



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.

For more information, contact the Council's Government Relations Department at 703-879-0600 or govt@cof.org.

Background: Each year, private foundations pay an excise tax on their net investment income. This rate changes depending on how any single year's giving compares to the prior 5-year average payout rate. If the percentage of giving in a single year is more than the 5 year average, plus 1 percent of investment income, the excise tax rate is 1 percent for that year; however, if the giving rate in a given year is less than that amount, the excise tax rate increases to 2 percent of net investment income.

This two-tier system actually serves as a disincentive to significantly increase giving in a particular year. As a result, when foundations seek to respond to an immediate and significant need, such as our current economic crisis or Hurricane Katrina, they are penalized over the next several years because their average payout rate has increased significantly in one year. A flat, revenue neutral, excise tax rate will simplify tax planning for many foundations, especially the smaller foundations, and will encourage greater payouts at this time of need.

Rationale: In today's economy, nearly every private foundation in America is seeking to maintain its prior grant commitments, despite losing 30 percent of its endowment value. But in honoring those commitments, many foundations will necessarily increase their payout rates (the percent of total assets paid out in grants). Other foundations are proactively increasing their giving rate this year, and have in prior years, given the growing needs in their communities.

Unless we move to a uniform flat rate for the excise tax, those foundations making such extraordinary efforts now will be penalized in future years. These private foundations will face a 2 percent tax in the following years because their payout rate will have "declined" by returning to its traditional level of giving. Foundations should not be penalized for doing the right thing - that is why we urge Congress to simplify the tax system for private foundations.

Status of the 111th Congress: On March 24, 2009, Senator Charles Schumer (D-NY) introduced a private foundation excise tax bill (S.676) with five cosponsors. This proposal would amend the IRS Act of 1986 to remove the current two-tiered excise tax imposed on private foundations and replace it with a flat rate at 1.32 percent, which is expected to be a revenue-neutral level.

We Need Your Help: Please support Senator Schumer's excise tax bill, S.676, which includes a revenue-neutral flat excise tax that will encourage increased giving by private foundations.

May 2009