



ISSUE PAPER

# Simplify the Excise Tax on Private Foundations

**Position:** The Council on Foundations supports simplifying the private foundation excise tax on net investment income to a flat rate that is revenue neutral.

**Background:** Private foundations are generally subject to a 2 percent excise tax on their net investment income. However, the tax is reduced to 1 percent in any year in which the foundation's percentage of distributions for charitable purposes exceeds the average percentage of its distributions over the five preceding taxable years plus an amount equal to 1 percent of its net investment income.

Although intended as an incentive to increase giving, this two tier system actually serves as a disincentive. Foundations that increase giving in a particular year in response to an immediate and significant need, such as our current economic crisis, will be faced with paying tax at the 2 percent rate for the next five years because giving at their normal rate will not exceed the five-year average. A flat, revenue neutral, excise tax rate will encourage greater payouts at this time of need, by eliminating the five-year tax penalty that currently follows an unusually generous year of giving.

**Rationale:** In today's economy almost every private foundation in America is seeking to maintain its grant commitments, despite losing 30 percent of their endowment value. But in honoring those commitments, many foundations will necessarily increase their payout rates (the percent of total assets paid out in grants) often to as much as 8 percent or more. Unless we can move to a uniform flat rate for the excise tax, those foundations making such extraordinary efforts now will be penalized in future years when the value of their endowments recover in the markets. No one wants to penalize foundations for making these efforts to maintain grant commitments. **Simplifying the tax will result in increased philanthropic giving by private foundations.**

**We Need Your Help:** Please support a legislative proposal which includes a revenue-neutral flat excise tax that will encourage increased giving by private foundations.

For more information, contact the Council's Government Relations Department at 703-879-0600 or [govt@cof.org](mailto:govt@cof.org).

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