Foundations Say Excise Tax Proposal Is Good, but Not Good Enough

by Fred Stokeld

A proposed reduction and simplification of an excise tax on private foundations, although laudable, doesn't go far enough, according to members of the philanthropic sector.

The Taxpayer Certainty and Disaster Tax Relief Act of 2019 (H.R. 3301), which would replace the two-tiered excise tax on the net investment income of private foundations with a flat 1.39 percent revenue-neutral rate, would still be burdensome, nonprofit representatives say.

Groups such as the Alliance for Charitable Reform (ACR) and the Council on Foundations (COF) say they would prefer a flat 1 percent rate to replace the two-tiered tax under section 4940, which reduces the tax rate from 2 percent to 1 percent when a foundation's distributions exceed its average payout rate.

The two-tiered tax discourages foundations from paying out more to help with disasters or similar events because the foundations must maintain the higher giving levels to qualify for the 1 percent rate, the groups explained. Calculating the tax is also burdensome, especially for foundations with few employees, they say.

But these and other groups have expressed reservations about a 1.39 percent rate, pointing out that it would result in a higher tax bill for foundations that qualify for the 1 percent rate under the two-tiered system.

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"A revenue-neutral rate may be attractive to Congress, and [the COF] won't necessarily rule it out because simplification is so important, but at 1.39 percent, many private foundations will see a significant tax increase and a corresponding decrease in dollars available to support grantees," Suzanne Friday of the COF told *Tax Notes* August 16.

Friday added that with a decrease in charitable giving and new unrelated business income taxes resulting from the Tax Cuts and Jobs Act, "a flat rate of 1 percent will ensure that foundations do not incur an additional tax burden."

A Drain on Coffers

Likewise, the ACR doesn't necessarily oppose a 1.39 percent rate. But in an August 5 post on its website, the group said the figure would mean a 39 percent tax increase for many foundations, "driving money out of those organizations and into federal coffers."

The tax hike would be especially hard on some of the largest foundations that now pay 1 percent and grant the most money, the ACR added.

The ACR, COF, and other groups are encouraging lawmakers to consider a 1 percent rate. They have compared the two-tier system with the 1.39 percent rate, calculated the added tax burden for many of their private foundation members, and shared the research with congressional staff, according to Friday.

"By offering real data, coupled with reminders that the charitable sector took a hit with tax reform, we hope to persuade Congress that a 1 percent flat rate is the right thing to do," Friday said.

In the past, there has been bipartisan support in Congress for simplifying the tax. Twice the House has passed legislation that would establish a 1 percent rate, and an identical provision has surfaced in Senate charitable giving bills.

Thumbs Down

Alexander L. Reid of Morgan Lewis & Bockius LLP agrees it would be unfair to increase the rate from 1 percent to 1.39 percent on foundations that distribute grants above their required amount. He also thinks the tax should be eliminated regardless of the rate because, among other things, it doesn't fulfill its original purpose of funding IRS enforcement of private foundation excise taxes imposed 50 years ago.

The section 4940 tax is also causing Treasury and the IRS to get "wrapped around the axle" on implementing the new 1.4 percent tax on college endowments under section 4968, Reid added. The endowment tax cross-references the private foundation tax for implementation rules, but colleges and foundations have little to do with one another, he explained.

"I'd eliminate both taxes if I could," Reid said. ■