes Cambridge and surrounding suburban area where available), population 2,753,700	45,269,854
9. Pittsburgh, Pa. (Includes only the city), population 2,401,245	18,413,028
10. St. Louis, Mo. (Includes suburban areas where available), population 2,363,017	10,347,620
11. Baltimore, Md. (includes suburban areas where available), population 2,070,670	11,963,691
12. Cleveland, Ohio (includes suburban areas where available), population 2,064,194	16,166,459
13. Houston, Tex., (includes suburban areas where available), population 1,985,031	6,255,414
14. Newark, N.J. (all of State included as one metropolitan area), population 7,168,000	30,968,443
15. Minneapolis-St. Paul, Minn. (includes suburban areas where available), population 1,813,647	11,419,787
16. Dallas, Tex. (includes Ft. Worth and suburban areas), population 1,555,950	4,865,314
17. Seattle-Everett, Wash. (includes only the two cities), population 1,421,869	1,969,699
18. Anaheim-Santa Ana-Garden Grove, Calif. (includes these three cities only), population 1,420,386	222,936
19. Milwaukee, Wis. (includes suburban areas when available), population 1,403,887	2,562,849
20. Atlanta, Ga. (includes suburban areas where available), population 1,390,164	11,785,215
21. Cincinnati, Ohio (includes suburban areas where available), population 1,384,911	8,552,306
22. Paterson-Clifton-Passaic, N.J	(1)
23. San Diego, Calif. (suburban areas included where available), Population 1,357,854	2,059,435
24. Buffalo, N.Y. (includes Niagara Falls and Erie and Niagara Counties), Population 1,349,211	940,241
25. Miami, Fla. (includes Dade County), Population 1,267,792	1,622,279
Total grants 1972 for top 25 SMSA's	[2] 576,293,241
Total grants to areas other than top 25 SMSA's	616,334,151
Total population 1970 for top 25 SMSA's	75,699,686
Total population areas other than top 25 SMSA's	127,512,314

[1] See Newark, N.J.
[2] All data on grants is from the Foundation Center data bank.

DISTRIBUTION OF 1971–72 GRANTS BY STATES AND REGIONS FOR THE 50 LARGEST FOUNDATIONS LISTED IN NON-PROFIT REPORT [1]

In a determination of total giving for the 50 largest foundations, the authors of *Non-Profit Report* present figures derived from the use of survey techniques. Grant totals listed are usually for amounts paid out, but occasionally for amounts authorized. The year indicated is either the fiscal or the calendar year 1970, 1971, or 1972.

In order to provide more comparable data, we have concentrated on gathering grant information for the years 1971–72. In some cases, however, a total grant figure includes some 1970 grants. Given the limitations of The Center's data bank, this could not be avoided. Where possible, we have listed the total grants-paid figure extracted from 1972 annual reports. This allows one to compare total giving for 1972 with what has been recorded in the data bank.

[1] February 1973 issue.

PART A: SUMMARY OF 1971-72 GRANTS BY STATES AND REGIONS FOR THE 50 LARGEST FOUNDATIONS LISTED IN NONPROFIT REPORT

	Total grants paid 1971-72	Number of grants
New England:		
Maine	$782,727	18
New Hampshire	1,874,845	19
Vermont	992,123	16
Massachusetts	42,632,307	308
Rhode Island	1,686,962	14
Connecticut	14,294,531	90
Total	62,263,495	465
Middle Atlantic:		
New York	180,906,872	1,409
New Jersey	7,391,123	84
Pennsylvania	33,110,508	401
Total	221,408,503	1,894
East North-Central:		
Ohio	20,179,859	334
Indiana	12,833,392	193
Illinois	25,129,381	248
Michigan	17,939,901	123
Wisconsin	7,480,482	97
Total	83,563,015	995
West North-central:		
Minnesota	16,270,709	153
Iowa	1,248,713	17
Missouri	7,739,820	90
North Dakota	247,421	8
South Dakota	321,700	7
Nebraska	474,470	8
Kansas	149,797	7
Total	26,452,640	290
South Atlantic:		
Delaware	67,629,948	5
Maryland	5,036,903	53
District of Columbia	99,540,798	361
Virginia	6,395,498	50
West Virginia	876,691	14
North Carolina	34,031,595	222
South Carolina	4,689,183	75
Georgia	67,810,247	74
Florida	3,977,743	52
Total	289,988,606	906
East South-central:		
Kentucky	2,230,974	26
Tennessee	4,852,506	45
Alabama	1,858,809	24
Mississippi	2,322,731	30
Total	11,265,020	125
Mountain:		
Montana	290,905	6
Idaho	234,000	5
Wyoming	18,000	2
Colorado	8,548,624	84
New Mexico	2,009,981	21
Arizona	2,432,985	20
Utah	1,972,032	14
Nevada	4,443,680	23
Total	19,950,207	175
West South-central:		
Arkansas	251,950	8
Louisiana	2,525,407	30
Oklahoma	283,400	11
Texas	21,739,701	268
Total	24,800,458	317

PART A: SUMMARY OF 1971-72 GRANTS BY STATES AND REGIONS FOR THE 50 LARGEST FOUNDATIONS LISTED IN NONPROFIT REPORT—Continued

	Total grants paid	Number of grants
Pacific:		
Washington	$2,106,462	26
Oregon	2,802,155	26
California	47,544,281	554
Hawaii	902,876	10
Alaska	1,363,035	8
Total	54,718,809	624
Total, all grants	794,410,753	5,791
Total, foreign grants	78,562,832	539

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
1971-72		
Ford Foundation (New York):		
Alaska	$1,000,000	3
Alabama	715,000	6
Arkansas	72,500	1
Arizona	488,332	3
California	19,288,290	82
Colorado	1,898,376	10
Connecticut	3,488,893	18
Washington, D.C	68,119,739	122
Florida	590,435	5
Georgia	3,131,619	12
Hawaii	663,256	4
Iowa	100,000	1
Illinois	5,975,440	35
Indiana	365,000	2
Kentucky	474,593	3
Louisiana	549,935	4
Massachusetts	12,880,313	62
Maryland	928,405	8
Maine	100,000	1
Michigan	4,380,606	22
Minnesota	962,889	3
Missouri	636,602	5
Mississippi	1,200,000	9
Montana	150,000	1
North Carolina	1,367,000	8
New Jersey	2,297,276	13
New Mexico	1,262,590	6
New York	69,181,214	212
Ohio	2,626,386	13
Oklahoma	10,000	1
Oregon	139,128	1
Pennsylvania	4,794,278	27
Rhode Island	788,601	4
South Carolina	50,000	1
South Dakota	156,900	2
Tennessee	1,125,380	6
Texas	2,591,847	13
Utah	362,491	2
Virginia	35,000	1
Vermont	295,000	2
Washington	1,159,124	5
Wisconsin	2,280,182	12
Total (does not include foreign countries)	218,682,620	750 grants
From 1972 annual report (includes grants to foreign countries)	228,330,062	
Longwood Foundation, Inc. (Delaware): Operating foundation—all activities in Delaware. Total via Nonprofit Report for 1971	67,535,078	

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
The Rockefeller Foundation (New York):		
Alaska	$25,000	1
Alabama	146,500	2
Arizona	494,800	4
California	4,847,968	49
Colorado	88,940	6
Connecticut	1,340,921	8
Washington, D.C	1,970,450	44
Delaware	31,720	1
Florida	294,700	8
Georgia	42,900	3
Hawaii	114,620	2
Iowa	141,437	4
Illinois	2,474,866	17
Indiana	782,000	3
Kentucky	145,330	3
Louisiana	162,629	6
Massachusetts	4,181,067	33
Maryland	677,914	13
Michigan	1,077,772	12
Minnesota	1,246,100	10
Missouri	572,924	7
Mississippi	221,780	5
North Carolina	1,117,300	10
Nebraska	300,000	1
New Hampshire	49,500	3
New Jersey	518,059	9
New York	25,754,340	106
Ohio	685,000	4
Oklahoma	20,800	1
Oregon	505,900	2
Pennsylvania	2,147,073	13
South Carolina	150,000	2
Tennessee	276,900	6
Texas	537,400	7
Utah	745,000	2
Virginia	75,000	2
Vermont	76,850	3
Washington	15,000	1
Wisconsin	1,076,965	7
West Virginia	170,350	3
Total	55,363,773	423
From 1972 annual report	40,613,254	
The Andrew W. Mellon Foundation (Pennsylvania):		
California	3,775,000	9
Colorado	200,000	1
Connecticut	3,842,250	11
Washington, D.C	7,880,000	22
Florida	450,000	2
Georgia	1,415,000	3
Illinois	3,015,000	7
Indiana	250,000	1
Kentucky	150,000	1
Massachusetts	7,082,000	21
Maryland	900,000	5
Maine	25,000	1
Michigan	220,000	2
Minnesota	350,000	3
Missouri	700,000	2
Mississippi	150,000	1
North Carolina	950,000	6
Nebraska	40,000	1
New Hampshire	215,000	3
New Jersey	1,425,000	3
New Mexico	25,000	1
New York	21,341,932	113
Ohio	1,600,000	5
Oklahoma	75,000	1
Oregon	200,000	1
Pennsylvania	2,075,000	7
South Carolina	150,000	1
Tennessee	1,700,000	5
Texas	225,000	2
Virginia	2,350,000	8
Vermont	250,000	3
Washington	200,000	1
Wisconsin	540,000	2
Total	63,766,182	257
Total (includes some 1970 grants)	63,766,182	257
From 1972 annual report	32,020,499	

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
Emily and Ernest Woodruff Foundation (Georgia):		
More than ½ to Emory University Medical School, Georgia	$32,000,000	
To colleges in Georgia, each	476,000	15
Total 1972 payments	56,221,220	....
Charles Stewart Mott Foundation (Michigan):		
California	138,690	2
Connecticut	78,915	1
Florida	96,822	1
Michigan	978,790	13
Oregon	66,879	1
Utah	94,626	1
Virginia	88,000	1
Total	1,542,722	20
The Duke Endowment (New York):		
North Carolina	14,070,320	155
South Carolina	3,305,457	50
Total	17,375,777	205
From 1972 annual report	18,645,728	....
1972		
W. K. Kellogg Foundation (Michigan):		
California	1,627,100	6
Colorado	36,690	1
Washington, D.C	2,723,795	5
Georgia	530,465	2
Iowa	327,100	1
Illinois	794,864	6
Kansas	58,212	1
Kentucky	264,400	1
Louisiana	208,900	1
Massachusetts	590,500	1
Michigan	1,822,982	21
Minnesota	774,098	1
Montana	60,000	1
North Carolina	160,000	1
New York	1,727,926	8
Ohio	1,126,268	3
Pennsylvania	489,950	3
Tennessee	237,496	2
Texas	287,500	1
Utah	600,000	1
Vermont	95,220	1
Wisconsin	642,519	3
West Virginia	83,430	1
Total (does not include grants to foreign countries)	15,269,415	72
From 1972 annual report (includes grants to foreign countries)	18,610,512	....
1971–72		
Carnegie Corporation of New York (New York):		
Alaska	190,000	1
Alabama	243,000	1
California	2,671,133	15
Colorado	129,000	2
Connecticut	12,000	1
Washington, D.C	5,108,290	34
Florida	793,920	5
Georgia	1,057,276	6
Illinois	1,319,180	13
Indiana	96,000	1
Massachusetts	3,444,345	21
Michigan	301,500	2
Minnesota	427,000	2
Missouri	700,000	2
Mississippi	48,500	1
North Carolina	662,250	5
New Jersey	486,213	5
New Mexico	129,000	2
Nevada	200,000	1

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
Carnegie Corporation of New York (New York)—Continued		
New York	$15,052,580	43
Oregon	15,000	1
Pennsylvania	480,000	3
Tennessee	632,600	2
Texas	545,000	2
Vermont	107,280	2
Total (United States)	34,851,067	173
From 1972 annual report. (United States)	13,787,483	
1972		
Alfred P. Sloan Foundation (New York):		
California	1,137,220	7
Colorado	20,000	1
Connecticut	200,000	1
Washington, D.C.	854,100	7
Illinois	363,950	4
Louisiana	20,000	1
Massachusetts	1,606,000	10
Michigan	370,600	2
North Carolina	692,500	3
New Jersey	742,000	2
New Mexico	225,000	1
New York	3,032,600	13
Ohio	20,000	1
Oregon	11,500	1
Pennsylvania	371,000	2
South Carolina	15,000	1
Tennessee	20,000	1
Texas	601,000	3
Virginia	300,000	1
Wisconsin	13,800	1
Total	10,622,270	63
From 1972 annual report	13,917,776	
John A. Hartford Foundation, Inc. (New York):		
Alabama	114,092	1
Arizona	82,695	1
California	1,195,530	8
Colorado	56,585	1
Connecticut	331,588	2
Florida	572,721	3
Georgia	112,730	1
Illinois	401,424	4
Indiana	65,777	1
Louisiana	193,978	2
Massachusetts	1,992,084	13
Maryland	440,771	2
Michigan	17,600	1
Missouri	171,874	1
Mississippi	94,900	1
North Carolina	319,630	2
Nebraska	17,358	1
New York	1,276,625	9
Ohio	89,242	1
Pennsylvania	774,428	7
South Carolina	30,562	1
Tennessee	125,494	1
Texas	259,060	3
Wisconsin	171,195	1
Total	8,907,943	68
From 1972 annual report	12,474,263	
1971–72		
Edna McConnell Clark Foundation (New York):		
Arizona	1,150,000	1
Michigan	10,000	1
New Hampshire	696,013	2
New Jersey	100,000	2
New York	1,629,138	9
Total	3,585,151	15

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
Danforth Foundation (Missouri):		
Alabama	$243,500	4
California	981,000	5
Washington, D.C.	482,200	6
Florida	75,000	
Georgia	2,075,000	3
Illinois	107,000	3
Indiana	15,000	1
Louisiana	75,000	1
Massachusetts	16,000	1
Michigan	8,000	1
Missouri	3,954,345	47
Mississippi	225,000	3
North Carolina	28,500	2
New Hampshire	10,000	1
New York	375,000	4
Ohio	59,000	1
Virginia	500,000	1
Total	9,229,545	84
From 1972 annual report	7,785,842	....
Houston Endowment, Inc. (Texas):		
Washington, D.C.	3,200,000	1
New York	10,000	1
Tennessee	50,000	1
Texas	5,056,836	33
Total	8,316,836	36
From biennial report, 1971–72: 1972 appropriations	9,905,318	....
Rockefeller Brothers Fund (New York):		
Arkansas	29,000	2
California	150,000	2
Colorado	16,700	1
Connecticut	80,000	3
Washington, D.C.	2,019,608	35
Georgia	305,000	6
Illinois	158,000	5
Louisiana	80,000	2
Massachusetts	1,054,500	11
Maryland	35,000	2
Mississippi	115,000	2
New Hampshire	175,000	2
New Jersey	179,111	2
New York	10,772,780	220
Pennsylvania	100,000	5
South Carolina	60,000	1
Texas	30,000	1
Virginia	117,500	4
Vermont	10,055	1
Total	15,487,254	307
Lilly Endowment, Inc. (Indiana):		
Arizona	50,000	2
California	155,000	5
Colorado	320,000	2
Washington, D.C.	780,800	9
Delaware	25,000	1
Georgia	75,000	1
Illinois	195,500	6
Indiana	9,658,650	156
Kentucky	200,000	3
Massachusetts	35,000	1
Maryland	110,000	2
Michigan	280,000	3
Missouri	25,000	1
New Jersey	77,500	4
New York	874,000	30
Ohio	177,000	7
Oklahoma	22,500	1
Pennsylvania	159,000	3
South Carolina	25,000	2
Tennessee	90,000	2
Texas	120,000	1
Total	13,454,950	242
From 1972 annual report	14,262,600	....

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
De Witt Wallace Fund, Inc. (New York):		
New York	$15,000	1
The Vincent Astor Foundation (New York) Figures taken from 1971–72 annual report):		
Massachusetts	248,000	3
Rhode Island	18,750	1
New Mexico	5,740	1
Indiana	5,000	1
Washington, D.C.	15,000	1
New York	8,853,648	58
Total	9,151,138	66
1972		
The Kresge Foundation (Michigan):		
Alaska	25,000	1
Arkansas	100,000	1
California	842,000	10
Colorado	120,000	1
Connecticut	2,500,000	5
Washington, D.C.	475,000	4
Florida	60,000	2
Georgia	200,000	3
Iowa	325,000	3
Idaho	100,000	1
Illinois	2,075,000	4
Indiana	1,040,000	7
Kentucky	635,000	4
Louisiana	20,000	1
Massachusetts	2,050,000	9
Maryland	300,000	2
Maine	175,000	2
Michigan	3,805,350	23
Minnesota	150,000	2
Missouri	215,000	4
Mississippi	50,000	1
Montana	25,000	1
North Carolina	200,000	4
North Dakota	75,000	2
Nebraska	25,000	1
New Hampshire	505,000	2
New Jersey	400,000	2
New Mexico	144,000	3
New York	1,380,000	15
Ohio	522,000	6
Oregon	150,000	3
Pennsylvania	760,000	11
Rhode Island	50,000	1
South Carolina	180,000	6
South Dakota	15,000	1
Tennessee	295,000	6
Texas	250,000	3
Utah	50,000	1
Virginia	75,000	2
Wisconsin	190,000	3
West Virginia	100,000	2
Total	20,653,350	165
From 1972 annual report	26,094,923	
Ford Motor Co. Fund (Michigan) (Information provided by Ford Motor Co. Fund)		
Alabama	31,888	
Alaska	1,135	
Arizona	12,350	
Arkansas	2,950	
California	307,550	
Colorado	15,048	
Connecticut	4,748	
Washington, D.C.	51,980	
Florida	20,145	
Georgia	99,257	
Illinois	198,136	
Indiana	99,257	
Iowa	27,376	
Kansas	20,585	
Kentucky	76,738	

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
Ford Motor Co. Fund (Michigan) (Information provided by Ford Motor Co. Fund)—Con.		
Louisana	$9,595	----------
Maine	515	----------
Maryland	2,524	----------
Massachusetts	138,790	----------
Michigan	3,153,102	----------
Minnesota	83,220	----------
Mississippi	5,755	----------
Missouri	199,957	----------
Montana	1,520	----------
Nebraska	12,462	----------
New Hampshire	12,292	----------
New Jersey	120,890	----------
New Mexico	3,175	----------
New York	164,390	----------
North Carolina	6,665	----------
North Dakota	970	----------
Ohio	596,095	----------
Oklahoma	10,570	----------
Oregon	2,608	----------
Pennsylvania	314,276	----------
South Carolina	10,700	----------
South Dakota	12,600	----------
Tennessee	91,426	----------
Texas	68,012	----------
Utah	6,815	----------
Vermont	1,718	----------
Virginia	45,460	----------
Washington	8,315	----------
Wisconsin	23,713	----------
Wyoming	200	----------
National	930,825	----------
Total	6,996,298	----------
1971-72		
The Cleveland Foundation and Greater Cleveland Associated Foundation (Ohio):		
Greater Cleveland Associated Foundation: Ohio	556,308	21
The Cleveland Foundation:		
Washington, D.C.	10,000	1
Illinois	75,000	1
New York	25,000	1
Ohio	10,687,947	236
West Virginia	212,611	3
Total	11,010,558	242
De Rance, Inc. (Wisconsin) (Information from 1972 Annual Report):		
Alabama	70,000	3
Alaska	105,500	1
Arizona	72,855	4
California	25,000	2
Colorado	25,000	1
Connecticut	53,953	2
Washington, D.C.	417,664	10
Idaho	9,000	2
Illinois	214,500	9
Indiana	14,800	2
Louisiana	150,000	1
Maine	67,800	2
Maryland	5,000	1
Massachusetts	379,000	11
Michigan	10,500	1
Minnesota	263,000	1
Missouri	246,320	5
Montana	1,500	1
Nebraska	35,000	2
New Mexico	125,000	3
New York	982,120	21
North Dakota	49,500	2
Ohio	62,250	3
Oregon	96,000	3
Pennsylvania	95,000	2

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
De Rance, Inc. (Wisconsin) (Information from 1972 Annual Report)—Continued		
Rhode Island	36,373	1
South Dakota	87,200	3
Texas	407,172	14
Virginia	125,237	4
Wisconsin	929,207	52
Wyoming	10,000	1
Total	5,130,951	170
New York Community Trust—Community Funds, Inc. (New York):		
California	10,000	1
Connecticut	200,900	4
Washington, D.C.	174,885	3
Florida	110,000	2
Georgia	40,000	2
Illinois	10,000	1
Massachusetts	77,825	2
New Jersey	20,000	1
New York	3,333,868	130
Ohio	122,500	3
Pennsylvania	60,000	3
Tennessee	10,000	1
Vermont	29,000	1
Total	4,198,978	154
The Commonwealth Fund (New York):		
California	1,081,336	6
Colorado	278,142	1
Connecticut	949,765	4
Washington, D.C.	817,985	4
Florida	330,000	2
Hawaii	25,000	1
Illinois	459,000	3
Louisiana	185,500	1
Massachusetts	489,100	4
Maryland	861,300	4
Maine	9,000	1
Missouri	5,000	1
Mississippi	125,796	1
New Jersey	29,052	1
New York	1,468,563	13
Ohio	155,604	1
Pennsylvania	1,016,935	4
Texas	240,000	1
Virginia	37,600	1
Washington	10,410	1
Total	8,575,088	55
From 1972 annual report	6,878,521	
1972		
The Moody Foundation (Texas):		
Texas	4,263,652	77
From 1972 annual report	6,630,088	
1971–72		
San Francisco Foundation (California):		
California	4,715,932	181
Massachusetts	15,000	1
Total	4,730,932	182
From 1972 annual report	5,218,319	
Sid W. Richardson Foundation (Texas) (Information provided by Sid W. Richardson Foundation):		
Texas	955,540	36

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
Exxon Education Foundation (New York) (Formerly Esso Education Foundation):		
Alabama	$30,000	1
California	277,340	9
Colorado	30,000	1
Connecticut	198,866	3
Washington, D.C.	444,725	13
Florida	74,850	1
Illinois	45,780	2
Indiana	62,727	1
Louisiana	119,750	2
Maine	56,500	1
Maryland	43,400	1
Massachusetts	415,340	12
Michigan	90,800	1
New Hampshire	52,380	1
North Carolina	101,500	2
New Jersey	259,806	8
New York	724,649	20
Ohio	415,700	5
Oklahoma	73,830	2
Oregon	31,543	1
Pennsylvania	18,554	1
South Carolina	60,000	1
Tennessee	31,050	1
Texas	71,185	1
Virginia	35,000	2
Washington	10,060	1
West Virginia	192,500	2
Total	3,967,835	96
Charles E. Merrill Trust (New York):		
California	420,000	13
Colorado	25,000	1
Connecticut	25,000	1
Washington, D.C.	25,000	1
Florida	42,000	3
Illinois	75,000	3
Massachusetts	197,000	9
Maine	25,000	1
New Jersey	50,000	2
New York	470,252	15
Oklahoma	20,000	1
Pennsylvania	85,000	3
Texas	25,000	1
Total	1,484,252	54
Research Corp. (New York):		
Alabama	17,141	1
California	345,350	23
Colorado	66,605	5
Connecticut	62,584	5
Washington, D.C.	2,175,353	7
Delaware	6,150	1
Florida	104,350	7
Georgia	78,925	5
Iowa	58,800	5
Illinois	95,010	9
Indiana	61,255	4
Kansas	18,000	2
Kentucky	18,345	2
Louisiana	20,320	2
Massachusetts	215,253	13
Maryland	27,710	3
Maine	21,600	1
Michigan	82,465	6
Minnesota	32,450	3
Missouri	63,680	6
Mississippi	24,000	2
Montana	10,385	1
North Carolina	56,000	3
North Dakota	21,062	3
Nebraska	44,650	2

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
Research Corp. (New York)—Continued		
New Hampshire	$22,380	2
New Jersey	89,300	7
New Mexico	15,576	2
New York	432,929	28
Ohio	131,746	7
Oklahoma	25,700	3
Oregon	20,050	2
Pennsylvania	147,795	11
Rhode Island	18,500	1
South Carolina	59,464	4
Tennessee	104,808	7
Texas	118,805	12
Utah	25,300	3
Virginia	76,401	5
Vermont	15,000	1
Washington	87,234	7
Wisconsin	54,009	5
Total	5,172,380	228
From 1972 annual report	4,208,133	
The Seely G Mudd Fund (California):		
California	400,000	1
Massachusetts	1,775,000	1
North Carolina	1,500,000	1
Oregon	1,000,000	1
Pennsylvania	1,250,000	1
Total	5,925,000	5
Callaway Foundation, Inc. (Georgia):		
Georgia	1,951,455	6
From 1972 annual report	1,927,369	
The Haas Community Fund (Pennsylvania):		
Illinois	10,000	1
Massachusetts	83,000	1
North Dakota	10,100	1
New Jersey	17,000	1
New York	195,000	6
Pennsylvania	4,516,141	92
Virginia	35,000	1
Total	4,866,241	103
From 1972 annual report	5,313,357	
The Bush Foundation (Minnesota):		
Washington, D.C.	32,750	1
Florida	280,000	6
Illinois	960,000	9
Louisiana	680,000	2
Michigan	1,000,000	1
Minnesota	9,030,885	82
New York	75,000	2
Pennsylvania	271,000	3
Virginia	311,300	2
Wisconsin	60,000	1
Total	12,700,935	109
From 1972 annual report	5,405,016	
El Pomar Foundation (Colorado):		
Colorado	4,925,690	35
Mississippi	10,000	1
Total	4,935,690	36
From 1972 annual report	4,812,915	
The Robert A. Welch Foundation (Texas):		
Texas	4,561,210	34
From 1972 annual report	4,701,937	

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
1972		
The Wm. R. Kenan, Jr. Charitable Trust (New York):		
Georgia	$400,000	1
Illinois	750,000	1
North Carolina	260,000	3
New York	790,000	2
Pennsylvania	1,500,000	2
Rhode Island	750,000	1
South Carolina	500,000	1
Virginia	300,000	1
Total	5,250,000	12
1971-72		
Richard King Mellon Foundation (Pennsylvania):		
Washington, D.C.	750,000	3
Massachusetts	1,000,000	2
New York	100,000	1
Pennsylvania	3,915,000	20
West Virginia	100,000	1
Total	5,865,000	27
From 1972 annual report	4,714,846	
1972		
Sarah Mellon Scaife Foundation, Inc. (Pennsylvania):		
Connecticut	15,425	1
Washington, D.C.	80,000	2
Florida	25,000	1
Massachusetts	10,000	1
New York	325,000	2
Pennsylvania	1,972,325	53
South Dakota	50,000	1
Virginia	25,000	1
Total	2,502,750	62
From 1972 annual report	2,789,788	
1971-72		
Surdna Foundation, Inc. (New York) (Figures taken from 1971-72 annual report):		
California	30,000	1
Illinois	35,000	2
Iowa	200,000	1
Kentucky	25,000	1
Maine	100,000	2
Massachusetts	600,000	3
Maryland	350,000	2
Minnesota	600,000	5
Mississippi	25,000	1
New Hampshire	100,000	1
New Jersey	365,000	2
New York	3,166,500	36
Pennsylvania	170,000	7
South Carolina	50,000	1
Tennessee	15,000	1
Vermont	100,000	1
Virginia	25,000	1
Total	5,956,000	68
1972		
The Grant Foundation (New York):		
California	697,000	8
Colorado	130,500	4
Connecticut	582,500	7
Washington, D.C.	295,500	7
Florida	5,000	1
Hawaii	75,000	1
Illinois	105,000	3
Kentucky	150,000	1
Louisiana	7,500	1
Massachusetts	563,000	8
Maryland	282,026	6
Maine	100,000	1

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
The Grant Foundation (New York)—Continued		
Michigan	$242,700	4
Minnesota	83,210	3
Missouri	75,000	1
North Carolina	13,000	1
New Jersey	5,000	1
Nevada	150,000	1
New York	1,276,000	22
Ohio	13,000	1
Pennsylvania	180,000	3
Tennessee	25,000	1
Virginia	200,000	3
Wisconsin	25,000	1
Total	5,280,936	90
1971-72		
The Pew Memorial Trust (Pennsylvania):		
Arkansas	10,000	1
Arizona	10,000	1
California	127,500	4
Colorado	20,000	2
Washington, D.C.	325,000	5
Delaware	20,000	1
Florida	10,000	1
Georgia	20,000	1
Illinois	115,000	4
Kansas	10,000	1
Kentucky	15,000	1
Louisiana	25,000	1
Massachusetts	730,230	4
Maine	50,000	1
Michigan	25,000	1
Minnesota	50,000	1
Mississippi	15,000	1
North Carolina	35,000	2
New Jersey	42,500	3
New York	252,000	10
Ohio	20,000	1
Oklahoma	25,000	1
Pennsylvania	3,824,399	67
Texas	105,000	6
Total	5,881,629	121
Max C. Fleischmann Foundation (Nevada):		
Alaska	16,400	1
Alabama	10,000	1
Arkansas	10,000	1
Arizona	71,953	4
California	943,794	21
Colorado	90,000	4
Washington, D.C.	100,000	2
Georgia	46,600	2
Hawaii	25,000	2
Idaho	25,000	1
Illinois	100,002	4
Kentucky	25,000	1
Massachusetts	70,000	3
Missouri	35,000	1
New Jersey	30,000	2
New Mexico	74,900	2
Nevada	4,093,680	21
New York	492,823	8
Ohio	280,000	3
Oregon	35,000	2
Pennsylvania	10,000	1
Rhode Island	10,000	1
Tennessee	10,000	1
Texas	20,000	1
Utah	50,000	1
Virginia	15,000	1
Washington	546,340	3
West Virginia	10,000	1
Total	7,226,492	96
From 1972 annual report	4,295,141	

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
Sears-Roebuck Foundation, Inc. (Illinois):		
Illinois	$30,000	1
Massachusetts	40,000	1
Missouri	85,000	1
New York	520,000	3
Wisconsin	1,363,937	1
Total	2,038,937	7
From 1972 annual report	4,175,241	....
Z. Smith Reynolds Foundation (North Carolina):		
North Carolina	12,365,632	108
From 1972 annual report	4,113,169	....
1972		
John Simon Guggenheim Memorial Foundation (New York) (Information provided by John Simon Guggenheim Memorial Fund):		
Alabama	11,500	1
Arkansas	12,500	1
California	770,738	76
Colorado	36,348	3
Connecticut	84,817	10
Delaware	12,000	1
Washington, D.C.	18,250	2
Florida	10,000	1
Illinois	322,433	29
Indiana	52,926	6
Kansas	12,000	1
Louisiana	9,500	1
Maine	32,312	3
Maryland	62,853	5
Massachusetts	451,095	42
Michigan	54,894	5
Minnesota	42,654	4
Missouri	26,606	3
New Hampshire	12,280	1
New Jersey	137,416	14
New York	759,962	75
North Carolina	66,298	6
Ohio	65,313	7
Oregon	12,000	1
Pennsylvania	155,645	15
Rhode Island	44,738	4
South Carolina	18,000	2
Tennessee	12,352	1
Texas	120,482	11
Virginia	34,000	3
Washington	69,979	7
Wisconsin	78,955	7
Total	3,622,855	349
1971-72	25,000	1
Washington, D.C.	35,000	1
New York	2,332,394	29
Virginia	1,565,000	1
Total	3,957,394	32
United States Steel Foundation, Inc. (Pennsylvania):		
Alabama	182,800	3
Arkansas	15,000	1
California	85,300	5
Colorado	20,000	1
Washington, D.C.	97,800	7
Florida	32,800	3
Georgia	7,800	1
Iowa	7,800	1
Illinois	389,400	10
Indiana	255,000	6
Kansas	10,000	1
Kentucky	32,800	3
Louisiana	7,800	1
Massachusetts	26,600	3

PART B: GEOGRAPHICAL DISTRIBUTION BY FOUNDATION OF THE ACTIVITIES OF 50 LARGEST FOUNDATIONS—Continued

N.B. Information is presented in the order in which the foundations are listed in the February 1973 Nonprofit Report

	Total grants paid	Number of grants
United States Steel Foundation, Inc. (Pennsylvania)—Continued		
Maryland	$10,000	1
Maine	20,000	1
Michigan	7,800	1
Minnesota	63,000	3
Missouri	22,800	2
New Hampshire	25,000	1
New York	683,400	27
Ohio	188,500	6
Pennsylvania	1,367,700	25
Texas	50,000	3
Utah	37,800	3
Virginia	25,000	4
West Virginia	7,800	1
Wyoming	7,800	1
Total	3,687,500	125
From 1972 annual report	3,956,860	
W. Clement and Jessie V. Stone Foundation (Illinois):		
California	473,512	2
Connecticut	76,406	2
Washington, D.C.	49,924	2
Illinois	4,259,896	46
Indiana	10,000	1
Kansas	21,000	1
Kentucky	18,768	1
Massachusetts	178,265	1
Minnesota	11,608	1
Missouri	14,722	1
Mississippi	12,000	1
New York	1,070,239	16
Pennsylvania	90,000	4
South Carolina	25,000	1
Texas	230,000	2
Total	6,541,340	82
Louis W. and Maud Hill Family Foundation (Minnesota):		
Connecticut	150,000	1
Washington, D.C.	20,000	1
Iowa	61,200	1
Idaho	100,000	1
Minnesota	2,100,595	29
Montana	42,500	1
North Dakota	90,789	1
Oregon	516,547	6
Wisconsin	25,000	1
Total	3,106,631	42
From 1972 annual report	3,111,598	

Examples of Foundation Grants to National Organizations Whose Activities Are Then Widely Dispersed Geographically

W. K. KELLOGG FOUNDATION (MICHIGAN)—FROM ANNUAL REPORT, 1972

Grants in 1972 to national organizations headquartered in New York

	Amount
1. Academy for Educational Development	$205,000
2. State Communities Aid Association	22,865
3. National Medical Fellowships, Inc	50,000
4. United Negro College Fund, Inc	97,763
5. National Health Council	10,000
6. Council on Foundations	100,000
7. National Council of Homemaker-Home Health Aid Service, Inc	81,578
8. Community Health, Inc	203,195
Subtotal	769,901

Grants in 1972 to national organizations headquartered in Washington, D.C.

	Amount
1. Association of Governing Boards of Universities and Colleges	$4,081
2. Good Will Industries of America, Inc	194,000
3. American Association for Higher Education	63,089
4. National Association of State Universities and Land-Grant Colleges	6,000
5. National 4-H Club Foundation	175,000
6. Association of University Programs in Hospital Administration	54,050
7. Institute of Medicine of the National Academy of Sciences	100,000
8. National Academy of Sciences	140,000
9. Association for Academic Health Centers	51,500
10. Association of Schools of Allied Health Professions	13,500
Subtotal	802,720
Total	1,572,021

THE KRESGE FOUNDATION (MICHIGAN)—FROM ANNUAL REPORT, 1972

Grants in 1972 to national organizations headquartered in New York

	Amount
1. Population Council	$400,000
2. Recording for the Blind	50,000
Subtotal	450,000

Grants in 1972 to national organizations headquartered in Washington, D.C.

	Amount
1. American National Red Cross	$250,000
2. Arctic Institute of North America	75,000
3. Association of American Colleges	50,000
Subtotal	375,000
Total	825,000

THE ANDREW MELLON FOUNDATION (PENNSYLVANIA)—FROM ANNUAL REPORT, 1972

Grants in 1972 to national organizations headquartered in New York

	Amount
1. Institute of Judicial Administration, Inc	$100,000
2. Legal Aid Society	25,000
3. National Committee on U.S.-China Relations	33,000
4. Recording for the Blind	22,500
5. Salvation Army	20,000
6. National Audubon Society	60,000
7. American Council of Learned Societies	250,000
8. Asia Society, Inc	50,000
9. Institute of International Education	50,000
10. National Affairs, Inc	20,000
11. Cancer Care, Inc	10,000
12. Margaret Sanger Research Bureau	25,000
13. Planned Parenthood Federation of America	67,000
14. Population Council, Inc	150,000
15. World Rehabilitation Fund	100,000
16. Big Sister, Inc	15,000
17. Children's Aid Society	10,000
18. Girls' Clubs of America	20,000
Subtotal	1,027,500

Grants in 1972 to national organizations headquartered in Washington, D.C.

	Amount
1. American Society of International Law	$50,000
2. Overseas Development Council	50,000
3. Conservation Foundation	100,000
4. American Council on Education	25,000
5. Association of American Colleges, Inc	20,000
6. Association of Research Libraries	13,500
7. Atlantic Council of the United States	30,000
8. Council for Basic Education	10,000
9. National Academy of Sciences	50,000
10. National Endowment for the Humanities	324,457
Subtotal	672,957
Total (New York and Washington, D.C.)	1,700,457

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PRESERVATION *AND* INNOVATION, CONTINUITY *AND* CHANGE

Robert F. Goheen

The question of whether foundations tend to overemphasize "innovation, experimentation, exploration, and other manipulative forms of change" is widely discussed. Dr. Goheen, long-time president of Princeton University and a former chairman of the American Council on Education (1961–1962), suggests that "the old may sometimes be more deeply relevant than the new" in this statement made soon after he was named chairman of the influential Council on Foundations, Inc.

IN A STATEMENT emphasizing the conservation of human freedom and the conditions that permit it, rather than the innovation, experimentation, and manipulated change that many mistake for it, Pierre Trudeau observed:

> What I think is serious is that we're all relying on centuries or at least decades of stability to bring us through all these contradictions [of our times]. We're saying no matter how hard you hammer at federalisms, or how hard you hammer at the parlimentary system or the democratic system, it will survive because it has in the past. I just don't think that follows....
>
> Aren't there periods in society where it is proper that authorities everywhere be challenged—periods of great stagnation and great stability where we can't get off dead center and where in families and in churches and in the schools and in the governments and in the unions and in the companies we should be challenging authority and sort of saying "get off of it"? There are also times when that challenge has reached an excessive point and where we should look for more stabilizing elements.
>
> I think that we are living in such times now....[1]

These sober, sane, and timely conclusions may strike a particularly responsive chord in the academic administrator, because so much time in recent years has had to go into scheming and cajoling and fighting to maintain some reasonable stability, and, even more, some essential, agreed upon sense of common, guiding purpose in his institution.

Whether one looks at the testimony submitted by foundation executives and others in the hearings on Title I of the Tax Reform Act of 1969 or at recent foundation reports and other writings, one cannot but be struck by the recurrent emphasis on innovation, experimentation, exploration, and other manipulative forms of change as the peculiar forte and raison d'être of foundations. Kingman Brewster made this point in his eloquent advocacy of philanthropic pluralism in 1969.[2] Fritz F. Heimann chose this theme in justifying the role of foundations in public welfare areas where large amounts of governmental funding are now available.[3]

[1] "Roots of Freedom," *New York Times*, 21 December 1971.

[2] "In Defense of Private Charitable Enterprise," address to the Economic Club of Chicago, 8 May 1969.

[3] "Developing a Contemporary Rationale for Foundations," *Foundation News*, January/February 1972, pp. 7–13.

In some ways, this emphasis on change and innovation is natural and perhaps necessary. Change is the law of life, as Heraclitus taught long ago. It is especially so now—and with a pace that is often staggering. In many ways—some mindless—science and technology are constantly thrusting new opportunities and new demands on us, so that change invades virtually all aspects of one's daily life and work. To live with change, there is no choice but to recognize it, perhaps embrace it, and seek to guide it toward better, rather than worse, ends. Accordingly, perhaps, philanthropic foundations are not to be faulted if they mount the change bandwagon and seek to determine whether they can steer it to some good end.

Novel effort

Beyond that, given the relatively limited resources of even the largest foundations and the magnitude of the gaps that persist between America's ideals and accomplishments, and given the grave problems and worthy causes calling for philanthropic attention, it is not surprising that foundations seek undertakings that may offer some particular fresh leverage. The foundations, of course, must be selective and so, again, it is not surprising that, quite often, it is not the tried and true but the novel effort that catches the eye, intrigues the imagination, and gets the grant. Furthermore, when institutions are under scrutiny, as the foundations are now, their friends and defenders may seek to identify and underline what is *distinctive* about them and, hence, may give them a particular functional claim to existence.

To seek the functional validity of a complex entity in some principal element or attribute is, however, rather like saying that the most important thing about a drink of water is hydrogen. The hydrogen atoms are, to be sure, essential to the drink and twice as plentiful as the oxygen atoms, but to know that is to know only a part of what constitutes the drink and nothing at all about how differently water may taste in different circumstances.

In this same way, the work and significance of foundations are distorted when they are considered essentially engines for change and innovation, instead of multivalent instrumentalities that may, in many ways and circumstances, help to meet significant, felt human needs that would not otherwise be met, or be met in such sensitive and timely fashion. As implied, a measure of stability in certain existing institutions and sustained standards of excellence are highly important human needs, especially in these fluid, change-driven, change-pursuing times.

This is not utterly to disparage innovation and experimentation, only their exaggeration, much of it more faddish than purposeful. Nor is it to suggest that there are in hand tried-and-true remedies for the many ills and deficiencies of American society.

In support of pluralism

However, the emphasis on novelty and pathfinding is an inadequate defense and rationale for the philanthropic grant-making foundation. Such foundations have a much broader, more variegated, and potentially more pervasive role in society. The foundation generically is an institution created to enable many different sources of private initiative, concern, and energy to come to bear on human needs. These needs are multiple and diverse. In brief, then, the argument for pluralism still seems best.

If it is to be meaningful, pluralism, of course, implies that each individual foundation will choose its own targets and that it would do well to choose a sphere or spheres of concern in which to become knowledgeable before it becomes active.

Now, it may be that doubts about the overemphasis on pioneering and innovation in the foundation world are more a reflection of foundation testimony and literature than of general foundation practice. The Peterson Commission made the point that the typical foundation program is often not nearly as "venturesome, innovative, or at the cutting edge of social change" as foundation champions often indicate. Yet, fascination with novelty and romantic hope for dramatic

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Robert F. Goheen, president of Princeton University from 1957 until 30 June 1972, is chairman of the Council on Foundations, Inc., in New York. This article is adapted from an address to the Foundation Luncheon Group, 12 April 1972, in New York.

breakthroughs may be detected in at least some foundation practice.

To nurture innovation as the dominant guiding spirit of foundation practice is to be one-sided and probably to err. From the standpoint of operating philanthropy, if not from that of grant-making philanthropy, renovation can be more crucial than innovation. Help in closing a budget deficit can mean more to an institution's ability to perform its charitable function than support for some new venture. Help in maintaining high-quality efforts—supporting proven excellence as well as the pursuit of excellence—may offer more leverage in the long run in solving America's complex problems than help for short-run endeavors that seek solutions by some new twist of the key. The old may sometimes be more deeply relevant than the new.

Sometimes the idiosyncrasies and excesses of a culture are highlighted when they are imitated by another culture. A piquant example is in a brochure announcing a symposium at Yonsei University in South Korea:

> The spirit of rebirth is the key to institutional vitality.... In essence the university must be a lighthouse of innovation through self-renewal, instead of a warehouse of the past.

How American can one get?

Of course, universities must be concerned with self-renewal. Intellectual discovery and fresh approaches to pressing problems are essential parts of their proper concern, but so, too, should be the records of the past, its experience, both good and bad, and its wisdom. Either side of the total venture of learning will be barren without the other. Or, to return to the metaphor, the lighthouse and the warehouse are parts of the same house of learning and intellect when that house is in good repair.

Need for interaction

Today the breakdown of old authorities and the pervasiveness and heightened tempo of change complicate the achievement of a rational, comprehensive sense of purpose and maintenance of an effective balance among all the competing claims. Yet, whatever the sphere of action, it is well to refuse to become simplistic and one-sided. It is well to put into effective interaction and counterpoint such competing but essential values as change *and* continuity, freedom *and* discipline, equality *and* excellence, innovation *and* conservation.

Wherever one looks in areas bearing on human rights, human dignity, and human development, one sees a long agenda of urgent, unfinished business. There is, indeed, a great need for fresh, imaginative, and critical insights and for new efforts toward better solutions. This need seems obvious, but the purview should be wider.

First, in our kind of constitutional democracy, the public interest to which foundations should be addressed is both broad and variegated, allows much scope for intelligent, beneficent choice, and—especially today—embraces some deep tensions that call for comprehension and conciliation. Second, as many of the young have been saying, more attention must be given to ends—to what makes the good life and the good society—fully viewed. This means looking beyond change and beyond novelty per se to seek lines of action and adjustment which are not just responses to immediate, one-sided pressures, compelling though such pressures often are.

Widespread distrust

The private, grant-making foundation is a highly worthwhile institution under attack from both the New Left and the Old Right. The Tax Reform Act reflects less than total popular approbation. The pervasive public suspicion of foundations may be partly a matter of mythology. The sort of myth which attaches to the private foundation—not entirely without justification—carries connotations almost opposite to that attached to institutions of higher education—also not entirely without justification. Until recently, the dominant myth about the university was that the institution was founded and served by self-denying, pure-minded, public-spirited people, from whose teaching both enlightened thought and material achievement could be gained. Hence, even today, innumerable deficiencies and evidences of less lofty motivation are glossed over. Education is a good thing; ipso facto, so are universities.

The myth of the foundation seems to work in reverse. Philanthropy is a good thing, but

its agencies are not necessarily so. Because the foundation is the creation of privilege, may be a way of perpetuating personal interests, and is frequently formed to minimize taxes, both the public spirit that properly guides most foundations and the public benefits they confer tend to be obscured at the very start. Suspicion would probably attach to them even if there had not been occasional salient abuses of the foundation privilege to reinforce the myth and deepen the distrust. In other words, however well foundations behave, they will never entirely escape the suspicion that attaches to them because, first, most are creations of the rich and, second, in many cases the gain of personal or family advantage through tax exemption figured in their establishment.

Since the public distrust has deep roots, it is of the utmost importance that foundations meet at least two requirements to lessen suspicion and to build clearer understanding of the positive contributions they can and do make to the public welfare. The first requirement is simply good foundation practice: to be scrupulously sure that there is bona fide public purpose, as distinguished from self-interest, in everything a foundation does, including not only its grants but also its investment and management practices. The second requirement is the fullest possible disclosure of and publicity for foundation activities. Although this practice may invite the attention of hordes of importunate grantseekers, much greater disclosure and publicity are patent necessities if foundations are to gain and hold the degree of public understanding needed. Although there is no novelty in it, the motto, "Physician, heal thyself," remains good advice. Foundations would do well to heed it. □

Statement of Robert F. Goheen, Chairman of the Council on Foundations

Summary

Introduction
Structure and Function of the Council on Foundations:
- a. Advancing effective foundation performance
- b. Broadening public understanding of grant-making foundations

General dimensions of the foundation field:
- a. Examples of grant-making in states represented by Subcommittee members
- b. Description of foundations by:
  - (1) type
  - (2) size
- c. Assets and grants for the field overall
- d. Foundations compared with other groups

The Tax Reform Act of 1969 is working:
- a. Broad summary of the Act's requirements
- b. The IRS audit program and sanctions under the Act

Problems raised by the 1969 Act:
- a. The 4% tax should be lowered, earmarked and tied to audit costs; proposal for Assistant Commissioner for Employee Plans and Exempt Organizations
- b. Mass and intricacy of regulations, especially program restrictions
- c. Erosion of support power coupled with disincentives to creation and augmentation of new and existing foundations will diminish foundation capacities to meet continuing and growng needs.

Related Concerns:
- a. Treasury and IRS should update and expand collection and reporting of data on foundations
- b. Current estate and gift tax incentives to charitable giving should not be curtailed
- c. Further discussion and support for the proposed Office for Employee Plans and Exempt Organizations and revision in the 4% tax

Summation—A new approach to foundations by Congress is timely

Statement

Introduction

Mr. Chairman, I am Robert F. Goheen, Chairman of the Council on Foundations. With me is Mr. Thomas Troyer of the firm of Caplin and Drysdale, our legal counsel. We welcome this opportunity to appear before this committee to speak about the state of the grant-making foundations and the effects of the 1969 Tax Reform Act on them.

The Council on Foundations

The Council on Foundations which we represent is a membership association of grant-making foundations which currently has 650 members, some with large assets and some with small, located in all parts of the country. The members include 105 community foundations, 62 company foundations, and over 450 independent family and general purpose foundations. In 1973 65% or more of all estimated assets in the hands of grant-making foundations are administered by Council members.

The chief function of the Council is to advance effective and responsible performance throughout the foundation field. We do this by bulletins and newsletters on such matters as the tax regulations—a busy line of activity, as you can imagine, the last couple of years. We conduct seminars and conferences both on a regional and national basis. We provide consultative services to individual foundations and promote, where we can, a sharing of experience and cooperation among them. We also publish a bi-monthly journal of information and ideas, entitled *Foundation News*.

The Council operates under the guidance of an elected Board of Directors, whose 35 members are broadly representative of the foundation field, but also include 10 persons not directly linked to foundations. Two policy statements of

our Board, recently published in *Foundation News*—one stressing the importance of public reporting by foundations, the other a broader definition of principles and guidelines—are attached to this testimony as Exhibits #1 and #2.

Another important function of the Council is to broaden public understanding of all private charitable activity as well as of the role within it of the grant-making foundations. The leadership of the Council and its members see foundations as part and parcel of the voluntarism and privately directed philanthropic endeavor which have meant so much in the development and extension of the wide and vital array of educational, cultural, and other charitable services which characterize this country. And we see the chance to appear before this Subcommittee as a particularly important responsibility for the Council in performing this interpretative and informational role.

When the 1969 Tax Reform Act was passed, some saw it as a death-knell for private grant-making foundations—or if not that, at least as setting restrictions that would severely inhibit their ability to serve as effective charitable agents. I am happy to say that those doom-sayers were wrong. Let me illustrate with just a few examples drawn from the past 18 months and the states representated by the members of this Subcommittee.

Gary, Indiana, is like many cities with large minority elements. It has been hit by a series of adverse events, including an exodus of business enterprises, draining money away when more is needed. The Cummins Engine Foundation granted funds to the city to establish an Office of Resource and Development. It is functioning to seek out Federal and other sources of assistance to give Gary the financial stability it needs to operate, to redevelop worn-out sections, and to deal with such problems as poverty, discrimination, and housing.

Lincoln is Nebraska's capital, the home of a fine university, a spendid place to raise a family. But as with so many other communities it has a drug problem. The Lincoln Foundation took the lead in setting up a program to combat the problem. The foundation not only acted by granting funds, but also has had an important role in co-ordinating community efforts to deal with drug abuse in Lincoln.

The Navajo Community College at Chinle, Arizona has become a pace-setter for the development of educational opportunities so badly lacking for reservation Indians. Among the many foundations which have contributed to the College's support are the William H. Donner Foundation, which has supplied funds to permit publication of books on the recent history of the Navajo people as part of its continuing interest in improving education on the reservation. Through a grant directly to the Navajo Tribe the Donner Foundation has also support the development of a reservation-wide educational agency comparable to a state department of education, to enable the Tribe to establish an effective means of contracting for and administering the numerous federal and state educational programs which operate on the reservation.

In Arkansas, the medical school of the state university received $145,236 from the Inglewood Foundation in Little Rock for child study programs; Ouachita Baptist University in Arkadelphia was granted $100,000 from the Jess Odum Foundation, also of Little Rock, for general support; and the Kresge Foundation of Michigan contributed $100,000 to the building of a university center in John Brown University in Siloam Springs.

In Alaska, the Jesse Lee Home for disturbed and homeless children in Anchorage received $10,000 from the Arthur Vining Davis Foundations of Florida, while an application by the University of Alaska brought $400,000 from the Ford Foundation for a 3-year study of policies affecting Alaskan education.

Altogether within the 5 states during 1972 and 1973, foundation grants over $5,000 and $10,000 on record with The Foundation Center totalled 376 in number and $24,883,459.[1] In Indiana alone during the 18 months there were 267 such separate major foundation grants totalling over $17,000,000, and they went to a wide array of service organizations in the state. YMCAs, the Girl Scouts, childrens' homes, local health centers, programs combatting racism, programs fostering ecumenical cooperation, planned parenthood clinics, 4-H Clubs, public

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[1] The Foundation Center's *Grants Index* through 1972 includes only grants of $10,000. Beginning with 1973, grants over $5,000 are being listed. Information on grants included in the *Index* is obtained from press releases and annual reports furnished by foundations to the Center and does not include additional grants that would, for example, appear in IRS reporting forms. The Center plans to record information on grants shown in IRS reporting forms for foundations with assets over $1 million in the future.

TV, children with learning disorders, drug addicts, and deaf adults were among the beneficiaries—alongside colleges, hospitals, museums, and churches.

These then are a few examples of grant-making foundations doing their job, which primarily is to assist organizations, both public and private, that serve the myriad needs of people. If this Subcommittee is to have further hearings, beyond those scheduled for today and tomorrow, I would like to urge that the testimony of a broader span of representatives of recipient organizations be sought. There is no better way to get a feel for the many sensitive and indispensable ways in which foundations are helping meet significant needs.

GENERAL DIMENSIONS OF THE FOUNDATION FIELD

I have been asked to give an over-view of the foundation field in its current state.

As the Chairman and members of this Subcommittee doubtless know, philanthropic foundations are of several kinds and vary greatly in size, structure, chosen areas of activity, and modes of operation.

Under classifications established by the Tax Reform Act of 1969, as many as 37,000 foundations may exist today in this country. Of that total, according to the most recent IRS reports, slightly over 700 are private operating foundations. That is, they are primarily involved in conducting charitable activities with their own personnel or facilities, rather than through grants to other institutions or agencies.

Then there are the community foundations or trusts, numbering about 240 at latest count. They are marked by a local or regional focus, relatively broad funding from the local or regional sources, and boards of directors that are also broadly based. Some of the community foundations own substantial assets. This is the case, for example, in the oldest of them, The Cleveland Foundation. Its endowments altogether now amount to some $166.8 million (market value). But most community foundations are far newer and remain much less richly endowed.

Finally, there are the so-called private non-operating foundations. These, too, are of several kinds and encompass great differences in purpose, scale, and method. They include, for example, somewhere between 1,200 and 1,400 company sponsored foundations established by business corporations to help them institute and carry out systematic programs of charitable giving. Far the most numerous of the private foundations, however, are the independent family and general purpose foundations.

According to most recent reports from the IRS, organizations classified as private, grant-making foundations number today in the neighborhood of 31,000 and possibly as many as 4,000–6,000 more will be added to that total from among organizations still awaiting definitive rulings on their tax status.

Altogether, by estimate of The Foundation Center the private, grant-making foundations hold $28 to $30 billion of assets at market value. But only about 2,000 foundations are worth more than $1 million each, while about 350 hold assets worth over $10 million. Foundations known to have assets over $100 million (market value) numbered 46 in 1972. I cite these figures not only to outline the broad dimensions, and very considerable diversity, of the foundation field as it exists today; but also, the limited and dispersed nature of the economic power resting in foundations merits recognition.

For instance, of all the private giving in the United States—some $23 billion in 1972—foundation grants accounted for about 10%, or $2.2 billion. That percentage surprises most people. They assume the foundations are bigger than they are. Actually, the largest contributor to charitable causes is the people—you and I and millions of other individual Americans. Those who worry that foundations exercise excessive financial power should compare $2.2 billion disbursed by 31,000 or so separate entities with the over $25 billion in annual program outlays of the Department of Health, Education and Welfare over and above Social Security payments or with the billion dollar transactions of any number of corporate giants.

Even in aggregate, the wealth controlled by the some 31,000 grant-making foundations is, for example, very much less than one-fifth of that held in the country's pension trusts, reported as $150 billion at book value in 1972, and several individual pension trusts considerably exceed in size the assets of the Ford Foundation—which at $3.2 billion are in turn 2 or 3 times greater than

those of the next largest foundations, and many more times larger than the general run. In brief, an important feature of the financial resources represented in the foundations is that they are not under centralized control but are instead broadly dispersed, available to help respond to the great variety of human needs in their just and varied circumstances.

In comparisons of size such as those offered, foundations are Davids to Goliaths. But as that analogy reminds us, small assets well directed can produce important results. That is the prime significance of foundations. Foundations can be more objective, more searching, more systematic, and have a longer eye to the future than the giving of individuals tends to be. They can also be more flexible, more adaptable to specific situations and to specific institutional potentials, less bureaucratically constrained, than governmental appropriations and governmental agencies generally can be. In other words, the organized foundations, devoting time and care to the choices that confront it, is in position to make its dollars have a maximum charitable impact.

Some foundations do so by helping established institutions meet their expenses. They give money to colleges and private health-care agencies, to churches and museums, to symphony orchestras and the like. Others support experimentation. They give to new approaches in inner-city schooling, rural cooperatives helping former sharecroppers, population stabilization agencies, groups aiding mature women find careers. Many, many more foundations are variously involved in the vast range of public purpose activities that span the spectrum of American life, from day-care centers to wildlife conservation to basic research of submicroscopic viruses and the vast realms of astronomy.

Over the decade 1963 through 1972, annual foundation giving increased from about $.82 billion to about $2.2 billion by best available estimate. Through 1971 and 1972, according to records of The Foundation Center, the distribution of gifts overall was education 30%, welfare 16¾%, health 15¼%, science and technology 13%, international activities 11%, humanities 9%, and religion 5%. These proportions seem in keeping with the averages for the past 10 years and more, except for an upward shift of 3–4% in support for welfare agencies since the mid-1960's, and a commensurate down-swing of 2–4% in support for international activities and education. In particular, grants dealing with problems of the inner-city, minority groups, delinquency and crime have increased. Support has also grown in the health area following new concerns relating to environmental protection and drug abuse prevention.

THE 1969 TAX REFORM ACT IS WORKING

I wish to turn now more specifically to the 1969 Act and its consequences for foundations. As indicated, a chief concern of the Council on Foundations has been to advance effective and responsible performance throughout the foundation field. Thus, as some members of this committee may remember, during the 1969 hearings the Council went firmly on record favoring federal legislation to foreclose self-dealing in the management of foundations, to insure a reasonable annual pay-out, to institute strengthened auditing of foundations funded by an audit fee, and to require a better public accounting from them.

The legislation that resulted in 1969 imposed all of these restrictions, and more, on the private foundations. Major additional requirements of the 1969 Act include: phased divestiture of substantial interests in companies, prohibition of speculative investments, new controls over grants to individuals and certain other types of grantees, stringent restrictions on the funding of voter registration drives and on activities that might influence legislation, an additional set of special limitations on deductions for gifts to most private foundations, and a 4% "excise tax" on net investment income.

These rigorous provisions of the 1969 Act have been accompanied by a marked extension and intensification of the supervision of foundation performance by the Internal Revenue Service. As evidence of this, IRS expenditures on the auditing of foundations have increased more than eight-fold, rising from $1.6 million in 1968 to $12.9 million in 1972. It is now the announced intent of the IRS to have conducted audits of all foundations by the end of 1974.

Moreover, the 1969 Act has armed the IRS auditors with a range of tough, new sanctions—including penalty taxes against both foundations and foundation managers that can aggregate well over 100% of the amounts involved in some situations—to enforce compliance with the laws governing foundations.

Among existing foundations no one could claim that all are beyond reproach, fully efficient and fully responsible under both the law and their basic charitable mandate. Acceptance of public accountability is not the instinctive disposition of some. Moreover, the 1969 Act recognized the difficulties involved in compliance with some of its new requirements by providing transition periods. Consequently some of the reforms that Congress enacted in 1969 remain to be fully implemented. Nonetheless, as the Act's substantive provisions come into full effect, these situations will be corrected. IRS supervision with attendant sanctions should insure that. Under the mass and complexity of the new regulations a number of private foundations have decided to terminate, and the creation of new foundations appears distinctly to have been slowed. But, in all parts of the country we observe foundation managers and trustees taking their responsibilities very seriously indeed, doing all that they can to meet the requirements and complexities of the new law.

PROBLEMS RAISED BY THE 1969 ACT

The 1969 Act on the whole, then, seems to us to have brought necessary and beneficial regulation to the foundation field. There are, however, several features of the Act which are troublesome, particularly in their impact on the actual or potential beneficiaries of foundations activities—that is to say the colleges, research institutions, libraries, arts organizations, welfare agencies, needy students, and many other persons and agencies that draw on foundation help. These elements of the 1969 Act, therefore, merit, we believe, further consideration by the Congress.

(a) First, there is the 4% excise tax on the net investment income of foundations. The excess revenue raised by this tax beyond the amounts needed for proper auditing and supervision of foundations represents a serious loss to the activities supported by foundations. In 1972, $40 million that would have been available to various operating charities was denied to them by the 4% tax.

In 1969 the Senate voted for an audit fee tax of one-tenth of 1% of a foundation's assets. Not only was that rate equivalent to roughly half of the 4% investment tax subsequently arrived at by the Conference Committee and enacted into law, but the Senate version also tied the rate to the costs of administering the new law. We urge now that the rate be set again at a level closer to the actual auditing and supervisory costs, that it be earmarked for that purpose, and that tax be redesignated as a fee for auditing and supervision. I shall return to this matter a little later in some comments on the proposal for the establishment of a new Assistant Commissioner for Employee Plans and Exempt Organizations contained in the pension reform measure just passed by the Senate.

(b) Second, Congress should be aware that the mass and intricacy of the regulations implementing the 1969 Act are very great. The complex provisions relating to restrictions on programs are especially troublesome. While the final regulations for this area were issued only in December 1972, we have already seen real concern on the part of many of our members with their potentially stifling effect on giving programs. Much time of staff, attorneys and accountants must now be spent on determining the precise tax category of the grantee, on assessing the effect of a grant on that category, and on obtaining formal reports required from certain grantees. It is too soon, however, to urge specific answers to these difficulties. The experience of another year or so of audits and reporting should be helpful. The new IRS form for private foundations, 990-PF should be helpful in these regards.

(c) Third, there are two broad aspects of the Act which in conjunction raise troubling prospects as to the future capability of fundations to continue as significant sources of assistance to the country's various educational, cultural, medical and other charitable service activities which foundations have helped to stimulate and support.

On the one hand, these activities are almost all highly labor-intensive and the opportunities for increased productivity in them are small and come slowly. Hence cost-rises in excess of the general increase of the cost-price index are part and parcel of these activities. Their particular inflation (which must be figured to run 3% or so per year in excess of the general increase of the costs of producing goods in the U.S. economy [2]) coupled to the high pay-out requirement

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[2] A recent study by Joseph Goldberg and Wallace Oates, *The Costs of Foundation-Supported Activities* (1973), copies of which we shall be glad to supply to the Subcommittee, shows this to have been so consistently over the past 20 years. The chart attached as Exhibit No. 3 illustrates this phenomenon.

(in the range of 6% of foundation assets by 1975) means in all probability a progressive decline in the *real* support power of the existing foundation dollar. This is so because even very well-managed portfolios are not likely to earn a total return of more than 9% a year on the average.[3]

Join to this erosion of the support power of existing foundation assets the several requirements of the Tax Reform Act which discourage the establishment of new foundations and the augmentation of old ones: e.g., the 4% tax, the "less-favored" treatment of gifts of appreciated securities to foundations, the added administrative and legal costs occasioned by the complexities of the Tax Reform Act. The composite effect is a steady diminishment over time of the capacity of foundations to support the sorts of activities and organizations they now assist.

Because we believe firmly that foundations have made important contributions to the educational, cultural, medical, and other charitable services available to our people—and because we are convinced that comparable contributions remain important for the future—we are much concerned about these apparent long-term consequences of the Tax Reform Act as it is presently constituted. We therefore hope that these two matters of the required annual pay-out rate and of reduced incentives can be re-examined by the Congress in order to secure both a reasonable annual current return to charity and due regard for the needs that lie ahead.

The actual and potential significance of the privately supported, grant-making foundations in the private service sector of America, let me emphasize, lies not simply in the funds that they make available to operating charities, such as universities, hospitals, welfare agencies and the like; they are themselves also examples of the pluralism which is one of the great strengths of our society, for they serve as points where independent scrutiny, sympathetic concern, imaginative initiative, and purposeful planning are often fed into the total effort.

Moreover, chruches are not eligible for Government support, while agencies for the character-building of youth and many other bona fide charitable purposes must derive most of their support from private sources. Even when Government money may be available, it is vital that it not be in monopolistic control. According to a December 1972 survey conducted for the Council by the Gallup organization, 70% of the people hold that view. They believe private philanthropy to be as important today as ever in the past, and think that foundations should be active in attacking many of the same social concerns that also properly engage governmental agencies. Foundations can often respond quickly and flexibly to emergency needs. They can fund studies and trial programs on which Government programs may later be based. Even when foundations make mistakes, they are on a relatively small scale, and if they help Government not to legislate bigger ones, their very capacity to err is a benefit.

For all these reasons, it seems to us of very considerable moment whether the tax laws are going to permit and encourage foundations in the future to play at least as telling a role as the best of them now do within the context of American philanthropic enterprise. The argument here is not that every foundation should exist forever—but I would insist that foundations which show a capacity for self-renewal and for sensitive and responsible service over time surely thereby have a claim to continued existence at least as great as that of any other charitable institution. Our main concern is that foundations as a whole not be consigned to a diminishing role in our country's future. The need for the contributions which the grant-making foundations now make to the general welfare is not going to shrink unless there are to be radical changes in the structuring of our society. Instead, the needs will grow. Consequently the flow of new resources into the foundation field should be encouraged rather than discouraged.

RELATED CONCERNS

Before offering a concluding statement there are three related concerns to which I wish to call the committee's attention briefly.

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[3] For example, the National Association of College and University Business Officers and Prof. J. Peter Williamson at the Tuck School at Dartmouth have been keeping records on about 150 institutional endowments and some 158 mutual funds. Of 95 endowments, only 7 (i.e., 8%) were able to produce a total average return of 9% or better for the 5 years ending June 30, 1972. If one adds in the 158 mutual funds, making a new grouping of 253 funds, the number that achieved a 9% return was only 25 (=10%).

One is the great difficulty we all now face when we seek accurate, systematic data about the current extent of American philanthropy and its many components. There is really only one source that could be definitive, if it were so organized, and that is the Treasury Department using the records of the Internal Revenue Service.

Because of the heightened interest which has been generated in recent years about private philanthropy in relation to tax receipts and tax law, it would be both timely and most useful if the Internal Revenue Service's procedures for collecting and reporting information on charitable giving were brought more nearly up to date and made to include more distinctions as to scales of donation and types of recipients. (Currently the only available summary of this sort is *Giving USA* published by the American Association of Fund-Raising Counsel, Inc. and we are fortunate to have it. But as its editors regularly say, it represents broad estimates as much as it does firmly verifiable facts.) I would like to suggest that Congress urge on the Treasury the importance of a more current and useful record of philanthropic giving.

Second, even in the absence of all the evidence one would like, it is very evident that the charitable deductions provided by estate and gift taxes have performed important functions in encouraging substantial donations to the country's charitable organizations, both public and private. Today these deductions constitute a highly important, continuing set of encouragements for those fresh additions to the foundation field which I have already argued to be in the public interest.

Historically, according to a 1969 study, 54% of the assets of foundations in the $1–10 million size and 46% of the assets of those in the $10–100 million size derived from bequests as of 1968.[4] 81% of the capital of community foundations had a similar origin. Available data are too fragmentary to permit an updating of these figures. But with inter vivos contributions to foundations clearly down, estates take on heightened importance for the foundation field as the one remaining area in which tax incentives are conducive to its replenishment and growth. In various quarters proposals are afoot to limit the proportion of estates that may be left to charity free of tax. For the reasons indicated, it seems to us that the incentives to charitable giving through bequests should not be curtailed, and we would hope the members of this Subcommittee will help to uphold the existing incentives.

Thirdly, let me comment on the proposal for a new Assistant Commissioner for Employee Plans and Exempt Organizations. Ideally, I believe, the supervision of charitable activities would best be conducted by an independent agency established for that purpose, as is the case, for example, in Great Britain where the Charities Commission performs that function. One of the panels scheduled for tomorrow will, I understand, be testifying to the Subcommittee on that sort of approach.

Short of a solution that far reaching, the proposal in the new Pension Bill appears to us to have much to commend it. As the report of your parent committee points out, the proposed realignment in IRS should make it easier for the Service to respect and further the basic objectives of charitable organizations while insuring also the effective regulation of foundations in accordance with the 1969 Tax Reform Act. One feature of the new proposal that we particularly favor is the earmarking of a portion of the 4% investment tax on foundations for the costs of auditing and supervision. As previously indicated we would further urge, however, that that tax be redesignated as an auditing fee and that its rate be set at a level consonant with the actual costs.

SUMMATION

In concluding, I wish to suggest to this Subcommittee, as I have earlier to the House Ways and Means Committee, that the time has come for a new approach to foundations by the Congress. In 1969, the American people and their elected representatives in Washington were deeply disturbed by evidence that certain foundations had been misused for personal gain and by disclosures of bad judgment, even, perhaps, irresponsible behavior, on the part of other foundations.

[4] *Foundations, Private Giving and Public Policy* (Chicago, 1970), pp. 247–248.

Although the instances of this abuse and misfeasance were in fact limited, they were sufficient to place the entire foundation field under a cloud.

Clearly it was necessary for the Congress to act, both to protect the public interest and to protect the reputation of the many good foundations. Although as I have testified, I believe some of the controls contained in the Act are overly restrictive of bona fide foundation activity and therefore not in the public's best interest, the task of so regulating foundations that they must necessarily serve the general good of the nation has been accomplished, and on the whole accomplished well. For this reason, we submit, a new climate of opinion is now merited, one which recognizes the capacity of foundations to help meet important human needs. Congress, the Council believes, can properly—and should—take a hand in establishing such a new climate of opinion. It is time for Congress to show that it considers foundations a national asset and that it wishes to give encouragement to their activities.

Never, indeed, have foundations been more needed than today. With many grievous social problems calling for new, experimental approaches at solution, with severe cutbacks in the availability of Federal funds, with private sector educational, medical and social welfare institutions in deep finanical trouble, the initiative and resources foundations can provide are desperately required. No longer should they be regarded as marginal institutions operating in a twilight zone of official disapprobation. It must be made clear to them that they enjoy the confidence of the nation's highest legislative body and that superior performance is needed and expected of them. For their part, foundations, we believe, will respond to such a new approach and will give their best.

Exhibit No. 1

[From the Foundation News—January–February 1973]

A POLICY ON PUBLIC INFORMATION

(The Council on Foundations has undertaken a "national awareness program" that is designed to inform the public of the positive contributions of foundations to society, and to emphasize to foundations those policies and procedures that can improve performance.

(The Policy on Public Information published herewith is the first of a series of statements on issues of importance to the foundation field, which the directors of the council intend to develop and issue as part of the national awareness program.)

It is the policy of the Council on Foundations to encourage foundations to communicate to the public facts about their activities. To this end, the council has sought both to assist foundations in the development and carrying out of individual public information programs and itself to gain public attention and understanding for the work of grant-making foundations. Although it represents no new policy, the council seeks to reaffirm with this statement the desirability of an active information program as part of the normal operations of a grant-making foundation.

There are a number of reasons why foundations should seek to be open and informative.

Foundations exist to facilitate the application of private resources and private initiatives to the public good, and it is this capacity for public benefit which justifies their tax exemption. This is the case regardless of a foundation's character—whether it be large or small, an independent, corporate or community foundation. In this sense, foundations are public trusts and it is incumbent on them to provide a public accounting periodically and when events of special moment occur. Federal law and the regulations of some states today require an annual accounting from each foundation. Those requirements are rudimentary. The normal discharge of responsibility by organized grant-making philanthropy should include full and frequent reporting over and above the requirements of the law.

Beyond this is the benefit that may accrue to philanthropic endeavors through open and shared information. Money from foundations, in hundreds of millions

of dollars each year, supports a great variety of educational, cultural, medical and other charitable projects. In many cases the benefits from these undertakings would be extended if they were better known. More coordinated efforts might be engendered, wasteful duplication might be avoided, additional support might be attracted and potential recipients would be aided if information about each foundation's activities were available.

To be sure, needs to be met usually outrun available sources and publication of a foundation's objectives and activities may, therefore, seem to be only inviting increased administrative burdens. But, in fact, the time-consuming task of screening grant applications can often be lightened by regular reporting, for it can discourage inappropriate requests no less than encourage appropriate ones. Moreover, when foundations make known their interests they increase the likelihood that they will gain useful assistance and advice from other parties concerned with the same problems.

Foundations engage in activities which reach deeply and constructively into American life. In a vast, complex and fast-moving society these activities may be misunderstood if not presented clearly or put into perspective. This requires information to be put forward accurately to the public via the communications media.

The reticence of many foundations about publicity is often anchored in modesty and/or self-protectiveness. Nowadays, such denials of the public interest are more likely to be self-defeating than beneficial. The endeavor and accomplishments of grantees often merit the greater attention, but foundations should not therefore spurn recognition for timely assistance given or jobs well-done. This is not to suggest a publicity program designed to stimulate plaudits; that would be as wrong as false modesty. Getting factual information to the public is the objective.

Today in America there is a general disposition to scrutinize, question and test all institutions. The conviction that foundations perform functions vital to the well-being of our pluralistic society is not universally shared. In the face of the doubts, foundations—like universities and chruches, corporations and labor unions—must be prepared to demonstrate their worth in the effectiveness of their activities and by making these activities better known. They must be prepared to exhibit their wares in the marketplace of ideas to gain and hold public understanding, the good will of the people, the support of elected representatives.

For all these reasons, the Council on Foundations urges on all foundations the value of a public information program. Even the smallest of foundations can plan and carry forward a realistic program, one appropriate to its size, in discharging its responsibilities to the public, to the foundation movement and to itself.*

ROBERT F. GOHEEN,
Chairman.

Exhibit No. 2

[From the Foundation News—January 1973]

SOME GENERAL PRINCIPLES AND GUIDELINES FOR GRANT-MAKING FOUNDATIONS

A POLICY STATEMENT OF THE DIRECTORS OF THE COUNCIL ON FOUNDATIONS

(Preamble.—We have often been asked how the directors of the Council on Foundations view the foundation field and what the Council stands for. This policy statement endeavors to answer those questions, at least partially, and we hope it may be useful both to persons responsible for foundations and others concerned about them.)

1. Basic rationale

The grant-making foundation as an institution is a means whereby nongovernmental initiatives and resources can be committed to the service of the public

*The council plans to issue a manual to help foundations implement such programs.

welfare over time. The foundation is thus an element in the creative pluralism of America and is in partnership with all those engaged in the alleviation of the many human needs felt within our society and the world at large.

Foundations have, of course, no magic keys. But overall, in the many diverse efforts they support to heal and uplift the human condition, and where possible to get to the roots of its persistent ills, the contributions of the foundations to human welfare are enormous. When at their proper tasks, they reflect the humaneness of America at its best, as expressions and instruments of the outgoing concern for one's fellow man which is so deep in our heritage and is still so much a part of the nation's best hope.

2. Diversity

Grant-making foundations differ greatly in origin, size, purpose, organization and mode of operation. In this diversity they correspond to the multiplicity of society's bona fide charitable needs, and because of it, satisfactory generalizations about foundations are difficult. Within their general philanthropic mandate, it is fitting that some foundations should be concerned particularly with the search for fresh solutions and inonvative lines of development while others center more on the support and strengthening of existing institutions of proven worth; that some should favor progressive social causes and others more conservative ones; that some should focus on local or regional needs while others seek to extend their scope of effective concern to human welfare the world around. In these respects no orthodoxy can properly be prescribed for foundtions though partisans of various limited interests keep trying to do so. The one common requirement is an essential public spiritedness. While perhaps an awkward referent in a cynical age, a commitment to the service of others must nevertheless be the basic guiding principle for all who direct or manage foundations.

3. Governmental supervision and the Tax Reform Act

The capacity of foundations to contribute to the public welfare under nongovernmental management is the basic justification of the privileges granted to them by both the Federal government and the states—the most important of which is the tax exemption they enjoy. For the same reason, foundation trustees are allowed broad latitude as to how they perceive the public good and what elements of it they wish especially to address themselves to.

Abuse of this privilege in some cases for personal or partisan purposes has come to reflect adversely on the reputation of foundations generally, and in 1969 it led to numerous restrictions being put on them in the Tax Reform Act of that year. The act effectively rules out financial self-dealing by foundation trustees and officers, requires a greater openness and public accounting from foundations and properly insists on a substantial current pay-out to charities from foundation assets. It also contains negative features—particularly a 4 percent excise tax on net investment income, damaging especially to recipients of foundation support; a series of provisions discouraging the formation of new foundations and the enlargement of existing ones; a setting of the pay-out requirement at levels where it may mean progressive diminution, over time, of the ability of private foundations to finance the kinds of philanthropic activities they now support; an immense amount of highly technical regulatory detail that makes the management of small foundations particularly difficult.

Despite the "overkill" contained in these provisions—which one must hope will prove open to Congressional adjustment as working experience with the effects of the Tax Reform Act become clearer—the act's forceful reminders that foundations exist for the public benefit and must be so directed have to be recognized as necessary and for the good. The same applies to state regulations affecting foundations where these have been instituted.

4. Management

Once a foundation is established and given tax exemption, neither the donors nor trustees nor staff own it. All such parties may and should have a critically important roles to play in how a foundation defines its interests, selects its targets and conducts its activities. The essential requirement is that both trustees and employees recognize their involvement in and responsibility for a public trust in relation to which self-aggrandisement and self-dealing can have no proper place.

The degree to which foundation boards or staffs should be diversified in membership to insure independent views and broad representation of the public presents difficult questions. The differences in size and scope among foundations exclude pat answers. Many foundations are being guided with marked sensitivity and concern by a donor assisted only by several friends or associates serving as fellow trustees. Yet, generally, diversified boards and staffs will tend to insure the sensitivity of foundations to the needs of segements of the society who have too often been denied adequate voice and representation. Persons from minority groups and women, moreover, often have important perceptions to bring to bear on foundation activities. Their inclusion in positions of influence within the foundation field is highly desirable.

Whether a professional staff is required by a foundation depends on the nature of the foundation, its program, and the time and attention which trustees can bring to the work. The most important thing is the quality of the work—including its sensitivity and its realism—not whether it is done by trustees, professional staff or consultans.

5. Evaluation and program review

No foundation, however large or small, should be complacent about the wisdom and efficacy of its giving program. Each should be constantly concerned to see how it can improve its performance and make limited resources meet as effectively as possible needs that generally far outstrip available funding. Periodic, systematic review and evaluation of program can lead to improved performance by the small, trustee-managed foundation as well as the foundation which employs staff and disburses substantial funds. The use of outside consultants or review panels will often add to the validity and usefulness of the evaluation.

6. Disclosure

Out of the public trust vested in foundations grows the need to accept the principle of full disclosure and readiness to share with concerned persons, as well as with public officials, information about objectives and activities. Too often foundations have proved inaccessible and their decision-making processes cloaked in secrecy. Federal and in some cases state legislation now require at least minimal disclosure, but positive steps taken voluntarily to minimize secretiveness can better show the concern of the foundations to serve the public with sensitivity and good faith.

A concern for informing the public of what its objectives and activities are—even when very modest—can also often help a foundation's managers gain useful advice and criticism relating to areas of particular interest to them. It also can forestall inappropriate applicants and the irritation of exaggerated expectations let down.

7. Cooperation

More cooperative activitiy among foundations can be beneficial both to them and to potential recipients of foundation support. Small foundations can often increase their effectiveness by pooling resources to employ expert advice or to hire a staff which none of them could afford alone. Community foundations and the larger private foundations can often assist smaller foundations by sharing information and experience.

It is the policy of the Council on Foundations to encourage and extend such cooperative possibilities within the foundation field. At the same time the Council seeks to serve as a center for useful information and guidance for grant-making foundations of all shapes and sizes.

8. Operating relations with government

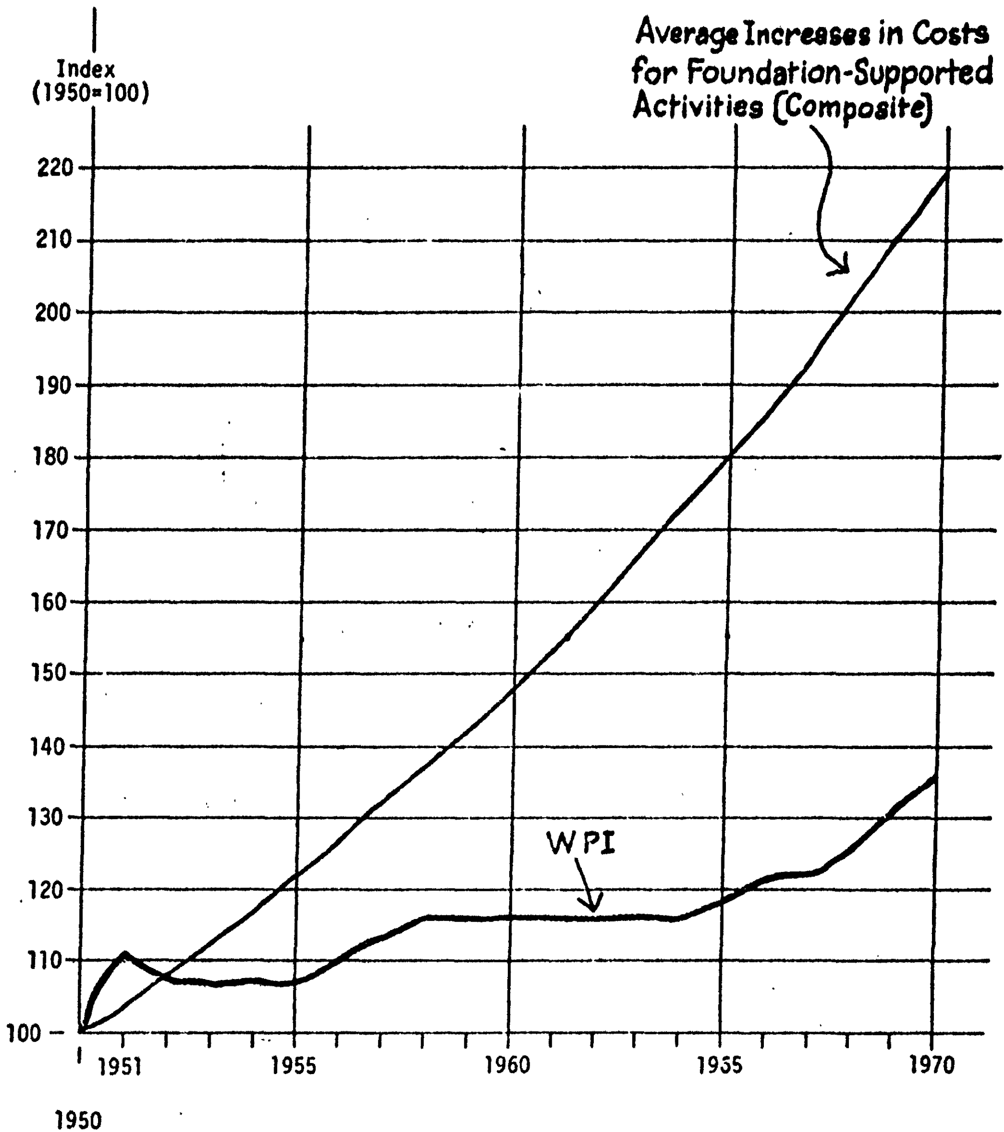
The law rules out partisan political activities and, with limited exceptions provided by Congress in 1969, action to influence legislation. Foundations are not barred from sponsoring the study and discussion of public issues even when such issues are taken up by Congress and other legislative bodies. And foundations are fully entitled to inform members of the Congress, as well as other agencies of government and the general public, of their activities.

Moreover, foundations are entitled under the law to interact with executive agencies at Federal, state and local levels. Not only may they work in partnership with government agencies, they can promote objective evaluation and moni-

toring of government programs, and can fund competitive programs in fields of interest to both government agencies and private philanthropy.

EXHIBIT 3

Indices for a smooth 4% trend-line
representing costs of foundation-supported activities
and the Wholesale Price Index



Senator HARTKE. He have a panel discussion to deal with the overview on the role of foundations, and I am delighted to see that panel headed by a dear old friend of mine, Landrum Bolling, former president of the Earlham College, Richmond, Ind.; Raymond Wieboldt, the Wieboldt Foundation from Illinois; and Robert Guenzel, Lincoln Foundation; and David Freeman, Council on Foundations president.

You gentlemen may come forward and assume your place and proceed in any fashion which you feel is most appropriate.

I would ask you when you speak to pull the microphone in front of you, it would help everyone concerned.

Senator CURTIS. Mr. Chairman, I am sure the entire panel is made up of distinguished people, but I do want the record to show that I welcome here Mr. Robert Guenzel, one of our leading lawyers in Nebraska, and he has given a great deal of his time to matters of public interest and public concern, and is well qualified to speak for public foundations in my State.

Senator HARTKE. All right, who is first?

PANEL DISCUSSION: LANDRUM BOLLING, FORMER PRESIDENT, EARLHAM COLLEGE, RICHMOND, IND.; DAVID FREEMAN, PRESIDENT, COUNCIL ON FOUNDATIONS; ROBERT GUENZEL, ATTORNEY, LINCOLN, NEBR.; AND RAYMOND WIEBOLDT, DIRECTOR, WIEBOLDT FOUNDATION, CHICAGO, ILL.

STATEMENT OF LANDRUM BOLLING

Mr. BOLLING. Mr. Chairman and members of the subcommittee, we are here as a diverse group of representatives of foundations from different parts of the country with different sizes and styles of operation.

All of us invited to testify before this Senate Subcommittee on Foundations, I am sure, welcome the opportunity to report on the activities of foundations as we know them and to try to answer any questions that might be raised about them.

It is a healthy thing that there should be continuing investigation and debate over the proper role of foundations in our society.

At the heart of the debate over foundations—a debate that has already lasted for several years—is an argument over this basic question: Should a private, nonprofit corporate organization be allowed to hold and manage substantial funds given to it by private donors and decide on their use in the public interest or should all such funds be taken over by governmental agencies for disposition through political/governmental processes? Some of the earlier issues over foundations are now settled—thanks to the Tax Reform Act of 1969—and should have been settled long ago. Foundations can and must meet some minimal pay-out requirement, though the exact percentage is still debatable. They should and must avoid self-dealing with trustees or staff members or their relatives. They should and must refrain from efforts to influence the outcome of political campaigns. They cannot and must not be used to enable certain individuals to escape their just and lawful tax obligations. All of these are, in essence, issues that have been settled. No one with any sense of social responsibility can defend the abuses by a few foundations that those prohibitions were designed to correct.

Today the debate over foundations seems to come down to these questions: Should foundations be allowed to exist at all? Should punitive restrictions on legitimate foundations be removed? Should new foundations be encouraged? If the answer to all these questions is yes—and

I believe it should be—then the public policy implications of such an answer are fairly clear.

The case for foundations rests ultimately on the case for private philanthropy in general.

(1) The importance of encouraging voluntarism in the satisfying of social needs, of maintaining the human, empathetic feeling of personal responsibility in the face of social needs.

(2) The wisdom of decentralization, down to the local grassroots, of some portion of the tasks of providing our educational, cultural, charitable services.

(3) The usefulness of having available some alternatives to many Government services, even where those Government services may be universally accepted as the norm.

There are many other ways of stating the justification for private philanthropy—the oldest being the ancient teachings of all the great religions of the world about the obligation of man—in fulfillment of his obligation to God—to give of his resources and his time to aid the widows, the orphans, the sick, the poor, the oppressed. But even to secular minds in a secular age it is clear that we become a poorer, less humane, less responsible, less efficient, more bureaucratic and more callously indifferent society if we stifle private initiative and responsibility for philanthropic giving in favor of a Government monopoly in the handling of all social needs.

All of this being true, we need a comprehensive, coherent and consistent public policy to encourage private philanthropy. With all the proper safeguards to prevent selfish abuses, we still need incentives to encourage individuals and organizations to act upon their charitable impulses.

Speaking entirely as a private citizen, not in any way as a spokesman for Lilly Endowment or foundations in general, I want to express strong personal endorsement of the concept that the incentives to private giving should be broadened and strenghtened so that the lower-income individual might have inducements for giving comparable to the inducements afforded to higher-income givers.

It seems to me the whole question of the future of foundations relates very much to our whole concept of philanthropic giving in general.

Specifically, I would urge the Congress to offer to all taxpayers the right to make contributions of up to perhaps $100 each to any legitimate IRS-approved educational, religious or charitable organization on a full, direct tax credit basis.

It is sometimes pointed out that it is possible for a high-bracket taxpayer to give a $100 contribution to his charity at a net cost to him of $30, under current deduction schedules, but that a low-income taxpayer who wants to give that same amount of $100 to perhaps the same charity does so at a net cost to him of $70.

This arrangement it is argued is not fair or equitable. It isn't. But the answer is not to denounce all gift incentives as "tax loopholes" (an overworked and often misleading swearword in much of the debate). The answer is to design an equitable system for encouraging the broadest possible base for philanthropy with suitable incentives

for both high-income and low-income taxpayers, not to hamper giving from the larger pools of wealth.

Foundations should and can function—and those I know do function today—within the bounds of propriety and social responsibility. As part of the total complex of private philanthropy they not only make possible useful public services that in most cases would otherwise, in one way or another and often at much greater expense, have to be provided by tax moneys; they also help to maintain the very pluralism and freedom of American society.

Rather than being regarded, as they are by some critics, as privileged and selfish enterprises to be tolerated only so long as may be politically expedient and then laid to rest, foundations should be seen as playing a permanent role in serving essential human needs and in encouraging voluntary initiative and private responsibility. Those now in existence should, under appropriate regulation, be encouraged to continue. And, under appropriate controls, new foundations should be helped into being.

Foundations vary enormously in their fields of interest and programs, as well as in the size of their resources. They, moreover, do not remain the same. For most of them what they did yesterday is not necessarily what they are doing today or what they will be doing tomorrow. They, like other social institutions, try to repond to the current needs of society—a society characterized by constant change and changing social needs.

Today, quite clearly, a number of the larger foundations give high priority attention to urgent issues related to our decaying cities, to problems of drug abuse, juvenile delinquency, poverty, family distintegration. At Lilly Endowment we, too, have provided support for a number of urban projects—minority business development projects in Indianapolis, street academies for young dropouts in New York, child care training programs in Chicago, and addiction services and youth recreation programs in a number of cities. But, at the same time, we have also felt we should give deliberate attention to the economic and social needs of small towns and rural areas.

To that end we support self-help economic, educational and cultural projects in small communities in Alabama, Kentucky, Tennessee, North Carolina, Indiana, and Arkansas. We have contributed to Indian reservation projects in Arizona and the Dakotas. We are actively exploring the possibilities of investing more of our resources in matching programs in which people in the forgotten smaller towns and rural areas are attempting to help themselves.

The roles of private foundations in the fields of scientific research and medical facilities and services have obviously changed drastically in the last several years.

The billions of tax dollars for these purposes have tended to persuade private foundations to allocate their funds to other fields. Yet, in spite of that general tendency, the Robert Wood Johnson Foundation, one of the largest in the country, has committed itself to devote most of its grant money to various efforts to improve the health delivery systems across the country. It was the Rockefeller and Ford Foundations that stimulated and largely underwrote the extensive research

and testing programs that gave the world the new super-strains of food grains that sparked the so-called Green Revolution.

Sometimes a foundation may play a useful role in applying the science and technology already available. Today in another place in this city the privately supported philanthropic organization Africare is holding a press conference to tell of the drought and famine conditions in the parched areas of several of the sub-Sahara countries of West Africa—and to report on a recent small success in which an American foundation was involved. The several million people whose very survival is threatened by this natural disaster can probably be enabled in time to win their age-old struggle with the elements through much more extensive boring of wells and building of large and small reservoirs and applying more generally both ancient and modern methods of irrigation. For this considerable planning and financing—chiefly from governmental sources, including the United States—must be provided. Meanwhile, what happens to crops that once more are about to fail?

Based on the use of photographs taken by America's orbiting astronauts and onsite studies by U.S. meteorologists, it was decided that during the month of September it would be possible to produce the Republic of Niger significant quantities of rain by artificial cloud seeding techniques.

The President of Niger, having failed to get help through the normal international and national governmental channels, appealed to Africare, a public U.S. charity concerned with African projects. Africare in turn presented a grant request to Lilly Endowment. We were fortunately able to get a U.S. citizen consultant to make a quick independent check on the project through a visit to the area and to secure reports and recommendations from technical experts. Our executive committee, accordingly, authorized a grant of $50,000. This made it possible for two experienced American pilots to ferry two small planes and the necessary equipment across the South Atlantic to West Africa and to start the cloud-seeding operation promptly. All of this was done within about 2 weeks after the meteorological survey had been completed. Fortunately, the gamble paid off. Rain was produced. Some benefit to this year's crop was provided. Other countries in West Africa are now officially studying this approach to a partial solution to their drought problems.

Senator HARTKE. Let me ask you as an aside, are you sure some of the rain doctors didn't go ahead and pray at the same time?

Mr. BOLLING. I can't guarantee you a thing.

This, as I must point out, can only be called a "small success." It is certainly not an answer to the long-term famine threat to West Africa. And it could have been a total failure. Yet we had, as a private foundation, the flexibility to act quickly and the freedom to take a chance.

I might say, we were, and others were, encouraged by Government officials to make this gamble, even though it was a risky thing, and insofar as it has succeeded it is going to cut down considerably, immediately on the appeals that are going to have to be made, demands being made for Government support for famine relief.

That kind of flexibility, that kind of risk-taking freedom is one of the significant justifications for foundations—and always will be.

Education is and will remain a major concern of the foundations. Here, too, priorities are shifting. After World War II these were among the high-priority concerns of educational institutions and of both the Government and the foundations:

1. The rapid expansion of physical facilities to take care of what were thought to be ever-bulging enrollments.

2. The raising of wretchedly low faculty salaries.

3. The expansion of graduate training in order to turn out more teachers and more scientists.

With all three objectives America has succeeded—almost too well.

Senator HARTKE. Have we really eliminated the low faculty wages?

Mr. BOLLING. Well, we have made a great improvement on this.

Senator HARTKE. You say with all three objectives we have succeeded almost too well. I just wonder if the faculty would agree with that.

Mr. BOLLING. I think in terms of producing more teachers, scientists, building more facilities; the salary thing would be a different matter, but I think we can say we have succeeded extremely well in building facilities, expanding graduate training, and these are not the current issues by the American community.

Senator HARTKE. What is the current issue?

In the strike in Mishawaka, Indiana, teachers' salary is the issue.

Mr. BOLLING. That is in the public school system, I believe, sir, and there are many differences in faculty salary ranges across the country. Some of them are still low in many of our smaller colleges.

Senator HARTKE. I understood you to say among the high priority concerns of educational institutions—you meant in the private educational institutions?

Mr. BOLLING. I meant higher education primarily here.

Senator HARTKE. I see.

Mr. BOLLING. But these are changing. We have built up a tremendous surplus, I think one can fairly say at the moment, of certain kinds of teachers, certain kinds of graduate facilities. Perhaps they have been overexpanded.

I am saying that these priorities are shifting.

I speak only for Lilly Endowment when I say that now among our high priorities in education are the following objectives:

1. We are concerned to encourage the private colleges and universities to do a better job of fund raising from their own natural constituencies and to improve their internal management. We are providing a variety of challenge grants to this end.

2. We want to support efforts directed at greater cooperation and joint planning between the public and private sectors in higher education. As a society we cannot afford endless duplication.

3. We are interested in certain modifications and improvements in undergraduate education that look toward more explicit preprofessional training and for relating the academic community more closely to the "outer world." In that connection Lilly Endowment has just funded the Woodrow Wilson Foundation in launching a program of

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senior visiting adjunct professors drawn from business, diplomacy, journalism and other professions to participate in the educational programs on a number of smaller and more isolated college campuses across the Nation. We are delighted that your long-time colleague Senator Margaret Chase Smith has agreed to be one of the first of these visiting adjunct professors.

4. At all levels of education we are interested in encouraging a variety of efforts to improve education for personal value development—to use an old-fashioned term, for character development.

One question inevitably raised about foundations has to do with the extent to which these organizations meet the needs that are represented in the appeals made to them and in the grants dispersed.

This is the kind of question the chairman raised a few moments ago.

The answer is that inevitably only a very small fraction of the needs presented to foundations are ever met by the grants made, simply because most grant requests have to be turned down. It is a kind of rule-of-thumb that in dollar terms foundations can attempt to satisfy only something less than 10 percent of the requests they receive, and my impression is that the correct figure may be even less than 5 percent. Foundations just don't have and never will have enough money to take care of more than a small percentage of the legitimate and worthy requests brought to them.

One of the questions to which I have been asked to speak is the question of whether and how the foundations are involving the public in the grantmaking processes. My answer must necessarily deal with several types of public involvement.

In recent years the Lilly Endowment Board has been enlarged and made more diverse. Today it included only one member of the Lilly family—out of 11 Board members. It has drawn an increasing number of members from business and professional life unconnected with the other activities of the family, and with diverse interests, backgrounds and political affiliations.

Obviously, the employed professional staff play big roles in foundation decisionmaking. Even in our relatively small staff (35) we have professionals drawn from the law, the ministry, education, business, social welfare service, Government administration, accounting. We have a healthy representation of racial, religious, and political, socioeconomic backgrounds—and, of course, both men and women. To have significant input from the broad society a foundation is intended to serve it needs a diverse staff.

In addition to the full-time staff, Lilly Endowment, like many other foundations, makes considerable use of consultants drawn from a variety of backgrounds. They are used to review grant proposals, to evaluate funded projects, to advise the board and staff on policies, even, on occasion, to make detailed recommendations for decision. They, too, provide a significant input from the broader public.

Perhaps one of the most significant ways in which a foundation can demonstrate its concern for genuine public involvement in its grantmaking process is through its style of administration. At Lilly Endowment we try to operate, insofar as is humanly possible, on an open-door policy. We are accessible to phone callers and to visitors who walk in off the street and we are approached by many of both every-

day. The mail requests and suggestions pour in in unbelievable volume every day. We endeavor to give every request serious attention. From time to time, we try to get people with related interests together, assisted by outside experts, to examine alternative approaches to a given problem. We constantly seek advice from a variety of professional, cultural, educational, religious and governmental leaders.

Behind all of this rather demanding, at times exhausting, style of open-door administration, we at Lilly Endowment try to operate on a philosophy of stewardship, as do other foundations I know.

Let me close with the following excerpts from that statement recently adopted by our board:

> Foundations must be scrupulous, responsible and imaginative in discharging their trusteeship function. This is not merely noble, it is necessary. Only if foundations see their work as a public trust, and operate that way, will they survive. Meanwhile, they have opportunities for significant achievement given to few agencies in our whole society.

Thank you, sir.

Senator HARTKE. Thank you for an excellent statement.

I think we will proceed with the rest of the statements before we go to the questions.

Dr. Raymond Wieboldt, you are next. However, you want to move.

STATEMENT OF RAYMOND WIEBOLDT

Mr. WIEBOLDT. I appreciate the opportunity to present a statement this morning, Senator.

I am here as a representative of smaller and medium-size foundations—those of us whose endowment and annual giving figures place us outside the category of the largest 100 or so foundations. We are different from them in many ways. We don't have large staffs; board members, like me, are very much involved, on a volunteer basis. The scope of our grants is usually limited; we often concentrate on support of organizations in our own local communities. Most of us are content to respond to requests for grants, rather than initiating programs.

Beyond such broad characteristics many of us may have in common, our foundations present a great variety of purposes and ways of doing things. That's how it should be; foundations play a useful role in preserving a practical everyday sense of pluralism in America. Let me describe briefly one example.

The Wieboldt Foundation was established in 1921 by my grandfather and grandmother, Mr. and Mrs. William A. Wieboldt. They set aside $4,500,000 as the endowment for the foundation. We have made grants through the intervening years totaling $15,300,000 from both normal income and capital gains. Last year our grants totaled $718,000 or about 6½ percent of the $11 million average market value of the foundation's assets during the year. Our grants were all in the Chicago area, largely to organizations and agencies attempting to deal with some facet of urban problems for urban people. The foundation has a staff of three: executive director, administrative director, and secretary.

There have been no further grants to the foundation since the original grant.

Many of our grants now and for several years past have been to community organizations—groups of citizens who want to get together and work toward some constructive goals for improving the quality of life in their own neighborhoods. Money in such cases is the least important ingredient, compared to the precious value of citizens' energies themselves, but it's a necessary enabling ingredient. A typical grant of $10,000 or so would be used to help pay for the day-to-day expenses that have to be incurred to make a community organization work.

The activities we fund with such grants cover the whole scope of community life. Attempts to improve schools through citizen participation, new ways to create health services, developing new economic opportunities and job resources, are just a few examples. The communities involved vary a great deal, too; all colors and creeds, all income levels are represented in our current grants to Chicago community groups.

We also make grants to professional agencies. Some are providing social services to individuals; we help where we can to maintain such services and yet also in efforts to find ways to get at root causes of problems. Other agencies with grants this year are in a variety of fields—a public interest law firm, a teachers' center, a group working on the potentials of cable television, a Puerto Rican Cultural Center bringing the art and craft of silk screening from its island heritage to Puerto Ricans in Chicago. These grants are investments in new energies coming forward to enrich our city and try to solve some of its problems.

It seems to me that this broad scope of activities funded by foundations is one of the clearest differences between the old days of philanthropy and the new. Urban people have higher expectations about themselves and their communities than ever before. Yet our cities are full of disappointments, full of functions and services that don't work. Organizations arise in every conceivable field to try to overcome the troubles, and they deserve attention and respect. Instead of being off in some corner of society concerned with something called charity, we are forced to be very much a part of the mainstream life of the city. From the standpoint of public accountability of foundations, this is a healthy change. To the extent that we are in that mainstream responding to needs that are being felt in communities, our priorities reflect the priorities of the people, rather than some set of priorities we have invented for ourselves in a vacuum.

We keep in close touch with our grantees. Our executive director makes this his most important activity, and board members frequently visit grantees and always receive and read progress reports. We evaluate the consequences of our grants largely through observation; we know what the grantee is trying to do because we have worked hard with him to understand and help articulate those objectives. By gaining the grantee's trust and sticking with him, we can see the successes, and the failures. We don't have much hard data in a statistical sense because we're not a research-oriented foundation. We are most of all interested in making grants that will enhance leadership qualities of people and their abilities to help others. Accomplishments with such purposes are hard to evaluate. But we can talk about specific new dialogs being established between police and community, new services

being won for handicapped children, families being successfully encouraged to live in integrated neighborhoods, changes in urban renewal plans to reflect community wishes.

I think this close relationship with grantees is a style of practice that more and more foundations are turning to. We must, if we are going to be in touch enough with what's going on in our communities to make intelligent choices about grants.

We are also communicating more among ourselves. In Chicago, for instance, we have established the Chicago Foundation Group this year, to exchange information, learn from each others experiences, and help each other look at new opportunities for making our foundations useful in the public interest. About 40 foundations have been actively involved so far; the total amount granted by these 40 foundations in the most recent reported year was slightly more than $19 million. We have had meetings so far about how to comply with the Tax Reform Act, an analysis of where we as a group are giving our money, and what some of the options are in making grants to help work on urban problems. This month we will have a joint meeting with representatives of the National Endowment for the Arts, a nuts and bolts session on administrative practices in handling grant requests, and a meeting on how foundations can best relate to colleges and universities and vice versa. I feel the enthusiasm being shown by foundation board members as well as staff members, and the tangible benefits we can all see coming from the experience, are good indications of the sincerity of foundation people trying to make foundations useful in our community.

The Wieboldt Foundation publishes an annual report and at least two interim lists of grants each year. We have published a report every year since 1921. We distribute these reports broadly in the community so people can know what we're doing. We are anxious to show that we are available as a resource. I spoke of being in the mainstream; we spend more time in evaluating requests and performances out in communities with community people than we do in the office. When we get an application from a community group, we insist on finding out where that group stands in the community, who is involved, and to whom they are accountable. We feel that only in that way can we begin to be properly accountable to the community ourselves.

The Chicago Foundations Group is also helping us and all the other foundations establish closer community relationships, not only because that's one of the major points of encouragement among the group but also because we involve public representatives in our meetings. We find that when a dozen foundation representatives get together with a dozen community people involved in urban programs, for instance, the conversation can be a great deal more open and enlightening than the conventional 1-to-1 relationship. Everyone involved can get a clear idea of his community responsibilities.

I can't let this occasion go by without remarking on the 1969 Tax Reform Act. We find the new regulations fairly easy to live with; we are experienced enough and perhaps large enough to know how to comply with concepts such as expenditure responsibility without undue anxiety. We fear for the smaller or less experienced foundation, however; we beseech the Government to work constructively with

foundations and encourage them, rather than run them out of business with a lot of threats and redtape. As far as the tax is concerned, we pay it with great misgivings. The $15,000 we paid this year meant at least one major grant we couldn't make; we were that much less effective as a useful community resource. We ask that the tax be eliminated or substantially reduced.

Thank you for the opportunity of appearing before you on this panel; I'd of course be glad to answer questions and help in any way I can.

Senator HARTKE. All right, thank you, Mr. Wieboldt, and now Dr. Robert Guenzel from the famous State of Nebraska.

STATEMENT OF DR. ROBERT GUENZEL

Mr. GUENZEL. Thank you, Mr. Chairman, I am Robert Guenzel, a director of the Lincoln Foundation, a community foundation, and I am here on this panel as a representative of the community foundation.

A community foundation is a different type of entity, although a foundation from the private foundations in that a private foundation makes grants generally over as wide an area as it chooses. A community foundation is limited generally in its grant-making activity to a particular community although that community may be regional in nature.

The guidance of the community foundation likewise comes then from that same geographic area so that the community foundation should have and must have on it a broad representation from the community. When community foundations were initially programed, they were considered to be sort of an adjunct or complement to the community chest or the united fund agency in many instances; however, since the development of community foundations, they have progressed, and that is no longer true. We have had a substantial shift in the past years, particularly since the Second World War, in the activities of the community foundation, away from this type of program and into innovative programs involving fundamentally high-risk programs in the community, and I think today all community foundations recognize that their activities should be directed to those areas of new programs where those programs cannot be undertaken by governmental agencies because they are unproven and where they cannot be funded through the ordinary united fund agencies because they are not established.

For example, one program that we funded with a very small grant was in a Veterans' Hospital in Lincoln. They were conducting a research program on alcoholism. They found that within the framework of permissible purchases by the Veterans' Administration bourbon whiskey was not included, and we provided the funds to purchase a case of whiskey so they could conduct their research program.

Senator HARTKE. Being Chairman of the Veterans' Affairs Committee, coming from a State which still outranks Kentucky in the amount of bourbon being bottled, I am not too sure how I feel about that. [Laughter.]

Let me say to you, this field of alcoholism is still the No. 1 drug problem of America, so I commend you for it.

Mr. GUENZEL. In addition to that, the Lincoln Foundation also made a grant perhaps of more seriousness than the research grant, in that we financed a study which resulted in the problem of hard drugs and marihuana in the community being placed into the already existing program on alcoholism, so that we have a single entity which handles the problems of alcoholism and the problems of the use of other types of drugs in the community.

Senator HARTKE. Thank you.

Mr. GUENZEL. I think it also important from the point of view of a community foundation that the foundation, because of its broad community membership, not only make grants in local areas, but it reject grants, and that rejection is sometimes more important to the community than the making of the grant, because within the framework of the community foundation the foundation should know the other entities, other organizations in the community that are undertaking programs so that if someone comes in with a new idea perhaps there is already an existing place for that new idea, and that new programs in the community.

For example, the alcoholism council already existed, already was dealing with drug problems, that was an existing agency already funded, much better equipped to undertake the total drug program than establishing a new agency that would compete for funds for a portion of the drug program.

Senator HARTKE. I understand that. I hear you and I would like to command you for it, but I point this out to the foundations generally as a problem that you must concern yourselves with ultimately. It involves the whole question I referred to earlier about the philosophical approach. A foundation may have a positive function in society, but this negative function can be as serious in its implications.

In other words, if, for example, a prestigious foundation refuses to proceed with it, they may have the effect of preventing what really needs to be done.

Mr. GUENZEL. Indeed, Senator, this is true and this is one of the problems that foundations have and it is particularly a problem in a community foundation where, if this broad representation of the community should reject a program, it can be construed by the remainder of the community as a disapproval of the program.

Senator HARTKE. Let me give you a specific which everyone on my staff would advise me not to mention. They would say why get your nose into something in which you are not primarily concerned? As I have indicated before, we have in Indianapolis an issue which is at least the No. 1 issue in the community, and that is school busing, because the simple fact is that it is going on through the courts and has engendered opposition to the point where they want to circulate a petition for the impeachment of the judge and the Supreme Court. So it is certainly not a matter which is without controversy.

Now, what if, for example, there was a request that came to the Lilly Foundation to make a study upon the question of whether or not this issue is being met in the proper way and they refused to do the study? Couldn't that be interpreted in effect as a decision by the foundation that maybe the decision by the court was wrong?

Mr. BOLLING. I am happy that you said a theoretical kind of situation. That is, of course, as you know, Senator, a very active hot issue

in Indianapolis and our State. We are studying this kind of question with a number of groups, what can be done that would be constructive in trying to deal with the total problem. So, yes, you're quite right if you say "No"; you may then discourage other constructive efforts.

On the other hand, the first proposal made to you may be only the beginning exploration and you may need to get several different groups together and get their ideas and then together find out what is to be done. I think that here is where you really need the wisdom of Solomon, which none of us has, but in dealing with many of these controversial questions, on the one hand, we must avoid preemptory turning down an idea because it is difficult or controversial. On the other hand, we need to be wise enough to exercise some long-range views about what are the kinds of issues that have to be dealt with and try to make sure that you get the input from many different relevant groups as you can in order to proceed.

So sometimes the best thing you can do is delay while you gather the facts, and I think one of the places where foundations have not done their job well enough, they have tended to react to immediate appeals instead of saying: Let's look at the problem and try to find out the best way to get at that problem.

Mr. GUENZEL. With relation to public involvement, obviously in the community foundation, the problem is not as acute, because of the very nature of the community foundation, as it is with other types of foundations. By its very essence a community foundation can exist only if the public is involved.

The funds for the future of the community foundation are a continuing and ongoing thing; there must be a flow of funds from the public. Only if the public has confidence in the community foundation, ously through not only the broadening of the membership of the community foundation but through the use of news media.

At the Lincoln Foundation we have involved the public continuously through not only the broadening of the membership of the Community Foundation but through the use of news media.

All of our meetings are open to the news media and news media are given notice of the meetings along with the regular members of the board, and news media attend all of our meetings. I really shouldn't hold that out as being some great thing that we are doing; we are selfish and greedy, and this gets us newspaper publicity without the problem of purchasing advertising.

I cannot close without drawing the attention of this subcommittee to one fundamental problem the community foundations have with the Government.

Following the passage of the 1969 act, the Government administration devoted its attention properly to the immediate problems of devising regulations for private foundations. Thereafter they followed up with the regulations relating to community foundations which were not initially published until, I think, early in November of 1971.

Subsequently, a hearing upon those regulations was held on December 7, 1971, and those proposed regulations were withdrawn. To this date the regulations on the 1969 act for community foundations have not been published. We lack guidance where to go. There have been—I think I am correct—no new community foundations established be-

cause there are no regulations to guide the establishment of community foundations. The increase in funds flowing into community foundations has been held up pending these regulations, and it has been difficult for community foundations to grow since the passage of the 1969 act.

Senator HARTKE. I think that is a very legitimate complaint.

Mr. GUENZEL. We would hope that we could have these regulations published.

I would like to add to the written statements submitted this booklet or pamphlet, which contains additional data with relation to the grants made by the Lincoln Foundation as well as containing the annual report which, as has been stated, we fully believe in and we have published an annual report every year since our formation.*

Senator HARTKE. They will be included by reference.

Thank you.

David Freeman, Council on Foundations.

STATEMENT OF DAVID FREEMAN

Mr. FREEMAN. Thank you, Mr. Chairman.

Mr. Chairman, I am also president of a relatively small foundation, the Southern Education Foundation, about which I will have something to say later in my testimony. I welcome the opportunity to appear before this committee and address some of the questions which the committee has suggested for this panel.

Since my fellow panelists have already described the activities of three different types of foundations, let me round out that part of the picture by describing a fourth type—the special purpose foundation.

The Southern Education Foundation, which traces its founding back to the Peabody Fund, established in 1867, has as its purpose the improvement of educational opportunity for blacks in the 13 Southern States. With an integrated board and staff, it has pursued this purpose through scholarships, graduate fellowships, internship programs which it administers itself, conferences, publications and grants.

Here we make distinctions from the private operating foundation in that we are a grant-making foundation still, even though we have a special purpose.

The staff, based in Atlanta, keeps in close touch with State and local educational authorities as well as with southern colleges and universities and attempts to gear both the operating and grant-making parts of the foundation's program to current needs in the field.

One example of the kind of thing this type of specialized foundation is able to do relatively quickly with limited resources was the preparation and distribution, shortly after passage of the Education Acts of 1964–65, of a looseleaf service which helped predominantly black colleges in the South to obtain their share of Federal funds. Those pieces of legislation, as you may remember, are very complex—this was an attempt to get a diagnosis of that legislation out to that particular part of the educational area as promptly as we could. Another more recent program has helped several Southern States to

*The material referred to was made a part of the official files of the subcommittee.

train teachers for the just established preschool and kindergarten programs in their public schools. As is true with other special purpose foundations, this type of activity makes the staff members themselves valuable resources of information, both for other foundations and for educational institutions.

Now let me shift gears and discuss specifically the types of relationships that exist between foundations and the way in which these relationships seem to be developing. There are three principal types of cooperation which the Council on Foundations has identified, and which it makes every effort to support. The first of these is cooperation between smaller unstaffed foundations to enable them to employ professional help in their grant-making programs and administration. The Southern Education Foundation itself is an early example of this, since it represents the merger of three funds with closely allied purposes and has since 1937 operated as a single entity with a professional staff.

There are much more recent examples where a number of small foundations have banded together and have been able to hire for the first time a full-time person.

Recently, a second pattern of cooperation has developed. In such areas as Boston, Hartford, Chicago, Los Angeles, Minnesota, Michigan, and New Hampshire individual foundations and corporate givers have formed associations. Together they engage in small staff to improve their fact gathering capability, analyze area needs, and to maintain contact with Government grant-making agencies, the public and applicant agencies and institutions. Such associations don't make grant decisions for their members but rather help them to get the facts they need to make their own decisions.

Frequently a community foundation in a particular city serves as the initiator of such groupings of foundations and helps with some of the initial administration expenses. That happened in Boston and Hartford.

These two types of close cooperation relationships are logical solutions to some of the problems smaller foundations face in meeting the new administrative and program requirements of the Tax Reform Act.

Another type of cooperation, one which the associations of foundations also frequently employ, is the pooling of grants from several foundations to finance a particular project which no one of them is in a position to fund itself. Here the pattern has been set by several of the largest and best known foundations, which have jointly supported very large and important philanthropic activities. One example worth mentioning is the "green revolution"—the extensive work in the development of new strains of rice and grains initiated by Rockefeller Foundation but now supported jointly by that foundation, the Ford Foundation and others. Another more recent effort to work toward the solution of a major problem of our society is the formation of the Drug Abuse Council in 1972 with funding from the Carnegie Corporation, the Ford Foundation, Commonwealth Fund, Equitable Life Assurance Society and the Henry J. Kaiser Family Foundation.

Many other examples could be given of cooperative grant-making not only between foundations but between foundations and Government agencies. The development of the matching grant technique, now widely used in a number of Federal programs, often requires this kind

of cooperation and a recurring theme at the council's annual meetings is that of cooperation in program areas with Government.

As the earlier speakers on this panel have suggested, many foundations are studying the composition of their boards and their methods of reaching policy decisions, in order to be as responsive as possible to the public interest. In some instances this has meant a broadening of the membership of foundation boards to include members of minority groups and increased representation of women. Other foundations have developed and used effectively a pattern of advisory committees and consultants to better inform their boards and staff of the needs in particular program areas. In this connection, the council recently circulated to member and nonmember foundations the result of Gallup survey on public attitudes about foundations and the programs that the public wants foundations to support.

Since there are never enough funds in a particular foundation to meet all of the meritorious requests which a foundation receives, it is often difficult, and some feel unwise, to have direct representation of prospective grantee organizations on a particular board, but foundation leaders are acutely aware of the need to respond as flexibly as possible to the opportunities and needs presented to them.

Finally, let me add a few brief words to what Mr. Goheen has already said on the subject of informing the public. The council and its sister agency, the foundation center, have long recognized the need to provide much better information about foundations to the general public as well as those who seek foundation grants. Since the passage of the Tax Reform Act with its requirements for disclosure of the essential facts about every foundation, both organizations have redoubled their efforts to encourage and assist organized philanthropy in telling its story. Specifically, the foundation center, which maintains libraries in New York and Washington, is now in the process of establishing regional collections of material on foundation grants, with a goal of 50 such collections throughout the United States. In addition, the foundation center has developed a capability to provide grant information on demand from a computerized data bank and has stepped up its publications program.

The council cooperates with the center through the publication in each issue of Foundation News of a grants index listing current grant activities divided by subject categories. In addition to the policy statement on the importance of public reporting referred to in Mr. Goheen's testimony, the council has recently published a handbook on public information which has been widely disseminated to member and nonmember foundations, and will later this year be conducting the third in a series of workshops on the how-to-do-it aspects of public reporting. The council's annual report, in addition to covering its own activities, attempts to present each year a picture of grant-making by a wide range of foundations, large and small.

In all these efforts we have been encouraged by the response of our members, but there is still much to do. At the last count, only some 350 of the grant-making foundations were publishing reports of their activities beyond the reports required by the Tax Reform Act.

As you've heard this morning, foundations do have interesting and positive stories to tell about their activities. We hope that many more of them can be led to effective and frequent public reporting.

Thank you.

[Supplementary questions submitted to Mr. Freeman follow:]

Question 1. Should there be a requirement that evaluation of the results of programs involving grants in excess of a stated sum be made by an independent agency—similar to the audit of businesses by certified public accountants? (For example, private agencies specializing in evaluation of foundation programs and registered with the Internal Revenue Service could be developed to perform this service.)

Answer. My answer is that while in fact foundations do on occasion use outside agencies to evaluate their programs, just as government agencies do, the evaluation techniques now available are not sufficiently developed to warrant any formal required program. This does not mean that there is no evaluation process available, however, for both public and private programs are in an important way evaluated by the public. Those that prove themselves as successful means of solving problems or providing new services are frequently recognized as such and supported, either by increased governmental appropriations where the programs are of such dimensions as to require expenditure of tax dollars, or by increased private support. Often a combination of public and private support may take a demonstration project that has shown real promise and expand it for either a wider test or for delivery of the needed services.

A high degree of interest is being shown by both governmental agencies and foundations in the evaluation process. It is interesting to note that few people would claim any high degree of accomplishment for evaluation programs, at least at this point in the development of evaluation techniques. At our annual conference last May in St. Paul, one of the best attended panels concerned the evaluation process and Mr. Joseph S. Wholey, Director of Program Evaluation Studies of the Urban Institute, was the principal speaker. His general observation, based on practical experience, was that while the potential usefulness of evaluation is great, the utility of the information produced by evaluation remains low in most cases.

It should also be noted that evaluation must be tailored to the type rather than the size of the grant. Thus a major grant for construction of a new library at a university, or the endowment of a chair there, would not need the same type of evaluation, if any, which a new experiment in treatment of drug addiction at the local level might involve, even though the latter, as a pilot project, might require only a few thousand dollars a year for one or two years in order to demonstrate its capability of accomplishing results.

Question 2. To what extent are private foundations involved in the business sector—that is, to what extent do they have a decisive influence on corporate management? Has the 1969 Tax Act lessened this impact to any significant degree?

Answer. My answer is that while there is no evidence that foundations have had a wide influence on corporate management as a general factor in the overall economy of the country, whatever influence they may have had in specific situations is already being lessened. When the Tax Reform Act provisions have come fully into effect, any such impact will have been still further reduced.

Sec. 4943 of the Tax Reform Act, requiring gradual divestiture of "control" stock in corporations, has been in effect for the past three years. Except for foundations which have been created since 1969, the impact of this provision of the Act has not yet been fully felt, since the tax-writing committees of Congress recognized the difficulties of divesting control stock and provided for transition periods varying from 10 to 35 years for foundations which were created before the end of 1969. However, we have already seen considerable movement in "one-stock" portfolios, caused at least as much by the necessity of meeting the pay-out requirements of Section 4942 as by the divestiture requirements themselves. According to an informal tally which we have been keeping at the Council, during 1972 publicly reported secondary distributions of stock owned by foundations totalled over $925,000,000 in value.

On October 2nd, the second day of the hearings before your subcommittee, the Council held an informal seminar on divestiture procedures, which was attended by representatives of some twenty-five foundations of all sizes. There was great interest in various alternate means of disposing of control stock, with the objectives of maximizing return to the charitable foundations and minimizing impact on the general shareholders of the companies involved.

The need was expressed at the seminar to have final regulations promulgated under Section 4948 as soon as possible, since the Act does contain one early deadline relating to divestiture. Any divestiture transactions between the foundation and the "controlled" corporation must have been completed by the end of 1974 in order to take advantage of an exception provided for such transactions from the self dealing provisions of Section 4941.

It is worth noting that while the Act generally requires only the reduction of the aggregate holdings of the foundation and of so-called "disqualified persons"—to 20%, many foundations are proceeding to reduce their holdings in any one corporation to 2% (the *de minimus* holding allowed by Section 4943) in order to avoid possible penalties which may be incurred when a "disqualified person" not under the control of, and sometimes perhaps not even known to the foundation, purchases additional shares of the corporation's stock.

Question 3. Are corporations adequately involved in charitable giving? If not, what could be done to encourage them to participate more?

Answer. Certainly aggregate corporate giving has never approached 5% of net income, the level permitted for corporate charitable deductions. The best estimates available from the Conference Board and the Council for Financial Aid to Higher Education indicate that corporate giving has seldom gone over 1% and that in recent years the percentage of giving has actually fallen below 1% several times. Thus many believe, and I personally share their view, that corporations are not as involved in charitable giving as they should be and that a measure which would provide additional incentive for their giving would strengthen the whole private non-profit sector.

In fact, in one particular area of giving, a provision of the 1969 Act actually discouraged charitable contributions by corporations. This discouragement was felt to a great extent by church organizations and others involved in provision of direct relief to disaster areas and to the hungry peoples of underdeveloped countries. I refer to the provisions which reduce the incentive for corporations to provide, through such agencies, the gifts in kind which had formerly represented an important part of the direct relief supplies which such agencies furnish. The testimony presented before the hearings of the Ways and Means Committee on this topic last April might be of interest in this connection and I attach excerpts from that testimony for your possible interest.

One suggestion for increasing the involvement of corporations in charitable giving has been made by Waldemar Nielsen, author of the recent book "The Big Foundations," in testimony which he presented last spring before the Ways and Means Committee. At that time Mr. Nielsen proposed that only when corporate contributions reach a floor of 2% should they be permitted as deductions. It is problematical whether such a proposal would in fact increase giving—it might have the reverse effect, just as the increase in the standard deductions for individuals has removed tax incentives for giving for many millions of taxpayers.

Perhaps another way to increase the charitable giving of corporations would be for the Finance Committee to take testimony from representatives of the handful of corporations which have in fact come close to or achieved the 5% allowable deduction. It would be interesting to learn from such individuals as J. Irwin Miller what the rationale has been for the very generous giving of the Cummins Engine Company and whether he feels that it has been good business as well as good corporate citizenship.

I have welcomed this opportunity to continue discussion with your Committee on the important issues which were raised by the recent hearings and would be glad to expand further on any of the points mentioned above should you or your staff so desire.

Sincerely,

David F. Freeman,
President.

Excerpts From Statement of Bishop Edward E. Swanstrom

Contributions From Inventory

Under an amendment to the charitable contribution provisions of the Internal Revenue Code enacted in the 1969 Tax Reform Act, deductions for charitable contributions of so-called "ordinary income property" were limited to the cost basis thereof. This was a change from the prior treatment of such contributions

under which a taxpayer was allowed a charitable contribution deduction for the fair market value of the contributed property.

It has always been the practice of ACVAFS members only to accept gifts of property that will be put to use in the conduct of their tax-exempt purposes (religious, charitable, etc.) or will be distributed by the donors for actual charitable purposes. The size of gifts of inventory or other ordinary income property that the voluntary agencies received prior to the enactment of the amendment to Sec. 170(e) have significantly diminished.

The 1969 change of the Internal Revenue Code was thought necessary because of the large tax benefit accorded contributors of such property as compared with cash contributors. In addition, specifically with respect to inventoriable assets, there seemed to be some thought underlying the 1969 amendment that the public was not getting its money's worth—that is, the property received by charity in consideration for the charitable contribution deduction was not of sufficient value to society to justify the large tax subsidy accorded by the charitable contribution deduction. This thinking was supported in part by evidence, documented or otherwise, that charities were induced to accept property that was virtually worthless to it or that it had no immediate intention of using for active charitable purposes because the goods were given to it free and therefore there would be no reason to refuse such a gift.

The American Council cannot testify to the practices of other charities—though it believes that the practices of most public charities were the same as member agencies.

The American Council believes that a further amendment to Sec. 170(e) can be enacted that would eliminate any possible loopholes and unwarranted tax benefits, while continuing to provide incentive to donors to maintain contributions of inventoriable assets. The American Council can find no justification for the complete removal of financial incentive to donate such property. In fact, present Section 170(e) offers manufacturers a financial incentive to discard such property—thereby eliminating the availability of foodstuff, medical supplies and the like from the world's needy.

The American Council believes that its goal of maintaining incentives while eliminating tax loopholes can be accomplished first by adopting the principles of legislation proposed by Congressman Carey in the last Congress. Mr. Carey's bill would allow a deduction in the case of "ordinary income property" equal to the cost of the property contributed plus one-half of the difference between cost and fair market value, this to be applicable if, *but only if,* the recipient charity or other organization exempt under Sec. 501(a) and described in Sec. 501(c)(3) certifies to the donor that the donated property will be put into use or distributed by the donee for its tax-exempt purposes before the close of the year following the year of contribution. If no such certification is obtained by the donor, no contribution for an amount in excess of cost would be allowed.

Senator HARTKE. It is now 12:30. I wonder if the members of this panel or the second panel would be inconvenienced if we reconvene at 2 o'clock?

Any of you pressed with an engagement to make sure the foundations keep running?

All right, the committee will recess until 2 o'clock.

[Whereupon, at 12:30 p.m., the subcommittee recessed, to reconvene at 2 p.m., the same day.]

AFTERNOON SESSION

Senator CURTIS. I believe since the panel are all here and I have a few questions to direct to the panel, and by this time I am sure our chairman will be here.

I might ask you, Mr. Wieboldt, do you mind telling us what was the form of the original contribution made by your grandparents to establish a foundation?

Was it cash or was it stock?

Mr. WIEBOLDT. I believe it was real estate, Senator.
Senator CURTIS. It was real estate?
Mr. WIEBOLDT. Yes. I was 2 years old at the time.
Senator CURTIS. I realize that, but you perhaps have familiarized yourself with the record.
Mr. WIEBOLDT. That is right. There was an entity known as the Wieboldt Realty Trust, and I think that was gobbled up by the foundation at that time.
Senator CURTIS. I am very much interested in the establishment of new foundations, and that is the reason for these questions.
Do you know whether or not some years elapsed between the creation of the foundation and the making of substantial grants or gifts?
Mr. WIEBOLDT. The granting was immediate. The policy at the time was the distribution of the entire income.
Senator CURTIS. Then over the years has there been a divestture of the corpus and reinvestment in other matters, or what can you tell us about that?
Mr. WIEBOLDT. Yes. Originally, the real estate was in the form of mortgages and land that was sold off over a period of time. Some of the mortgages, I think there are two individual apartment-building mortgages that are left. We established a policy of divesting ourselves of all of the real estate and getting into equity investments many years ago, in the middle thirties, and we are now entirely in equities. I think about 6 percent of the fund is in Government bond for purposes of servicing the grants when they come due. It is the equivalent of cash. And the rest is in equities.
Senator CURTIS. Has the foundation operated any business as such?
Mr. WIEBOLDT. No.
Senator CURTIS. I believe you said that this foundation originally was established for $2.3 million, something like that?
Mr. WIEBOLDT. Four and a half million.
Senator CURTIS. And the grants up to date exceed $15 million?
Mr. WIEBOLDT. $15.3 million, yes.
Senator CURTIS. And about what is the corpus now?
Mr. WIEBOLDT. About $11 million at market.
Perhaps this is appropriate at this moment to ask whether I could enter our 1972 annual report in the record?
Senator CURTIS. Very happy to receive it.
It will be an exhibit rather than reprint it. It will be an exhibit available for the committee and their staff.*
Mr. WIEBOLDT. This has a complete list of our investments as well as grants in it.
Senator CURTIS. Do you have any particular recommendation for changes in the 1969 laws that relate to foundations?
Mr. WIEBOLDT. I alluded to the one thing, that of the tax, in my written statement. It has the effect of reducing our granting by in effect one grant—one $15,000 grant per year.
Senator CURTIS. You pay approximately $15,000, you did pay?
Mr. WIEBOLDT. Yes, sir.
Senator CURTIS. In excise tax?

*The report referred to was made a part of the official files of the subcommittee.

Mr. WIEBOLDT. Yes. As far as the mandatory granting is concerned, at the time the law was created we went back 15 or 20 years and found only in the 1 year had our granting gone below 6 percent. This has not been a hardship on us.

Senator CURTIS. But you happen to have foundation holdings which were subject to a sizable capital gain increase; is that true?

Mr. WIEBOLDT. Because of the fact that we are in equities to a great extent, yes. We did not hesitate to go into capital to make grants. I think the way I phrased it in my remarks, we are comfortable with the total return concept.

Senator CURTIS. Mr. Guenzel, in your paper there were some facts and figures about small donors to the Lincoln Foundation. Will you elaborate on that a little bit?

Mr. GUENZEL. Yes, those donations are solicited for a program called the Book of Memory Program, which is a program that I think is familiar to many types of charitable institutions throughout the United States. Upon the donation of a dollar, $5, $10, the individual's name is written into a large permanent volume which is displayed around the city of Lincoln. It will be displayed in the lobby of banks, presently it is on display in the lobby of the Community Service Building.

Of course, there may well be received into that fund more than a single donation with reference to a particular individual. Most frequently these are individuals who are recently deceased, although that is not always the case, and I think the largest amount we ever received in connection with any individual would be in the neighborhood of $600, but that would have come in $1 to $10 gifts.

This program has been publicized through the use of the Book of Memory at various places throughout the city.

Senator CURTIS. What is the total that you added to your foundation as receipts by reason of these small gifts?

Mr. GUENZEL. About $118,000.

Senator CURTIS. What has been your average earnings on your endowment fund?

Mr. GUENZEL. Off the fund? We get a return that varies, but between 5 and 7 percent.

I think I should say, Senator, that because of the nature of a community foundation, we look to a continuing gift program so that our disbursements, as Mr. Wieboldt said, really are not limited to solely return on the investments in the community foundation.

Senator CURTIS. In other words, assuming a 6-percent return, this great number of small contributions are providing for something in excess of $12,000 a year that might be disbursed for good causes in perpetuity, isn't that right?

Mr. GUENZEL. That is correct.

Senator CURTIS. So you provide a vehicle for donors where it wouldn't be practical at all for them to make any arrangement for the handling of their gifts?

Mr. GUENZEL. I think, Senator, that you have stated concisely one of the purposes of a community foundation. It is to enable the small donor to put his funds with those of other small donors and have the total utilized for the good of the community.

Senator CURTIS. What is the nature of the investment of the sum $8 million in your fund?

Mr. GUENZEL. That figure is misleading because a substantial portion, almost half of the total is involved in the community services building that we have which was built by a donation to the foundation for the purpose of housing all of the Community Chest or United Fund agencies in the city of Lincoln, and we now have in that building at a very low rent figure all of those United Fund agencies.

Senator CURTIS. That is about half?

Mr. GUENZEL. About half. The remainder then is handled in trust by the two banks in Lincoln having trust departments, and the investments, the total investment policy, with the overall direction of the board of the Community Foundation is in the hands of those trust departments.

Senator CURTIS. Is it carried as part of what they call common trust shares?

Mr. GUENZEL. Generally not.

Senator CURTIS. Is it handled as an individual account?

Mr. GUENZEL. Yes, and there may be, we do have specific funds established within the framework of that, and this is generally true of community foundations, so that you may have a donation or a gift or a bequest from a particular individual that is of sufficient size that it is kept as a separate fund within the trust department.

Senator CURTIS. Now, are there any of the provisions or requirements of the 1969 law or any other law that fall upon private foundations that do not fall upon public foundations such as yours?

Mr. GUENZEL. Yes, Senator.

Senator CURTIS. For the record, would you name them?

Mr. GUENZEL. Well, the problem of the payout, for example, falls upon private foundations so that private foundations are required to follow the payout provisions where a public foundation, qualified public foundation, is not.

Senator CURTIS. What is the situation with reference with the tax?

Mr. GUENZEL. The public foundation is not taxed on its return.

Senator CURTIS. Before I turn the gavel back to the chairman, there are many points I agree with, but I won't take time to go over them all. The papers are very good.

Dr. Bolling, you made a remark that presents a very important problem to the tax writing commitees of the Congress. You alluded to the fact that when some taxpayers contributed $100 they had a tax benefit of $7, others maybe $20. This isn't a question, but I want to call it to your attention because it certainly points up the problem we must face here.

If a married couple have $4,000 income, they are in the 19-percent bracket. Their taxes would be $760. If they gave $100 away, they received a $19 tax benefit. But that is 2½ percent of their total taxes paid. They reduce their taxes by 2½ percent.

A couple that makes $4,400 are in the 50-percent bracket. It is true if they gave $100, they would receive a $50 tax benefit, but they would only reduce their taxes by 23/100 of 1 percent.

And we are faced with the problem of, you go down the ladder at the same rate you come up. Whether we are talking about a special

statute for political contributions or charitable contributions or anything else, it has a very definite appeal to everyone, especially on some activity we want to encourage, but we are faced with the problem, should it call for similar tax treatment if you deduct $100 as if you add $100 to your income; and as I say, I do not propound that to you as a question, but it is a very important thing in the revenue law.

Mr. BOLLING. May I make a comment on this?

I think obviously you people have a terribly difficult job of trying to work out the most equitable design of this system, but the reason I made the point was simply this.

It seems to me in much of the discussion about private charities, about the deduction schedules, about foundations and other forms of philanthropic giving, often the debate is diverted in some sense to irrelevant channels by this constant harping on the so-called "unfair" treatment of the lower taxpayer as against the wealthier taxpayer, and it seems to me that if we could have some kind of incentive which said to the very low taxpayer, we want you to get the maximum benefit out of your participation in philanthropy, that psychologically we might remove one of these constant incitements to a sort of a tax on charity from the larger donors, from foundations. Obviously, you have to watch how much erosion of the revenue system that would take place here, but I put this out as only one suggesiton that has been talked about from time to time. Here is a way of trying to encourage us to think in terms of the importance of private philanthropy and to get as many people into the act as possible and not to have the deduction system thought of as just a special privilege for the rich. It ought to be a kind of civic responsibility and opportunity for all of us, and I think if we can change the way people look at this thing this might help us in so many different directions.

Senator CURTIS. I think probably with that we will have to change the speeches of some of the officeholders and candidates for office, too, who do not fully understand the situation.

Senator HARTKE. Let me comment upon the subject matter so at least you have an idea of what the chairman thinks the problem is instead of the technicalities as to the tax.

My understanding is that your tax avoidance, as I said a moment ago, is around $610 million. I do not know whether this is right or wrong. But it certainly is not much more than that. You are dealing with about $30 billion in assets, according to the information. The question is whether or not those $30 billion in assets can be held in the way in which they are being held today, and is there any justification for any tax consideration at all, and, if so, what?

What you are dealing with, you are making self-laudatory statements about what you are doing. I am not critical of the foundations as such, but I am saying to you that I did not generate the charges of political interference, I mean of interference by foundations in the political structure. I do say to you, and I say this with absolute most certainty in my own mind, that if you are going to continue to do anything except give to ladies aid societies in the future, that, if you are going to continue to be innovative in your operations, and even contributory to the present social institutions which are under attack throughout the Nation, that the foundations are going to find them-

selves faced not with the question of how much the tax should be or whether it should be 4 percent or nothing, or the technicalities or procedures or anything else, you are going to be faced with the question whether you have any right to exist at all in this social structure. That is what I am talking about.

And to the extent that I force you to address yourselves to that question, I am doing you the biggest favor you have, and I say that to you in kindness, not in accusation.

In other words, what is the role of the foundation, if any, why should it be given any tax advantage? And is the tax advantage which it has too much or too little?

Now, you may say that it hard to answer, but let me ask you this in line with that. What evidence is there that the foundations themselves are changing their priorities in order to keep pace with the present change in the whole system?

Let me back up before I ask that.

If there is anyone who doubts that the institutions of this country are not under attack, they are missing the point of what is going on in this country. There isn't an institution I know that is not under attack, including the very religious foundations themselves, and the religious structure of this Nation is aware of the fact they are under attack.

The question whether God is dead or alive is no longer a debatable issue. The whole question is what do you do about that concept, and churches are facing up to that problem. They might be coming up with good answers. The political institutions of this country are under attack. The political parties are under attack. The Government is under attack. Corporate enterprise is under attack. The labor unions are under attack. All of them being questioned as to whether or not they are serving man, and that is the only reason an institution can exist, the only reason for a government.

The Government was not created to go ahead and have man to be a slave. The Government was only created to go ahead and perform functions for the people. That is the whole point about foundations. If they do not perform a function in the overall context which I described earlier, then you are going to be hard pressed, much harder pressed than you have ever been because the light of day is coming and I am not the one who created the subcommittee, it was created by the Finance Committee, and that was Russell Long, and he is the one that picked out the investigation and recommended that there be a subcommittee on foundations. He didn't do that simply as an afterthought but there is a lack of information. You cannot tell me how much tax is being avoided in your own group. Everybody is looking at his own little cubby hole, and I am not being critical. In other words, Lily looks at it from theirs; Lincoln from theirs; Wieboldt Foundation looks at it from theirs; and Southern Education Foundation looks at it from theirs.

But that is not the problem.

Did you follow what I am saying to you? Am I just talking? You don't follow me? Is it falling on deaf ears? If I am, you are wasting my time and I am wasting yours.

I don't want to sit here listening to nothing and hear you praise yourselves. I don't think you are going to come in and condemn yourselves

any more than I am going to condemn the Senate. I think, considering everything, they do a pretty good job, but to the public generally, they don't look very good.

So I think it's incumbent upon us to understand what in the world you are going to do about it.

So I will ask you now the question in line with that, in the light of the changing situations in American society, Is there a change in priorities in the foundations, or is that that a question which cannot be answered?

Mr. BOLLING. Well, let me say that we all agree that the light of day is on the foundations and should be and we all recognize that in the past there have been some very terrible things that have been done by a few irresponsible foundations. So the corrections that have to be made were necessary, desirable, and nobody with any sense of decency or responsibility would defend the old abuses.

It does seem to us there is a lot of misconception about how foundations operate and what they accomplish.

The instructions we were given for the presentation of our discussion today was to try to give some overview of what the foundations are doing. We didn't come here to praise ourselves or we could have brought letter files to let others praise us, but we were told that we should give some idea of the kinds of things we are doing.

That is what we have attempted to do.

Senator, you are very much concerned about what is the philosophy behind the foundation. I think it is a very pertinent kind of question, and I would like to take a stab at it myself, because I think there are some central basic concepts that lay behind the operation of the foundations.

One of these, it seems to me, is the concept that it is terribly important in our very heterogeneous, diverse, pluralistic society to maintain some kind of local initiative, private initiative, disburse authority and responsibility, get people into the act. If a democracy means anything, it means getting a wide diversity of segments of our population taking responsibility for maintaining our society and improving it, and one of the things which I think you will find running through as a philosophical silver threat though to all of the foundation operations is this desire to strengthen voluntary grass roots initiative. I think this is very important. It is a repudiation of the kind of thing you find in many societies and many governments, whether they are of the right or left, which says that big government has to do everything. We are a very diverse society and I think pluralism of American society is part of our great strength. You look at America, you have all of these groups—religious groups, ethnic groups, racial groups. There is nothing else like this under the sun that functions in the way we do. One of the reasons why we are able to hold together as well as we have, in spite of all of our conflicts, is this: we have stumbled into a number of arrangements in this country that provide for division of power, for decentralization of authority, and for maintaining a very active private sector taking many kinds of public responsibilities.

Now, the foundations, I think, play a very important catalytic role in that and I think that is a very pretty central philosophical concept.

Senator HARTKE. I appreciate that because I think that is exactly one of the points I was driving at, what is their concept.

Now, you refer to diversity. The first thing that comes to my mind is geography. The second thing that comes back to my question is population and yet when I ask that question here to the opening witness there was no answer to that. Maybe that is a problem. Maybe there is not enough information gathered.

Mr. BOLLING. There is abundant information, it is a matter of pulling it together.

I have a Lilly report in front of me and I could thumb through and get some indication of the geographic range of the types of programs and amount of money we gave in various places. In my earlier statement this morning I pointed to a number of projects scattered across the country in which we have been involved. We are only one foundation and there are many others.

It is true that in recent years I think there has been a very strong tendency on the part of a number of foundations to concentrate on urban problems, so the big cities like new York and Philadelphia and Chicago have gotten perhaps a very large share of the foundation grants because of this great concern about urban problems. The drug addiction problem, for example. Ten years ago this was hardly thought of as the responsibility of foundations.

You ask me what are our changing priorities. There has been a great deal of interest in the whole drug question in the last few years. Then this is the question of how to help minority people get started in business. This is again one of those things that maybe we should have been thinking about long ago, but we weren't, but in the last 10 years there has been a considerable number of efforts by foundations to help black enterprise really get started. We have done some in Indianapolis and you will find it in various parts of the country. There are some of the examples.

Senator HARTKE. Those are examples. Let me ask you this, though. Of the various activities that are involved today, what do the foundations consider to be the proper and the most important and the most appropriate for their concern? Is there such an approach?

Mr. BOLLING. Well, I would think——

Senator HARTKE. Or is it an ad hoc situation?

Mr. BOLLING. Well, to be honest, there is an awful lot of ad hocking going on in all of our social institutions including the foundations, we know that, and I have just come into this work, as you know, Senator, very recently in my life and I have had to learn a lot of things the hard way. I had an idea I could come in and change a lot of things overnight and while I have changed a number of things, I find that you are locked into a lot of commitments and obligations to a lot of social and cultural and educational institutions. There are some parochial schools that are in terrible straits if we suddenly pulled the rug out from them. There are museums, boys' clubs, there are all sorts of organizations that are doing good work. You can't just suddenly abandon them, and I think one of the questions which comes up over and over again, you alluded to it briefly this morning, is this: Do you support existing institutions or do you work for social change? My answer is you have to do both.

What is the proportion?

Senator HARTKE. I frequently find that in the desire to continue to create, to have the initiative, to have the private sector working, that we stumble into programs.

You see, most people consider planning to be not in any way a part of the American system, that we have to stimble into everything.

Mr. BOLLING. We don't.

Senator HARTKE. That is the point I was going to make. That you can go into planning doesn't mean you have to go into control society.

Mr. BOLLING. Let me tell you one thing we did, the Lilly Endowment a few weeks ago. I got our board of directors, very busy people, to go off for 2 days down in Brown County and sit down and get away from the telephone, away from outside pressures and think about the long-term future of this foundation; what are we going to do with this money. I said we simply can't sit and wait to react to everything that comes walking in off the street and let other people make up our minds for us, you are stumbling into things. They agreed with this, so we tried to lay out long-term objectives we ought to be concerned about. We have to make choices and I think more and more the foundations are coming to feel this is what has to be done. I don't think we are at all unique in this.

In fact, I just have on my desk right now a big, thick document prepared by another major foundation of their look ahead to new programs they think should be undertaken. There is a lot of soul searching, I think, also some of the pressures you people on the Hill have put on the foundations is helpful. We have to look at our job in the much more long-range view than has been the case perhaps for many years.

Senator HARTKE. Are there any projects at the present time or any programs that are being conducted that are so small in their activities that it would be better if the foundations would no longer engage in those activities?

In other words, has it become sort of an item which is so expensive to handle, concerning the magnitude of the problem?

Mr. BOLLING. Well, certainly there are some foundations which I believe, at least, maybe one or two foundations that take the position they can't process certain kinds of applications if they are, say, less than $10,000 or less than $25,000, it just isn't worth it.

I think most of the foundations feel they have never come to this point of view, and in our staff some of our people say that some of the most creative things have been done with very small grants.

Again, I don't think it is either/or. I think you have to maintain some flexibility to look at some small things if that small grant is going to catalyst other people to take hold of a problem and work at it, and I come back to this as one of our main responsibilities. How can we act as really significant catalytic agents to help other people to do the jobs that cry out to be done? It isn't just a matter of our going out and paying for it. If the foundations are just going out and buying solutions, then they are deluding themselves because we don't have enough money to buy solutions to our problems.

Senator HARTKE. Now I think you have put your finger on the problem which is a matter of concern to a lot of people, whether or not foundations have a method of providing funds to buy solutions.

Mr. Bolling. We can't. The total combined assets of all the foundations in this country is slightly more than the annual budget of HEW.

Senator Hartke. That brings me to a question.

Are there certain things which no longer should be considered to be within the private sector or within the purview of charity, and should be now handled by the Government?

Mr. Bolling. Well, I think a lot of direct relief, let's say, the terribly impoverished person who has been kept alive with food and rent and so on, I think most of the foundations have got out of that, the Government has taken over that kind of direct relief.

Senator Hartke. Is that good or bad?

Mr. Bolling. Well, I don't know that one can answer that except in terms of one's own philosophical viewpoint.

Senator Hartke. I am not asking you is it proper, I am trying to find out is this direction in which foundations should be going, or is it the direction in which they are going because the Government has assumed that responsibility?

Mr. Bolling. Well, I would say most foundations have pulled away from direct relief in this term because the Government is there and is doing it and, just as I mentioned earlier in my statement this morning, some of the foundations at least have pulled away from the science field because the Defense Department, National Science Foundation, the Institutes of Health, are going into this field in such a tremendous way our small amounts wouldn't mean that much.

So you do get some changes because of the Government action.

Senator Hartke. When you come back to the question of priorities, the Peterson report makes certain suggestions, and I think for the basis of the record, the Peterson report was done under the auspices of the Rockefeller Foundation. Isn't that true?

Mr. Freeman. No, Mr. Rockefeller III, was the person who really took the leadership in establishing the Peterson Commission, but the financing was shared by a number of individuals, corporations, and foundations.

Senator Hartke. I see.

As a result of that, they came back and made certain recommendations. They received suggestions that they should define the highest priority areas of our society that should demand foundation support, that is, they formulate a hierarchy of programs, weighted in order of importance, and the foundations would then be required to address their efforts in these directions.

This recommendation was rejected by the Peterson Commission.

Do you believe it is desirable for the Congress or for any other organization to really define the charitable areas in which the foundations may operate?

Mr. Freeman. Part of the definition has been done by the Congress over the years in terms of what charity means, so that the outer limits in a sense are already defined.

I think to try to set priorities for the entire charitable field, which is a much bigger area, would be a mistake because I think that we would then lose exactly the pluralistic aspect of it that Dr. Bolling has been suggesting is very important.

I think that the fact that there are a number of centers of decision for philanthropy—and that means private individuals giving directly to the institutions they think are doing a good job as well as what foundations give to them—is part of the magic of keeping that private sector going effectively.

I would like to comment, if I may, very quickly on your suggestion that perhaps there are some areas where foundations ought to pull back because it is really too small to bother with.

Senator HARTKE. All right.

Mr. FREEMAN. I have had the fun of working with several of the largest foundations and also serving as a consultant for very small foundations, and when you do that, the latter, and you are dealing with a very small board with relatively very small funds; in fact, there aren't any areas that are so small you can't put in some time on them, and if I can be quite specific, some of the best things that I have seen done with small grants have been bets on individuals, direct grants to individuals.

Here the Tax Reform Act, as it finally came from the conference committee, allows grants to individuals. Thanks to the work of the Senate Finance Committee, that is still possible to do although it is surrounded with some redtape which sometimes gets a little complicated, but we in the council try hard to explain to foundations that in fact they can still make grants to individuals under the rules that have been laid down in the act. I think that is terribly important.

It is for a large foundation a very expensive way to spend money, for a smaller foundation it need not be.

Senator HARTKE. I am going to have to go and vote and them I will come back just as soon as I can.

[Short recess.]

Senator HARTKE. Lest I be misunderstood, these hearings are being conducted for the purpose of determining the role of foundations in view of the fact that they are serving certain tax benefits.

In discussing this matter with some of my colleagues, you don't find the foundation necessarily in the highest esteem of all of them. In addition to that, one of them remarked to me that there is a study which has been done, which I do not vouch for, but even if it is partially correct, in which a study has been made of the foundations and trusts which basically are either tax-free or receiving specialized tax treatment. Within the next few years, if the present situation is continued, 50 percent of the tax revenue now being collected would no longer be collected, which, if true, is going to present a problem of the character of which I was speaking earlier. Some type of explanation or better explanation is going to have to be made of what the utilization of these funds are and how the activities are being conducted.

Historically speaking, one of the reasons the Roman Catholic Church had its trouble with the accumulation of wealth for so-called charitable purposes is that it got to the place where those who were the recipients of the charitable purposes no longer felt themselves being served for that purpose.

Let me put it in a little bit more common language. I think the foundations are skating on extremely thin ice today. I don't think foundations are aware of it. And if you have a good purpose and an-

swer, you are going to have to present it in a form in which it is understandable. So I say to this extent that most of the criticism, as I understand it, or a lot of it which has been directed to foundations, which is still being publicized, allegedly, occurred before the 1969 act.

What suggestions do you have for at least alleviating some of the apprehensions and anxieties which are still being created as a result of the pre-1969 activities, or to restore confidence in the foundations?

How are you going to inform the public of your good works?

Mr. FREEMAN. You put your finger on part of the problem when you suggested that this panel shouldn't come in and just talk about what good things they were doing, and it goes to what Dr. Goheen was saying in his presentation and in his explanation to you as to why foundations have been reluctant to blow their own horn more. As Dr. Goheen has indicated, and as my own testimony suggests, we in the council and in the foundation center, which are the two primary service organizations for the foundation field, are making every effort to get the foundations themselves to tell their own stories, particularly in their own community, which they know best and where most of their grants typically are going.

I would suggest to you that your own subcommittee's actions may be a big help. If you take a good look at the foundation field, as you are planning to do, and as you have started to do today, and if you and your colleagues on the subcommittee find that on balance foundations are more useful to our society than if we did away with them, then I would urge you to say so, because part of the problem that the foundations have and have had since 1969 is the aura of suspicion which surrounded us in 1969. I testified both before the Senate Finance Committee and before the House Ways and Means Committee, so I know what the concerns of the Congressmen and Senators were at that point.

Part of the problem has been there is very little recognition, even by Senators and Congressmen, that a pretty darn tough act was enacted, and that the Treasury is very busy enforcing that act, and you will hear a lot more about that in the panel tomorrow on the Tax Reform Act. It won't be negative testimony—there are audits going on, the audit program is a tough audit program, but they are doing it fairly in our estimation.

All of these things which suggest that the field is now thoroughly policed, that the abuses that the act was intended to stop seem to us to be pretty well stopped, is a story that is very hard to get out, and if you can help us get it out, we will appreciate it.

Senator HARTKE. Would it be advisable to authorize or permit the foundations to have regional magazines or public broadcasting to disseminate some of the information in some of the areas they are operating and to give information as to how the problems are being attacked by the foundations? Would that type of authority be helpful?

Mr. FREEMAN. It doesn't really need to be authority, Mr. Chairman. It needs to be encouragement, and that is precisely the kind of thing that the council itself has undertaken and has stepped up its activities on.

We have a magazine that has a very limited circulation, which we regret—we are trying to build its circulation. We has a regional re-

porter, an occasional newspaper-type thing which we send out to a much wider distribution. We are engaged in the kinds of workshops I have suggested to you to help foundations learn how to get their stories out to the media, and as we were discussing during the recess here, there have been programs on public television about foundations, but they have been somewhat limited in their scope and I think it would be a little delicate for foundations to push very hard for time on public television when so much of the real life-blood of public television has come from foundations.

Senator HARTKE. Maybe that is a——

Mr. FREEMAN. Maybe we are unduly sensitive, I don't know.

Senator HARTKE. I was going to use a different word. Maybe it is a feeling of guilt, that you can't make a case.

Mr. FREEMAN. No, just the contrary. We think the case is there and that as you examine us you will be convinced that it's there.

Senator HARTKE. I challenge you at least.

Mr. FREEMAN. It is very challenging.

Senator HARTKE. If you are going to support public television, why can't you come in and televise a program of what you are doing on public television instead of going ahead?

They criticized some of the salaries being paid to those people, they complained about hiring those liberal commentators; I was upset by Bill Buckley being on there.

In the words of Harry Truman, "If you can't stand the heat, better get out of the kitchen." The foundations better understand that, the heat is on you now.

One of the Members of the Senate told me a moment ago that foundations are, in his opinion, skating on disaster. You might be surprised at the Member who told me that. If you wanted to classify him, you would classify him as one of your strongest supporters.

Mr. FREEMAN. I can assure you at least the most active members of our council are not complacent.

Senator HARTKE. Is it desirable in monitoring some of these actions of the foundations themselves to go ahead and reveal to the public the successes and the failures? Is that desirable to go ahead and show where you have been successful, for example, in short strand wheat? You know what I am talking about.

Mr. FREEMAN. Green revolution.

Senator HARTKE. That has been somewhat publicized. The other successes maybe which have not been publicized; what about going ahead and saying we tried something and it failed?

Mr. FREEMAN. That, too, has been done, Mr. Chairman.

Mr. Goheen made reference to a recent example of that, the Ford Foundation undertook a very careful evaluation of its programs in the education field, particularly the public education field, and published a report which, while it pointed to some initiatives that seemed to be continuing, on balance probably would have to be said to be a report that they had not batted very high. That was a pretty forthright report. I think Dr. Bolling as an educator would agree.

Mr. GUENZEL. I think it is extremely important that this subcommittee recognize that one of the advantages of the foundations and one of the arguments for their existence is their failures, because the

foundations can undertake, and I know this is particularly true of community foundations and of small community foundations, because I have lived with it, can undertake programs that are very high risk programs, that are programs that may be exposed to adverse publicity in the community, which Government itself could not undertake politically or which other ongoing charities such as United Fund could not undertake support for, and I am sure that these, at least to the experiences of the Lincoln Foundation, we have had plenty of public recognition of our failures.

Mr. BOLLING. Might I say a word further about your comments about the foundations being on thin ice?

I don't think anyone of us who reads the papers or talks to people very much would disagree with that, but I would say that the statement ought to be broadened, and that is to say that our whole society is on thin ice.

Senator HARTKE. I quite agree. That is the point I raised earlier.

Mr. BOLLING. There are various public institutions that are under attack, and the whole field of private charities is on thin ice. In one sense it is not really important whether the foundations survive as institutions or not, it is not important whether our jobs are preserved. After all—most of them can get jobs somewhere else. What is important is whether the volunteer private sector approach for dealing with some of our problems is going to be handled properly or not. That is the real question. What is really at stake is not the preservation of a group of corporate entities called foundations, what is really at stake is whether with the terribly urgent social-economic-cultural problems that we face in our society we will get all of the input of a creative sort into the whole process of dealing with them we ought to get, and there is where it seems to me that we have a real responsibility in determining our total social policy to see that a diversity of resources and initiatives can be provided. That is the real guts of the question as I see it, Senator, not whether these particular corporate entities survive or not.

Senator HARTKE. Let me do the reverse of that then.

What would be the effect then upon some of the governmental activities if there is a increased siphoning away of the funds by institutions in the private sector?

Mr. BOLLING. Senator, I would have to say, first of all, I see no indication historically, of any diminution of governmental activity of foundations.

Senator HARTKE. There is a diminution of governmental activities in many fields. For example, the report today which came out saying tuition had to be increased for college students.

If this country was ever built on one thing, it was built on the concept of an educational system to educate the populace, and if we are going to be an antieducational society, there is no question we are in trouble.

Mr. BOLLING. That particular report I think needs to be read in the context of the ever-rising costs of education and the refusal of many of the State legislators to go on adding more and more to the budget of the State institutions, year by year, and the cutbacks in Washington from Federal aid to higher education, so the money has to come from somewhere.

One of the things which we have not faced up to in this country is the equitable charging for education. The people who get the greatest subsidy for going to college are not the poor, Senator, they are the affluent. You go to Berkeley and go to Ann Arbor, two of the most highly selective student bodies in America, and you find out the average family income of the parents of the under-graduate students, it would shock you. The idea that a State university with low tuition is necessarily thereby serving the poor is the great myth of American higher education. I speak with some feeling, because I have lived with the thing for 20 years. It is a myth. I can show you in the State of Indiana, that the boys who go to Rose Poly at Terre Haute and study engineering by and large come from average income and below average income families. The myth is you go to a private institution like Rose Poly and you are taking care of the rich. What this particular report that you are referring to calls for, I think, in part is a more equitable bearing of the cost of tuition by those who are best able to pay—and providing subsidy, scholarships, full-ride support if necessary, for the poor who have to be helped. I think it is time we need to get honest about how we finance higher education, which we have not done in this country, up to now.

Senator HARTKE. Are the foundations addressing themselves to this?

Mr. BOLLING. They have spent a tremendous amount on subsidizing studies on higher education and helping State bodies to think through how the financing should be done. There is a great deal of activity by Ford, Rockefeller, Lilly, Kellogg, Danforth, in this field. We can't do more than a limited amount of this, but we are very much concerned about this.

We ought not to focus our attention on higher education. There are other areas of education where we have to think more seriously about this question.

From my own limited experience, on the other side of the fence, as a foundation executive now, I think that we have got our priorities somewhat cockeyed in this country. I think we put too much money relatively speaking into higher education and particularly graduate education compared with what we do for preschool education and early childhood education. We have to correct some of those imbalances and foundations may help the point.

Senator HARTKE. Who establishes those priorities, that is a question I asked about six questions back?

Should the Government get involved in setting priorities for foundations? You said that there has been an over-emphasis on higher education. Who should make that determination of the priorities, or should it be left as it is today?

Mr. BOLLING. Well, I think that the establishment of those priorities has got to emerge out after a very vigorous dialog within the academic community and in the political communities about what our needs are and I think that vigorous discussion and debate about it, is going on. That debate will help to bring about corrections. I would be reluctant to see some educational czar handing down directives as to just what a State should do or what particular institutions should do.

Senator HARTKE. I quite agree with you, but I think we have to go ahead and address ourselves to that question how do you establish the

priorities without that type of Government intervention and still have an effective utilization of money. You are dealing here with millions of dollars in taxes.

Mr. FREEMAN. The present rate is 56.

Senator HARTKE. $50 million tax on a $30 billion asset. Is that right? Am I wrong? $30 billion?

Mr. BOLLING. That money is not our money in a sense, this is in trust to——

Senator HARTKE. But it is not taxable.

Mr. BOLLING. But the tax is not a tax on foundations, it is a tax on charity.

Senator HARTKE. Well, in this field I am not a novice in taxation. Let me say to you the same argument could be made on corporate taxation. The tax on corporations is not a tax on corporations but a tax on consumers. Theoretically speaking, a tax on profits is pretty hard to defend. I mean the same argument that this is a tax on recipients is the same basic argument made that the tax on corporate profit is a tax on the consumer, which I grant you, is true.

Mr. BOLLING. Except the corporate entity has it for profit and has has a great deal more freedom as to what it does with money. We are operating under very specific directives as we should be, from the Congress, as to what the money can be spent for, and it cannot be spent for a lot of other purposes and most of those purposes are if we did not provide for them, they would have to be provided for by Government.

Senator HARTKE. Maybe.

Mr. BOLLING. A large percentage of them would be.

Senator Hartke. Let me take one swat at this thing. You must deal with these problems in those terms when you are talking about taxation. The same thing is true when you tax the corporations, you only tax the profit and, therefore, that must be passed on as ultimate expense to the consumer.

Now, you say that foundations are performing a function which otherwise would have to be performed by the Government. That is the reason you have nationalization of some of the means of production in some of these countries, and you have to be careful once you go into that direction.

I'm not arguing about the merits or demerits of that situation, I am just saying to you when you say that you are passing this on to the recipient that that in and of itself does not suggest any meritorious operation.

Mr. BOLLING. I agree. Let me give you the facts on Lilly Endowment. Last year, 1972, our Federal excise tax for the income of Lilly Endowment for the year was $1,799,098. Now, that was $1,799,000 that did not go to charity.

Senator HARTKE. I understand.

Mr. BOLLING. It is up to you to decide where you want it to go. You have the authority to do so, but it didn't reduce our operations of our staff.

Senator HARTKE. Senator Curtis, do you have any questions?

Senator CURTIS. I will be very brief. Maybe this is already in the record. Can someone tell me what the total grants were made by foun-

dations, all foundations in the last year for which there is a tabulation?

Mr. FREEMAN. Senator, the figures again are inexact for the very reasons we have been discussing, that the IRS and Treasury has trouble pulling these figures out of their tapes, but the best guestimate we have is a little over $2 billion.

Senator CURTIS. What percentage of that is made by operating foundations as compared to nonoperating?

Mr. FREEMAN. Again, we don't have a breakdown in terms of the actual expenditures. Mr. Goheen's testimony suggests that from the new book which is out, which lists various exempt organizations and has some key numbers to distinguish between private operating and private nonoperating, the private operating foundations number only some 800, and with perhaps a half dozen exceptions, my guess would be that most of those have assets of less than $10 million. Even for those that have assets of more than $10 million probably the assets in some sizable measure represent physical facilities such as community center that Mr. Guenzel referred to. The Lincoln Foundation is, in a sense both a community foundation and an operating foundation in that it owns a physical plant. One of the larger operating foundations in the Twin Cities has several physical facilities it runs, so the assets include the fair market value of those facilities.

Senator CURTIS. You are talking about the grant rather than the assets.

Mr. FREEMAN. A typical operating foundation makes very few grants. It must restrict the percentage of its grants in order to remain qualified as an operating foundation. It must spend the great majority of its funds on its own programs. When we talk about the $2.1 billion we are talking primarily about grant-making foundations and not about the operating ones.

Senator CURTIS. What is the best guess as to the amount of the expenditures made by operating foundations that are charitable in nature, and by charitable I mean in the broader sense which would include education and the rest.

Mr. FREEMAN. If the operating foundation is qualified as an operating foundation, all of its expenditures must be charitable in nature.

Senator CURTIS. I know.

Mr. FREEMAN. Or it wouldn't qualify.

Senator CURTIS. What does that amount to?

Mr. FREEMAN. We don't have a dollar figure for it. As I suggested, it is probably a fairly small dollar figure relative to this $2.1 billion.

Senator CURTIS. I won't take any more time.

Speaking of the inadequacy of information, the staff found out for me that about 32,000 returns were filed by private foundations, but they have to find out whether they owe any tax or not. So there aren't that many tax payers among them, and some of these may never become alive and others are created as a vehicle for the future, the donor expects to put assets in.

Thank you.

Senator HARTKE. Any other final comments you want to make?

Well, let me say it is not your last chance. It is not a case of comment now or forever hold your peace. I hope you will continue to help

us in what I consider has been a very good discussion, at least from my viewpoint, and I appreciate what you have done.

Mr. BOLLING. We thank you for your patience in listening to us.

Mr. FREEMAN. And for your interest.

[The statements of Messrs. Bolling and Guenzel follow. Hearing continues on page 115.]

STATEMENT BY LANDRUM R. BOLLING, EXECUTIVE VICE PRESIDENT OF LILLY ENDOWMENT

SUMMARY

1. Many earlier issues in debate over foundations now settled, thanks to Tax Reform Act of 1969. Central question relates to whether foundations should exist at all and whether they truly serve public needs.

2. Case for foundations similar to case for private philanthropy in general: (a) to encourage voluntarism and personal responsibility; (b) to promote decentralization of some public services; (c) to provide alternatives to governmental methods of financing and operating certain services. Need for comprehensive public policy to encourage private philanthropy. Endorsement of idea of direct tax credit incentive for lower-income taxpayers to give for charitable purposes (perhaps up to $100) to eliminate present inequity in "cost" to individual donors of their gifts. This broadening of incentives for all charitable giving far better policy than attack on gift deductions as "tax loopholes".

3. Foundation policies and priorities shifting—but vary considerably. Generally, lessened interest in science and technology due to massive expenditures by government in these fields. Growing concern for urban problems and small-town economic development. Shift away from interest in educational buildings, teacher salaries and graduate training. Growing interest in pre-professional preparation and values education.

4. Public input in foundation work through broadening of boards and professional staffs, use of consultants, and "open-door" style of administration.

5. Ultimate influence of a philosophy of trusteeship on which foundations should be operated.

STATEMENT

It is inevitable, and desirable, that foundations should be called upon, from time to time, to account for their performance, to document their service to mankind, to justify their existence within our pluralistic society. All of us invited to testify before this Senate Subcommittee on Foundations, I am sure, welcome the opportunity to report on the activities of foundations as we know them and to try to answer any questions that might be raised about them.

Let it be quickly said that the foundations, as institutions dedicated to the use of private funds for the support of public educational, religious, scientific, charitable and cultural purposes, simply could not exist in a totalitarian dictatorship of the Right or in a totalitarian dictatorship of the Left. Nor could they be created and sustained in a society devoid of individual impulses to generosity and public service. Nor will they long survive if our governmental policies come to be shaped by the judgment that governmental agencies, spending tax monies, could and should provide all the charitable, educational and cultural services hitherto supplied or supported by private philanthropy.

At the heart of the debate over foundations—a debate that has already lasted for several years—is an argument over this basic question: Should a private, nonprofit corporate organization be allowed to hold and manage substantial funds given to it by private donors and decide on their use in the public interest or should all such funds be taken over by governmental agencies for disposition through political/governmental processes? Some of the earlier issues over foundations are now settled—thanks to the Tax Reform Act of 1969—and should have been settled long ago. Foundations can and must make public reports on their operations. They can and must meet some minimal annual pay-out requirement, though the exact percentage is still debatable. They should and must avoid self-dealing with trustees or staff members or their relatives. They should and must refrain from efforts to influence the outcome of political campaigns. They cannot and must not be used to enable certain individuals to escape their just and

lawful tax obligations. All of these are, in essence, issues that have been settled. No one with any sense of social responsibility can defend the abuses by a few foundations that those prohibitions were designed to correct.

Today the debate over foundations seems to come down to these questions: Should foundations be allowed to exist at all? Should punitive restrictions on legitimate foundations be removed? Should new foundations be encouraged? If the answer to all these questions is Yes—and I believe it should be—then the public policy implications of such an answer are fairly clear. If the answer is No, then we have to call into question the whole justification for private initiative and private generosity in the service of public needs.

The case for foundations rests ultimately on the case for private philanthropy in general. That case, I suggest, is based upon these concepts:

One, the importance of encouraging voluntarism in the satisfying of social needs, of maintaining the human, empathetic-feeling of personal responsibility in the face of social needs.

Two, the wisdom of decentralization, down to the local grass roots, of some portion of the tasks of providing our educational, cultural, charitable services.

Three, the usefulness of having available some alternatives to many government services, even where those government services may be universally accepted as the norm.

There are many other ways of stating the justification for private philanthropy—the oldest being the ancient teachings of all the great religions of the world about the obligation of man—in fulfillment of his obligation to God—to give of his resources and his time to aid the widows, the orphans, the sick, the poor, the oppressed. But even to secular minds in a secular age it is clear that we become a poorer, less humane, less responsible, less efficient, more bureaucratic and more callously indifferent society if we stifle private initiative and responsibility for philanthropic giving in favor of a government monopoly in the handling of all social needs. It is obviously not a case of either-or; it is a case of both together. We have to have government programs for social and cultural services, but we also need private philanthropy, including the foundations.

All of this being true, we need a comprehensive, coherent and consistent public policy to encourage private philanthropy. With all the proper safeguards to prevent selfish abuses, we still need incentives to encourage individuals and organizations to act upon their charitable impulses. That these impulses may be tinged at times by less than totally altruistic motives is no argument against the wisdom of providing incentives to giving.

Speaking entirely as a private citizen, not in any way as a spokesman for Lilly Endowment or foundations in general, I want to express strong personal endorsement of the concept that the incentives to private giving should be broadened and strengthened so that the lower-income individuals might have inducements for giving comparable to the inducements afforded to high-income givers. Specifically, I would urge the Congress to offer to all taxpayers the right to make contributions of up to perhaps $100 each to any legitimate IRS-approved educational, religious or charitable organization on a full, direct tax credit basis. It is sometimes pointed out that it is possible for a high-bracket taxpayer to give a $100 contribution to his charity at a net cost to him of $30, under current deduction schedules, but that a low-income taxpayer who wants to give that same amount of $100 to perhaps the same charity does so at a net cost to him of $70. This arrangement it is argued is not fair or equitable. It isn't. But the answer is not to denounce all gift incentives as "tax loopholes" (an overworked and often misleading swearword in much of the debate). The answer is to design an equitable system for encouraging the broadest possible base for philanthropy with suitable incentives for both high-income and low-income taxpayers, not to hamper giving from the larger pools of wealth.

Foundations should and can function—and those I know do function today—within the bounds of propriety and social responsibility. As part of the total complex of private philanthropy they not only make possible useful public services that in most cases would otherwise, in one way or another and often at much greater expense, have to be provided by tax monies; they also help to maintain the very pluralism and freedom of American society. Rather than being regarded, as they are by some critics, as privileged and selfish enterprises to be tolerated only so long as may be politically expedient and then laid to rest, foundations should be seen as playing a permanent and vital role in serving essential human

needs and in encouraging voluntary initiative and private responsibility. Those now in existence should, under appropriate regulation, be encouraged to continue. And, under appropriate controls, new foundations should be helped into being.

In the long run, of course, private giving can be justified only if it provides real social benefits. Foundations have to be judged by what their giving has accomplished, by how well they allocate their money to serve the needs they are supposed to serve. They are today being increasingly monitored—by I.R.S., by the media, and by the Congress. Increasingly, and rightly, they are doing a more extensive job of monitoring the projects they support.

Foundations vary enormously in their fields of interest and programs, as well as in the size of their resources. They, moreover, do not remain the same. For most of them what they did yesterday is not necessarily what they are doing today or what they will be doing tomorrow. They, like other social institutions, try to respond to the current needs of society—a society characterized by constant change and changing social needs.

Today, quite clearly, a number of the larger foundations give high priority attention to urgent issues related to our decaying cities, to probelms of drug abuse, juvenile delinquency, poverty, family distintegration. At Lilly Endowment we, too, have provided support for a number of urban projects—minority business development projects in Indianapolis, street academies for young drop-outs in New York, child care training programs in Chicago, and addiction services and youth recreation programs in a number of cities. But, at the same time, we have also felt we should give deliberate attention to the economic and social needs of small towns and rural areas. In considerable measure, the problems of our great cities today are compounded by the excessive flight of poor people from the farming communities and the small towns where many of the problems might have been more humanely solved. It is our conviction at Lilly Endownment that we can and should attempt to do more to help improve economic opportunity and advance the quality of life in the often neglected open country regions of America. To that end we support self-help economic, educational and cultural projects in small communities in Alabama, Kentucky, Tennessee, North Carolina, Indiana and Arkansas. We have contributed to Indian reservation projects in Arizona and the Dakotas. We are actively exploring the possibilities of investing more of our resources in matching programs in which people in the forgotten smaller towns and rural areas are attempting to help themselves. It is not a question of either-or; again, it is a matter of both together. We need to work with local organizations for human advancement in both the big cities and the small towns.

The roles of private foundations in the fields of scientific research and medical facilities and services have obviously changed drastically in the last several years. The enormous investments of recent years by the Federal Government in research through the Department of Defense, the National Science Foundation, the various National Institutes of Health, and other government agencies have changed the whole situation so far as foundation programs in science are concerned. The billions of tax dollars for these purposes have tended to persuade private foundations to allocate their funds to other fields. Yet, in spite of that general tendency, the Robert Wood Johnson Foundation, one of the largest in the country, has committed itself to devote most of its grant money to various efforts to improve the health delivery systems across the country. Moreover, it was the Rockefeller and Ford Foundations that stimulated and largely underwrote the extensive research and testing programs that gave the world the new super-strains of food grains that sparked the so-called Green Revolution and brought such enormous benefit to vast areas and vast populations in the so-called developing nations. We have all become aware of a critical food problem around the world. Think what it might have been had it not been for those Rockefeller and Ford Foundation grants!

Sometimes a foundation may play a useful role in applying the science and technology already available. Today in another place in this city the privately supported philanthropic organization AFRICARE is holding a press conference to tell of the drought and famine conditions in the parched areas of several of the Sub-Sahara countries of West Africa—and to report on a recent small success in which an American foundation was involved. The several million people whose very survival is threatened by this natural disaster can probably be enabled in time to win their age-old struggle with the elements through much more extensive boring of wells and building of large and small reservoirs and

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applying more generally both ancient and modern methods of irrigation. For this considerable planning and financing—chiefly from governmental sources, including the U.S.—must be provided. Meanwhile, what happens to crops that once more are about to fail?

Based on the use of photographs taken by America's orbiting astronauts and on-site studies by U.S. meteorologists, it was decided that during the month of September it would be possible to produce in the Republic of Niger significant quantities of rain by artificial cloud seeding techniques. But how to get such a risky project undertaken on such impossibly short notice? The President of Niger, having failed to get help through the normal international and national governmental channels, appealed to AFRICARE, a public U.S. charity concerned with African projects. AFRICARE in turn presented a grant request to Lilly Endowment. We were fortunately able to get a U.S. citizen consultant to make a quick independent check on the project through a visit to the area and to secure reports and recommendations from technical experts. Our Executive Committee, accordingly, authorized a grant of $50,000. This made it possible for two experienced American pilots to ferry two small planes and the necessary equipment across the South Atlantic to West Africa and to start the cloud-seeding operation promptly. All of this was done within about two weeks after the meteorological survey had been completed. Fortunately, the gamble paid off. Rain was produced. Some benefit to this year's crop was provided. Other countries in West Africa are now officially studying this approach to a partial solution to their drought problems.

This, as I must point out, can only be called a "small success." It is certainly not an answer to the long-term famine threat to West Africa. And it could have been a total failure. Yet we had, as a private foundation, the flexibility to act quickly and the freedom to take a chance.

That kind of flexibility, that kind of risk-taking freedom is one of the significant justifications for foundations—and always will be.

Education is and will remain a major concern of the foundations. Here, too, priorities are shifting. After World War II these were among the high-priority concerns of educational institutions and of both the government and the foundations: 1. the rapid expansion of physical facilities to take care of what were thought to be ever-bulging enrollments; 2. the raising of wretchedly low faculty salaries; 3. the expansion of graduate training in order to turn out more teachers and more scientists.

With all three objectives America has succeeded—almost too well. The American educational community and the foundations, of necessity, are now turning to other priorities, though obviously, as always, there are differences of opinion and differences of interest concerning the new priorities.

I speak only for Lilly Endowment when I say that now among our high priorities in education are the following objectives:

1. We are concerned to encourage the private colleges and universities to do a better job of fund raising from their own natural constituencies and to improve their internal management. We are providing a variety of challenge grants to this end.

2. We want to support efforts directed at greater cooperation and joint planning between the public and private sectors in higher education. As a society we cannot afford endless duplications of educational facilities and programs, particularly in a time of slowing growth in college enrollments.

3. We are interested in certain modifications and improvements in undergraduate education that look toward more explicit pre-professional training and for relating the academic community more closely to the "outer world." In that connection Lilly Endowment has just funded the Woodrow Wilson Foundation in launching a program of senior visiting adjunct professors drawn from business, diplomacy, journalism and other professions to participate in the educational programs on a number of smaller and more isolated college campuses across the nation. We are delighted that your long-time colleague Senator Margaret Chase Smith has agreed to be one of the first of these visiting adjunct professors.

4. At all levels of education we are interested in encouraging a variety of efforts to improve education for personal value development—to use an old-fashioned term, for character development. This is perhaps the hardest, most elusive task in education, but we feel that in time of great stress and confusion over moral, ethical and social values, these issues have to be confronted and we are encouraged to discover that a considerable number of educators and parents share these

concerns, as did Socrates, Jesus and other great teachers a long time ago, and are working at both teaching and research projects in this area.

One question inevitably raised about foundations has to do with the extent to which these organizations meet the needs that are represented in the appeals made to them and in the grants dispersed. The answer is that inevitably only a very small fraction of the needs presented to foundations are ever met by the grants made, simply because most grant requests have to be turned down. It is a kind of rule-of-thumb that in dollar terms foundations can attempt to satisfy only something less than ten percent of the requests they receive, and my impression is that the correct figure may be even less than five percent. Foundations just don't have and never will have enough money to take care of more than a small percentage of the legitimate and worthy requests brought to them.

In the end, foundations have to be judged not in terms of the percentage of grant requests they approve but on the effectiveness and significance of the grants made. They in turn have to exercise increasing care in evaluating the uses to which their grants are being put. Unquestionably one of the positive results of the Tax Reform Act of 1969, and the expanded public scrutiny of foundations, has been to make most foundations give more explicit attention than previously had been the case in evaluating the results of the projects they have funded. This means, inevitably, higher administrative costs, but the results should improve the performance of both te grant-making foundations and the grant recipients.

Other witnesses have been asked to present testimony on the various effects of the Tax Reform Act of 1969, and that is not my assignment. However, I should like to submit as an annex to this statement some details as to our experiences and reactions to the operation of that Act.

One of the questions to which I have been asked to speak is the question of whether and how the foundations are involving the public in the grant-making processes. My answer must necessarily deal with several types of public involvement.

Traditionally, most family foundations—and Lilly Endowment was created by members of the Lilly family—were set up to function under small, closely knit boards composed largely of members of the family concerned and of their business associates. This was for a long time true of Lilly Endowment. Yet in recent years the Lilly Endowment Board has been enlarged and made more diverse. Today it includes only one member of the Lilly family (out of ten Board members). It has drawn in an increasing number of members from business and professional life unconnected with the other activities of the family, and with diverse interests, backgrounds and political affiliations. Thus it has moved over the years to be a truly public board with full decision-making power.

Obviously, the employed professional staff play big roles in foundation decision-making. They must do the screening, evaluating and recommending for the Board, and this involves the examination of an enormous number of applications, the rejection of most of them, and, in some cases, the modifying, refining and even the initiation of grant proposals. Overwhelmingly, in all the foundations I know anything about, the recommendations of the staff become ultimately the decisions of the Board. It is important, therefore, that the staff be broadly representative of the public. Even in our relatively small staff (35) we have professionals drawn from the law, the ministry, education, business, social welfare service, government administration, accounting. We have a healthy representation of racial, religious, and political, socio-economic backgrounds—and, of course, both men and women. To have significant input from the broad society a foundation is intended to serve it needs a diverse staff.

In addition to the full-time staff, Lilly Endowment, like many other foundations, makes considerable use of consultants drawn from a variety of backgrounds. They are used to review grant proposals, to evaluate funded projects, to advise the board and staff on policies, even, on occasion, to make detailed recommendations for decision. They too provide a significant input from the broader public.

Perhaps one of the most significant ways in which a foundation can demonstrate its concern for genuine public involvement in its grant-making operation is through its style of administration. At Lilly Endowment we try to operate, insofar as is humanly possible, on an open-door policy. We are accessible to phone callers and to visitors who walk in off the street and we are approached by many of both every day. The mail requests and suggestions pour in in unbelievable volume every day. We endeavor to give every request serious attention. From time

to time, we try to get people with related interests together, assisted by outside experts, to examine alternative approaches to a given problem. We constantly seek advice from a variety of professional, cultural, educational, religious and governmental leaders.

Behind all of this rather demanding, at times exhausting, style of open-door administration, we at Lilly Endowment try to operate on a philosophy of stewardship, as do other foundations I know. Others might state it differently, but our philosophy, I believe, as defined in a statement recently adopted by our Board of Directors is representative of the essential purposes of most major foundations. Let me close with the following excerpts from that statement:

The concept of trusteeship must be the basis for the administration of any foundation. It is central to the philosophy on which Lilly Endowment operates.

Foundations exist under laws of the state and federal governments. They perform a public service and are granted certain rights and privileges for the performance of that service.

Foundations must be scrupulous, responsible and imaginative in discharging their trusteeship foundation. This is not merely noble, it is necessary. Only if foundations see their work as a public trust, and operate that way, will they survive. Meanwhile, they have opportunities for significant achievement given to few agencies in our whole society.

Foundations represent freedom and flexibility. Despite certain governmental constraints, foundations are remarkably free to interest themselves and invest their money in what worthy causes seem important to them. They can, if they feel it right and necessary, move with a speed governments can rarely approach. They also represent the decentralization and pluralism essential to a truly free society. They do not have to reflect a monolithic party line.

There are obviously many acceptable definitions of trusteeship. Lilly Endowment defines its trustteship in its own terms and tries to live up to its own definition. We should not only do what we are legally required to do to fulfill our trusteeship obligations, we should set a still higher standard of responsibility than is demanded of us.

That "higher standard of responsibility" can be described in something more than generalities. That standard is shaped by the following principles:

1. Lilly Endowment funds will be distributed in such a way as to further the creation and maintenance of conditions and incentives that will encourage people to develop to their fullest potentials. We hope for both the improvement of human beings and the advancement of our society—not just the perpetuation of certain of society's existing institutions. We do not intend to be just a patron of worthy causes or a mere adjunct to the United Fund. Certain stop-gap ameliorative services we will always have to help support, but we must go beyond those things toward preventive and curativie measures for dealing with social problems.

2. Finitude is one of the givens of human existence. We are not God and cannot solve all human problems. No foundation can begin to do more than a small fraction of the good things it is asked to do. Therefore, the Endowment will impose clear limits on the range of its interests and program activities.

3. Lilly grants will be awarded in large measure as investments in effective people and good ideas. Efforts will be made to determine the quality of the people who seek grants, the quality of their proposals, and the practical possibilities that the proposals can be successfully carried out.

4. While giving consideration to any thoughtful proposal related to its fields of interest, Lilly Endowment will interpret its trusteeship responsibility as requiring it to seek out individuals and organizations that give promise of being able to deal in a significant way with the problems and issues of interest to the Endowment and will help them to develop their proposals. We will not merely react to applications that walk in off the street. Moreover, we will attempt to remain alert and watchful concerning issues, problems and emerging ideas that need to be worked on whether others initiate proposals or not.

5. Within manageable limits to its fields of interest, Lilly Endowment will endeavor to be both a national and international institution, even while it maintains a strong continuing interest in the City of Indianapolis and the

State of Indiana. It will distribute its funds so as to serve human needs on a broad ecumenical, interracial, transcultural basis.

6. A significant part of our trusteeship responsibility is to engage in continuous and meaningful evaluation of the operation of projects we fund. Part of our accountability is to hold those who receive our grants to reasonable standards of both fiscal and project performance accountability.

7. A never-ending aspect of foundation trusteeship must be to maintain a constant watch on the changing needs and problems of society and an ongoing willingness to re-examine from time to time our program interests and policies.

STATEMENT OF ROBERT C. GUENZEL, DIRECTOR OF THE LINCOLN FOUNDATION, INC., AND CHAIRMAN OF THE COMMITTEE ON COMMUNITY FOUNDATIONS OF COUNCIL ON FOUNDATIONS, INC.

SUMMARY

1. Community foundations are actively engaged in every area of philanthropy.

2. Community foundations emphasis originally was in areas compatible with United Fund activities. In recent years this emphasis has shifted to the funding of innovative programs for the preservation of the environment, promotion of cultural and artistic activities, and aid to those disadvantaged whether by race, language, poverty or physical or mental disabilities. This change in emphasis has occurred because of governmental activities in areas with which such foundations were formerly concerned and because of the recognition of a need for the funding of "risk" programs.

3. Recipients of grants from community foundations have been assisted in the initial fundings of their proposed programs and aided in adopting proper budgetary and administrative procedures.

4. Community foundations have provided the leadership in many communities in the cooperation between foundations and such cooperation now exists to a high degree.

5. Community foundations can continue to exist only if the public is involved as continuing financial support is generally an essential element to such foundations. Community foundations, therefore, generally have a continuing program of public information as well as a continuing search for innovative methods of involving the public in their activities.

6. Community foundations generally require written reports from grant recipients as to the use of such funds and most community foundations have a standard program of a follow-up investigation by the staff after a prescribed period of time with a report back to the Board of such foundation.

STATEMENT

This statement concerns itself with the area of community foundations in general and particularly with the activities and experiences of The Lincoln Foundation, Inc., which is a relatively small, three million dollars and a relatively young, fifteen years, community foundation. However, the remarks, except as to individual specific activities, will apply generally to the community Foundation field.

When community foundations first were conceived, shortly after the turn of the century, it was with the idea that charitable bequests or gifts by individuals in a community could be best utilized if continuing community direction were given to the pooled funds rather than a simple carrying out of the wishes of the long-dead donor under circumstances certain to change. The primary thrust of the activities of such foundations was initially in the broad area of social programs such as those operated by then community chests or United Funds. In recent years and months such program direction has taken a decided shift away from this area to much more divergent programming. This has been occasioned partially by the movement of government, both local and national, into fields formerly supported solely by private funding but, perhaps more importantly, by the recognition of community foundations that they should supply funds, primarily in areas unsupported by other sources, either public or private. Thus, today, we see community foundations undertaking programs where the risk of failure is so high that they would not be properly the subject of the expendi-

ture of public funds or of support of the United Fund agencies. In the past two years the primary emphasis in such programs has been in the area of environmental problems, minority development, local government studies, innovative drug abuse programs, and cultural activities.

From the foregoing it can be seen that the recipients of grants from community foundations are generally new entities in the process of organization to solve a new community need or existing entities that are developing a new program to meet a need not being met by others. The community foundation thus can provide the "seed" money to get the program underway and can provide advice and assistance in administrative and budgetary procedures. In addition, of course, if the community foundation is doing its job properly it can advise applicants for grants of others who are attempting to meet the need or of existing agencies where a small expansion can better meet the need than by the creation of a totally new entity or agency. From this point of view the refusal or rejection of an application for a grant can sometimes be of more benefit to the community and the applicant in long range economies of community funds than anything else the community foundation could do.

In Lincoln, Nebraska, there are four major foundations (although it would probably be difficult to qualify them as "major" in other areas of the country). The three, other than the community foundation, have specific fields of interest and the executives of all communicate with each other with reference to grant applications. The obvious purpose of this is to avoid duplication of grant applications and to conserve community funds to the best purpose. In some instances cooperative grants have been made where two or more of the foundations would furnish a portion of the funds for a particular project. Generally, the community foundation has provided the catalyst for such cooperative endeavors. Nationally, the community foundations have provided the impetus for "clearing-house" activities among foundations in many communities. For example in San Francisco monthly luncheons are held of the executives of the foundations in the area.

A community foundation that does not involve the public in its activities will not survive. It is the essential element of a community foundation that continuing direction be given by the community to the use of the funds in the foundation. Further, the community foundation can grow only through the gifts from the community. It is true that a few of the major community foundations have received substantial bequests commensurate with the size of the cities in which they operate. Our gifts or bequests are commensurate with the size of our city, as well, and we are totally dependent upon a continuing gift program. Many of these are small—over the years of its existence we have received $181,000 in gifts of from 1 to 10 dollars or so. The more a community foundation can involve the public in its activities the faster it will grow and the better job it can do in the community. Obviously the initial step is to have a Board of Directors broadly representative of the community, and if the community foundation has members its membership should similarly reflect the total community. In order to further broaden the participation of the community in our decision making we have established several committees to deal with particular areas of grants. For example, we have the Educational Assistance Committee made up of professional and concerned lay persons in the field of higher education and administration to advise the foundation on grants in this specific field. A similar committee exists in the medical field. A most important example of such a committee is our Youth Advisory Committee made up of representatives from each of the five high schools in the City of Lincoln. Since youth is a fleeting thing we could devise no permanent membership in this area but this committee meets with us and any request for a grant affecting youth is referred to this committee for a study and a report.

A caveat must be noted with reference to the foregoing, however. Prospective donors must have confidence in the judgment and continuing stability of the community foundation or no donation or bequest will be made. The Board of the community foundation then should represent the total community but the leadership, probably, of the community elements. It is a problem that must be solved by balance and by innovative solutions.

In order to keep the public informed as to our activities we make full use of the local newspapers. Stories are carried on every meeting held by the Foundation and the actions of the Foundation are reported. In addition, annual reports are published covering each year's activities and these reports are sent to local, state and national officials as well as a general mailing throughout the commu-

nity and are available for public inspection at our office. Every operating community foundation in this country with which I am familiar makes such annual reports and sents them to officials at all levels of government as well as making other distributions thereof. Approximately every two years a representative of our Foundation participates in a program with the local Bar Association to continually remind the attorneys of our functions. Materials, including the annual report, with reference to the Foundation are made available at the local banks and other public or quasi-public places, including, for example, the office of the Mayor.

Mollowing the making of a grant the grantee is required to file a written report upon the completion of the program or purpose for which the grant was made. At the end of a two-year period from the making of the grant the executive director reports to the Board meeting next following on the results of the grant. Upon request by the grantee we will provide continuing assistance and advice in administration. We believe that we cannot expect each of our grants to meet meet with success. Indeed, we believe that we would not be fulfilling the true purpose of the community foundation if we only funded those programs where success was assured.

Community foundations are an important part of the field of philanthropy. Together with other foundations, private and corporate, they will continue to be a proper, necessary, and desirable part of the American society. I would, however be less than candid if I did not point out that the growth of existing community foundations and the creations of new foundations of this nature has been hampered, substantially, in recent years by the Federal Government. I am sure that this has not been the intention of the Congress or the Administration, but this has been the result. After the passage of the many changes relating to foundations contained in the 1969 Act proposed regulations relating to community foundations were published and a lengthy hearing held thereon on December 7, 1971, a perhaps appropriate date. Thereafter, these proposed regulations were withdrawn and new regulations prepared. A committee of attorneys representing community foundations has had conferences with various parties concerned in drafting these new proposed regulations on occasions since the hearing. This committee stands ready to have further conferences with relation to any problems therein with anyone involved but we have not been asked to attend such conference, nor have we been informed of any difficulties or problems recently with such regulations. Nevertheless, to this date no regulations have been issued. With respect to community foundations great assistance could be provided to existing foundations and encouragement to the formation of new ones if proper direction could be given by the issuance of regulations compatible with both Congressional intent and sound community foundation practices.

Senator HARTKE. We will go to the second panel. Carl Holman, Urban Coalition president, Merrimon Cuninggim, author of "Private Money and Public Service," and Fritz Heimann, author of "The Future of Foundations." You may proceed.

STATEMENT OF MERRIMON CUNINGGIM, AUTHOR OF "PRIVATE MONEY AND PUBLIC SERVICE," ADVISER OF FORD FOUNDATION; ACCOMPANIED BY FRITZ HEIMANN, AUTHOR OF "THE FUTURE OF FOUNDATIONS," ASSOCIATE CORPORATE COUNSEL OF THE GENERAL ELECTRIC CO.; AND CARL HOLMAN, PRESIDENT OF URBAN COALITION

STATEMENT OF MERRIMON CUNINGGIM

Mr. CUNINGGIM. We thought we would go, Mr. Chairman, in the order in which we have been listed on this sheet, which calls for me to be first, alphabetically.

My name is Merrimon Cuninggim and the information on that sheet, sir, happens to be mistaken in every regard with the exception of the two places it indicates I went to school.

Senator HARTKE. Let me say to you that I do not accept the responsibility for doing that but whatever staff member did that has to go ahead and contribute to the foundation of your choice.

Mr. CUNINGGIM. Thank you, that is excellent.

My name is Merrimon Cuninggim, the title of my book happens to be mistaken.

Senator HARTKE. What is the proper title?

Mr. CUNINGGIM. "Private Money and Public Service." And the subtitle happens to be the exact title chosen for this particular panel, which I was very grateful for, "The Role of Foundations in American Society."

Senator HARTKE. All we had to do was look at the book.

Mr. CUNINGGIM. Isn't that strange? Thank you, sir. I have already turned in a statement, sir.

Senator HARTKE. The entire statement will appear in the record.

Mr. CUNINGGIM. And perhaps the easiest thing, the most helpful at this point, would be to hit the highlights of that statement in very quick order. I know you are eager to bring this to an adjournment today.

The committee posed to this particular panel five major questions and if it is appropriate I will try to sketch out briefly what my answers to those questions were.

Senator HARTKE. Let me say to you since we do have a copy of this book, in order to make it available we will include it by reference and also include the next book which is correct, "The Future of Foundations." I will include both of these books in the record by reference and, therefore, they will be available to us.[1]

Mr. CUNINGGIM. The first question posed to us was, How useful or necessary are foundations in American society today? What functions do they perform? Are these, or could these functions be performed by other groups? My answer in short is that they are useful and I hope that this will not be thought to be an answer full of self-praise. It is an effort to state quite clearly that foundations in a wide variety of ways across the face of American society have spoken to the needs of America in ways that I think have not been widely recognized. But the word "necessary" in the question bothers me. I think, strictly speaking, one could not say that foundations are necessary any more than one could say that a symphony orchestra or research institutes. At the present time there is no substitute for the assignment of generous private money to public service, which is the task of foundations; and if America feels that this is desirable, then in this sense I think we can say that foundations are necessary.

The second question that seems to get to the heart of the business has been touched on already by the panel you have been interviewing. What are the negative aspects of foundations? What are they doing wrong?

Now, I want to say, sir, and comment specifically to your comment earlier, sir, that I think foundations are indeed aware that they are under attack, they know they are on thin ice, they know the negative aspects are being mentioned over and over again, so there is no diffi-

[1] The books referred to were made a part of the official files of the subcommittee.

culty among foundation people as to this question, but the key thing that must be said in fair answer to the question to my way of thinking is it is important to distinguish, to discriminate between charges against foundations that the facts support and other charges that the facts do not support.

Foundations suffered in 1969, and still suffer from the fact that what they are doing wrong and what they are accused of doing wrong are not the same thing.

In my answer I then go on to mention six kinds of charges against foundations that have to do with the field of structure and finance and I speak to those six very briefly in respect to which ones to me seem valid and which ones are not. I take note of the fact they are charged with being tax dodgers, they are guilty of giving business and family advantage, that they are investment policies running counter to the public interest and so on, and my own feeling out of those six is that that charge in toto adds up to the suggestion that foundations are serving as bulwarks of special privilege in American life. This is a kind of generalized charge of which these six are illustrations. In many an individual instance the answer is undoubtedly yes, but for most of the large foundations and on balance for the field as a whole the answer, I believe, is no. Foundations are not bulwarks of special privilege on balance.

Foundations can take only part of the credit for that, however, because Government regulation has helped a great deal in correcting abuses.

The second major area of foundation life in which this question of the negative aspects need to be faced is the area of program and operating policy. The area has been under discussion in these recent minutes. There are at least six negative aspects in this area. Foundations are charged with not spending enough, with being secretive, with being engaged in inconsequential work, ladies aid societies, for example, or conversely, with effectively propagating extremism in business or whatever. Again, that they indulge in partisan politics, and we had a recent illustration of that in the Watergate hearings, of course.

And, finally, that they do not monitor and evaluate their work as carefully as they should.

May I answer those six briefly and then obviously, if you wish me to say anything more I would be happy to do so.

In respect to the charge that foundations do not spend enough. The Tax Reform Act of 1969 has pretty much taken care of this problem of inadequate spending already. Foundation behavior across the board is indeed much better than it has ever been here and foundations are writing a good record, they are better than ever before.

In respect to the second charge I mentioned, that they are secretive, again, one has to say that the Tax Reform Act of 1969 did indeed help the requirement of disclosure. Foundations are no longer as secretive as formerly but many of them, especially a large proportion of the smaller ones, are unduly reticent.

In respect to the third charge, those who start the inconsequential work charge, those who start from the premise that the work of foundations is inconsequential and unlimited as their conclusion, which is

simply to say you can find what you are looking for all the way in unimaginative and safe activities to courageous and even risky projects. My own view is that the routine, looking at the field as a whole now, is that the routine outweighs the daring by a larger margin, which is what one would probably have to say about any other type of organization specializing in public service.

In respect to the next charge I mentioned, foundations generally are engaging in extremism whether of the left or right. I have to say, sir, that I feel that charge is nonsense. Only a handful of valid examples can be discovered. Foundations are not antibusiness, they are not unpatriotic, they are indeed engaged in controversy because they deal with the subjects that have to do with American social problems and yet they themselves are not aiming at being controversial.

In respect to the next charge, of political partisanship, this is a very serious kind of thing and must also be answered as frankly as we know how in spite of the supposed heinous instances cited in the congressional hearings in 1969, and except for a very few indiscretions, very few indiscretions here and there, the facts do not support such a charge.

And I would be happy to be given a chance to comment on that at greater length by virtue of the extent that Mr. Buchanan mentioned, charged specifically in his testimony the other day.

The final one I mention in respect to these matters is the one that foundations do not monitor and evaluate their work as well as they should. On this point I say foundations do not monitor and evaluate their work very well. Here we have not been charged as fully as we should but we are guilty.

The summary question for the areas of programs and operating policy might well be, therefore, our foundations act as an agent of constructive change in society with allowance for disappointments and failures, which all foundations know they have experienced. And when I wrote that sentence I did not realize that a question might be raised as to whether foundations recognize their failures and will admit to them. And so if you will, sir, let me repeat that phrase. Which all foundations know they have experienced disappointments and failures. On balance, I believe is yes, sir, they are engaged in constructive change in society.

The next question of the committee, however, does follow something close to a particular phrasing. The committee's question is fundamental: Are foundations a victim of the rich to use their economic resources in order to change our society? Should the rich be allowed to have this much influence? There are two questions here, not one. The phrasing of the second seems to me suppose the answer to the first is affirmative, but this seriously oversimplifies the situation, it seems to me.

The second question is easy as well as irrelevant: Should the rich be allowed to have this much influence? Rich men should not be allowed to mold the society to their pleasure irrespective of the desires of others and neither should anybody else. But there very simply is no convincing evidence back to the first question that fundamentally wealthy people have successfully employed foundations to change things to their selfish liking or that foundations are nothing more than the tools of the rich to win their will.

Earlier today, the discussion was this problem, namely, Are foundations out to villify the rich and to aid and abet only those who are either eager to tear down the rich? Neither way do the facts support the proposition.

The rich are not winning their will through foundations, I believe, but this does not mean that individual men of wealth may not have tried such a ploy and got away with it on occasion just as in any other area or vocation in which shady activity is possible.

It does mean the reputable foundations believing in constructive change proceed to address the social problems chosen for attention not on the merits of the case, not on the whims of the rich or anybody else, but on the merits of the case they believe in change, do they achieve in scheming by the rich to arrive at some forcordained conclusion, no. In my own view, there is no way to escape the fact that foundations are engaged in change. I know of no foundation whose work is based on the premise that they hope nothing will happen.

Question four: Can we say that foundations are established in order to financially support programs to aid our society, or are they established merely as tax dodges and public relations victims? My answer there briefly, is to say that in my view, it is not either/or, we always need to be careful in assigning motives to others and this is a question of motive, of course.

I do not believe that it is impossible that these two should be put together, but be that as it may, the human condition being what it is, it is likely that setting up a foundation was nearly always a combination of generosity and selfishness. In my view, government policy should be aimed at encouraging the former and holding the latter in check.

Once a foundation is established it can hardly be said to be a tax dodge for it pays the tax prescribed, but that is to get off this particular subject.

The next one: Is it a public relations vehicle for the persons establishing them in motive and in actuality? It is possible but the benefit can go far beyond merely good public relations for the people involved, and since the opportunity for abuse of this sort still exists in spite of TRA 69, the surprise is that there seems to have been so little in fact.

I have a feeling here, Mr. Chairman, that the broadening of foundation management as called for in the Treasury report on foundations of 1965 is an important concern which TRA 69 did not notice, it was the one recommendation that the Treasury Department report of 1965 on which action was not taken, and this matter could be helped if attention were paid to it.

Finally, No. 5: Should foundations be considered self-perpetuating institutions in our society which are valuable and necessary today and in the future, or should a reasonable limit be put on their lives?

The choice is unreal. For example, it is not impossible that someone opposes perpetuity, yet still believe that foundations "are valuable and necessary today and in the future." And what is "a reasonable limit"? The question seems to be trying to get at something else which is not clarified.

"Self-perpetuating institutions" constitute the way America usually sets up its non-profit, public-service agencies. They are not required, as a rule, either to liquidate by a certain time or to go on forever. They themselves make the choice. If the suggestion were made that they should not go on forever, it would presumably be because they are not serving the public, or because government or some other kind of agency could do their job better, or because the public interest is insufficiently represented in the determination of direction and program. Are these, perhaps, the concerns at which the question is aimed?

If so, let me say that I find it hard to imagine any "limit * * * on their lives" that would be "reasonable." Granting that foundations, like all other institutions, make mistakes and that bad choices, they do serve the public remarkably well; any person whose eye might fall upon this page will have been benefited in countless ways during his lifetime by foundation activity. Government, or perhaps some other agency, could indeed take over much of their work, of course but this would represent a serious dilution of our pluralistic society in which ideally public and private segments work hand in hand. And if the real aim of a time limitation is to secure the "broadening of foundation management," then specific legislation to that effect would be more effective and less dangerous than a cancellation of the time-honored and time-tested principle of perpetuity. Longevity brings experience, which more often than not makes for wise use of resources. A time limit for foundations would mean the waste of experience and less effective philanthropy.

Thank you very much.

STATEMENT OF FRITZ F. HEIMANN

Mr. Heimann. My name is Fritz Heimann, I am counsel for the General Electric Co., however, I am appearing here in a purely personal capacity.

I am counsel for the General Electric Co. I am, however, appearing here in a purely personal capacity and not as a representative of General Electric.

I served first as associate director and then as executive director of the Peterson Commission on Foundations and Private Philanthropy in 1969 and 1970. Last fall I directed the American Assembly Conference on Foundations at Arden House and edited "The Future of Foundations," which represented the background reading for the Arden House conference. My work involving foundations has been solely extracurricular; I have never worked for a foundation, nor applied for or received a grant from a foundation.

I am delighted to be invited here. I think the establishment of the Subcommittee on Foundations is an extremely welcome development. One of the principal concerns which the Peterson Commission developed during the course of 1969 was the lack of a clear governmental focus on the problems of foundations and philanthropy. The subcommittee fills a very important need. I am particularly impressed by the series of questions you have posed because they address the underlying philosophical issues regarding the need for foundations. This subject was totally ignored during the 1969 tax reform hearings.

Let me turn now to the questions you have raised.

RATIONALE FOR FOUNDATIONS

The first question raises the basic issue, what is the rationale for foundations? The traditional rationale, even though never very clearly articulated, was what foundations were doing useful things that the Government was not doing, but which were sufficiently important to justify tax incentives. We must recognize that the problem is now totally different. With massive spending of Government funds in practically every area in which foundations are working, you can no longer justify foundations on the basis that they are doing things which the Government is not doing.

Annual foundation expenditures total about $2 billion. Government expenditures in the same fields are 30 or 40 times the level of foundation spending. Nevertheless, I believe there is a useful rationale for foundations, resulting from their much greater flexibility, compared with Government agencies. I have developed that rationale in some length in my book. Let me use one example to illustrate this point.

The New York Times of Saturday, September 22, had a very interesting story about Dr. Irving Cooper and his development of radically new techniques for brain surgery. He is dealing successfully with epilepsy and a number of other diseases which had never before been dealt with surgically. The article pointed out that Dr. Cooper had not obtained any Government grants but that he had received foundation support.

I do not know any more about Dr. Cooper and his work than was in the article in the New York Times. But we all know that Government grants in the medical research field generally reflect a professional peer group evaluation process. One result of such a process is that the mavericks in a professional field, the people who want to do something which is radically different from the conventional wisdom, often have difficulty getting support. On the other hand, foundation support in the medical field often reflects personal experiences, rather than formal selection processes. For example, a surgeon may have operated successfully on a member of the family of the donor of a foundation, and the foundation thereafter supports that surgeon's research.

My point here is that the decisionmaking process of a foundation can be very different from that of a Government agency and this results in a desirable degree of diversity. Foundation money will often go to places where Government money does not go. Foundations have flexibility that Government agencies do not have and should not have. Government agencies by their nature must operate on the basis of the objective standards. In dispensing public funds, they must operate in as even-handed a manner as possible. Foundations are not subject to the same constraints. The Mott Foundation can very properly concern itself with Flint, Mich., and spend little or no money elsewhere. The Hartford Foundation can single out Dr. Cooper as the one surgeon they want to support. A Government agency cannot and should not op ate that way. Furthermore, a substantial element of consensus is generally necessary before the Government can enter a new field. Foundation work in the population control field began two decades

before the Government became active. Until the late sixties the field was much too controversial politically to obtain congressional support for Federal spending.

SHORTCOMINGS OF FOUNDATIONS

Now, turning to the second question you have raised, the shortcomings of foundations, I would say one of my major concerns is that foundations are too timid. I think the 1969 Tax Reform Act did a great deal of good. But one bad effect was that a group that was, with a few exceptions, pretty timid to begin with, has had the hell scared out of it, and is even more timid now than it was before. I am not suggesting you can legislate that foundations be bolder or more innovative or original, but I think you can affect the climate in which they work and the climate within which the law is administered.

If foundations spend money only in areas that are widely approved, then they lose their ability to do anything that is particularly distinctive, because the amount of public money that will go to popular subjects is so much larger than the resources that foundations can possibly bring to bear. Unless foundations use their ability to do those things they are uniquely able to do, and which Government agencies don't do, they lose their reason for being.

FOUNDATIONS AND THE POWER OF THE RICH

Your third question very properly raises the whole issue of the legitimacy of foundations. Should the rich by creating foundations be able to assert their own sense of priorities whether for or against social change? Let me tackle that in two ways. First, I think what we need is a realistic sense of proportion. We have already remarked that total foundation spending is only a small fraction of Government spending. As organizations, foundations are small and not particularly formidable. The Ford Foundation is big only when you compare it with other foundations. By any other standard of comparison, whether you deal with Government agencies, or with corporations, or with universities, the Ford Foundation is not a very large organization.

Furthermore, there is great diversity in the foundation field. Even if you focus only on the 350 with more than $10 million assets, you will find a highly diverse group.

A second and very different point, is that most of the larger foundations have become substantially professionalized. This produces results somewhat like those that have been widely observed in the newspaper business. The owners of newspapers are generally pretty conservative but the hired hands who write the news stories and usually much more liberal. You have a somewhat similar selection process at work in the foundation field. The people who are likely to make a professional career of foundation work are very different types from those who made the fortune on which the foundation is based. As a broad generalization, the professional foundation staffs are likely to be more liberal than the donors who set up the foundations.

TAX DODGES AND PUBLIC RELATIONS GIMMICKS

Turning to your fourth question, are foundations public relations gimmicks or tax dodges? Here again, I think a sense of realism is desirable. The whole concept of tax incentives is obviously based upon the existence of mixed or impure motives. The important issue is whether foundations make socially useful contributions, not whether the motives of their founders were unselfish. The work of the Rockefeller Foundation has undoubtedly resulted in good "public relations" for the Rockefellers. I do not begrudge that, because the foundation has in fact made many useful contributions. Similarly, with the Ford Foundation, I think its work, both good and bad, should be judged on its own merits, not by whether the creation of the foundation helped the Ford family to maintain control over the Ford Motor Co.

PERPETUAL LIFE

Last, the question of self-perpetuation and permanent life. As Dr. Cuninggim has already noted, permanent life is no longer an unusual privilege in our society. No just charitable organizations, but most organizations in our society are set up on a perpetual life basis. I know of no compelling reasons why foundations should be singled out for limited life. The important point is to impose a discipline to make sure that foundations maintain a proper level of charitable activity. Here the Tax Reform Act of 1969 came up with a major improvement over the prior law, the payout requirement. I might note that this idea was first proposed to the Senate Finance Committee by the Peterson Commission. As long as foundations maintain an adequate level of payout to charity, they should be permitted to remain in existence indefinitely. If they do not do so, they should not be permitted to stay in existence whether it be for 25 years or for 40 years.

The fact that you are receiving some complaints about the level of the payout requirement may well be a healthy sign. The payout requirement should impose a real discipline for good investment management, which was lacking before 1969. If nobody objects, you would know that the level is not tough enough.

That concludes my comments on the five questions you presented to our panel.

QUALIFYING THE TAX LOSS

I would like to comment briefly on the question raised at this morning's hearing on the amount of the tax loss caused by foundations. An annual figure of $610 million was mentioned. This is a subject that the Peterson Commission attempted to deal with.

It would obviously be very helpful to the formulation of public policy if you could make some kind of cost/benefit analysis comparing the benefits resulting from foundations with the loss in taxes. Pete Peterson and the staff of the Peterson Commission spent quite a bit of time trying to figure out how you might make such an analysis. We were very disappointed to conclude that there is no way to do it. Neither the cost, nor the benefit can be quantified in any meaningful way. The tax loss cannot be computed because we don't know what

the donor would have done with his money if there was no tax deduction for foundations. You can observe that several major foundations, including Carnegie and Rockefeller, were set up before there was an income tax. Therefore, it is reasonable to assume that some more foundations would have been established even if there were no tax incentives.

However, it is very clear, and responses to Peterson Commission questionnaires emphasized this, that most donors are very much concerned with tax deductibility. Even if we assumed that without tax incentives no money would go to foundations, there is no way to compute the tax loss caused by foundations. The tax loss may not be great, because it is reasonable to assume that tax conscious donors will avail themselves of alternative ways of minimizing taxes. If there had been no deduction for foundations, the donor's money might have gone directly to charity in the forms of tax deductible grants to universities, hospitals or churches. Conceivably some donors might have decided to spend more money on yachts or racing stables, and thereby reduce their taxable estates. We are obviously dealing with very iffy questions. There is no meaningful way to compute the tax loss caused by foundations.

Even if we make the highly unrealistic assumption that donors would have given the same amounts to nontax-exempt foundations, and both donors and foundations had paid substantial taxes, is that necessarily desirable? Even if, for the sake of discussion, we accept the $610 million figure which was mentioned this morning, the amount involved is not large enough to permit any reduction in tax rates.

There is no question that the Government can always use another $610 million, but would it spend the money more or less wisely than the foundations? Here, we get back to the same underlying philosophical questions where we begin. Do you want the Government to sell all or most of the priorities in social expenditures or do you want a more diversified system? I think that is the bottom line question you are asking. It is a very important question to ask, and I hope that your deliberations will produce illuminating answers.

Thank you very much.

Senator HARTKE. We will proceed with the next witness and we are getting close to 4 o'clock and the next vote is 4.

STATEMENT OF M. CARL HOLMAN

Mr. HOLMAN. I am Carl Holman, president of the National Urban Coalition, and I think since I suppose I am the only person here representing an organization which is on the receiving end, I might just briefly say what the coalition is. It is made up of representatives of business, labor, minorities, public officials, religious, professional, and community leaders, and while established at the time of the urban riots in the sixties, the coalition tries as best it can to try to deal with the social, economic, and philosophical problems of cities and especially the problems of the central cities, and in so doing works with 34 of its localities to try also to lessen racial and ethnic polarization.

I found some difficulty in dealing, as I have in the past, with some of the questions which arise concerning foundations because often they

seem to assume that foundations have a monolithic quality which does not square with my experience at least. In other words, there is no way of dealing with foundations as though this is a convocation of groups which come together from time to time and set priorities and operate in that particular manner.

In addition to that, there is the problem, I think, of seeing foundations in terms of one or two headline-making episodes which occur and then attempting to judge all foundations in that way.

I am certain that is not the way the Senate will go about making policy in terms of that but it is very clear that is what has happened a good deal in terms of the press and was involved to some degree in the way the conversation went the other day in the Watergate hearing which I happened to be tuned into at that moment.

It seems to me that foundations are imperfect but that they are vital and necessary parts of our society. They do stimulate and permit the private sector to play an active role in meeting social and economic needs not only of nations but of particular localities or regions, and I think this has to be thought about very, very seriously, that foundations are in the American tradition of diversity and plurality providing initiatives and alternatives not available in countres where almost everything tends to be done by the Government.

So that when the Senators are having a conversation about foundations, I think this is something which they might take very seriously to heart.

I will strive to give a couple of quick examples that the foundations can respond more quickly to emerging problems and issues than either Government or corporations. These may be limited by other political priorities and realities or overriding obligations to stockholders or in the case of Government, the national bureaucracy of Government. I will give one case in point.

Two years ago I helped put together for the coalition, using foundation money, the Midwest Conference on Criminal Justice. My interest there was in trying to see if we could look at what was really happening not in the big city but to go into the cities of Indiana, Illinois, of Michigan, and try to see what was happening with LEAA, a Government program which was supposed to run 5 years in those cities.

We got together mayors, police chiefs, community people, people from the courts, people from corrections. One of the interesting things about that was that this was to be a joint venture between ourselves and LEAA. LEAA had a lot more money for this purpose than we.

On the day when the conference was to take place in Gary, the LEAA paper had not all been signed and the money was not there, and so that conference was put on with the use of foundation moneys by the coalition. The more interesting thing which occurred was that in the course of that 3½ days an amazing amount of consensus people from Gary, Terre Haute, from Madison, began to find that they had very, very much certain kinds of problems in common, they found in some cases that the LEAA State directors were virtual dictators in suggesting what sorts of programs had to be instituted and they asked if we would do one thing more, bring them here to Washington to meet with the Attorney General and the Justice Department.

They were skeptical that we could do this and they were skeptical that the Government would be willing to have that done. We did indeed bring them here to Washington, they did indeed meet with the Justice Department, the head of the Justice Department and with the LEAA people, and some of the things that they suggested resulted in a kind of change which never would have occurred had this gone through the usual bureaucratic process which is involved.

In the same way, we have looked at the financing of public schools. A lot has been said about what foundations have done in terms of higher education. We have been very much concerned about the kind of inequities which are suffered by rural and urban low-income neighborhoods in terms of what they get from the States by the way of support for public education. It was foundation money that made the research possible to do that in the first place. It could not have been gotten elsewhere. And though a series of lawsuits took place thereafter, and some of those lawsuits lost, it is significant to see in four or five States now the States have moved on their own to try to change what the pattern is there.

Foundations do the kind of frontier work very often that will not be done by the Federal Government or any other such agency.

Several references have been made to what Ford and Rockefeller did in terms of the so-called green revolution. I think what is being forgotten at this point in history is that with the current food prices we have in the world, imagine what that crisis would have been like had not the amazing new grains, which were possible only because these foundations were able to do what Government would not have then done, and moved out in terms of that, the same thing could be true. I was with the party when the Senator from South Carolina went down to see for himself what was happening in his State in terms of hunger in that State. That, too, was done by foundations and by the work that foundations had made possible in taking a look at that.

What I am trying to get at, sir, is that I think we cannot deal with the horrible examples and the celestial examples which at any foundation would bring before us. It is fully true, as bad as race relations have been, at some point in this country it is difficult to believe how much worse and how much more destructive race and class relations would have been without some of the work foundations made possible. Higher education, special training, leadership opportunities, for a certain segment of our population have been provided that otherwise would not have.

Reference was made to a fact that even small foundations very often will give to a person. This again is more like what happens in this country and not in other countries so much.

I know a girl who began as a student in Atlanta, Ga. and was sent off to college on a small fellowship and who was as powerful a force in trying to see to it that in the State of Mississippi things did not go totally in collapse as any three, four, five, six, seven groups of people might have been. She did go on from that point to have a distinguished career throughout here in Washington and again in Harvard and again this has been made possible by the kind of things I do not think you can expect the Federal or any other government to do.

I think the relation between social policy and public policy in the role of foundations is an important one and I would like to take perhaps an unpopular bull by the horns and say that the other night when we looked at the number of elected officials from minorities who have come into office, and there is still a small smattering in this country, over the past several years, I would not again say the importance of foundation-supported efforts at voter registration and voter education and I fully understand the reaction to what was seen as abuse and a single instance, what I do not see happening is the counterbalancing of this by the fact that a great number of people who, when I saw them as students in the south, were very much opposed to the system and who now have come out of the student movement and are now in the political movement.

[The statements of Messrs. Cuninggim, Heimann, and Holman and questions submitted to the witnesses follow:]

STATEMENT OF MERRIMON CUNINGGIM, ADVISOR OF FORD FOUNDATION

Gentlemen: The five questions drawn up for consideration by this Panel are so large and important that the temptation, in light of my long-time experience in the foundation field, is to write a book in comment on them. Fortunately for me, the book has already been written; and it delights an author's heart, of course, that my book's sub-title, *The Role of Foundations in American Society*, happens by chance to be the theme chosen for this Panel.

In an effort to make this Statement as brief as possible, I will simply sketch out answers to the questions posed by the Subcommittee. In case elaboration should be desired, I will indicate where the various topics are discussed in my book; and will be happy to comment at greater length orally.

Question 1. How useful and/or necessary are foundations in American society today? What functions do they perform? Are these—or could these—functions be performed by other groups?

Answer. "Useful"? Very. The myriad "functions . . . they perform," in fulfillment of their over-arching function to enchance the general welfare, undoubtedly make immense contributions to the improvement of American society. No area of life is ignored—at least none that is legal and moral. (Chapter 4 of my book.)

This doesn't mean that everything that every foundation does is useful. Lots of the roughly 26,000 are small and often ineffective, and some of the big ones have not yet learned their proper role. But on balance the record of positive accomplishment is impressive. (Chapter 1, passim.)

"Necessary," however, is another matter. How strictly is the word being used? If it means, could we get along without foundations, the answer has to be Yes—and in the same limited sense we could get along without symphony orchestras, or research institutes, or maybe even some of our hospitals, schools and churches. At least some of the activities of foundations could indeed "be performed by other groups," and would undoubtedly *have* to be performed by other groups, including especially government, if foundations were to get, or be put, out of business. At the present time there is no substitute for the assignment of generous private money to public service, which is the task of foundations; and if America feels that this is desirable, then in this sense I think we can say that foundations are necessary. (Chapters 1, 5 & 6, passim.)

Question 2. What are the negative aspects of foundations? What are they doing wrong?

Answer. It is important to discriminate between charges against foundations that the facts support and other charges that the facts don't support. What they are "doing wrong," and what they are accused of "doing wrong" are not the same thing. I shall touch briefly on both.

A number of the "negative aspects" have to do with the structure and financing of foundations: (2) that they are said to be tax dodges; (b) that they are used primarily for business and family advantage; (c) that their investment policies run counter to the public interest; (d) that they represent dangerous concentrations of power; (e) that they are elitist in management and general outlook; and

(f) that they are not accountable to the public. (Chapter 2, and chapter 6, passim.)

Shorthand will have to substitute for a full, careful analysis; and my own answers will undoubtedly disagree with those of swashbuckling critics on one side and nervous defenders on the other. I would welcome a chance to respond to these charges at greater length; here I can give only brief, summary judgments, as follows:

In re (a), foundations themselves are not tax dodges, but many donors may indeed have received excessive tax concessions in establishing their charitable funds.

In re (b), see question No. 4, below.

In re (c), unimaginative investment policies have been the norm, but the Tax Reform Act of 1969 effected an improvement here, and consequent pay-out to charity has been notably increased.

In re (d), leading foundations do have considerable influence in their fields of activity, but, in my view, the facts do not support the notion that their power is either massive or dangerous.

In re (e), elitism can be broadly documented, but many foundations, especially the larger ones, are beginning to do something about it.

In re (f), thanks to TRA 69 as well as to developments already under way at the time, foundations are now more accountable than ever before, though they still have a way to go.

All these seem to suggest the question, Are foundations serving as bulwarks of special privilege? In many an individual instance, the answer is undoubtedly Yes. For most of the large foundations, and on balance for the field as a whole, the answer, I believe, is No. But foundations can take only part of the credit for improvement in these matters; government regulation has brought about many desirable changes in the areas of structure and finance. (Chapters 2 & 6)

Again, much needs to be said, but since answers must be pithy, then:

In re (g), TRA 69 has pretty much taken care of the problem of inadequate spending.

In re (h), foundations are no longer as secretive as formerly, courtesy of TRA 69, but many of them, especially a large proportion of the smaller ones, are unduly reticent.

In re (i), those who start from the premise that the work of foundations is inconsequential end up with it as their conclusion—which is simply to say that you can find what you are looking for, all the way from unimaginative and safe activities to courageous and even risky projects. My own view is that the routine outweighs the daring by a large margin—which is what one would probably have to say about any other type of organization specializing in public service.

In re (j), that foundations generally are engaging in extremism, whether of the left are right, is nonsense. Only a handful of valid examples can be discovered.

In re (k), almost as preposterous is the muted companion charge of political partisanship, in spite of the supposed heinous instances cited in Congressional hearings in 1969. Except for a very few indiscretions here and there, the facts don't support such a charge.

In re (l), it is indeed true that, on the whole, foundations don't monitor and evaluate their work very well.

The summary question for the areas of program and operating policy might well be, Are foundations acting as agents of constructive change in society? With allowance for disappointments and failures, which all foundations know they have experienced, the on-balance answer, I believe, is Yes. (Chapters 3, 4 & 6) But my phrasing of this question is slightly, and crucially, different from the wording of the next question posed by the Subcommittee:

Question 3. Fundamentally, are foundations a vehicle of the rich to use their economic resources in order to change our society? Should the rich be allowed to have this much influence?

There are, of course, two questions here, not just one. The phrasing of the second seems to pre-suppose that the answer to the first is affirmative; but that is seriously to oversimplify the situation.

The second question is easy as well as irrelevant: Rich men should not be allowed to mold the society to their pleasure, irrespective of the desires and needs of others—and neither should anybody else.

In the areas of program and operating policy are other "negative aspects," alleged or real, that must be noted: (g) that foundations don't spend enough;

(h) that they are secretive; (i) that they engaged in inconsequential work; (j) that, conversely, they are effectively propagating extremism; (k) that they indulge in partisan politics; and (l) that they don't monitor and evaluate their work as carefully as they should. (Chapter 3, & chapter 6, passim.)

But there is simply no convincing evidence—and now I'm going back to the first question—that "fundamentally" wealthy people have successfully employed foundations to change things to their selfish liking, or that foundations are nothing more than the tools of the rich to win their will. This doesn't mean, of course, that individual men of wealth may not have tried such a ploy—and got away with it on occasion, just as in any other area or vocation in which shady activity is possible. But it *does* mean that reputable foundations, believing in constructive change, proceed to address the social problems chosen for attention, on the merits of the case, not on the whims of the parent rich or anybody else .Change? Yes. Insidious scheming by the rich to arrive at some foreordained conclusion? No. The overwhelming body of foundation activity, concentrated as it is in the large foundations, supports no such conception. (Chapters 2 & 3, passim.)

Question 4. Can we say that foundations are established in order to financially support programs to aid our society, or are they established merely as tax dodges and public relations vehicles for the persons establishing them?

Answer. The first thing to say is that it is not either/or. Though we always need to be careful in assigning motives to others, there are clearly many more motives for establishing foundations than simply the two cited, and even those two may not be mutually exclusive in every instance. As I've already noted, foundations do "aid our society," and their charters and programs suggest that this was at least one of the things their founders meant them to do. As I've also noted, rich men have often received tax concessions, and it would be naive to hold they didn't know they'd get them. The human condition being what it is, it's likely that setting up a foundation is nearly always a combination of generosity and selfishness. In my view, government policy should be aimed at encouraging the former and holding the latter in check; that is, reasonable tax incentives for genuine benevolence should be provided, and loopholes to allow the rich to escape their just share of taxes, on their spurious claim of being charitable, should be closed up. (Chapters 1 & 5, passim.)

Once a foundation is established, it can hardly be said to be a tax dodge, for it pays the tax prescribed—even when, as is now the case, the so-called audit fee of 4% raises twice as much as was originally anticipated when TRA 69 was passed, which amount itself proved to be twice as much as was needed to perform the desirable audits. But that's to get off the particular subject. The remaining item in this question has to do with whether it was the intent that foundations serve as "public relations vehicles for the persons establishing them." In motive? Perhaps. In actuality? Even more possible. That is, donors, their families, their businesses, their professional careers, can all be favored by the way in which foundations conduct their affairs. The benefit can go far beyond merely good public relations for the persons involved; and since opportunity for abuse of this sort still exists, in spite of TRA 69, the surprise is that there seems to have been so little in fact. But there is enough, in my view, to justify specific legislation. The 1965 Treasury Department's Report on Foundations recommended, among other things, the "broadening of foundation management" as a way of solving the problem of "close donor involvement," but this was the one recommendation of the Report that TRA 69 did not pick up. (Chapters 2, 5 & 6, passim.)

Question No. 5: Should foundations be considered self-perpetuating institutions in our society which are valuable and necessary today and in the future, or should a reasonable limit be put on their lives?

Answer. The choice is unreal. For example, it is not impossible that someone oppose perpetuity, yet still believe that foundations "are valuable and necessary today and in the future." And what is "a reasonable limit"? The question seems to be trying to get at something else which is not clarified.

"Self-perpetuating institutions" constitute the way America usually sets up its non-profit, public-service agencies. They aren't required, as a rule, either to liquidate by a certain time or to go on forever. They themselves make the choice. If the suggestion were made that they shouldn't go on forever, it would presumably be because they aren't serving the public, or because government or some other kind of agency could do their job better, or because the public interest is insufficiently represented in the determination of direction and program. Are these, perhaps, the concerns at which the question is aimed?

If so, let me say that I find it hard to imagine any "limit . . . on their lives" that would be "reasonable." Granting that foundations, like all other institutions, make mistakes and bad choices, they do serve the public remarkably well; any person whose eye might fall upon this page will have been benefited in countless ways during his lifetime by foundation activity. Government, or perhaps some other agency, could indeed take over much of their work, of course, but this would represent a serious dilution of our pluralistic society in which ideally public and private segments work hand in hand. And if the real aim of a time-limitation is to secure the "broadening of foundation management," then specific legislation to that effect would be more effective and less dangerous than a cancellaton of the time-honored and time-tested principle of perpetuity. Longevity brings experience, which more often than not makes for wise use of resources. A time limit for foundations would mean the waste of experience and less effective philanthropy. (Chapters 2 & 5, passim.)

STATEMENT OF FRITZ F. HEIMANN, ASSOCIATE CORPORATE COUNSEL, GENERAL ELECTRIC CO.

FOUNDATIONS AND GOVERNMENT: PERSPECTIVES FOR THE FUTURE

Any effort to consider the future of foundations must deal with the ultimate question: is there a continuing rationale for foundations? Foundations are in a difficult period in their history. The legislative battles of 1969 demonstrated that they have very limited political support and no effective popular constituency. The pervasive role of government programs means that the traditional rationale for foundations has largely disappeared. That rationale, though never very explicitly formulated, rested on the premise that there were spheres of activities in which the federal government had little or no active role, but which were of sufficient public interest to justify the use of tax incentives to stimulate private initiative.

In the face of political hostility, foundations could resign themselves to a low visibility role as disbursing agencies for noncontroversial projects whose priority is too low to secure government support. The financial pressures on all private sector institutions—museums, universities, hospitals, symphony orchestras—are so great that there would be no difficulty disbursing the $1.5 to 2 billion per year which the foundations have to spend.

However, as tax-favored institutions, foundations are certain to be under renewed scrutiny, and will be required to justify their existence. Not having made anybody mad may not be an adequate defense. If foundations support only what is popular with politicians, their role will be insignificant because such projects will have access to much larger government funds. If they limit their grants to the institutions supported by individual giving, they are vulnerable to the attack that they are unnecessary middlemen.

In the long run, the only real justification for an institution is that it does things which others cannot do as well. Foundations have made many distinctive contributions in the past, but that was much easier before government agencies became active with vastly greater resources. Foundations must prove that they can continue to make distinctive contributions in an environment of massive governmental involvement if they are to develop sufficient public support to maintain their existence.

A RATIONALE FOR FOUNDATIONS

I believe that their ability to make distinctive contributions is considerable. Of all of our institutions, foundations are potentially the most flexible, because they are least encumbered by internal or external constraints. This is of enormous value in a time of rapid change when most public and private institutions cannot cope with the need for change because of the constraints under which they operate.

Foundations are less constrained than any other type of organization by the pressures of their ongoing activities. Because they are essentially grant-making rather than operating institutions, their internal needs are quite modest and the bulk of their available funds are uncommitted. Thus, they have the potential to respond to change by launching new programs. Even though existing programs generate pressure for continued funding, it is far more difficult to eliminate or reduce a program carried on by an in-house staff than it is to cut support going to another organization. This phenomenon operates also with government pro-

grams and in the corporate world. The unique characteristic of foundations is the ratio of in-house expenditures to external grants. Only a very small percentage of the available funds are needed to keep the internal show running. Thus, the inertial force of ongoing activities is much smaller, and the ability to reallocate resources is correspondingly greater.

The fact that foundations are not required to raise money frees them from many external pressures. An endowed foundation does not have to satisfy the demands of an external constituency, such as voters, customers, or advertisers, to assure its continued existence. It may be argued that, in view of political and other public criticism, foundations are hardly free from external pressure. There is, however, a basic difference between having to earn the active and continuing support of outside constituencies to remain in existence, and having to avoid activities which could trigger widespread opposition. The latter is at most a negative discipline. Our basic premise is still true: external constituencies do not impose any affirmative demands which foundations must meet.

The freedom from internal and external constraints gives foundations great flexibility to respond to the changing needs of American society. This flexibility provides the best basis for defining a useful role for foundations, because it suggests that there are activities which foundations can perform better than other institutions.

It is clearly easier for a foundation to engage in experimental activity than it is for a government agency. The system of checks and balances under which government programs are conceived and executed makes it extremely difficult to tolerate the failures that are an inevitable concomitant of experimentation. The same constraints also make it very difficult for government agencies to operate either on a small scale or on a long-time cycle. This introduces a twofold bias. An experimental program which looks as though it may produce negative results is likely to be killed too early. A program which appears promising may well be given broad application prematurely. For example, one of the major problems of such antipoverty programs as community action was that experimental approaches were proliferated too early.

The very fact that foundations do not respond to a political constituency means that it is possible for them to sponsor a project in one community without being exposed to irresistible pressure to duplicate the experiment in other communities. Similarly, the freedom from political checks and balances, Budget Bureau reviews, appropriation committees, and partisan criticism means that a foundation can accept the consequences of an unsuccessful experiment without the risks inherent in a governmental program.

The absence of political checks and balances also means that foundations can be much more selective in their allocation of resources. A foundation can decide to support only the best law school or hospital, or other institution, without being subjected to pressure for even-handed distribution to all similar institutions. It appears that some foundations have in recent years become concerned about charges of "elitism." This has led to the distribution of grants to broader groups of recipients. Without debating the wisdom of any particular program, I believe that foundations lose their ability to be distinctive if they adopt grant-making criteria which closely resemble those of government agencies.

Foundations can also center sensitive or controversial areas more readily than government agencies. Strong opposition by a vocal minority can often stop a government program. Foundations can be considerably more venturesome. For example, foundations began working in the birth control field at least two decades before the government entered it. Most observers credit the initial work financed by foundations with laying the basis for the government's ultimate entry.

The development of higher-yield food grains is probably the greatest success of the foundation held since World War II. The crucial importance of increasing agricultural productivity in countries like India with rapidly growing populations and limited available land, was widely recognized. However, for several decades the dominant political interest in Washington was the disposal of United States agricultural surpluses. Increasing the productivity of foreign countries had no political support. Thus here, too, political inhibitions on governmental action created an opportunity for foundation initiatives.

The greater flexibility with which foundation programs can be administered provides opportunities in such fields as support for artists, where subjective judgments are inevitably more useful than objective criteria. Government-financed

programs must necessarily be operated with relatively formal procedures. Thus, it is questionable whether government programs in the humanities and in the arts could, even with increased funding, be as successful as, for example, the fellowship program of the Guggenheim Foundation.

Another obvious opportunity is the field of religion, from which the government is excluded by the Constitution. Here foundations can operate free from the competition of government programs. Surprisingly, relatively little foundation spending has gone for religious purposes.

It appears to be fashionable to be critical of large foundations which operate on a local, rather than a broader geographical scale. To me such a local emphasis would seem to be at least one justified response to the unequal competition with large-scale government programs. By concentrating on a limited area, a foundation is more likely to bring to bear meaningful expertise, and its available resources are more likely to have a perceptible impact.

To my mind, there are ample opportunities for foundations to play a role which is both unique and important. To play this role successfully requires first of all a realistic recognition of the role of government. This requires a much more sophisticated model than the simplistic "private sector-public sector" dichotomy with which the foundation literature abounds. Foundations must understand both the enormous scope and resources of government programs and their inherent limitations. Against this backstop the role of foundations can be defined.

There is room for collaboration between foundations and government programs, as Richard Friedman suggests in his chapter. However, collaboration with government programs has its dangers. The role of being a junior partner in government-dominated programs does not provide an adequate solution to the future role of foundations. The traditional reluctance of many foundations to become closely involved with government-operated programs reflects a fear which, while perhaps exaggerated, is not unfounded in view of the much greater resources of the government, not merely in money but in other important factors, such as experienced manpower. The concern that foundations might lose any individuality or impact if their programs were closely coordinated with government programs cannot be dismissed. The reality, however, is that the government is active in most fields of foundation activity and unless foundations learn to operate in that environment there is very little scope left for them.

THE MANAGEMENT OF FOUNDATIONS

Our discussion of the future role of foundations makes clear that there are no simple answers. Careful and sophisticated determinations must be made within each field of activity to find areas where foundations can make a distinctive contribution. The development of such programs is no job for dilettantes. A foundation which decides how to spend its money after the trustees have finished their drinks at an annual dinner is unlikely to be very effective. It does not follow from this that there is need for "professionalization in giving." What is required is detailed knowledge and convictions with respect to the particular field of activity, not expertise in the methodology and procedures of philanthropy. Effective philanthropy is serious work. However, if the donor or the trustees are willing to do the work, that's fine. If not, they should obtain the necessary help to make sure the job is done right.

The argument that "independent" professionals will necessarily do more useful work than the donor or his family is far from clear. Any judgment is bound to be impressionistic at best. However, even Waldemar Nielsen, whose book on *The Big Foundations* is strongly critical of donor control, describes various instances where highly productive programs were originated by donor-controlled foundations. In fact if the emphasis in foundation work should be on innovation, donors and trustees may at times be more venturesome than the foundation professionals. As one case in point, it is worth noting that John D. Rockefeller 3rd was unable to get the Rockefeller Foundation, of which he was then chairman, to become interested in the population problem. Because of his strong convictions regarding the importance of the subject, he finally established a separate organization, the Population Council, to work in this area. Only many years later, after the subject had become more widely recognized and much less controversial, did the Rockefeller Foundation itself begin to participate.

In a review of foundation activity in the field of economics, George Stigler made the following perceptive observations about foundation professionals.

The large foundations in general are staffed by men whose personal convictions on the proper type of research are fairly representative of the consensus of respectable professional opinion. It would be considered irresponsible or dangerous for a large foundation to plunge on a large scale into an eccentric program, and men who seek to do this do not get on or stay on foundation staffs. This trait is probably due to the professionalization of the administration of large foundations and possibly also to their vulnerability to criticism.

People working for foundations, like beauticians and undertakers, want their work to be granted "professional" status. However, it is a gross oversimplification to associate good foundation work with professionals and bad foundation work with donor- and family-run foundations. The need for staff depends primarily on the complexity of the programs which are undertaken. Even a very large foundation can get along with little or no staff if it limits itself, for example, to making unrestricted grants to universities. A foundation which wishes to become involved in a substantial volume of complex activities will certainly require a staff.

AMENDING THE TAX LAW

One of the key issues for the future is whether and how the foundation provisions of the 1969 Tax Reform Act should be amended. The Act was the result of a complex process of political pulling and hauling and the results show it. There were some useful reforms, notably the payout requirement. While its formulation could be improved, the principal that there be a minimum level of payout to charity seems unassailable. It cured a serious flaw in the prior law. No one should get a current tax deduction when he creates a foundation, unless the foundation promptly commences its charitable activities and continues to maintain a minimum level of payout.

At the other end of the spectrum is the 4 percent tax on the investment income of foundations. It is an indefensible absurdity which should be repealed at the earliest opportunity. In fiscal year 1972 the Treasury collected over $50 million from foundations. This amount was lost to charity. It was more than double the Treasury's estimated cost for auditing all tax-exempt organizations. If the tax is not promptly repealed, there is a danger that, in accordance with Professor Parkinson's first law, the amount of work performed by the Internal Revenue Service will rise to the level necessary to eat up all the dollars available.

The restriction on transactions between foundations on the one hand and donors, trustees, and other "related persons" represents an exercise in overkill. A more sensible balance between the cure and the disease should be developed.

The requirement that foundations exercise "expenditure responsibility" when grants are made to organizations other than tax-exempt charitable organizations is sound. That it appears to be having the effect of discouraging grants to minority and poverty groups is a commentary on the administrative weakness or timidity of many foundations, not on the desirability of the requirement. Foundations should learn to live with the expenditure responsibility requirement and not use it as an excuse for failing to make grants which should receive adequate supervision.

Conversely, the fact that the Treasury has drafted fairly reasonable regulations interpreting the statutory restrictions on legislative activities, and that most foundations find they can live with these restrictions, should not divert attention from the inherent unsoundness of the restrictions. Congress does not need to be shielded from foundation-financed lobbying. Every other interest group is busy lobbying, including unions and corporations, churches and veterans' groups, and most powerfully of all, the executive branch of the government. The process is and should be wide open. There is no very persuasive reason for excluding foundation-financed inputs. They will add only a trickle to the torrent and their product will be no worse, and might occasionally be a little better and a little more disinterested, than most lobbying.

Professor Bittker's chapter demonstrates there is little or no logical or factual justification for most of the distinctions in treatment between foundations and other types of charitable organizations. Over a period of time the less favored status of foundations is likely to have a serious effect on the birth rate of new foundations. In particular, the restriction on the percentage of stock holdings in a corporation which may be owned by a corporation will almost certainly have an adverse effect on the creation of large foundations. Here too we seem to have

a case where Congress made the remedy more severe than the disease warrants. In all likelihood, the minimum payout requirement will cure the most serious dangers presented by foundation ownership of controlling blocks of stock; namely, failure to provide an adequate financial return to charity. I would be inclined to drop the excess business holding requirement until after the effects of the minimum payout requirement can be determined. If there still is a problem at that time, the more drastic remedy can be reimposed.

While hard proof is not available, the Tax Reform Act is probably having a sharp impact on the creation of very small foundations. These have constituted an overwhelming percentage of the total number of foundations. (In 1969 more than 80 percent of all foundations had less than $500,000 in assets.) The legal and accounting requirements established by the 1969 law appear sufficiently burdensome to discourage the creation of small foundations. Tax and estate planners no longer bother with foundations when only a modest amount of money is involved. To my mind, this is a welcome development which illustrates the serendipitous delights of our legislative process. Students of foundations have long questioned whether the same tax incentives which encourage the establishment of multimillion-dollar foundations should be available to individuals who create a foundation which, because of its small size, is bound to be nothing more than another checkbook for the donor's personal giving. Unfortunately, it has never been possible to draw a practical line of demarcation between the "incorporated checkbook" and the "real" foundation. Any size test—whether it be $100,000 or $1 million—has the political defect of looking like discrimination in favor of the very rich. Conceptual distinctions are even harder to define. The burden of paperwork created by the 1969 law seems to be accomplishing by indirect means what was impossible to do directly. It will probably take several years before we will know how high the entry barrier really is.

Congress should make a thorough review of the foundation provisions of the tax law. Such a review should preferably be undertaken as a separate matter and not, as in 1969, as part of a broad tax reform effort, The foundation provisions are very complex and will require detailed attention by the Treasury Department and by the congressional committees responsible for tax legislation. If the foundation provisions are taken up as part of an omnibus package together with issues of greater fiscal impact or political sensitivity, the foundation provisions will not receive the attention they require. While something different from the 1969 amendments might emerge, the results would probably be another ill-considered response to then current charges and countercharges.

THE GOVERNMENT AS REGULATOR AND THE ROLE OF THE IRS

Because federal encouragement for foundations has come through tax incentives, the regulation of foundations has inevitably become the province of the Internal Revenue Service. However, the principal interest of the IRS is to bring dollars into the Treasury. As a result, its interest in foundations has been directed primarily to questions of fiscal abuse. Moreover, because the auditing of tax-exempt organizations is not a very productive way of bringing dollars into the Treasury, the IRS has, during much of its history, paid only scant attention even to the fiscal regulation of foundations. With continuing public concern about tax equity, the need for adequate policing of foundations is beyond argument. However, the need for additional tax audits hardly justifies the tax on foundation income.

Much more difficult than determining the proper level of policing of fiscal abuses are the issues raised by government regulation of foundation program activities. The 1969 law enacted more detailed restrictions on foundation programs. The mere existence of the statutory provisions means that some regulation to achieve compliance is necessary. Furthermore, because many of the provisions raise problems of interpretation, it is necessary to develop regulations which will enable foundations to find their way through the complex statutory maze. In the area of foundation programs, however, the role of the Internal Revenue Service is more questionable than in the field of fiscal abuses. Very few people would ordinarily consult a tax lawyer or tax accountant in order to define, for example, a meaningful line between proper educational activities and improper participation in politics.

If we question the competence of the IRS in such areas, the issue is presented, if not the IRS, what other agency should do the job? Here we have a dilemma. It

is true that some other agencies may have more sophistication than IRS with respect to questions raised by foundation program regulation. However, such sophistication is likely to have been obtained by engaging in government programs which in a real sense are competitive with those of foundations. Asking some branch of HEW to pass on the propriety of foundation programs is probably even less desirable than letting IRS do so. The alternative of setting up a new agency has its own problems. For one thing, do the problems really justify the creation of even a small new agency? Should we run the risk that an agency with a limited mandate will inevitably work to create a bigger job for itself?

As indicated earlier, I would cut back on the scope of program regulation. (By eliminating the restriction on legislative activities, some of the more insoluble definitional problems disappear.) On balance I would be inclined to leave the remaining program regulation to the Treasury, as the lesser evil. Benign or even uncomprehending neglect is probably better than overzealous attention.

While the lack of external constraints gives foundations flexibility to launch new and useful programs, it also leaves them free to continue old programs which have outlived their usefulness. That some percentage of foundation grants will be dull and unimaginative is inevitable. However, I question whether government regulation can do more than deal with the quantitative aspect of foundation work by insisting on a minimum payout level. I do not see any practical basis for government action with respect to the qualitative aspect of foundation work.

This presents almost insurmountable definitional problems. No group of legislators or administrators are likely to agree on any workable standards for distinguishing between good and bad foundation work. Even if by some miracle of the politics of consensus the definitional problem could be solved, the result would inevitably undermine the rationale for foundations previouly suggested. If foundations were to spend their funds on the basis of government-defined standards of what is good and bad philanthropy, foundation programs will wind up resembling government programs. Unless we are willing to let foundations spend their money differently from the way government agencies would spend it, there is no point having foundations. The IRS might as well collect the money and let the government spend it.

PERSPECTIVE ON FOUNDATION PERFORMANCE

Any study of the foundation field should conclude with some overall evaluation. Are foundations healthy or are they sick? Should the institution be encouraged, discouraged, or eliminated? Like all ultimate questions these are hard to answer in any meaningful way. Even to make an approach requires, first, a realization of the limitations of the évaluative process and, second, a fair perspective of the strengths and capabilities of foundations.

In the course of the work of the Peterson Commission, much time was spent wrestling with the question of how to make some overall evaluation of the work of foundations. In particular the possibility was considered of making a "cost-benefit analysis" comparing the cost of the tax subsidies with the benefits to society resulting from foundations. After consulting some of the foremost experts in the Arcane techniques of cost-benefit analysis, it was concluded that the job was impossible. The number of indeterminable variables is just too large. Even the "cost" of foundations, in terms of lost taxes, is impossible to measure. If there would be no tax benefit for contributions to a foundation, would a donor give the same amount directly to his university or to some other tax-exempt organization? Would he buy a bigger yacht, or improve his wine cellar? Would he leave the money to his children and, if so, by taxable or nontaxable methods? Would he set up a foundation even without tax incentives? A number of the major foundations were created before there were any strong tax incentives for doing so.

The analysis becomes even more unfathomable when we go beyond the donor's options. Let us assume that there had been no tax incentive for foundations, and that foundation donors had not availed themselves of other opportunities to keep the money away from the tax collector—what would the government have done with the extra taxes? Would tax rates have been lower? Would the national debt be somewhat smaller? Would the government have been impelled to spend more money in the fields in which foundations have been operating? If the latter is the case, would the money have been spent more or less productively than the

way the foundations have spent it? It is self-evident that there are no good answers to any of these questions and that the whole notion of a cost-benefit analysis of the role of foundations is unworkable.

Accepting the reality that the role of the institution as a whole cannot be evaluated in any meaningful way, there is left the possibility of appraising the work of individual foundations and then somehow building up a cumulative judgment of the institution. This is the approach taken by Waldemar Nielsen in his book *The Big Foundations*. He reviews the work of the 33 largest foundations, those which in 1970 had assets exceeding $100 million. Based on that review Nielsen concludes that foundations are sick and malfunctioning institutions with little hope for recovery. He is willing to grant them a brief term of years in which to improve. Failing to achieve adequate improvement they should be allowed to expire.

Whether Nielsen's assessment of foundations is justified depends largely on one's judgment of American society as a whole. If one begins with a vision of a society overwhelmed by problems with which our existing institutions are incapable of coping, and then asks what the foundations are doing to prevent the apocalypse, the obvious answer is: not enough. However, is it reasonable to expect foundations to sponsor programs which will change the system? As Nielsen correctly points out, the foundations are very much a part of "the system" and are interconnected with many of our other private-sector institutions, including corporations, banks, and universities. They are also dependent on the continued favor of the government. To expect them to play the part of well-financed and well-mannered Nader's Raiders is hardly realistic.

In defense of Mr. Nielsen, it should be recognized that he does little more than take the foundations on their own terms. After a thorough immersion in the pretentious prose of foundation annual reports and other statements of purpose, he compares the accomplishments with the rhetoric. Not surprisingly he finds a large gap. I will grant that anyone who has suffered through as much foundation prose as Mr. Nielsen has deserves to get even. However, I question the perspective underlying his analysis.

In order to achieve a realistic perspective on foundations, we ought to look at resources rather than rhetoric. The annual expenditures of foundations are in the range of $1.5 to $2 billion. In a nation with a gross national product exceeding $1 trillion, there are serious limits as to what can be accomplished by foundations. Furthermore, there are thousands of foundations—most of them very small—and their funds are spent over a wide range of activities. Even the Ford Foundation, whose size disturbs Mr. Nielsen sufficiently that he wants to break it up into three or four pieces, is hardly a big institution when we lift our view beyond the foundation field. When we use yardsticks other than financial resources, the size of foundations seems even less significant. The number of people employed by foundations is in the range of two to three thousand. Even Ford with a disproportionate total of the manpower has fewer than five hundred professional employees. I would suggest that the real starting pint for the assessment of foundations is the recognition that we are dealing with institutions of modest resources which for a whole variety of reasons can exercise only limited influence.

How useful such organizations can be depends on one's perspective of the problems which need to be addressed. As already noted, if we start from the premise that our society is doomed without radical restructuring of all of our principal institutions, foundations are hardly relevant. It is true that the prophet Jonah was able to save Niniveh even without a foundation grant. However, he lived in another age and had connections which even the Ford Foundation is unable to draw upon.

If evolutionary change, rather than radical overhaul is required, then an institution which is a part of the system, but free from many of the constraints of other institutions, can make some useful contributions. Financing the development of improved food grains at a time when the Department of Agriculture would not do so, supporting the creation of children's TV programs better than those which are produced within the profit limitation of commercial TV, sponsoring research in birth control when government was immobilized, are all very useful. There are no reasons to believe that foundations cannot continue to make similar contributions.

To my mind foundations have a useful role because we have an extraordinarily complex society whose problems must be addressed in a wide variety of ways. Even though many of our problems are interrelated, there are no large, simple

solutions. Foundations are important because they are different from other institutions in that they are largely free from the internal and external constraints which tend to keep other organizations in their accustomed orbit. This gives them the potential to address a great variety of problems to which other institutions are not attending. One of the most difficult challenges for the leaders of the foundation field is to inspire foundations to come close to reaalizing their potential, without at the same time elevating the level of rhetoric to a point where totally unrealistic expectations and anxieties are aroused.

At this time of uncertanties, it seems appropriate to recall the wise words of William the Silent, at the beginning of the Eighty Years War:

> It is not necessary to hope in order to undertake.
> It is not necessary to succeed in order to persevere.

Testimony of M. Carl Holman, President, National Urban Coalition

My name is M. Carl Holman and I am president of the National Urban Coalition, which was formed during the period of the urban riots of the 1960's. I would like to say a preliminary word about the Urban Coalition, so as to give some notion of the perspective from which I speak.

The Coalition is made up of representatives of business, labor, minorities, public officials and religious, professional and community leaders. The basic mission of the Coalition and its 34 local affiliates is to improve the quality of urban life, especially for the people who live and work in central cities. Our current basic programmatic focus is in three areas—housing and urban growth, education and health; with some strong continuing interest in two other critical areas: Urban crime and criminal justice reform, and jobs and income.

The coalitions seek to carry out their mission by bringing national and local elements together in the attempt to call attention to and try to solve the most pressing social, economic and fiscal problems of cities, and to lessen racial and ethnic polarization.

While I do not profess to be an expert on foundations, I am probably guilty of some built-in institutional bias since the Coalition is a 501–c–3 organization which receives the bulk of its support from corporations and foundations. Perhaps I should add that I am a member of the board of a small foundation, which I joined prior to coming to the Coalition, and a board member of the Council on Foundations. However, my understanding of my role in today's discussion is that the views I express are not to be interpreted as constituting official organizational positions.

Some of the questions which generally arise concerning foundations I find difficult to deal with, because they often seem to spring from an assumption that foundations have a monolithic quality which does not square with my admittedly limited experience. On the occasions when I have had to deal with or contemplate foundations I have been struck, as much as by anything else, not only with the differences between one foundation and another, but with the variations in the way a single foundation may respond to a given problem or need. As a representative of a nonprofit organization, I naturally have wished from time to time that foundations would behave in a manner more compatible with our needs and desires. But I doubt that in the long run that would be a healthy state of affairs.

I believe that foundations are an imperfect but vital and necessary part of our society. First of all, they stimulate and permit the private sector to play an active role in meeting the social and economic needs of the nation and of particular localities or regions. Foundations are in the American tradition of diversity and plurality, providing initiatives and alternatives not available in countries where almost everything is done by the government.

Moreover, foundations can often respond more quickly to emerging problems and issues than can either government or corporations, which may be limited by other political priorities and realities or by overriding obligations to stockholders, or by the natural bureaucratic delay of governments. For example, the Coalition was about to use foundation funds three years ago to convene in Gary, Indiana a midwestern conference on crime and criminal justice reform. This conference brought together in working sessions mayors, police chiefs, magistrates and corrections officials and community leaders from medium-sized cities in the region to seek answers to problems that the participants had identified as

critical prior to the meeting itself. Though LEAA had agreed to be a co-sponsor and though the agency did assist later with a followup session in Washington in which recommendations from the Conference were presented to the Attorney General and other Justice Department officials for action, it proved impossible to free up the Federal share of the initial funding in time for the conference itself. In another instance, it was foundation support which made it possible for the Coalition and others to do the early analysis of the inequities in public school financing and the laying out of alternatives which might assure that states would provide increased educational resources for low income urban and rural children.

Lacking some of the constraints faced by government and business, foundations can be—and many of them are—flexible, innovative and experimental, dealing with issues that cannot be readily touched by other agencies.

Foundations are more likely than government to pioneer new fields of public policy and take certain long-term gambles.

For example, foundations were active in the family planning field at least twenty years before government was, and their pioneering work laid the way for ultimate government involvement. The same could be said of other advances in health and medicine. The support by the Ford and Rockefeller foundations of the effort to produce higher-yield food grains to meet international food shortages, occurred during the years when the U.S. government was focusing on limiting food production and disposing of surplus food and had little interest in increasing food productivity of other countries. Now that the world is experiencing a food crisis, there are amazing new grains available, thanks to the efforts supported by those foundations. It was the support of foundations, too, which sparked investigation and revelation of the nature and extent of hunger in America.

Anecdotal critics to the contrary notwithstanding, it was certain foundations that helped spare this nation even more destructive race and class relations than we have experienced; provided higher education and special training and leadership opportunities for certain segments of the population that would otherwise have been denied—with great loss to the country; which supported American art and culture at a time when our government was almost totally uninvolved, and when the governments of other nations were providing such support as a matter of course.

Let me state my firm belief that, despite some mistakes or failures, certain foundations have laid the groundwork for sounder social policy and have helped offset, in some measure, the feeling of some elements in our society that government is inimical to their interests, or inaccessible. I maintain that—considering our often relatively dismal showing when the level of political participation by our citizenry is compared to that of other modern democratic nations—foundation-supported efforts at voter registration and voter education have, on balance, made our politics a little more representative and more broadly responsive. The current public majority opinion in favor of Federal support of political campaigns, like earlier indications of public sentiment for simplified access to the ballot and for opportunities to run for office, reflect something more than reaction to current allegations of campaign abuses.

And on another front, there is now at least the possibility that the Congress and the Executive Branch may ultimately move to genuine reform of the present greviously inadequate budget process. This development rests in part on the foundation-supported efforts of the Coalition and others to throw light on the need to better understand and to reform that process. More people are beginning to see the existing and potential significance of the Federal Budget as a more responsible and effective means of setting national priorities than it is now.

I would be the first to say that not all foundations have played what I consider to be the kinds of basically-useful roles in the public interest which I have tried to sketch. Too many foundations have in the past spent too little of their money, and in this regard the Tax Act of 1969 performed a useful function. That legislation also caused many foundations to open up their operations, and join those foundations which were already providing a public accounting of their activities. To the degree that foundations have been used as tax dodgers, I'm certain that the current legislation makes that much less possible.

On the other hand, I find it very hard to believe that foundations represent any substantial threat as a mean employed by the rich "to use their economic power to change our society." I have read that what foundations give, amounts

to less than two-tenths of one percent of the Gross National Product and that their total worth represents two percent of the GNP. To my knowledge, few foundations have ever pooled their relatively modest resources to "change society" either in the radically Left direction critics usually suggest, or in radically Right directions for that matter. The exceptions, I think, can be dealt with without straitjacketing everybody. Really fundamental tax reform would have targets other than foundations.

The faults I would find with foundations may not be the ones which others, differently situated, will see. Aside from the lamentable fact that not all of them have the wisdom to fund the Coalitions and their good works, or to care as much as we'd like them to about urban problems, many of them share with government the tendency to embark for a short while on supporting a possible answer to a serious problem, only to abandon ship before the program or approach has had sufficient time to prove itself out.

Many corporations plan and implement three to five to ten years ahead. But most foundations and governments are very often tied to testing one-year solutions to problems decades in the making and resistant to twelve-month miracles. On the other hand, foundations certainly should wrestle harder with the problem of evaluating, within reasonable limits and without snatching open the oven doors every minute or so, what they intended to accomplish with their money and how it all seems to be working out. But this is not an exercise, it seems to me, which requires further Federal legislation.

On the question of limiting the life of a foundation I think it would be useful for the Committee to weigh the pros and cons of this argument, as there is some substance on both sides.

Factors supporting arguments to limit foundations' lives to 25 or 50 years include:

It would keep foundations from perpetually controlling the funds that some critics view as potentially sinister. (Viewed in the overall context of our trillion-dollar annual economy, the total assets of all foundations, which is less than $30 billion, could obviously not be a controlling factor.)

It would discourage foundations from investing large amounts of money in impressive buildings for themselves. (Actually, only a handful of the 20,000 foundations have the funds for erecting such buildings anyway, and several of these operate in rented quarters.)

Arguments favoring the perpetuity of foundations are:

It takes time to train and season good executives who with the least amount of funds can get the best results by knowingly examining proposals and following-up on the programs of the ones which are funded.

Even if a foundation keeps its name and endowment, its control and management change because of mortality, new board members, changing priorities. Some foundations have deliberately decided to set limits on their durations, some have not. It does not seem to me a pressing priority for further legislation.

I am one of those who feel that an unfortunate consequence of the most recent existing legislation, the 1969 Tax Act, has been an increase in uncertainty and caution among a great many foundations. Rather than having to do this, I would much rather see them inclined to take on only the safest and least controversial areas of concern. Meanwhile, minorities and others who see themselves as relatively powerless and cut off—as others are not—from any real opportunity to be heard on matters of public policy are understandably skeptical about some aspects of the Act and proposals to further tighten governmental oversight and control. They see a worsening of their relative disadvantage when it comes to understanding and exerting some influence on public actions which may help or hurt them.

I think most of them would agree with me that, on balance, the wiser and juster course would be to encourage, not restrict, foundations in supporting the programs and activities that are designed to bring about a more diverse, open and healthy American society.

Finally, now that the Senate, through this Subcommittee is seriously considering the value and role of foundations, I would respectfully suggest that great care should be taken to secure the broadest and most balanced range of advice. I feel sure that you would agree that this is an area in which sound policy cannot be made by giving undue weight either to the horrible examples or the celestial exceptions. I raise this, not because I feel that the Committee is now inclined to proceed in this direction, but some of us are aware of a disturbing

tendency in some quarters to over-react to isolated errors which have been exaggerated to the point of obscuring the customary practices and policies of foundations involved and of the majority of all American foundations.

I am sure you would agree that the balance between the functions and usefulness of public and private institutions in our society is delicate and still imperfectly understood by all of us. It is possible either to recommend further sweeping changes which might shift that private-public balance in ways which might produce unforeseen trauma, or to move more deliberately to assess and act on what has been learned in the aftermath of the 1969 Tax Act. I would respectfully urge the latter course.

I would be happy to respond to any questions you might have.

SUPPLEMENTARY QUESTIONS SUBMITTED TO MERRIMON CUNINGGIM

Question 1. Do you share the view of some foundation critics that the only worthwhile foundation is one which concentrates on innovative programs?

Answer. No. Nor do I know any reputable "foundation critics" who take such a position. Imagine trying to sustain this position for some other type of nonprofit, public-service organization—that, say, the "only worthwhile" college is one that "concentrates on innovative programs." We have now, and we *ought* to have, assorted types of both colleges and foundations.

Question 2. If foundations are basically created and supported by the wealthy, is it possible that the image of organizations concerned with preserving the status quo is more descriptive of foundations than the image of organizations dedicated to innovation?

Answer. Yes, it's "possible." As I said in my October 1 statement to the Subcommittee, "My own view is that the routine outweighs the daring by a large margin—which is what one would probably have to say about any other type of organization specializing in public service." But "descriptive of more" foundations would be a more accurate way of saying it than "more descriptive."

Question 3. Even if we stipulate that foundations are innovative, are they not the playthings of the wealthy—powerful organizations which allow the wealthy to promote their notion of social change and their ideas for social reform?

Answer. No matter where the emphasis is placed—that foundations on the one hand are "playthings," or on the other are "powerful organizations . . . to promote . . . social change"—it simply is not fair to characterize a whole class of organizatons in such a fashion. The ambivalent nature of the question puts me in mind of the hearings themselves on October 1, in which some observer might well have concluded that foundations are damned if they do and damned if they don't. Contradicting remarks that foundations are nothing but "ladies' aid societies" were other remarks alleging that they are engaged in dangerous or disreputable activities, though there was no agreement as to the brand of subversion they supposedly practiced. One minute they were "a vehicle of the rich," the next they were accused of being "anti-business" and unpatriotic. It reminded me of the language and tone of the 1969 hearings. If one looks hard enough, of course, one can find a few examples of each of these aberrations; but the statement as a whole, whatever "we stipulate," does not fit the facts as a whole.

(I'm tempted to add: "muckraking" critics to the contrary notwithstanding. The adjective, incidentally, comes from the publisher's own estimate of the author, as noted on the jacket of Joseph Goulden's book, *The Money Givers*, from which some of the quotations prepared for Panel No. 2 on October 1 were near-quotes.)

The phrase, "powerful organizations," reminds me of another disappointment in the October 1 hearings, and I think you would want me to share it candidly with you. The Subcommittee's press release last week began with a suggested headline. "Ford, Carnegie, among other financial endowments, testify on tax law. 31,000 U.S. philanthropic entities give away $21-billion annually." But that is the total bill for *all* charity, personal benevolences included: and foundations give away less than one-tenth of that amount per year—as the article itself finally got around to saying in its last paragraph. By that time, however, the damage of suggesting how monstrous foundations are had already been done. The point is, foundations are indeed sometimes frivolous and sometimes powerful, but they are *neither* in the degree attributed to them by loose and ill-informed criticism.

Question 4. In considering the merit or evil of substantial control over foundations by the wealthy individuals and families who have donated substantial portions of their wealth to private philanthropy, should a distinction be drawn between those foundations which support existing institutions and provide the conventional charitable assistance and those foundations which primarily support innovative social reform programs?

Answer. No, such "a distinction" should not be attempted, for it would be both impossible to defend and improperly punitive to one type or the other. Who is to say what is "conventional" and what is "innovative"? Even more to the point, is either of these wrong. Or for that matter, automatically good? What about foundations that do both? If the problem is thought to reside in "the merit or evid of substantial control" by donors, the wise solution, as I indicated in my October 1 statement to the Subcommittee, is for Congress to heed the Treasury Department's Report on Foundations, 1965, in regard to the "broadening of foundation management."

Question 5. Since foundations supporting social action programs in many cases are working in the direction of changing our basic social structure, isn't the need for restrictions on control by wealthy individuals and families much greater than in the case of foundations involved in more conventional charitable giving?"

Answer. No. Here again is the suggestion that "a distinction" could or should be drawn, and I've already commented on that in the preceding question. But there is much else here as well.

For example, "changing our basic social structure": What does this mean? Is there a hint here of the kind of position that Patrick Buchanan took in the Watergate hearings a couple of weeks ago? He charged foundations, and Ford particularly, with engaging in partisan politics, but gave no convincing evidence. Senator Muskie, it seemed, had gone to Japan on some fact-finding delegation, another member of which was Senator Baker—but Buchanan didn't mention that. Nor did he mention that Ford had had no part in choosing the delegation, its only condition being to insist that the project be genuinely non-partisan. These are hit-and-run tactics, and I'm sure you agree with me that such behavior is disreputable. Other than a handful of fly-by-night outfits of the far right and the far left, I don't know any foundations involved in "changing our basic social structure." (Perhaps you'll be interested in the enclosed copy of an editorial on Buchanan and foundations, which appeared in yesterday's St. Louis Post-Dispatch.)

But lots of foundations, of course, are involved in "supporting social action programs," and these will inevitably lead to many changes, though hardly of "our basic social structure." Is change bad? Moreover, even those foundations whose work might be said to be "conventional" are engaging in "social action," inescapably, and are bringing about changes. The whole cut of the question is unfortunate, for it implies premises that no careful analysis could sustain. "Restrictions" on an undue amount of "control" by any one person or group, when that control is to the detriment of the broader public that foundations are meant to serve, are always desirable; but they should not do violence either to our kind of free society in general or to the broad-ranging spirit of philanthropy in particular.

In this connection I'm reminded of a phrase used several times in the hearings on October 1. It was "use tax dollars"; and it occurred in this type of question: "Is it proper to use tax dollars for so-and-so activity?" The answer, coming from some decent person who didn't want to offend the questioner and who was eager to show the legitimacy of the enterprise mentioned, tended to skip over the unexamined premise; but it is important that it not be ignored. A foundation is a legitimate private enterprise, non-profit, serving the public; and its resources are no more "tax dollars," somehow escaping from government use, than are those of museums, hospitals, colleges and churches.

To try to discuss such important issues in short compass is a tease and a frustration. In my October 1 statement I mentioned, quite immodestly, that I've commented on all these matters at much greater length in my book, *Private Money and Public Service*, published this past year by McGraw-Hill; and perhaps you may wish to look at it. I appreciate your courtesy in asking for my point of view, and if I can be of any further help to your Subcommittee in its commendable effort to strengthen the work of philanthropic agencies in America, I hope you will call on me again.

23-812—73——10

[From the St. Louis-Post Dispatch, Wednesday, Oct. 10, 1973]

An Attempted Smear

It now turns out that Patrick J. Buchanan, a top consultant to President Nixon, was only quoting an obscure magazine when he set out to smear the Ford Foundation in testimony before the Senate Watergate Committee last month. In an affidavit received by the committee yesterday, Mitchell Rogovin, attorney for the Institute for Policy Studies and a former chief counsel for the Internal Revenue Service, declared that Mr. Buchanan had made several false statements.

Here is what Mr. Buchanan said, in part, during his insufferably arrogant appearance:

"Well . . . the Ford Foundation, for example, provides funds for the Institute for Policy Studies. The I.P.S. holds, has held, it is my recollection . . . seminars with Congressmen, for staffers and the like, and they deal in trying to influence Congressmen and the like to vote in one direction . . . The I.P.S. has in turn funded the *Quicksilver Times* which . . . is one of the radical, what they call underground newspapers, which has a political point of view which is sold for profit."

Mr. Rogovin said that contrary to Mr. Buchanan the Ford Foundation's only contribution to the I.P.S. was a grant in 1964 of $7,800 for a seminar. He said also the institute had never given funds to the *Quicksilver Times*, a short-lived now defunct publication. When taxed with Mr. Rogovin's affidavit, Mr. Buchanan lamely said he read about Ford and the I.P.S. in a 1969 issue of something called the *Washingtonian*.

Mr. Buchanan's attempted smear of a major philantropic foundation was nothing but a contemptible effort to draw a red herring across the Watergate trail. Sad to say, it is no worse than the country has learned to expect from the White House palace guard.

Supplementary Questions Submitted to Fritz Heimann

Question 1. Do you share the view of some foundation critics that the only worthwhile foundation is one which concentrates on innovative programs?

Answer. As my testimony at the October 1 hearing makes clear, I regard innovation as an important activity for foundations. However, it would be a gross overstatement to say "that the only worthwhile foundation is one which concentrates on innovative programs." Foundations clearly play a very valuable role in supporting the ongoing programs of universities and other institutions.

To me, the key point is that foundations must recognize the difficulty of operating in an environment where Government funding, in practically all areas of foundation activity, is many times greater than the resources available to foundations. Effective foundation work requires intelligent consideration where foundations can make a useful contribution.

I hope that some substantial number of foundations will conduct some "innovative programs". It would be unrealistic to expect the majority of foundations to be innovative. Furthermore, the emphasis on being "innovative" can easily be overdone. This could lead to overly rapid changes of focus from one year's fashionable subject to the next year's. This would undercut one of the distinctive features of foundations, the ability to stay with a long-term project without being subject to the pressures of a year-by-year appropriation process.

In sum, the important thing is that foundations focus on what they can do that other institutions cannot do as well. Being distinctive is much more important than being innovative, although the two will to some degree overlap.

Question 2. If foundations are basically created and supported by the wealthy, is it possible that the image of organizations concerned with preserving the status quo is more descriptive of foundations than the image of organizations dedicated to innovation?

Answer. I do not believe that there is any single valid "image" of foundations. The current public view of foundations may have been shaped in large measure by the publicity given to the activities of some of the more liberal foundations. However, the reality is that foundations are a highly varied lot covering the full range from extreme conservation to extreme liberalism.

Furthermore, any effort to classify foundations in terms of "preserving the status quo" or "dedicated to innovation" is difficult. For example, a foundation with conservative predilections in political or economic matters may well support very innovative programs in delivery of health care or in the treatment of juvenile offenders.

Question 3. Even if we stipulate that foundations are innovative, are they not the playthings of the wealthy—powerful organizations which allow the wealthy to promote their notion of social change and their ideas for social reform?

Answer. I have dealt with this question in my October 1 statement before the Subcommittee. The only point I want to add is that the spectrum of ideas concerning desirable social change favored by the wealthy is likely to be as broad as it is among other groups. I see little reason for concern that foundations will promote any particular ideology.

Question 4. In considering the merit or evil of substantial control over foundations by the wealthy individuals and families who have donated substantial portions of their wealth to private philanthropy, should a distinction be drawn between those foundations which support existing institutions and provide the conventional charitable assistance and those foundations which primarily support innovative social action programs?

Answer. I do not believe that any meaningful line, for regulatory purposes, can be drawn between "support of existing institutions" and "support of innovative social action programs". For example, in which classification would a grant to the Yale Medical School for the study of health care in a black slum fall?

The tax law provisions covering foundation activities are already overly complex. Far too much time is required for tax lawyers to review foundation programs. To establish additional regulatory distinctions, which are difficult to interpret and administer, would be a step in the wrong direction.

Question 5. Since foundations supporting social action programs in many cases are working in the direction of changing our basic social structure, isn't the need for restrictions on control by wealthy individuals and families much greater than in the case of foundations involved in more conventional charitable giving?

Answer. For the reasons indicated in response to the previous question, I do not believe that it is practical or desirable to place different restrictions on foundations depending on the character of their activities.

I recognize that there is concern about possible abuse of the considerable discretion which is and, in my judgment, should be available to foundations. I do not believe that additional legislative or regulatory restrictions represent a desirable response to this concern. The underlying issue is whether we are willing to accept the risk that some foundation activities of an "innovative" or "social action" character are going to be poorly conceived or even mischievous. Is that risk worth taking when compared to the likelihood that other innovative programs may produce some uniquely beneficial results?

I would be inclined to take the risk. A real problem with innovative programs, whether conducted by foundations, by corporations, or by Government agencies, is that it is often impossible to screen out the good and the bad ideas in advance. A certain amount of experimental activity is therefore necessary. Particularly during a period when our established institutions are being challenged in many ways, foundations have a unique potential for engaging in such activities and the danger of abuses, in my judgment, is relatively limited. The most that foundations can do is to provide funding for some limited experiments. The ultimate decision whether the innovations sponsored by foundations will be accepted on any broad sale will be made by our political institutions.

I appreciate the oportunity to participate in your inquiry of this important subject and hope that my responses are helpful to you.

Senator HARTKE. We are going to have to go vote and I am going to excuse you because you have been here for a long day. If we have any more comments we will resume the hearing tomorrow.

[Whereupon, at 4:10 p.m., the hearing was adjourned until 10 a.m. the following day.]

PRIVATE FOUNDATIONS

TUESDAY, OCTOBER 2, 1973

U.S. SENATE,
SUBCOMMITTEE ON FOUNDATIONS
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 9:40 a.m. in room 2221, Dirksen Office Building, Washington, D.C. Senator Vance Hartke (chairman of the subcommittee) presiding.

Present: Senators Hartke, Curtis, and Fannin.

Senator HARTKE. The committee will come to order.

Today we begin the second in this series of panel discussions on the issue concerning foundations in the United States. Yesterday I pointed out to the panel that they should hopefully try to address themselves to the underlying philosophy which directs foundations because, without some type of agreement on philosophy or at least an understanding of the nature of it, discussion of what foundations are doing and what they are not doing, becomes meaningless.

Today we will focus on the impact of the 1969 Tax Act on foundations and on the regulation of foundations in other countries.

The hearing record will remain open to receive additional material from members of the subcommittee, partcipants and the panel for no more than 2 weeks.

I have asked repeatedly, and I hope you can accommodate us in this, to make your oral presentations cover the substance of your statement, the entire statement will appear in the record for the purposes of the hearing, and you do make it possible in a way for everyone to receive a little bit more understanding and give time for things which sometimes the committee would rather get into.

Now, we will proceed and this panel we have this morning is an illustrious one: Howard Dressner, secretary and general counsel of the Ford Foundation: Russell Mawby, president of Kellogg Foundation; John Holt Myers, member of Washington law firm, Williams, Myers & Quiggle: John Simon, professor at Yale Law School and president of the Taconic Foundation; Malcolm Stein, lawyer from New York: George Webster, member of Washington law firm of Webster & Kilcullen.

Gentlemen, the committee is ready to receive your testimony.

STATEMENT OF HOWARD DRESSNER, SECRETARY AND GENERAL COUNSEL OF THE FORD FOUNDATION

Mr. DRESSNER. Mr. Chairman. I am Howard Dressner, secretary and general counsel of the Ford Foundation and I want to thank you for

this opportunity to participate in this hearing of the Subcommittee on Foundations.

Senator HARTKE. Let me say to you, the Ford Foundation—you are the secretary?

Mr. DRESSNER. Secretary and general counsel of the Ford Foundation.

Senator HARTKE. Well, now, we had some other hearings here in the Senate called the Watergate hearings in which the Ford Foundation was singled out for being somewhat prejudiced in its viewpoint by Mr. Buchanan.

I wonder if you would address yourself to that first?

Mr. DRESSNER. You mean before addressing myself to the question of the effects of the Tax Reform Act?

Senator HARTKE. Yes.

Mr. DRESSNER. Mr. Chairman, would there be some specific point that you would like me to address?

Senator HARTKE. If you didn't see any specific point in the Buchanan statement, then I don't see any specific point in it.

I would think you would be concerned about it.

Mr. DRESSNER. Very much concerned.

Senator HARTKE. I am rather shocked.

I thought it was a rather severe accusation. If it is true, why then the committee has much more work in front of it than I even thought.

Mr. DRESSNER. I do not think the accusations in many cases in the Buchanan testimony, Senator Hartke, were true and indeed after Mr. Buchanan had stated that the Ford Foundation had engaged in partisan politics, within moments after we had observed that testimony, which we watched with as much interest as many millions of other Americans, we issued a categorical denial that we had engaged in partisan politics in any way whatsoever.

I think the brunt of that charge by Mr. Buchanan was somehow that the Ford Foundation was a Democratic foundation, with a capital "D," and I would like to say for the record here, Senator, the Ford Foundation is neither a Democratic foundation nor a Republican foundation, and we do not believe, in response to your question about philosophy, that foundations should be Democratic or Republican in that sense.

We fully support a point that has been in the laws of the country for years and was even more emphasized in the Tax Reform Act of 1969, that foundations should not be engaged in partisan politics, should not use their funds to support the candidates of one party or another, and indeed our programs are directed not to such support but to pressing social problems in the country. Philosophically, I think one could say that the Ford Foundation philosophy is best expressed in its own charter in existence since 1936, and that is to advance the public welfare.

All of our funds are to be spent for that purpose and certainly not for the purpose of particular party goals or particular partisan party programs, and in that respect we, of course, would take complete issue with the charge that somehow the Ford Foundation has alined itself with any party.

Indeed I want to add one other point. I have been with the Ford Foundation now for nearly 10 years. We have had comments about our programs from members of both great political parties in the country, some, I am proud to say, commendatory, some critical, but they have not gone to the question, during all of these years that I have been there, as to why we did or did not support this particular part of a party platform.

Senator HARTKE. All right, sir.

Mr. DRESSNER. Shall I return now to the——

Senator HARTKE. Proceed any way you want to.

Mr. DRESSNER. My duties, Senator Hartke, as secretary and general counsel of the Ford Foundation include legal and administrative oversight of all parts of our grantmaking process, and this means, among other things, assuring the Ford Foundation's compliance with the Internal Revenue Code, counseling of program staff in the formulation of relevant internal guidelines and procedures, responding to questions that arise under the 1969 legislation, and verifying the tax status and classification of prospective grantees.

Your subcommittee had asked this particular panel, as you pointed out a few minutes ago, to address itself to the effects of the Tax Reform Act on foundations, and in accordance with the instructions that our panel received from the subcommittee I would confine my own brief opening statement to the effects of that part of the act containing what have come to be known informally as program restrictions.

And during the panel discussion I shall certainly be glad to respond to any and all questions that you may have.

Mr. Chairman, we welcome this hearing as an opportunity to advance understanding of the practical effects of the Tax Reform Act. It is right and proper in our belief that committees like yours should seriously and closely examine the work we are privileged under the law to do.

Since the adoption of this important legislation we at the Ford Foundation have devoted substantial time and energy to understanding and implementing the provisions that pertain to our work.

We have held frequent staff meetings and have worked closely with our grantees on the applicable provisions.

We have prepared internal procedures to insure our full compliance Mr. Chairman, in letter and in spirit under the directions of our board and our president, full compliance with the legislation and the Treasury regulations.

We have discussed the effects of the act on our work in our comprehensive annual reports, all of which are available to the committee and we would be glad to put into the record of this hearing.

We have discussed these effects in testimony before other committees of Congress and in other forums.

Most important, Mr. Chairman, we believe that continuing review of this legislation, of which these hearings are an excellent example, is wise and important.

We share your desire to make sure that the legislation is safeguarding and promoting the public interest.

We believe that the tax provisions you passed in 1969 relating to charity are intended to encourage the charitable tradition of American society as it is carried forward by individual citizens and by such philanthropies as foundations, hospitals, colleges, and universities.

In our view the Tax Reform Act is working and it is working well. We believe that it is helping to preserve and encourage the purposes and the best traditions of American philanthropy.

The main program restrictions you have asked us to address relate to the work of private foundations, first, with respect to attempts to influence legislation; second, with regard to grants individuals, and third, the concept of expenditures responsibility for grants to organizations other than those that are publicly supported.

In the effort to expedite the hearings and the time, let me say just a few words, Mr. Chairman, about each of those three main aspects.

First, attempts to influence legislation.

The act prohibits foundations from attempting to influence legislation. However, it explicitly permits and thereby we believe on the basis of the hearings in which we participated, implicitly encourages foundations to support nonpartisan—I stress that in light of your opening question—nonpartisan analysis, study, or research on issues that are or may become the subject of legislation or other Government action.

We were pleased that the Congress specifically recognized such work as well within the scope of the legitimate philanthropic activity. We believe research and analysis supported by private foundations has contributed importantly to the discussion and the understanding of significant public issues.

Much of the work we support, Mr. Chairman, and members of the committee, has been done in the universities of our country. Such studies have frequently been employed by Congress, other branches of Government, and the public as they consider and wrestle with matters of public interest.

We believe firmly that the ideal of an open society which thrives on a diversity of views, public, private, is embodied in the act's provisions which permit foundation-supported studies and analysis regardless of the subject of major problems.

But while it is clear to us that the Congress has shown its understanding and the approval of this function of private foundations, as written in law, it seems to me to be less clear—as I believe it seems to you and as we listened to yesterday's exchanges—it seems to be less clear that the public at large is aware of the nonpartisan role of foundations along with many other American institutions in the marketplace of ideas.

Having demonstrated its awareness of that role and expressed itself in legislation, the Congress is in a position, we believe, to add to such understanding generally.

The establishment of this subcommittee and the holding of these hearings are certainly steps in the right direction. We believe these hearings will result in a wider awareness of the role of philanthropy and the study and discussion of public issues and we were especially pleased when you pointed out yesterday that you hoped there will be continuing exchanges of this kind because if we have not made our-

selves clear to the Congress and the public, Mr. Chairman, that is not your fault, that is our fault, and we intend to keep doing better in this regard until we are understood, because we believe when we are understood we will be fully respected and private philanthropy will be even more encouraged than it has been over the years past.

Insofar as the Ford Foundation is concerned—a not inconspicuous foundation in American society, as others have pointed out—we carefully scrutinize grants for such research, nonpartisan research, to assure ourselves that they fall wholly within the activities permitted by the act passed by Congress and the regulations that have been issued under that act.

Happily, from our point of view, and I believe from yours, the act permits foundations to support study and discussion of a wide variety of the kinds of issues that you talked about yesterday, issues of deep public concern, and this the Ford Foundation continues to do.

Thus we have in the last 4 years laid on the open record extensive annual reports; we have contributed millions of dollars for research on drug abuse, research on crime, the criminal justice system, research on environment, research in the area of arms control and disarmament, research in population policy, and other matters affecting the well being of the American people, all subjects of major significance to the citizens of our country, and we hope that foundations will not shy away from the support of activities related to real issues that may indeed at some time or another become the subject of legislative action, not shy away either in the mistaken impression that such support is not permissible or in the interest of playing it safe. If they do so, we believe they would be abandoning a constructive means of furthering public knowledge and understanding.

A word about grants to individuals and other major sections of the program restrictions.

Assistance to individuals has a long and honored place in the history of American philanthropy. Scholarships. fellowships. other forms of encouragement to individual scientists, artists, scholars, and others have yielded great benefits to our society in all fields of endeavor.

Congress recognized this in the Tax Reform Act, but in order to prevent abuses, and we shared that point of view and supported it, and in order to insure objectivity and nondiscrimination in this area, the act and the regulations have established a new procedural framework for such grants to individuals.

To comply with those proceedings requires a substantial amount of administrative work and it imposes additional requirements on the recipient of such grants.

The additional workload can be handled by a foundation that has a full-time legal staff, notwithstanding the cost, and they are considerable, but the weight and complexity of the provisions have led some foundations, I understand, to reduce the number of grants to individuals and in a few instances it may be that foundations have stopped individual grantmaking altogether. If that is so. it is regrettable.

Earlier this year, in a talk I had an opportunity to present to the Association of the Bar of the City of New York, I urged that foundations review their understanding of the act's provisions on grants to individuals because I believe that the difficulties, while they are formidable, are not insurmountable. Although the costs and complexity

of doing so have increased, I am pleased to report to this subcommittee that the Ford Foundation continues to make grants to individuals under the provisions of the law and the regulation, and at the same time I can understand the reluctance of some foundations to do that, in light of the administrative requirements, and again it is our hope that these hearings will help to clarify what we perceive as the act's intent to preserve this important part of philanthropy.

A word or two finally, Mr. Chairman, on expenditure responsibility.

A grantor foundation must exercise, as you know, expenditure responsibility with respect to grants to organizations which are not under the act's technical provisions publicly supported.

In abbreviated terms, expenditure responsibility means that we must establish and follow fairly complex procedures to assure that grant is spent for charitable and educational purposes for which it is made.

A foundation must obtain complete reports from the grantee on how funds are spent and it must make full reports to the IRS with respect to such expenditures. In most cases where expenditure responsibility must be exercised the requirements are perfectly reasonable, but I would hope we could make one small suggestion simply for possible consideration by the committee.

It may be that where grants are small in amount the expenditure responsibility requirements impose a relatively large administrative cost, particularly on smaller foundations, and you might wish to consider over time the possibility of having a specified level below which expenditures responsibility in all of its technical forms would not have to be exercised.

Just one other difficulty that I would mention with respect to provisions that are related to expenditure responsibility.

You will recall that under the new definitions in the act, the provisions create an arbitrary and somewhat, we believe, harmful distinction among charitable institutions. In some cases the result has been the reclassification as private foundations of organizations whose activities consist entirely of study and research and not at all the kinds of activities that the Ford Foundation and other foundations are engaged in, namely, grantmaking.

This reclassification has had, we believe, some serious financial and possibly program effects on organizations so classified because some foundations have chosen to avoid the burden of expenditures responsibility altogether simply by eliminating that class from consideration as possible grantees.

Our own experience is that it is worth the effort of assuming expenditure responsibility, particularly for new organizations that have new ideas to meet changing priorities, Mr. Chairman, and who need in the beginning the support of one or two foundations in order just to get a start on the problems in drugs or in police enforcement and other problems in the cities; yet the net effect of all of this is to penalize charitable organizations that need funds badly, and for this reason we believe the Congress may wish at some point to study the practical consequences of the classification provisions.

I conclude with two very brief observations which I believe I can make in less than a minute.

One, you have heard, of course, from many of us on the various panels, and that is that if it is possible to reduce the excise tax so as to meet the costs of auditing and permit the remainder of those funds to be used to further the charitable and educational purposes that we are all trying our best to further, we believe that this would be a welcomed change in the law.

In conclusion, Mr. Chairman, I want to say that I believe that the Tax Reform Act has not only provided very useful rules and guidelines for private philanthropy—and this may be the most important thing of all—it has led, Mr. Chairman, to a fuller, a more critical and, I believe on the whole constructive self-examination on our part.

We have looked at ourselves more closely than we ever have before and the kind of incisive and penetrating questions that are put to us in hearings of this kind make us think that much harder about our mission and our purpose and in your terms our underlying philosophy.

I am pleased that your committee has provided me with this opportunity to make these several observations.

Senator HARTKE. Thank you.

[Mr. Dressner's prepared statement and his response to questions submitted, follows:]

SUPPLEMENTARY QUESTIONS SUBMITTED TO HOWARD DRESSNER

DEAR SENATOR HARTKE: Thank you for your letter of October 3, 1973, requesting my answers to six questions relating to the activities of private foundations. I am pleased to respond.

Let me first comment briefly on a fundamental point underlying the first five questions. Their common theme is the extent to which the additional requirements of the Tax Reform Act of 1969 may have adversely affected the grant-making programs of private foundations.

The additional statutory requirements have been burdensome for all foundations irrespective of the administrative resources at their disposal. Large foundations, including the Ford Foundation, have been able to carry the additional burdens by employing additional personnel and turning to outside counsel when necessary, but they have done so at a cost—a cost paid ultimately by reducing charitable activities. Many smaller foundations, I understand, have simply curtailed or abandoned certain of their grant-making activities because of their inability to cope with the added procedures under the Act.

If that is the case, it is regrettable. Small and medium-size foundations play vital roles in advancing educational, charitable, and scientific objectives. Together with large foundations, they provide important sources of private initiative at state and local levels, and their impact on problems of national importance is often significantly greater than their financial resoures might suggest.

Now let me turn to the several specific questions you have asked.

Question 1. If the current law discourages grants to individuals by foundations, what can Congress do to encourage responsible grants to individuals?

Answer. The Tax Reform Act does not bar grants to individuals; it does impose new and burdensome administrative requirements. As I indicated in my testimony before your Subcommittee, the additional workload can be handled by a large foundation with a full-time legal and accounting staff, but I believe the current law discourages medium- and small-size foundations with limited staff resources from making grants to individuals.

The portions of the Act relating to grants to individuals were intended to eliminate favoritism and discrimination in making awards—not to curtail them or even limit their use. I believe Congress should reassess the relevant provisions of the Act to determine whether the administrative burdens might be eased without sacrificing the safeguards against abuses. Here are two specific proposals you may wish to consider:

First, instead of requiring formal submission of individual grant procedures to the Secretary of the Treasury, permit foundations to adopt in good faith

their own procedures to insure fairness in making awards. Such procedures would of course be subject to periodic IRS audit. For some time following passage of the Tax Reform Act, temporary Regulations did permit foundations to adopt individual grant procedures without formal submission to the Treasury, and there is no evidence that foundations abused this privilege.

Second, exempt from the requirements governing grants to individuals the smaller awards made exclusively for travel and reasonable out-of-pocket living expenses in connection with attendance at educational or similar conferences. (Grants involving honoraria or compensation, irrespective of amount, would not be excluded from the standing requirements.) I very much doubt that Congress ever intended to cover grants of this sort.

Equally important, a Congressional expression of the value of foundation assistance to individuals should help to restore public confidence in this form of charitable giving. Such an expression might be included in the Subcommittee's report.

Question 2. To what extent have the "expenditure responsibility" provisions of the Tax Act encouraged foundations to avoid grants to organizations which do not qualify as public charities?

Answer. I do not believe that the "expenditure responsibility" provisions of the Act have curtailed the grants of the Ford Foundation to such organizations; I understand this is also true for other large foundations with relatively large professional staffs. However, my experience at foundation meetings and conferences leads me to believe that many smaller foundations have been discouraged from making grants to such organizations by the complex procedures now required (1) to assure that such grants are spent for the purposes for which made, (2) to obtain detailed reports from the grantees on how funds are spent, and (3) to make detailed reports to the IRS with respect to such expenditures. Indeed, for many small foundations whose grants are typically small in amount, the large administrative costs entailed in meeting the "expenditure responsibility" requirements have forced them to abandon grants to such organizations altogether.

Question 3. How many organizations are now awaiting Internal Revenue Service determinations as public charities? If there is a backlog, doesn't this backlog encourage foundation grant delays for fear that, if the recipient is not a public charity, the foundation will have to impose expenditure responsibility?

Answer. I do not know how many organizations are now awaiting IRS determination as public charities. However, I gather from the delays often encountered by prospective grantee organizations of the Ford Foundation that have applied for such determination that the number may be substantial.

When a prospective Ford Foundation grantee encounters such a delay, our practice is to proceed with the grant by assuming and exercising "expenditure responsibility" until the organization receives an IRS determination as a public charity. For the reasons I have indicated above, however, many small and medium-size foundations are unable to assume "expenditure responsibility" even on a temporary or provisional basis; they have no alternative but to defer action on the grant. Thus, assuming there is a backlog, I agree that it would undoubtedly lead to delays in grant action by foundations.

Question 4. What burdens does the "expenditure responsibility" requirements place on both foundations and recipient organizations? Are these burdens unnecessarily cumbersome?

Answer. The Regulations impose a considerable number of requirements, including pre-grant inquiries and detailed reports, on both donor and donee in the case of "expenditure responsibility" grants. Each requirement adds to the volume of paperwork. While there is no question that foundations should make certain their funds are expended for charitable purposes, there is a serious question as to how extensively the monitoring process needs to be documented on paper.

As I have indicated earlier, how burdensome the new procedures are depends to some extent on the staff and financial resources available to a foundation. For most foundations, the introduction of "expenditure responsibility" constitutes a major departure from past practices and places major new demands on limited staff resources. For all foundations, the added paperwork alone is time-consuming, distracting, and costly.

In my statement to the Subcommittee, I suggested that the burdens of "expenditure responsibility" are unnecessarily cumbersome in one particular in-

stance. For small grants, "expenditure responsibility" imposes a relatively large administrative cost upon both the grantor and the grantee to carry out the reporting and accounting requirements. Therefore, for grants paid to any one grantee organization during any one taxable year which do not exceed a specified level, the grantor foundation should be excused from exercising "expenditure responsibility" provided, of course, that the grantee organization is organized and operated as a charitable organization.

Question 5. Should not expenditure responsibility cover all foundation grants to assure that the grant is used for the intended purpose?

Answer. Extension of "expenditure responsibility" to cover all grants would impose major hardships on foundations, many of which already find it difficult to meet such requirements for only part of their grant-making activities. Given the existing state and Federal controls and monitoring procedures over all charitable organizations, including publicly-supported charities, expanded "expenditure responsibility" coverage is unnecessary. To add additional costs and administrative burdens to foundation operations would in my view be wasteful and further reduce amounts available to charity.

Question 6. It is inevitable that many areas of foundation activity will touch upon legislative issues because practically every area of significant foundation activity is one in which some level of government is also active. Does it make sense to require that foundation studies of such subjects always present a full and fair exposition of the facts on both sides even though the legislative issue is not the primary concern of the study and there is no intention to attempt to influence any legislation?

Answer. Foundations have traditionally played an important role in supporting the study and discussion of a wide variety of issues that are also of concern to government. In recent years, for example, the Ford Foundation has contributed millions of dollars for research on drug abuse, crime, environmental and energy issues, arms control and disarmament, population policy, and a host of other matters affecting the well-being of the American people. The subjects of this research were, or subsequently became, the subjects of governmental attention at the federal, state, or local level.

This foundation activity follows the long tradition in our society of encouraging individuals in all walks of life and private organizations to become involved with social problems and to work toward constructive solutions. This subject was considered at length by the Congress in drafting the Tax Reform Act of 1969, and the Act reaffirms its importance.

Foundations, of course, have commensurate responsibilities. One is to assure that the results of foundation-supported research on issues of public concern are non-partisan. Another is to assure that foundation-supported studies provide a full and balanced exposition of the facts and represent all sides of an issue fairly.

In this regard, Treasury Regulations in effect for many years prior to the 1969 Act have provided that an organization may be educational "*even though it advocates a particular position or viewpoint* so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion. . . ." (Emphasis supplied.) The same point was reaffirmed in the Regulations issued as a result of the 1969 Act.

The principle expressed in these Regulations strikes me as right and proper; I strongly believe that private foundations should follow that principle whenever they address public-policy issues. But I think it would be a mistake to impose further legislative or administrative constraints and requirements in this area. They are not necessary because foundations are aware that their viewpoints on serious issues will be quickly dismissed if they are not accompanied by a "full and fair exposition of the pertinent facts."

Statement of Howard R. Dressner, Secretary and General Counsel, Ford Foundation

SUMMARY

1. Continuing review of the *practical effects* of the Tax Reform Act of 1969 on private foundations, of which these hearings are an example, is important. It is also important that foundations review their own activities and that the Congress be fully informed.

2. In general, the Tax Reform Act of 1969 has helped preserve and encourage the purposes and best traditions of philanthropy.

3. Three main restrictions of the Act relating to foundation programming are:

(*a*) *Influencing legislation*

(i) The Act specifically recognizes that objective nonpartisan study and research is well within the scope of legitimate philanthropic activity regardless of its subject matter.

(ii) These hearings can help make the public more aware of the legitimate role of foundations in supporting nonpartisan objective studies on significant public issues.

(*b*) *Grants to individuals*

Although the Act has imposed greater administrative requirements, foundations should not abandon the time-honored philanthropic practice of assisting talented individuals.

(*c*) *Expenditure responsibility*

(i) In cases where grants are small the expenditure responsibility requirements impose relatively large costs on both grantor and grantee. Perhaps expenditure responsibility could be waived for small grants.

(ii) Congress may also wish to reexamine the practical effects of classifying non-grant-making charitable organizations as "private foundations".

4. The Tax Reform Act has not only provided useful rules but has led to constructive self-examination by foundations. Hopefully it will lead to increased understanding of how foundations operate by the Congress and the public.

STATEMENT

I am pleased to respond to the request of the Chairman of the Subcommittee to participate in this hearing.

My name is Howard Dressner. As Secretary and General Counsel of the Ford Foundation, my duties include legal and administrative oversight of the grant-making process; among other tasks, assuring the Foundation's compliance with the Internal Revenue Code, counseling our program staff in the formulation of relevant guidelines and procedures, responding to questions that arise under the 1969 legislation, and verifying the tax status and classification of prospective grantees.

I will confine this opening statement to the effects of that part of the Act containing what have come to be known informally as "program restrictions" on private foundations. During the panel discussion I shall of course be glad to respond to questions.

At the outset, let me say that we welcome this hearing as a further opportunity to advance understanding of the practical effects of the Tax Reform Act of 1969. Since the adoption of this important, complex, and—for the philanthropic community, far-reaching—legislation, we at the Ford Foundation have devoted substantial time and energy to understanding and implementing the provisions that pertain to our work. We have held frequent staff meetings and have worked closely with our grantees on the applicable provisions. We have prepared internal procedures to ensure our full compliance with the legislation and the Treasury Regulations. We have discussed the effects of the Act on our work in our Annual Reports, in testimony before other committees of Congress, and in other forums. Further, we believe that continuing review of the legislation, of which these hearings are an example, is wise and important so that all of us may be sure it is achieving its goal of safeguarding and promoting the public interest.

We believe that tax provisions relating to charity are intended to encourage the charitable tradition of American society, as it is carried forward by individual citizens and by such institutionalized philanthropy as foundations, hospitals, colleges and universities, and voluntary associations. In our view, the Tax Reform Act has, on the whole, worked well. We believe it helps to preserve and encourage the purposes and the best traditions of American philanthropy.

The main program restrictions in the Act relating to the work of private foundations concern:

(a) Attempts to influence legislation;

(b) Grants to individuals; and

(c) "Expenditure responsibility" for foundation grants to organizations other than publicly-supported charities.

(a) Attempts to influence legislation

The Act prohibits foundations from attempts to influence legislation. However, it explicitly permits—and thereby, we believe, implicitly encourages—foundations to support nonpartisan analysis, study, or research on issues that are or may become the subject of legislative or other governmental action. We were pleased that the Congress specifically recognized such work as well within the scope of legitimate philanthropic activity. Research and analysis supported by various private foundations has contributed importantly to the discussion of ideas and the understanding of significant public issues. Such studies have frequently been employed by Congress, other branches of government, and the public in considering matters of public interest. In short, the ideal of an open society, which thrives on the diversity and multiplicity of views, is embodied in the Act's provisions which permit foundation-supported objective study and analysis, regardless of the subject.

While it is clear to us that Congress has shown its understanding and approval of this function of private foundations, it seems to me to be less clear that the public at large is aware of the nonpartisan role of foundations, along with other American institutions, in the marketplace of ideas. Having demonstrated its awareness of that role and expressed itself in legislation, the Congress is in a position to add to such understanding generally. The establishment of this Subcommittee and the holding of these hearings are certainly steps in the right direction. Those of us in the foundation field believe these hearings will result in a wider awareness of the role of philanthropy in the study and discussion of public issues.

Insofar as the Ford Foundation is concerned, we carefully scrutinize grants for such research and to assure ourselves that they fall within the activities permitted by the Act and the Regulations issued under the Act. Happily, the Act permits foundations to support study and discussion of a wide variety of issues, issues of deep public concern, and this the Ford Foundation continues to do. Thus we have in the last four years contributed millions of dollars for research on drug abuse, crime, environmental and energy issues, arms control and disarmament, population policy, and other matters affecting the well-being of the American people—all subjects of major significance to the citizens of our Country. We hope that foundations will not shy away from support of any activity related to issues that may become the subject of legislative action, either in the mistaken impression that such support is not permissible or in the interests of playing it safe. If they do so, they would be abandoning a constructive means of advancing public knowledge and understanding. I hope these hearings will play a part in preventing that kind of retreat on the part of foundations.

(b) Grants to individuals

Assistance to individuals has a long and honored place in the history of American philanthropy. Scholarships, fellowships, and other forms of encouragement to individual scientists, artists, scholars and others have yielded great benefits to society in all fields of endeavor. Congress recognized this in the Tax Reform Act, but in order to ensure objectivity and nondiscrimination in this area, the Act and the Regulations have established a new procedural framework for grants to individuals. To comply with these provisions requires a substantial amount of administrative work by foundations and imposes additional requirements on the recipients of individual grants. The additional workload can be handled by a foundation with full-time legal and accounting staff, notwithstanding the costs. But the weight and complexity of the provisions have led some foundations to reduce the number of grants to individuals, and in a few instances I understand that foundations have stopped individual grant-making altogether. If this is so, it is regrettable. Earlier this year, in a talk to the Association of the Bar of the City of New York, I urged that foundations review their understanding of the Act's provisions on grants to individuals. I believe that the difficulties, while administratively formidable even for large foundations, are not insurmountable. Although the costs and complexity of doing so have increased, I am pleased to report that the Ford Foundation continues to make grants to individuals. At the same time, in light of the administrative requirements, I can understand the reluctance of some foundations to make grants to individuals. It is our hope that these hearings will help to clarify what we perceive as the Act's intent to preserve this important mechanism of philanthropy.

(c) Expenditure Responsibility

Much of what I have said about grants to individuals applies as well as grants to organizations that require foundations to exercise expenditure responsibility. Grantor foundations must exercise "expenditure responsibility" with respect to grants to organizations which are not publicly-supported charities. In abbreviated terms expenditure responsibility means that a grantor foundation must establish and follow fairly complex procedures to assure that a grant is spent for the purposes for which made, must obtain complete reports from the grantee on how funds are spent and must make full reports to the IRS with respect to such expenditures.

In most cases where "expenditure responsibility" must be exercised, the requirements are perfectly reasonable. But in cases where grants are small in amount, expenditure responsibility requirements impose a relatively large administrative cost upon both the grantor and the grantee to carry out the reporting and accounting requirements. We, therefore, believe that for grants paid during any taxable year which do not exceed a specified level the grantor foundation should be excused from exercising expenditure responsibility provided, of course, that the grantee organization is organized and operated as a charitable organization. To prevent misuse of this exemption from expenditure responsibility, all grants made by any one grantor to any one grantee organization during the taxable year should be aggregated.

I want also to mention one other difficulty with the provisions of the Act related to "expenditure responsibility". These provisions have created an arbitrary and somewhat harmful distinction among charitable institutions. In some cases the result has been the reclassification as private foundations of organizations whose activities consist almost entirely of study and research and not the making of grants to other organizations.

This reclassification has had serious financial and consequent program effects on such organizations, because some foundations have chosen to avoid the burden of expenditure responsibility simply by eliminating them from consideration as possible grantees. Our own experience is that it is worth the effort of assuming expenditure responsibility in the interest of assisting these organizations' charitable activities. But some foundations have chosen not to, and given the administrative burdens I have referred to, their reluctance is understandable. Yet the net effect is to penalize charitable organizations that need funds badly. For this reason, we believe the Congress may wish at some point to study the practical consequence of the "classification" provisions of the Act.

I conclude with a brief observation about a provision of the Act outside the category of program restrictions—the four percent "excise tax" imposed by the Act on the income of foundations. As Mr. Bundy, President of the Ford Foundation, stated before a House subcommittee earlier this year ". . . the terms 'audit fee' and 'service charge' far better describe the Congressional interest than the term 'excise tax', and . . . it is desirable to reflect this fact in the law." While there may be legitimate grounds for requiring foundations to cover the costs of proper federal regulation of foundations, the experience of the Internal Revenue Service since the Act went into effect is that the proceeds of the excise tax far exceed the costs of auditing. Since the amounts in excess of need reduce the resources available for grants to charitable activities, we believe there should be a reduction in the excise tax, at least to a level commensurate with the costs of regulation.

In conclusion, I believe the Tax Reform Act has not only provided useful rules and guidelines for private philanthropy but has also led to a fuller, more critical—and constructive—self-examination on the part of the foundations themselves, and I am pleased that your Committee has provided this opportunity for us to say so.

Senator HARTKE. We will proceed with the rest of the panel.

STATEMENT OF JOHN HOLT MYERS, MEMBER OF WASHINGTON LAW FIRM, WILLIAMS, MYERS, & QUIGGLE

Mr. MYERS. Mr. Chairman, my name is Jack Myers, and I am attorney for the Robert Wood Johnson Foundation, outside attorney. I am also attorney for the American Council on Education and many of the major associations of the colleges and universities. In addition I teach

a course on exempt organizations at George Washington University so I appear here in a broader capacity rather than just as the representative of any one foundation.

My task, as assigned, is to discuss the divestiture provisions of the Tax Reform Act of 1969.

As you know, that act provided that foundations, private foundations, would have to rid themselves of excess business holdings. Basically a private foundation is not permitted to hold more than 20 percent of the stock of a business enterprise and that 20 percent includes the holdings of all disqualified persons. In other words, the disqualified persons and the foundations together can hold no more than 20 percent. If an excess business holding occurs by bequest or death, the foundation has only 5 years to get rid of it.

With respect to foundations in existence on the effective date in 1969, there are different and more liberal rules.

Basically a foundation then in existence can continue to hold 25 percent of the stock provided that no more than 50 percent is held between the foundation and the disqualified persons.

Finally, there are some fair and liberal transitional rules which permit foundations which have very large excess business holdings to get rid of them in periods up to 25 years.

The requirements that are imposed by the statute are basically to prevent a foundation from becoming so involved in a business enterprise that it is diverted from its real function as a charitable and educational institution. This is made clear from the legislative history.

With that in mind, we probably should examine whether the statute does really effectively carry out the purposes of Congress.

We first have to admit that there is no real evidence as to the effect of the statute and, frankly, there will not be for some period of time. Every foundation in existence had at least 5 years, within which to make any required divestitures so the first date of any real pressure is 1974. In fact the Treasury and IRS recognized this in the regulations which are only in proposed form, whereas most of the other regulations are final.

However, the other sections of the act, particularly section 4942, which imposes a payout requirement on foundations, has stimulated divestitures by foundations and considerable divestiture. The experience with this does suggest that we have some problems coming up in connection with the divestiture requirements.

One of the first problems I would point out has to do with the definition of "disqualified person." A "disqualified person" is any one of a very broadly defined category of induividuals and entities. Perhaps this is proper in connection with "self dealing" restrictions where the term is first used. The definition as applied to section 4943 may be unfair and too broad and unnecessary to the effectuation of Congress' intent. In section 4943, the presumption is that the disqualified persons and the foundations together are involved in the business. In fact many disqualified persons are not only not acting in concert with the foundation or each other but may well be mutually antagonistic.

This follows from the fact that quite often the founder of the foundation is a substantial contributor who has left part of his stock to the foundation, part of his stock to the descendants who may be in the second or third generation. They are all "disqualified" persons but

they may not give a heck about the foundation. They may even be opposed to the foundation. So they are not in any way acting in concert.

So I suggest, one, that the disqualified person definition is far too broad and requires reconsideration.

Second, I would note that Congress thought that the transition rules, which are fairly liberal, should apply with respect to foundations in existence on the effective date of the statute. These permit periods of up to 25 years within which investiture may occur on the other hand the foundation coming into being by bequest or otherwise has only 5 years to get rid of the stock "excess holdings." For the reasons that I will explain below this may be virtually impossible, particularly where a large interest is concerned. As a consequence I think the transition rules deserve reexamination.

What about the problems of disposition of "excess business holdings," assuring that these holdings do exist? I am satisfied that there will be a number of situations involving both large and small foundations where the foundation will simply not be able to comply with the statute.

In the case of closely held corporations where the foundation has an excess business holding stock, there may be no market whatsoever. The company which would be a logical purchase may not be able to purchase, it may not have funds. More likely the company officers may be antagonistic to and care nothing about the foundation, further the existence of a minority interest does not bother them not in the least.

So there may be very great difficulties of marketability particularly where small companies are concerned.

The same problem may well exist in the case of the very large foundation because, whatever the circumstances, there has to be a market for the fairly large block of stock, and the market may not be equipped to absorb the stock within the period of time set in the statute.

Now, one other factor should be taken into account with respect to a fairly large foundation. I have indicated there may be no market in the case of small foundations, there may be large foundations which have a substantial number of shares of stock which is actually traded on an exchange. However, the stock held by the foundation ordinarily is lettered or unregistered stock. It cannot be sold except under certain circumstances which are governed not only by the Securities and Exchange Act rules but by "Blue Sky" rules in every State. Under those rules, the foundation will be able to sell only a limited number of shares without restriction.

At the present time it can sell some in private transactions to a small number of sophisticated buyers. Actually the SEC has proposed rules which would eliminate that. It can sell a small number of shares proportionately under what is known as SEC rule 144. If the rule is applicable, a foundation, only once every 6 months, may sell the lesser of 1 percent of the outstanding stock or the average weekly sales on the exchanges over a 4-week period.

Again the percentage of stock that can be disposed of in this way is very limited.

In many cases the way to accomplish a substantial fall is by way of registering the sale with the SEC and registration presents some serious problems.

In the first place, as I said above, the market has to be ready to absorb the number of shares which must be disposed of.

In the second place, registration can be made only by and through the company, and the company for good and sufficient reasons, namely, the protection of its other shareholders, may not want to participate in a public or "secondary" offering. In such case the sale cannot be made.

All of these circumstances militate against an easy disposition of assets which the tax law will require.

In connection with all of the above, I would suggest for the consideration of the Congress three proposals, all of which have to do with making the statute flexible. At the very least, I think that under section 4943, the foundation ought to be able to go to the Secretary and prove that a person or entity who is treated as a "disqualified person" is in fact not a disqualified person, and that his or her shares should not be considered in connection with the divesting under section 4943 requirement.

In this connection there is a special problem with respect to purchase of disqualified persons which begins to come into effect only in 1979 because of a grandfather clause.

It is possible, for example, a founder may have created a foundation many years ago. The family may be totally unrelated to the foundation now. However, if the great grandson's wife after 1979 purchases one share of stock in the foundation, (the foundation may not even know of her existence or a trust of which she is a substantial beneficiary purchases one share of stock) an automatic tax is imposed upon the foundation.

I think that this is the sort of situation that could be corrected by some liberalization in the definition of disqualified persons.

Secondly (again this is a matter of the Secretary's discretion). I think the Secretary has to have the power to extend the period of time within which divestiture is required. For the reasons that I tried to outline very briefly, it is obvious that some foundations will be in an untenable position. Even where it is possible for a foundation to force a registration in securities, it may not be able to do it because of the effect on the other shareholders who would be very much damaged if a forced sale resulted in a diminution of the value of the stock on the market.

So I urge that the Secretary have discretion in this regard to extend the period of time.

Finally, I think it is very important in terms of this discussion that Professor Simon is going to continue, that the transition rules similar to those given to foundations existing in 1969 should be adopted in connection with all fundings of foundations after the date. Congress may want to limit this to foundations funded by bequests, but certainly you will want to have such rules in that instance.

Thank you very much.

Senator HARTKE. Thank you.

[Mr. Myers' prepared statement follows:]

STATEMENT OF JOHN HOLT MYERS, WILLIAMS, MYERS AND QUIGGLE

SUMMARY

1. Introduction—TRA requires requires divestiture of "excess business holdings." Purpose of Section 4943 was to eliminate business holdings which diverted foundations from their exempt functions.

2. There is no clear evidence as to the effect of the statute because private foundations have until at least 1974 to comply with the divestiture provisions.

3. Divestitures resulting from pressure of other provisions of the Act, particularly the pay-out provisions under Section 4942, indicate that private foundations may face serious difficulties in attempting to comply with Section 4943 requirements.

a. "Disqualified Persons"—Definitional Problems—Because of application to self-dealing provisions, definition of disqualified persons is very broad. Includes many individuals and entities who are not in sympathy and who do not act in concert with the private foundation. This will force divestiture which does not serve the purpose of the statute.

b. Transition Rules—The transition rules with respect to stock by foundations in existence on the effective date of TRA are complicated but fair. However, they do not apply to funding subsequent to the effective date where the rules require divestiture within a very short period of time.

c. Disposition Problems—The problems of disposing of excess business holding interests are such that private foundations may in ome circumtances find it impossible to comply with the requirements of Section 4943 within the periods set by the statute.

(1) Marketability—Whether the business is small or large, there may in fact be no market for the interest held by the foundation. Even if there is a market, it may not be able to absorb the excess business holdings of the foundation within the period set by the statute.

(2) Restrictions on Sale—Securities Act Rules—In many cases the only reasonable market for the excess business holdings may be the public. In such cases, sale will be governed by the Federal Securities Act as well as local "blue sky" rules. Sale of a limited number of shares may be possible in private transactions not governed by the statute or under Rule 144 if the securities are traded on a national exchange. In other cases, sale will be possible only by registering the securities for sale in a public offering. Even if the condition of the market is such that it is possible to sell enough of the excess business holdings to meet the requirements of Section 4943 within the time set therein, registration may not be possible because it can be accomplished only by and through the company whose cooperation many not be forthcoming for good and sufficient reasons.

4. Conclusions and Recommendations.

a. For the purpose of Section 4943, the foundation should be able to establish that a person or entity identified as a disqualified person is in fact not such.

b. In all events, the Secretary should have the discretion to extend the period of time within which compliance is required for good and sufficient reasons.

c. Transition rules similar to those in effect with respect to holdings of private foundations on the effective date of the TRA should apply with respect to additional funding of new foundations by bequests.

STATEMENT

Introduction

Under Section 4943, as added by the Tax Reform Act of 1969, generally a private foundation and disqualified persons may own between them no more than 20 percent of a business enterprise. When an interest in excess of this limitation is acquired by bequest or gift, the foundation is given five years within which to reduce the holdings to the limit set in the statute. More generous rules apply with respect to foundations in existence on the effective date of the statute (May 26, 1969) or funded under wills extant on that date and unchanged thereafter. Generally, the holdings of such foundations may be 25 percent, provided the holdings of the foundation and disqualified persons do not exceed 50 percent. Finally, with respect to excess business holdings as of May 26, 1969, transition rules permit extended periods up to 25 years within which divestiture may be accomplished.

The requirements of divestiture under Section 4943 have their origin in the concern that a charitable organization's significant investment in a business may cause its managers to "become so interested in making a success of the business, or in meeting competition, that most of their attention and interest (is) devoted to this with the result that what was supposed to be their function, that of carrying on a charitable, educational, etc., activities (is) neglected." (See "General Explanation of Tax Reform Act of 1969", Staff of the Joint Committtee on Internal Revenue Taxation, page 41.) In a sense it was a response to the absence of any

law providing guidance as to "(the) point (at which the) * * * noncharitable purposes (of managing a business become) sufficiently great to disqualify (a) foundation from exempt status." ("General Explanation", *supra*, page 40.) This concern was not confined to the situation where a donor or his family utilizes a foundation to retain control of a family concern, large or small. "Even where such a fundation attains a degree of independence from its major donor, there is a temptation for its managers to divert their interest to the maintenance and improvement of the business and away from their charitable duties." ("General Explanation", *supra*, page 41.)

If we accept Congress's premise, then it is pertinent to examine whether or not Section 4943 effectively prevents the kind of excess business holding which Congress felt was dangerous to the charitable purposes for which a foundation is granted exemption. At the outset, it would be stated that there is little, if any, indication as to the effect of Section 4943. This follows from the fact that there is a period of at least five years, namely, until May 26, 1974, within which foundations may comply with the strictures of the statute if in effect they apply. In addition, there are in the statute a number of transition rules extending the period of compliance in certain circumstances.

The lack of pressure with respect to the effect of Section 4943 is demonstrated by the fact that the regulations under this section were promulgated in proposed form only in January of this year after the regulations with respect to most of the other sections have been adopted.

Other provisions of the statute, particularly Section 4942, which beginning in 1972 imposed upon private foundations a requirement of paying out the greater of its investment income or a fixed percentage of the fair market value of its assets, have exerted considerable pressure on foundations to divest themselves of low-yield assets. In many cases the divestiture is of stock of the nature which may or will be subject to the strictures of Section 4943. Experience with these divestitures suggest that there may well be problems with the implementation of Section 4943 when and as it becomes effective.

Disqualified persons—Definitional problems

It is too early, therefore, to determine to what extent the divestiture requirements effectuate the purpose of Congress. There is some indication however, that the provisions may be so rigid as to work considerable hardship and inequities on foundations which in fact are not in the least involved in the operations of the businesses in which they may have substantial interests. This, in part, flows from the interaction of Section 4943 with the definition of "disqualified persons" under Section 4946, since it is the holdings of both the foundation and the "disqualified persons" which effectively determine the "excess business holding" to be disposed of.

The definition of "disqualified person" had its origin in the outright prohibitions against self-dealing under Section 4941. Thus, understandably the definition of "disqualified person" under Section 4946 is extraordinarily broad. However, its application to the excess business holdings provision results in presumptions of common interest and concerted action which simply are not justified. This is particularly true insofar as the family relationships are concerned. The descendants of a donor to a foundation who share ownership of a business enterprise with that foundation may be and often are totally estranged from the foundation itself. To lump their shares with the foundation's for the purpose of determining whether or not an excess business holding exists can be totally unrealistic and result in a determination that the foundation has excess business holdings. In such case, the correction can only be made by foundation divestiture which for reasons discussed below may not be possible.

The penalty which may be imposed upon the foundation having excess business holdings by reason of purchases by disqualified persons demonstrates the strange results which can flow from the statute. In a foundation, either because of the regular rules or the grandfather clause, is at the limit of its excess business holdings, then the purchase of stock in the company by a disqualified person results in an immediate penalty of 5 percent of the value of the purchase. Assume that the estranged wife of a grandson of the substantial contributor to the foundation is the 35 percent beneficiary of a trust managed by a corporate trustee totally unrelated in any way whatsoever with any of the parties (including the wife). (There are more liberal rules with respect to foundations in existence on May 26, 1969, or funded under wills effective on that date and

unchanged thereafter.) If after May 26, 1979, the trustee purchases as a legitimate investment for the trust a share of stock of the company (and the foundation may not know of the trust or even the wife and the trustee have no knowledge of the restrictions of the Code), then there is an immediate 5 percent penalty imposed upon the foundation in addition to the requirement that it dispose of a share of stock.

However strict the definition of "disqualified persons" for self-dealing purposes, it should be subject to correction on the basis of the realities of the situation in applying Section 4943.

Transition rules

As indicated, the statute includes a number of special transition rules with respect to foundation holdings as of May 26, 1969. Some extend the period of time within which excess business holdings as of that date may be disposed of. Others permit variance from the basic rule that the permitted holdings of any foundation in a business venture must be, when combined with the holdings in the voting stock of disqualified persons, no more than 20 percent. (The holdings of the foundation and disqualified persons together may be 35 percent if the Secretary of the Treasury is satisfied that effective control of the corporation is in individuals or entities which are not disqualified persons.) The transition rules clearly represent an attempt at a generalized statement to cover a number of specific situations which were brought to the attention of the Ways and Means and Finance Committees. As a compromise reached in conference, it is quite remarkable. As a provision of law, it is practically incomprehensible.

Because of the difficulties of disposition outlined below, it would seem that, where a new foundation is created or an old foundation funded with post-May 26, 1969, assets, the extended periods of time of the present transition rules should apply. Under the present law, a foundation would have only five years within which to dispose of such excess business holdings. Although some predeath planning could be made, it seems appropriate to suggest that extended transition rules apply with respect to excess business holdings acquired by bequest.

Disposition of excess business holdings

The problems which have arisen in connection with dispositions encouraged or required by Section 4942 clearly suggests that there may be serious problems ahead for a foundation attempting to comply with the divestiture rules. This may be as true of an interest in a small closely held corporation as in interest in a large company whose securities are traded on a national exchange. The fact is there are almost certain to be circumstances whereunder the foundation will not be able to comply with the divestiture requirements within the period set by the statute.

(a) *Marketability*

There may in fact be no market whatsoever for the securities. In the case of a small closely held corporation whose stock is not listed on any exchange, the only potential market may be the company itself. It is possible that for one reason or another the company may be a disqualified person, in which case a transaction between the company and the foundation could be an act of self-dealing. Assuming that this is not the case or that certain transition rules apply, the company may be financially unabel to purchase the stock. In many cases, the company will be controlled by persons ("disqualified" or not) who are not interested in are antagonistic toward the foundation. If the stock is in fact a minority interest, there may well be no market for its sale.

Even if the corporation is one whose securities are listed on an exchange and even if the foundation's holdings are not restricted as to sale, market conditions may be such that the excess business holdings cannot be disposed of in the period set forth in the statute without seriously depreciating the value of the stock held. The forced sale in this case would work a serious hardship not only on the foundation but on the other stockholders of the company.

(b) *Restrictions on Sale*

Quite often the kind of holding which may be "excess" under Section 4943 is of a block of securities in the company of the foundation's founder which is sub-

ject to restrictions as to sale even though the securities of the company are traded regularly on a national exchange. This is especially true of a number of relatively large foundations.

Under the Securities Acts and the rules of the Securities and Exchange Commission, such stock is salable by the foundation only if certain conditions are met:

(1) Under certain circumstances, the stock may be sold in a private transaction with a purchaser who is deemed to be sufficiently sophisticated and knowledgeable as not to need the protection which the registration described below provides. The rules with respect to such transactions are strict. The securities as acquired by the purchaser are subject for a substantial period of time to the same restrictions as to sale which are imposed upon the foundation and the purchaser must in effect certify that the assets are acquired for investment purposes. Because of the penalties imposed on both parties to the transaction, sale after an extended period of time may be made only upon satisfying the seller that the rules of the Securities and Exchange Commission have been met. The potential of any substantial blocks of excess holdings being sold by private transactions is limited.

(2) *Sales under SEC Rule 144.*—The foundation may be able to dispose of some of its shares on the open market under a rule of the Securities and Exchange Commission recently modified (Rule 144). Under this, in effect every six months the foundation can dispose of a certain number of shares. The number of shares which may be disposed of is the lesser of one percent (1%) of the outstanding shares or the average of the weekly number of shares sold on the exchanges during a specified period. There are rules which may require the foundation to aggregate these sales for purposes of the limitation with the sales of other parties for a period of time, thus, further limiting the number of shares which can be disposed of. The problems of selling restricted securities under Rule 144 are discussed in detail in a paper will appear in the forthcoming issue of "The College Counsel", the journal of the National Association of College and University Attorneys ("Rule 144: The Applicability of the Restricted Securities Requirements to Colleges and Universities," Bruce R. Hopkins). A copy of this as yet unpublished article is enclosed for reference purposes. In many cases, the number of "excess business holding" stock which a foundation could dispose of in the time would be relatively minor compared to the disposition required.

(3) *Registration.*—The only feasible alternative may be to register the securities for sale in a public offering. The first question which must be faced is whether there is a market for any of the shares which must be disposed of and, if there is, how many of them may be disposed of without disturbing the marketplace to the detriment of the other shareholders. If the company has never made a public offering before, then there is a serious question as to whether or not a market would exist. At the present time, for instance, very few new offerings are being made because of the economic situation. In other times, certain kinds of business enterprises would be received on the marketplace and others might not.

In the case of a large concern, the holdings of the foundation, although a relatively small percentage of the outstanding shares, may be absorbable by the market only over a long period of time in a series of registrations. It is to be noted that the registration route is quite expensive and is, therefore, available only where large sums are involved. Even if the market conditions are such that a sale of all or a portion of the excess business holdings is appropriate, the registration for sale of securities of a shareholder (a so-called "secondary offering") might practically be impossible because under the law it can be made only by and through the company. There are many good and valid reasons why a company might not wish to register securities for sale.

The problems with respect to finding a market, the restrictions imposed by law and sale are such that foundations under legal requirement of divestiture under Section 4943 may well be unable to comply. They will, thus, become subject to automatic fine and perhaps continuing penalties. In other cases, where the institution can literally comply with the requirement of divestiture, the act of compliance may seriously damage the interest of other shareholders in the business enterprise. Under these circumstances, clearly there ought to be discretion in the Secretary to grant extensions of time within which foundations may dispose of excess business holdings.

Conclusion

As the above indicates, the structure of Section 4943 is such as to require many foundations to dispose of assets which are in no way involved in the business in which they are alleged to have excess business holdings. Thus, Congress's purpose is in no way being furthered by the required divestiture. If we accept the necessity of having a fairly objective mathematical basis for determining what is an excess business holding, then at the very least the definition of "disqualified person" for the purpose of Section 4943 should be subject to challenge on the part of the foundation. There is no reason why the Secretary should not be given the discretion to find that an individual or entity identified as a disqualified person is not such for the purpose of the statute. By the same token, as indicated above, it is quite clear that under some circumstances foundations will not be able to comply with the requirement of divestiture imposed by Section 4943. The imposition of an automatic tax to bring about this divestiture can, in these circumstances, have no effect whatever. It would seem much more reasonable, as in the case of the definition of "disqualified persons", to give the Secretary of the Treasury discretion to extend the period within which divestiture is required, perhaps upon the basis of a plan of divestiture which meets with the Secretary's approval. (In this connection the more liberal self-dealing rules with respect to redemption of excess business holdings might well be extended.) Finally, if extended transition rules were appropriate with respect to the time of disposition of excess business assets when the statute was enacted in 1969, then they are equally appropriate with respect to a new or enlarged foundation created or funded by bequest after that date.

Most of the discussion above has dealt with the overreaching of the statute insofar as excess business holdings are concerned. This does not mean to say that the statute clearly reaches every foundation holding with respect to which there may be excess involvement in business enterprises. For example, it has been suggested that the use of a holdin company may provide a means for avoiding some of the restrictions of the Act. Further, there are some results which seem strange in light of the purposes. For example, if a foundation on May 26, 1969, owned 25 percent of the stock of the company on May 26, 1969, and if upon his death the founder bequeathed an additional 25 percent (under a will in effect on May 26, 1969) to another foundation controlled by the same parties as control the first, then it may be that the separate interests can be retained by each entity. This results from the grandfather rules and the fact that the two commonly controlled foundations are not treated as one but each is treated as a disqualified person vis-a-vis the other. Such examples are bound to come to light as the time approaches for giving effect to the statute.

Before closing, mention should be made of the proposal which was made by Congressman Patman in introducing H.R. 5729 earlier this year and considered by the Subcommittee on Domestic Finances of the Committee on Banking and Currency of the House of Representatives in hearings on April 5 and 6. This bill would require further divestiture with the purpose of imposing diversification on foundations. Under the bill, a foundation would have five years within which to reduce its holdings in any one security to 10 percent of its assets. Such a provision would impose a far heavier burden of disposition on private foundations than that required by Section 4943. If, as is suggested, foundations holding interests in business may well experience considerable difficulty in complying with the schedule of divestitures imposed by the Tax Reform Act, then it appears that the burden of complying with divestiture proposed in H.R. 5729 may well become intolerable. The purpose of such a provision is seriously to be questioned. As indicated above, there is every indication that the divestiture provision of Section 4943 will effectively end foundation involvement in the control of business enterprises. At the very least, the statute should be given an opportunity to work. Moreover, foundations, other than exempt entities, are generally subject to the local "prudent man" rules with respect to management of investment assets. It is doubtful a rigid rule such as proposed is appropriate in regulating the investment policy of any organization. If serious consideration is given to the proposal, extended transition periods similar to those provided in the Tax Reform Act should be available not just from the effective date of the statute but also from the time a foundation is funded. Furthermore, as indicated above, the Secretary must have discretion to extend the period further where the circumstances warrant.

Senator HARTKE. Mr. Simon?

STATEMENT OF JOHN G. SIMON, PROFESSOR OF LAW, YALE LAW SCHOOL

Professor SIMON. Mr. Chairman, my name is John G. Simon, I am a professor of law at Yale, where I have been teaching, among other things, a course on nonprofit institutions. I also have a part-time role as president of a foundation but that foundation is not affected by any of the provisions on which my statement focuses, so I am here wearing an academic hat rather than a foundation hat.

About a year after the Tax Reform Act was passed, Prof. John Taggart in the Tax Law Review wrote that "The bell may well have faintly tolled for the private foundation: it is now to be found only in captivity and there are strong doubts about its ability to reproduce.

We do not yet have data permitting a systematic appraisal of this statement but I have done what I could in a short time, with the help of the staff of the Council on Foundations, to assemble some information.

The evidence is fragmentary but it gives some fairly good clues about what has happened since the Tax Reform Act was passed in late 1969 with respect to the death rate and the birth rate of foundations. By birth rate I mean to refer both to the formation of new foundations as well as the contributions of capital to existing but not fully funded foundations.

As to death rate, the data I have set forth seems quite clearly to show an increased rate of terminations since the passage of the act—terminations of family and general purpose foundations and apparently a high rate of terminations of company foundations. These figures give us a range of estimates, from a low estimate that the annual rate of terminations has doubled since 1969 to a high estimate that the annual rate of 6½ times the rate of terminations prior to 1969.

Whatever its dimensions, the death rate increase is an understandable outcome of a Tax Reform Act which imposes extra administrative and reporting burdens on foundations, levies the 4-percent investment tax and exposes foundations and their managers to the risks of various penalties.

Some observers, however, have doubted that an increased death rate will be a long term phenonmena while other observers have said that the terminations, even though at a high rate, are and will be found mainly among the smaller foundations, which find the administrative tasks most difficult.

What no one seems to doubt, however, is that the Tax Reform Act, as long as it is not amended, will continue to have a deep and continuing impact on the birth rates of private foundations. Already the effects are clear.

My statement points to a dramatic decline in new foundations and in the number of gifts to existing foundations, and that phenomenon, Mr. Chairman, is very logical if one looks at the Tax Reform Act—not only the various provisions mentioned above, but two other provi-

sions which directly and specifically discourage the process of creation or expansion.

First, there is the new appreciated property rule Code Section 170(e), which in effect causes a realization of long-term gain when appreciated property is given to a nonoperating private foundation, unless the foundation redistributes these assets within a year.

Donors to all other charities continue to deduct the full market value of the appreciated property without paying tax on capital gains, a dramatic difference in tax treatment.

The other provision—which discourages testamentary as well as lifetime gifts to foundations—is the excess business holding rule—Mr. Myers has just referred to it which in effect prevents a foundation from receiving a gift of any but a de minimis part of the donor's corporate control stock, unless the combined voting interest of the foundation and the donor is brought below 20 percent within 5 years of the gift.

A 5-year divestiture deadline presents great, often insuperable problems, for many a potential founder whose nest egg consists of a family business interest. Mr. Myers' statement gives some details on this point.

Now, the impact of these two provisions on the formation and expansion of foundations can be easily appreciated if we look at the data set forth in my statement.

I won't give the details here but these data indicate that the overwhelming majority of all foundations with more than $10 million in assets were formed with gifts of appreciated property and/or corporate control stock that would now be subject to the 5-year divestiture rule. Therefore, the inevitable effect of these two new rules is massively to discourage formation and funding of new somewhat larger foundations.

Now, one may ask, what is wrong with all of that? Why should one be concerned with this retarded birth rate?

I take as my text here Kingman Brewster's statement that our system of private charitable enterprise rests, and I quote, "on the great importance of giving each new idea a chance to find a sympathetic sponsor by offering it more than one doorbell to ring. Innovation is the essence of progress. Independence and variety are the essence of a free society. Both seem to make it absolutely essential that an idea, a person, an institution not be dependent on the ability to persuade or please any single source of support."

But it may be said that there are many thousands of foundations in the country. Wouldn't a zero or even a minus population growth still leave us with enough options?

I would point out that there are only about 350 foundations whose assets exceed $10 million. It is largely to this group of 350 that individuals and charitable bodies must turn to gain substantial foundation financing for new programs and new ideas. Moreover, if you need financing you cannot turn to all 350, for in any one geographic area or any one field of activity—for example, water pollution, crime control, mental health—there are only a handful of foundations at work.

In other words, there are already severe limitations on the foundation funding options open to those who wish to try out fresh ap-

proaches to our many pressing national problems, or for that matter, to those who seek new funds for our hospitals, day care centers, symphonies, and so on.

We need more rather than less alternatives for these fund seekers alternative sources that represent varying perspectives—conservative, liberal and all of the other labels that make up our spectrum of values.

The Tax Reform Act provisions I have mentioned will give us fewer of these alternatives, and the fewer the alternatives—the fewer number of doorbells to ring—the more likely it is that when a foundation says no to an applicant, that answer may represent the applicant's first, second, and third strike. So here in the area of private charitable enterprise, as in the area of private commercial enterprise, a decreasing rate of entry by new firms hurts the consumer—in our case the seeker of funds—and here, as well as in commerce, a decreasing rate of entry gives too much market power to the existing firms—in our case the existing foundations—who, if they are not joined by new foundations, are left with an undesirable degree of power to determine the fate of new charitable endeavors.

Well, since these two rules seem to have such a baleful effect on pluralism, what is to be said for them, what function do they perform? If the appreciated property rule seeks to carry out a tax reform mission, preventing taxpayers from escaping capital gains tax on disposition of appreciated assets, it falls seriously short of the mark. It is a strange tax reform measure that leaves the great majority of charitable donors untouched by reform and singles out, without any explanation in the legislative history, a single class of donors representing a fraction, probably a small fraction, of the total problem.

As for the excess business holdings rule, I am not sure what function it performs.

It purported to cure three specific evils alleged by the Treasury in 1965 and 1969 and reiterated in the committee reports. But one of these complaints, the allegation that foundations holding corporate control stock won't pay proper attention to their philanthropy, simply does not stand up logically or factually, as my written statement points out.

The other two evils were the low income allegedly yielded by foundation controlled companies and the unfair competitive advantage allegedly enjoyed by these companies.

Neither of these grievances was well established on any kind of overall statistical basis; indeed, the supporting documents submitted today by Mr. Mawby tend to rebut the low yield complaints.

Moreover, as my statement points out, both of these alleged abuses are correctable in part by other provisions of the Tax Reform Act and by other specific remedies that can be enacted with a lot less complexity than the divestiture provision the Tax Reform Act gave us. Not only is the radical surgery of divestiture unnecessary; in my view, it may also prove in the long run to be ineffective and counterproductive. For here, as in the case of the appreciated property rule, only the foundations were singled out for regulation. Yet there must be hundreds or thousands of financially hard pressed colleges and churches

and other public charities that would be delighted to receive corporate control stock, perhaps with all kinds of informal understandings as to control. And for such a church or such a school, there are no self-dealing rules, no minimum pay-out rules, to prevent abuses; the churches don't even have to file an information return.

Accordingly, to the extent that corporate control stock now may be diverted from foundations to public charities, we may be worse off from a regulatory viewpoint.

To sum up, there is no sound justification, in my view, either as a matter of tax reform or as a matter of fiduciary regulation, for subjecting the foundation world to the appreciated property rule and the excess holding rule.

For this reason, and because such discrimination against the foundations restricts entry into the foundation field and thereby impairs the health of private charitable enterprise, I join with the members of the American Assembly who last November expressed their concern about the effect of these two provisions on the establishment of new foundations. And I respectfully suggest that these discriminatory features of the Tax Reform Act ought now to be reexamined and, in my opinion, eliminated.

If the Congress is not willing to take such action in the case of the excess business holdings rule, then I suggest that the disincentive effect of that rule should at least be minimized by substantially extending the deadline for divestiture beyond the 5-year period set forth in the statute.

Thank you, Mr. Chairman.

[Mr. Simon's prepared statement and his response to questions submitted follow:]

SUPPLEMENTARY QUESTIONS SUBMITTED TO JOHN G. SIMON

Question 1 (first part): "How many of the foundations which have terminated since the 1969 Tax Act provisions took effect were, in reality, more like public charities?"

Answer. The following chart will help me to answer this rather difficult question. The chart draws on I.R.S. lists of charitable organizations that "terminated their existence or, for other reasons, no longer qualify as organizations contributions to which are deductible . . ." The chart draws upon sample data found in (a) all I.R.S. bulletins for the first eight months of 1973 and (b) I.R.S. bulletins for the month of May for the years 1967–1973. Column 1 shows the total number of terminating charitable organizations. Column 2 shows the number of terminating organizations that appear, primarily on the basis of organizational names, to be "private, non-operating foundations", i.e., primarily grant-making foundations. Column 3 shows the number of terminating organizations that appear *not* to be private non-operating foundations—and which are therefore either "operating foundations" (engaged in active conduct of programs rather than grant-making) or so-called "public charities" (schools, churches, hospitals, and publicly-supported organizations).

Columns 4, 5 and 6 deal with those organizations appearing in the first column that include the term "foundation" in their titles. Thus, Column 4 indicates the number of Column 1 organizations (i.e., all terminating organizations) that have the word "foundation" in their name. Column 5 shows the number of such self-styled "foundations" listed in Column 4 that appear to be private non-operating foundations. Column 6 shows the number of self-styled "foundations" listed in Column 4 that appear *not* to be private non-operating foundations, i.e., which are either operating foundations or public charities.

CHART OF SAMPLE TERMINATION DATA

Month, year	All terminating organizations (excluding mergers)	Terminating private nonoperating foundations	Terminating public charities and private operating foundations (col. 1 minus col. 2)	Col. 1 organizations with "Foundation" in their title	Col. 4 organizations that are private nonoperating foundations	Col. 4 organizations that are public charities or private operating foundations (col. 4 minus col. 5)
	(1)	(2)	(3)	(4)	(5)	(6)
January to August 1973	1,204	624	580	671	539	132
May 1968	22	11	11	9	9	0
May 1969	89	23	66	28	18	10
May 1970	105	29	76	32	24	8
May 1971	98	31	68	36	27	9
May 1972	100	55	45	52	46	6
May 1973	137	74	63	68	59	9

Returning to your question, the term "foundations" as used in this inquiry might be interpreted to refer to any of four categories of charitable organizations that have terminated since 1969:

(a) The term can mean all charitable organizations that have terminated since the Act took effect. Using this interpretation, and referring to the preceding table, we find that of all terminating organizations (Col. 1), roughly half would be public charities or private operating foundations (Col. 3) and thus "more like public charities." (An operating foundation is not a public charity but, as indicated below, it bears a closer resemblance to a public charity than does a private non-operating foundation.) The data for the sample month of May in different years further suggest that an *increasing* proportion of terminating organizations *are not like public charities*, and a *decreasing* proportion *are more like public charities*. (The best source of more precise data would be the I.R.S. and the Treasury Department.)

(b) The term "foundation" can mean all charitable organizations that include the term "foundation" in their title. Using this interpretation, the preceding table indicates that of al lorganizations entitled "foundation" (Col. 4) roughly 19.4% were public charities or private operating foundations (Col. 6) and thus "more like public charities."

(c) The term can mean all foundations as defined in the Internal Revenue Code—i.e., "private operating foundations" or "private non-operating foundations." If this is what is meant, then it is not possible to tell how many of these foundations are "more like public charities," i.e., operating foundations, for the available data do not permit us to tell how many of the organizations listed in Column 3 are private operating foundations. I suspect, however, that only a small percentage of the Col. 3 organizations were operating foundations and, accordingly, that only a small percentage of all terminating private foundations were of the "operating" variety as defined in the Code.

(d) The term "foundations" may refer to "private non-operating foundations," i.e., primarily grant-making foundations. If this is what is meant, none of these terminating organizations are "more like public charities." By Code defintion, these non-operating foundations have a single source, or at least a narrow basis, of support and primarily make grants rather than operate a service program. These private non-operating foundations are the organizations to which I referred in my testimony on birth and death rates. In other words, when I testified about the increased death rate among foundations, I was not referring to terminating organizations that are "more like public charities." Moreover, as stated earlier, it appears that in recent years, the proportion of total terminations attributable to these non-operating foundations has been accelerating.

Question 1. (second part): "Did not many of these organizations simply transform themselves into public charities?"

Answer. (I assume that "these organizations" refers to the private non-operating organizations.) A number of private non-operating foundations (I do not have access to statistical data) have "transform[ed] themselves into public

charities"—or have started the lengthy process of doing so—by acquiring broad public support or becoming a school, church or hospital (and thus qualifying as a public charity under Code Sections 509(a)(1), (2)), or by becoming controlled by or closely affiliated with an existing public charity (and thus qualifying as a public charity under Code Section 509(a)(3)). But none of the organizations that have thus transformed themselves have terminated their organizational existence; it is not possible to dissolve and, at the same time, to transform into a public charity. Unless these "transforming" organizations changed their names in the course of their transformation—an unlikely event, they would not be listed by I.R.S. as organizations that terminated their existence. Accordingly, none, or hardly any, of the transforming organizations to which your question refers are included in the death rate data I supplied to the Subcommittee. (Of course, a private non-operating foundation (and, for that matter, any other charitable organization) that decides to go out of existence must transfer its remaining assets to other charitable organizations. I would not consider such transfers as "transformation.")

Question 2. (first part): "Is this transformation from private foundation to public charity encouraged by the Tax Act and I.R.S. Regulations?"

Answer. In one sense, the answer is no: the Act and the Regulations do not encourage such transformation *as an alternative to dissolving* the foundation and distributing the assets to an existing public charity. The latter procedure is far easier than transformation into a public charity. A glance at the Regulations (Section 1.507-2(b)) will indicate some of the difficulties of the transformation process, which generally requires five years to complete.) In another sense, however, the answer is yes: The Tax Reform Act encourages such transformation *as an alternative to retaining private non-operating foundation status.* Continuation as a non-operating foundation is disfavored by a number of Tax Reform Act provisions to which my testimony refers—provisions that make it difficult to administer the foundation and which make the foundation a distinctly disfavored vehicle for charitable contributions until and unless it converts to public charity status.

Question 2. (second part): "Should not more operating foundations be encouraged to make this transformation?"

Answer. (I assume that the phrase "operating foundations" is intended to refer to grant-making foundations now in operation—i.e., existing grant-making foundations—rather than to "operating foundations" in the technical, Code sense (essentially non-grant-making organizations).) Here, as in responding to the first part of this question, my answer depends on what we assume to be the alternative to such transformation.

(a) If the alternative to such transformation is *dissolution of the foundation* and distribution of its assets to existing public charities, then I am in favor of encouraging transformation instead. It is true that such transformation has the effect of diluting the individualistic—the "private"—nature of the foundation and thus reduces the likelihood that it will contribute to the overall diversity of the charitable sector. But transformation at least preserves more of the individuality of the enterprise than wiping it out completely and placing its assets in the hands of existing public charities.

(b) On the other hand, if the alternative to such transformation is *maintaining the organization as a private foundation,* then I am *not* in favor of encouraging conversion to public charity status. In this case, transformation produces a *loss* in individualization of decision-making. The private grant-making foundation is more likely to exhibit independence and flexibility—more likely to offer alternative "doorbells" for the seeker of funds in our system of "private charitable enterprise"—than is the foundation-turned-public-charity, with a public constituency, or with the obligations of operating as a school, church or hospital, or with a symbiotic connection to an existing public charity.

In order to meet both points—to encourage transformation as an alternative to dissolution but not an alternative to continued private foundation status—I recommend (a) reducing the difficulty of conversion to public charity status under the Regulations and (b) removing some of the statutory disincentives to continuation of private foundation status. My testimony discusses these statutory disincentives—in particular, the appreciated property and excess business holdings rules that make the private foundation such an unattractive object of charitable giving and yet serve no essential tax reform or regulatory purpose.

Question 3. "What is the justification for allowing a greater percentage of adjusted gross income in the form of contributions to public charities as compared to non-operating foundations?"

Answer. In my view, there is no justification for such discrimination against private non-operating foundations in this respect. There are, of course, various arguments that can be advanced in favor of legislative efforts to divert gifts away from foundations to other charitable bodies—quantitative arguments, qualitative arguments, and arguments relating to the "power" and "non-accountability" of foundations. When testifying before the Committee on Finance in 1969, I analyzed these arguments and pointed out why they strike me as deficient. That analysis was reprinted in a later compilation of testimony published by The Foundation Center. I take the liberty of setting forth a copy of that reprint as an appendix to this letter.

I should like to take this opportunity to supplement the record of the October 2 hearing in one other respect.

At the October 2 hearing you asked the panel of which I was a member a question along the following lines: Do any abuses remain in the foundation field following the passage of the Tax Reform Act of 1969? The failure of the panel members to come up with a coherent answer to this question obviously left you unsatisfied, and I am sure that some or all members of the panel must have felt the same way. There is, I believe, an explanation, and I take the liberty of offering it to the Subcommittee so that the record may be somewhat less puzzling on this point.

On my part and, I suspect, on the part of the other panel members (with whom I have not talked since the hearing ended), there was some doubt about the meaning of your question. It was not clear whether your reference to remaining "abuses" related to

(1) *categories of abuse* (e.g. self-dealing, insufficient pay-out) not embraced by the Tax Reform Act and still to be dealt with by the Congress, or

(2) *specific actions* by individual foundations or their managers taking place in violation of the provisions of the Tax Reform Act.

If the *first* meaning was intended, I believe that the answer would probably have been that the 1969 Act thoroughly covered all categories of abuse. (Indeed some panel members have testified that there was a degree of overkill.)

If the *second* meaning was intended, the question would have been very difficult for any panel member to answer. None of us knows in detail about the activities of any foundations other than those we serve as lawyers or officers. If anyone is able to answer this question, it would be the representatives of the Treasury Department and the Internal Revenue Service. As Dr. Robert Goheen testified before your Subcommittee, the I.R.S. has greatly intensified its audit activities, spending almost $13 million for auditing in 1972 (eight times the 1968 level), and plans to have audited all foundations by the end of 1974. (I should note that the tentative total of penalty taxes collected from all foundations under all the foundation provisions of the Tax Reform Act during the fiscal year ending June 30, 1973, as set forth in Mr. Malcolm Stein's testimony was only $117,000, implying a minimal level of violations of the Act.)

In short, I suggest that it was doubt about the meaning of your question, and the difficulty of dealing with the second of its possible interpretations, that may have caused the panel to hesitate in its response; at least, that is what caused me to do so.

I am grateful for this opportunity to supplement the record of the hearing.

Appendix—Analysis of Arguments Favoring the Diversion of Charitable Gifts Away From Foundations

AN EXCERPT FROM TESTIMONY OF JOHN G. SIMON BEFORE COMMITTEE ON FINANCE, UNITED STATES SENATE, OCTOBER 7, 1969, ON H.R. 13270 (TAX REFORM ACT OF 1969)

1. One argument is *quantitative*. It contends that a dollar donated to a private foundation produces a direct charitable benefit "too little and too late" in comparison to a dollar donated to an operating charitable organization.

a. The "too little" argument presupposes that foundation endowments generate an inadequate yield compared to other charitable endowments. Yet the only comparative data I have seen do not support this premise: the average

ordinary income (excluding capital gains) received by 59 large colleges and universities in 1962, as a percentage of assets at market value, was extremely close to the comparable percentage yield for the same year for foundations surveyed in the 1965 Treasury Report (3.87 per cent for the colleges, 3.7 per cent for the foundations.) Moreover in the same year (1962), foundations paid out 6.5 per cent of the market value of their assets in charitable grants or almost twice the ordinary income received. The annual distribution requirement found in H.R. 13270—applicable to private foundations but not to other charities—should assure the continuation of this favorable pay-out performance on the part of the foundations.

b. The "too late" argument presupposes that gifts to foundations typically become part of endowments, emerging only slowly as income grants to operating charities, where as a gift to a non-foundation charity is immediately deployed for active charitable operations. Yet many gifts to non-foundation charities—especially major gifts of appreciated property—become part of the endowment funds of the college, church, hospital or other recipient organization, either because the donor so prescribes or because of the policies of the recipient charity. A dollar of endowment income given away by a foundation produces a direct public benefit just about as quickly as a dollar of endowment income spent by an operating charity. It is true that a good part of the appreciated assets donated to non-foundation charities are used for current operations rather than endowment, but that is also true for some portion of foundation assets; unfortunately I know of no comparative data on this point. In any event, even if there were data to support the "too late" argument, the dimensions of the problem must be considered in true perspective: in 1962 (the latest year for which I have figures), $450 million were deducted on individual income tax returns for gifts to foundations, as compared to $7.5 billion deducted on individual income tax returns for all charitable contributions—a figure which probably understates the total charitable gifts made by all itemizing and non-itemizing taxpayers.

2. Another argument for diversion is *qualitative*. Many critics are opposed to some of the ideas and approaches foundations have supported; others simply do not believe the foundations have accomplished very much. On these issues, I respectfully suggest that this Committee could benefit from the forthcoming findings of the Peterson Commission or some other dispassionate appraisal of the overall record of the foundations. A cursory examination of the testimony the House Ways and Means Committee received last February about foundation achievements in the health field alone—resulting in the savings of many millions of lives from such diseases as polio, yellow fever, hookworm and nutritional disorders—should, in my view, cause this Committee to pause before it concludes that foundations are charity's least effective branch and therefore deserve to be the object of tax discrimination.

3. Finally, there are arguments as to the "*power*" and "*non-accountability*" of foundations. Once more I take the liberty of suggesting that the Committee await the conclusions of the Peterson Commission on these points, offering at this time only the following brief comments:

a. With respect to overall power to control resources, the S.E.C. reports that as of June 1968 foundations held less than a third as much common and preferred stock as the private non-insured pension funds, and the trust department of one New York bank manages almost as many assets as are held by all American foundations. Moreover, the 1965 Treasury Report on Private Foundations noted that during the period 1950–1963, when the percentage of total corporate invested capital held by the pension funds increased more than seven times, the foundations' percentage did not increase at all.

b. With respect to foundation power over grant recipients, I have already suggested that this is a danger only if the foundation "birth rate" is suppressed so as to foreclose the range of options open to those recipients.

c. With respect to power over the decision-making processes in the larger society, I would submit that because their grant-making powers are quite limited—annual foundation grants account for approximately 10 per cent of total charitable giving and amount to less than one per cent of Federal Government spending—the foundations cannot impose new ideas or approaches on the nation; they can only point out alternative possibilities in the arts and sciences, or in health, education, and welfare, which other institutions are free to accept or reject. Some innovations demonstrated by the foundations—such as multi-stage rockets or

pre-school education for poverty children—have been embraced by public institutions. Other innovations have been rejected and have dropped from sight. In the last analysis, the public-at-large decides.

d. The point I have just made also relates to the question of "non-accountability." There is, of course, no lack of accountability with respect to compliance with statutory and fiduciary standards; on these law enforcement issues, foundation managers must account to the appropriate federal and state government agencies, whose power would be increased in important ways by H.R. 13270. Accountability for the wisdom of grant-making decisions is another matter. If foundation trustees had to seek approval from a large stockholder-like constituency, the foundations would lose some of their special capacity for flexibility and risk-taking. In a larger sense, however, there is a form of accountability: in the long run, as noted above, any foundation must win the approval of the general public for its ideas.

STATEMENT BY JOHN G. SIMON, PROFESSOR YALE LAW SCHOOL

SUMMARY

1. Private foundation death rates appear to have increased, and birth rates appear to have sharply declined, since the passage of—and as a result of the provisions of—the Tax Reform Act of 1969.

2. While some have raised questions about the depth and permanence of the death rate increase, there is no doubt that the Tax Reform Act will continue to have a highly negative impact on the birth rate. (Birth rate involves both the formation of new foundations and the contribution of capital to existing but not-fully-funded foundations.)

3. This negative impact principally results from two provisions which directly discourage contributions to private foundations:

(a) The new rule pertaining to contribution of appreciated property (Code Section 170 (e)), which, in effect, permits all charitable organizations *except private non-operating foundations* to receive gifts of appreciated property without subjecting the donor to tax on the long-term capital gain.

(b) The excess business holdings provision of the Act (Code Section 4943), which, in effect, prevents a foundation from receiving a gift of the donor's corporate control stock unless the combined voting interest of the foundation and the donor is brought below 20% within five years.

4. The significance of these two provisions, for birth rate purposes, can be appreciated in the light of the fact that prior to the Tax Reform Act,

(a) approximately 80 percent of gifts to foundations with more than $1 million in assets were composed of gifts of appreciated property;

(b) more than half of foundations with more than $10 million in assets had, at one time, held stock of companies in which the foundation and the donor together held a 20 percent interest—i.e., a holding to which the divestiture provision of the Tax Reform Act applies.

5. A retarded foundation birth rate, as a result of the foregoing provisions, has an unhealthy impact on the field of "private charitable enterprise," for the following reason:

(a) There are only about 350 foundations in the $10 million-and-over class—i.e., with enough resources to be major sources of financing for new ideas and approaches.

(b) Only one or a handful of these 350 foundations may operate in a given field of work (e.g., mental health, pollution control) or in a given geographical sector. Accordingly, persons and groups seeking funds for new programs often have very few doors on which to knock.

(c) A declining rate of entry into the foundation field will further reduce the already limited options available to those who seek financing and, at the same time, will leave the remaining foundations in a particular field of work or a particular region with an undesirable degree of power to determine the rate and form of social and scientific innovation.

6. No persuasive rationale is found in the legislative history of either the appreciated property or excess business holdings provisions for imposing these rules solely on the private foundations. Moreover, limiting these rules to foundations sharply limits the effectiveness of the appreciated property provision

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as a tax reform measure and the effectiveness of the excess business holding rule as an abuse-policing device (for other public charities can take the foundations' place as holders of corporate control stock). Moreover, the abuses to which the excess business holdings provision was addressed can be cured by specific remedies less drastic than divestiture.

7. Because there is not an adequate justification for imposing the appreciated property and excess business holdings restrictions solely on the private foundations, and because such discrimination restricts entry into the foundation field and thereby impairs the health of "private charitable enterprise," it is respectfully suggested that these discriminatory features of the Tax Reform Act be eliminated. (With respect to the excess business holdings provisions, at the very least it is suggested that the disincentive effect of the provision be minimized by substantially extending the deadline for divestiture beyond the five-year period set forth in the statute.)

STATEMENT

Is the private foundation, as a result of the Tax Reform Act of 1969, an endangered species? An article appearing in the Tax Law Review one year after the Act's passage offered such a prognosis:

> The bell may well have faintly tolled for the private foundation; it is now to be found only in captivity and there are strong doubts about its ability to reproduce.

Early returns provide some support for this grim estimate. The death rate for private foundations appears to have increased since 1969, and the birth rate appears to have plunged. Neither from the I.R.S. nor from any other source can we yet obtain data that permit a systematic review of the demographic trend, but the clues are plentiful.

Death rate evidence

As for deaths, we have these clues:

(a) Each month the Internal Revenue Bulletins announce exempt organizations which "have terminated their existence or, for other reasons, no longer qualify as organizations [eligible to receive deductable contributions]." The Council on Foundations has examined the bulletins for a sample month (May) since 1968 (the Tax Reform Act was enacted in December 1969), and finds the following numbers of terminating organizations that appear to have been private foundations:

May, 1968	11	May, 1971	31
May, 1969	23	May, 1972	55
May, 1970	29	May, 1973	74

(b) The New York State Attorney General's Office reported to an American Bar Association committee in 1972 that in 1969, 1970 and 1971 the following numbers of private foundations had dissolved with the consent of that office:

1969	28	1971	91
1970	76		

(c) Charles W. Rumph, Assistant Attorney General of California, reported to the Subcommittee on Domestic Finance of the House Committee on Banking and Currency, in April 1973, that "[p]rivate foundations are being dissolved at a rate nearly double what it was prior to the [Tax Reform] Act."

(d) The Council on Foundations, basing its information on monthly Internal Revenue Bulletin termination announcements, estimates that there were approximately 624 foundations included in the terminations reported during the first eight months of 1973.

(e) Twenty community foundations have reported to the Council on Foundations that between January 1, 1970 and the summer of 1973, they received the assets of 91 dissolving private foundations; the transferred assets had a market value in excess of $60 million.

(f) A report by The Conference Board, "The Impact of the Tax Reform Act of 1969 on Company Foundations," states that 24 out of 240 company foundations "have either been terminated or are in the process of being phased out."

Birth rate evidence

The birth rate phenomenon has two components: formation of new foundations and the addition of capital to existing, not-fully-funded foundations. With re-

spect to the first point, the following evidence strongly suggests a reduced rate of formation:

(a) The Council on Foundations has counted the number of "new organizations" which appear to be private foundations and which are listed in two supplements to the I.R.S. Cumulative List of Organizations—Supplement 1969-1 (Jan.-Feb. 1969), published prior to the Tax Reform Act, and Supplement 1973-1 (Jan.-Feb. 1973), published three years after the passage of the Act. The results:

Jan.-Feb. 1969 Supplement: 433 new private foundations.
Jan.-Feb. 1973 Supplement: 181 new private foundations.

(Even the January-February 1973 figure of 181 foundations may be misleadingly large. Many of these organizations may have been created *prior* to passage of the Act but were only recently added to the Cumulative List because of the notice provisions of Code Section 508 and other factors. Other foundations among the list of 181 may have been formed after passage of the Act but in accordance with provisions contained in wills executed, or trusts created, *prior* to passage, i.e., provisions not affected by the Act.)

(b) On April 24, 1972, the Committee on Charitable Trusts of the American Bar Association's Section on Real Property, Probate and Trust Law reported, on the basis of a survey of 90 law firms in New York State and reports from other states, that, "[b]ecause of the burdens of the Tax Reform Act, there has been a marked slowdown in the establishment of new private foundations."

(c) In a survey published last January in TAXES magazine, 13 lawyers and accountants representing 256 private foundations stated that they would have recommended formation of only one quarter of these foundations had the Tax Reform Act been in effect at the time of creation. Twelve of these advisors also reported that they had in fact recommended the formation of 17 foundations since passage of the Act, compared to the 36 they would have recommended if there had been no change in the law.

On the second aspect of birth rate, contribution of new capital to existing foundations, the available information is quite spotty. But once again there are clues:

(a) The Council on Foundations has examined two random samples of 100 foundations with assets of more than $5 million. The first sample of 100 foundations was examined for gifts received in accounting years ending before January 1, 1970; the second sample of 100 foundations was examined for gifts received in accounting years beginning after December 31, 1969. The examination showed that:

Forty-two foundations in the first group received gifts in 1967, 1968 or 1969, totaling in value $37 million; 29 foundations in the second group received gifts in 1970 or 1971, totaling in value $35 million.

This comparison probably does not begin to measure the full impact of the Tax Reform Act on gifts to existing foundations, for many of the gifts received by the second group of foundations appear quite clearly to have been made under wills executed or trusts created prior to the passage of the Act; in other words, if only gifts under post-Act instruments were counted in the second group, the drop-off would be much more marked. (Unfortunately, one cannot always tell from the information returns whether or not a gift received by a foundation was made under a pre-Tax Reform Act instrument.)

(b) The Conference Board's report on the impact of the Tax Reform Act states that "there is abundant evidence that gifts of appreciated property to company foundations have been either cut back sharply or eliminated and there is no reason to expect any change in this situation."

Impact of the Tax Reform Act

Is the Tax Reform Act responsible for these death-and-birth phenomena? One can argue that the terminations result from cyclical causes—an historic fall-off in enthusiasm for private foundations—and that such an explanation, coupled with the severe turbulence in the stock market, also accounts for the reduced birth rate. But there seems little reason to dispute the first-hand testimony of the 13 foundation lawyers and accountants, referred to earlier, who unequivocally attribute recent liquidations and reduced births to the Tax Reform Act.

The foundation species, then, seems to have been somewhat endangered by the 1969 legislation. Some observers, however, including some of the 13 tax advisors mentioned above, believe that mortalities will mainly be found among

the smaller foundations; other foundation-watchers, including the ABA committee quoted above, believe that it is too early to announce a *long-run* death rate trend: "for the time being, most private foundations appear to have assumed the burdens and are prepared to continue, keeping a careful eye on their experience as it develops." But the observers have not been so cautious when it comes to the long-run reproductive capacity of the foundations, involving formation and expansion; I have heard no dissent from proposition that the birth rate prospects are bleak.

The reasons for this prognosis are simple enough. Consider the matter from the perspective of the person who contemplates starting a foundation or adding further capital to a foundation already established. Not only does this person have to consider the administrative burdens, the program restrictions, and the investment tax and payout obligations now imposed on foundations; the prospective founder also confronts three other rules which are specifically related to—and directly discourage—the process of creation or expansion.

First, there is the 50–20 differential in the percentage of adjusted gross income a donor can annually contribute in cash to a "public charity" (50%) as compared to a non-operating foundation (20%), coupled with the donor's inability to use a carry-over for excess contributions to a foundation. Even more important disincentives are the following ones.

Second, there are the appreciated property rules (amended Code Section 170(e)), which cause, in rough effect, a realization of long-term gain when appreciated property is given to a non-operating private foundation, unless the foundation redistributes these assets within a year. In other words, the gift of appreciated property to a foundation (for other than "passthrough" purposes) receives dramatically less favorable treatment than the gift of the same property to other charities. Yet most contributions to foundaions prior to he Tax Reform Act consisted of appreciated property; in October 1969 the Peterson Commission reported to the Senate Committee on Finance that, in a recent period of time, 78 percent of gifts to foundations in the one-to-ten-million-dollar asset category consisted of appreciated intangible property; for foundations with assets of one hundred million dollars and over, this figure was 88 percent. In short, the inevitable effect of the new appreciated property rules is heavily to discourage contributions to private foundations. A donor can continue to make such contributions without adverse tax effect if he does so under his will; the estate tax has not been changed in this respect. But most foundation donors want to begin to fund their foundations while they are alive; if they have to wait until death for the foundation to get going, there is a good chance that they will not start at all.

The *third* provision to which I refer discourages testamentary as well as inter vivos gifts to foundations: the excess business holdings rule (Code Section 4943), which in effect prevents a foundation from receiving a gift of any but a *de minimis* part of a donor's corporate control stock unless the combined voting interest of the foundation and the donor is brought below 20 percent within five years of the gift. As the 1969 legislation went through the Senate, liberalizing provisions were inserted to permit foundations to hold on to their *existing* corporate control stock for much longer periods of time—up to 25 years in some cases. But no such liberalization was provided for *post-1969* gifts to new or old foundations. It is true that even these post-1969 gifts are treated somewhat more favorably than under the 1965 or 1969 Treasury Department recommendations, but the five-year deadline will still present great problems for many a potential founder whose nest egg consists of a family business interest.[1] (Ease of redemption is, of course, a factor, but while the Tax Reform Act removed accumulated earnings tax obstacles to the redemption of stock held by foundations prior to the passage of the Act, it failed to remove such obstacles to the redemption of stock donated after 1969.) The impact of this provision on the birth and expansion of foundations can be easily appreciated if we consider the fact, reported by the Peterson Commission, that substantially more than half of all foundations in the ten-million-dollar-and-over asset category have held, at one time, stock of

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[1] It should be noted that I am referring only to the provision affecting post-1969 *gifts* to foundations, not the provision relating to post-1969 *purchases* of business interests by foundations; the latter rule does not affect the birth rate problem, and I have no quarrel with it.

companies in which the foundation and the donor together owned a 20 percent interest—precisely the form of asset covered by the Tax Reform Act prohibitions.

The public policy implications

One factor that contributed to the enactment of all of these birth rate disincentives was that the foundations yet to be born were not able to represent their own interests before the Congress, and the existing foundations, for the most part, were too busy dealing with their own pressing problems to fight the cause of the unborn. As a result, a very important public policy point got largely overlooked in the 1969 deliberations—one that significantly affects the health of the philanthropic sector.

While there are many thousands of foundations in the country, there are only 350 which have assets in excess of $10 million; only the members of this group have an annual giving capacity of more than approximately half a million dollars and therefore a capacity to engage substantial professional assistance. It is largely to these 350 foundations that individuals and organizations must turn to gain substantial foundation financing for new programs and approaches. Moreover, to obtain support in any one field of work (for example air pollution, crime control, mental health), or in any one area of this country, an organization can turn to only a handful of these foundations, for, in order to husband their resources, most foundations must specialize to some extent. In the course of time, even the small group of foundations dealing with a particular problem—or operating in a particular geographical region—will be reduced in size by dissolution, or reduced in effectiveness by the onslaught of tired blood. This circumstance has a significant impact on the performance of individual foundations and on the overall functioning of the philanthropic marketplace.

A foundation's performance inevitably suffers from its status as the only substantial foundation (or one of the few substantial foundations) that resides in a particular state or region or that deals with a particular topic—to be the only foundation interested in urban design in New England, for example, or the only foundation in the Southwest interested in mental health. A foundation in this situation may be regarded as the relief agency for all groups operating in its field, with the result that it may deny no one—it may try to provide some small, fractional solace to all who knock on its door. That is not the way to promote adventurous philanthropy.

On the other hand, if the foundation says "no" to an applicant, that answer may represent the applicant's first, second, and third strikes. The fact that the applicant may have no other place to turn in the marketplace for grants presents a serious matter of public policy. For the purpose of increasing the capacity of our society to respond to its vast and varied challenges, we need to offer a variety of funding options to those who have new ideas for solving our problems. Here, in the area of "private charitable enterprise," as in the area of private commercial enterprise, a decreasing rate of new entry into the foundation field would, over time, leave the remaining foundations with an undesirable degree of power to determine the rate and form of social and scientific innovation. A decreasing birth foundation rate thus impairs pluralism in the charitable world.

A justification for the provisions

If these are the negative consequences of the appreciated property and excess business holdings provisions, what is to be said on their behalf?

Perhaps the appreciated property provision was meant to promote the cause of tax reform, to respond to the demand that taxpayers be prevented from escaping the capital gains tax normally resulting from dispositions of appreciated assets. But, if so, it seems strange indeed to impose such a basic reform on only one group of charitable contributors, the donors to foundations, whose gifts represent only a fraction of the total problem. The House and Senate Committees did not provide an answer to this puzzle when they reported out the Tax Reform Act. Despite the fact that the appreciated property rule was not located in the part of the Act dealing with foundations, the Committee reports made no attempt to explain why this reform measure should apply *only* to those taxpayers who give to foundations.

As for the excess business holdings rule, the House Ways and Means Committee explained that the new provision sought to combat three quite specific evils said to be inherent in foundation ownership of corporate control stock. One of these complaints—the "diversion" of the foundation managers' attention to

business affairs, "away from their charitable duties"—is difficult to understand logically or to sustain empirically.[2] To the extent that they are factually significant, the other two evils—the low productivity of some corporate control stock and the allegedly unfair business advantage accruing to some foundation-controlled companies—are correctable in large part by other provisions of the Tax Reform Act, as supplemented by other specific remedies that can be enacted in lieu of a total divestiture rule.[3] In short, any abuses that are generated by the corporate control phenomenon can and should be handled with these specific techniques rather than radical surgery.

Moreover, in the case of the excess business holdings rule, as in the case of the apreciated property rule, we are left to wonder why this reform measure was directed only at the foundations.[4] Conceivably, Congress thought that only foundations were likely recipients of corporate control stock or at least the only entities likely to "cooperate" with the donor in supressing dividends or committing other abuses. But there are hundreds or thousands of financially hard-pressed colleges and churches which would be delighted to receive control stock, with all kinds of informal voting understandings. And for such a church or such a school, there are no self-dealing rules and no minimum-payout rules to regulate abuses; the churches do not even have to file an information return. Accordingly, to the extent that corporate control stock now is diverted from foundations to non-foundation charities—and there is evidence that such diversions are being actively solicited—we may be worse off from a regulatory viewpoint.

Conclusion

Because the case for discriminating against foundations with respect to the appreciated property and excess business holding provisions has not been made, and because such discrimination restricts entry into the foundation field and thereby impairs the functioning of the philanthropic marketplace, I respectfully urge this Subcommittee to give careful consideration to the views expressed by the representative groups of citizens convened by The American Assembly within the last year. The 72 participants in the Western Assembly, meeting at San Francisco in June 1973, took the position that

> [t]he 1969 Tax Reform Act favors public charities over private foundations and should be modified so that public and private charities are similarly treated,

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[2] A small foundation, without a staff, will be run by members of the family who would, in any event, be spending some of their time on business, some of their time on philanthropy. It is difficult to see why the amount of time devoted to philanthropy would be any less, merely because the family's philanthropic interest (the foundation) happens to be linked to the family's business activity (the controlled corporation). On the other hand, the foundation large enough to have a substantial professional staff will have employees who are spending full time on philanthropy and lay trustees who would not be devoting full time to foundation affairs in any event. Moreover, the diversified portfolio of a *non*-corporate-controlling foundation may require just as much financial attention as the single predominant investment of a corporate-controlling foundation. Finally, logic aside, the roster of corporate-controlling larger foundations contains many names of distinguished foundations (e.g., Danforth, Lilly, Hartford, Irwin-Sweeney-Miller) which go about their charitable work without being "diverted" by the nature of their business holdings.

[3] The low-yield phenomenon, where it is found, can be corrected by a combination of the minimum payout requirements of Code Section 4942, coupled with vigorous enforcement of the existing tax on accumulated corporate earnings. To give further assurance of productivity, the law could prohibit or penalize a foundation's retention of corporate-control stock unless the annual return on *that stock*, measured alone, equalled the minimum percentage which, under the Section 4942 payout provision, the foundation is required to distribute each year.

With respect to any unfair competitive advantage a foundation-controlled business (although fully taxed) may enjoy, the adavntage would be substantially reduced if, through the techniques suggested above, foundations were placed under pressure to exact an adequate dividend payout from their controlled companies. Moreover, the Tax Reform Act in Code Section 4941 prevents a foundation from making any loan, on preferential terms or otherwise, to any corporation 35% owned by the donor's family. In the interest of preventing unfair competitive advantage, this provision could be expanded to prohibit a foundation from providing debt or equity financing to a controlled business except (a) through the purchase of its securities from unrelated third parties on a national exchange, or (b) with the approval of the I.R.S. or the state court having equity jurisdiction.

I suggest that, in any event, these two problems are not as serious as is frequently asserted. My reasons are set forth in detail in vol .1, House Committee on Ways & Means, "Written Statements . . . on Treasury Department Report," 89th Cong. 1st Sess. (1965), pp. 458–462.

[4] The problem of the foundations' least-favored-nation treatment under the Tax Reform Act, with respect to the excess business holdings rule as well as other provisions, is discussed by Professor Boris Bittker in "Should Foundations Be Third-Class Citizens?", a chapter in Fritz Heimann (ed.), *The Future of Foundations* (1973), pp. 132–162.

and the 72 members of The Forty-first American Assembly, meeting in New York State last November, stated,

> We question the soundness of the differences in tax incentives between foundations and other charities established by the 1969 tax legislation.

Even more to the point of this discussion, The Forty-first American Assembly announced that

> [c]oncern was expressed about provisions in the law that may adversely affect the incentives for establishing new foundations, particularly the provisions regarding the donation of appreciated property and the restrictions on the holding of control stock. From the public's point of view, the new energy and new ideas that can come from the establishment of new founda-must be encouraged.

If "new energy and new ideas" are to be generated with the help of new foundations, the discriminatory features of the Tax Reform Act that retard the foundation birth rate ought to be re-examined and, in my opinion, eliminated, (If the Congress is not willing to take such action in the case of the excess business holdings rule, I suggest that Congress should at least minimize the disincentive effect of the provision by substantially extending the deadline for divestiture beyond the five-year period set forth in the statute.)

As the appreciated property and excess business holdings provisions now stand, they are likely to inflict serious damage on our system of "private charitable enterprise," for that system, as Kingman Brewster, Jr., has stated.

> "rests . . . on the great importance of giving each new idea a chance to find a sympathetic sponsor by offering it more than one doorbell to ring. Innovation is the essence of progress. Independence and variety are the essence of a free society. Both seem to make it absolutely essential that an idea, a person, an institution not be dependent on the ability to persuade or to please any single source of support.

NOTE: Although this statement grows out of my academic studies of tax policy relating to philanthropy, for the purposes of full disclosure I should mention that I also serve as the President of the Taconic Foundation, an organization which is not, and is not likely to be, affected by the legislation under discussion in this statement.

Senator HARTKE. Mr. Webster?

STATEMENT OF GEORGE D. WEBSTER, MEMBER OF WASHINGTON LAW FIRM OF WEBSTER & KILCULLEN

Mr. WEBSTER. Mr. Chairman, my name is George Webster; I am a practicing attorney in Washington, D.C.

My firm represents a number of nonprofit organizations.

I want to thank the subcommittee for providing me with this opportunity to appear before it and discuss the effects of the 1969 Tax Act on foundations.

It is an understatement to say that the Tax Reform Act has had a substantial effect on private foundations.

The overriding effect of the chapter 42 provisions has, of course, been much greater caution by foundations in their dealings.

Examples of this are the extreme caution which is exercised in terms of making grants, both to individuals and to other foundations.

With respect to the establishment of new foundations and the continuance of existing foundations, it appears to us that there is a diminishing a number of new private foundations being established.

In many instances, this is not an adverse effect in view of the fact that it has prevented many of the very small foundations with assets of between $10 and $200,000 from being formed.

With the problems of the pay-out requirements and other restrictions, it is simply not feasible in many instances to establish such foun-

dations but rather the assets can be channeled to existing comparable organizations.

In terms of the continuance of existing foundations, there have been a number of foundations which have been terminated of which we are aware.

To the extent that the foundations have not been terminated, we have noted that there have been a number of them which have been changed to qualify as section 509(a) (3) support organizations; that is, control of these foundations has been vested in public foundations.

This has placed a great deal of pressure on section 509(a) (3) and in terms of suggested changes in the law, it would appear that in addition to the present language of section 509(a) (3), there should be some additional provision made for foundations which, while they are not controlled by public foundations, are required to distribute all of their income to public organizations. Specifically, it is suggested that in instances in which there is this requirement, that foundations be exempted from the 4-percent taxable investment income. In fact, it is the 4-percent taxable investment income which has, in many instances, forced foundations to make the change to come within section 509(a) (3).

The pay-out requirement has also created a great deal of pressure in this direction, and this is primarily because the requirement of the pay-out provision—6 percent of assets—is certainly too high and very few foundations at the present time are able to achieve a 6-percent return on their investment.

They are simply not in the business of being in business. In effect, by the requirement that they pay out 6 percent of their assets, the provision has the effect of forcing the foundation to give additional consideration to its investment policy as opposed to its charitable activities.

I have alluded earlier to the audit fee tax and suggested one instance in which it could be eliminated in the case of trusts or other organizations which are required to distribute all of their income to public foundations.

However, it is my opinion that the 4-percent investment income tax should be reduced to not more than 2 percent, and further that the audit fee should be channeled to the Exempt Organizations Branch of the Internal Revenue Service, as I understood the congressional history back in 1969, so that it will be in a position to improve its audit techniques and otherwise improve the services which should be available to private foundations for rulings and other transactions.

If the law is to continue with respect to private foundations in its present strict manner, then foundations should be in a position to inquire of the service concerning the effect of prospective transactions.

Further, when they inquire, there should be competent persons who have been fully trained who can respond to their inquiries in the form of rulings.

In my opinion, there are many individuals in the National Office of the IRS Exempt Organizations Branch who are extremely competent and they are, in many instances, limited by staff requirements and are not in a position to give as full attention to many issues which present themselves as they would like.

However, in terms of the field personnel of the IRS District Director's Offices, it is difficult to generalize. It has been my experience in many instances that many of these individuals have not been properly trained not only in the private foundation area, but also in other areas of exempt organizations. Thus, the points that they raise are in many instances not real problems, and they unduly prolong audits because of their failure to reach intelligent decisions.

I noted a couple of days ago, for instance, that there is something that the IRS has called an exempt organization handbook which has been in existence for a number of years and may be made available to the public by virtue of the Freedom of Information Act. This exempt organization handbook has not been updated to reflect the changes that were made in 1969.

In terms of changes which could be made in the present law, I have alluded to several including a proposed change in section 509(a)(3) and also a change with respect to the 4-percent tax on mandatory payout trusts. Also, it would seem that any charitable organization which is controlled by membership organizations should be treated as other than a private foundation. Thus, the last sentence of section 509(a) should be changed to add other sections in addition to those referred to, which are presently only section 501(c) (4), (5), and (6).

Another problem for many organizations, particularly orphanages and old age homes, is that they have been in existence for many years and already have their fixed plants. They, however, get no credit for this in terms of the payout requirement, and it has been difficult for many of these organizations to meet the payout requirement of the statute. Further, of course, there is the question of whether these organizations should even be treated as private foundations, in any event. It seems, in my opinion, that they should be treated as hospitals and educational organizations, with independent status as other than private foundations.

There have been a number of bills introduced in the Congress which would have that effect.

The provisions of section 507, which at the present time provide that private foundation status can only be terminated over a 5-year period should, in my opinion, be changed to permit a termination over a period of not more than 2 years. The 5-year period is unduly long for an organization to have to wait for a final determination of its termination.

Two years should be more than sufficient to establish that it is now a public foundation.

In terms of reporting by exempt organizations, I have always been an advocate that exempt organizations should be required to fully report their activities to the public. By so reporting their activities they, of course, dispel from the public mind the notion that they in some way act other than in the public interest, reporting will force them to change their ways or face public pressure. Also, from a technical standpoint, it does not seem necessary to separate the two sections of the Code's requirements concerning reports by private foundations and those of other organizations which are exempt.

In this connection, if information is to be made public by the Internal Revenue Service with respect to all exempt organizations as is re-

quired by section 6104, it does not seem that it would be unreasonable to require that all exempt organizations make available this information to the public as private foundations are required to do.

With respect to the reporting requirements, it is suggested further that foundations might be required to report salary level of all of their officers and directors and division heads.

Thank you, Mr. Chairman.

Senator HARTKE. Mr. Mawby?

STATEMENT OF RUSSELL MAWBY, PRESIDENT, KELLOGG FOUNDATION, ACCOMPANIED BY J. W. RIDDELL, ATTORNEY AT LAW

Mr. MAWBY. Mr. Chairman, Senator Curtis, my name is Russell G. Mawby and I am president of the W. K. Kellogg Foundation of Battle Creek, Mich. With me today is Mr. J. W. Riddell, who is our legal counsel in Washington, and I appreciate very much this opportunity of visiting with you about the impact of the Tax Reform Act of 1969.

I have been asked to comment specifically on the minimum distribution rule of the act and, therefore, my remarks will be restricted to section 4942 of the Internal Revenue Code.

That section specifies that private foundations must make annual distribution in the amount of the greater of either their earned income or a fixed percentage of the current market value of their investment assets.

The rationale behind this concept, of course, was to insure that current distributions by private foundations are sufficient to justify tax benefits which the donors might have received and to prevent private foundations from investing in the stock of companies which retain most of their earnings and thereby delay charitable expenditures commensurate with the value of their assets.

In order to avoid this delay of benefit to charity, section 4942 requires private foundations to make annual distributions at a prescribed level even if an invasion of capital may be necessary.

Many of us find this approach objectionable not only because it mandates an encroachment on capital but also because many private foundations that are currently able to support charitable programs in a major way are able to do so only because their assets have been historically invested to provide a reasonable appreciation in value as well as a fair current return.

To illustrate this point, the Kellogg Foundation historically has distributed all of its income. In addition over the years the foundation assets have doubled in value every 10 years. And, most importantly, because of this appreciation, the payout to charity, the public benefit, has more than doubled each decade.

As I will show later, continuing invasions of principal would have made this record of charitable contributions impossible.

My statement then briefly traces the legislative history which led to the minimum distribution rule. The 1965 Treasury reports on private foundations, suggested that a reasonable income equivalent or minimum distribution would be in the range of 3 to 3½ percent. Then later the statement of former Secretary of the Treasury Fowler used an example which assumed a 5-percent income equivalent.

This example was apparently the basis for the Committee on Ways and Means adopting a 5-percent minimum payout adopted by the House, and the Senate Finance Committee also accepted this 5-percent level which had been recommended by the House.

Then in December of 1969, Senator Percy in the floor amendment which was passed raised the level from 5 percent to 6 percent, which was accepted by the conference committee.

Senator Percy explained that his action was based mainly on the recommendations of Mr. Peterson, Chairman of the Commission on Foundations and Private Philanthropy, who suggested that a proper rate of return for foundations would allow such entities to pay out between 6 and 8 percent annually. Thus the 6-percent payout requirement represents a 100-percent increase in the minimum initially proposed by the Treasury and in addition it is premised upon and reflects certain inaccurate conclusions of the Peterson report.

It is rather interesting to note in introducing the floor amendment Senator Percy stated that more important than the particular percentages were the assumptions on which the percentage should be based, and to quote from Senator Percy, "The payout requirements should be high enough to require private foundations to invest their funds productively but the percentage should not be so high as to amount to a delayed death sentence," end of quote, and enough of history.

Now, to illustrate our concern with the payout provisions, I will use the experience of the Kellogg Foundation as a representative case.

Mr. Kellogg, our founder, realized a tax benefit of $364,000——

Senator HARTKE. What year was that?

Mr. MAWBY. The gift was primarily in the midthirties, 1935.

Senator HARTKE. What was the tax rate then?

Mr. MAWBY. The tax rate would have been quite different than now. But his total tax benefit simply illustrates that his motivation was not tax benefit related, it was a benefit of $364,000 on gifts of $45 million. In the years since the foundation was established in 1930 total distributions to the public have been $272 million and this year will be about $22 million.

The total of these assets of the foundation are maintained in two separate portfolios which we refer internally to as Kellogg and diversified. The Kellogg portfolio consists entirely of Kellogg Co. stock with the value now of $529 million. The diversified portfolio consists of stocks, bonds, and other interest-bearing investments and has an approximate value of $47 million.

Through the years Kellogg has consistently outperformed the diversity portfolio which is used to measure the merits of diversification.

The principal contention reflected in the Peterson report was that the portfolios of private foundations had not produced the rate of return thought to have been produced by mutual funds.

By any measure of return the Kellogg Foundation has outproduced mutual funds for the period covered by the Peterson report and has continued to do so since.

For example, in the last 7 years, the Kellogg Foundation income because of holdings in the Kellogg Co. has continued to be substantially greater than it would have been had its income been derived entirely from diversified investments.

The increase in income for our 1972 tax year, compared to 1966, was 66½ percent, for the Kellogg holdings, as compared to an increase of 12.8 percent under the foundation diversified portfolio.

It is, therefore, evident that the sale of Kellogg stock and divestiture of funds would result in a lower return to charity over the years.

The real question, of course, of concern to us is what is the impact of pegged payout requirements and so we asked ourselves the question, what would be our situation today had the 6 percent minimum distribution rule been in effect from the beginning of the foundation. On page 6 in my statement I summarize the consequences from 1934 when the trust consisted of 221,000 shares of Kellogg stock with a then market value of $38 million, had we met the 6 percent pegged distribution requirement.

Since that time the following would have occurred: First, for 1934 through 1972, the trust made an actual distribution of $222 million. Had the minimum distribution rule been applicable, distribution of $259 million, or an increase of $37 million would have been made.

Second, to meet that payout requirement the trust would have had to sell the equivalent of 18 million shares with a market value of $265 million. Therefore, the trust holding would have been reduced to a market value today of $265 million, and thus in summary the short-term higher return to charity of $37 million would have cost $265 million in corpus value thereby reducing the current size of the trust by 50 percent.

Further, for 1973–74, the distribution from the reduced assets would have been only $10 million rather than the $20 million which will in fact be distributed.

For years of experience under the 1969 law there has been time to examine how section 4942 will operate to undermine overall foundation grants and thereby has been an opportunity to further examine the assumptions of the Peterson report. For this purpose, we commissioned a study by Dr. Norman Ture entitled "The Impact of the Minimum Distribution Rule on Foundations."

The findings and conclusions of this study as briefly summarized in its own language are as follows:

First, any minimum distribution rule which ignores the foundation rate of return will have a highly differential discriminatory and possibly capricious impact on foundations and on their long-term capacity to support charity.

Second, the Peterson Commission contention that the investment performance of foundations is relatively poor is based on inadequate information and inappropriate statistical measure. The records of foundations for which data was available in the preparation of this Ture report certainly do not support this contention.

Third, no sound evidence was advanced by the Peterson Commission to support the view that the allegedly poor investment performance of foundations is related to the concentration of their investment assets.

Fourth, it is neither realistic nor reasonable to assume that a minimum distribution rule will result in a significant increase in the rate of return on foundation investments. And, finally, the Ture report

concludes that the tax savings allegedly realized by those establishing foundations are in all likelihood very small.

Foundation distributions to charity have represented a sizable amount of benefits relative to the foregoing tax revenues.

Finally, the Peterson Commission assumed that the charitable services which a foundation normally supports will not rise in cost any faster than the general rate of inflation, and for that purpose assumed a rate of inflation of 2 percent.

This report assumption is also wrong for it completely disregards the fact that the organizations and activities generally supported by the foundations have relatively little possibility of significant gains in productivity.

As only one example, higher education is a very labor-intensive sector of the economy in which it's difficult to achieve gains in productivity that are experienced in goods producing industries.

In conclusion, from the foregoing, these things are apparent.

First, the analysis which led to enactment of the 6-percent distribution rule reflected incomplete, inaccurate information, and misinterpretation of the actual situation.

Second, the 6-percent payout requirement mandates the continuing invasion of corpus by private foundations, an unsound practice we believe in prudent fiscal management.

Finally, cost increases in the charitable services supported by foundations exceed the general inflationary rate thus putting pressure on foundation ability to continue to maintain their relative contribution to society.

In conclusion, unless the minimum distribution rule is reduced it is clear that the principles incorporated in section 4942 will progressively impair the effectiveness of all foundations and even eliminate many of them, to the detriment of society.

If private philanthropy, therefore, is to continue its historic contribution to American life, changes in the current legislation including a reduction in the payout requirement are necessary.

We urge your adoption of such modifications to insure that our society will continue to benefit from the constructive activities of private foundations.

Thank you.

[Mr. Mawby's prepared statement and his response to questions submitted follows:]

SUPPLEMENTARY QUESTIONS SUBMITTED TO RUSSELL MAWBY

Question 1. What has been the average yearly increase in value of Kellogg stock since the foundation's inception?

Answer. The average yearly increase in the value of Kellogg stock since 1935 has been 6.9%.

Question 2. What has been the average yearly dividends of Kellogg stock since the Foundation's inception?

Answer. The average yearly dividends of Kellogg stock since 1935 have been 3.5%.

Question 3. What percentage of the Foundation's portfolio is invested in Kellogg stock?

Answer. As indicated in the second paragraph on page 4 of my prepared statement, assets maintained on behalf of the Foundation are in two separate portfolios. One, the W. K. Kellogg Foundation Trust, is comprised exclusively of Kellogg Company common stock. The Diversified portfolio contains 2.2% Kellogg

Company common stock. The combined holdings of Kellogg stock in the two portfolios was 92% as at August 31, 1973. On the August 31 date, Kellogg stock held in behalf of the Foundation had a value of $530,162,740. The total market value of the two portfolios on that date was $576,765,104.

Question 4. What has been the average payout percentage since the Foundation's inception?

Answer. The average payout percentage on Kellogg stock since 1935 has been 3.5% of its market value. The average return on the Foundation's Diversified portfolio over the past 20 years has been 3.7%. However, although the percentage rate on the Diversified has slightly exceeded that of the Kellogg stock, the return to charity from Kellogg has dramatically exceeded the return from the Diversified portfolio because of the spectacular market growth in Kellogg stock as described on page 4 in my prepared statement. For example, the Foundation's Diversified portfolio earned $2,090,946 in 1973 as opposed to $1,362,351 in 1954, a gain of 53%. By contrast, the Kellogg portfolio earned $18,775,544 in 1973 as compared to $2,691,732 in 1954, a gain of 598%. Since the receipts from both funds during this period have been utilized 100% for charitable purposes, it is obvious that the benefit to charity has been spectacularly enhanced by the market growth in Kellogg. A similar comparison for the past seven years was made on page 5 of my prepared statement.

Question 5a. Do you agree with the contention that the public has a right to expect a proportionate benefit from the tax privileges granted to foundations?

Answer. We agree, and the W. K. Kellogg Foundation is representative of foundations providing such public benefit. As indicated on page 4 of my prepared statement, our founder, W. K. Kellogg, realized a total tax benefit (income, gift, and estate) of approximately $364,000 on gifts made to and in behalf of the Foundation of $45,000,000. From that $45,000,000, the Foundation has provided a public return to charity through its philanthropic endeavors of $272,000,000.

Question 5b. And don't you think that the 6 percent payout provision was put into law to assure just such a reasonable public benefit?

Answer. As indicated on page 2 of my statement, we recognize that the rationale behind the minimum distribution rule of Section 4942 of the Internal Revenue Code ". . . was to insure that current distributions are sufficient to justify tax benefits donors might have received . . ." However, the 6% payout provision will not assure a "reasonable public benefit." As indicated in the balance of my testimony, it will do the opposite because it mandates a continuing encroachment on capital and thus does not provide opportunity for reasonable appreciation in value of capital as well as a fair current return. In the bottom paragraph on page 2 of my prepared statement, I illustrate this point by stating that ". . . the Kellogg Foundation historically has distributed all of its income. Over the years the Foundation's assets have doubled in value every ten years. Most importantly, because of this appreciation, the payout to charity has more than doubled each decade." As stated on page 6 of my prepared statement, had the 6% payout requirement been in effect, the market value of our holding in Kellogg stock would now be eroded to $265,000,000 (instead of its present $530,000,000) and our 1973–74 distribution from the reduced assets would be only $10,000,000 rather than $20,000,000 which we will in fact be distributing.

Question 6. In your testimony you recommended that the 6 percent payout requirement should be reduced. Would another acceptable alternative be to apply the 6 percent rule to the total rate of return (interest, dividends, realized capital gains, and so forth) rather than just to investment return?

Answer 6. No, as we interpret this suggested alternative. The 6% payout requirement relates to the market value of assets and not to either investment return or total rate of return. A payout percentage should be in line with the average sustainable rate of return that can be attained from reasonable investments. As indicated on page 3 of my prepared statement, the "1965 Treasury Report of Private Foundations" submitted to the House Committee on Ways and Means, concluded that a reasonable income equivalent would be in the range of 3 to 3½%. The alternative suggested, applicable to the total rate of return, would be more damaging than the present payout requirement and would further reduce the capacity of foundations to help meet society's ever-expanding charitable needs.

Question 7a. Does the 6 percent rule encourage an over-emphasis on investment in debt obligations with their more immediate return rather than long-run capital appreciation investment?

Answer 7a. Yes.

Question 7b. If so, is this detrimental to foundations?

Answer 7b. It is detrimental to foundations insofar as they must proportionately reduce equity holdings which provide for the market appreciations necessary to generate the increased annual earnings required for foundation giving to offset the effects of inflation and to keep pace with the growing needs of charity. As pointed out on pages 8 and 9 of my prepared statement, education and health are labor-intensive services in which it is difficult to achieve gains in productivity that are experienced in goods-producing industries. Therefore, costs in the educational and health sector of our economy increase more rapidly than do other costs in our economy as measured by the Consumers Price Index. As indicated in my answer to Question 4 above, Kellogg stock is an equity holding which has permitted this Foundation to increase its annual return to charity very spectacularly.

Question 8a. Does not the payout provision put an effective limitation on the life of a foundation which does not maintain an adequate level of payout to charity?

Answer 8a. As indicated on page 6 of my prepared statement, the present payout provision would have caused, historically, such an erosion of Kellogg assets that our 1973–74 payout would be reduced to $10,000,000 rather than the $20,000,000 which we will in fact be distributing in behalf of charity. The present payout provisions will have a detrimental effect on *all foundations* irrespective of whether the foundations have or have not maintained "adequate" levels of payout to charity.

Question 8b. Isn't this a good idea?

Answer 8b. We concur with the wisdom of some device to assure an adequate and reasonable return to charity—BUT NOT A DEVICE WHICH HAS A DETRIMENTAL EFFECT ON ALL FOUNDATIONS, including those maintaining an "adequate" level of payout to charity. As indicated on page 10 of my statement, "unless the 6% minimum distribution rule is reduced, it . . . will progressively impair the effectiveness of *all foundations* and even eliminate many of them to the detriment of society."

I hope these answers provide the additional information you desire. If not, we would be pleased to provide further clarification.

Testimony by Dr. Russell G. Mawby, President, W. K. Kellogg Foundation

Summary

1. The analyses by the Commission on Foundations and Private Philanthropy (The Peterson Commission) which led to the enactment of the 6 per cent distribution rule in Section 4942 of the Internal Revenue Code of 1954 reflected inaccurate information and misrepresentation of the actual situation.

The principal contention reflected in the Peterson Report was that portfolios of private foundations had not produced rates of returns thought to have been produced by mutual funds. This conclusion was based upon a one year analysis and was erroneous in terms of continuing performance.

2. The 6 per cent pay-out requirement enacted by a Senate Floor Amendment and later accepted by the Conference Committee mandates the continuing invasion of corpus by private foundations, an unsound practice in prudent fiscal management.

Studies show that the 6 per cent pay-out rule results in short term increases to charity but that the diminution of assets of private foundations to meet the payout requirement is so drastic as to cause long term reductions in their philantropic distributions for charitable purposes.

3. The Peterson Commission Report also erred in assuming that annual increases in costs in the educational and health sectors of the economy were no different than in the economy generally and its studies were based upon a presumption of an annual cost increase of 2 per cent.

Higher education and the health sectors are labor-intensive service industries where it is difficult to achieve gains in productivity experienced in goods-producing industries. Cost increases in the health and educational sectors greatly exceed those in the economy generally, thus putting pressure on the abilities of foundations to continue to maintain their relative contributions to society.

4. Unless the 6 per cent minimum distribution rule of Section 4942 is reduced the rule will progressively impair the effectiveness of all foundations and even eliminate many of them, to the detriment of society.

If private philanthropy is to continue its historic contribution to American life, changes in the current legislation—including a reduction in the pay-out requirement—are necessary.

STATEMENT

My name is Russell G. Mawby, and I am President of the W. K. Kellogg Foundation in Battle Creek, Michigan. On April 10 of this year the W. K. Kellogg Foundation testified before the Committee on Ways and Means of the U.S. House of Representatives on the subject of the impact of the minimum distribution rule (Section 4942 of the Internal Revenue Code of 1954) on Foundations. Much of the brief testimony which I give today will parallel the testimony presented at those hearings. My testimony is also supported by a study entitled "The Impact of the Minimum Distribution Rule on Foundations" by Dr. Norman B. True. A copy of that study is submitted along with my testimony for incorporation into the record.

Since my testimony is concerned with the minimum distribution rule as enacted by the Tax Reform Act of 1969, my remarks will be restricted to Section 4942 of the Internal Revenue Code. However, I would like it to be known for the record that we share the concern that the 4% excise tax levied under Section 4940 should be eliminated or, in the alternative, reduced to a rate which would equal the audit costs the tax is intended to defray. Similarly, the Kellogg Foundation joins other Foundations concerned over the substantial reductions in assets which have been occasioned by forced diversifications of Foundation holdings, both to meet the arbitrary percentage standard of the 4942 payout requirements and to satisfy the divestiture rules of Section 4943.

Before briefly setting forth the legislative history concerning section 4942, I would remind you of the requirements of the provision; that is, private foundations must make annual distributions in the amount of the greater of either their earned income or a fixed percentage of the current market value of their investment assets.

The rationale behind this concept was to insure that current distributions are sufficient to justify tax benefits donors might have received, and to prevent private foundations from investing in the stock of companies which retain most of their earnings and thereby delay charitable expenditures commensurate with the value of their assets. In order to avoid this delay of benefit to charity, section 4942 requires private foundations to make annual distributions at a prescribed level, even if an invasion of capital may be necessary.

Many find this approach objectionable, not only because it mandates an encroachment on capital, but also because many private foundations that are currently able to support major charitable programs are able to do so only because their assets have been historically invested to provide a reasonable appreciation in value as well as a fair current return. To illustrate this point, the Kellogg Foundation historically has distributed all of its income. Over the years the Foundation's assets have doubled in value every ten years. Most importantly, because of this appreciation, the payout to charity has more than doubled each decade. As I will show later, an annual invasion of principal would have made this record of charitable contributions impossible.

I would emphasize that philosophically I support the concept of a minimum annual charitable distribution. However, I am concerned with the method of determining such a distribution as set forth in section 4942; and even if that method of determination were acceptable, the 6-percent rate should be reduced because it is historically unrealistic.

Moving now to the legislative history, the minimum distribution rule has its origin in the "1965 Treasury Report on Private Foundations" submitted to the House Committee on Ways and Means. That report espoused the theory that there should be a correlation between the immediate tax benefit to foundation donors and the time of foundation grants or benefits to charity. However, it also noted that the income of assets held by foundations should be on a parity with other tax-exempt entities such as colleges and universities. Also, it stated that the retention of capital by foundations is justifiable.

The report concluded that a reasonable income equivalent would be in the range of 3 to 3½ percent. Thus, it is obvious that the report did not intend to require foundations to distribute to charity an amount that would require diminution of corpus as section 4942 clearly requires.

The first hint that the minimum rate proposal as adopted in 1969 might be above the 3- to 3½-percent level appears in former Secretary of the Treasury

Fowler's statement to Congress on December 11, 1968, when he used an example which assumed a 5-percent income equivalent. This example was apparently the basis for the Committee on Ways and Means adopting a 5-percent minimum payout. The Senate Finance Committee accepted the 5-percent level recommended by the House committee.

On December 6, 1969, Senator Percy in a floor amendment which was passed, raised the level from 5 percent to 6 percent, which was accepted by the conference committee. Senator Percy explained his action was based mainly on the recommendation of Mr. Peter G. Peterson, Chairman of the Commission on Foundations and Private Philanthropy, who suggested that a proper rate of return for foundations would allow such entities to pay out between 6 and 8 percent annually. Thus, the 6-percent payout requirement represents a 100-percent increase in the minimum initially proposed by the Treasury, and, in addition, it is premised upon and reflects the inaccurate conclusions of the Peterson report. It is interesting to note that, in introducing his floor amendment, Senator Percy further stated that, more important than the particular percentages, are the assumptions on which the percentage should be based: "The payout requirement should be high enough to require them (private foundations) to invest their funds productively. The percentage should not be so high as to amount to a delayed death sentence."

To illustrate our concerns with the payout provision, I will use the experience of the Kellogg Foundation as a representative case. Our founder, W. K. Kellogg, realized a total tax benefit (income, gift, and estate) of approximately $364,000 on gifts of $45 million which today have a total fair market value of approximately $576 million. The total of these assets are maintained on behalf of the Foundation in two separate portfolios, which we refer to as "Kellogg" and "Diversified." The Kellogg portfolio consists entirely of Kellogg Co. stock with a value of $529 million. The Diversified portfolio consists of stocks, bonds, and other interest-bearing investments and has an approximate value of $47 million. Through the years, Kellogg has consistently outperformed the Diversified portfolio which is used to measure the merits of diversification.

A principal contention reflected in the Peterson report was that the portfolios of private foundations had not produced the rate of return thought to have been produced by mutual funds. By any measure of return, the Kellogg Foundation has outproduced mutual funds for the period covered by the Peterson report and has continued to do so since. For example, in the last 7 years the Kellogg Foundation's income, because of holding in the Kellogg Co., has continued to be substantially greater than it would have been had its income been derived entirely from diversified investments. The increase in income for our 1972 tax year compared to 1966 was 66.5 percent for the Kellogg holding as compared to an increase of 12.8 percent on the foundation's diversified portfolio. It is evident that the sale of Kellogg stock and diversification of funds would result in a lower return to charity over the years.

	Kellogg		Diversified	
	Net income from Kellogg stock	Percent increase over 1967	Foundation income from other investments	Percent increase over 1967
Year ended Aug. 31—				
1967	$11,272,650		$1,852,705	
1968	12,177,062	8.0	1,954,008	5.4
1969	14,438,092	28.0	1,834,420	(.9)
1970	14,890,298	32.0	1,831,344	(1.1)
1971	17,606,034	56.1	1,711,651	(7.6)
1972	17,349,265	53.9	1,941,018	4.7
1973	18,775,544	66.5	2,090,946	12.8

Not only was the Peterson report incorrect in regard to performance, but its premise that a pegged payout requirement would be good for charity is also wrong. For example, had the minimum distribution rule been in effect at 6 percent from 1934, when the trust consisted of 221,000 shares of Kellogg stock, with a then market value of $38 million, the following would have occurred:

1. From 1934 through 1972, the trust made an actual distribution of $222 million. Had the minimum distribution rule been applicable, distributions of $259 million (or an increase of $37 million) would have been made;

2. To meet that payout requirement, the trust would have had to sell the equivalent of 18 million shares with a market value of $265 million; therefore, the trust's holding would have been reduced to a market value of $265 million; and thus

3. The short-term higher return to charity of $37 million would have cost $265 million in corpus value, thereby reducing the current size of the trust by 50 percent. Further, for the 1973–74, the distribution from the reduced assets would have been only $10 million rather than the $20 million which will in fact be distributed.

With 3 years of experience under the 1969 law, there has been time to examine how section 4942 will operate to undermine overall foundation grants, and there has been the opportunity to further examine the assumptions of the Peterson report. For this purpose, seven Foundations[1] commissioned a study by Dr. Norman B. Ture entitled "The impact of the Minimum Distribution Rule on Foundations". This is the study to which I referred in my introductory remarks. The findings and conclusions of that study, as briefly summarized in its own language are as follows:

First, any minimum distribution rule which ignores the foundation's rate of return will have a highly differential, discriminatory and possibly capricious impact on foundations and on their long-term capacity to support charities.

Second, the (Peterson Commission) contention that the investment performance of foundations is relatively poor is based on inadequate information and inappropriate statistical measure; the records of foundations for which data was available in the preparation of this (Ture) report certainly do not support this contention.

Third, no sound evidence was advanced (by the Peterson Commission) to support the view that the allegedly poor investment performance of foundations is related to the concentration of their investment assets.

Fourth, it is neither realistic nor reasonable to assume that a minimum distribution rule will result in significant increases in the rate of return on foundation investments.

Finally, the (Ture) report concludes that the tax savings allegedly realized by those establishing foundations are, in all likelihood, very small. Foundation distributions to charity have represented a sizable amount of benefits relative to the foregone tax revenues.

Finally The Peterson Report assumed that the charitable services which a foundation normally supports will not rise in cost any faster than the general rate of inflation and for that purpose assumed a rate of inflation of 2 percent. The report's assumption is wrong, for it completely disregards the fact that the organizations supported by foundations have little possibility of significant gains in productivity.

Let me cite a few quick examples.

Higher education is a labor-intensive service sector of the economy in which it is difficult to achieve the gains in productivity that are experienced in goods-producing industries. Educational costs per credit hour consistently rose more rapidly than the consumer price index from 1953–54 to 1966–67. Over the period as a whole, educational costs rose at an annual average rate of 3.5%, as compared with a rate of 1.6% for the consumer price index—a difference of 1.9%.[2]

The most noticeable feature of the budgets of all institutions of higher education is how fast they have gone up in the years since World War II. Total educational and general expenditures on current account by all institutions of higher education went up from less than $1 billion in 1945–46 to more than $7 billion in 1963–64. Total educational and general expenditures less expenditures on organized research have gone up, on the average, more than 7% a year at all private universities. The direct instructional cost per student over the period 1955–56 works out to an average annual rate of increase of 8.3% for all private universities.[3]

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[1] The Hormel Foundation, the Kellogg Foundation, the Kresge Foundation, the Lilly Foundation, the McClellan Foundation, the Pew Memorial Trust, and the Woodruff Foundation.

[2] Source: "The More Effective Use of Resources—An Imperative for Higher Education," A Report and Recommendations by the Carnegie Commission on Higher Education, June 1972, pp. 33–38.

[3] Source: "Economic Pressures on the Major Private Universities," William G. Bowen, Reprinted from "The Economics and Financing of Higher Education in the United States," a Compendium of Papers Submitted to the Joint Economic Committee, Congress of the U.S., Government Printing Office, 1969, pp. 399–439.

In the period 1958–71, the average operating budget for medical schools increased from $2,056,000 to $8,475,000, an increase of 412%. The mean salary for basic science faculty and for all ranks of clinical science faculty increased 59% and 66% respectively.[4]

A major program concern and site of W. K. Kellogg Foundation expenditures has been the hospital field. The Foundation has assisted a wide variety of programs in community hospitals such as in recent support for coronary care units and the improvement of burn patient care facilities and services.

The increase of such support by the Foundation has substantially paralleled the general rise of medical care and hospital costs in the United States. Such costs have risen at an annual rate of 11.8% between the years 1950–1970 and the expenses per patient day during the same period rose at an annual rate of 8.6%.[5]

In conclusion, from the foregoing these things are apparent:

1. The analysis which led to enactment of the 6% distribution rule reflected inaccurate information and misinterpretation of the actual situation.
2. The 6% payout requirement mandates the continuing invasion of corpus by private foundations, an unsound practice in prudent fiscal management.
3. Cost increases in the charitable services supported by foundations exceed the general inflationary rise, thus putting pressure on foundation ability to continue to maintain their relative contribution to society.

Unless the 6% minimum distribution rule is reduced, it is clear that the principles set forth in the Peterson Report and incorporated in Section 4942 will progressively impair the effectiveness of all foundations and even eliminate many of them, to the detriment of society.

If private philanthropy is to continue its historic contribution to American life, changes in the current legislation—including a reduction in the payout requirement—are necessary. We urge your adoption of such modifications to insure that our society will continue to benefit from the constructive activities of private foundations.

Senator HARTKE. Mr. Stein?

STATEMENT OF MALCOLM STEIN, ATTORNEY, ROBERTS AND HOLLAND

Mr. STEIN. My name is Malcolm Stein and I would like to thank the chairman and Senator Curtis for the opportunity to participate in this panel.

By way of introduction, I was a staff member in the Office of the Assistant Secretary of the Treasury for Tax Policy from 1969 through 1971 where I was concerned with both Treasury policy and the drafting of the statute, as well as supervising the drafting of the proposed Treasury regulations, in the entire private foundation area.

I am now associated with the firm of Roberts and Holland in New York, and I am speaking with the background of feedback from both large and small foundations in the last 2 years.

The provisions of the Tax Reform Act of 1969 relating to private foundations imposed a comprehensive body of law on these organizations for the first time.

I view these provisions as a set of reasonable restrictions on foundation activities accompanied by flexible sanctions and penalties which are tailored to the extent of the violations.

The self-dealing and income distribution provisions of the Act are probably the most necessary limitations placed upon the activities of foundations—they affect the greatest number of foundations and quantum of activities and were the proposals most widely supported by the foundation community in 1969.

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[4] Bradford, Malt and Oates, "The Rising Cost of Local Public Services," National Tax Journal.
[5] Source: Hospitals, J.A.H.A.

Of course, the business divestiture requirements and the restrictions on political and grantmaking activities are also having a substantial impact on foundations.

In three areas, the foundation provisions of the act vary somewhat from the Treasury proposals of April 22, 1969.

First, Congress imposed a tax of 4 percent of net investment income, which will materially reduce the funds available for charitable purposes.

Second, the restrictions on political activities, grantmaking, electioneering and voter registration drives go well beyond Treasury proposals.

Third, although the penalties in the Act are more flexible than those in the 1969 House bill, although the violations can be corrected in certain circumstances, and although sanctions are imposed on foundation managers only if they act willfully and without reasonable cause, they do not provide as wide a degree of flexibility as would the Treasury proposal, which was not adopted, for equity jurisdiction in the courts.

I would like to spend the remainder of my time tying together some disparate threads in the previous presentations and relating them to the effect on the birth rate and the mortality rate of foundations, the self-dealing and general administrative provisions of the Act, and other factors and legislative proposals which may affect the birth rate and death rate.

With respect to self-dealing between foundations and related parties, the arm's length standards of prior law proved to require disproportionately great enforcement efforts, resulted in reluctance in enforcement because of the disparity between the sanctions imposed and the offense involved, and led to the encouragement of extensive litigation. Thus, Congress found that pre-1970 law frequently did not preserve the integrity of private foundations. Congress further found that even arm's length standards permitted use of a private foundation to benefit improperly those who controlled the foundation.

Section 4941, as added by the 1969 law, expresses the determination of Congress to prohibit self-dealing transactions even on an arm's length basis and to provide a variety and graduation of sanctions.

I point out in my typed speech that one untoward consequence of the act is that many transactions which would actually benefit a foundation are penalized because of the elimination of the arm's length standards. Nevertheless, the IRS has found the arm's length standards of self-dealing to be unadministrable and the penalties of the Tax Reform Act seem to be much more workable.

Furthermore, they are self-enforcing. Tentative figures for the taxes that have come due under the chapter 42 provisions seem to show that, with the expanded IRS audit procedures, the foundations are not finding the 1969 law to be unworkable.

Tentative excise tax figures for the fiscal year ending June 30, 1973, not yet verified, show that the self-dealing tax is about $50,000 for all the foundations in the country, the income distribution taxes are about $43,000, the business divestiture taxes are $11,000, the jeopardizing investment taxes are about $11,000, and the taxes on taxable expenditures are under $2,000.

The only areas in the self-dealing provisions that I believe require some legislative attention in the next few years are some of the transitional rules which have been causing undue difficulty to many foundations.

Very briefly, there are at least four transitional rules that could be considered by Congress.

First, there is a transitional rule now in the statute which allows a disposition of excess business holdings by a private foundation to a related party if the foundation receives an amount which at least equals the fair market value of the property.

If the foundation receives less than fair market value, the transition rules do not apply and self-dealing taxes are imposed.

The regulations offer the best solution possible by imposing the self-dealing tax only on the difference between the amount the foundation receives and the actual fair market value.

There should perhaps be a transitional rule that states that a good faith attempt to reach fair market value and a promise to pay any amount by which a foundation is shortchanged should be sufficient without a self-dealing tax.

Second, there is much property that was owned before the Tax Reform Act in coownership by a foundation and its related parties.

Under the present law, the related party may either retain his partial interest, give his interest to his foundation, or sell his interest to an outsider. He generally is not permitted to purchase the foundation's interest, and in many cases the uniqueness of the property and its development have made it difficult to sell to outsiders.

There should be a transitional rule in the case of the sale of commonly owned property between a foundation and its related parties where the common ownership predates May 27, 1969, as long as the foundation receives fair market value as of the date of sale of the commonly owned property.

Third, Congress might consider a transitional rule for the leasing of office space for general administrative offices of the foundation and for routine supplies which are furnished by related parties to the foundation as long as the foundation is paying no more than fair market value for the property.

Fourth, there are many cases in which a private foundation is leasing property to a related party and, in cases where the property is unique and the related party has adapted the property for its own use, the foundation should be permitted within a transitional period to dispose of the property under the lease to the disqualified person as long as the foundation obtains fair market value.

This fourth proposed transitional rule is evidenced by a similar rule in the current pension bill for pension trusts which are allowed to dispose of property leased to related parties.

Returning to the general topic of my talk, the birth rate and mortality rate of foundations, at the present time, as Professor Simon has pointed out, the analysis of whether there has been a decline or increase in the birth rate may be premature, as the Tax Reform Act provisions have taken effect in the too recent past.

However, some speculation has been advanced to demonstrate that foundations are terminating in greater numbers than before the Tax

Reform Act and that fewer foundations are being created since the Tax Reform Act.

With regard to death and mortality, the reporting provisions and restrictions on foundations enacted in 1969 have probably made it uneconomical for many very small foundations to continue their operations. Thus, there has probably been an initial surge of foundation terminations which will not continue beyond the next few years and which is not an indication of a permanent trend.

Many small foundations, instead of terminating, have become affiliated with community foundations, have become affiliated with public charities, or have qualified as conduit organizations passing through their assets to public charities.

Other small foundations have developed economies of scale by engaging with one another in various types of joint service arrangements.

With regard to the birth rate, as Professor Simon has pointed out, the Tax Reform Act has provided less incentive for contributions of appreciated property to private foundations. I would like to recommend strongly that, when estate tax reform comes up for consideration in the next year, there should not be enacted any further restriction on bequests to private foundations.

The birth rate problem for foundations is a serious one, and there are currently many fortunes in real estate, the aerospace industry and oil, to name but a few, in the Midwest and Far West which could become the source of many foundations which would be able to service their immediate areas of the country.

It is my understanding that foundations now are primarily concentrated in the East and in urban areas, and I spoke last Friday to representatives of one large foundation which has received many requests over the last several years for grants to organizations in the Far West and the Midwest. Those organizations should have the opportunity to seek funds in their own areas.

Furthermore, as pointed out by other panelists, especially Mr. Dressner, the expenditure responsibility requirements have inhibited the birth rate of foundations. Many foundations have become lazy and, rather than complying with the reporting requirements, most of which are excellent, have required that their grant recipients be public charities.

Officers of one foundation have told me that, just as the IRS has long and short forms for taxpayers, their foundation has developed long and short forms for grantees, depending upon the size of the grantee, whether it is a new organization and whether the grantee is returning for a second or third grant.

At the very least, the reporting requirements might be made less onerous for operating foundations and where seed money is being given to a new organization to get its start in an innovative area.

The future birth rate of foundations may be affected by whether the private foundation rules introduced in 1969 are extended by additional legislation to public charities. As a general rule, the discipline of public support has proved to be an adequate restraint on the activities of public charities. There is no clear need for such specific rules as the self-dealing, income payout, business divestiture and taxable expenditure rules as are present for private foundations.

The principal concern with respect to public charities regarding future legislation should be the inflexibility of the present sanctions and the consequence of loss of exempt status.

The loss of exempt status is not an appropriate sanction because it does not enforce the charitable use.

It seems more appropriate, as was done for private foundations, to lock section 501(c)(3) charitable organizations into their charitable status.

Similarly, it would be desirable to permit small violations by public charities to be dealt with by a lesser penalty than denial of exempt status.

In this manner, there would be a substantially reduced incentive for private foundations to convert to public charity status or otherwise to terminate in order to escape the private foundation provisions of the 1969 act.

In conclusion, some factors have affected the birth rate and the mortality rate and future legislation may also do so.

Nevertheless, every effort possible has apparently been made by the statute and the Treasury regulations to provide for maximum flexibility in foundation operations.

The regulations have developed rules which offer more certainty, are conducive to better enforcement, and can be administered with greater assurance that they comply with congressional intent. The rules regarding the taxes on foundations and their managers seem to be both reasonable and consistent with the continued viability of philanthropic endeavors.

Thank you.

[Mr. Stein's prepared statement with his response to questions follows:]

SUPPLEMENTARY QUESTIONS SUBMITTED TO MALCOLM STEIN

Question 1. There is no question but that there were some transactions before 1969 which unfairly benefited a donor at the expense of a private foundation. Nevertheless, were these abuses so great as to justify the rather complicated self-dealing provisions of the Tax Reform Act of 1969?

Answer. With respect to self-dealing between private foundations and their disqualified persons, the arm's-length standards of prior law proved to require disproportionately great enforcement efforts, resulted in reluctance in enforcement because of the disparity between the sanctions imposed and the offense involved, and led to the encouragement of extensive litigation. Thus, Congress found that pre-1970 law frequently did not preserve the integrity of private foundations. Congress further found that even arm's-length standards permitted use of a private foundation to benefit improperly those who controlled the foundation. Section 4941, as added by the 1969 law, imposes the determination of Congress to prohibit self-dealing transactions even on an arm's-length basis and to provide a variety and graduation of sanctions. The self-dealing provisions seem to be self-enforcing, as only about $50,000 in penalty taxes were collected under section 4941 for the fiscal year ended June 30, 1973.

Question 2. Do the self-dealing provisions of the Tax Act present a possible booby-trap for unwary persons? For example, where do the guests of a small foundation stay when the only hotel in town is owned by a "disqualified person"?

Answer. The self-dealing provisions of the Tax Reform Act of 1969 did not present a possible trap for the unwary. The wide publicity given to the provisions, the audit programs of the Internal Revenue Service, and the efforts of such groups as the Council on Foundations have made private foundations generally aware of the pitfalls of violating the Tax Reform Act of 1969. Concerning the example which you have given in your letter of October 3, asking where the guests of a small foundation would stay when the only hotel in town is owned by a dis-

qualified person, Internal Revenue Code section 4941(d) prohibits the foundation from paying for the rooms of its guests where the hotel is owned by a disqualified person. The guests of the foundation may, of course, pay for their own rooms and stay at the hotel.

In my oral testimony on October 2, I did point out several areas that are presenting hardships to private foundations in the self-dealing area. I stressed the fact that legislative reform is advisable in the self-dealing area to adopt the following transitional rules:

(a) The transitional rules under section 4941 permit a disposition of excess business holdings by a private foundation to a disqualified person in certain cases if the foundation receives an amount which equals or exceeds the fair market value of the property. Thus, if the foundation receives less than full fair market value, the transitional rule does not apply and there may be an act of self-dealing. The Treasury Regulations impose a self-dealign tax only on the difference between the amount the foundation receives and actual fair market value. I recommended the adoption of a transitional rule that a good faith attempt to determine fair market value and a promise by the disqualified persons to pay the difference between the amount the foundation receives and actual fair market value are sufficient and that there should be no self-dealing in such a situation.

(b) I recommended a transitional rule to allow sales between a foundation and its disqualified persons of commonly-owned property where the common ownership predates May 27, 1969, and where the foundation receives full fair market value as of the date of sale.

(c) A third transitional rule which I suggested was that, in cases which predated the Tax Reform Act of 1969, a private foundation should be permitted to continue to lease its administrative offices from disqualified persons and to purchase routine office supplies from disqualified persons, as long as the foundation pays no more than fair market value.

(d) I recommended a transitional rule (similar to a rule in the Senate version of the current pension reform bill) that would allow the sale by a foundation to its disqualified person of property owned by the foundation and leased to the disqualified person, as long as such sale occurs within 10 years after the Tax Reform Act and provided that the foundation receives full fair market value as of the date of sale.

Question 3. Is self-dealing any more prevalent among foundations than it is among religious, education, medical or publicly supported institutions?

Answer. There is no necessary correlation between the type of organization (private foundations or religious, educational, medical or publicly supported institutions) and the prevalence of self-dealing. It should be pointed out, however, that the incidence of self-dealing was extremely low even before the Tax Reform Act of 1969, as indicated by pages 51–57 of the statement of Peter G. Peterson, Chairman of the Commission on Foundations and Private Philanthropy, before the Senate Finance Committee on October 22, 1969 (copy enclosed).

Question 4. Has the self-dealing regulation caused unjustifiable harm to people who entered into transactions in 1970 without an awareness of the self-dealing prohibitions of the 1969 Act? Should Congress provide a special transitional rule to protect such unwitting people, or should Congress provide a maximum tax of, say, $10,000 for a violation of the self-dealing provision coupled with the requirement to correct the improper practice?

Answer. The self-dealing rules have not caused unjustifiable harm to people who entered into transactions in 1970 without an awareness of the self-dealing provisions of the 1969 Act. No special transitional rule need be enacted by Congress at this time, because a special transitional rule has already been provided by section 53.4941(f)-1(b)(2) of the Treasury Regulations. That rule provides that, in the case of an act of self-dealing engaged in before July 5, 1971, the self-dealing tax shall not apply if the participation by the disqualified person in such act was not willful and was due to reasonable cause, if the transaction would not be a prohibited transaction if pre-1969 law applied, and if the act was corrected on or before July 15, 1973 (extended by any period which the Commissioner of Internal Revenue determines is reasonable and necessary to bring about correction of the act of self-dealing).

I hope the above answers prove helpful to you in your consideration of the Tax Reform Act provisions affecting private foundations and any additional proposed legislation. If you require any further information, I would be pleased to furnish it to your Subcommittee.

Thank you again for having invited me to participate in the proceedings of your Subcommittee on Foundations.

[Excerpt from Statement of Peter G. Peterson, Chairman, Commission on Foundations and Private Philanthropy, Before the Senate Finance Committee, Wednesday, October 22, 1969.]

V—Regulation of Foundations

While we conclude that foundations are institutions that have vital and in some ways unique roles to play in our society, we also conclude that certain abuses and dangers exist that deserve serious attention.

Precisely because foundations are private sector organizations, it is important they be given a great deal of freedom to make their distinctive contribution in their own way. On the other hand, precisely because foundations have been granted substantial tax deductions, the public has a distinct interest in knowing that charity receives a proper return on the investment society has made. Like any capital investment—and a foundation is ultimately a form of capitalized philanthropy—it is essential to look at both the short term—what are foundations doing for charity currently—and long term—what are foundations going to do for charity in the years ahead.

What kind of actions are needed to assure that foundations provide society with an adequate social return on the capital invested in them?

First, of course, we need to be concerned about various kinds of financial abuses that benefit the donor at the expense of the foundation and therefore of charity. This may be attributable, in some measure, to the donor's misconception that it is "his" foundation and therefore "his" money.

As an aside, let me note that the use of the term "private foundation" in the House bill is unfortunate. We believe the emphasis should be on the public, rather than on the private, character of foundations. Substituting the term "*philanthropic* foundation" might help to emphasize that foundations are there to benefit charity, not private individuals.

Second, there are what we might call grant making abuses that result from spending foundation money for purposes that are not properly charitable.

Third, and perhaps more serious are problems which adversely affect the amounts paid out to charity. This may be due either to poor investment management or to decisions to save foundation earnings for future uses.

SELF-DEALING PROBLEMS

Let us start with the financial abuses—the so-called self-dealing problems that give rise to a good deal of the "tax dodge" criticism.

What is the incidence of these abuses? Are they so frequent as to cause one to doubt whether the institution of foundations is worth saving, or are financial abuses at a level which represents an irritant which must be cured but not a cause for severely restricting foundations.

The problem this question presents to a non-governmental commission such as ours is an obvious one. We have no subpoena powers, nor the authority to audit. Thus, we had to try some indirect approaches. I use the word indirect to suggest that it obviously isn't as simply as asking the given foundation whether it engages in financial abuses.

Our first approach was to estimate the extent of transactions between the donor and the foundation that give rise to the possibility for abuse. Foundations are required on their tax return (Form 990–A) to answer certain questions relating to self-dealing transactions. We decided to tabulate some 500 of these forms. The answers are shown below and suggest that a relatively small fraction of the foundations seem to have transactions between the donor and the foundation.

SAMPLE OF IRS 990–A FORMS PRELIMINARY—OCTOBER 1969

Extent of self-dealing transactions[1] reported on form 990–A

	Percent
Borrowing income or corpus	1.5
Receiving compensation for service	2.5
Using services or assets	.5
Purchasing securities or other property	3.5
Selling services or property	5.5
Receiving income or corpus in any other transaction	1.1
Number of form 990–A's examined	492

[1] It must be emphasized that the current law does not prohibit self-dealing transactions but rather imposes an arms-length or reasonable standard. Thus, while these transactions are potential self-dealing abuses, it should not be assumed they are violations.

All this indicates of course is the potential for abuse and we searched for ways of getting at least an indication of the extent to which this potential was realized.

It occurred to our staff that tax accountants are perhaps better informed than anyone else and might be a source of information.

Arthur Andersen, a leading accounting firm, promised complete anonymity to some two hundred accountants across the country (they did not sign the questionnaires) if they would indicate their own experience with foundation abuses.

The answers of the accountants speak for themselves. They indicate that a very substantial majority feel that self-dealing abuses are rare. At the same time 5% to 10% believe these abuses to be quite common.

FOUNDATION ABUSES: ARTHUR ANDERSEN

STUDY C.P.A. FIRMS

A. "There are loose financial self dealings between small foundations and the donor or friends which work to the advantage of the donor or friends."

	Percent
Very infrequent	69
Not common	22
Fairly common	7
Very common	2
Total	100

B. "There is loose record-keeping by small foundations which make it difficult to know whether personal advantage is being taken by the donor or his friends."

	Percent
Very infrequent	68
Not common	24
Fairly common	5
Very common	3
Total	100

C. "There are high operating expenses relative to the assets or income of the foundations."

	Percent
Very infrequent	72
Not common	22
Fairly common	4
Very common	2
Total	100

Clearly any tax abuse is bothersome, but when it reaches a level above the extreme exception—then something drastic should be done. Our reading of these findings is that while it is quite unwarranted to suggest "foundations are nothing but tax dodges" there is enough potential for abuse to warrant vigorous action. We strongly support legislation that prohibits self-dealing.

A study of abuses would be superficial if it assumed that the currently acknowledged abuses are the only ones to be concerned about. Through a wide variety of sources we have identified some additional abuses that we believe are worth your specific attention. Permit me to illustrate some of these.

1. Company foundations have been largely ignored in much of the anxiety over foundation abuse. They should not be. We believe these are solutions in which company foundations seem to be making grants that are more appropriately business expenses. The privilege of tax exemption on income is, of course, extended to foundation income but *not* company income. It is thus improper to use foundation funds for what are properly business expenses.

Two illustrations will suffice. *First*, grants of a foundation for research in the industry in which the company operates has significant potential for special benefits to the company. How should the *public* be made aware of and benefit from such research? How do competitors gain access to this research? *Second*, company foundation grants to customers or suppliers of the company present some complex issues which deserve careful scrutiny.

2. Serious abuses may result from the over-valuation of property contributed by a donor to his foundation. Although over-valuation problems can also arise in

connection with contributions to other charitable organizations, the potential for abuse may be somewhat more acute in the case of foundations where the donor is in effect on both sides of the transaction. The risk of self-dealing abuse is aggravated by the infreqeunt level of government auditing; the passage of time after a transaction has taken place complicates the problem of determining a fair valuation.

We would recommend that significant contributions of property to foundations be validated by independent appraisals at the time of the contribution.

3. Substantial overlap in stock ownership between donors and foundations appears to be fairly common. This raises some rather interesting questions of how one can be sure that the foundations' interest in maximizing the return from portfolio protected. One need not be unduly imaginative to visualize a case in which the donor has the foundation buy stock in a company in which he also owns stocks, in order to inflate the price artificially so that he can profit; or, alternatively, sell his stock in a market downturn before the foundation stock is sold.

Disclosure requirements specifically directed to such transactions would probably help reduce their incidence.

4. We have also heard about cases in which the foundation conditions a grant to a charitable organization by specifying that an individual related to the donor should receive benefits, such as free tuition in a religious school. Once again, improved disclosure on all grants where individuals are specified, could be helpful in discouraging such practices.

5. We have seen a few cases where excessive administrative expenses resulted in a diversion of funds from charity.

The Commission favors a legislative prohibition on payment of excessive or unnecessary expenditures. Such expenditures should be limited to the same kind of "ordinary and necessary" rule of reason that is used in the deductibility of business expenses.

INCREASED IRS AUDITING

Once the abuses to be corrected have been identified, it is obviously necessary to make sure that the legislative intent be carried out. We believe that the most effective weapon both for determining the level of abuses and minimizing them in the future is an intensive auditing program. That audits program has not been adequate, at either the federal or the state level, is obvious from the following chart from our foundation survey.

Testimony by Malcolm L. Steen, Attorney, Roberts & Holland

I. INTRODUCTION

The provisions of the Tax Reform Act of 1969 relating to private foundations imposed a comprehensive body of law on these organizations for the first time. The viewpoint of Treasury Department officials as to how the foundation provisions would affect foundations' operations, at least from May 1969 to September 1971 while I was a staff attorney in the Office of the Assistant Secretary of the Treasury for Tax Policy, was not too divergent from the views of State attorneys general and the foundation community.

In general, the Treasury Department viewed these provisions as a set of reasonable restrictions on foundation activities, accompanied by flexible sanctions and penalties which are tailored to the extent of the violation. The self-dealing and income distribution provisions of the Act are probably the most necessary limitations placed upon the activities of foundations—they will affect the greatest number of foundations and quantum of activities and were the proposals most widely supported by the foundation community in 1969. Of course, the business divestiture requirements and the restrictions on political and grant-making activities will also have a substantial impact on foundations in the future.

In three areas, the foundation provisions of the Act vary somewhat from the Treasury proposals of 1968–1969. First, Congress imposed a tax of 4 percent of net investment income, which will materially reduce the funds available for charitable purposes. Second, the restrictions on political activities and grant-making go well beyond Treasury proposals. Third, although the penalties in the Act are more flexible than those in the 1969 House bill, although the violations can be corrected in certain circumstances, and although sanctions are imposed on foun-

dation managers only if they act willfully and without reasonable cause, they do not provide as wide a degree of flexibility as would the Treasury proposal, which was not adopted, for equity jurisdiction in the courts with regard to the imposition of penalties.

This statement deals primarily with the effect of taxes and penalties upon foundation operations, activities, potential for innovation, and birth rate.

II. TAXES AND PENALTIES ON FOUNDATIONS AND MANAGERS

A. Taxes on self-dealing illustrate the statutory pattern

In 1950, amendments were made to the Internal Revenue Code setting forth specific self-dealing transactions which were prohibited between certain classes of persons and their foundations. Arm's-length standards were imposed with regard to loans, payments of compensation, preferential availability of services, substantial purchases or sales and substantial diversions of income or corpus. Sanctions were the loss of exemption for a minimum of one taxable year and the loss of the charitable contribution deduction under certain circumstances.

The arm's-length standards proved to require disproportionately great enforcement efforts, resulted in reluctance in enforcement because of the disparity between the sanctions imposed and the offense involved, and led to the encouragement of extensive litigation. Thus, Congress found that pre-1970 law frequently did not preserve the integrity of private foundations. Congress further found that even arm's-length standards permitted use of a private foundation to benefit improperly those who controlled the foundation. Section 4941, as added by the 1969 law, expresses the determination of Congress to prohibit self-dealing transactions even on an arm's-length basis and to provide a variety and graduation of sanctions.

If an act of self-dealing occurs, the first-level tax on the self-dealer is 5 percent of the "amount involved" with respect to each act of self-dealing for each year (or part thereof) from the date the act occurs until the self-dealing is corrected or a deficiency notice is mailed regarding the transaction, if that is sooner. The "amount involved" is the greater of the value of what the foundation gave or what it received at the time of the self-dealing, except that in the case of excess compensation paid for personal services to persons other than government officials it is only the excess compensation which is the "amount involved."

The first-level tax is imposed, jointly and severally, on all disqualified persons who participated in the act of self-dealing other than a foundation manager acting only as such. This tax is imposed even if the violation is inadvertent, except that as to a government official acting in his governmental capacity the tax is imposed only if he knowingly participated in the self-dealing.

In addition, there is a tax of 2½ percent on any foundation manager knowingly participating in the self-dealing, unless the participation is not willful and is due to reasonable cause. The tax may not exceed $10,000 in the aggregate for all managers with respect to any one act of self-dealing, and they are jointly and severally liable.

A second-level tax of 200 percent of the amount involved is payable by the persons on whom a 5 percent tax is levied if the act is not "corrected" (*i.e.*, undone to the extent possible). If undoing is not possible, the foundation must be made whole by being placed in a financial position not worse than that in which it would have been if the disqualified person had been dealing under the highest fiduciary standards. Correction must be made within a "correction period" beginning on the date on which the act of self-dealing occurs and ending 90 days after the mailing of the notice of deficiency with respect to the second-level tax, extended by any period in which a deficiency cannot be assessed as a result of the filing of a petition in the Tax Court or any other period which the Commissioner determines is reasonable and necessary to correct the act.

A second-level tax of 50 percent of the amount involved is imposed on any foundation manager who refuses to correct the act of self-dealing, but the maximum tax is $10,000 in the aggregate for all managers with respect to any one act of self-dealing and the liability of the managers is joint and several. The amount involved for purposes of the second-level tax is determined at its highest fair market value during the correction period.

The type of property involved, the complexity of the transaction, and the manner in which correction may be accomplished may affect the amount of the taxes imposed under the Treasury regulations.

B. *Specific problems involving penalties upon foundations and their managers*

A brief selection of problems under the various foundation provisions will serve to illustrate various beneficial or deleterious effects of the rules.

1. Self-dealing

An installment sale between a foundation and one of its managers may involve a sale, a loan, and a transfer to a disqualified person of the foundation's income or assets. The question arises whether the manager should be taxed once or more than once with respect to the same transaction. Such a self-dealing transaction may also be covered by the provisions of section 4945(d)(5), which penalizes any amount paid or incurred by a private foundation for any purpose other than a charitable purpose.

One possible position would be to impose only one tax under a particular Code section for a particular transaction, but to impose more than one tax on the transaction if it is covered by more than one section of the Code. However, perhaps it is too harsh to tax a transaction doubly even in the situation where two different sections are involved. The question then remains whether the Internal Revenue Service should have the option to choose that section which will produce the highest tax or which has the lightest burden of proof. It is probably too difficult for the regulations to prescribe detailed rules in this area, and the Service should be accorded the discretion to choose the section which it desires to use.

Another untoward consequence of the Act is that many transactions which actually benefit a foundation are penalized because of the elimination of arm's-length standards. For example, a transfer of real property by a disqualified person to a private foundation is treated as a sale or exchange if the property is subject to a mortgage which the foundation assumes or if it is subject to a mortgage which a disqualified person placed on the property within the 10-year period ending on the date of transfer. Thus, in the case of private foundations such a transaction is prohibited rather than merely being limited by the bargain sale rules of section 1011(b).

2. Income distribution

The income distribution requirements imposed on foundations by the Tax Reform Act should generally be considered beneficial, although certain drawbacks are present. Although a large number of foundations have supported these provisions, a majority of foundations will be forced to change their investment and expenditure policies in order to comply with the new distribution rules. Some foundations have already complained about these provisions and at least two have attempted to get legislative relief.

The high distribution requirement is principally the result of testimony by The Honorable Peter G. Peterson before the Senate Finance Committee in October 1969 when he was the head of the Commission on Foundations and Private Philanthropy. He testified that foundations should be required to make annual distributions to charity in the range of 6 to 8 percent of the fair market value of their assets. The Commission's reasoning was:

> The annual total return of a wide variety of balanced investment funds over the previous ten years was about 9 to 10 percent. Allowing for an annual rate of inflation of 2 to 3 percent, we felt that a payout of 6 to 8 percent would permit a reasonably managed foundation to maintain its size in *real* dollars.

It was the Commission's position, therefore, that "the only correct yardstick for measuring investment performance is the *total rate of return.*"

The final result was not totally in accord with the Commission's recommendation. The distribution rules of section 4942 require a foundation to spend the greater of 6 percent of the fair market value of its portfolio or all of its adjusted net income, excluding long-term capital gains, on an annual basis. A definition of income that excludes long-term capital gains represents a distortion of the central intent of this provision, because "the income test will tend to cause foundations to invest in growth stocks or other appreciating assets in order to receive return in a form which is not 'income.'"

Another problem concerning the distribution requirements involves the criteria for changing the 6 percent standard from time to time. Code section 4942(e)(3) sets forth the rule that the percentage distribution requirement for any taxable

year beginning after 1970 shall bear a relationship to 6 percent which is comparable to the relationship which the money rates and investment yields for the calendar year immediately preceding the beginning of the taxable year bear to money rates and investment yields for the calendar year 1969. The regulations should relate changes in the percentage distribution requirement to a standard which will insure substantial philanthropic distributions but at the same time will not fluctuate widely from year to year.

3. *Lobbying and political activity*

The rules relating to lobbying, political activities and grant-making by foundations, coupled with the penalties under section 4945, seem on their face to inhibit foundations from participating in many fields of social concern and human endeavor. For example, section 4945(e) prohibits a private foundation from making "any attempt to influence any legislation through an attempt to affect the option of the genoral public or any segment thereof, . . . other than through making available the results of nonpartisan analysis, study, or research." The prohibition against an attempt to affect public opinion, rigidly construed, might allow no room for the continuance of constructive work by foundations in the fields of population control, ecology, the arts, public broadcasting, and the administration of justice, to name but a few.

However, in this area as in others relating to program activities of foundations, the regulations have interpreted the statute liberally, construing "nonpartisan analysis, study, or research" to permit "examinations and discussions of broad social, economic, and similar problems . . . even if the problems are of the type with which government would be expected to deal ultimately." The regulations proceed to state as follows:

> Thus, the term "any attempt to influence any legislation" does not include public discussion, or communications with members of legislative bodies or governmental employees, the general subject of which is also the subject of legislation before a legislative body, so long as such discussion does not address itself to the merits of a specific legislative proposal.

Another ameliorative provision permits a private foundation to appear before, or communicate with, any legislative body with respect to a possible decision of such body which might affect the existence of the foundation, its powers and duties, its tax-exempt status, or the deduction of contributions to the foundation. Thus, had this provision been in existence before 1969, it would have been clear that foundations could have testified for or against the Tax Reform Act provisions affecting them which were eventually enacted that year. The final Treasury regulations make it clear that a foundation may initiate legislation of this type by communicating with a legislative body without first receiving a request from the legislative body to do so.

The problems presented by the statute and its lack of clarity compound the fact that the penalties on foundations and managers are seemingly harsh, because the foundations and managers are deterred from acting in the gray areas where the rules are unclear. However, as illustrated above, the final Treasury regulations have considerably alleviated this deterrent effect by eliminating much of the lack of clarity.

4. *Liability to state penalties*

There is one further area of potential problems confronting foundation managers. Regardless of whether a foundation or its manager is subjected to taxes or penalties under the Internal Revenue Code as a result of a particular transaction, the scope of the manager's liability under state law is unclear. Such liability varies from state to state, and there is very little developed authority at this time after only about four years of experience under the Tax Reform Act of 1969. In any event, depending upon the state in which the foundation is located and the transaction occurred, state law may be yet another inhibiting factor with respect to the foundation's creative instincts and natural areas of concern.

III. EFFECT OF TAX REFORM ACT OF 1960 ON BIRTH RATE AND MORTALITY RATE OF PRIVATE FOUNDATIONS

At the present time, an analysis of whether there has been a decline or increase in the birth rate of foundations may be premature, as the Tax Reform Act provisions have taken effect in the too recent past. However, some speculation has

already been advanced to demonstrate that foundations are terminating in greater numbers than before the Tax Reform Act and that fewer foundations are being formed since the Tax Reform Act.

The reporting provisions and restrictions on foundations enacted in 1969 have probably made it uneconomical for many very small foundations to continue their operations. Thus, there has probably been an initial surge of foundation terminations which will not continue beyond the next few years and which is not an indication of a permanent trend. Many small foundations, instead of terminating by distributing all of their net assets, have become affiliated with community foundations or other public charities or have qualified as pass-through organizations. Other small foundations have developed economies of scale by engaging with one another in various types of joint service arrangements.

The Commission on Foundations and Private Philanthropy stated in 1969 that "contributions to grant-making foundations in the future will be discouraged by provisions in the tax law—this because the provisions make contributions to a grant-making foundation a less attractive prospect for a wealthy individual than it has been in the past." It is true that the Tax Reform Act has provided less incentive for contributions of appreciated property to private foundations, and the limitation on foundation ownership of business enterprises appears greater than necessary in order to insure that the donor will not use his foundation to maintain control of his company. However, the foundation community seems to be living quite well under the Tax Reform Act restrictions as interpreted by the Treasury regulations, and the volume of complaints about the private foundation provisions has considerably subsided in the past two years.

The Commission evaluates the 1969 Act as a mixture of blessings and burdens, with blessings predominant. The report strongly endorses the self-dealing, income distribution, reporting, and foundation manager penalty provisions. It criticizes the 4 percent tax, the business divestiture rule, and the imposition of taxes upon the assets of the foundation. However, the report itself recognizes that charity often suffers when foundation assets consist of stock with voting control over a business enterprise, and there are exceptions in the Act to many of the private foundation provisions which meet some of the Commission's concerns.

The future birth rate of foundations will also be affected by whether the private foundation rules introduced in the 1969 Act will be extended by additional legislation to encompass public charities as well. Although some changes affecting public charities may be merited, neither Congress nor the Treasury Department has apparently reached any final conclusions as yet. As a general rule, the discipline of public support has proved to be an adequate restraint on the activities of public charities. There is no clear need for such specific rules as the self-dealing, income payout, business divestiture, and taxable expenditure rules as are present in sections 4941 through 4945 for private foundations. The conditions arising at law generally that the public charity's property be devoted to charitable use will ordinarily be sufficient.

The principal concern with respect to public charities, as for private foundations before the 1969 Act, is the inflexibility of the present sanctions and the consequence of loss of exempt status. The loss of exempt status is not an appropriate sanction because it does not enforce the charitable use, on the basis of which the deduction for charitable contributions and the exempt status of the organization were previously allowed. It seems more appropriate, as was done by section 509(b) in the case of private foundations, by some means to lock all section 501(c)(3) organizations into charitable status. Similarly, it would be desirable to permit small violations of the charitable use condition to be dealt with by a lesser penalty than denial of exempt status. The net effect would be that an organization, once determined to be legally organized as a charity for federal tax purposes, could not thereafter escape the requirements of federal law regarding administration of its assets for charitable purposes. In this manner, too, there would be a substantially reduced incentive for private foundations to convert to public charity status or otherwise to terminate in order to escape the private foundation restrictions of the 1969 Act.

IV. EQUITABLE REMEDIES

The Treasury proposals of April 22, 1969 provided for specific sanctions for each of the substantive rules, in the form of civil penalties against errant individuals and divestiture requirements against the foundation. Imposition of these

specific sanctions was to be mandatory upon the finding of a violation. In addition, United States district courts were to be invested with a set of equity powers sufficient to remedy any violation of the substantive rules in such a manner as to insure no financial detriment to the foundation (including, but not limited to, power to rescind transactions, surcharge trustees, and order accountings) and to preserve the assets of the foundation for charitable purposes (including, but not limited to, power to substitute trustees, divest assets, enjoin activities and appoint receivers).

In order to give the states a substantive right to enforce the prohibitions against self-dealing, inadequate charitable distributions and improper business interests, the Treasury proposed a rule which would have conditioned the grant of exemption upon inclusion in the organization's governing instrument of provisions requiring it to comply with the statutory standards. Old organizations were to be given five years to apply for exemption with amended governing instruments. Any organization which failed to apply in such manner would have lost its exemption from the effective date of the legislation.

Equitable remedies, even as proposed by the Treasury Department in 1969, were in addition to the specific sanctions and not in lieu of them. Thus, the Treasury apparently recognized that specific rules were necessary in order to make more certain the types of activities which would be prohibited, while equity powers in the courts would enable the sanctions to be tailored more closely to the extent and magnitude of the violations. In light of the manner in which the Treasury regulations have safeguarded foundation managers against the imposition of taxes and penalties, and in view of the liberal interpretation which the regulations have given to violations of the private foundation rules, equity powers seem less necessary now than they did before the regulations were published. Moreover, rescission of certain transactions is required under the Treasury regulations, and state officials have been involved in the enforcement process by reason of the governing instrument provisions, the procedures for correction of various transactions, and the reporting and disclosure requirements imposed upon foundations.

V. CONCLUSION

The Treasury Department seems to be relying heavily upon the cooperation of the attorneys general and the foundation community in the years following the enactment of the 1969 law. Every effort possible has apparently been made in the regulations to provide for maximum flexibility within the statutory limits, without any desire or purpose to limit the scope of proper foundation activities in any way. The regulations have developed rules which offer more certainty, are conducive to better enforcement, and can be administered with greater assurance that they comply with Congressional intent. The rules regarding taxes and penalties on foundations and their managers seem to be both reasonable and consistent with the continued viability of philanthropic endeavors.

Senator HARTKE. Senator Curtis.

Senator CURTIS. Mr. Chairman, I will make my questions brief.

I want to say that the statements presented this morning in the main have confirmed my belief all along, I think the 1969 Tax Act was the worst tax bill ever passed by the U.S. Congress, and I said so at the time, and it was not only foundations but across the board. It was anticharity from the beginning.

I voted against it in this committee, I wrote a minority report, I voted against it on the floor, I refused to sign the conference report, I voted against the conference report. My only regret is that I only had one vote to vote against the bill.

I concur with the criticism advanced.

I would like to ask Mr. Mawby what effect will the divestiture requirements have upon Kellogg?

Mr. MAWBY. I think, Senator, it is clear from the evidence which we have presented that the holding of Kellogg stock has been beneficial to public charity because of both the rate of current return and the appreciation in value, which has permitted the expanding program of public activities of the foundation.

The divestiture provisions of the law, of course, we are very familiar with and very concerned about. Under the provisions of the transitional period of the act, it has not yet been necessary for us to sell any of our holdings. We are conscious of the divestiture provisions and we will be operating in conformance with those.

But we would hope that those provisions might be modified as the testimony has suggested this morning.

Our primary concern, however, is with the payout provision which will require divestiture of our holdings. We feel that is not in the best long-term public interest.

Senator CURTIS. You base that statement on the fact that timewise divestiture has not caught up with you?

Mr. MAWBY. Hasn't caught up with us yet; that is right.

Senator CURTIS. In the bill the House sent over you had a 5-year period.

Mr. MAWBY. That is correct.

Senator CURTIS. Which would mean about a year after they got the regulation out.

But in general I think that is a very harsh provision. I think when new foundations are created the individual or the company give that which they have, which is stock in their own company.

Mr. MAWBY. I think, Senator, a number of foundations have found it necessary to sell their major holdings. Their experience has been really that they have lost their shirt in this process, they have been forced to sell stock and the impact in terms of the assets of the foundations and their long-term viability in public benefit has been reduced by this course, divestiture.

Senator CURTIS. And you have made a real contribution in your tabulation, showing the effect the minimum distribution requirement had in applying it to the years back.

Senator HARTKE. I thought there was a sincere effort made here, as far as I saw and what I participated in, to provide for some elimination of what appeared to be abuses in the administration of foundations, not against foundations but abuses in the procedures and the operation of the foundations to make them more responsive to public need.

Senator CURTIS. Well, I guess we must have been listening to different people.

Senator HARTKE. I don't know who you listened to. I was in the Senate hearings and I didn't hear that in the committee hearings.

Senator CURTIS. At one point in the conference——

Senator HARTKE. I wasn't in the conference.

Senator CURTIS. I said this provision, if it remains will mean the end of new foundations. The reply I got was "That is what we want."

Senator HARTKE. The reply from whom?

Senator CURTIS. I am not going to disclose that.

Senator HARTKE. If the accusation is made, it is only fair we have—in other words, if these hearings are going to go out on the basis of being anti- or pro-foundation, I think that the hearings have been established for the purpose of trying to——

Senator CURTIS. I didn't say anything about these hearings.

Senator HARTKE. For an assessment and oversight hearings basically at this moment of the 1969 law, and even in the panels there is a difference of opinion which has been expressed upon certain parts of the legislation, which I think is not necessarily indicative of the fact that they are profoundation, antifoundation, or pro anything, except that that is their interpretation, which I think is fair.

I personally——

Senator CURTIS. Mr. Simon, I noted what you had to say about the declining of the birth rate of foundations.

Professor SIMON. Yes, sir.

Senator CURTIS. The fact of the matter is it has laterally stopped, hasn't it?

Professor SIMON. I don't know that I can say it has stopped. I must say that the information which was presented in my statement is information that is inevitably out of date already, that is, that the latest information I presented here was from a supplement to the cumulative list of organizations, and that supplement came out in early 1973 and therefore probably covered a period in 1972.

I do not know what has happened in the last year.

As of the end of 1972, it hasn't stopped, but it had slowed down dramatically, the formation of new foundations had slowed down dramatically.

If I may say there may be lawyers who represent foundations who could provide more up-to-date information on what is happening these days.

Senator CURTIS. Well, the statistical reporting is always a little bit behind the fact in any field but the report I get from various law officers, they are not creating any new foundations, just at a standstill.

Mr. Myers, I was very much interested in your discussion of the divestiture provisions.

Will you enumerate again just in very brief capsule what amendments you would suggest to the law?

Mr. MYERS. Well, there are three or four proposals. These are the mildest amendments, I should say. They keep the statute alive but they provide for flexibility. One would permit the foundation to prove that that someone identified as a "disqualified person" for section 4943 purposes so his stock is lumped with the foundation, is in fact not a disqualified person or even an adverse person so that the situation disqualified person's stock would not be counted in determining the requirements of divestiture.

The second would give the Secretary the essential power, under rules which could be established, to extend the period of time within which divestiture is required because as I have indicated, it is perfectly clear that there will be many situations where the foundations simply cannot comply because they cannot sell sell the interest. A third propose which I think is very important, is that there should be liberal transition rules with respect to divestiture in the case of foundations coming into being or being funded, which are subject to the immediate 20 percent limitation.

Senator CURTIS. Extend the time?

Mr. MYERS. That is right. If the basic rules had been applied as of 1969 many foundations would have found it impossible to comply before 1974.

Senator CURTIS. An absolute requirement would have been a lot of fire.

Mr. MYERS. Yes, and I think I am particularly concerned about foundations which have interests in small companies where development of a market may be impossible.

Senator CURTIS. I think your suggestions are very good. It would be my hope that not too much of the relief be granted, or at least not be restricted to the discretion of the Treasury Department, not that they would not be fair. I am sure they would intend to be fair, but I am thinking of the smaller foundation, the donor with less property to give and a less sophisticated group of talent to turn to to get those things done.

Mr. MYERS. I would agree completely because the case of the small company and the small foundation, there will not be available the advice and the sophistication that is otherwise available. I would agree with you that the rules could well be more rigid in the sense of taking away from the Secretary discretion and where certain facts exist, providing an automatic extension of time.

I had one more comment.

I did propose one other suggestion in my written statement and that which has to do with the question of self-dealing, in the case of redemption by the company itself.

Under the present statute there is a transition period of 5 years within which the company can redeem stock if the company is a disqualified person without there being an act of self-dealing.

I think that this method of divestiture should be available beyond that 5-year period and I would hope that the Congress would write a statute that would permit that rather than cut it off in 5 years.

Senator CURTIS. My recollection of the argument often heard in favor of the divestiture was one where they contended that the foundation was maneuvered for the benefit of the other stockholders.

Of course there were instances where that would not apply at all.

I had in mind one foundation which has done an outstanding job where it was the sole owner of the business that paid every tax under the sun, there could be no conflict of interest because there wasn't anybody to benefit by the maneuvering of the foundation owned stock.

During that time I had a conference with some people identified with another foundation that has done a most outstanding job. For hospitals, new schools, and good causes, and I knew that they would be very materially affected by the divestiture requirements, but they never mentioned it.

I asked them why. Well, they said we have an answer to it. We can merge with a larger company and bring the percentages down. So, while not every merger is against the public interest, but certainly the Government itself should not be adding impetus to mergers of companies, and this is a good size company.

Mr. MYERS. I can conceive that this pressure will exist. I know situations where that is the only solution.

I might say that Professor Simon mentioned three reasons for the divestiture. He referred to competition, unfair competition, the fact that foundations had a low-income yield and, of course, a diversion of the interest of the management from the exempt functions of the foundation.

Now, as far as competition is concerned, that cannot be the reason. Since 1950 the foundations have been fully taxable on business ventures. I cannot see any competitive advantage whatsoever. As far as the low-yield problem is concerned, this is settled by the payout provision because it does not make any difference whether it is low income or not, there is a payout required. So the only reason for the statute must be the alledged diversion of interest from exempt function. As I have indicated, I understand the necessity of having an absolute, flat percentage kind of a test, any other test is rather difficult to administer. However, there should be flexibility within this test to permit holdings which do not really contravene the intent of the statute.

Senator CURTIS. There is a vast difference between cumulating income that could be disposed of——

Mr. MYERS. That is right——

Senator CURTIS [continuing]. And a requirement that forces a liquidation of the corpus.

Isn't that right?

Mr. MYERS. Yes, sir.

Mr. MAWBY. While our main statement was on payout, as you wisely sensed, we are very much concerned also with divestiture. We feel that the evidence to date would suggest that serious consideration should be given to repeal of the divestiture provision, that those foundations which have been involved in divestiture, as I have indicated, have lost their shirts.

We do not feel that it is the best long-term interests of the public to continue——

Senator CURTIS. I don't think it is.

I think that the one type of abuse that it sought to deal with can be dealt with in other ways.

Mr. MAWBY. Exactly.

Senator CURTIS. I would be the last person to contend that foundations here and there have not done something wrong. I know of a particular one, where the foundation did own considerable company stock. The manager of the company, the owner-manager picked up his phone and called the manager of the foundation and told him to buy *x* number of shares of the company stock.

There were other ways to deal with such a case, it is covered very clearly by the fiduciary requirements in the fairly dealing and so on. But that was the category of evils that were cited in reference to the need for divestiture.

But the act, I hope something can be done before the 5 years run.

Mr. Dressner, I want to make sure I understand your question.

Excuse me, I want to ask Mr. Mawby one more question.

How much tax did the Kellogg Foundation pay, the foundation, on this new 4-percent tax?

Mr. MAWBY. About $880,000 this year.

Senator CURTIS. What would have been done with that if the tax hadn't existed or had been in a lesser amount just to pay for the servicing fee?

Mr. MAWBY. Well, our policy is also to distribute all income so those funds would have gone to grantees, universities, colleges, hospitals, other eligible grantees in our fields of interest, which are health, education, and agriculture.

Senator CURTIS. Mr. Dressner, do you now support the 4-percent excise tax on foundations?

Mr. DRESSNER. We do not support it at that level, Senator Curtis. We are hopeful and I think we share the views that have been expressed on the platform frequently in the last 2 days, the hope that the tax could be leveled at a rate that would provide the IRS with the fund that it needs to do a very thorough ongoing audit of the charitable field.

Senator CURTIS. Do you now support the 6-percent mandatory payout, which will reach 6 soon?

Mr. DRESSNER. Senator, our position is that we have no difficulty in the Ford Foundation in meeting that requirement.

I think we are quite sympathetic, I should say think, we are quite sympathetic to the concerns that have been expressed by other foundations that have not been able to divest as we have been able to over the last many years.

In a recent hearing before the Ways and Means Committee there were a number of, I am happy to report, complimentary remarks made by Members of the House about the way in which we have divested our Ford Motor Co. stock over the years. At one time we held 85 percent, all nonvoting shares of the equity of that company. Today we are down to below 9 percent and by December 1974, when the act will completely prohibit any further dealings between the Ford Foundation at fair market value, between the Ford Foundation and Ford Motor Co., we really hope to be wholly out of ownership of Ford Motor Co. stock or certainly below the 2 percent.

Senator CURTIS. I am not asking how it applies to Ford, I am asking you as a representative citizen here testifying, do you favor the mandatory payout requirements of the law?

Mr. DRESSNER. We certainly favor mandatory payout requirements but we are very sympathetic to the concerns of foundations that find it difficult to meet the rate of payout as now prescribed and we would certainly not oppose in any way a reconsideration by the Congress of the payout requirements.

Senator CURTIS. Do you recommend it?

Mr. DRESSNER. Senator Curtis, I would be speaking without the authority of our board of trustees to say that on behalf of the foundation I recommend it.

But I believe our board of trustees would be sympathetic to such a review and even reduction.

Senator CURTIS. Do you now support the provision in the law requiring divestiture?

Mr. DRESSNER. Well, we believe, Senator, that the divestiture provisions on the whole probably enable most foundations to divest in an orderly way, but again, as you pointed out yesterday, there are thou-

sands of foundations, and in particular instances, perhaps many, I would assume there are some foundations who would have difficulty with even the present divestiture provisions.

I certainly share the recommendations that John Holt Myers has made this morning that there should be some liberalizing of some aspects of those provisions.

Senator CURTIS. Do you support the present provisions of the law with respect to gift of appreciated property to a foundation?

Mr. DRESSNER. I would like to see a change there, Senator Curtis.

Thus, assuming again Congress continues to support the idea of private philanthropy, I would like to see a change that would permit appreciated securities to be given to established foundations without the present "penalties," in a sense, in the law against doing that.

Senator CURTIS. I am glad to get your further elaboration on these points because I got a totally different view of your contention when you opened by saying the law is working well.

Mr. DRESSNER. Well, you see——

Senator CURTIS. I don't think it is working well, I think it is creating havoc with most of our foundations. I just cannot understand how it could be contended the law is working well.

Mr. DRESSNER. Senator Curtis, I do want to attach a proviso to my statement. I was asked to address particularly, in the way our panel was organized, the program restrictions and my comments were addressed very particularly to those restrictions.

There is no doubt in my mind that there are some changes that could be made advantageously in other provisions of the law which other panelists addressed and which you have now asked me about more specifically.

Senator CURTIS. Well, I do not think that the actions of the Congress should be measured by those things that a large foundation like Ford could survive under.

Mr. DRESSNER. I agree with you.

Senator CURTIS. I think that is what happened and I think that was an element in the 1969 deliberations.

Mr. DRESSNER. I agree with you wholeheatedly on that point. I want to add for the record over these last few years when we have often been the center of inquiry, the Ford Foundation, because of additional administrative staff, has been able to attend to these kinds of problems and study them.

We have often been the center of inquiry on the part of smaller foundations who have come to ask for assistance in interpretation of this or that section of the law and I certainly agree that small and medium size foundations are probably having considerable difficulty, and certainly the kind of administrative costs in some cases that are penalizing charitable objectives.

Senator CURTIS. How much stock did the Ford Foundation own in the Ford Co. at the end of its fifth year?

Mr. DRESSNER. Well, I don't have that——

Senator CURTIS. It was a sizable amount?

Mr. DRESSNER. Yes; and, as I say, we began with ownership of a large number of shares outstanding at that time. In the beginning 85 percent and then we had the large public offerings in the early years and gradually divested.

Senator CURTIS. That was more than 5 years after?

Mr. DRESSNER. Yes, sir.

Senator CURTIS. What would have happened to the value of Ford stock in the hands of others if there had been a 5-year divestiture requirement?

Mr. DRESSNER. Well, I really do not address that question with any authority but I am sure——

Senator CURTIS. I think you owe it to the other foundations to carry on their battle a little bit.

That is all, Mr. Chairman.

Senator HARTKE. All right, let me ask a question here of this panel.

You know, I suppose that I am just naive enough to believe that maybe foundations are still not without some sin, especially since we live in a human world in which infallibility is not the hallmark of all activities, and in the announcement of these hearings I said there would be two panels on this day. The first panel will discuss the effects of the Tax Reform Act of 1969 on the operation and support of private foundations. I think to a great extent you have done that, including consideration of whether any areas of abuse remain.

You certainly have done that.

Now, are you that prejudiced in your viewpoint that there are no abuses in the foundations whatsoever, or did we get the wrong group?

Mr. DRESSNER. One of the things that hasn't happened yet insofar as the Tax Reform Act in 1969 is concerned is the thorough-going audit that I am certain all foundations are going to be subjected to. I can recall prior to the Tax Reform Act the last audit of the Ford Foundation was a 3-year audit covering 2 of our fiscal years prior to the Tax Reform Act. So it is quite possible that—not necessarily at the Ford Foundation not with the scrutiny that we have made of every grant since the Tax Reform Act—but abuses may be uncovered here and there.

Senator HARTKE. I just address this to all of you.

Mr. DRESSNER. I'm sorry.

Senator HARTKE. No, no. Here is the proposition as I see it.

Whether Senator Curtis is right or wrong at this moment is one of the problems we are having these hearings about, and he is certainly entitled to his views and he evidently has them. But that is not my deep concern. If I am correct, and you said that I was correct this morning, there is at this time still a feeling in the general arena of the public marketplace that the foundations are not performing all of the things they should in the interest of the general welfare. I think maybe it would appear much more objective if there had been a look at some of the abuses, or am I just to assume that there are no abuses left in foundations?

Mr. MAWBY. As the administrator of one foundation I did not understand that I was invited here by the subcommittee to testify on foundation abuses. There was nothing in the invitation extended only 10 days ago or in the agenda provided to us which suggested I comment on that topic. We work hard at our business of doing a good job as a foundation. There is no way in which I would have available to me such information.

I assume that if the subcommittee is interested in the question of possible abuses in foundation operations——

Senator HARTKE. You are not interested?

Mr. MAWBY [continuing]. Then there may be experts drawn for that purpose. Of course I am concerned with this topic. I share exactly the concern you have that private foundations should in fact do an outstanding job, but I have no actual basis on which to give testimony. As for the Kellogg Foundation, our intent is to operate in accordance with the highest standard of philanthropic management.

We have been audited. We were very much impressed with the audit by IRS representatives. They issued no change reports. We are proud of that fact. We are doing our best to operate in the spirit and the letter of the law and I assume that I was asked to come before the subcommittee in that context.

Senator HARTKE. May I ask you to come here and talk about the legislation and maybe you people are not concerned about your public image or what people think of you, and that is the indication I get from what your statement is, that you really don't care what the public image of you is.

Mr. MAWBY. We care very much.

Senator HARTKE. You are inviting much more severe action. In other words, if we are going to have to go ahead and do all of the work for you, that is fine.

Let me just be very specific to you. I had to draw a question, the only question I asked of the entire panel was addressed to you, and you left an impression, quite honestly, that somehow Mr. Kellogg out of the graciousness of his heart had not really saved much taxes. That was an impression I do not want to leave unchallenged. If he gave the same amount today, how much tax would he have avoided?

Mr. MAWBY. I presume the tax rates now are substantially different.

Senator HARTKE. You mean you do not know?

Mr. MAWBY. No. We will supply that for the record for you. We will put that in the record for you.

Senator HARTKE. Let me say, and I say this in kindness, it is this type of evasion of the issue upon which we are trying to deal with, because if we are all going to come here and say the foundations are doing everything except you have done too much to the foundations, then it is a one-sided operation.

Mr. MAWBY. I am awfully sorry if I have created——

Senator HARTKE. You don't have to be sorry about anything, you can do anything you want to, it is a free country.

Mr. MAWBY. But you apparently have misinterpreted my position. I do not regard myself as an expert on the administration and affairs of all of the foundations in the country. I regard myself as a competent foundation administrator representing one of the foundations that is trying its best to do a very responsible job in fulfilling its role. I understand from the invitation you extended to me just 10 days ago that I came in that context to share with you some of my concerns as a responsible administrator.

To the extent that there may be abuses, I would share the concern that those should be corrected and I assume that the appropriate regulatory authorities would be knowledgeable about those abuses and would be taking appropriate action.

I frankly, sir, in the fulfillment of my responsibilities have not pursued that particular area.

I am very much concerned about the apparent negative image which so many people have of foundations. It is unfortunate that such impressions are based upon rare examples and isolated instances, generalized through the media and by unsubstantiated public statements. I think many of the provisions of the Tax Reform Act of 1969 were an overreaction to exceptions to the general picture of foundations' philanthropic activities in this country. So I very sincerely say I share your concern for the highest concept of philanthropy and the highest standards of philanthropic operation.

Senator HARTKE. Since you do not refer to any others except Kellogg, which I did not understand that you people were going to do. I expected you to reflect your own association but I did expect a little bit deeper.

The Ture report says the tax savings allegedly realized by those establishing foundations are in all likelihood very small. How much are the tax savings?

Mr. MAWBY. I would have to refer, Mr. Chairman, to the details of the Ture report [1] and we have submitted a copy of that report as part of the record.

Senator HARTKE. We will make it by reference.

Mr. MAWBY. I will check on that and provide that detailed information, Mr. Chairman.

Senator HARTKE. You don't have it there?

I don't think you are going to find it. That is what worries me about submitting it later.

Mr. RIDDELL. We promised to submit to you a copy of the report for the record together with the testimony of the panel on family foundations before the Committee on Ways and Means of the House this spring. We ask that this testimony be made a part of the record in this hearing.

Senator HARTKE. The would be appreciated.

[The Ways and Means testimony referred to follows. Hearing continues on p. 260.]

Mrs. GRIFFITHS [presiding]. We are very pleased to welcome the panel on family foundations. Will you please introduce yourselves and proceed as you choose.

PANEL CONSISTING OF H. LAWRENCE FOX, MODERATOR; RAYMOND B. ONDOV, THE HORMEL FOUNDATION, MINNESOTA; RUSSELL G. MAWBY AND JAMES W. RIDDELL, THE KELLOG FOUNDATION, MICHIGAN; WILLIAM BALDWIN, THE KRESGE FOUNDATION, MICHIGAN; LANDRUM R. BOLLING, BYRON P. HOLLETT, AND THOMAS J. LYNCH, LILLY ENDOWMENT, INC., INDIANA; THOMAS C. THOMPSON, JR., THE MacLELLAN FOUNDATION, TENNESSEE; ALLYN BELL AND JOHN B. HUFFAKER, THE PEW MEMORIAL TRUST, PENNSYLVANIA; AND BOISFOUILLET JONES, THE WOODRUFF FOUNDATION, GEORGIA

Mr. FOX. Madam Chairman and members of the committee, I am H. Lawrence Fox, Washington, D.C., and I am acting as moderator with the following foundations who are represented as shown above.

For purposes of brevity, only four of our group will testify; however, all are available for answering questions of the committee.

Since our primary concern is with the minimum distribution rule as enacted by the Tax Reform Act of 1969, our testimony will be restricted to section 4942

[1] The Ture report was made a part of the official files of the subcommittee.

of the Internal Revenue Code. However, we would like to state that we concur with the position of the Council on Foundations regarding section 4940, discussed by Dr. Goheen, that the excise tax should be eliminated or, in the alternative, reduced to a rate which would equal the audit costs.

Dr. Bolling will testify on the role of foundations in America, Mr. Boisfouillet Jones will discuss the erratic application of section 4942, Mr. Allyn Bell will testify on the difficulties associated with the minimum distribution rule based on current value, and Dr. Mawby will conclude our testimony with a statement concerning the ultimate impact of the minimum distribution rule.

The testimony being given is supported by a study entitled "The Impact of the Minimum Distribution Rule on Foundations" by Dr. Norman B. Ture. That study, as well as a detailed submission, is submitted for incorporation into the record.

Mrs. GRIFFITHS. Without objection, it will be so incorporated into the record.

Mr. FOX. Thank you.

Incidentally, one of your members previously suggested an in-depth study by your committee concerning the performance of foundations. The Ture report should help to facilitate such a study.

Our first witness is Dr. Landrum B. Bolling, executive vice president of the Lilly Endowment. He will testify on the role of foundations in America, Dr. Bolling.

STATEMENT OF LANDRUM R. BOLLING

Mr. BOLLING. Madam Chairman, and members of the committee, legislation concerning foundations, we assume, is or should be directed toward making sure that they contribute the greatest possible benefits to society, now and into the future, and that all real and potential abuses by and through foundations should be eliminated or prevented. With those purposes we agree.

Before I proceed with the statement I have prepared I should like to make a brief reference to certain portions of the testimony given just before noon by Mr. Waldemar Nielsen as having very good relevance to the statement I want to make and the philosophy out of which I speak.

Mr. Nielsen spoke about the fact that, despite our widespread public declaration in support of pluralism and volunteerism, a great many of our private colleges and universities, cultural organizations, and charities are today hanging on the ropes. Inasmuch as I am just completing 15 years as president of a small, church-related college and am just beginning my new assignment as a foundation executive, I know firsthand the reality behind that statement. To the extent that these private, voluntary associations and institutions go under—and they can survive only with expanded voluntary, private giving—the services they now render will, in most cases, have to be picked up by governmental bodies and inevitably at greater expense than ever before.

As a college president in past years I have urged upon Members of the Congress ideas strikingly similar to the one advocated by Mr. Nielsen this morning; namely, a modest but forthright tax credit to encourage the widest possible participation in support of charitable organizations for the strengthening of volunteerism in our pluralistic society. That kind of idea in no way contradicts the ideas I want to present concerning foundations.

At the heart of the case for the existence of foundations is the role they play in encouraging and sustaining a great variety of voluntary associations that serve the health, education, religious life, social welfare, scientific advancement, and cultural enrichment needs of the American people.

A summary of some of the programs supported by Lilly Endowment will be illustrative of the things foundations are now doing.

Since the founding of the Lilly Endowment in 1937 we have operated in three broad fields: Education, community services, and religion. In education we have made grants to a great variety of colleges, universities, and schools—both for their general support and for the improvement of their programs, their faculties, their teaching methods, and their facilities.

As a former college teacher and as one who has served for 15 years as a college president, I can say that many educational institutions would not have survived had it not been for the actual support provided by foundations and, just as important, the incentive stimulation for giving to education by many other organizations and individuals that was triggered by foundation challenge grants. Foundations now provide more than one-fifth of the total gift support of most colleges and universities and stimulate a considerable part of the rest.

In community services Lilly has made grants to a great number of social agencies, institutions, government units, and churches to develop and carry on child care centers, programs to combat juvenile delinquency and drug abuse, rehabilitation of released offenders, aid to the retarded and handicapped, housing renewal, and economic development in inner city slums. We pioneered in support of the street academy project for high school dropouts in Harlem, a program that has spread across the Nation, with the backing of a number of other foundations.

In the field of religion we have provided support for a wide range of theological seminaries and religious education programs for Protestant, Catholic, and Jewish institutions from coast to coast. We have been particularly concerned to support ecumenical youth programs and lay retreat centers.

Other foundations emphasize aid to medical services, to the arts, to scientific research, to conservation, and to many other worthy causes.

The record of Lilly Endowment and of other foundations provides convincing evidence of the value of the broad range of social benefits provided by the activities supported by foundations. This, I take it, is not seriously in doubt. What appears of ten to be at issue, however, is this question:

"Wouldn't it be better if the Government put foundations out of existence, confiscated their assets, and then undertook to do with tax moneys most of the things foundations and voluntary associations they support do with contributed funds?"

Or put more gently, more often, is the suggestion that foundations might be phased out of existence slowly, painlessly, and over a period of years and that the formation of new foundations should be discouraged. Somehow, society is supposed to benefit by the adoption of such a policy. It is our considered judgment that some of the existing and some of the proposed regulations affecting foundations, whether by intention or not, if carried out over a period of relatively few years, will in fact, eliminate a number of foundations entirely and will certainly discourage the formation of new ones.

To weigh the meaning of such policies I think it important to refer again to this fact—that much of the greatness of America can be explained on the basis of these characteristics: our pluralism, our voluntarism, and third, the flexibility and decentralization of our social and political institutions. Foundations today play a significant role in sustaining those great characteristics of American society.

Foundations are not and should not be regarded as playthings of the rich, and by law should not be allowed to be. They are agents for performing vital public purposes on a voluntary basis and with the use of privately accumulated funds. They make possible a variety of approaches to dealing with complicated issues. Foundations are not only needed now, they will be needed far into our future.

Foundation represent not special privilege to be tolerated only until they can be conveniently killed off and buried—as seems sometimes to be suggested—they are an integral, significant part of the underpinning of a free, vigorous society of great pluralistic diversity. They are essential to the continuation of our American tradition of voluntarism.

At a time when liberals and conservatives, Democrats and Republicans, can so often agree on the wastefulness, inefficiency, and dehumanizing bureaucratization brought on through overly centralized, top-down, governmental approaches to many complex problems, we need a reaffirmation of the role of voluntarism and of the foundations in helping to build a truly human society and on catalyzing many divergent grassroots approaches to our problems and social needs and in stimulating expanded giving for these purposes.

On many details of the law and the regulations governing foundations men and women of honesty and goodwill will differ. But we appeal to you not for some grudging concession to some supposed special privilege for foundations but for a positive determination to see to it that foundations, within the most scrupulous observance of the highest standards of honesty, integrity, and social responsibility, can do their important work for the public good to the very best of their capabilities and over the long future.

Their ability to function over the long future will undoubtedly be affected by such provisions of the law as the 6-percent payout requirement. Had the 6-percent rule been in effect when Lilly Endowment began operations in 1938, and had gifts of additional capital been provided exactly as they were provided, Lilly Endowment's assets would have been so substantially reduced that it would, of course, not have been able to make from income anywhere near the additional more than

$70 million grants Lilly Endowment in fact did pay out between 1964 and 1972. The Lilly Endowment record can be paralled by numerous other foundations. Yet, in the long run, it may well be that the greatest danger from the 6-percent payout provision will come in the discouragement of the formation of new foundations.

We urge you to take into account the fact that the pluralism and diversity of American society extend even into the foundation field. For some foundations, at some times, a certain payout rate may be both justified and easily managed. Yet for others at another time such regulations could, as other witnesses will show, destroy those foundations or severely curtail their ability to perform the very public services that they are supposed to perform. Efforts to force diversification of foundation holdings to fit some arbitrary percentage standard are similarly debatable, as I can demonstrate from Lilly Endowment's experience so far with diversification.

In your own wisdom you will undoubtedly weigh all these factors and come to responsible conclusions. We can only ask that you get all the facts and come to your decisions in the light of a positive commitment to the ongoing value of the role of voluntarism in American life and to the establishment and maintenance of a pattern of law and administrative regulation under which foundations can continue to live and can maximize their contribution to society over time.

Mr. Fox. The next member of our group testifying is Boisfouillet Jones, president of Emily & Ernest Woodruff Foundation and managing director of the Lettie Pate Evans Foundation, Inc., and the Joseph B. Whitehead Foundation, all of which are based in Atlanta, Ga. He will discuss the adverse effect on charity by the application of section 4942.

Mr. Jones.

STATEMENT OF BOISFOUILLET JONES

Mr. JONES. I am also vice chairman of the Southeastern Council of Foundations with some 80 foundations in the Southeast as members.

As a prelude to my schediuled remarks, I respectfully request permission of the committee to insert in the record a statement from the council prepared by its executive director.

Mrs. GRIFFITHS. We are going to have to vote and we don't have much time. We will be right back.

[A recess was taken.]

Mr. Fox. Madam Chairman, whenever one testifies before a committee we assume there will be a difference of opinion but we have never, never blown a committee out of the room just as we did. I had just introduced Mr. Jones, I will let him take up his statement.

Mr. JONES. Madam Chairman, to pick up the continuity, and I assume the recess was on the committee's time and not ours——

Mr. CONABLE. You did not blow us out of the room; somebody rang a bell on us.

Mr. JONES. Madam Chairman and members of the committee. I am also vice chairman of the Southeastern Council of Foundations with some 80 foundations in the southeast as members. As a prelude to my scheduled remarks, I respectfully request permission of the committee to insert in the record a statement from the council prepared by its executive director, Mr. Charles Brooks.

Mrs. GRIFFITHS. Without objection, it will be admitted.

Mr. JONES. Before setting forth the legislative history concerning section 4942, I would like to define the requirements of the provision; that is, private foundations must make annual distributions in the amount of the greater of either their earned income or a fixed percentum of their investment assets.

The rationale behind this novel concept was to insure that current distributions are sufficient to justify any tax benefit donors might receive from their contributions, and to prevent private foundations from growing indirectly by investing in the stock of companies which retained most of their earnings and thereby delaying indefinitely charitable expenditures commensurate with the value of their assets. In order to avoid this delay of benefit to charity, section 4942 requires private foundations to make annual distributions at a prescribed level, even if an invasion of capital would be needed to do so.

Many commentators have found this approach objectionable, not only because it mandates an encroachment on capital, but also because many private foundations that are currently able to support major charitable programs are only to do so because their assets have been historically invested to provide a reasonable appreciation in value as well as a fair current return.

Nevertheless, for purposes of this presentation, the group has assumed that a foundation's total rate of return is the sum of dividends, interest, and capital gain, realized and unrealized, divided by the market value of the assets. Also, it should be unmistakably clear that none of the group is philosophically opposed to the concept of a minimum annual charitable distribution, but rather is concerned with the method of determining such a distribution as set forth in section 4942; and even if that method of determination were acceptable, the 6-percent rate should be reduced.

Moving now to the legislative history, the minimum distribution rule has its origin in the "1965 Treasury Report on Private Foundations" submitted to the Committee on Ways and Means. That report espoused the theory that there should be a correlation between the immediate tax benefit to foundation donors and the time of foundation grants or benefits to charity. However, it also noted that the income of assets held by foundations should be on a parity with other tax-exempt entities such as colleges and universities. Also, it stated that the retention of capital by foundations is justifiable.

The report concluded that a reasonable income equivalent would be in the range of 3 to 3½ percent. Thus, it is obvious that the report did not intend to require foundations to distribute to charity an amount that would require diminution of corpus as section 4942 clearly requires.

The first hint that the minimum rate proposal as adopted in 1969 might be above the 3-to 3½-percent level appears in former Secretary of the Treasury Fowler's statement to Congress on December 11, 1968, when he used an example which assumed a 5-percent income equivalent. This example was apparently the basis for the Committee on Ways and Means adopting a 5-percent minimum payout. The Senate Finance Committee accepted the 5-percent level introduced by your committee. It appears that no examination of this high rate was made because of the testimony to that committee by Mr. Peter G. Peterson who suggested that a proper rate of return for foundations would allow such entities to pay out between 6 and 8 percent annually.

On December 6, 1969, Senator Percy in a floor amendment which was passed, raised the level from 5 percent to 6 percent, which was accepted by the conference committee. Senator Percy explained his action was based mainly on the Peterson report. Thus, the 6-percent payout requirement represents a 100-percent increase the minimum initially proposed by the Treasury, and, in addition, it is premised upon and reflects the inaccurate conclusions of the Peterson report. This harsh judgment is well documented by some examples:

In the case of the Emily and Ernest Woodruff Foundation, its qualifying distributions during the years 1939–72 were approximately $114 million. If a 6-percent annual payout requirement had been in effect since 1939 and the foundation had distributed just enough each year to meet the requirements, its aggregate distributions would have been approximately $92 million, or approximately $22 million less than the amount actually paid out for this period. However, because mandatory invasions of capital would have been required to meet the 6-percent standard during some of these years, it is estimated that the present value of the foundation's assets, approximately $261 million as of December 31, 1972, would have been reduced to approximately $188 million, a decline of almost 30 percent; and that the current income at the 1972 level of the foundation, $3.2 million, would have been reduced to $2 million, a decline of more than 33⅓ percent.

The same figures for the Joseph B. Whitehead Foundation are even more arresting. In that instance, total qualifying distributions for the years 1940–72 were $15 million, whereas the 6-percent annual payout requirement would have necessitated distributions of $16 million. Admittedly, almost $1 million would have been paid out for charitable purposes over this 3-year period if the mandatory distribution rule had been in effect, but the cost to the foundation would have been staggering.

For example, on December 31, 1972, the market value of its assets was appro-proximately $93 million, whereas those assets would have been reduced to approximately $32 million, and its current income of $1.3 million would have been reduced to $350,000 by the 6-percent payout rule. In other words, the asset shrinkage to provide that $1 million additional payout over 32 years would be slightly more than $61 million, and the loss of almost $1 million of current income indicates that the differential, if indeed there was one, would be made up in approximately 1 year.

[The statement of the Southeastern Council of Foundations follows:]

STATEMENT OF CHARLES S. ROOKS, EXECUTIVE DIRECTOR, SOUTHERN COUNCIL OF FOUNDATIONS

INTRODUCTION

This statement is presented to the Committee on Ways and Means in order to acquaint the members of the Committee with some important developments in the foundation world since the passage of the 1969 Tax Reform Act and to recommend certain important revisions in that Act. This statement is submitted by the Executive Director of the Southeastern Council of Foundations with the approval of the Southeastern Council's Board of Trustees. While it should not be taken as a statement of each individual member of the Southeastern Council, the views presented herein are based on the Executive Director's discussions with a large majority of the Council's membership and with a number of other foundation executives in the Southeast. I have restricted my remarks to foundations in the Southeast simply because that is the region represented by the Southeastern Council of Foundations and the region with which I am most familiar.

FOUNDATIONS IN THE SOUTHEAST ARE COMPLYING WITH THE TAX REFORM ACT OF 1969

I believe that foundations in the Southeast are making sincere and unqualified efforts to conform to the guidelines of the 1969 Tax Reform Act. It will, of course, take time for foundations to absorb and implement all aspects of the regulations which the Internal Revenue Service is issuing under this Act, but foundations are making a whole-hearted effort to understand these regulations and adapt their operations to them. If any non-compliance has occurred, I believe it has been unwitting and will be of a very temporary nature.

DEVELOPMENT OF THE SOUTHEASTERN COUNCIL OF FOUNDATIONS INDICATES THAT FOUNDATIONS ARE CONCERNED WITH KEEPING ABREAST OF GOVERNMENT REGULATIONS AND IMPROVING PHILANTHROPIC ACTIVITIES IN THE REGION

One of the significant developments in the foundation world since the passage of the 1969 Tax Reform Act has been the creation of the Southeastern Council of Foundations. That foundations want to learn about and comply with the new legislation and to improve the quality and effectiveness of philanthropic organizations in this region is evidenced by the growth of this association.

The Southeastern Council was created in 1970 by a group of foundation executives and trustees in that region who believed that foundations needed to be in closer communication with each other and needed to develop better liasion with public officials.

The founders believed that a regional council, closer to the "grass roots" of the foundation world, would be an effective way to promote these goals. Moreover, such an organization could encourage a more concentrated and systematic attention to the region's problems. By serving the interests of southeastern foundations and stimulating their participation in organized efforts to improve philanthropic activities, the Southeastern Council can provide a helpful supplement to the Council on Foundations and other programs organized on a national basis.

From the beginning, the Southeastern Council has devoted large parts of its meetings to analyses of the 1969 Tax Reform Act and to discussions of the administrative practices necessary for complying with the Act. The meetings have also included sessions on how foundations can improve their general operating procedures and more effectively meet the needs of the region and the general society.

As of March 26, 1973, seventy-nine foundations have joined the Southeastern Council. Over forty per cent of the foundations with assets of more than $1 million in the states of Alabama, Florida, Georgia, Mississippi, North Carolina, South Carolina, and Tennessee have already become members. Additional members are anticipated as a result of efforts begun in February to acquaint other foundations in the region with the purposes of the Southeastern Council. Actually, the Council already reaches a greater number of foundations than its membership roll would indicate, since a single executive or trust officer who manages

several foundations may choose to take out only one membership. Furthermore, the members of the Southeastern Council recently voted to add the states of Arkansas, Kentucky, Louisiana, and Virginia to those mentioned above, and the Council reasonably expects that a number of foundations in these new states will seek membership during the next few months. (A list of the Southeastern Council's members is attached.)

In the fall of 1972 the Southeastern Council opened a full-time executive office in Atlanta, and the services it provides its members have been expanding since that time. The general goals of the organizations are:

To facilitate communication among foundations.—Through conferences, publications, and its role as the center of an information network the Southeastern Council promotes better communication among foundations, so that they can discuss common problems, learn from the experiences of one aonther, organize for coordinated action when needed, consider joint support for projects, and in general, improve the state of philanthropy in the Southeast.

To maintain liaison with State and National governments.—The Southeastern Council informs its members of legislative activities affecting foundations and assists members in developing appropriate communication with public officials.

To promote among the public a better understanding of foundations.—The Southeastern Council tries to inform the public of the important contributions which foundations make to this society. The Council also tries to keep its membership informed of public attitudes towards foundations and philanthropy.

To provide services to foundations.—The Southeastern Council notifies its membership about IRS regulations and other pertinent governmental actions and informs its members of any important developments in the general field of philanthropy. Through conferences, publications, and consultations, it assists members with administrative, legal, financial, and program concerns.

CONGRESSIONAL AND PUBLIC VIEW OF FOUNDATIONS MUST BE BROUGHT UP TO DATE

It is crucial that Congress and the general public fully appreciate the effect of the 1969 Tax Reform Act and the manner in which private foundations are operating under it. A few foundations in the past abused the public trust inherent in the tax exempt status they enjoyed, but it should be recognized that the 1969 law effectively eliminates the possibility of such abuses now. Furthermore, it should be pointed out that the great majority of foundations never have engaged in such abuses and are seriously concerned that tax-exempt organizations operate not only legally but in the most effective manner possible to serve the public interest. Many foundations have objections to the 1969 Tax Reform Act, but these are primarily directed toward provisions which are considered to be actually detrimental to the best interests of philanthropy in this country.

NEED FOR PRIVATE PHILANTHROPY IS INCREASING

Private philanthropy has played an important role in the development of this nation, and the contribution of private foundations has been a prime ingredient in this. There appears to be no lessening of the need for such philanthropy. The costs of many institutions and programs partially or wholly supported by charitable contributions are increasing. Many of these programs could not continue if foundation support were decreased or cut off. At the same time, the federal government seems to be reducing its commitments in many areas of social welfare. Foundation and other private philanthropic assistance is needed to maintain some of the important programs which are now threatened with drastic reductions in government support. It is also important that foundations support of innovative ideas and techniques be continued so that future government programs can build upon the discoveries and experiences of these experimental efforts.

The philanthropic role of foundations is needed for other reasons as well. Foundations represent the only certain source of support for charitable needs in the future. Whereas both individual philanthropy and government programs presently contribute far more in dollar terms than foundations to the society's needs, the future commitment of individuals or the future priorities of governmental budgets can not be predicted with any certainty. By their very nature, foundations can be of continuing assistance in meeting the nation's charitable requirements. Furthermore, foundations can provide the quickest response to

changes in the country's needs. It takes considerable time to educate large numbers of individuals about new philanthropic needs, and the creation and implementation of governmental programs are long and complicated processes. But foundations can react quickly to new and unforeseen problems.

Foundations are also valuable to the society because they provide a variety of viewpoints about the nation's problems and the appropriate responses to these problems. This multiplicity, along with their flexibility of operation, is an invaluable resource in a modern society in which government inevitably tends to become larger and more monolithic. Foundations are vitally needed if a healthy pluralistic society is to be maintained in this country.

CONTRIBUTIONS OF FOUNDATIONS BELONGING TO THE SOUTHEASTERN COUNCIL OF FOUNDATIONS

Although they represent only a portion of the foundation philanthropy in the Southeast, the charitable contributions made by members of the Southeastern Council of Foundations illustrate something of the importance of foundations in this region. Over $65 million were granted by seventy-four members of this Council in one year. (Most grants referred to were made in 1970, but the data on some of the foundations covers at least part of 1971.)

Over three-fourths of this $65,000,000 was granted to institutions and programs within the southeastern region. About one-half the funds was contributed to education, primarily higher education, including grants for endowment, construction, faculty and administration improvement programs, scholarships and loans, and special research programs. Approximately one-fourth of the total funds granted by these foundations went to the field of health, mainly for support of hospitals, but also for programs in medical education, rehabilitation, research and public health. Around fifteen per cent of the grants was given to such programs as child welfare, youth agencies, recreation programs, assistance to the handicapped, community funds, community development, and social agencies. The remaining grants were distributed mainly to programs in the fields of religion, science, technology, humanities, and the arts.

CONGRESS SHOULD NOT DISCOURAGE PRIVATE PHILANTHROPY

Because of the important contributions of foundations, it would be contrary to the national interests for Congress to place unnecessary constrictions on the role which foundations play in this society. This is not to suggest that those provisions of the 1969 Tax Reform Act which are needed to prevent abuses of the tax-exempt privilege should be abolished. Such protections of the public interest are certainly legitimate, and foundations have no quarrel with this principle. Certain aspects of the present law are not needed for this purpose, however, and in fact have a harmful effect on private philanthropy and thus on the public interest. In particular, the minimum pay-out requirements should be lowered and implemented over a longer transitional period, the four per cent excise tax on foundations should be eliminated or substantially reduced, and the differential in deductibility of an individual's contribution to private foundations and his contribution to other charities should be removed.

RECOMMENDATION 1: LOWER THE MINIMUM PAY-OUT REQUIREMENTS ON FOUNDATIONS AND ESTABLISH A LONGER TRANSITIONAL PERIOD FOR MEETING THESE REQUIREMENTS

The minimum pay-out requirements of the 1969 Tax Reform Act have a surface appearance of benefitting charity, but, in fact, the long-run consequences are quite the opposite. There is no quarrel with the principle that the resources of foundations should be used for charitable purposes; this obviously is the purpose of their existence. The present law, however, is written in such a way as to destroy some foundations and to discourage the creation of new ones. For many foundations the concept of minimum investment return is in effect a means of forced liquidation. The assets of these foundations do not yield returns equal to the demands of the law, and these foundations may be forced to use part of their corpus to meet the pay-out requirements. While this has a marginal benefit to charity at the very beginning, the overall effect is to reduce the resources of these foundations year by year and gradually eliminate the benefits to charity which would accrue if the foundations could retain their

original principal fund and be required to spend only income or the equivalent at a reasonable level.

Foundations have the alternative, of course, of divesting themselves of low-yield assets and investing in what promises to give a higher return. The presently established levels of the minimum investment return are nevertheless unreasonably high, since a prudent investor in today's market cannot reasonably expect consistently to earn enough to meet this requirement and thus avoid pay-outs from corpus.

While maintaining the principle that foundations should use their resources for the full benefit of charity, Congress should reduce the current minimum pay-out requirements to a level which is not out of line with the reasonable expectations of prudent investors. Congress should also revise the law to allow foundations a longer transitional period to meet these requirements, so that a foundation can carefully and more efficiently make whatever changes may be necessary in its portfolio.

The assets of some foundations are largely in growth type securities whose current yield is relatively low. If the foundations are forced to trade large amounts of these securities in a hasty manner, the market value of the securities will be depressed. This would reduce the value of the foundations' assets and thereby reduce the resources available to charity, not to mention the adverse effect on other holders of these securities who have no relationship to the foundation.

Congress recognized the need for a long transitional period in which foundations with excess business holdings can divest themselves of some of these holdings in an orderly manner. The much shorter transitional period of the minimum pay-out requirements, however, is forcing some foundations with excess business holdings in closely-held low-yield corporations into the kind of hasty divestiture which Congress recognized as undersirable.

RECOMMENDATION 2: REDUCE THE FOUR PERCENT EXCISE TAX

There are several legitimate objections to the four percent excise tax. Foundations, of course, do not suggest that they should not be audited, but this tax, which was designed to raise revenue that would reimburse IRS for the cost of such audits, actually produces far more income than is used for this purpose. Since the law also requires foundations to pay out all of their income, the effect of this excise tax is to reduce the amount of a foundation's income going to charitable purposes and instead to divert this money to the government through the excise tax. At the very time that charitable contributions are needed more than ever, this tax takes away millions of dollars from charities. Unless one could convincingly argue that this money is used more effectively and efficiently for the country's needs by channelling it through the government's bureaucratic processes rather than by transferring the funds directly to a charitable program, then it clearly is contrary to the national interest to reduce charitable contributions of foundations with this tax. One might also add that it is inequitable to single out a particular type of tax-exempt organization for such taxation.

RECOMMENDATIONS 3: REMOVE THE DISCRIMINATORY VARIATION IN DEDUCTIBILITY FOR INDIVIDUAL CONTRIBUTIONS TO CHARITIES AND CONTRIBUTIONS TO FOUNDATIONS

The present law allows an individual to deduct up to fifty percent of his adjusted gross income for contributions to public charities, but he can deduct no more than twenty percent for contributions to foundations. Contributions to foundations should be treated in the same fashion as donations to public charities. A foundation, in effect, is an endowment for support of a number of charities year by year according to changing needs. It would be more rational, therefore, to allow an individual as much tax reduction for a contribution to a group of charities, by way of a foundation, as for a contribution directly to a single charity. As indicated above, one of the real values of foundations, which should be supported rather than undermined, is that they represent an assured source of charitable support for future needs. Certainly there is a need for charity now, but the law should also acknowledge the need for future support and encourage institutions which can be counted on to provide this support.

Mr. Fox. Our next member is Allyn Bell, president of the Glenmede Trust Co., trustee of the Pew Memorial Trust, Philadelphia, Pa.

STATEMENT OF ALLYN BELL

Mr. BELL. Madam Chairman, honorable committee members, chapter 42 of the Tax Reform Act of 1969 promulgated a new concept in regard to private foundations; that is, instead of regarding those who had transferred their funds to a charitable trust as persons to be held in public esteem, the attitude seemed to be that these persons were probably up to nefarious tax schemes warranting elaborate safeguards. The implication somehow was that the Treasury was being cheated. However, the so-called protection which has been afforded the Treasury operates to punish many foundations and their charitable beneficiaries.

The requirement of distributions to charity as a rate of 6 percent of the current market value of the foundation's assets, confronts foundation managers with difficult decisions that do not necessarily relate to the well-being of charity. For example, many foundations hold all or substantial portions of the original gifts from their founders. This condition is often consistent wth the founders' expressed desires as set forth in the declaration of trust, and, more importantly, the investment performance of the donated holdings have justified continued retention rather than venturing into unknown territory through diversification of investments.

As a required rate of distribution, the 6 percent is not realistic. Value Line Investment Survey, which studies 1,400 dividend paying stocks on a year-round basis, expects that over the year dividends of 3.6 percent will be paid when measured against recent market prices. Using this as a measuring stick, it can be seen that most foundations would thus be forced to reduce principal assets. They would have to make up the difference up to 6 percent.

Obviously, this serves charity today but also obviously reduces charitable distribution for the next year and subsequent years. You have already seen the perfect examples of this conclusion, the Emily and Ernest Woodruff Foundation and the Joseph B. Whitehead Foundation, which Mr. Jones described and the same is true for all of the foundations of this group.

Assuming that the 6 percent rate was in effect since creation, these results occur. There is a slight increase in annual giving coinciding with a dramatic reduction of corpus, because the minimum investment return rule is expressed as a fixed percentage of the fair market value of the assets held by a private foundation. Often this fair market value is established by a public market, as in the case of common stocks of companies listed on a national stock exchange. In these instances, the traditional indicia of value is the public's expectancy of future earnings. Therefore, increased current earnings by the companies involved produce a proportionately greater increase in traded value, necessitating a greater investment of principal to comply with the payout requirement.

An example would be foundations holding the common stock of a single company which is traded on the New York Stock Exchange. Because this company has enjoyed good management and a highly favorable earnings pattern over the years, it frequently trades at a multiple of more than 40 times earnings on the market.

In 1972, this company reported earnings of $3.19 a share on its outstanding stock, and when those earnings were announced on April 5, 1973 its stock closed at a value of $137.50 a share. If this per share value is multiplied by 6 percent, the rate is $8.25 a share. Clearly when a company earns $3.19 it is hard for a foundation to pay out $8.25.

When this figure is compared to the earnings per share of $3.19, it becomes apparent that the payout requirement is more than 260 percent of the current earnings of the company, indicating that a foundation owning this sound investment can never expect dividends to equal the payout requirement which is tied to the investing public's high regard for the value of the stock.

Obviously, not all stocks sell at such a high price earning ratio. In fact, in today's economy with stock selling at 15 to 16 times annual earnings rates, no one can expect dividend rates to exceed the 3.6 percent average set forth in the Value Line Investment Survey. That is true because most companies, if they are to grow and remain financially sound, must limit their dividend distributions to a maximum of 50–60 percent of earnings. Many companies, such as the extractive industries, are forced to retain larger portions of earnings to underwrite exploration and development programs. Likewise, other groups, faced with constant heavy drains for research and development costs, must limit their dividend pay-

ments to small percentages of annual earnings in order to provide funds for expanding operations. Thus, many sound companies cannot pay out enough dividends to support a 6-percent payout requirement for foundations.

Prices which investors will pay for shares in our companies usually reflect an evaluation of the future earning capacity of the company, both short- and long-range. The nature of the operation and the romance in its future will determine the general range of market prices, but these are always subject to varying degrees of influence from the outside factor at work in the marketplace; war or peace, inflation, cost of living, foreign trade balances, foreign exchange rates, cost of money, and so on and on. This explains why many foundations managers choose to stay invested in the companies they know best.

Now matter how the problem is stated, under the 1969 Tax Reform Act, foundations must tap their capital resources for the difference between the required distribution rate of 6 percent and their actual cash income. This is unfortunate for foundations and bad for charity.

In addition, the trustees in so doing may be required to take actions contrary to the desires of the donors as expressed in original trust documents. Surely such a policy will discourage future donors and strikes at the credibility of all tax incentives. Moreover, the retention of such assets has generally been highly advantageous to charity.

There are other problems that may not be obvious regarding a distribution rule assessed on current value. Among these the monthly valuation requirement consumes time and attention that is nonproductive of charitable benefit. Foundation managers find themselves viewing investments like a speculator concerned with short-term market trends rather than with basic soundness of an investment. The short-term trend is not important to the long-term investor and his attention to underlying value is the area of legitimate interest. Instead, we see the current formula attaches such importance to current values that it cannot help but be diversionary.

Thank you very much.

[Mr. Bell's prepared statement follows:]

STATEMENT OF ALLYN BELL

Chapter 42 of the Tax Reform Act of 1969 promulgated a new concept in regard to private foundations, i.e., instead of regarding those who had transferred their funds to a charitable trust as persons to be held in public esteem, the attitude seemed to be that these persons were probably up to nefarious tax schemes warranting elaborate safeguards. The implication somehow was that the Treasury was being cheated. However, the so-called protection afforded the Treasury operates to punish many foundations and their charitable beneficiaries.

The requirement of distributions to charity at a rate of 6% of the current market value of the foundation's assets, confronts foundation managers with difficult decisions that do not necessarily relate to the well-being of charity. For example, many foundations hold all or substantial portions of the original gifts from their founders. This condition is often consistent with the founders' expressed desires as set forth in the declaration of trust, and, more importantly, the performance of the donated holdings have justified continued retention rather than venturing into unknown territory through diversification of investments.

The 6% is not realistic. Value Line Investment Survey indicates that 1,400 divident-paying stocks will pay an average of 3.6% in dividends in the next twelve months when measured against recent (early March) market prices. Using this as a measuring stick, it can be seen that most foundations would thus be forced to reduce principal assets. Obviously, this serves charity today but also obviously reduces charitable distribution for the next year and subsequent years. You have already seen the perfect examples of this conclusion, the Emily and Ernest Woodruff Foundation and the Joseph B. Whitehead Foundation. The same is true for all of the foundations of this group.

These results occur, slight increase in annual giving coinciding with a dramatic retention of corpus, because the minimum investment return rule is expressed as a fixed percentage of the fair market value of the assets held by a private foundation. Often this fair market value is established by a public market, as in the case of common stocks of companies listed on a national stock exchange. In these instances, the traditional indicia of value is the public's expectancy of future earnings.

Therefore, increased current earnings by the companies involved produce a proportionately greater increase in traded value, necessitating a greater invasion of principal to comply with the payout requirement. An example would be foundations holding common stock of a single company which is traded on the New York Stock Exchange. Because this company has enjoyed good management and a highly favorable earnings pattern over the years, it frequently trades at a multiple of more than 40 times earnings on the market. In 1972, this company reported earnings of $3.19 a share on its outstanding stock, and when those earnings were announced on April 5, 1973, its stock closed at a value of $137.50 a share. If this per share value is multiplied by 6%, the rate is $8.25 a share. When this figure is compared to the earnings per share of $3.19, it becomes apparent that the payout requirement is more than 260% of the current earnings of the company, indicating that a foundation owning this sound investment can never expect dividends to equal a payout requirement which is tied to the investing public's high regard for the value of the stock.

Obviously, not all stocks sell at such a high price-earnings ratio. In fact, in today's economy with stock selling at 15 to 16 times annual earnings rate, no one can expect dividend rates to exceed the 3.6% average set forth in the Value Line Investment Survey. This is true because most companies, if they are to grow and remain financially sound, must limit their dividend distributions to a maximum of 50–60% of earnings. Many companies, such as the extractive industries, are forced to retain larger portions of earnings to underwrite exploration and development programs. Likewise, other groups, faced with constant heavy drains for research and development costs, must limit their dividend payments to small percentages of annual earnings in order to provide funds for expanding operations. Thus, many sound companies simply cannot pay out enough dividends to support a 6% payout.

Prices which investors will pay for shares in our companies usually reflect an evaluation of the *future* earning capacity of the company, both short and long range. The nature of the operation and the romance in its future will determine the general range of market prices, but always subject to varying degrees of influence from the outside factor at work in the market place; war or peace, inflation, cost of living, foreign trade balances, foreign exchange rates, cost of money, and so on and on. This explains why many foundation managers choose to stay invested in the companies they know best.

No matter how the problem is stated, under the 1969 Tax Reform Act, foundations must tap their capital resources for the difference between the required distribution rate of 6% and their actual cash income. This is unfortunate for foundations and bad for charity.

In addition, the trustees may be required to take actions contrary to the desires of the donors as expressed in original trust documents. Surely such a policy will discourage future donors and strikes at the credibility of all tax incentives. Moreover, the retention of such assets has generally been highly advantageous to charity.

There are other problems that may not be obvious regarding a distribution rule based on current value. First, the monthly valuation requirement consumes time and attention that is nonproductive of charitable benefit. Foundation managers find themselves viewing investments like a speculator concerned with short-term market trends rather than with basic soundness of an investment. The short-term trend is not important to the long-term investor and his attention to underlying value is the area of legitimate interest. Instead, we see the current formula attaches such importance to current values that it cannot help but be diversionary.

Second—and probably most important—is the problem associated with handling grants. Foundations typically have some sort of application submission and screening process before final action and these preliminaries are time consuming for both the charity and foundation. It is difficult for the foundation and the charities it supports not to have a fairly concrete and fairly long-term concept of the required distributions. It is unfair to a potential grantee to encourage an application when his likelihood of success is remote, and it is unfair to the grants committee not to have an adequate selection of applications. Thus, fluctuating levels of required distributions are inefficient for both the applicants and the trust.

An example will illustrate the problem. Let me assume that a foundation has divided income of $1 million and investment management expenses of $30,000, so it has $970,000 to use for charity out of income. If the corpus is $25 million, the minimum distribution of 6% would be $1,500,000 so corpus must be invaded in the amount of $530,000.

The next year the stock market takes a different view of the stock and it is valued at $35 million, while dividend income remains constant. This means minimum distributions rise to $2,100,000 and the corpus invasion more than doubles to $1,130,000.

A staff established to process applications for $1,500,000 will be inadequate for $2,100,000; likewise, the expectations of charity built on a year when $2,100,000 is distributed will not be met when a lower year follows. One of the frequent challenges to the foundation is to engage in new and innovative activities. This means fuller exploration of the nontraditional applications and probably a longer time between application and grant. At any rate, the fluctuating minimums—particularly at an unrealistic level—will obviously be counterproductive to any desire to get into fields requiring greater attention per application. This serves to prevent foundation managers from being efficient and frustrates the objectives of foundation grants.

Mr. Fox. The final member of our panel is Dr. Russell Mawby, president of the W. K. Kellogg Foundation, Battle Creek, Mich. He will conclude our testimony with the statement concerning the ultimate impact of the minimum distribution rule.

STATEMENT OF RUSSELL MAWBY

Mr. MAWBY. Madam Chairman, members of the committee, as the final spokesman, my responsibility is to illustrate and summarize the conclusions of this group. For this purpose, I will use the experience of the Kellog Foundation, since we are representative of the group of foundations subscribing to this statement.

Our founder, Mr. Kellog, realized a total tax benefit (income, gift, and estate) of less than $500,000 on gifts of $45 million which today have a total fair market value of approximately $576 million. The total of these assets are maintained on behalf of the Foundation in two separate portfolios, which we refer to as "Kellogg" and "Diversified." The Kellogg portfolio consists entirely of Kellog Co. stock with a value of $529 million. The Diversified portfolio consists of stocks, bonds, and other interest-bearing investments and has an approximately value of $47 million. Through the years, Kellogg has consistently outperformed the Diversified portfolio which is used to measure the merits of diversification.

A principal contention reflected in the Peterson report was that the portfolios of private foundations had not produced the rate of return thought to have been produced by mutual funds. By any measure of return, our group of foundations has outproduced mutual funds for the period covered by the Peterson report and has continued to do so since. For example, in the last 7 years the Kellogg Foundation's income, because of the foundation trust's holdings in the Kellogg Co., has continued to be substantially greater than it would have been had its income been derived entirely from diversified investments. The increase in income for 1973 over 1967 was 66.5 percent for the Kellogg holding as compared to an increase of 12.8 percent on the foundation's diversified portfolio. It is evident that the sale of Kellogg and the diversification of funds would result in a lower return to charity over the years.

Not only was the Peterson report incorrect in regard to performance, but its premise that a pegged payout requirement would be good for charity is also wrong. For example, had the minimum distribution rule been in effect at 6 percent from 1934, when the trust consisted of 221,000 shares of Kellogg stock, with a then market value of $38 million the following would have occurred:

1. From 1934 through 1972, the trust made an actual distribution of $203 million, and had the minimum distribution rule been applicable, distributions of $243 million (or an increase of $40 million) would have been made;

2. To meet the payout requirement, the trust would have had to sell the equivalent of 9 million shares with a market value of $215 million: therefore, the trust's holding would have been reduced to a market value of $226 million; and thus

3. The short-term higher return to charity of $40 million would have cost $215 million in corpus value, thereby reducing the current size of the trust by almost 50 percent. Further, for 1973, the distribution from the reduced assets

would have been only $10 million rather than the $20 million which will in fact be distributed.

Within 3 years of experience under the 1969 law, there has been time to examine how section 4942 will operate to undermine overall foundation grants, and there has been the opportunity to further examine the assumptions of the Peterson report. For this purpose, the foundations subscribing to this statement have had an independent study prepared by Dr. Norman B. Ture. The findings and conclusions of that report, as briefly summarized in its own language, are as follows:

[The findings and conclusion follow:]

First, any minimum distribution rule which ignores the foundation's rate of return will have a highly differential, discriminatory and possibly capricious impact on foundations and on their *long-term capacity* to support charities.

Second, the [Peterson Commission] contention that the investment performance of foundations is relatively poor is based on *inadequate information* and *inappropriate statistical measures;* the records of foundations for which data was available in the prepartion of this report certainly do not support this contention.

Third, no sound evidence was advanced [by the Peterson Commission] to support the view that the allegedly poor investment performance of foundations is related to the concentration of their investment assets.

Fourth, it is neither realistic nor reasonable to assume that a minimum distribution rule will result in significant increases in the rate of return on foundation investments.

Finally the [Ture] report concludes that the tax saving allegedly realized by those establishing foundations are, in all likelihood, very small. Foundation distributions to charity have represented a sizeable amount of benefits relative to the foregone tax revenues.

The Peterson Report assumed that the charitable services which a foundation normally supports will not rise in cost any faster than the general rate of inflation and for that purpose assumed a rate of inflation of 2 percent. The report's assumption is wrong, for it completely disregards the fact that the organizations supported by foundations have little possibility of significant gains in productivity.

From the foregoing, two things are apparent: One, the underlying premise of the 6-percent minimum distribution rule is predicated upon false assumptions; and two, this rule must be changed if private foundations are to continue to serve their function in the support of charitable undertakings.

If this is not done, it is clear that the principles set forth in the Peterson report and incorporated in section 4942 will progressively impair the effectiveness of all foundations and even eliminate many of them, to the detriment of society.

If private philanthropy is to continue its historic contribution to American life, changes in the current legislation are necessary. We urge your adoption of such modifications to insure that our society will continue to benefit from the constructive activities of private foundations.

Thank you.

Mrs. GRIFFITHS. Thank you very much, Dr. Mawby.

[The statement of the council and report previously referred to follows:]

STATEMENT OF THE PANEL ON FAMILY FOUNDATIONS, REPRESENTING THE HORMEL FOUNDATION, THE KELLOGG FOUNDATION, THE KRESGE FOUNDATION, LILLY ENDOWMENT, INC., THE MACLELLAN FOUNDATION, THE PEW MEMORIAL TRUST, AND THE WOODRUFF FOUNDATION

I. INTRODUCTION

As a group we support the action taken by the Congress in the Tax Reform Act of 1969 to eliminate certain abuses previously associated with certain foundations. And, we strongly endorse the efforts of Congress to assure that Foundations operate properly in the public interest. We recognize then that the abuses of some Foundations necessitated corrective action, both to provide safeguards against the recurrence of those abuses and also to reassure the public that continued tax exemption for foundations would serve the national interest. On the other hand, we were concerned that correction of such abuses through undue and unnecessary restrictions might well be a disservice to that public interest if legitimate foundation operations were curtailed thereby.

Now, we are concerned because two of the rules adopted in 1969 unduly restrict legitimate foundation activities and, accordingly, urge that each of them be re-examined and changed. The first rule is the imposition of the 4% excise tax on net investment income of private foundations, and the second is the requirement that the annual distributions of private foundations must be at least equal a certain percentage of the current value of their investment assets (hereinafter referred to as the "minimum distribution rule").

A. Section 4940, 4% excise tax.

This Committee proposed a tax on the investment income of private foundations in 1969 for two reasons. First, it was thought that private foundations ought to help share the cost of government in light of their ability to pay. Second, it was felt that vigorous and extensive administration would be required to provide appropriate assurances that private foundations will promptly and properly use their funds for charitable purposes and that these foundations ought to bear the cost of this audit activity.

The Senate Finance Committee recommended the tax as an audit fee to reimburse the government for the cost of examining the finances and activities of private foundations.

Whether the ultimate rationale adopted by Congress was based on the ability of private foundations to pay part of the cost of government or the desirability of imposing an audit fee on private foundations, it is clear that the imposition of this tax singled out private foundations from all other tax exempt organizations, each of which presumably has an ability to pay, and each of which must ultimately be audited by the Internal Revenue Service. A more serious objection to the tax, however, is the fact that it directly reduces the funds available for distribution, thereby placing the ultimate burden for the tax on those charities which would otherwise receive the funds involved as grants.

We know of several instances in which the audit tax is almost twice as much as the total expenses of operating the Foundation, and others in which the audit fee is equal to the operating expenses of the Foundations.

Under the circumstances, we urge that the necessity for this tax be re-examined critically and eliminated or drastically reduced, since the rationale behind it is questionable and since the tax is borne by charitable beneficiaries who are least able to pay it and have heretofore been accorded an exemption from both direct and indirect taxation.

B. Section 4942, the minimum distribution requirement.

Of more serious concern to this group is the requirement that private foundations pay out a fixed percentage of their investment assets each year in pursuit of their charitable activities. The rationale behind this novel concept was apparently, one, to insure that current distributions were sufficient to justify any tax benefit donors might receive from their contributions, and two, to prevent private foundations from growing indirectly by investing in the stock of companies which retained most of their earnings and thereby delaying indefinitely charitable expenditures commensurate with the value of their assets. In order to avoid this delay of benefit to charity, Section 4942 requires private foundations to make annual distributions at a prescribed level, even if an invasion of capital would be needed to do so.

Many commentators have found this approach objectionable, not only because it mandates an encroachment on capital, but also because many private foundations that are currently able to support major charitable programs are only able to do so because their assets have been historically invested to provide a reasonable appreciation in value as well as a fair current return.

Nevertheless, for purposes of this presentation the group has assumed that a foundation's total rate of return is the sum of dividends, interest, and capital gain realized and unrealized, divided by the market value of the assets.[1] More importantly, it should be unmistakably clear that none of the group is philosophically opposed to the concept of a minimum annual charitable distribution but rather is concerned with the method of determining such a distribution as set forth in Section 4942 and even if that method of determination were acceptable, the 6% rate should be reduced. In short, this group knows that Section 4942 as enacted in 1969 is detrimental to charity and the well being of this nation.

[1] This is the definition submitted to the Senate Finance Committee by Mr. Peter G. Peterson, Chairman of the Peterson Commission, testifying before the Senate Finance Committee on H.R. 13270 on October 22, 1969 (Cf. Report. P. 74.).

C. Foundations are important to America

Part of the development of this nation has occurred at the instigation of private foundations. Any status which affects the existence of such foundations is bound to have an effect on the future of our country. This group is convinced that Section 4942 has the potential for the elimination of foundations, and accordingly, the potential for altering the country's future. This last conclusion is ironic since it is clear that the purpose for enactment was not to banish foundations from the country but to insure present and future grants to charity in relationship to tax benefits, if any, enjoyed by foundation donors. We attribute this delayed, but certain, death sentence and ultimate harm to the country to the unfounded conclusions of the Peterson Report which were presented to the Congress in 1969.

II. THE SUBSTANTIVE PROVISIONS OF SECTION 4942

A. Legislative history

1. The concept of Section 4942, minimum distribution rule has its origin in the 1965 Treasury Report.[2]

The 1965 Treasury Report proposes a minimum investment return on the theory that there should be a correlation between the immediate tax benefit to the donor and the time of the benefit to charity.

The Report proposes two changes in the law to prevent the delay in benefit to charity. First, private foundations would be required to devote all of their net income to active charitable work on a reasonably current basis. Second, the Report provided for a minimum investment return, which it terms an "income equivalent formula."

It is apparent that the Report in attempting to place those foundations with low-yielding assets on "a parity with foundations having more diversified portfolios" did not intend to create a situation whereby *all* or most foundations would be required to dispose of their capital. Since it states that retention of capital is generally justifiable, the 6% payout in Section 4942(e) cannot be justified in light of this Report. Rather, it is apparent that it merely intended to upgrade the payouts of those foundations with minimal income[3] and to prevent a "significant lag" between the time of the tax benefit to the donor and time of benefit to the public. The Report proposed to solve this time lag by two provisions, one, a reasonably current distribution of all realized income (with the exception of long-term capital gain), and two, an income equivalent formula.

The Report states that "the income equivalent should be comparable to the yield on investment funds held by comparable organizations—such as universities. . . . Based upon existing market conditions it would appear that a reasonable income equivalent would be in the range of three to three-and-one-half percent." Thus, it is obvious that the Report did not intend to require foundations to have such a high rate of return that it would be necessary to eat into its capital as Section 4942 clearly requires. Supporting data for the Report established that approximately 90% of foundations had ordinary income of less than six percent of their fair market value. Copies of the relevant tables published in the 1965 Treasury Report are attached as Appendix A.

The first hint that the minimum return proposal is adopted in 1969 might be above three or three-and-one-half percent, appears at page 301 of Secretary Fowler's statement to Congress on December 11, 1968. In illustrating the operation of the minimum payout requirement, Fowler states: "For example, assuming a *five percent* income equivalent. . . ." (Emphasis added.)

2. *Ways and Means Committee Report (Page 25).*[4] The Report on the Committee of Ways and Means gives the following as its "general reasons for change" in existing law.

"Under present law, 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. . . . A graduation of sanctions designed to produce current benefits to charity is provided."

[2] Treasury Department Report on Private Foundations issued on February 2, 1965, submitted to the Committee on Ways and Means, H.R. Doc. No. 54-833, 89th Cong., 1st Sess. (1965).

[3] *Ibid.*, pp. 14, 36, 37.

[4] H.R. Rep. No. 413, 91st Cong., 1st Sess. 25 (1969).

3. *Treasury Statement to Senate Finance Committee.*—In the Treasury statement to the Senate Finance Committee, Edwin S. Cohen expressed support for the bill as passed by the House including the five percent minimum investment return.[5] The Senate Finance Committee passed the provision substantially as it passed the House.

4. *Percy Amendment.*—The bill was amended on the Senate floor by Senator Percy. His amendment raised the minimum investment return from five percent to six percent. Senator Percy stated that this increase was based on the Peterson Commission. The Peterson Commission recommended a minimum investment return of six to eight percent. It recognized, however, that this included unrealized appreciation. The floor debate is contained in the Congressional Record of December 6, 1969, at Pages S15959 through S15964 and explains Senator Percy's action:

(1) The higher percentage would make foundations more vigorous in their investment policies;

(2) Private foundations should make "substantial annual distributions" to charity to help meet rapidly accelerating charitable needs; and

(3) Data on university endowments and professionally managed funds show that six percent is fair and reasonable, especially considering that many mutual funds have averaged an "*appreciation*" of ten percent. (Emphasis added.)

Senator Percy further stated that, more important than the particular percentages, are the assumptions on which the percentage should be based: "The payout requirement should be high enough to require them (private foundations) to invest their funds productively. *The percentage should not be so high as to amount to a delayed death sentence.*" (Emphasis added.)

Percy also cited the following additional reasons as grounds for a higher percentage:

(1) The peculiar nature of foundations as grant-making institutions;

(2) The correlation between tax deduction and a prompt charitable benefit; and,

(3) Perpetual existence should be a reward only for continuing productivity, not an automatic privilege.

5. *Conclusion*—The rationale originally expressed in the 1965 Treasury Report was that there should be a correlation between the timing of the tax deduction and the benefit to charity. The 1965 study proposed to insure that its objective would be accomplished by requiring an income equivalent equal to that earned by similar organizations—i.e., colleges and universities. The study stated that this percentage would be three or three-and-one-half percent. This study was the backbone for H.R. 13270. As the bill passed along its various stages, Congress was further influenced by the Peterson Commission. The six percent payout requirement finally enacted represents a one hunderd percent increase in the minimum payout requirement initially proposed by the Treasury Department in 1965. In addition, it is premised upon and reflects the inaccurate conclusions of the Peterson Commission.

B. Minimum distribution rule is wrong

Chapter 42 of the Tax Reform Act of 1969 promulgated a new concept in regard to private foundations. Instead of regarding those who had transferred their funds to a charitable trust as persons to be held in public esteem, the attitude seemed to be that these persons were probably up to nefarious tax schemes warranting elaborate safeguards. The implication somehow was that the Treasury was being cheated.

1. *Difficulties in Rule Based on Current Value.*—The requirement of distributions to charity at a rate of 6 percent of the current market value of the foundation's assets, confronts foundation managers with difficult decisions that do not necessarily relate to the well being of charity. For example, many foundations hold all or substantial portions of the original gifts from their founders. This condition is often consistent with founders' expressed desires as set forth in the declaration of trust, and, more importantly, the performance of the donated holdings have justified continued retention rather than venturing into unknown territory through diversification of investments.

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[5] Thus, it is clear Mr. Cohen recognized that a five percent minimum return would require the distribution of corpus. This is contrary to the 1965 Treasury recommendations. Moreover, the concept of corpus depletion is inconsistent with "curing" the potential abuses cited in the 1965 report but is with ending foundations as charitable vehicles by forcing dissipation of corpus.

The 6 percent is not realistic. Value Line Investment Survey indicates that 1,400 dividend paying stocks will pay an average of 3.6 percent in dividends in the next twelve months when measured against recent (early March) market prices. Using this as a measuring stick, it can be seen that most foundations would thus be forced to reduce principal assets. Obviously, this serves charity today but also obviously reduces charitable distribution for the next year and subsequent years. Perfect examples of this conclusion are the Emily and Ernest Woodruff Foundation and the Joseph B. Whitehead Foundation.[6]

In the case of the Emily and Ernest Woodruff Foundation, its qualifying distributions during the years 1939–1972 were in excess of $113,959,396. If a 6 percent annual payout requirement had been in effect since 1939 and the Foundation had distributed just enough each year to meet the requirement, its aggregate distributions would have been $92,237,015, or $21,722,381 less than the amount actually paid out for this period. However, because mandatory invasions of capital would have been required to meet the 6 percent standard during some of these years, it is estimated that the present value of the Foundation's assets, $260,837,180, would have been reduced to $188,132,423, a decline of almost 30 percent, and that the income of the Foundation, $3,206,738, would have been reduced to $2,077,691, a decline of more than 33⅓ percent.

The same figures for the Joseph B. Whitehead Foundation are even more arresting. In that instance, total qualifying distributions for the years 1940–1972 were $15,061,837, whereas the 6 percent annual requirement would have necessitated distributions of $16,045,078. Admittedly, almost $1,000,000 would have been paid out for charitable purposes over this 32 year period if the mandatory distribution rule had been in effect, but the cost to the Foundation would have been staggering. For example, on December 31, 1972, the market value of its assets was $92,662,157 whereas those assets would have been reduced to $31,606,443 and its current income of $1,308,033 would have been reduced to $349,054 by the 6 percent payout rule. In other words, the asset shrinkage to provide that $1,000,000 additional payout would be slightly more than $61,000,000 and the loss of almost $1,000,000 of current income indicates that the differential if indeed there was one, would be made up in approximately one year.

The figures which we have compiled in this regard, and similar information gathered by the other Foundations represented illustrate without a doubt that the minimum distribution rule will, based on these actual figures, cost the charitable beneficiaries of these foundations a staggering amount, if past hostory repeats itself.

These results occur because the minimum investment return rule is expressed as a fixed percentage of the fair market value of the assets held by a private foundation. Often this fair market value is established by a public market, as in the case of common stocks of companies listed on a national stock exchange. In these instances, the traditional indicia of value is the public's expectancy of future earnings. Therefore, increased current earnings by the companies involved produce a proportionately greater increase in traded value, necessitating a greater invasion of principal to comply with the payout requirement. An example would be Foundations holding the common stock of a single company which is traded on the New York Stock Exchange. Because this company has enjoyed good management and a highly favorable earnings pattern over the years, it frequently trades at a multiple of more than 40 times earnings on the market. In 1972, this company reported earnings of $3.19 a share on its outstanding stock, and when those earnings were announced on April 5, 1973, its stock closed at a value of $137.50 a share. If this per share value is multiplied by 6 percent, the rate is $8.25 a share. When this figure is compared to the earnings per share of $3.19, it becomes apparent that the payout requirement is more than 260 percent of the current earnings of the company, indicating that the Foundations can never expect dividends to equal a payout requirement which is tied to the investing public's high regard for the value of the stock in question.

Obviously, not all stocks sell at such a high price earnings ratio. In fact, in today's economy with stocks selling at 15 to 16 times annual earnings rate, no one can expect dividend rates to exceed the 3.6 percent average set forth in the Value Line Investment Survey. This is true because most companies, if they are to grow and remain financially sound, must limit their dividend didstributions to a maximum of 50–60 percent of earnings. Many companies, such as the

[6] The same is reflective for the group.

extractive industries, are forced to retain larger portions of earnings to underwrite exploration and development programs. Likewise, other groups, faced with constant heavy drains for research and development costs, must limit their dividend payments to small percentages of annual earnings in order to provide funds for expanding operations. Thus, many sound companies simply cannot pay out enough dividends to support a 6 percent payout.

This point may be again illustrated by the following example: Assume a stock earns $5 per share. It would sell at about $75 with a multiple of 15. If it paid 60 percent of its earnings as dividends, the dividend would be $3 and the yield 4 percent—a little higher than normal. The retained earnings of $2 would probably not cover depreciation from inflation.

Hopefully, it should be clear that there is no general rule to correlate stock prices and earnings. Some sell at 5 or 6 times earnings and could yield 6 percent or better; others at 40 or 50 times earnings so they have no possibility of such a yield currently. Thus, it is irrational to have a general rule requiring payments based on current values that in no way reflect current earnings.

The irony of this situation is clear. Private foundations are now forced to sell sound income-producing common stocks held over a long period of time only because the investing public places a high value on those same shares for future appreciation potential. In fact, the greater the potential for a common stock, the more difficult it is for a private foundation to hold or secure that common stock for its own portfolio. This foreclosure of private foundations from investments in marketable securities which are recognized by investors for their proven performance would appear to be based on an invalid assumption concerning the long range responsibility of these foundations.

Prices which investors will pay for shares in our companies usually reflect an evaluation of the *future* earning capacity of the company, both short and long range. The nature of the operation and the romance in its future will determine the general range of market prices, but always subject to varying degrees of influence from the outside factor at work in the market place; war or peace, inflation, cost of living, foreign trade balances, foreign exchange rates, cost of money and so on and on. This explains why many foundation managers choose to stay invested in the companies they know best.

No matter how the problem is stated, under the 1969 Tax Reform Act foundations must tap their capital resources for the difference between the required distribution rate of 6 percent and their actual cash income. This is unfortunate for foundations and bad for charity.

In addition, the trustees may be required to take actions contrary to the desires of the donors as expressed in original trust documents. Most of the large foundations today were born decades ago out of successful one-family directed corporations. In a national atmosphere that was receptive and generally grateful and in accordance with the law of the land then in effect, family leaders dedicated major portions of their personal fortunes to charity through the establishment of foundations and trusts in various forms. Their wisdom produced certain requirements and restrictions governing the conduct of their trustees. Provisions covered investment policies, income distribution guidelines and rules for grant making among other stated wishes and directions of the donors. As long as these provisions were legal when drawn, done in good faith, in the interest of charity, and provide for prompt payout of cash income, we believe they should prevail and not be subject to change after the game is underway. Surely such a policy will discourage future donors and strikes at the credibility of all tax incentives.

2. *Management difficulties caused by 1969 rules.*—There are problems that may not be obvious that a distribution rule based on current value introduces. First, the monthly valuation requirement consumes time and attention that is nonproductive of charitable benefit. Foundation managers find themselves viewing investments like a speculator concerned with short-term market trends rather than with basic soundness of an investment. The short-term trend is not important to the long-term investor and his attention to underlying value is the area of legitimate interest. Instead, we see the current formula attaches such importance to current values that it cannot help but be diversionary.

Second—and probably more important—is the problem associated with handling grants. Foundations typically have some sort of application submission and screening process before final action and these preliminaries are time consuming for both the charity and foundation. It is difficult for the foundation and the chari-

ties it supports not to have a fairly concrete and fairly long-term concept of the required distributions. It is unfair to a potential grantee to encourage an application when his likelihood of success is remote and it is unfair to the grants committee not to have an adequate selection of applications. Thus, fluctuating levels of required distributions are inefficient for both the applicants and the trust.

An example will illustrate the problem. Let us assume that a foundation has dividend income of $1,000,000 and investment management expenses of $30,000 so it has $970,000 to use for charity out of income. If the corpus is $25,000,000, the minimum distribution at 6 percent would be $1,500,000 so corpus must be invaded in the amount of $530,000.

The next year the stock market takes a different view of the stock and it is valued at $35,000,000 while dividend income remains constant. This means that minimum distributions rise to $2,100,000 and the corpus invasion more than doubles to $1,130,000.

A staff established to process applications for $1,500,000 will be inadequate for $2,100,000; likewise, the expectations of charity built on a year when $2,100,000 is distributed will not be met when a lower year follows. One of the frequent challenges to the foundation is to engage in new and innovative activities. This means fuller exploration of the non-traditional applications and probably a longer time between application and grant. At any rate, the fluctuating minimums—particularly at an unrealistic level—will obviously be counter-productive to any desire to get into fields requiring greater attention per application. This serves to prevent foundation managers from being efficient and frustrates the objectives of foundation grants.

C. Statement of impact.

1. *Diversification: Not the Answer, Case in Point.*—As stated above, the object of the minimum distribution rule reflected in Section 4942 was to assure that the amount of distributions by foundations to charities was sufficiently high to justify the tax savings afforded to those establishing such foundations. Therefore, it is fair to examine the group of foundations subscribing to this statement for the purpose of determining whether or not the tax savings afforded to their founders have in fact been earned by adequate payment to charities. In this connection, we will use the experience of the Kellogg Foundation as illustrative for its experience is representative of and consistent with that of the group of foundations subscribing to this statement.

The founder of the Kellogg Foundation and virtually the sole contributor to it, W. K. Kellogg, realized total tax benefits (income, gift and estate) well below $500,000 on gifts which today have a total fair market value of approximately $590 million. The total of these assets are maintained on behalf of the Foundation in what may be said to be two separate portfolios (hereinafter "Kellogg" and "Diversified"). Kellogg consists entirely of Kellogg Company stock which represents less than 51 percent of the total stock of the Kellogg Company, having an approximate value today of $543 million.

Diversified consists of stocks, bonds and other interest-bearing obligations which is expertly managed and has an approximate value of $48 million. Kellogg has consistently out performed Diversified which was established to measure the fruits of diversification and to establish a standard of investment performance in order to evaluate the continued holding of Kellogg stock.[7]

A principal contention reflected in the Peterson Report, which has been referred to above, was that the portfolios of private foundations had not produced the rate of return which it was thought to have been produced by mutual funds. By any measure of return, this group has out-produced mutual funds for the period covered by the Peterson Report and has continued to do so since. The point is that this portfolio has not only out-performed the standard set by the 1965 Treasury Report (3 to 3.5 percent annual return for tax exempt entities) but has exceeded that of the mutual fund standard. For example, in the last six years the Kellogg Foundation's income has continued to be substantially greater than it would have been had its income been derived entirely from diversified investments. The increase was 53.9 percent for income received from the Kellogg holdings as compared to an increase of 4.7 percent of the Foundation's diversified portfolio. Obviously, this result shows that the diversification of funds would result in a great handicap to meeting the payout requirements of

[7] It must be borne in mind that the trustees have the discretion to sell the Kellogg stock.

the Tax Reform Act of 1969 and result in a lower return to charity over the years.

2. *Assume Section 4942 was Enacted from Creation.*—Again we will use the Kellogg Foundation as being illustrative of the group.

(1) Assume that the minimum distribution rule had been in effect at 6 percent from 1934.

(2) In that year, Kellogg contained 221,000 shares of Company, fair market value $37,570,000.

(3) From September 1, 1934, through August 31, 1972, the Foundation made an actual distribution of $203,092,196.

(4) If the minimum distribution rule had been applicable, distributions of $242,706,811 (or an increase of $39,614,615) would have been made.

(5) However, the Foundation would have had to sell the equivalent of 8,813,-928 shares with a market value of $214,839,495.

(6) Thus, the Foundation's holding would have been reduced to 9,274,312 shares with a market value of $226,061,355.

(7) The higher return to charity of $39,614,615 would have cost $214,839,495 thereby reducing the current size of the Foundation by almost 50 percent.

(8) In 1973 the distribution under the reduced assets would be $10,016,257 rather than $19,535,899 which it will distribute, almost 100 percent greater than the amount called for by blind application of the minimum distribution rule.

In summary, the facts establish the proposition that charity would have benefited in the short run by the minimum distribution rule, but only a great cost to the assets of the Foundation. Further, due to the depletion of these assets, the current an ergo the future benefit to charity would have to be reduced dramatically.

3. *Ture Economic Study.*—After three years there has been time to examine how Section 4942 will operate to undermine overall foundation grants and there has been the opportunity to further examine the assumptions of the Peterson Report. For this purpose, the foundations subscribing to this statement have had an independent study prepared by Dr. Norman B. Ture. Filed herewith and incorporated in this statement is that study, entitled "The Impact of the Minimum Distribution Rule on Foundations", prepared by Norman B. True, Inc., at the direction of the Ad Hoc Committee on Section 4942. The findings and conclusion of that report, as briefly summarized in its own language, are as follows:

"First, any minimum distribution rule which ignores the foundation's rate of return will have a highly differential, discriminatory and possibly capricious impact on foundations and on their long-term capacities to support charities.

"Second, the contention that the investment performance of foundations is relatively poor is based on inadequate information and inappropriate statistical measures; the records of foundations for which data was available in the preparation of this report certainly do not support this contention.

"Third, no sound evidence was advanced to support the view that the allegedly poor investment performance of foundations is related to the concentration of their investment assets.

"Fourth, it is neither realistic nor reasonable to assume that a minimum distribution rule will result in significant increases in the rate of return on foundation investments.

"Finally, the (this) report concludes that the tax savings allegedly realized by those establishing foundations are, in all likelihood, very small. Foundation distributions to charity have represented a sizable amount of benefits relative to the foregone revenues."

4. *Peterson Report Ignores Increased Needs of Charity.*—The Peterson Report assumed that the charitable services which a foundation normally supports will not rise in cost any faster than the general rate of inflation and for that purpose assumed a rate of inflation of 2 percent. *The Report's assumption is wrong,* for it completely disregards the fact that the organizations supported by foundations have little possibility of similar gains in productivity.

The costs of programs normally supported by foundations have increased faster than the general rate of inflation. These increasing costs are seen as limiting the work of many charitable organizations and and come at a time when government programs can't meet demand and when budgetary considerations require cutbacks in federal spending. This situation increases the dependence of charitable institutions on private foundations and other private sources for a dependable and continuing flow of funds. It is in the public interest that

charitable organizations have access to a number of sources of both private money and public spending to finance their activities.

Over the years, this group has supported charitable institutions engaged in higher education, medical and health education, and hospital services. Attached hereto is Appendix B illustrating the increasing costs experienced by these organizations.

5. *Conclusion.*—From the foregoing, two things are apparent: One, the underlying premise of the 6 percent minimum distribution rules is predicated upon false assumptions; and two, this rule must be changed if private foundations are to continue to be permitted to serve their function in the support of charitable undertakings.

If this is not done, it is clear that the principles set forth in the Peterson Report and incorporated in Section 4942 will impair the effectiveness of all foundations and eliminate many of them to the detriment of charity. This position is not only supported by the groups' accomplishments and experience, but by the Ture study which indicates that private foundations can give a better return per dollar to charity than the Federal Government.

No one has suggested increasing the Government's role in advancing philanthropy, which is precisely what must happen if the 6 percent rule of Section 4942 is not revised downward.

APPENDIX A—TABLES PUBLISHED IN THE 1965 TREASURY REPORT WHICH INDICATE THAT APPROXIMATELY 90 PERCENT OF FOUNDATIONS HAVE ORDINARY INCOME OF LESS THAN 6 PERCENT OF THEIR FAIR MARKET VALUE

DISTRIBUTION OF NUMBER OF FOUNDATIONS BY VARIOUS RATIOS

		Percent of donor-related influence over investment policy					Asset size			
	All foundations	50 percent or more	Over 33 percent, not over 50 percent	Over 20 percent, not over 33 percent	Not over 20 percent	Unclassified	Very large, over $10,000,000	Large, $1,000,000 to $10,000,000,	Medium, $100,000 to $1,000,000	Small, under $100,000
Total [1]	14,850	10,990	810	100	2,420	530	164	800	4,910	8,980
Ratio of grants to contributions received:										
Below 25 percent	2,010	1,530	60	10	360	50	6	60	620	1,320
25 percent to 50 percent	1,770	1,370	130	1	240	40	7	60	680	1,020
50 percent to 100 percent	2,620	2,220	80	20	230	70	7	70	850	1,700
100 percent to 150 percent	1,550	1,240	100	4	150	50	8	80	840	1,020
Over 150 percent	2,060	1,460	100	20	390	80	58	250	730	1,020
No computation (no contributions received)	4,850	3,180	330	40	1,060	230	78	280	1,590	2,900
Ratio of total income to book net worth:										
Total income negative	990	800	70	10	50	50	1	20	370	600
0 to 1 percent	3,600	2,940	160	10	360	140	7	30	400	3,160
1 to 3 percent	2,830	2,095	150	10	470	110	11	100	1,060	1,660
3 to 6 percent	4,730	3,350	260	50	950	110	63	360	2,040	2,260
6 to 10 percent	1,260	890	90	20	260	10	55	180	520	500
Over 10 percent	1,150	730	60	10	270	90	26	100	460	560
No computation (no book net worth)	310	190	20	0	80	20	1	10	60	240
Ratio of total income to market net worth:										
Total income negative	990	800	70	10	50	50	1	20	370	600
0 to 1 percent	3,640	2,920	190	10	370	140	7	40	390	3,200
1 to 3 percent	3,270	2,440	160	20	530	110	28	140	1,280	1,820
3 to 6 percent	4,620	3,240	270	50	950	120	89	420	1,990	2,120
6 to 10 percent	930	690	50	3	180	3	27	100	390	420
Over 10 percent	1,150	720	50	4	300	80	11	70	450	620
No computation (no market net worth)	260	170	20	0	50	20	1	20	40	200
Total [1]	14,850	10,990	810	100	2,420	530	164	800	4,910	8,980

See footnote at end of table.

APPENDIX A—TABLES PUBLISHED IN THE 1965 TREASURY REPORT WHICH INDICATE THAT APPROXIMATELY 90 PERCENT OF FOUNDATIONS HAVE ORDINARY INVOME OF LESS THAN 6 PERCENT OF THEIR FAIR MARKET VALUE—Continued

DISTRIBUTION OF NUMBER OF FOUNDATIONS BY VARIOUS RATIOS

		Percent of donor-related influence over investment policy					Asset size			
	All foundations	50 percent or more	Over 33 percent, not over 50 percent	Over 20 percent, not over 33 percent	Not over 20 percent	Unclassified	Very large over $10,000,000	Large, $1,000,000 to $10,000,000	Medium, $100,000 to $1,000,000	Small, under $100,000
Ratio of ordinary income to book net worth:										
Ordinary income negative	440	260	50	10	60	30	0	10	220	180
0 to 1 percent	3,840	3,160	170	10	370	130	9	20	430	3,380
1 to 3 percent	3,600	2,720	160	50	550	160	15	140	1,330	2,120
3 to 6 percent	5,280	3,720	310	15	1,070	140	87	460	2,330	2,400
6 to 10 percent	840	550	80	5	170	30	40	110	310	380
Over 10 percent	570	400	20	10	120	20	12	50	230	280
No computation (no book net worth)	310	190	20	0	80	20	1	10	60	240
Ratio of ordinary income to market net worth:										
Ordinary income negative	440	260	50	10	60	30	0	10	220	180
0 to 1 percent	3,880	3,150	200	20	390	130	10	30	420	3,420
1 to 3 percent	4,140	3,120	190	50	640	160	44	220	1,540	2,340
3 to 6 percent	4,990	3,500	280	2	1,020	140	90	460	2,260	2,180
6 to 10 percent	570	390	50	4	100	30	16	40	210	300
Over 10 percent	620	420	10	10	160	20	3	30	220	360
No computation (no market net worth)	260	170	20	0	50	20	1	20	40	200
Ratio of grants to book net worth:										
0 to 1 percent	1,370	730	120	20	450	50	9	20	280	1,060
1 to 3 percent	1,470	1,000	110	20	280	60	14	90	630	740
3 to 6 percent	2,810	1,890	190	10	670	60	66	280	1,420	1,040
6 to 10 percent	1,820	1,410	80	10	250	70	44	170	860	740
Over 10 percent	7,070	5,780	300	40	680	270	30	220	1,660	5,160
No computation (no book net worth)	310	190	20	0	80	20	1	12	60	240
Ratio of grants to market net worth:										
0 to 1 percent	1,440	730	120	20	510	50	9	30	280	1,120
1 to 3 percent	1,820	1,200	160	20	380	60	39	160	810	280
3 to 6 percent	2,750	1,850	190	10	630	60	76	280	1,350	1,040
6 to 10 percent	1,710	1,380	40	2	220	60	28	140	180	740
Over 10 percent	6,880	5,660	270	40	670	280	11	190	1,620	5,060
No computation (no market net worth)	260	170	20	0	50	20	1	20	40	200

[1] Differs slightly from number in tables 10 and 11 because this table excludes about 10 large foundations for which data were not available when this table was prepared.

Source: 1964 Treasury Department Survey of Private Foundations.

PERCENT OF FOUNDATIONS IN VARIOUS CATEGORIES WHOSE TOTAL GRANTS WERE LESS THAN CERTAIN PERCENTAGES OF NET WORTH

	Foundations whose grants were less than—							
	Of market net worth				Of book net worth			
	1 percent—	3 percent—	6 percent—	10 percent—	1 percent—	3 percent—	6 percent—	10 percent—
All foundations	10	22	40	[1] 52	9	19	38	50
Foundations with donor-related influence—								
Over 50 percent	7	18	34	47	7	16	33	46
33 to 50 percent	15	35	59	64	15	28	51	61
20 to 33 percent	21	43	57	59	21	41	52	58
0 to 20 percent	21	37	63	72	19	30	38	68
Very large	5	29	76	93	5	14	54	81
Large	4	24	57	76	2	14	49	70
Medium	6	22	50	66	6	19	48	65
Small	12	21	33	41	12	20	32	40
All foundations except small, total	5	22	51	68	5	18	48	66
Foundations with donor-related influence—								
Over 50 percent	4	20	48	67	4	16	45	64
20 to 50 percent	10	39	68	74	10	26	57	72
0 to 20 percent	8	25	60	72	8	19	56	71

[1] The remaining 48 percent of foundations contributed 10 percent or more of their market net worth, 60 percent contributed 6 percent or more, 78 percent contributed 3 percent or more, etc.

Source: 1964 Treasury Department survey of private foundations.

PERCENT OF FOUNDATIONS IN VARIOUS CATEGORIES WHOSE ORDINARY INCOMES WERE LESS THAN CERTAIN PERCENTAGES OF MARKET NET WORTH

	Foundations whose ordinary incomes were less than—				
	Of market net worth				
	0 percent—	1 percent—	3 percent—	6 percent—	10 percent—
All foundations	3	29	57	90	94
Foundations with donor-related influence—					
Over 50 percent	2	31	59	91	94
33 to 50 percent	7	21	58	90	96
20 to 33 percent					
Under 20 percent	3	19	45	87	93
Very large foundations	0	6	31	89	98
Large foundations	1	5	32	89	93
Medium foundations	4	13	44	91	95
Small foundations	2	40	66	90	93

Source: 1964 Treasury Department survey of private foundations.

PERCENT OF FOUNDATIONS RECEIVING NO CURRENT CONTRIBUTIONS WHOSE TOTAL GRANTS AND ORDINARY INCOME WERE LESS THAN CERTAIN PERCENTAGES OF NET WORTH

	Foundations whose percentage grants or market net worth were less than—				Foundations whose percentage ordinary income of market net worth was less than—				
	1	3	6	10	0	1	3	6	10
All foundations receiving no current contributions	19	35	50	69	2	24	49	87	92
Foundations with no contributions received whose donor related influence was:									
Over 50 percent	17	29	49	61	2	29	53	88	92
33 percent to 50 percent	27	39	67	82	6	20	40	88	94
0 to 33 percent	24	49	84	98	1	11	41	84	92
Foundations with assets over $100,000 with no contributions received whose donor related influence was—									
Over 50 percent	8	24	62	77	3	10	86	91	94
33 percent to 50 percent	5	38	74	79	0	5	42	99	100
0 to 33 percent	10	33	78	87	2	5	25	87	94

Source: 1964 Treasury Department Survey of Private Foundations.

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Appendix B—Brief Summary of the Increased Costs Associated With Higher Education, Medical Education, and Hospital Services

HIGHER EDUCATION

Higher education is a labor-intensive service sector of the economy in which it is difficult to achieve the gains in productivity that are experienced in goods-producing industries.

For purposes of historical comparisons of educational costs, the most useful data are those compiled by June O'Neill in a study conducted for the Carnegie Commission. Educational costs per credit hour consistently rose more rapidly than the consumer price index from 1953–54 to 1966–67. Over the period as a whole, educational costs rose at an annual average rate of 3.5%, as compared with a rate of 1.6% for the consumer price index—a difference of 1.9%. However, costs in private institutions of higher education rose more sharply than those in public institutions. The rate of increase for private institutions was 4.8%, or 3.2% more than the consumer price index, and for public institutions, 2.9%, or 1.3% more than the consumer price index.[1]

The most noticeable feature of the budgets of all institutions of higher education is how fast they have gone up in the years since World War II. Total educational and general expenditures on current account by all institutions of higher education went up from less than $1 billion in 1945–46 to more than $ 7 billion in 1963–64. Total educational and general expenditures less expenditures on organized research have gone up, on the average, more than 7% a year at all private universities and more than 12% a year in three institutions (Chicago, Princeton, and Vanderbilt). The direct instructional cost per student over the period 1955–66 works out to an average annual rate of increase of 7.3% for Chicago, Princeton and Vanderbilt and to 8.3% for all private universities.[2]

MEDICAL EDUCATION

In the area of medical care, hospital costs and doctors' cost per patient show increases substantially above the general price cost index as illustrated in Bradford, Malt and Oates, "The Rising Cost of Local Public Services," *National Tax Journal*. In the period 1958–71, the average operating budget for medical schools increased from $2,056,000 to $8,475,000, an increase of 412%. The mean salary for basic science faculty and for all ranks of clinical science faculty increased 59% and 66% respectively in the following statistics:

[1] Source: "The More Effective Use of Resources—An Imperative for Higher Education," A Report and Recommendations by the Carnegie Commission on Higher Education, June 1972, pp. 33–38.

[2] Source: "Economic Pressures on the Major Private Universities," William G. Bowen. Reprinted from "The Economics and Financing of Higher Education in the United States," a Compendium of Papers Submitted to the Joint Economic Committee, Congress of the United States, Government Printing Office, 1969, pp. 390–439.

AVERAGE OPERATING BUDGET FOR MEDICAL SCHOOLS[1]

Year	Number of schools	Average budget
1958-59	85	$2,056,000
1959-60	86	2,235,000
1960-61	87	2,461,000
1961-62	87	2,755,000
1962-63	87	2,944,000
1963-64	87	3,289,000
1964-65	87	3,674,000
1965-66	87	4,230,000
1966-67	87	4,933,000
1967-68	89	5,518,000
1968-69	91	6,324,000
1969-70	93	7,206,000
1970-71	92	8,475,000

[1] Does not include sponsored projects.

Note: The number of schools reporting equaled total number of schools existing in all years except 1970-71 when 92 of 95 schools reported.

Mean Salaries for All Basic Science Faculty—(Strict full-time)

Year:	*Mean salary*
1963–64	$13,806
1964–65	[1]
1965–66	15,018
1966–67	15,996
1967–68	17,336
1968–69	18,236
1969–70	19,353
1970–71	19,765
1971–72	21,051
1972–73	[2] 21,972

[1] Not available.
[2] 59% over 1963–64.

Mean Salaries for All Ranks of Clinical Science Faculty—(Strict full-time)

Year:	*Mean salary*
1963–64	$19,044
1964–65	[1]
1965–66	20,096
1966–67	21,515
1967–68	23,688
1968–69	24,738
1969–70	26,407
1970–71	28,223
1971–72	30,008
1972–73	[2] 31,640

[1] Not available.
[2] 66% over 1963–64.

Source: Dr. John A. D. Cooper, Association of American Medical Colleges, One Dupont Circle, Washington, D.C.

HOSPITAL SERVICES

A major program concern and site of W. K. Kellogg Foundation expenditures has been the hospital field. The Foundation has assisted a wide variety of programs in community hospitals such as in recent support for coronary care units and the improvement of burn patient care facilities and services.

The increase of such support by the Foundation has substantially paralleled the general rise of hospital costs in the United States. Such costs have risen at an appreciably greater rate than the general cost of living. The following is a depiction of the dramatic rise in hospital expenditures between the period 1950 to 1970:

TOTAL EXPENSES AND EXPENSE PER PATIENT DAY, COMMUNITY HOSPITALS, 1950–70

Year	Total expenses (in millions)		Expenses per patient day	
	Amount	Percent increase	Amount	Percent increase
1950	$2,120		$15.62	
1951	2,314	9.1	16.77	7.3
1952	2,577	11.3	18.35	9.4
1953	2,867	11.2	19.95	8.7
1954	3,121	8.8	21.76	9.1
1955	3,434	10.0	23.12	6.3
1956	3,733	8.7	24.15	4.5
1957	4,160	11.4	26.42	9.4
1958	4,655	11.8	28.27	7.0
1959	5,091	9.3	30.19	6.8
1960	5,617	10.3	32.23	6.8
1961	6,250	11.3	34.98	8.5
1962	6,841	9.5	36.83	5.3
1963	7,532	10.1	38.91	5.6
1964	7,349	10.8	40.58	6.9
1965	9,147	9.6	44.48	7.0
1966	10,276	12.3	48.15	8.3
1967	12,081	17.6	54.08	12.3
1968	14,162	17.2	61.38	13.5
1969	16,613	17.3	70.03	14.1
1970	19,560	17.7	81.01	15.7
Average annual increase		11.8		8.6

Source: Hospitals, JAHA

Of the nearly $14 billion rise between 1960 and 1970, the following factors have contributed:

INCREASE IN TOTAL U.S. HOSPITAL EXPENDITURES, 1960-70, 14,000,000,000

	Percent	Amount (billions)
Population changes	8.6	1.2
Increased patient usage	13.6	1.9
Inflation	20.0	2.8
Increased payroll	31.4	4.4
Increased supplies and materials	26.4	3.7
Total	100.0	14.0

The American Hospital Association has informed us that the estimated 1973 per diem cost for hospital care is $102.37. This is in contrast to a similar cost of $15.62 in 1950 and $32.23 in 1960.

One example of rather marked escalation in the cost of program activities supported by the Kellogg Foundation in the health field relates to our recent grant to make possible a national study of education for health administration and as contrasted to an identical commission in 1952–54. The earlier commission covered a life span of two years with a professional staff complement of two members plus one secretary. The total cost of this national study and which was completely defrayed by the Foundation was $71,199.

The Commission on Education for Health Administration was established in 1972 and its activity is scheduled to be completed by mid-1974. It has a similar purpose as the earlier group. The professional and secretarial complement is precisely the same, although there are some variables, such as complexity and the growth of this field. It is striking that the Foundation's commitment to the present Commission now totals $463,573.78.[3]

Hospital care has taken the largest share of increased spending on health. Since 1960, the cost of a day in a hospital has gone up 204%—to $92 in 1972, on average. The charge may run up to 50% higher in large cities. Physicians' fees, now costing Americans 16.2 billions a year, are up 74% over the same span.[4]

Hospital costs in Michigan have been rising faster than the cost of living since 1960, and particularly since the 1966 introduction of Medicaid and Medicare. From 1966 to 1971, Michigan hospital costs increased by 105.4% with 19.6% attributed to the increase in inflation.[5]

THE IMPACT OF THE MINIMUM DISTRIBUTION RULE ON FOUNDATIONS

(A Report Prepared for the Ad Hoc Committee on Section 4942 by Norman B. Ture, Inc.)

ACKNOWLEDGMENTS

This report on The Impact of the Minimum Distribution Rule on Foundations was commissioned by the Ad Hoc Committee on Section 4942 to provide an objective analysis and evaluation of Section 4942 of the Internal Revenue Code. The report is focused on the impact of the 6 percent minimum distribution rule with respect to foundations' investment performance and their capacity to provide financial support for charities.

Throughout the preparation of this report, I have enjoyed the complete cooperation of the Ad Hoc member foundations in providing me data and other assistance. The member foundations are: Maclellan Foundation, R. J. Maclellan Charitable Trust, Lettie Pate Evans Foundation, Lettie Pate Whitehead Foundation, Joseph B. Whitehead Foundation, W. K. Kellogg Foundation, Pew Memorial Trust, Lilly Endowment Kresge Foundation, Emily and Ernest Woodruff Foundation, and Hormel Foundation. (In the interests of preserving confidentiality, the data pertaining to these foundations are identified in this report by code letter in an order which does not coincide with the sequence shown here.)

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[3] Source: Andrew Pattullo, Vice President—Programs, W. K. Kellogg Foundation.
[4] Source: "Soaring Cost of Health Care", U.S. News and World Report, Inc., January 22, 1973, p. 23.
[5] Source: "Enquirer and News", Battle Creek, Michigan, Thursday, March 15, 1973.

At no time, however, have the foundations or their representatives attempted to influence the substance of or the methodology used in preparing the report. The analysis, findings, and conclusions are those of Norman B. Ture, Inc.

NORMAN B. TURE, *President.*

THE IMPACT OF THE MINIMUM DISTRIBUTION RULE ON FOUNDATIONS

I. INTRODUCTION

Section 4942 of the Internal Revenue Code requires tax-exempt foundations to distribute to qualified organizations amounts equal to or greater than 6% of the market value of the foundation's assets. This requirement was enacted in the Tax Reform Act of 1969 ostensibly for the purpose of removing the uncertainties and vagaries of prior law under which foundations accumulating income in unreasonable amount or over an unreasonably long period might lose their tax-exempt status. This loss of tax-exemption was thought to be an inadequate threat to avert unreasonable accumulations in some cases and an excessively severe penalty in others. In addition, if a foundation invests in assets that generate no current income flow to the foundation, the unreasonable accumulation rule was, obviously, inoperative. In such cases, it was alleged that the donor of the foundation's assets might receive substantial tax benefits from his contribution, while charities might receive no current benefits, i.e., grants, from the foundations.

During the legislative development of those provisions of the Tax Reform Act bearing on foundations, a large number of issues pertaining to foundations, their role in the U.S. society, and their operations were raised. The focus of legislative deliberations was on efforts to correct alleged abuses by foundations and to circumscribe modes of operation deemed to be inconsonant with the public objectives sought in the tax exemption of these organizations.

Insofar as a minimum distribution rule is involved, the principal issue was whether the amount of distributions by foundations to charities was a sufficiently high return on the tax savings afforded those establishing the foundations. To this point, the matters that were raised during the hearings and in floor debate included the contentions that (a) the investment performance of foundations, i.e., the rate of return they realize on their assets, compares unfavorably with that of mutual funds; (b) in some, perhaps considerable part, this poor performance is attributable to undue concentration by a foundation of its assets in a single class of stocks of a single corporation; (c) in many cases, this investment policy by the foundation revealed that its real purpose was to afford continuing family control over the corporation rather than to provide financial support for charitable activities; (d) better investment performance would significantly augment the amount of distributions by foundations to charities: (e) better investment performance called for both more highly diversified and higher yield portfolios, and (f) imposing some relatively high minimum distribution requirement on foundations would effectively impel them to improve investment performance by diversifying their portfolios and increasing their yield, which by the same token would require them to relinquish concentration of asset holdings in a single class of stock in a single company, and which would result in their increasing their distributions to charity.

This report subjects these considerations advanced in favor of a minimum distribution rule to critical examination, both factual and analytical.

Clearly, the fundamental objective of any minimum distribution rule is to increase the amount of private financial support for charitable organizations and their activities. Whether such a rule would achieve any of the other objectives attributed to it is a secondary matter, if not indeed irrelevant.

The findings and conclusions of this report may be briefly summarized. First, any minimum distribution rule which ignores the foundation's rate of return will have a highy differential discriminatory and possibly capricious impact on foundations and on their long-term capacity to support charities. Second ,the contention that the investment performance of foundations is relatively poor is based on inadequate information and inappropriate statistical measures: the record of the foundations for which data were available in the preparation of this report certainly does not support this contention. Third, no sound evidence was advanced to support the view that the alledgedly poor investment performance of foundations is related to the concentration of their investment assets. Fourth, it is neither realistic nor reasonable to assume that a minimum distribution rule will result in significant increases in the rate of return on foundation investments. Fifth, an appropriate distribution rule should be based on the rate of increase

in the amount of distributions desired by public policy, adjusted in the case of each foundation by the rate of return that foundation realizes on its investment.

Finally, the report concludes that the tax savings allegedly realized by those establishing foundations are, in all likelihood, very small. Foundation distributions to charity have represented a sizeable amount of benefits relative to the foregone revenues.

II. PORTFOLIO INVESTMENT POLICIES OF FOUNDATIONS

One of the principal arguments advanced in 1969 in favor of some minimum distribution rule was that, relative to their total assets, foundations generally ". . . are not providing an adequate payout to society in return for the immediate tax deductions society has given their donors."[1] In turn, the allegedly too low distribution rate was related to an allegedly poor investment performance by foundations compared with that of mutual funds. While avowing that it had not exhaustively reviewed the investment performance of foundations (a caution neglected in the 1969 legislative discussions which relied heavily on its data), the Commission nevertheless asserted that ". . . the investment performance of foundations is below par, and perhaps significantly so. . . . Since each percentage point of added total return on foundation investments would yield between two and three hundred million dollars of additional funds for charity, the cost to society of a lackluster management of these investments could be on the order of hundreds of millions of dollars annually."[2]

The issues raised in the Report and in the 1969 legislative discussions, although separately identifiable, are obviously interrelated. On the one hand, there is the issue of the type of assets held by foundations and of the yield per dollar of such assets, measured against some relevant performance standard. On the other hand, there is the issue of the disposition of the annual return on foundation assets, i.e., the allocation of that return between current year distribution to charities and augmentation of the foundations' future capacity to support charities.

Evaluation of the management of foundation investments is not merely a question of comparing the rate of return on foundation assets with that realized by other investors, say mutual funds. That evaluation must also include an assessment of the long-term objectives of foundations in support of charitable, educational, scientific, medical, etc., activities and of the overall portfolio and grant policies in the light of those objectives.

A. Return on foundation assets

Testifying on October 22, 1969, before the Senate Finance Committee on H.R. 13270, Mr. Peter G. Peterson, then Chairman of the Commission, reported that one of the Commission's findings was that the *total rate of return* on foundation assets was materially lower than that of mutual funds. The total rate of return, asserted to be the performance yardstick commonly used by mutual funds, profit sharing and pension funds was defined as the sum of dividends, interest, realized and unrealized capital gains divided by the market value of the assets.[3]

Using this measure, the Commission's findings, based on a sample of foundations' forms 990A for the year 1968, are summarized in the following table:

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[1] Commission on Foundations and Private Philanthropy, *Foundations, Private Giving, and Public Policy*, University of Chicago Press (Chicago), 1970, p. 76. The Commission and the report are referred to hereafter as "the Commission" and "Report," respectively.

[2] Report, p. 75. The implications of the quoted statement are examined at a later point in this report.

[3] Cf. Report, p. 74.

Total Returns on Foundation Assets as Percentage of Assets, 1968[1]

Foundations with assets:	*Median total return on assets (percent)*
under $200,000	4.7
$200,000–$1,000,000	6.7
$1,000,000–$10,000,000	6.0
$10,000,000–$100,000,000	7.7
over $100,000,000	8.5
Company foundations	5.8
Community foundations	5.2
Weighted figure for all foundations	5.6

[1] Report, p. 74.

By contrast, the Commission found an annual average total return for the years 1959–68 for 21 balanced funds of 9.2 percent and for 10 large general growth funds of 14.6 percent. For 1968, the Commission cited an average total return of 15.3 percent for common stock mutual funds and of 14.9 percent for balanced funds.[4]

A number of aspects of these "findings" cast serious doubt on their interpretability and reliability. First, the percentages reported are median values, not weighted arithmetic means or averages. The Commission explained the use of the median figure as intended to help offset any disproportionate effects of those foundations which did not reports assets at market value. For reasons explained below, any such foundations should have been eliminated from the calculation. Use of the median rather than mean does not bear on the bias introduced by the inclusion of data from such foundations. The median measure reported by the Commission for each size class identifies the total rate of return of that foundation with respect to which there were an equal number of foundations with a lower and a higher rate of return. But this measure does not tell one how the foundations in that size class, taken together, performed. For example, suppose a size class consisted of 5 foundations each with $1 million of assets, one of which had a zero total rate of return (as measured by the Commission), one had returns of $10,000 or 1 percent, one had returns of $20,000—2 percent—and two had returns of $200,000 each—20 percent. The median return "found" by the Commission would be 2 percent, although taken as a group, the five foundations had total returns of $430,000 on $5,000,000 of assets, or an average return of 8.6 percent.

In addition, the Commission apparently compared its *median* rate of return with a weighted *mean*—or average—return for the unidentified mutual funds to which the Report alludes. Suppose that the distribution of mutual funds by rate of return was identical with the distribution of foundations in the illustration above. Then comparing the *median* value of foundation rate of return with the *mean* value of mutual fund rate of return would come up with the "finding" that the mutuals had outperformed the foundations by 4.3 to 1, despite the fact that their respective performances were by hypothesis identical.

Moreover, as noted above, the inclusion of results based on book values for some foundations with market values for other foundations puts the "findings" of median rate of return quite beyond interpretation or analysis. Referring to the Commission's definition of total return—the sum of dividends, interest, realized and unrealized capital gains—consider a foundation whose assets are reported per book rather than market values. Suppose the market value of the foundation's assets increase by, say, 15 percent from the beginning to the end of the year, because the corporation whose stock constitutes the assets of the foundation has retained the full amount of its earnings. The appreciation in the market value of the stock of course reflects the market's capitalization of the increase in the corporation's future earnings which will flow from the retained earnings of the current year. But this market appreciation will not necessarily be fully or even substantially reflected in the book value of the stock held by the foundation. The computed total return on assets, relying on book values, may therefore fall materially short of that which would result from using market values.[5] Including measures of total rate of return based on book values, therefore, is highly likely to bias the Commission's findings downward from the actual total rate of return of the foundations. Moreover, it invalidates any comparison with the total rates of return realized by other institutional investors.

Finally, the Commission's "findings" that the investment performance of foundation is below par is based on the results of a single year's operation by the sampled foundations. The Report conceded that one year is not an adequate period for evaluating investment return, nevertheless, this perfectly correct caution did not preclude the Commission from making a comparison of investment performance and from concluding on the basis of that comparison that foundation management of their portfolios was lackluster.

[4] Ibid.

[5] In fact, some of the foundations in the Commission sample reported no change in book value of assets on their Forms 990–A, although the market value of their assets rose significantly. While it is conceivable that book values might increase more than market values, this is far less likely to occur.

In contrast with the Commission's findings, which were the principal data source for legislative discussions in 1969, examination of the investment performance of several major foundations leads to the conclusion that these foundations were highly efficient in their investment management, at least a measured by the Commission's total rate of return. For foundations, the annual average rate of return from the time of first endowment through 1972 ranged from a low of 10.0 percent to a high of 21.5 percent.[7] For some of these foundations, to be sure, considerable fluctuations in total rate of return from year to year were experienced, but even so, the rate of return record of each over its lifetime has been impressive. Thus, the average annual total return, including dividends and appreciation in the market value of assets, computed as the compound interest rate of growth from the year of initial endowment through 1972, ranged from a low of 7.9 percent to a high of 17.2 percent.

	Foundation year of endowment	Average annual total rate of return (percent)	Endowment (percent)[1]
A	1958	13.3	13.1
B	1957	12.3	12.0
C	1945	14.6	9.0
D	1954	21.5	17.2
E	1940	15.1	9.7
F	1935	13.9	7.9
G	1939	14.5	9.0
H	1924	14.9	9.1
I	1955	16.7	10.6
J	1948	10.0	8.0
K	1938	14.0	[2] 16.9
L	1942	10.8	9.5

[1] Compound interest average annual rate of increment over market value of initial endowment. Adjusted for additional contributions and stock splits.
[2] Since 1952.

There are, in short, substantial grounds for skepticism about the Commission's "findings" of poor, investment performance by foundations. It is regrettable that the "findings" and the conclusion drawn by the Commission from them were not subject to more critical examination in the legislative development of the Tax Reform Act of 1969.

B. The appropriate measure of return for foundation distributions

The minimum distribution rule of Section 4942 relates the required distribution by a foundation to the average *market* value of its assets. In this respect, the rule follows the reasoning advanced by the Commission with regard to the measure of the base against which foundation distributions should be evaluated.[8]

For purposes of the investment policies of households and businesses, choice among investment property depends on the potential gain in net worth afforded by the investment alternatives open to the investor. This gain in net worth is the sum of current income flows from the investment and appreciation in the market value of the investment assets. Thus, for purposes of evaluating the investment performance, the measure cited by the Commission is approprate.

It does follow, however, that gain in net worth as measured in the marketplace over given time period affords an appropirate basis for rules governing distribution policies.

Consider the case of a corporation with earnings in a particular year of, say, $1,000,000, where its earnings are measured according to the provision of the Internal Revenue Code and Regulations. In general, earnings so measured will be equal to receipts from the company's operations less expenses. Earnings do not include the appreciation in the market value of the corporation's equity. Nor should they. If these unrealized capital gains were included in income for the year, gross double counting would result, since the capital gains are, for the

[7] Average, for each foundation, of the total rates of return for each year from initial endowment through 1972.
[8] Report, p. 74.

most part, the market's capitalization of the increase in the company's future income.

Suppose the corporation retains the full amount of its earnings for that year. These retained earnings, prudently and effectively invested by the corporation, will produce an increase in the companys future income. The valuation in the market place to that additional future income will be reflected in an increase in the market value of the company's equity. But the unrealized capital gain can hardly be regarded as part of the company's income for that year.

For purposes of the accumulated earnings tax (Section 531–537), this retention of earnings may be deemed to represent an improper accumulation, and an additional tax may be imposed. But the accumulated taxable income on which the additional tax may be imposed is determined by reference to the corporation's taxable income (with certain adjustments), which does not include the company's unrealized capital gains, i.e., the increase in the market value of its equity.

The shareholders of this company will enjoy unrealized capital gains, assuming that they retain their stockholdings and the market value of their shares increases in some proportion to the company's retained earnings. These unrealized capital gains, however, are not included in the income of the stockholders, nor should they be, even though the appreciation in market value of their shares increases their net worth. To include this appreciation in the shareholders' current year's taxable income would be to subject them to tax on the capitalized value of future income as well as on the future income itself as materializes over time.

A foundation as one of the stockholders of the corporation no more than any other shareholder realizes income by virtue of the increase in the market value of its shares of the corporation's stocks. For effective management of its operations, the foundation must be constrained by the income it receives on its assets, not by the increase in the market value of these assets. The imposition of rules, pertaining to its operations, which rely on changes in the market value of the foundation's assets, thus, subjects the foundation to contraints dissimilar from and far harsher than any others applied by the Internal Revenue Code to any other class of entities.

For the reasons presented below, any uniform minimum distribution rule is likely to be at odds with public policy objectives concerning foundations and their financial support of charities. Apart from these considerations, a minimum distribution rule which relates required foundation distributions to the market value of foundation assets rather than to foundation income will almost certainly produce highly analogous and disparate results among foundations.

The obvious case in point involves differences among foundations with respect to the liquidity of their assets and the current flow these assets produce. Thus, a foundation with a substantial proportion of its assets in, say, a low payout, growth corporation may very well be required under the minimum distribution rule, to liquidate significant amounts of its assets, while another foundation with a substantial part of its assets in high payout, low yield shares in a slower growing company may be under no such constraint. In terms of investment performance and growth in capacity to provide financial support to charities, the first foundation may very well be highly superior to the second. The impact of the minimum distribution rule, however, is precisely contrary to the objectives articulated for it in this case. Indeed, if the first foundation's stock is that of a closely-held company for which little or no market exists, the foundation may be put into an impossible position with regard to both effective management of its investments and building the capacity to support charity.

Similar difficulties will arise where substantial amounts of the foundation's assets are in real estate on which the net cash flow is less than 6 percent of the market value of the property. The investment in this property may very well be superior to any alternative available to the foundation in terms of the Commission's total rate of return as well as in terms of building capacity for distribution to charities. Yet the minimum distribution rule might very well require the foundation to liquidate these assets and either to replace them with others which are inferior or to reduce permanently their capacity to support charity.

There is, as one might expect, substantial variation among foundations in their investment policies and asset composition. The minimum distribution rules of Section 4942 make no adequate allowance for these variations. The impact of Section 4942, therefore, is likely to be highly discriminatory. Moreover, since

these differences in effects are not necessarily, if at all, in line with public policy objectives, the minimum distribution rule is likely to be highly capricious.

If some minimum distribution rule, imposed at a uniform rate on all foundations, is to be continued, it should be applied with respect to foundation income, not foundation assets.

C. Investment Performance and Portfolio Concentration

One of the explanations offered for the allegedly poor investment performance of foundations, according to the Commission, is that ". . . a significant portion of a foundation investment portfolio is often control stock in a company."[9] Regrettably, the Commission provided no data showing the number or proportion of foundations whose portfolios were highly concentrated nor did it attempt to correlate foundations' rate of return experience with the degree of portfolio concentration.

The Commission did, however, provide some data, drawn from its 1968 sample of foundations, bearing on the distribution of foundation assets by type of asset. Excluding the Ford Foundation, the Commission found that stock in a company in which a donor and his family owned a controlling interest (20 percent or more of the total issued) constituted 30 percent of total foundation assets. Appreciated real property was 4 percent of the total, other appreciated intangible property was 36 percent, while cash or unappreciated property was 25 percent. The proportions differed somewhat depending on the foundation size class; for foundations with over $100 million of assets (excluding the Ford Foundation) control stock was 56 percent of total assets, compared with 19 percent for foundations with total assets less than $200,000. Moreover, the Commission found, only 14 percent of the sampled foundations had received half or more of their contributions in control stock.[10]

The view that the allegedly poor investment performance of foundations results from the lack of adequate portfolio diversification is without substantiation. Appropriate data, if available, might indeed reveal a correlation between rate of return and degrees of diversification, but as matters stand, such correlation is pure conjecture.

Quite a different surmise emerges from examination of the investment performance of the foundations shown in the table above. In each case, the foundation's assets are highly concentrated in a single class of stock. The wide range of average rates of return is not correlated with portfolio diversity.

Some significant degree of portfolio diversification may be a valid general prescription for balancing yield and risk. It does not follow, however, that the diversification appropriate for one investor is equally appropriate for any other. Diversification per se is not an investment objective to be blindly or slavishly pursued in disregard of the rate of return experience of existing portfolios. Changing portfolio composition entails the costs of acquiring information on other investment assets and, generally, some transaction costs. It is by no means clear that any of the foundations shown in the table above could reasonably expect by diversifying their potfolios to improve their investment performance sufficiently to warrant incurring the costs such diversifying would require.

D. Distribution policy and rate of return

More fundamentally, the relevance of foundation investment performance to the desirability of a minimum distribution rule is obscure. Surely the occasion for a minimum distribution rule is not to improve foundations' investment management, in and of itself. A tax provision aimed at such a result for foundations would be highly discriminatory, since no other provision of the Internal Revenue Code bearing on any other class of entities is endowed with a similar intent. The purpose of a minimum distribution rule, rather, is to increase the amount of foundations' distributions to charities. Any such increase currently or in the near future will occur at the expense of less capacity by foundations than they otherwise would have to provide such support over the longer term unless foundations are able sufficiently to increase the rates of return on their investments. If it is desired to increase distributions currently or in the near-term and if the amount of the increase in distributions is relatively large, a minimum distribution rule designed to achieve this result will require large-scale inroads on the existing assets of foundations, the effects of which on future total returns and

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[9] Report, p. 75.
[10] Report, Tables A31-33, pp. 243-245.

distribution capacity will far outweigh any increase in rate of return that might be realized by changes in foundation portfolios.

To the extent that public policy calls for a continuing and growing distribution capacity by foundations over the long term, a minimum distribution rule is counterproductive, irrespective of the total rate of return on foundation assets. The higher the required minimum distribution rate, the greater the likelihood of required reduction in foundation corpus, the effect of which on long-term distribution capacity is likely to outweigh by far any increase in rate of return which may be realized by changing the composition of the remaining corpus.

This may be illustrated by a hypothetical example. Suppose a foundation's initial endowment was $1,000,000, which was invested at an annual interest rate of, say, 15 percent, and suppose the foundation's annual distributions were 1 percent of its assets. At the end of 10 years, it would have distributed a total of $386,800, roughly, and would have accumulated total assets, i.e., distribution capacity, of about $3,658,750. If the foundation had been required to distribute each year 5 percent of its accumulated principal at the end of each year, the accumulated principal at the end of 10 years would be about $2,482,240, about $1,236,510 less. Distributions of $1,623,310 during the first 10 years instead of $386,800 would reduce distribution capacity over the succeeding 10 years by about $5,002,400 or by roughly 4 times the additional distributions in the first 10 years. In order to distribute each year 5 percent of the accumulated principal at the end of each year and to achieve the same distribution capacity at the end of 10 years as if annual distributions were 1 percent of assets, the initial principal would have to be invested at an interest rate of 19.84 percent, 32.3 percent greater than the assumed actual rate of 15 percent.

With a 6 percent minimum distribution rule, distributions totaling $1,866,560 would be required in the first 10 years, resulting in accumulated assets of about $2,179,000 at the end of 10 years. Distribution capacity for the succeeding 10 years would be reduced by roughly $7,550,000. To avert this loss in distribution capacity, the initial endowment would have had to have been invested at a rate of return of 21.1 percent, about 41 percent more than the assumed actual rate of 15 percent.

If the foundation's rate of return were 10 percent, instead of 15 percent requiring it to increase its distribution rate from 1 percent to 5 percent would result in additional distributions of $792,760 over the first 10 years, but would reduce the accumulated distribution capacity over the next 10 years by $1,860,000, roughly. A 6 percent minimum distribution rule would require $948,700 in additional distributions in the first 10 years but would reduce distribution capacity in the succeeding 10 years by about $2,225,000. To avert this loss in distribution capacity, the rate of return on the foundation's assets would have to increase to 14.6 percent and 15.85 percent, or by 46 percent and 58.5 percent, respectively.

Quite clearly, increases in rates of return of these magnitudes are hardly likely to be attained by even the most active and speculative investment management. Any minimum distribution rule which in practice requires foundations to increase the rate of their payouts to charities cannot realistically be justified as intended to improve the investment performance of foundations. On the contrary, the justification for any such rule must be the value judgment that the benefits from an increase in current distributions outweigh the costs of the reduced distribution capacity for the longer term.

E. Distribution Policy Criteria

For the long term, an appropriate distribution rate for any foundation must depend both on the desired rate of increase in its distributions and on the rate of growth of its distribution capacity, as well. Unless a fixed time horizon is placed on charities' requirements for financial support, or unless it is desired to substitute government financial support for private sources, the distribution rate required of foundations must take into account the impact of current and near term distributions on the capacity of foundations to provide the desired distribution in any future year. The higher the desired rate of growth in distributions relative to the rate of growth of assets, the lower must be the annual distribution rate if the foundation is to be able to meet its long term commitments.

The present 6 percent minimum distribution rule obviously does not take these considerations into account. For a great many foundations, it will require a sharp deceleration in the growth of their distributions. And for any foundation with a rate of return less than 6.5 percent, it will result in reduction and eventual

exhaustion of assets and an absolute decline in the amount of distributions.

The following table shows the maximum rate of growth in the amount of foundation distributions, given alternative rates of return, under the 6 percent minimum distribution rule. For any foundation with a rate of return of, say, 10 percent whose distributions to charity have been growing at a rate faster than 3.4 percent, the 6 percent minimum distribution rule will require a cut back in the rate of expansion of distributions. Moreover, this cut back in the rate of growth of distributions is not a hypothetical matter. Every one of the foundations shown in the table below will be required to slow the increase in its distributions as a result of the 6 percent minimum distribution rule. In most cases, the required reduction in the rate of growth will be substantial.

Percent maximum rate of growth in amount distributed

Percent rate of return:	Percent
7.5	1.05
10.0	3.40
11.7	5.00
12.5	5.75
15.0	8.10

Foundation	Actual rate of growth of distributions	Percent reduction in rate of growth of distributions
A	15.7	59.9
B	14.9	64.2
C	9.9	71.7
D	12.9	20.9
E	7.6	59.2
F	2.8	50.0
G	16.5	84.8
H	10.4	75.0
J	7.2	79.2
K	11.4	13.2
I	4.1	28.5

In all but two cases, the 6 percent minimum distribution rule will result in reductions in the distribution growth rate of well over 50 percent. In fact, the smallest reduction is 21 percent.

For all foundations, the average annual rate of increase in distributions to charities over the years 1955–1971 was about 10.2 percent.[11] The 6 percent minimum distribution rule, applied across the board, may very well reduce this growth rate to 5 to 6 percent.

These consequences of the 6 percent minimum distribution rule clearly are grossly at odds with the ostensible objective of the rule, viz, to impel foundations to *accelerate* the growth in their distributions. There is a broad consensus that the needs of charities for private financial support are expanding at an accelerating rate,[12] clearly implying that the desired growth rate of foundation distributions to charities over the next decade and a half should exceed that of the decade and a half from the mid-1950's. And indeed, it must be this persuasion that is the basis for the public policy position that foundations should increase their distributions to their recipient charities. But the minimum distribution rules of Section 4942, as demonstrated, are contraproductive to this end, when account is taken of the facts of foundations' distributions and earnings.

Any uniformly applicable minimum distribution rule, therefore, will discriminate severely among foundations, not in line with objectives of public policy but on the basis of factors over which public policy has little control. As shown above, these discriminatory effects of a minimum distribution rule cannot reasonably or realistically be justified as impelling foundations to manage their investments more efficiently.

[11] *Statistical Abstract of the United States*, 1972, Table No. 499, p. 306, from American Association of Fund Raising Counsel, Inc., *Giving U.S.A.*

[12] Cf. Report, Chapter 3 and Appendix II, 1.

F. Investment performance and distributions

The Commission contended that improved investment performance by foundations would result in increases in distributions to charities,[13] and this assumption was repeatedly articulated during the legislative hearings and debates. A minimum distribution rule, as already noted, was widely viewed as impelling foundations to improve their investment performance. Presumably, any increase in investment returns resulting from this improvement would be immediately passed on in additional distributions to charities. To complete the syllogism, by requiring foundations to improve their investment performance a minimum distribution rule would result in additional distributions to charity.

Interestingly enough this line of reasoning is the reverse of the justification for a minimum distribution rule based on the view that foundations were not distributing enough of their earnings. The clear implication of the latter view is that given their rate of return, foundations could well afford to increase their distributions.[14]

The Commission's reasoning and much of the legislative discussion appears to be exclusively mechanistic, ignoring a host of considerations which enter into foundations' determinations of the amount of their distributions. In the first place, as the discussion above demonstrates, full distribution of any increase in earnings resulting from an increase in rate of return would not conform with the condition that the foundation should be able to meet any future, targeted distribution. Beyond this observation, however, foundation distribution policy is also guided by considerations of the specific charitable activities which the foundation wants to support, the present demands of such charities relative to those which may be reasonably anticipated at a future date, the capacity of the donee effectively to utilize additional grants currently compared with their use at a later date, and so on. The balance among these and numerous other considerations dictate efficient distribution policy.

To be sure, the foundation's rate of return sets a limit on distributions, at least over a period of years. But it certainly does not follow that an increase in rate of return either would or should be promptly reflected in an equal increase in distributions. Moreover, if account is taken of the variability in investment return experience, on the one hand, and of the much steadier increase in charities' demands for financial support over the long term, and the extended time period of many grants, on the other, prompt year-to-year change in response to changes in rate of return would be neither practicable nor desirable.

Over the long term, increases in foundations' rates of return should be expected to result in increases in distributions, based on extrapolation of historical experience. But this historical relationship does not afford the basis for contending that a minimum distribution rule of the sort now in the law will impel an increase in distributions over the long term by virtue of an improvement in foundations' investment performance.

III. FOUNDATION DISTRIBUTIONS AND DONOR TAX SAVINGS

As noted above (section II), one of the major inputs into the 1969 revisions of the tax provisions pertaining to foundations appeared to be the view summarized by the Commission in its assertion that ". . . foundations . . . clearly are not providing an adequately payout to society in return for the immediate tax deductions society has given their donors."[15] At issue is (1) the magnitude of the revenue loss sustained by the Treasury by virtue of the deduction of donors' contributions to foundations and by virtue of foundation tax "exemption", and (2) the comparison of returns which might be expected from the Government's use of the foregone revenue with the foundations' distribution to charities.

Clearly, if it were shown that the magnitude of the tax savings from the deductibility of contributions to foundations is small, or if given the amount of savings it could be shown that the aggregate flow of benefits from the Government's use of the foregone revenue was exceeded by the amount of foundation distributions, the view that foundation payments were inadequate to justify the tax "benefits" would be unwarranted.

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[13] Report, p. 75.
[14] Congressional Record, December 6, 1969, pp. S15959–15963.
[15] Report, p. 75.

A. Amount of tax benefits

Net tax savings to donors, hence revenue losses to the Treasury resulting from the income, estate, and gift tax deductibility of contributions to foundations are in all likelihood quite small in magnitude. Close estimation of these tax savings is not feasible, primarily because of the inadequacy of data pertaining to such contributions. It is hardly surprising, in view of these difficulties, that the Commission did not support the quoted statement with a comparison of foundation payout with their donors' tax savings.

According to the Commission, the market value of foundation assets in 1968 was between $20 billion and $30 billion.[16] If one were to assume that the average age of the foundations in 1968 was, say, 15 years, and that the average rate of increase in the market value of foundation assets has been, say, 7 per cent, then the value of the foundations' assets at the time they were contributed to the foundations would have been between roughly $7.25 billion and $10.88 billion. The tax benefits resulting from these contributions, of course, would have varied substantially, depending on when they were made, the tax deduction allowed at the time, and the applicable tax rate. But suppose that on the average, the contributions had been fully deductible and at a tax rate of, say 50 per cent. Then the tax savings to the donors and the revenue loss to the Treasury would have been of the order of $3.6 billion to $5.4 billion.

Alternatively assume that the average age of foundations in 1968 was, say 25 years and that the average rate of growth in the market value of the assets was, say, 15 per cent. On these assumptions, the value of the assets at the time they were donated to the foundations would have been between roughly $600 million and $900 million. With an assumed marginal tax rate of 50 per cent, the deductibility of these donations provided tax savings of between $300 million and $450 million.

Given the wide range of the estimated age and rate of growth of the assets of foundations and the lack of data pertaining to donor's tax situations at the time of donations, any estimates of the actual amount of the tax savings is subject to an extremely large margin of error. Merely for illustrative purposes, however, assume that the tax benefits, hence Treasury revenue loss, were of the order of magnitude of $2 billion. Further assume that the average age of foundations, consistent with this estimate of tax savings, is 20 years (as of 1968).

B. Comparison of foundation distributions with Government use of tax savings

On these assumptions, one might ask, "What would have been the cumulative amount of "benefits" to society if no deductions had been allowed and if the Government had distributed 6 per cent per year of its returns on the $2 billion of additional revenues, assuming that these returns were equal to 6 per cent of the net-of-distributions amount of the $2 billion of revenues? How does this cumulative amount of Government benefits compare with the cumulative amount of foregone foundation distributions, given the actual rate of growth of such distributions?"

Given these assumptions, Government benefits distributed to society in amounts equal to the earnings on the $2 billion of additional revenues would have aggregated roughly $2.9 billion from 1948 through 1972. If donors had not been allowed to deduct these contributions, and if their donations to foundations had been less than assumed above in an amount equal to the additional taxes they would have paid, then the cumulative amount of foregone distribution by foundations to charities from 1948 through 1972 would have been roughly $11.3 billion.[17] Even if the foregone foundation distributions had been only half as much—$5.6 billion—as estimated, and if the Government's use of the additional tax revenues had provided half again as much additional benefits—$4.4 billion, it is clear that the lost foundation distributions would have substantially exceeded the additional benefits from Government.

Granting the imprecision of these calculations, they nevertheless strongly urge that there is little factual justification for the notion that foundation payouts

[16] Report, p. 151.

[17] This assumes that the initial foundation distributions in 1948 would have been half the amount estimated for that year and that distributions would have increased at the same average annual rate—10.1 percent—as over the years 1955–1971.

have been an inadequate return to society for the tax deducions society has given their donors. Indeed, relatively few government spending programs could meet the benefit-cost standards implied by foundation distributions in relation to tax savings to the donors of foundations' assets.

Mr. Fox. That concludes our testimony. We are available for any questions.

Mrs. GRIFFITHS. I would like to know what happened to the Kresge Foundation under the payout rule.

Mr. BALDWIN. Madam Chairman, I will be glad to tell you that had a 6-percent rule been in effect since 1924 when Mr. Kresge established the foundation, it would have resulted in the gross assets of the foundation being $625 million less than they are at the present time. There would have been $32 million more paid out to charity over that period of time that will obviously be made up within slightly over a year with the current state of the assets.

I should tell you in addition that we are much concerned about the inflationary effects. One is often told that a high total return rate can be gotten. In my own experience it would seem to me that 8 percent is about as well as anybody can do on that.

I thoroughly endorse what has been said here before with respect to a 8½ percent return, perhaps 3¾ percent on dividends and interest, and the rest might come from realized capital gains. But when one adds a 4- or 5-percent inflationary factor on top of that, or in our case, since we deal mainly with bricks and mortar, another 4 percent on the top of that, it is clear that the erosion is an almost impossible situation to meet.

I had, for example, yeserday before me an application from a prominent university in which they calculated—this was a construction project and it would take over 2 years to do—they calculated the rate of inflation with respect to the construction at 8 percent a year. I think this is a factor that must be taken into account.

I would comment also on perhaps a little known aspect of the 4-percent excise tax. Kresge Foundation a year ago embarked on a secondary offering of some size, $270 million. We did this by way of diversification, by way of increasing our income. On the other hand, we are required under the act to pay a 4-percent excise tax on the capital gain involved in that particular secondary offering. Therefore, on May 15 the Kresge Foundation will pay a 4-percent excise tax of $5.8 million of which $600,000 is attributable to current dividends and interest and $5.250 million is attributable to the offering, which we did in order to increase our yield, and also to diversify.

So it seems to me that that portion of the 4-percent excise tax should certainly be eliminated. I must say as to the effect on us, last year we had some 800 applications involving I suppose a total asking of some $150 million. I am aware that to the members of the Ways and Means Committee this is not an exorbitant sum. On the other hand, we had to turn down about $11 out of $12 asked for. In 1971 that was the case. In 1972 the total asking was about the same. Our giving trebled under the act because we were under the minimum investment return provisions. All that it meant was that we had to turn down $3 out of $4 asked for. So the demand continues. Unless there is a diminution in the minimum investment return payout for all the reasons that have been stated here, I see no reason to believe that there won't be a gradual phasing out of foundation activity. This is what I think the members of the committee must face up to.

Thank you.

Mrs. GRIFFITHS. I would like to say to you, Mr. Baldwin, that there is no committee in Congress which is more impressed with large sums of money than this committee is. This is the only committee on which I have ever sat where there is only one copy of the transcript ever made available. Everybody has to correct it and send it back on to the next one. In all other committees, everybody gets a special copy.

Mr. BALDWIN. Madam Chairman, my worry was that the figures I gave were too small.

Mrs. GRIFFITHS. Well, we run this whole committee on $50,000 a year and with great effort we got the chairman to ask for more this year.

Mr. BURKE. Regarding the Kreske Foundation, what is the net worth of the Kresge Foundation today?

Mr. BALDWIN. I don't know what the market is doing at the moment, sir. I would guess somewhere in the neighborhood of $850 million.

Mr. BURKE. What was its net worth in 1969?

Mr. BALDWIN. I have the figures. I can give them to you.

Mr. BURKE. I would like to have them right now because I think it contradicts your testimony somewhat.

Mr. BALDWIN. The market value of assets as of December 30, 1969 was $432 million, sir, in round figures.

Mr. BURKE. They are up to $800 million today?

Mr. BALDWIN. As of yesterday's market that would be it, yes.

Mr. BURKE. That is all.

Mr. BALDWIN. The reason for that, of course, is the appreciation in the Kresge stock of which we hold somewhat over 10 million shares.

Mr. BURKE. If their net worth went from $432 million up to $800 million in less than 4 years, I don't think that it is going to disappear from the horizon.

Mr. BALDWIN. Well, that presupposes the continued increase in the stock and it presupposes that section 4942 is not in effect, Congressman, and I am not sure that either can be depended upon. We had begun, long before the 1969 act, to diversify that. I should tell you if we had held all the Kresge stock we had the worth of this foundation would now be $1.8 billion.

Mr. BURKE. I have heard all these statements about these foundations disappearing. I don't think any organization whose assets would increase from $432 to $800 million in less than 4 years is going to disappear.

Mr. BALDWIN. I should point out, sir, that last year we invaded principal of $17 million and it is estimated this year we will invade principal of $20 million. This is under 4¼ percent, not 6 percent.

Mrs. GRIFFITHS. Mr. Schneebeli will inquire.

Mr. SCHNEEBELI. Gentlemen, Mr. Baldwin said that the inflationary factor to be considered should be 8 percent rather than 6 percent provided for in section 4942. Is that correct?

Mr. BALDWIN. No, sir, what I was making reference to is the commonly held assumption that one ought to get a total return of somewhere in the neighborhood of 10 or 12 percent depending obviously on which investment analyst you talk to. It is my own guess that probably 8 percent total return as the difference between realized and unrealized capital gains is a reasonable sound thing to look for during these days. I realize there were other times when that was not so. What I said was that if you paid out this 6 percent you would then theoretically have a 2-percent increment. I said further that adding a 4- or 5-percent inflationary factor to that would mean that in effect your foundation purchasing power was reducing by at least 3 percent a year.

Mr. SCHNEEBELI. What you are saying is that 6 percent in section 4942 is not sufficient to take care of the rate of inflation?

Mr. BALDWIN. I am saying it is too high. The 6-percent payout requirement is too high.

Mr. SCHNEEBELI. We have a lot of challenges to the accuracy of the Peterson report. Virtually everybody has challenged it. I, and some other members of the committee would like to know a little more about the background of the Peterson report. How was it authorized, by whom? Could you give us some information about the Peterson report? Is this the Mr. Peterson who was Secretary of Commerce, former president of Bell & Howell?

Mr. FOX. Yes, sir, at that time he was with Bell & Howell. He was not Secretary of Commerce.

Mr. SCHNEEBELI. That is how hee got hooked up with Senator Percy in this report, I presume.

Mr. FOX. Yes, sir. He was requested by Senator Long to come forth with a study which would, among other things, indicate to the committee what a proper rate of return for foundations would be. That study is entitled "Foundations, private giving, and public policy report and recommendations of the commission on foundations and private philanthropy." What we have done since then is to commission an independent study by Dr. Norman Ture to examine the conclusion and assumption in the Peterson report. Dr. Ture has found something that we guessed wasn't right, but were not able to substantiate simply because we were not economists, and that is that the logic that was applied in the Peterson report, in which he concluded that a foundation should pay out between 6 and 8 percent annually, was subject to question. He used the median values, not weighted arithmetic means or averages; in addition, many of his statistics were for only 1 year in regard to foundation income, and thus the entire result that he came out with is highly questionable. I think Mr. Baldwin has stated it by really

saying if you assume that you have an 8 percent total, including unrealized capital gains return by a foundation annually, if it were to try to pay out between 6 and 8 percent, its purchasing power because of inflation would obviously be diminished annually.

At this point in time no specific action has been necessary and therefore none had been taken but you can be assured that the trustees are very conscious of the requirements of the law.

Mr. CORMAN. Do you anticipate that you will need to change your potfolio? Do you anticipate converting it into relatively high yield bonds so that the 6 percent won't cause you any trouble, or might you put it into growth stock where the income will cause you some trouble?

Mr. MAWBY. I think it would be fair, Mr. Congressman, to say at this time no decision has been made, that we have a very responsible group of trustees, and appropriate actions, based upon what in their judgment seems to be in the best interest of charity and in conformance with the law, will be taken at the time it is necessary.

Mr. RIDDELL. Mr. Corman, while you had to go to vote Dr. Mawby pointed out to the committee that the Kellogg Foundation is unique in one regard. It holds, as he pointed out, what may be termed two separate portfolios. One portfolio, as he has said, consists entirely of the Kellogg Co., stock. The other portfolio is a broadly diversified, managed fund which is utilized principally for measuring the performance of the Kellogg portfolio. That diversified portfolio is managed with the assistance of the best available investment counsel that is obtainable. The fact is that the record of the diversified fund which is constantly being monitored and which is constantly changed in accordance with the advice that we get does not produce either the same yield or the same capital appreciation as is produced by the other fund.

Now, this is a fund which is mixed in equities, in bonds and in other interest-bearing securities. The plain truth of the matter is that the thought that a diversified portfolio is going to produce a higher rate for the benefit of charity evidently depends upon what is held to begin with and how well it is managed. There has been every effort made by the trustees of the Kellogg Foundation to improve and increase the yield of its diversified portfolio. It has not managed to do so in anywhere near the degree of success that has been produced by the wisdom of Mr. W. K. Kellogg in turning over one-half interest in a company, and that is essentially what he did, to the people of the United States.

Now it is not, as Peterson thought, that we should be measured as foundations with mutual funds. But let us compare the actual experience of every foundation represented at this table with the actual performance of mutual funds. Peterson was incorrect in assuming that mutual funds performed as well as they did and Peterson was wrong in assuming that mutual funds were doing anywhere near as well as he thought they were, and equally incorrect in assuming that we were doing badly because the plain truth of the matter is that both the diversified fund of the Kellogg Co. and its Kellogg Co. stock have both outperformed mutual funds. That is true, sir. Yet nevertheless notwithstanding that fact and for your benefit, Mr. Burke, the facts as we related them to you on what the 6-percent rule would have done to our foundation since 1934 is as follows: It would have reduced the total portfolio by 50 percent and the net short-term benefit would have been only around $39 million, which is to say that ultimately the gifts devoted to charity would have been reduced by almost $210 million over the short-term benefit to charity.

Mr. SCHNEEBELI. There is an item in the Wall Street Journal on that that is of interest. It was to me. The Robert Wood Johnson Foundation announced today a $15 million program for emergency medical service over a 2-year period of time, $15 million. I checked the record and I think the Federal Government investment for emergency medical services is $15 million per year. So this is 50 percent more to the Federal approach to this problem and I think that it further substantiates the need for foundations, and highlights the good that they do.

Mr. FOX. There is no question about that. The Ture study, for example, also refutes one of the premises that people assumed in 1969 was true and that is that donors got huge tax deductions in relation to what they were giving away.

Dr. Ture took our group's total tax deduction benefits and applied that to see what would have happened if instead the money had been given over to the Federal Government; and in short he just shows that charity gets a greater bang for its dollar from private foundations than it does from governments giving.

Mr. SCHNEEBELI. We have that Ture report as part of your testimony.

Mr. Fox. Yes, sir.

Mr. Schneebeli. Thank you very much, Mr. Chairman.

Mrs. Griffiths. Mr. Burleson?

Mr. Burleson. No questions.

Mrs. Griffiths. Mr. Corman.

Mr. Corman. I want you to know that I am friendly to the cause of charity, but I must tell you that I have sat here and heard that if we take away any of these tax incentives young people won't be able to go through college. We have a lot of tax incentives to make that possible. But when we suggest that foundations should spend about 6 percent of their assets for the charitable purposes for which we have been moved to give tax incentives, we are told it will destroy the system of private charity.

I must say I am a bit confused. I want to turn to Kellogg, for a moment, to look at what they are doing to comply with section 4943. I understand Kellogg is one of the companies that is going to make some changes.

I wonder what percentage of Kellogg stock is held by foundations, what percentage is held by disqualified persons, and if that presents you with any need for action under section 4943, what your plans are to come into compliance?

Mr. Mawby. Yes, Mr. Congressman. The situation is that of course Mr. Kellogg in establishing the foundation had determined that whatever he should accumulate would be somehow used to the benefit of mankind. So his wealth, which was his holding in the Kellogg Co., was put into the Kellogg Foundation and is now held in that trust fund. That amounts to about 50.2 percent of the stock of the Kellogg Co.

Now, the foundation and the trust have always operated in accordance with the law. We are very conscious of the provisions of 4943 and the trustees of the trust will be taking this into consideration as they make their plans for the future.

Now, of course, God knows each one of the sets of trustees that you see here represented today are charged with and they attempt the very best they can to discharge that responsibility to their trus insruments and to the public. But the ultimate question here before you today is what is the measure of investment experience. Is there any empiric formula that you can build into a rule such as the rule that is being discussed before you today that will, say, on a day-to-day basis guarantee maximum return to charity?

You have provided in the 1969 act rules which make it virtually impossible for any of the abuses, which continued in the instance of a very, very few foundations up to 1969, to continue. You asked us what family interest did Mr. Kellogg maintain in the Kellogg Foundation. There are absolutely no members of his family and none from the beginning which continued to have any exercise of control over the trust or the company at all. They are not in being.

Again, we come back to you and ask for your true consideration of the facts as we present them to you and for an opportunity to work with your staffs to design a rule which can accomplish what is certainly necessary but at the same time will, if you deem it proper, enable the foundations of the country to stay in business and do their job.

I am with you, Mr. Corman. The name of the game is to let us really sit down, take a look at what has happened, what the facts are, and try to work the rule out.

The Peterson report did not attempt to do us any injury. It was just simply put together within a very short timeframe, and it was put together under certain assumptions that were just basically inaccurate. I believe that that happened because of the very short time in which they had to examine the problem.

Thank you.

Mr. Corman. You said the Kellogg portfolio that held Kellogg stock did better than the diversified fund. What was the record of each?

Mr. Mawby. The record of the two funds, we will produce them month by months and year by year for the record. The fund initially contained nothing but Kellogg Co. stock. A certain portion of the Kellogg Co. stock was sold.

The funds produced thereby were set up, as I said, in a diversified holding of bonds, stocks, and other interest-bearing obligations. Now I don't have the day-to-day performance of that fund with me today.

Mr. Corman. I just want any one year. You said Kellogg did better on a percentage basis. What was the percentage profit of the two funds in a similar period of time?

Mr. MAWBY. I think, Mr. Congressman, that if we look at the total return, that the Kellogg portfolio through the years has performed somewhere on an average of 10 to 11 percent, about 4 percent in dividends, and about 7 percent in appreciation.

This means that the corpus of that trust holding has about doubled in its value each 10 years and therefore is about doubled in the income that it is producing each 10 years.

I do not have it right here, but we will provide to you the specific figures regarding the diversified portfolio.

I would emphasize, however, that the diversified portfolio has also outperformed mutual funds and outperformed the Dow Jones averages, and so forth. So it has been a well-managed fund, but it simply has not done as well as this unique holding of Kellogg stock.

I think the return to chairty, which is my concern as a foundation manager, has been maximized through the unique performance of this company.

Mr. RIDDELL. Mr. Corman, the difference is not small. It is large. The difference in performance is great. I am sorry that we don't have the actual percentage worked out. We should have.

Mr. CORMAN. Ten or eleven percent is a fairly revealing fact. I guess what you are asking us to do is to make a decision as to what foundations can grow internally by setting some of their profit for growth or whether we want to require that the profit be spent for a charitable purpose for which there is a tax incentive.

It is a hard question from where we sit.

Mrs. GRIFFITHS. Are there questions on this side?

Mr. Chamberlain.

Mr. CHAMBERLAIN. Madam Chairman, to follow up the point we are on right new, that Mr. Corman brought up, I would like to refer to this sentence in the middle of page 19 of your statement dealing with that. Maybe I am confused.

The increase was 53.9 percent for income received from the Kellogg holdings as compared to an increase of 4.7 percent on the foundation's diversified portfolio?

Does that relate to what we are talking about right now?

Mr. MAWBY. Mr. Chairman, that is a comparison. Perhaps it does answer Mr. Corman's question· It is a performance comparison over the last 6 years. It is a comparison of 1972 income with 1967.

It is income, including divdends and interest, so forth, only, not the appreciation or total return concept.

But the income produced by the Kellogg portfolio in 1972 was 54 percent, 53.9 percent to be exact, greater than the income produced by that portifolio in 1967.

Conversely, the income produced by the diversified portofolio was 4.7 percent greater in 1972 than in 1967. That, however, I would emphasize, is the income as we think of it, dividends and interest, not the appreciation.

I think it is illustrative of the point that the growth in the Kellogg portfolio has, indeed, been impressive.

Mr. CHAMBERLAIN. Thank you.

Thank you, Mr. Chairman.

Mr. BURKE [presiding]. Mr. Duncan will inquire.

Mr. DUNCAN. Thank you, Mr. Chairman.

What are the combined assets of all your foundations? Do you have that?

Mr. FOX. We can total it.

Mr. BURKE. If the gentleman will yield, when the rest of the members have concluded, I was going to ask the rest of the foundations to give me their net worth as of this year. So you, gentlemen, can be preparing for that. I will be glad to add up the total.

Mr. DUNCAN. Have the assets of your foundations increased or decreased since the 1969 Tax Reform Act?

Mr. RIDDELL. As a general rule, I think we can state that only those foundations which have sold the initial holdings granted to them by their grantors have declined, which sort of says something for the merits of diversification.

Mr. DUNCAN. If you held your assets——

Mr. RIDDELL. All of us who have held that which our donors gave us have seen appreciation. Those who have seen declines have sold that which was given them. Had those of us which held the substantial portion of what was given to us and sold only part of it, held it all, they would be much better off.

Mr. BOLLING. Could I give an illustration from Lilly Endowment?

We sold off last year a total of 3 million shares of Lilly stock in order to diversify. At the end of 1972, as we totaled up the results of the situation from this diversification, and Lilly put the returns from that sale in the hands of eight competing financial management firms, some of the best supposedly we could get in the country, the assets of the diversified fund at the end of 1972—admittedly this was only about a 9-month experience—but at the end of 1972 Lilly Endowment had $50 million less to use for charity than it would have had if it had kept the money in Lilly stock. That was our experience with eight diversified management firms for this first year of our attempt toward diversification.

Mr. BURKE. What would you say is the net worth of the Lilly Fund as of today?

Mr. BOLLING. As of the end of December it was $1,248,251,000.

Mr. DUNCAN. You mentioned the appreciated growth of the Lilly stock. What percent of that did you pay out in dividends from the Lilly stock? Is it very low?

Mr. BOLLING. It is a very low yield stock. It is around 1 percent in its normal dividend.

Mr. DUNCAN. Do you have one foundation contributing to another foundation?

Mr. BOLLING. I beg your pardon.

Mr. DUNCAN. Does one foundation contribute to another foundation. Have any of your foundations followed that practice?

Mr. HUFFAKER. Generally that would be contrary to the 1969 act, sir.

Mr. DUNCAN. Did you do that prior to that?

Mr. HUFFAKER. The Pew Memorial Trust did not. I am not aware of any of them that did that.

Mr. DUNCAN. The committee is concerned——

Mr. HUFFAKER. Excuse me, Mr. Duncan. I am referring now to a private, nonoperating foundation. You have operating foundations carrying on medical research, Medical research foundations, that type of thing, they are operating foundations.

Mr. DUNCAN. That is what I have reference to.

Mr. HUFFAKER. Yes, sir, we contribute to foundations that are carrying on charitable activities. We do not contribute to foundations that are themselves conduits.

Mr. DUNCAN. The committee is rightly concerned with some obvious abuses that have crept into foundations. Does anyone have recommendations or ideas on how to correct some of these abuses?

Mr. BALDWIN. I think the general feeling, sir, is that the 1969 act has taken most of those abuses into account and given a little bit of experience with that; from the point of view of the Kresge Foundation I see no further recommendations to be made at this time.

Of course, we are suggesting revision of the 4942 section, rejection of the minimum investment return payout to preserve the purchasing power for charity. Aside from that, I have no recommendations.

I might respond, Congressman Burke, to your question.

I did indicate that the assets of the Kresge Foundation were, at the end of December 31, 1972, in the area of $900 million.

I should tell you that in the 4 months that have elapsed since that time we have dropped in value $100 million by reason of stock market action, that is, downward stock market action.

I point that out, sir, only to indicate the volatility of the matter.

Mr. BURKE. Would you yield?

Mr. DUNCAN. I will be glad to yield.

Mr. BURKE. Could you give us the net worth on the Hormel Foundation?

Mr. FOX. Yes, sir. I have gotten this from the group. The Hormel Foundation is approximately $10 million; Kellogg, $590 million; Kresge, $890 million; Lilly, $1¼ billion; McClellan, $70 million; Pew Memorial, $500 million; the Emily and Ernest Woodruff Foundation, Lettie Pate Evans and Joseph B. Whitehead Foundation total approximately $580 million.

Mr. SCHNEEBELI. As of what date?

Mr. FOX. These are December 31 dates.

Mr. BURKE. I want to make the observation that every one of the foundations has just about doubled its net worth in the period in question.

McClellan Foundation increased from $10 million to $70 million. Lilly Endowment went from $777 million to $1¼ billion.

The Kresge Foundation went from $432 million to $800 million.

The Kellogg Foundation went from $392 million to $590 million.

The Hormel Foundation, it seems, has had the smallest growth, from $9.4 million to $10 million.

Mr. DUNCAN. Can any of you tell me what percentage of your contributions are for domestic purposes and for foreign operations?

Mr. BOLLING. I would say Lilly Endowment has a rule adopted by our board that at least at the present time we will give no more than 5 percent of our grants overseas and 95 percent for domestic grants in the United States.

Mr. DUNCAN. Do any of you gentlemen have a higher percentage?

Mr. BALDWIN. No. As far as Kresge is concerned, $185 million was given over a period of nearly 50 years, less than one-half of 1 percent has gone outside the United States. That includes Canada.

Mr. HUFFAKER. The percentage for Pew is about like that for Kresge.

Mr. DUNCAN. Do any of you run over 5 percent?

Mr. MAWBY. Yes, sir; the Kellogg Foundation has long relationships and program assistance in Latin America and Europe. Our domestic expenditures are about 82 percent of the budget. Overseas about 18 percent.

Mr. DUNCAN. Do any of your foundations support political activity of any kind?

Mr. MAWBY. Ours does not.

Mr. BALDWIN. No, sir.

Mr. DUNCAN. Have they ever supported a voter registration drive?

Mr. BALDWIN. Kresge does not.

Mr. DUNCAN. Do you support any groups that use funds for that purpose that you know of?

Mr. BALDWIN. Kresge does not.

Mr. MAWBY. Not that we are aware of.

Mr. DUNCAN. Do any of you own newspapers or other media?

Mr. FOX. No.

Mr. BURKE. Mr. Karth will inquire.

Mr. KARTH. Gentlemen of the panel, why would a foundation want to increase its net worth from $400 million to $800 million in just 4 years, when the purpose of their existence is to do good to assist charitable organizations?

Mr. BOLLING. Mr. Congressman, could I speak to that?

I think it is very important to try to establish the fact that basically that we on this side of the table and you up there are precisely in accord on central purpose of foundations, namely, to pay out in support of charitable, educational, cultural, religious purposes.

Mr. KARTH. Why don't you stay closer to a balance?

Mr. BOLLING. The increase in value has been due to the increase in the value of the stocks we have held. It has been due to the growth of these companies in which we have invested.

Mr. KARTH. My question is: Why don't you give more to the charitable organizations and stay closer to equilibrium? Then you could do twice as much good as what you are doing now.

Mr. BOLLING. I think yours is a very important question. Do you do good only for the short run or for the long run? It is certainly true in the short run, if you greatly increase the payout, you will do more good in this year than next year. I think the real question before us on your side of the table, and ours, is how do you write the formula in order to maximize the payout over time.

One of the oldest fables that all of us learned as schoolboys was the fable of the goose that laid the golden egg.

Mr. KARTH. Of course, carrying that argument to its most illogical conclusion, why don't you quit giving anything for the next 20 years, and you can give three times as much?

Mr. BOLLING. We have no reason to exist except to give this money away.

Mr. KARTH. That is precisely my point.

The last question, Mr. Chairman: Did it ever occur to anybody on the panel that it might be charitable to give to their Government because it is in trouble, too?

Mr. BALDWIN. We do, sir.

Mr. BOLLING. We do. Various ones of us make grants to various Government agencies.

Mr. BALDWIN. At least 20 to 35 percent of the grants Kresge makes are in conjunction with governmental grants.

Mr. RIDDELL. Bearing on the last question you asked, Congressman Karth, the total tax benefit to Mr. W. K. Kellogg, income, estate and gift, was approximately $864,000.

Just the other day, playing around with that figure, we rounded it off at $500,000 and assumed the return to the people of the United States on that $500,000 of total tax revenue that was forgone by virtue of the income tax statutes in existence at that time, interestingly enough that figure, if you assume it was $500,000, has been returned 502 times, and that is not a bad bet on a return on forgone revenues.

Mr. KARTH. I obviously have not been able to follow your rapid arithmetic which you have had time to think about, but maybe we can help you make it even more generous than that.

Mr. FOX. Once you dissipate 4 percent that puts the Federal Government back, or even more so, in the philanthropic field.

As I said earlier, the Ture study indicates the foundations have given to charity a much greater return on dollars that the Federal Government does.

Mr. BURKE. Mr. Gibbons will inquire.

Mr. GIBBONS. I have been kind of quiet up here, but I want you to know where I stand. If I had my way, I would put all of you out of business in 30 years from the time you were founded.

Mr. BALDWIN. Why is that, sir?

Mr. GIBBONS. Because I don't think you are worth what you claim you are. I don't think you are doing that much good.

You are sitting there perpetrating a big wad of wealth. You appoint yourselves to these boards and you just go on and on.

You exercise all kinds of economic power and the full extent of it is not clearly evident. I think there would be enough other rich people who will come along and make money and continue to do some good so that we needn't give such extraordinary treatment to foundations.

You are kind of sitting there like the dog in the manger.

Mr. BOLLING. I would be glad to examine line by line the contributions that are made by the foundation I represent to projects which, if we did not put that money into them, the taxpayers would be expected to again and again.

This is not something that is of benefit in terms of corporate power or personal wealth or advantage to the people who gave this money originally. We are professional managers put in here to manage this thing.

Mr. GIBBONS. We had the same trouble back about 500 or 600 years ago in England, where we had this constant perpetuation of wealth in the hands of a few people.

Now all of your boards are sort of incestuous. You reappoint each other to the boards. You pass the positions around.

While I don't want to belie your own personal motives, I think I have had enough experience in affairs of the world to know what goes on in these things.

As I say, I would give you about 30 years, and then let you divest yourselves of all of your wealth for the benefit of charity and let somebody else pass it around.

Mr. BURKE. Are there any other comments the panel would like to make?

Mr. Clancy is recognized.

Mr. CLANCY. I have one question, Mr. Chairman.

I believe it is your contention that the cost of the programs that the groups support have increased at a greater rate than the general rate of inflation.

Mr. MAWBY. That is correct.

Mr. CLANCY. How do you account for this?

Mr. BALDWIN. Mr. Clancy, I referred to that in terms of the Kresge Foundation. We give the brick and mortar. I think it is generally known that construction inflation is somewhat higher than regular inflation. At least I am so informed.

Several years ago it was as high as 1 percent a month in the Boston area, for example. Others are dealing in program grants to colleges where the services have increased faster than the regular rate of inflation.

Mr. CLANCY. Why did the cost of services in colleges increase at a greater rate?

Mr. HUFFAKER. I think the key to it is that you can't get greater productivity. As someone said this morning, one violin can't do the job of two violins in a symphony. You don't have the chance for increased productivity that you have in society as a whole.

I think attached to the statement are some very good statistical studies that really support this rise in cost of medical schools, rise in costs of the other things that have been the typical object of foundation support.

Mr. CLANCY. Has this gone to the salaries paid to the people engaged in the teaching profession?

Mr. HUFFAKER. Yes, sir.

Mr. CLANCY. Does that account for a great deal of the increase?

Mr. HUFFAKER. I think the committee heard yesterday the problem of the colleges. Everything that is labor-intensive has been increasing at a cost much faster than the overall situation of the economy. It is that sort of thing that the foundations have generally directed themselves toward.

Mr. CLANCY. Thank you very much.

Mr. BURLESON. Mr. Chairman.

Mr. BURKE. Mr. Burleson is recognized.

Mr. BURLESON. Mr. Chairman, I have passed the opportunity earlier to enter this discussion, but we come back to this proposition of who and what can best support charity and institutions of this country. It seems rather simple. Can the Federal Government best apply charity or can private wealth?

It seems to me this is central to the issue. You have some limitations. Contrary to what Mr. Gibbons just said, I would take the Government out of a lot of things we are doing very, very poorly with taxpayers' money. I would encourage private charity foundations like we once did in this country when we were more self-reliant than we are today. So I compliment you. I compliment any wealthy individual who, if he didn't have some incentive for going into foundations, he could bury his money.

There are objections on the part of a lot of people now to passing wealth on to their progeny. What do you do with it? I appreciate what you are doing.

Mr. BURKE. Are there any other observations that any member of the panel would like to make before we close?

Mr. JONES. Mr. Chairman, I spent 3½ years responsible for the health program in HEW in 1961 through 1964. Virtually all of the grants handled through NIH, for example, Public Health Service, Hill-Burton programs, required matching funds at the local level. Foundations supplied a very large percentage of matching funds that carried out the purposes of Government as legislated by this Congress.

Without foundations, many of these programs would have been nonexistent because the matching money just was not available.

As a specific example of what I know something about, Emory University, which has a very fine medical center, put over $100 million into this medical center over the last 25 or 30 years. It has continued to do so. This would have been a direct charge on public moneys if this had not been so because of the lack of medical professionals.

Emory serves the jurisdictions of many of the Congressmen on this committee, particularly in the Southeast.

I think it is quite important that we recognize that the capital in foundations is intended to meet public charitable needs as they occur year by year. If these moneys make an incursion on the capital, there is no chance for continuing developments of such programs as I have suggested, medical schools, a symphony, a park, some other types of activities.

Thank you, Mr. Chairman.

Mr. SCHNEEBELI. Mr. Chairman.

Mr. BURKE. Mr. Schneebeli.

Mr. SCHNEEBELI. Following up what Mr. Jones had to say, last year a foundation in my congressional district turned over a $50 million medical school which it funded completely to Penn State University for the price of $1.

Mr. BURKE. Are there any other members of the panel who would like to say anything?

Mr. FOX. In conclusion, I would like again to make it clear that we are not philosophically opposed to a minimum distribution to charity. We do feel that section 4942 as it now operates surely is a slow death sentence. We are appealing that death sentence which was put on our heads in 1969.

Thank you for your time.

Mr. BURKE. I want to make this observation before the panel leaves. We are not against foundations, but we have had a lot of complaints about activities of

some foundations. Our hearings in 1969 brought out many of these shenanigans and of course this gave a black eye to many innocent foundations that were doing good work. That is the difficulty. Sometimes the innocent have to suffer with the guilty.

I feel the foundations are doing a good job. I think they are a necessary part of our society. Also, I want to compliment and commend the selection by the Kellogg people, I believe, of Mr. Riddell as their representative, because no one was on our heels as much as Mr. Riddell was back in 1969, pointing out the problems that the foundation face. He is highly respected by this committee because he is a former member of our staff.

I wish to thank the panel here for their testimony and giving us your side of the story. Thank you very much.

Mr. Fox. Thank you, Mr. Chairman.

Senator HARTKE. Give me a copy and I will take a little time and look for it. We will hesitate for a moment.

Mr. MAWBY. Pages 26 and 27 of the report by Mr. Ture deals with the question of the amount of the tax benefits in which he says:

> Net tax savings to donors, and hence revenue losses to the Treasury resulting from the income, estate and gift tax deductibility of contributions, to foundations are in all likelihood quite small in magnitude. Close estimation of these tax savings is not feasible, primarily because of the inadequacy of data pertaining to such contributions. It is hardly surprising, in view of these difficulties, that the Commission did not support the quoted statement with a comparison of foundation payout with their donor tax savings.

Then Mr. Ture goes ahead with a hypothetical example.

I think the fact of the matter is, Mr. Chairman, that——

Senator HARTKE. These are all made on estimates, in other words.

Mr. MAWBY. It is very difficult to be precise because of inadequate information.

Senator HARTKE. That is right. Foundation distribution to charity has represented a sizable amount of benefits relative to the foregoing tax revenues. How much is that?

Mr. RIDDELL. Let's take the instance of W. K. Kellogg.

Senator HARTKE. I am not taking Kellogg. If you want to take Kellogg that is fine. This is not a report on Kellogg, the Ture report.

Mr. RIDDELL. We would suggest to you that you ask——

Senator HARTKE. You are a good lawyer.

Mr. RIDDELL. We would suggest to you that you ask each foundation to compute the tax savings to their donor. We can't do it for you.

Senator HARTKE. All right. I also take it this is a conclusion based on an assumption. It is not based upon any precise information. That is one of the problems. You shouldn't leave wrong impressions gentlemen and I think these types of self-serving declarations do a disservice to your operation rather than a service to you.

Mr. STEIN. Getting back to your original question, which concerned the areas of abuse, there are some specific figures that you may obtain from the Internal Revenue Service from the past few years.

First, I listed in my speech the taxes that have been imposed under the various sections of the Act, and they do indicate that the provisions have been primarily self-enforcing. Moreover, the Peterson Commission itself at the time of its report pointed out that the areas of abuse in self-dealing and taxable expenditures had been a very, very small percentage of the total foundation activities. This is also indi-

cated by the total of approximately $117,000 in chapter 42 taxes in the last fiscal year, ending June 30, 1973.

I would also like to note that I am a member of a tax luncheon group with representatives from large New York law firms with substantial exempt organization practices and, contrary to the general impression of the panel that the birth rate has declined and the mortality rate is increasing, the luncheon group does not think that that is the case, or at least it believes that there is insufficient information at this point to indicate that as a fact.

So far as the attorneys at the luncheon group are concerned, they are continuing to create foundations with substantially greater frequency than the figures furnished by other panelists would indicate. In fact, many people with motives other than tax considerations (such as family members whom they want to honor, or special programs they desire to create foundations today in spite of all of the 1969 Act requirements and with the knowledge that they will have to live with those requirements.

Senator HARTKE. Are rents and royalties reflected by foundations treated in the same manner as rents and royalties by other businesses?

Mr. STEIN. Rents and royalties received by foundations are subject to a 4-percent tax.

Senator HARTKE. Is it treated like an individual or corporation?

Mr. STEIN. Individuals or corporations would be paying tax on rents and royalties, but charitable organizations other than private foundations which are subject to the unrelated business income tax have an exemption in the statute from the taxation of rents and royalties.

Senator HARTKE. Let me ask you, Mr. Stein, do you think the payout and divestiture provisions should be changed?

Mr. STEIN. I agree with the policy decisions made in the Treasury Department in the past few years and the feedback I have obtained from foundations. I think the payout requirement, perhaps with some reasonable modifications in problem areas, is a good requirement. It has been adjusted by the Treasury in the past few years in accord with the statutory language passed in 1969. I think the view of many of the Treasury officials was that the divestiture requirements were in part superfluous and unnecessarily complex in light of the distribution requirements and self-dealing requirements. The major abuses could be eliminated by self-dealing restrictions and income distributions, and the other requirements were less necessary.

Senator HARTKE. Whoever discussed the legislative situation, who was that, the question of legislation?

Mr. DRESSNER. Attempting to influence legislation?

Senator HARTKE. From what I have gathered from what has been said, generally speaking, the Treasury Department has attempted to deal with that in a rather narrow scope, they have permitted the institutions and foundations to still continue participation in generally controversial issues even though they might be the subject of ultimate legislation so long as the specific legislation itself is not being promoted or if the general tone of specific legislation is not being promoted. Is that correct assumption?

Mr. DRESSNER. That is correct.

Senator HARTKE. Is there any difference of opinion on that?

Are the same type of restrictions in the law applicable to court decisions?

Mr. DRESSNER. You mean in the influence of court decisions?

Senator HARTKE. Could you attempt to ultimately effect or change a court decision?

Mr. SIMON. Yes.

Mr. DRESSNER. You could participate in the judicial process.

Senator HARTKE. For example, as I said yesterday, one of the highly controversial issues, at least in my home State, is busing, and does the same type of restriction apply, for example, in effecting the ultimate role of a court decision?

Could they participate in the impeachment proceedings?

Mr. DRESSNER. I don't know. Impeachment?

Senator HARTKE. It is a pretty rough thing but it is common verbage in American politics today. There is this attempt being made, I am neither condoning it nor condemning it.

Mr. MYERS. There are public interest law firms which are recognized as exempt entities, they follow certain guidelines, and these are the law firms that are engaged in litigation with respect to decisions and that don't offend the statute if they stay within those rules.

Senator HARTKE. In other words, if they come in as amicus curia they would be all right?

Mr. MYERS. Yes, sir, even actually as litigants.

Senator HARTKE. What about the same thing in the regulations?

Mr. MYERS. Administrative regulations in my opinion do not have anything to do with legislation and a foundation is not prohibited from dealing with regulations. The TRA restrictions on legislative activities have nothing to do with interpretation of a law.

Senator HARTKE. Do you think either one of those should be changed in either direction?

Mr. MYERS. No; I do not, I see no reason why an institution shouldn't be able to deal with regulations interpreting a statute. The statutes are already enacted. This is simply determining how the statute should be given effect and is not legislation at all. I think it is an absolute right any entity should have which is going to be affected by the regulation once the statute is passed.

Senator HARTKE. As I understand, the genesis of one of the restrictions on grants to individuals arose after the Ford Foundation, I think, provided some employment for some of the members of the staff of the late Senator Robert Kennedy; is that correct?

Mr. DRESSNER. Well, Senator, certainly there was a controversy that surrounded those grants but they were not made in terms of compensation or severance pay. Each one of those grants was made, as is fully in the testimony before the Ways and Means Committee, for what we conceived as fully permissible purposes, educational purposes.

Senator HARTKE. Well now, yesterday I think that the testimony here was former Senator Margaret Chase Smith was going to be given a position in one of these foundations.

Senator CURTIS. She was going to teach.

Senator HARTKE. A seminar. Senator Humphrey is another example, in the interim between time he was Vice President and went back to the Senate. Is that type of restriction applicable to other tax exempt organizations as it is to foundations today?

Mr. DRESSNER. The same restrictions are not applicable, Senator, to publically supported charities like the universities which may engage Members of the House of the Senate to teach this or that or the other course. Foundations are very severaly restricted in this regard. We may not pay such compensation, we may not choose such recipients any longer. That doesn't mean that if a Johns Hopkins University or Columbia University receives a grant from the "X" foundation for this or that educational purposes that it might not.

Senator HARTKE. It can go ahead and choose?

Mr. DRESSNER. Select some Senators or Congressmen to participate.

Senator HARTKE. Also, in another field, is it true that other tax-exempt organizations do not have the same type of restriction on social controversy that foundations have?

Mr. DRESSNER. The rest of the charitable field is still governed by the basic 501(c)(3) provision which allows them to engage in some insubstantial degree of lobbying or attempting to influence legislation. Foundations are now flatly barred from such attempts.

Senator HARTKE. What about not controversial items but what might be considered to be inconsequential or certainly frivolous? Let me give you an example: Say that I am going to have a foundation to do a study of the Ming dynasty vases?

Mr. DRESSNER. You know, Senator, in the thousands upon thousands of grants to support the efforts of individuals, it is sometimes hard to know, as we once testified in an earlier hearing what a particular scholar might contribute in this or that area. Some areas seem, I know, to some of us, and certainly to myself, to be "far out" in terms of perhaps current public policy issues but to that particular scholar who is adding to our general learning experience it may be quite important and over time may turn out to be even important to society as a whole.

Senator HARTKE. Probably. The reasons I mentioned the Ming dynasty vases, maybe 10 years ago a study on acupuncture would have been considered frivolous and far out.

Mr. DRESSNER. It might have. One of our witnesses testified yesterday sometimes in the foundation field, sometimes a $2,000, $500 grant to a particular person studying a pressing problem in the city, for example, may turn out to be quite a contribution.

Senator HARTKE. What about studying folklore?

Mr. DRESSNER. Well, again I am not a folklore scholar, Senator, but I assume, I know in some States, for example—our grants go to every State in the Union—there is a great deal of pride in the heritage of a particular State and I know we have had some requests that have been supported by Members of the Congress from both parties to provide funds to study heritage, sometimes folklore, and that kind of thing.

Senator HARTKE. I gather that there is some apprehension and some feeling of dissatisfaction with the present regulations and rules concerning grants to individuals, is that true?

Mr. DRESSNER. Well, I am not sure that there is a widespread dissatisfaction. What I testified to was that the rules that have been laid down are rather extensive and in some cases I suspect foundations that are not willing to meet those administrative costs have just said, well, we just can't spend that much money to supervise grants to individuals so perhaps we will not stay in that business.

I don't have any hard data on that, Senator Hartke, perhaps the Council can supply some.

Mr. STEIN. What many foundations have done is to create a form which they automatically send out to their grantees, be they individuals or organizations. Once the foundation has such a form prepared, ordinarily by an attorney, it is then able to supervise these grants in somewhat of a systematic way. However, for smaller foundations without the means to develop such a form, it would be appropriate for the IRS to publish a form that would help foundations in the administration of their own programs.

Senator HARTKE. I want to thank you gentlemen. We might have some other questions for you for the record.

While we have Sheldon Cohen here I will come back to the matter which was referred to in the Watergate, the question was: "As a matter of fact, in the same memorandum, March 24, which is a general memorandum on the so-called liberal foundations and the requirement for a Republican conservative foundation, at the very top of the page it states, 'one of the primary concerns about this is that it requires a strong fellow running the Internal Revenue Division and an especially friendly fellow with a friendly staff in the tax exempt office?' "

Answer: "Exactly. Let me give you the reason on this thing. After the election of 1964 when Barry Goldwater was defeated there was a conservative foundation who had some personnel who had worked in the Senator Goldwater's campaign. They came within an ace of losing their tax exemption even though they had not engaged in political activities. There is no question but in my mind—there is an apprehension in my mind that if the Democratic Party came into power and think—any exempt institution you had created which was not as clean as a hound's tooth in which any sort of violation had occurred would have that tax exemption jerked."

Senator HARTKE. Mr. Cohen, were you Internal Revenue Commissioner at that time?

Mr. COHEN. No, sir; I became Commissioner in 1965. I think Mr. Buchanan is referring to an earlier time, but I am afraid Mr. Buchanan does not even at this late date understand the U.S. Government nor the Internal Revenue Service.

Senator HARTKE. Well, explain it then, what is the situation?

Mr. COHEN. The Internal Revenue Service for a long time—I first went to work there in 1952—some 21 years ago—had a reputation for calling as it sees them and it did so, certainly since some early investigations around 1952 just before I entered the Service as a young lawyer right out of school. The Service was and is manned by career people. The only person in the Internal Revenue Service, at least during our day when I was Commissioner, who was appointed by the President with the consent of the Senate, was myself. There were 75,000 employees. There were approximately 75,000 employees and only one was a politically appointed person. That one cannot do very much in terms of individual audits and indeed while this person was Commissioner of Internal Revenue he neither ordered the audit of any

person or organization nor did he order that any person or organization not be audited. These were decisions made by the career staff under criteria that were selected and generally applied across the United States. There is no room, as Senator Talmadge answered Mr. Buchanan, in the Internal Revenue Service for political judgments on individual cases.

Senator HARTKE. All right, OK, now we will proceed.

STATEMENT OF ALAN PIFER, PRESIDENT OF CARNEGIE CORP. OF NEW YORK AND CARNEGIE FOUNDATION FOR THE ADVANCEMENT OF TEACHING

Mr. PIFER. I think I am to speak first on this panel.

My name is Alan Pifer. I am president of the Carnegie Corp. of New York and of the Carnegie Foundation for the Advancement of Teaching.

It is our intention this morning to speak about the entire field of charitable organizations, rather than simply about foundations. We are taking this approach because foundations are an integral part of charity at large and, in our view, are inseparable from it. We do not believe that the question of Government supervision of foundations, which we understand to be your interest in this session of the subcommittee's hearings, can be examined fruitfully except within the larger context of the supervision of charity.

We do not plan to deal with the many forms of tax-exempt organizations other than the charitable organizations covered by section 501(c)(3). As you know, section 501(c) of the tax code lists 18 other categories of exempt organizations, including such diverse entities as labor unions, chambers of commerce, social clubs, and telephone companies, cemetery companies, credit unions, mutual insurance companies, and pension funds. The distinguishing characteristic of these entities is that they exist for the benefit of their members or of limited categories of individuals. Charitable organizations, on the other hand, exist for the general benefit of the community. This, to our way of thinking, is a fundamental difference.

There are, of course, many types of organizations and institutions included under the 501(c)(3) charitable exemption provision of the tax code. To name just a few, there are private colleges and schools, religious organizations, voluntary hospitals, museums, organizations concerned with the arts, various welfare agencies, and both public and private foundations. As a proportion of the considerably more than 200,000 section 501(c)(3) organizations, foundations probably account for no more than 15 percent, although their importance is no doubt greater than their limited numbers would suggest. It is the view of this panel that the present supervision over charities by the Federal Government has some service deficiencies. Briefly, it has been quite ineffective, it is characterized by a negative rather than positive attitude toward charity and it is located in the wrong place within the Government.

To sketch out very broadly what we would consider the essential characteristics and functions of an ideal Federal Government arrangement for the supervision of charity. Mrs. Fremont-Smith will then describe the British system, including the charities commission followed by Mr. Spear who will talk about the situation in several other countries. Last, Mr. Cohen will discuss the question of the desirable location of the supervisory function within the Federal Establishment and, specifically, the pros and cons of having it within the Internal Revenue Service, elsewhere within the Treasury, or in a totally independent position.

Ideally, any mechanism, or center, for the supervision of charity in this country at the national level should have the following broad characteristics:

1. The center should be concerned only with the field of charity and not with other forms of tax-exempt organizations.

2. The center should rest on the assumption that charity exists for the benefit of the community, and the public interest is as much served by it as by governmental action. The essential purpose of supervision, therefore, is affirmative—to protect, strengthen, and encourage charity and build public confidence in it. Sanctions applied to prevent abuse should, it follows, be designed so as not to deplete charity itself, as this would by definition be contrary to the public interest.

3. The center should recognize that the States have many basic powers and responsibilities in regard to charity. Therefore, it should be the center's duty to develop means to cooperate with State authorities in furtherance of joint Federal and State objectives.

4. The center should be nonpartisan, objective, fair-minded, and independent in its operations.

5. The center should be manned both at policy and staff levels, by well-trained individuals with the necessary educational background and experience to deal competently with the needs and problems of the charitable field.

A supervisory center with these broad characteristics would perform a number of important functions. The principal ones are as follows:

1. The center would have the power to determine what is charitable and to grant or deny tax exemption accordingly, although this power might be limited by a right of appeal to the courts.

2. The center would maintain a publicly available register. Listing in this register would be an organization's guarantee that it enjoyed tax-exempt, charitable status.

3. The center would conduct audits of the operations of tax-exempt, charitable organizations.

4. The center would have the duty to see to it that the legal standards applying to charity were enforced.

5. The center would, when requested, give advisory opinions with respect to the legal consequences of proposed actions by charitable organizations.

6. The center would gather data about all aspects of charity, would issue publications periodically, and would provide information to the public on request.

7. The center would advise Congress and the executive branch of Government on charitable matters.

Mr. Chairman, I have spelled out the broad characteristics and general functions of a center for the supervision of charity. It is my belief that we have never, in this country, had anything which approximated such a center. Further, it is my belief that the growing pressure on private institutions makes the establishment of such a center imperative. The day has come when Government must encourage charity in every way it can, if the American system is to continue to embrace the traditional and well-proven concept of private initiative for the public good, for that concept is embodied in charity and given expression by it. I greatly hope that the Congress will give this urgent task high priority.

Thank you.

Mrs. Fremont-Smith.

STATEMENT OF MARION FREMONT-SMITH, LAWYER IN BOSTON

Mrs. Fremont-Smith. Mr. Chairman, Senator Curtis, I am Marion R. Fremont-Smith, and I am an attorney currently practicing law in Boston. During the past 10 years I have had a special interest in the field of supervision of philanthropy and have studied our State and Federal laws in this area and, to a limited extent, the experience in other countries.

As Mr. Pifer explained, I will attempt today to describe briefly the English system for supervision of charities and distinguish those aspects which differ from our own.

Supervision of charitable organizations in England has three basic elements, all of which were developed in Elizabethan times and continue in force today. They are first, that charitable trusts and corporations will be enforced as a secular matter by the court of Chancery; second, charities will be protected by the sovereign in his role as parens patria protecting those who cannot protect themselves. Interestingly, the class of individuals who are similarly protected are lunatics and minors, the third one being charitable organizations; third, the sovereign will delegate to a group of individuals, the charity commissioners, the immediate duty of supervising the management of charitable funds.

The present charity commissioners derive their powers and duties from legislation enacted in 1960. This act describes the functions of the commissioners as follows (and I believe the order is of importance).

It states that they shall promote effective use of charitable resources by encouraging the development of better methods of administration, by giving charity trustees information or advice on any matters effecting the charity, and, last by investigating and checking abuses.

The charity commission is composed of three individuals appointed by the Home Secretary. All of them must be public servants and two of them must be member of the bar. They operate with a staff of approximately 200 in London and 100 in Liverpool overseeing the activities of some 77,000 charitable organizations.

The power of the commissioners fall into four general categories. The first of them can be best described as advisory. They render advice on general and legal matters and trustees acting on this advice will be protected if called upon to account in the future.

A second set of powers are supervisory in nature. They include the maintenance of a registry in which all charities must be enrolled and with which they must file periodic accounts. This act of registration by the commissioners carries with it automatic exemption from taxation. Thus, the power to register lies at the heart of the system. The periodic accounts are scrutinized by the commissioners' staff which can require an independent audit when warranted.

The commissioners may also investigate alleged abuses and if necessary, report to the Attorney General who will bring court action to seek correction. In an emergency, the commissioners themselves may suspend trustees and freeze charity properties pending the outcome of court proceedings.

A third set of powers are revisory in nature, meaning that the commissioners may authorize changes in trust purposes or methods of administration prescribed by donors without resort to the court. They also exercise powers of the court to permit changes in trustee personnel.

Finally, there is a set of regulative powers through which the commissioners may permit deviation from fiduciary law. They may consent to mortgages or sales of permanent endowment or functional land that would otherwise be prohibited and may grant permission for certain actions that the trustees could not do without their approval.

This enumeration, however, does not present the true nature of the supervisory scheme. It is not primarily adversary; rather there is an assumption that the aims of the individual trustees are the same as those of the commissioners; namely, the improvement of the administration of charities. There is, therefore, much room for flexibility. Problems are looked at in a positive frame of mind and it is assumed that most abuses can be corrected without resort to the punitive powers that are ultimately available to the commissioners.

In part, this positive attitude is possible because of clearly defined limits on trustee behavior that have long been a part of the English substantive law. Self-dealing has always been prohibited; the range of investment has always been closely circumscribed; trustees may not borrow funds nor actively run noncharitable enterprises without a showing of special competence.

Another reason that this positive approach is possible stems from the constitutional basis of charity under British law. It starts with the principle that funds donated to charity are by definition for the benefit of the community.

I would like to quote here from Christopher P. Hill, a former English charity commissioner, because I think he expresses a basic philosophy which is quite different from that held by many people in this country.

He says:

> Since the Crown undertakes to enforce against all parties the use of the property for the public purposes chosen by the Donor, a Fortiori it will not divert part of the capital or income by taxation to use for purposes of its own.

In other words, exemption from taxation is not considered a privilege bestowed by Government but an implcit duty required by Government.

The system of registration, conferring as it does automatic exemption from taxation, is thus terribly important in this system. And exemption once granted cannot be removed by the taxing authority. In theory, the Inland Revenue can appeal a decision of the commissioners, whether to register a charity or to remove it from the roll. In practice, the commissioners ask the tax authorities for their views prior to making decisions, and, to date, disputes have rarely arisen between the two organizations.

This does not mean that the Inland Revenue has no dealings with charity trustees. In fact, the tax system requires submission of tax returns to it for two purposes; to obtain relief from real property taxes and to obtain refunds of taxes either withheld at the source or paid by individuals and corporations on income given to charity under a system called the "long term covenant."

There is, of course, a basic difference here between the English tax system and our own for, aside from the covenants and a limited estate tax deduction, British tax law does not offer incentives to individuals to make charitable gifts as ours does. It has been argued that the existence of deductibility is so crucial to our own system that only the Internal Revenue Service can supervise those organizations to which deductible gifts can be made. The importance of the Internal Revenue Service, however, has grown principally because there has been no other agency of Federal Government that could assure proper administration of charity. Clearly, assurance of this nature is a necessary concomitant of a viable tax system, but there is no reason to assume that only the Internal Revenue Service is fitted to provide it. In fact, the British experience suggest that just the opposite may be true.

There is, of course, another major difference between the British and American systems of Government that make it impossible for Congress to merely establish an independent body and delegate to it all of the functions and powers held by the English commissioners. I refer, of course, to the facts that each of the 50 States has an interest in the creation and dissolution of charities, that State courts have the power to correct abuses in administration, and that the attorney general in each State has been assigned the role of enforcement exercised by his counterpart in England. In short, the basic elements of the English system, other than delegation of the sovereign's powers to charity commissioners, have been adopted in each of our States and, even though the enforcement power is effectively exercised in only a handful of them, Congress is under some constraint to recognize and accommodate the States' interest.

This is not an insuperable task. There are patterns for accomplishing it to be found in the Tax Reform Act of 1969. What is missing in our federal system, however, is those elements of the ideal system described by Mr. Pifer that are designed to encourage and nurture philanthropy; to make it easier for trustees to function, and to assist them in their efforts to improve.

I would suggest that it is here that we can surely learn from the British experience. It should now be evident, in fact, that the ideal

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system that Mr. Pifer delineated has striking similarities to the English system. This is no accident. Mr. Pifer, Mr. Cohen and I were among a group of 13 Americans who attended a conference on Anglo-American philanthropy in England in the spring of 1972, where we learned firsthand of the effectiveness of the English supervisory system. On our return, seven of us participated in a series of exploratory discussions with other individuals interested in the foundation field in an attempt to determine whether any elements of the English system could be adopted here.

We do not pretend to have answered all of the questions posed by a proposal to establish an independent agency to supervise charitable organizations. We do feel, however, that it is an ideal toward which we should strive and we are encouraged by the fact that this committee is willing to explore the benefits that might accrue from a different approach to supervision than we have been able to achieve to date.

Thank you.

Senator HARTKE. Thank you.

[Questions submitted to Mrs. Fremont Smith follow:]

Question 1. Why is the English attitude toward the regulation of charity so positive while at the same time the attitude in the United States appears so negative?

Answer. I would suggest two reasons for the positive attitude toward regulation of charities in Britain. The first has historical roots. Since earliest times charitable institutions have been expected to provide services the state might otherwise have to provide. Thus, charities were to be encouraged and assisted; rather than antagonism, there was a sense of partnership. Today, with the spread of government activity into many traditional areas of philanthropy such as care of the poor, sick, and aged, voluntary societies, foundations, and other charitable organiaztions are still considered partners of the government able to act in areas where government is either unfitted or constitutionally prohibited from entering and able to do certain things that government cannot do.

A second reason for the positive attitude toward charity in England is that there is a well established body of laws governing the administration of charitable trusts and corpoartions and an agency of government which assures compliance with these laws. Instances where charitable funds have been used for private benefit are very few and they have been easily corrected. Thus, the public has not had cause to be suspicious of the activities of charitable institutions and the government can devote, as it does, the major efforts in its regulatory program to assisting and improving the administration of charity.

In the United States we do have a long-standing tradition of encouragement of charity. It is evident in the exemption from taxation granted by the state legislaures and the Congress in the very first tax laws that were passed. (We have actually gone a step further than the English in allowing donors to take deductions on their personal returns for gifts to charity.) However, we have provided neither a uniform body of laws clearly understood and accepted, nor an agency to assure that the managers of charitable funds adhere to those laws. Until passage of the Tax Reform Act, and then only in regard to private foundations, we have not created the climate in which a positive attitude toward supervision and regulation of charity can exist.

Question 2. Is there any governmental agency in the United States to advise and assist foundations and other tax-exempt organizations? Would such an agency be helpful in the United States?

Answer. There is no Federal agency to advise and assist either foundations, nor any other tax-exempt charitable organizations. Certain states have enacted legislation to enhance the common law power of the Attorney General to supervise charities. They do provide a governmental agency where charities can receive aid and assistance. Programs in these states have improved the administration of charity and diminished the possibility that its assets will be diverted to private hands. However, all suffer from lack of funds and inadequate personnel. State

laws vary in their limitations on the actions of charitable managers. In the vast majority of states, little or no attention is paid to the administration of foundations and other charities and it does not appear likely that this situation will change without some impetus from the Congress. It is the need for uniofrmity among all the states and the overriding national interest in the proper administration of charity, both from a tax and a social viewpoint, that have lead us to conclude that it is desirable to establish a Federal agency that could work in close cooperation with the states to assure the public that charitable funds are being properly administered for their benefit

Question 3. Is there a problem in England with foundations or other charitable groups attempting to influence legislation? If so, what has been the reaction of the public and the government to this problem?

Answer. There has been no general public reaction against the political activities of charities in England, nor any major protest in Parliament. The English definition of charity does preclude as a primary purpose any attempts to influence legislation or otherwise obtain a political object. Thus, no organization in England will be considered a charity that includes among its purposes the object of bringing influence to bear directly or indirectly on Parliament to change the general laws of the land. The British Charity Commissioners in their report for the year 1969, expressed "some concern" over the increasing desire of voluntary organizations for involvement in the causes with which their work was connected. They attempted in this report to set forth guidelines to assist trustees in determining whether any "political activities" were proper or not.

This statement by the Commissioners affords an excellent example of the manner in which they operate. They called upon trustees who are in doubt about the propriety of their activities to obtain legal advice of their own or to consult with the Commissioners in advance. By the very fact of facing this problem and offering guidelines to trustees, it would appear that the Commissioners have been able to forestall criticisms of the type we have seen directed against foundations in this country.

Question 4. Is innovation as important a part of the foundation experience in England as some have said it is in the United States?

Answer. There are far fewer charities in England that meet the description of private foundations. Just as in the United States, some critics have pointed to their lack of innovation, an equal number believe their principal worth is in helping to preserve a pluralistic system of democracy and that there is thus a place for both innovation and traditional philanthropy in the foundation field.

I appreciate having had the opportunity to present these answers to your questions and hope that they will be helpful in your deliberation.

Senator HARTKE. Mr. Cohen?

STATEMENT OF SHELDON COHEN, WASHINGTON ATTORNEY

Mr. COHEN. Mr. Chairman, members of the committee, I appreciate the opportunity to appear before you today to share some of my ideas with you on a constructive and perhaps improved technique for administering our most important system of foundations and charitable organizations.

I apologize for submitting an outline and not filling it out but I was in court most of last week and there were two religious holidays that did not allow time for a full draft.

I should add, Mr. Chairman, that reflecting back on your first question at the beginning, I don't know if I was Commissioner, I don't know what foundation it is, and I have no idea if I was Commissioner when it was investigated, because, as I indicated, I did not interfere in individual cases so my answer is I was not but I don't know.

Senator HARTKE. That is the Sierra Club, as I understand it.

Mr. COHEN. I don't believe Mr. Goldwater's people worked for the Sierra Club. Mr. Buchanan made another accusation——

Senator CURTIS. Mr. Chairman, I object to diverting the task that we have before us to replay the Watergate hearings.

Senator HARTKE. All right, as far as I am concerned your objection is sustained and we will proceed. How is that?

Senator CURTIS. I might consume several hours on that myself. I think the whole thing has been an outrage.

Mr. COHEN. The United States, as we all know, has a very complex system of both Federal and State law as it applies to exempt organizations.

As Mrs. Fremont-Smith indicated, these are creatures of State law. They are answerable to the very complex State law system and we must take account of that in any administrative system that we set up.

Both State and Federal law are woefully inadequate. There are very few States, as Mrs. Fremont-Smith indicated, perhaps six, that take any active role in the supervision of the charities organized under their law, and the Federal Government, even with its increased emphasis in the last 4 or 5 years, is still woefully inadequate in its supervision of charities.

Foundations are the element of charities which receive the most attention, certainly at the Federal level, since 1969.

To put this whole thing in perspective, your subcommittee is assigned only one little subdivision of section 501(c)(3), on which is the exemption granting section.

As you are well aware, Mr. Pifer mentioned there are some 20 different classifications of exempt organizations.

The present statute is horrendous. The statute in defining exempt organizations uses popular names. It uses popular names that were in existence in 1909 because the basic tax exemption statute follows from the Corporation Excise Tax Act of 1909. These organizations were listed and excused from taxes at that time, partially on the basis that they performed a useful public function, in some instances, on the basis that a tax at 1 or 2 percent was hardly worthwhile.

Congress has not examined into any, or rarely has examined into any of these classifications with the exception of foundations that we are discussing today in that 60 years of intervening time. Foundations have been visited on a number of occasions and, therefore, the law in dealing with foundations is more up-to-date, more modern and the practices more effective than it is in any other area of the tax-exemption law.

The sanctions as they exist in all other areas of the tax exemption law again, are terrible. It is kill them or leave them alone. The same problem we had with foundations before the 1969 statute. Some may have a problem today with the 1969 sanctions, but at least there was an attempt by the Congress to impose appropriate sanctions.

So that I think the subcommittee ought to be aware of at least, as I see it, its dealings with a small element of this whole tax exemption area and it is difficult to deal with a small element without taking cognizance of what the effect, if any, you mean to have or want to have in a generalized area.

Let's look for a moment at the Internal Revenue Service role in this administrative setup. We have a very large and very complex organization, a staff of approximately 75,000 people. There is a National Office staff of probably something less than 5,000 people in Washington, D.C., the remaining people are in seven regional offices and 58 district offices throughout the country, and from that branch

out into another seven or eight, perhaps close to 900 smaller offices that function in different localities.

The budget request for the current year is $1.2 billion. The revenue collections in the last fiscal year were $210 billion, and currently estimated for the current fiscal year at $260 billion. There will be approximately 117 million returns filed with the Revenue Service. During my term as Commissioner we reached 100 million for the first time.

We also reached, I might say, the first year I was Commissioner $100 billion in tax collections for the first time. So you can see the dramatic increase in the volume that has occurred.

The total revenue from audits is estimated this year at $3.2 billion and the total enforcement revenue, which means audits, mathematical verifying cases, collections and other activities, is $6.6 billion. The service estimates that it will audit approximately 2 million returns—which is terrible. We audited more than 2 million returns when I was Commissioner 5 years ago.

The number of taxpayers has grown and the Commissioner when he testified before both the Appropriations Committees decried the fact that over the last 5 or 6 years we have had a steadily falling percentage of audits. In other words, the Commissioner has inadequate resources to do the job which he is charged to do, collecting taxes. That is his basic job. He has a number of subjobs but his basic function is to collect the internal revenue of the United States.

So you can see from this outline that the administration of our system of tax-exempt organizations is going to be a stepchild. It is a stepchild now. And in my opinion it will continue to be a stepchild.

Exemption applications and audits of exempt organizations are now centralized in about 16 districts throughout the United States where there is some degree of specialization allowed because in smaller areas there would not be enough volume to have specialists working in the area.

Approximately 5 to 600 agents have some training in the audit of exempt organizations and have a greater or lesser degree of experience depending upon the volume in their particular area.

The rulings are handled in the National Office by the Assistant Commissioner and by a subdivision of his organization called Exempt Organization Branch of the Miscellaneous and Special Tax Provisions Division. That unit handles several activities. Exemption applications initially are filed with the district office. It will rule on only the most routine kind of application. So that any kind of organization likely to be a controversial application will be forwarded to the National Office for its consideration. So that it has a major rulings operation in determining initially the tax-exempt status.

Likewise, if an agent in the field were to determine that organization "*x*" should lose its exemption for one of a variety of reasons, that organization after handling its appeal in the normal fashion in the field would have an opportunity to request that that matter be sent to the Assistant Commissioner for the Exempt Organization Review of the technical aspects so that the organization would have an appeal to that very same group that would have initially passed on its exemption.

It serves both of those functions, ruling functions initially and appeal functions from the denial of an exemption after some period of operation.

As I indicated, I feel that the exempt organizations will be a step-child. We have a number of years now of substantial deficits in the budget of the United States. The Secretary of Treasury is greatly concerned about this. His concern is with increased revenues. The Commissioner of Internal Revenue is concerned with collection of all revenues it is possible to collect under our tax law properly applied and, therefore, when those pressures come and he has to cut the budget to determine where the resources are going to be spent, he is going to spend as little resources in the tax-exempt area as is possible.

Now, because of increasing congressional interest over the last 8 or 10 years, an increased amount of resources have been spent in the tax-exempt area. However, I just don't think that it is going to get to the point where supervision will be adequate in terms of encouraging and in terms of controlling both the operation and direction of our tax exempt system which is, as Mr. Spear described, a very unique and very successful part of our American system.

The attention that each one of these individuals, the Assistant Commissioner, the Commissioner or the Secretary can give to this very important area in this system of ours is miniscule and, therefore, I would suggest that we replace or rethink the placing of the scheme of things that control foundations and other charities.

Now, there is a bill before the Congress now which has been passed by the Senate, which suggests that there be a new Assisant Commissioner created within the Internal Revenue Service. I might say it will be the first statutory Assistant Commissioner which in itself is an administrative problem. The pension reform bill suggests there be an Assistant Commissioner who will be responsible for the administration of our laws insofar as they relate to pension trusts and exempt organizations. That includes all exempt organizations I presume, although the bill is not as clear as it might be.

This is an improvement. It may result in an improvement and perhaps is worthy of a try. But it is still going to be an uphill battle for whomever will be the person chosen for that particular important job.

The service's role is still going to be a tax collection agency. In the view of many of the employees, the way up the promotion ladder is through the audit or collection process because that is where the dollars are and many of these people in spite of lecturing by Commissioners of Revenue in a long series are still of the view and adds up in their own mind their success is on the basis of the dollars.

The type of person recruited will still be primarily accounting personnel whose role in the philosophical areas of tax exemption are going to be limited. I expect those people with the broad kind of socialogical, scientific, philosophical education, and other broadly based backgrounds will not seek positions with the IRS even with the new Assistant Commissioner for pension exempt organizations. Therefore, as was described to you by both Mrs. Fremont-Smith and Mr. Pifer, after the Ditchley conference a group of us who participated together with other individuals sat down to say if we were going to start over again, if there were no history of where exempt organizations had been administered, what would be the best system for the United States. I think this is a valuable exercise. You may not be able to reach that system that people would agree as being ideal and, this may

not be the system that is ideal. At least in the idea of these people it was better than the one we have and had a good deal to speak for it. We ought to be aware of it and moving in the direction that will improve the existence system. The new concept is based on our discussion at Ditchley and based on the volume resulting from the so-called Peterson Commission which I was privileged to serve also.

We think and I should say that the list of the individuals who participated in the discussions leading to these ideas are listed in my testimony. The participants didn't all agree on every aspect of this, indeed some of them may disagree with some aspects of it. This is the distillate that came out of the group thinking.

We thought that there ought to be a separate organization for charity and that is what is now classified as 501(c)(3) which is broader than foundations, as I indicated. It includes literary and educational institutions and a whole variety of other types of exempt organizations.

The principle draftsmen, I should have added, of this were Messrs. Nolan and Troyer. They tried to synthasize what the discussions of the rest of the group contained.

We would recommend a National Commission on Philanthropy. It would be independent of any existing organization. It would be modeled on something like the SEC perhaps, and I should say if there are problems with the completely independent commission, the second step back from that ideal would be a separate organization within the Treasury Department but not within the Internal Revenue Service.

The members of this organization would be appointed by the President and confirmed by the Senate. They would be picked for their broad contacts in the areas that are to be controlled and they are not to be picked because they had probias or antibias. They should not be picked on the basis of political consideration. We would hope political consideration in the area of tax-exempt organizations should be nonexistent.

Their role would be generally to promote, encourage, and advance private philanthropy in the United States.

They would provide annual reports to Congress on the status of private philanthropy in this country and indeed hopefully would be able to supply the committees with some of the information the committee and the public sorely needs, but is unavailable now because the data isn't maintained.

As I indicated, the Commission would cover all 501(c)(3) organizations. The remainder of the so-called exempt organizations would be left to the Internal Revenue Service, and on a personal side I hope re-examination by the Congress and the Service and the Treasury as to what the role of the various organizations listed in those other 20 categories in the 1970's.

This new organization would handle both the audit and ruling functions, its determination would be conclusive with the IRS. IRS would maintain a role in handling any unrelated business activity as probably presently defined in our code. And, of course, we feel very strongly that there should be some right of appeal to our courts from the decisions of this Commission.

One of the difficulties of the present system of tax exemption is the difficulty of making one's way through a court for a determination of an adverse finding of the Commissioner of Internal Revenue, at least at the inception of an organization.

In regard to audit fees, if they are necessary, they ought to be imposed at a reasonable amount. It is anomalous in today's world that foundations are the only group within the tax exempt area that pay a fee and indeed the foundations' fee is stated by Congress to support the tax audit function and other ruling functions of all tax exempt organizations of which the foundations are only a very small part. That seems to me to be a little anomalous.

That, Mr. Chairman, is the broad outline of that kind of structure I think would be helpful. The group of us, felt that this system would give better administration, we would have tighter administration, and we would have more forward looking ideas, and the administration would be more knowledgable.

Senator HARTKE. Senator Curtis.

Senator CURTIS. I will be very brief.

Mr. Spear, what other countries have a system or a practice or a tradition of philanthropy or charity or giving that is comparable to the United States?

Mr. SPEAR. To my knowledge only the English system from which ours is derived does, and that was commented on very fully by Mrs. Fremont-Smith.

Senator CURTIS. And it is a spillover in places like Canada and Australia, as part of the English system?

Mr. SPEAR. I would not say that any country outside of the United Kingdom has the type of system currently in operation that you referred to.

Senator CURTIS. And giving and philanthropy is not as big a factor as it is here.

Mr. SPEAR. No, no, that I would not say. Giving and all of the humanitarian aspects of it are very much in evidence throughout the world, but as far as a system that you speak of or the type of foundation or charitable trust, we are the inheritors of that and only in the Anglo-Saxon system do we find this.

Senator CURTIS. All I want is your best judgment on the existence of it and I don't mean to argue, but is the contention that all the countries throughout the world, particularly their wealthy people, you find philanthropy on the basis that you do in this country and in England?

Do the wealthy of Central America and South America, of the Mediterranean countries, Asia and so on, are they given to philanthropy on the same basis as the United States and England?

Mr. SPEAR. I would say generally no, if you are thinking of organized philanthropy; no, the answer would be no.

Senator CURTIS. Mrs. Fremonth-Smith, did I correctly understand you to say that this governing office or agency in England had power to change the trust purposes of the charity without consent of the donors?

Mrs. Fremont-Smith. I was referring to a common law power developed over the years and called the cy pres power. It permits a change in charitable purposes if the original ones become obsolete or incapable of being carried out. Usually this occurs long after the original donor's death. However, if a donor is alive, unless he has reserved the right to participate, his consent is not required.

Senator Curtis. Suppose the purpose is not obsolete and is not impossible to carry out?

Mrs. Fremont-Smith. Then there is no power in the courts to effect a change. Today in England, express power has been delegated to the charity commissioners in our States, however, it exists as a part of the equity powers of the courts.

Senator Curtis. Mr. Pifer, if a center was established, such as you discussed, what supervisory regulatory powers would it offer the non-operating foundation that the Bureau of Internal Revenue doesn't have now?

Mr. Pifer. Well, its functions would be somewhat similar to the functions performed by the Internal Revenue Service in regard to foundations except that the attitude, I think, would be quite different. It would be an affirmative attitude. It would start with the notion that foundations were a constructive element of American life, and an important part of charity, it would work with foundation trustees and administrative staff to try to improve their operations, wherever possible, and it would serve within the Federal Government as a center to help promote charity broadly and specifically foundations regarding that as a governmental responsibility in that the purpose of charities is to serve the general welfare very much the same, of course, exactly the same as the Government itself. So I think it would be very largely a difference of attitude and perhaps in specific details would include many of the functions now performed by the Internal Revenue Service.

Senator Curtis. Well, do you envision it as having either absolute or persuasive authority over the managers of foundations as to what was in the public interest and what was wise charity and who were worthy recipients and who were not worthy recipients?

Mr. Pifer. No; it would not have programmatic responsibilities of that kind, it would still be up to the trustees and managers of private foundations to make their individual decisions about the kind of programs they should be following and the kind of grants and particular grantees within that, but it would be a place, it would be a friend, so to speak, within the Federal Government for foundations, it would be a place that could present the positive side of foundations as well as its strictly regulatory functions. It would, of course, make a determination about what was charitable and who was to have a tax exemption, and this would be done by, as we suggested, by creating a total register not only of foundations but all charitable organizations which would contain considerable information about them and would in itself be a kind of master list, register of this entire charitable sector, something we have never really had and which the present cumulative list doesn't really pretend to be.

Senator Curtis. I am very much in accord with the idea that a positive attitude should replace the negative one and I think there is a great deal of hostility that is hurting the general cause of charities in

this country. I am intrigued about the suggestion. I want to think about it some more. I don't know whether a change in office location or a change in agency location, it would necessarily follow that there would be a change in public sentiment or a change in attitude of officeholders or candidates. But I thank you for your presentation.

Senator HARTKE. Senator Fannin.

Senator FANNIN. Thank you, Mr. Chairman. I regret that I had a conflicting committee meeting that precluded me having the opportunity to hear the panelists. I appreciate their being here and I will read their testimony.

Senator HARTKE. Yes.

Senator FANNIN. I will if I deem it necessary submit questions in writing. Thank you.

Senator HARTKE. Thank you. Let me say what you have said in substance, we are on uncharted seas and we are trying to bring a little bit of organization out of chaos. I see nothing wrong with that and I want to thank you for your testimony but we are going to recess.

Senator FANNIN. It does not involve the panelists who are here today, but yesterday, Mr. Chairman, during the first panel discussion, one of the panelists, I think it was Dr. Robert Goheen, referred to a funding of the Navajo Community College and I was commenting about the fund or the contribution that was made to that school and commending him for it. At the same time I asked if there were any restrictions placed on the particular contribution that was referred to, because I had been told that there were some restrictions that provided the matriculation would be without enrollment outside the State and outside the Indian community.

I checked with Mr. Dillon Patero, the president of the National Indian Association and Director of the Division of Education of the Navajo tribe at Window Rock and I determined, that the contributions were made without specific restrictions. Although they did give their advice in regard to having outside enrollment and did recommend that they have other than Indian students attending the school.

I want to make it clear that this was not a stipulation before the contribution was made.

Senator HARTKE. Thank you.

[By direction of the chairman the following communication was made a part of the printed record:]

STATEMENT OF MCGEORGE BUNDY, PRESIDENT, FORD FOUNDATION

HON VANCE HARTKE,
Chairman, Subcommittee on Foundations, Senate Finance Committee, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I have read with great interest the transcript of the hearings held on October 1 and 2 by the Subcommittee on Foundations of the Senate Finance Committee. Howard Dressner, by the Ford Foundation's Secretary and General Counsel, attended the hearings on both days and participated as a panelist on October 2. He has reported fully to me on the hearings and will also present a report to our trustees when they next meet.

Other important questions must be and were addressed, but the critical underlying issues are the ones you raised: What is the justification for foundations and what should their role be in our society today.

We think you are right to insist that foundations come to grips with these issues. In an effort to continue the dialogue constructively, we have tried to formulate some responses to these and related matters. They are set forth in the attached

paper; more can and will be said by the Ford Foundation and by others, but we wanted to respond soon enough to permit you to include these views in the printed record.

Our hope is that your Subcommittee can make an important contribution to a serious problem—the lack of understanding about the role of foundations. There has been a very substantial increase in the amount of information being published and provided about foundations but there is still a need for increased public understanding. It would be ironic and tragic if lack of such understanding should deprive foundations of the public support they must have at a time when their contributions and efforts are particularly needed.

If we can provide further information or otherwise be helpful, please do not hesitate to let us know.

Sincerely,

McGeorge Bundy,
President.

ATTACHMENT

FOUNDATIONS IN A CHANGING SOCIETY

The private philanthropic institutions we call foundations have their roots in colonel times; in their present form they date back to the late nineteenth century. They are uniquely American in conception, size and scope.

Some foundations are established by a single person, family, or corporation; others are supported by the communities they serve. Some operate in several program areas throughout the country and abroad; others are more specialized as to programs or geographic areas. All share these characteristics—

They are nonprofit and operate exclusively to advance the public welfare;

They are private, accountable for their policies to the sense of priority and propriety of their trustees;

They are accountable to government under state and Federal law to ensure that their funds are used exclusively for purposes that the law declares charitable; and

As with other charitable enterprises, donations to foundations are deductible for tax purposes, and their income is exempt from regular Federal income taxes (although in 1969 private foundations became subject to a 4% Federal excise tax on income).

The role of private philanthropy in the United States—particularly the role of foundations—has undergone periodic reexamination, most recently in the October 1 and 2 hearings of the Subcommittee on Foundations of the Senate Finance Committee. Two basic issues have been raised:

First, why should foundations as private institutions be authorized to use tax exempt funds to advance the public welfare? Why should not government alone assume the obligation to discharge the foundations' charitable purposes?

Second, assuming that full or partial tax exemption is granted, what special role should foundations discharge in a society undergoing rapid change and experiencing unfamiliar stresses? Should the emphasis be on preserving existing institutions and values or pressing the search for new ones? What should be the philosophy of foundations today?

In this brief statement, we set forth our present views. With respect to the second question, we speak only for ourselves. Different foundations have—and should have—different views about the role they should play; foundations, like business corporations, universities, and labor unions, have differing philosophies about the contribution they can make to a good society.

To be helpful today, the dialogue must focus on current questions. Before 1969, other issues appeared to be central—the abuses of self-dealing, insufficient pay-out of income, inadequate public disclosure, inadequate controls over grants to individuals, the use of funds for voter registration efforts, and the avoidance of activities that might influence legislation. These issues were dealt with effectively by the Tax Reform Act of 1969.

Indeed, the new law may have been more restrictive than necessary. Some provisions seem punitive, and find no counterpart in government regulation of other charitable enterprises, business, or labor unions. The four percent excise tax reduces to that extent the funds available to provide foundations for their

charitable activities. Changes in certain provisions of the Act may be desirable—and that of course is one reason for the Subcommittee's hearings—but the more serious abuses were certainly eliminated by the Tax Reform Act and some basic questions were settled.

WHY SHOULD WE HAVE FOUNDATIONS?

The first question—why should we have foundations—is surely legitimate and proper. Some countries have no foundations; in no country do foundations play the role that they do in the United States, although they are becoming more familiar abroad. The answer lies, we believe, in our history and in the basic beliefs of Americans about the organization of social, economic, and political activities: our traditions call for encouraging private initiative, decentralizing power, and broadening the base of decisionmaking.

Most of what foundations do, government could do—and in today's highly complex society the fundamental job of advancing the public welfare must lie with government because the resources required are so massive. All of the capital assets held by foundations in this country total less than the most recent annual appropriation for the Department of Health, Education, and Welfare.

Government Monopoly or Private Initiative

Would the public be better served if the government had a monopoly over the task of advancing the public welfare? We believe not.

All societies allocate social, economic, and political activities between government and private institutions. Totalitarian societies place virtually all activities under the control of the state. However, even among democratic societies, we find a degree of decentralization and private initiative in this country that is unique. In most other countries, higher education is a state function and the state owns or dominates the airlines, the telephone system, the television networks, and the major performing arts organizations. In most other countries, the state also assumes responsibility for much of what private philanthropy does in the United States, at least in such fields as health, education, welfare, and the arts.

We encourage private initiative more than other countries, because we believe that the diffusion of power stimulates experimentation, tests ideas in competition with each other, and provides greater flexibility in meeting the nation's needs. Private philanthrophy, including foundations, is a part of our historic commitment to these values.

Foundations have helped to preserve and strengthen other private institutions.

Foundations have provided a large additional marketplace for new ideas and new programs.

Foundations have provided much of the risk or venture capital for enlarging knowledge, frequently undertaking what neither government nor individuals were willing to attempt.

We now take for granted the government's substantial role in supporting medical research, assisting the performing arts, and dealing with problems of rural health and nutrition. Foundations were active in these areas before government. The Rockefeller Foundation established the pattern of modern public health practices and sought remedies against disease and hunger; Carnegie was responsible for thousands of free public libraries; the Julius Rosenwald Fund developed programs to improve education in the rural South; the Ford Foundation helped preserve our major symphony orchestras. The assumption of government responsibilities in these areas has led to government collaboration with foundations and has not ended foundation support or the need for such support.

The recorded achievements of foundations confirm the wisdom of encouraging private initiative in philanthropy.

Wealth and Tax Benefits

In the eyes of their harshest critics, foundations repersent large aggregations of wealth based on tax "loopholes" designed to benefit the rich. Most critics tend to overestimate the size of foundations and their power. In 1972 all charitable expenditures, foundation and others, totaled about $22 billion; foundations contributed about 10 percent of this total. The 2.2 billion dollars spent by foundations to advance the public welfare in 1972 amounts to less than one percent of the Federal budget.

The Ford Foundation's annual grants of roughly $200 million are about 10 percent of the grants made by all foundations but less than one percent of total philanthropic giving. The Ford Foundation's total assets of some $3 billion, while sizable, are exceeded by at least 70 business corporations. Although the Ford Foundation is large compared to other foundations, it is not a particularly large institution in our society.

It is misleading, we believe, to characterize the tax deduction for charitable giving as a "loophole." The tax savings from the deductibility of charitable gifts and bequests accrue to the donors but the consequence is a vastly greater flow of funds to charitable enterprise. The tax deduction is a stimulus for private effort and a mechanism for diverting the largest number of dollars to the public welfare. The Ford Foundation, for example, was established principally by gifts and bequests from Edsel and Henry Ford. Roughly calculated, the total gift, estate, and inheritance taxes that would have been paid if their gifts and bequests to the Ford Foundation had not been exempt from such taxes is about $136 million. In contrast, the Ford Foundation has made grants for charitable, educational, and scientific purposes of more than $4 billion during its life and continues to make grants of about $200 million annually. In the absence of the tax deduction for charitable gifts and bequests and the tax exemption for income of charitable organizations, some or all of the enterprises now supported by private philanthropy would have to be supported by government or abandoned.

The tax exemption on foundation income, granted as it is to advance the public welfare, gives rise to the legitimate demand that foundations be held to high standards of responsibility and accountability. That requirement is now embodied in the Tax Reform Act of 1969. As long as foundations meet this requirement, these tax benefits cannot fairly be regarded as special favors or "loopholes."

To some extent, continued criticism of foundations is a part of current disaffection for all traditional institutions, including business corporations, labor unions, universities, chruches, and government itself. Constructive criticism is all to the good, but we have come far with our traditional forms of social, economic, and political organization. There is no evidence that our society would be better served by a radically different system of higher education, by the dissolution of chruch organizations, by government ownership of business enterprises or, indeed, by abolishing foundations. In the experience of other societies there is much evidence to the contrary.

THE ROLE OF FOUNDATIONS IN A CHANGING SOCIETY

Foundations are often concerned with problems that affect public policy and are or will become the concern of Federal, state, and local governments. They should not, indeed must not, become involved in partisan politics. The distinction between partisan politics and public issues is important and often misunderstood.

Avoiding Partisan Politics

No reputable foundation is affiliated with a political party or with one or more candidates for political office. No reputable foundation contributes funds or staff resources to any political party, partisan group, or candidate. Nor do respecable foundations permit their grantees to use foundation funds for partisan political activities. If foundations engaged in these activities, they would lose their tax exempt status and incur severe penalty taxes under the Tax Reform Act of 1969.

To say that foundations should and do refrain from partisan entanglements is not to say that they have no legitimate function in the political process. In our free and open society, foundations have traditionally supported the study of issues of public concern and the development of programs to deal with them.

The distinction seems clear enough. Although the Tax Reform Act of 1969 strengthened and clarified the prohibitions on partisan activities by philanthropic organizations, these prohibitions have been law since 1934. Why, then, the recent misunderstanding? Why the recent charges that foundations have become agents of social change and may have become ideological in viewpoint? At least a partial answer may lie in the changed character of the problems our society confronts and the solutions that must be sought.

Changed Social Problems

Thus in recent years it has become clear that an urgent and persistent problem has been the failure to provide equal opportunity for blacks, Mexican Americans, and other minorities. The process that brought many of our minorities into the main currents of American society somehow stopped before they could be assimilated.

During the same period, there was growing concern over the deterioration of our cities, and the problem of sustaining essential services in the face of increased costs and a declining tax base.

So long as foundations concentrated their resources on higher education, scholarship programs, public libraries, control of disease, and the like—so long as foundations contributed their funds in traditional ways to the traditional objects of charity—they enjoyed a high measure of public esteem. Misunderstandings arose when some foundations began to seek solutions to minority and urban problems. Although foundations responded to these problems in much the same way as they had previously responded to the problems of education, health services, and disease, there were two important differences: the current problems touched more people more deeply; and while there was a consensus that the problems had to be dealt with, there was less agreement on how best to go about it.

In considering the role of foundations in these difficult areas, three points should be kept in mind:

First, the search for solutions to minority and urban problems has been a national effort not a partisan program. There have been differences of emphasis and approach between the major political parties, but only at the extremes of our political life has there been disagreement over the urgent need to bring equality to disenfranchised minorities and the means of restoring our cities. Certainly the last four administrations—two Republican and two Democrat—have been committed to these goals.

Second, foundations generally operate by responding to urgent needs pressed on them by others, and frequently act in cooperation with other institutions, including agencies of government. To regard foundations as the sole or even the most important agents of social change gives them more credit for foresight and influence than they deserve.

Third, total foundation resources committed to minority and urban problems are still far smaller than the resources committed to more traditional programs. If there is a problem of balance here, we doubt if it arises from overemphasis on the needs of those whose present need is greatest.

Foundations and Public Policy

Some examples, drawn from the Ford Foundation's experience, may help clarify the role of foundations in the formulation of public policy.

In 1969 and 1970, the Ford Foundation made grants to Syracuse University of $836,000 to chart the distribution of federal aid to local school districts, to examine the state and federal decisions that affect aid distribution, and to develop recommendations to improve the flow of federal aid funds to needy areas. Before the Syracuse studies it had been impossible to measure the consequences of existing federal assistance or to project realistic policy alternatives for the future. The Federal Government, under the present administration, has been sufficiently impressed with the Syracuse work to finance its continuing support.

This year the Foundation made grants totaling $142,000 to support the Center for Manpower Policy Studies at George Washington University, which evaluates antipoverty and manpower policies and programs. Since 1967, the Center has published dozens of books, monographs, and articles on this complex and controversial subject. Because of its reputation for authoritative, even-handed, and nonpartisan research, the Center has conducted background seminars for members of Congress and their staff, staff members of the White House, and staff members of concerned federal departments—wholly without regard to political affiliation.

In the past four years, the Ford Foundation has contributed millions of dollars for research on drug abuse, crime, environmental and energy issues, arms control and disarmament, population policy, and a host of other matters affecting the well-being of the American people. The same is true of many other private founda-

tions. All of the subjects of this research were, or subsequently became, subjects of governmental attention at the federal, state, or local level, but not one would argue that they were not also appropriate areas for private initiative and concern. The Tax Reform Act of 1969 reaffirmed that they were appropriate areas for foundation concern.

Changing Technology

Changing technology as well as changing problems has affected the character of foundation grants. Education, for example, has been a continuing concern of the Ford Foundation. The Ford Foundation's support for educational broadcasting—now public television—was an outgrowth of this concern. That support enabled public broadcasting to survive until Congress passed the Public Broadcasting Act of 1927. The cost, to the Ford Foundation, from 1951 to 1967, was $144 million. Traditionally, charity gave food to the hungry. With advances in the science of agriculture, foundations focused on research programs with potentially greater impact. From the programs came "the green revolution." In both cases, the concern was traditional but the approach was contemporary.

The Ford Foundation's Philosophy

The Ford Foundation's philosophy starts with its charter, which directs that all of the Foundations funds be administered for "scientific, educational and charitable purposes, all for the public welfare, and for no other purposes. . . ."

By critics of the right, the Foundation is frequently charged with being too liberal; by critics of the left, with being too conservative. Neither label is accurate. The Foundation's approach is not ideological; its deepest commitments are to improving the quality of life and preserving traditional values and institutions.

The Ford Foundation's approach is influenced in part by its size. An obvious advantage of size is the ability to make large grants. The Ford Foundation has made over 40 grants of more than $7.5 million each; the largest has been a $27.5 million grant to the Woodrow Wilson National Fellowship Foundation in 1962. More recently, a $30 million appropriation was approved, out of which grants are made for the establishment and support of the Police Foundation. It has undertaken more than 30 grant programs ranging from $10 million to $297 million in such areas as graduate and undergraduate education, urban development, public broadcasting, symphony orchestras, and international training and research. Large problems generally require large grants and only rarely can many boards of trustees be persuaded to act simultaneously and collectively.

Other advantages of size include the mixture of talents represented on the professional staff; the readier access to outside talent; the ability to discern the interrelationships among problems because of the larger scope of Foundation activities; the ability to organize large programs of interrelated activities, sustained over a period of years; and unified professional leadership.

Smaller organizations have made very important contributions. But the Ford Foundation's larger size gives it important opportunities that they cannot accept. Given the scale and complexity of the problems that exist today, the Ford Foundation is acutely conscious of these opportunities.

Existing Institutions and Social Change

At the recent Subcommittee hearings the panelists were asked how foundations should order their priorities as between support for existing institutions and grants designed to bring about social change. For the Ford Foundation, the allocation of funds between existing programs and new programs, between grants for established purposes and grants in new areas, varies from year to year; final decisions represent the composite judgment of the Foundation's staff of officers; and of seventeen trustees, drawn from all areas of the country, from many different occupations.

The Foundation draws no sharp distinction between preservation of existing institutions and values, and needed social change. Adaptation and change are as essential in social affairs as they are fundamental in biology. Existing social, economic, and political organizations always face a need to adapt to new conditions—"new occasions teach new duties." We view our contribution to this process of change and adaptation, although small in the total context of social forces and resources being brought to bear on our problems, as consistent with the deepest traditions of our national life.

[Whereupon, at 12:55 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

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