Fiscal Issues 2

Philanthropy in America
The Need for Action

by
Stuart M. Butler

The Heritage Foundation & iret Institute for research on the economics of taxation

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Introduction

> Americans of all ages, all stations of life, and all types of dispositions are forever forming associations. . . . Americans combine to give fetes, found seminaries, build churches, distribute books, and send missionaries to the antipodes. Hospitals, prisons and schools take shape in that way. Finally, if they want to proclaim a truth or propagate some feeling by the encouragement of a great example, they form an association. In every case, at the head of any new undertaking, where in France you find the government or in England some territorial magnate, in the United States you are sure to find an association.
>
> Alexis de Tocqueville, *Democracy in America* (1835)

As de Tocqueville observed during his travels through America, the private support of social activities and services is a deeply rooted element of the American way of life. In the colonial and early national period, it was quite common for leading citizens to promote the private funding of civic projects. Benjamin Franklin, for example, was instrumental in the creation of numerous philanthropic associations. He assisted in the foundation of a volunteer fire company, developed plans for lighting and paving the streets of Philadelphia, and was responsible for raising funds to found both the Pennsylvania Hospital and the academy which ultimately became the University of Pennsylvania. Although Franklin might have displayed more enthusiasm than most, he was typical of the age in his sense of duty. As one social historian has noted, during the Revolutionary era:

> Groups were formed for every imaginable purpose—to assist widows and orphans, immigrants and Negroes, debtors and prisoners, aged females and young prostitutes; to supply the poor with food, fuel, medicine, and employment; to promote morality, temperance, thrift, and industrious habits; to educate poor children in free schools; to reform gamblers, drunkards, and juvenile delinquents.[1]

[1]Walter Trattner, *From Poor Law to Welfare State: A History of Social Welfare in America* (New York, 1974), p. 37.

The use of non-profit voluntary associations to promote public ends has remained a basic feature of American society. It was almost uniquely an American development of the eighteenth-century concepts of self-advancement and improvement; a realization that it is in the interests of a society founded on individual initiative for it to seek voluntary, private means of acquiring the social services needed by the communities within it. This understanding that social responsibility is not merely a moral duty, but that it is also in the long-term interest of each individual to encourage the betterment of his community, lies at the heart of the American tradition of philanthropy, and has helped preserve the decentralized, pluralist society that is the United States.

This belief in private philanthropy is as strong today as it was in the early days of the Republic. A Gallup poll conducted in 1972 showed that over 70 percent of the population believe that private giving to health agencies, education, and welfare organizations is at least as important today as in the past, and a majority felt that it was even more important.[2] A poll commissioned by the Heritage Foundation in February-March 1980 gave similar results. Approximately 70 percent of the population oppose the trend towards the use of taxpayer's money to finance activities previously funded by the voluntary sector. The same proportion feels that private organizations have a better track record than government in providing charitable services (see appendix).

Private philanthropy is widely seen as a vital alternative to government provision of services based on compulsory "donations" (i.e., taxation). The private charity is non-coercive, and so reflects accurately the cumulative choices of individuals regarding social needs in a manner that congressional bargaining cannot hope to do. In a democracy, the tendency will always be for public support to be given only to those groups with whom the majority sympathizes, and to those institutions which further the existing attitudes of society. The voluntary sector, on the other hand, allows support to be channeled to social groups and institutions which do not necessarily enjoy the favor of the majority. This encouragement is essential for the preservation of a free and pluralist society, where alternative attitudes and approaches are tolerated and can be assessed for their value. A strong voluntary sector acts as a bridge between those with creative ideas and dedication, and those with the means and desire to assist them.

The notion of pluralism is deeply rooted in the American tradition, and it has been responsible in great measure for the remarkable evolu-

[2]The Gallup Organization Inc., *Public Awareness Toward Philanthropic Foundations* (Princeton, 1972).

tion of American society. A pluralist society is by its very nature more efficient than uniform systems in overcoming the problems of a community and responding to its changing needs and desires. When the state maintains monopoly in the support of social experiments and services, the society will be less free and will advance more slowly. As John Stuart Mill observed in his essay *On Liberty* (1859):

> Government operations tend to be everywhere alike. With individuals and voluntary associations, on the contrary, there are varied experiments, and endless diversity of experience. What the state can usefully do is to make itself a central depository, and active circulator and diffuser of the experience resulting from many trials. Its business is to enable each experimentalist to benefit by the experiments of others; instead of tolerating no experiment but its own.

The appreciation in America of the relationship between pluralism, freedom and progress lies behind the principle of tax exemption for charitable organizations and that of tax deductibility for gifts made to such institutions. As the House Ways and Means Committee stated in its report on the 1938 Revenue Act:

> The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.[3]

The basis of tax exemption, in other words, is that charitable organizations fulfill functions which would otherwise fall on the shoulders of government. They are an alternative to government provision, and thus it would be inefficient and damaging to tax them. Similarly, making donations to charities or charitable foundations can be seen as an alternative to having to fund government services through taxation. It is therefore reasonable to exempt such donations from taxation because they reduce the need for taxation. An additional argument comes from the point made earlier that the voluntary sector provides support for valuable organizations and groups in society which would be passed over by a purely democratic allocation of funds: the charitable deductions provides a means whereby such organizations can be fostered.

Tax exemption for philanthropic activities can also be justified from an efficiency standpoint. As several studies to be mentioned later have shown, the charitable tax deduction generates more support for chari-

[3]House Report No. 1860, 75th. Congress, 3rd. session (1939), at 19.

table ventures than it costs the Treasury in taxes lost. It is more cost effective to allow a deduction on money donated to, say, a school than to tax the donation and spend it on the same school. The inhibiting effect of the tax on the donor, and the administrative cost involved, would lead to a reduction in total support. Furthermore, a strong voluntary sector brings with it the efficiency of the market system. Charities depend for their support on showing that they provide the services which the donor wishes to support in a more effective way than competing alternative institutions (including government). If the organization does not do this, and does not innovate, it will gradually lose support to other bodies. This filtering out process is at the root of the private enterprise system, and provides the spur to efficiency and responsiveness in the voluntary sector. By encouraging the sector through a tax exemption, the government is promoting the efficient provision of research and services.

Although the value of private philanthropy is well understood in America, the voluntary sector is currently under threat as never before. As a result of the 1969 Tax Reform Act—legislation aimed ostensibly at improving the charitable process—the principle of tax exemption has been undermined, leading to fundamental changes in the level and pattern of giving. This erosion of the principle is a serious precedent and poses great dangers for philanthropy. As Chief Justice John Marshall explained in the early days of the Republic, the power to tax is the power to destroy. The 1969 legislation has shown the truth of Marshall's observation. Changes in the tax code, which will be examined later in this study, have seriously inhibited charitable giving and jeopardized the continued existence of many foundations. Indeed, it was one of the expressed intentions of the 1969 act to encourage a high turnover rate among private foundations by forcing them to increase the dispersal rate of their assets.

Philanthropy is also threatened by other legislation passed in recent years. Expanding state and federal regulation of charitable organizations is slowly strangling the sector in red tape. This has resulted in an increase in accounting and legal costs for organizations and has inhibited the creation of new bodies to replace those winding up their activities as a consequence of the 1969 act.

These changes in the tax code and the growth of regulation have produced a crisis in private philanthropy. Because of inflation, the underlying trends are not always obvious when one examines the current figures for the sector. But, as this study will demonstrate, the trend in giving in real terms underwent a dramatic change after 1969. Private

foundations—the clearing houses of philanthropy—have been especially damaged: real giving to and by them has fallen significantly and constantly. There is no reason to believe that there will be any turnaround in this pattern until major reforms in the tax law are enacted. If these changes are not made, and made soon, we will see the decline of private, voluntary philanthropy and its replacement by government services financed by taxation.

This study will first examine the scale and importance of private philanthropy in America, showing how funds are distributed among various types of charity and how the pattern has changed over the years. The law regarding charitable giving will then be considered in detail. It will be shown that legislation since 1969 has seriously inhibited private philanthropy in a number of ways. Finally, the broad implications of the present law will be reviewed, together with the reforms needed to restore philanthropy to its proper place in society.

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1

Private Philanthropy in America—An Overview

Scale and Distribution

Contributions to charity appear to have grown dramatically since World War II; and measured in current dollars, total giving more than doubled between 1970 and 1978, to a level of nearly $40 billion. Tables 1 and 2 indicate this growth and the pattern of allocation. As is the case with time series presented without an adjustment for inflation, however, the data in these tables disguise the real trend in giving. If one takes inflation into account, quite a different picture emerges, and one which gives cause for concern. Before the mid-1960s, inflation was not a significant factor in comparing financial statistics over time. But between 1960 and 1970 the price level rose by 31 percent, and between 1960 and 1978 prices more than doubled.

Tables 3 and 4 show the level and pattern of giving when adjustments are made for inflation since 1960. Between 1960 and 1970 total real giving increased by 64 percent. In the 8 years between 1970 and 1978, however, real giving increased by only 20 percent, despite the 106 percent rise when measured in current dollars.

Contributions from foundations and charitable bequests have actually fallen during the 1970s, in real terms, and this change has been reflected in the receipts of certain forms of charity. The income of religious organizations, for example (which comes predominantly from small individual donors), has kept pace with economic growth, but giving to education and health, where foundations and bequests are important, has stagnated in real terms, despite a 20 percent rise in population from 1970 to 1977.

Evidence to the Commission on Private Philanthropy and Public Needs (known as the Filer Commission),[4] published in 1977, suggests that the impact of inflation and tax law changes on philanthropy may

[4] *Department of the Treasury, Research Papers Sponsored by the Commission on Private Philanthropy and Public Needs* (5 volumes, Washington, D.C., 1977).

Table 1

Estimated Contributions to Philanthropy in the United States, 1930–1978 (Selected Years), in $ Billions

Source	1930	1940	1950	1960	1965	1970	1972	1974	1976	1978
Individuals	0.9	1.1	3.7	7.2	9.3	14.4	16.9	19.8	23.5	32.8
Foundations	0.03	0.06	0.1	0.7	1.1	1.9	2.2	2.1	2.1	2.2
Business Corporations	0.01	0.04	0.3	0.5	0.8	0.8	0.8	1.3	1.4	2.0
Charitable Bequests	0.2	0.1	0.2	0.6	1.0	2.1	2.7	2.1	2.4	2.6
Total	1.14	1.3	4.3	8.9	12.2	19.2	22.7	25.3	29.4	39.6

Source: American Association of Fund-Raising Counsel, Inc., *Giving USA* (New York).

Department of the Treasury, *Research Papers Sponsored by the Commission on Private Philanthropy and Public Needs* (Washington, D.C., 1977), vol. III, p. 1612.

Note: Due to rounding, individual entries do not necessarily add up to the totals.

Table 2
Allocation of Philanthropic Funds, 1960–1978 (Selected Years), in $ Billions

Recipient	1960	1965	1970	1972	1974	1976	1978
Religion	4.5	6.0	8.3	9.8	10.9	12.8	18.4
Education	1.4	2.1	3.1	3.6	3.7	4.1	5.5
Welfare*	1.3	0.9	1.4	1.6	2.3	2.7	4.0
Health*	1.1	2.1	3.1	3.7	3.9	4.4	5.5
Civic/Cultural		0.5	1.2	1.5	2.0	3.1	3.6
Foundations, International, Etc.	0.5	0.7	2.2	2.5	2.4	2.4	2.6
Total	8.9	12.2	19.2	22.7	25.3	29.4	39.6

Source: Giving USA.
Note: *For 1960, contributions for health to welfare agencies are included with welfare, thereafter with health.
Due to rounding, individual entries do not necessarily add up to the totals.

Table 3
Contributions to Philanthropy, 1960–1978 (Selected Years), in Constant 1960 Dollars (in $ Billions)

Source	1960	1970	1974	1978
Individuals	7.2	11.0	11.9	15.1
Foundations	0.7	1.5	1.3	1.0
Business Corporations	0.5	0.6	0.8	0.9
Charitable Bequests	0.6	1.6	1.3	1.2
Total	8.9	14.6	15.2	18.2

Source: Table 1, adjusted using price index published by U.S. Bureau of Labor Statistics, as used in the *Statistical Abstract of the United States.*
Note: Due to rounding, individual entries do not necessarily add up to the totals.

Table 4
Allocation of Philanthropic Funds, 1960–1978 (Selected Years), in Constant 1960 Dollars (in $ Billions)

Recipient	1960	1970	1974	1978
Religion	4.5	6.3	6.5	8.5
Education	1.4	2.4	2.2	2.5
Welfare	1.3	1.1	1.4	1.8
Health	1.1	2.4	2.3	2.5
Civic/Cultural	0.5	0.9	1.2	1.7
Foundations, International, Etc.		1.7	1.4	1.2
Total	8.9	14.6	15.2	18.2

Source: Table 2, adjusted using price index published by U.S. Bureau of Labor Statistics.
Note: Due to rounding, individual entries do not necessarily add up to the totals.

have been even more adverse than the above statistics indicate. The cost of services tends to rise faster than the general rate of inflation, and so charitable associations providing welfare and other services tend to suffer higher rates of cost increases than the average, since they are labor intensive.[5] Thus, in a period of inflation, these organizations need a correspondingly greater increase in income than that necessary to cover average price rises, merely to maintain a constant level of services. One research paper presented to the Commission attempted to incorporate this factor into the calculations, and concluded that even the apparently buoyant religious sector has experienced a downturn in its share of GNP in the 1970s.[6]

Categories of Donors

Individuals

By far the largest segment of donated funds is contributed by individual citizens. This may take various forms. It may be a gift of cash, which can be deducted from taxable income (if the contributor itemizes deductions). It may, on the other hand, be a gift in the form of stock or other property which may be deducted on the basis of saleable value. It could also be a bequest, which would result in a reduction of estate tax.

Foundations

Contributions may also be channeled through an independent private foundation, often set up by a single family or small group. There are approximately 24,000 such foundations in the United States: for the most part they are small, although some, such as the Ford and Rockefeller Foundations, have assets of hundreds of millions of dollars.

Corporations and Corporate Foundations

Corporations are an important source of funds for philanthropy. American business, on average, contributes approximately 1 percent of its net income to charitable institutions.[7] As a survey commissioned by

[5] See Joseph Goldberg and Wallace Oates, "The Costs of Foundation-Supported Activities," *Foundation News*, July/August 1973.

[6] Ralph Nelson, "Private Giving in the American Economy, 1960–1973," in Filer Commission, *Research Papers*, vol. I, p. 123.

[7] The federal tax deduction for corporate charitable donations is limited to 5 percent of taxable income. Contributions in excess of the annual limit may be carried forward and treated as a deduction during one of the following 5 years. Since it is rare for a company to wish to donate more than 5 percent of its income this is not a serious handicap to philanthropy.

the Filer Commission showed, the most commonly expressed reason for corporate giving to such sectors as welfare and the arts is the belief that good citizenship requires business to provide funds. While this motive also influenced gifts to higher education, a more important factor in that case was the desire to improve the supply of trained manpower to industry.[8]

As one might expect, the level of corporate giving tends to reflect the prevailing economic situation, and during depressed periods, business contributions have generally fallen as a percentage of income as well as in total real amount. This tendency means, of course, that for some charitable sectors, such as welfare, direct contributions from business fall at precisely the time there is an increase in the demand for services. For this, among other, reasons, many companies maintain their own private foundation—about 1,500 of these exist. The use of such a foundation means that the company can make contributions to the foundation when it is economically most attractive. The foundation, on the other hand, can make payments to individuals and other charities on the basis of need: it is thus possible for a corporation to ensure a steady or flexible contributions policy without regard to temporary fluctuations in corporate income.[9] By establishing its own foundation a company can centralize its decision-making regarding the allocation of charitable gifts, and keep these decisions outside the day-to-day management considerations of the company. On the other hand, the close links between the company and its foundation enables grant-making decisions to be made with an intimate knowledge of the profit strategy and likely future performance of the donor, and hence a more accurate picture of future gifts is available than would be so in the case of a totally independent foundation. A study carried out in 1972 estimated that approximately half of all companies contributing to charity did so through their own foundation, and that about 60 percent of total corporate giving was made in that way.[10]

[8]James Harris and Anne Klepper, "Corporate Philanthropic Public Service Activities," Filer Commission, *Research Papers*, vol. III, p. 1753.

[9]In the tables contained in this study grants by corporate foundations are itemized as donations by corporations, not foundations. If a corporation were to give, say, $1 million to its own foundation during one year, and that foundation disbursed $½ million to various charities during the year, these transactions would be tabulated as a contribution of $½ million by the corporation to charity. Corporate donations through their own foundations only appear in the tables, therefore, when the money is actually disbursed to an operating charity.

[10]R. P. Baker and J. E. Shillingburg, "Corporate Charitable Contributions," in Filer Commission, *Research Papers*, vol. III, p. 1859.

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Charitable Giving and the Law

The Growth of Government Controls

Until the 1950s, charitable organizations were exempt from virtually all taxes and controls. Yet criticisms were being voiced against certain aspects of the sector's activities well before that time. The business holdings of foundations, in particular, attracted many complaints. The Senate Industrial Relations Committee, for example, began to investigate allegedly high stockholding by foundations as early as 1913. In the following years, increasing attention was paid to the tax-exempt status of so-called feeder corporations (i.e. bodies engaged in business activities for the sole benefit of an affiliated charitable organization). Before changes in the law in 1950, the courts took the view that if business activities were to be tax-exempt when carried out directly by a charity, it would be absurd to tax those same activities if the organization chose to segregate them in the form of a business enterprise. The key test, according to the Supreme Court, was the "destination of income." If the profits of an affiliated business went solely to a charitable organization, then the business should be exempt from tax.

In 1950, however, Congress took a much closer interest in the "unrelated business income" of charitable organizations. This development was occasioned by a number of widely publicized acquisitions of major businesses by tax-exempt organizations, after which the businesses claimed exemption for their previously taxable profits. The principal objection to this type of activity was that it gave the untaxed business an unfair edge in the market, allowing it to undercut its taxable competitors and even possibly become a monopolist. As a result of this line of argument, Congress was persuaded in 1950 to enact legislation imposing a tax on unrelated business income.

From a theoretical point of view, there was at least some truth in the allegations behind the 1950 measure. A business which enjoys tax exemption faces a lower cost structure, all other things being equal, than

its competitors. Its payroll is reduced because its employees are exempt from FICA, and its profits are exempt from income tax. It could use this advantage to lower prices and increase its market share. In practice, however, it is very likely that such fears were greatly exaggerated. It is probable that a business operated by a church or school would be more cautious and conservative in its approach than most other enterprises, and so would not become a serious threat to the operation of an efficient market. Little evidence, in fact, was put forward to support the claim that charity-owned businesses would result in serious distortions of the market. As studies by two leading Yale law professors have shown:

> These predictions of unfair competition were rarely subjected to close analysis, and we know of no empirical examination of the results of such acquisitions.[11]

The 1950 legislation did not silence criticism of the charitable sector; instead the emphasis shifted to other activities. It was argued, for example, that some major donors to foundations engaged in various forms of self-dealing, using their connections with the foundation for personal gain. It was not claimed, except in very rare cases, that this was illegal, but it was suggested that many of the practices were unethical. Activities cited included the receipt of substantial compensation for services performed by the donor, the use of foundation facilities free of charge and access to foundation funds on favorable borrowing terms. This question was taken up by the Peterson Commission, a private research group set up at the suggestion of several major foundations to examine the state of the voluntary sector. The Commission reported to the Senate Finance Committee in 1969 that self-dealing activities of an objectionable kind were very rare. In a confidential survey of accountants dealing with foundations, for example, the Commission found that only 9 percent of the accountants felt that such practices were either fairly common or very common.[12]

The Peterson Commission recommended to the Senate a strict prohibition on self-dealing, on the grounds that it was wrong for a donor to be able to enjoy a personal gain by virtue of his association with a charity. The Commission also pressed for increased financial disclosure by foundations, both to enable the IRS to monitor the financial practices of foundations, and to discourage questionable practices by exposing

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[11]Boris Bittker and George Rahdert, "The Exemption of Nonprofit Organizations from Federal Income Taxation," *The Yale Law Journal*, vol. 85, No. 3, January 1976, p. 319.

[12]Senate Report No. 91-522, 91st. Congress, 1st. session (1969), 6157.

them to public scrutiny. The criticism of self-dealing was well taken by most charitable organizations, and there was wide support for the restrictions on such activities which were incorporated into the 1969 Tax Reform Act.

As the Peterson Commission pointed out, self-dealing was in all probability only a minor flaw in the operation of the voluntary sector, despite the criticism it generated, but there was broad acceptance that something needed to be done. Other practices also attracted the close scrutiny of Congress in the 1950s and 1960s, however, but in these cases the argument was far less clear-cut and accepted. There was great concern, for example, over the ability of a donor to make a gift of stock or other appreciated property, and then to take a tax deduction based on the current market value rather than his original cost. It was said that this was unjust and that there were many possibilities for fraud. Property could be overvalued, for example, since it was not actually sold when made over to a charity. Furthermore, in the case of a gift of inventory by a manufacturer, it was possible for the company to actually make a profit from donating, even if the current valuation was accurate. If the input cost of the product was a smaller percentage of its final valuation than the company's marginal rate of taxation, the saving in the tax bill would exceed the production cost of the gift, since the tax write-off would be based on final market value. Notwithstanding this rather special case, there was some feeling that it was wrong in general for a donor to be given a tax deduction greater than a gift "cost" him.

The last criticism is easily disposed of. If a donor gives a charity stock or other property which has appreciated in value, he is denying himself the use of the full market value of the gift, not its original cost, and so a deduction based on the original cost would be unjust and would inhibit giving. The possibility of overvaluation was a legitimate concern in cases where there was no clear market price (for works of art, collections of personal papers etc.). But the problem called only for a revision in the procedures for assessing value, not for radical changes in the whole basis for deducting appreciated gifts. Similarly, small adjustments in the tax code, to ensure that the tax gain could not exceed the current production cost for gifts of inventory, would have dealt with the problem of a real gain resulting from a charitable gift. But as we shall see later in this study, the measures enacted to solve these minor issues were drastic and had the effect of severely inhibiting gifts of appreciated property.

Another claim made by critics of charitable foundations during the

1950s and 1960s was that their officials were unduly cautious in both their investment and disbursement decisions, preferring to see the foundation's assets grow, rather than ensuring the maximum flow of funds to charitable activities. Part of the reason for this, it was said, was that foundations frequently held too great a proportion of their assets in the form of a single company's stock, resulting in relationships which were not in the best interests of philanthropy. This gave rise to pressure for some form of payout requirement for foundations, i.e. for a legal stipulation that private foundations would distribute at least a specified percentage of their assets every year. This, it was claimed, would increase the flow of support for charitable activities, and encourage a more businesslike investment attitude among foundation managers. If the manager remained unduly cautious the organization's assets would simply decline and the foundation would eventually cease to exist. This would be no bad thing, it was suggested, because it would filter out dead weight in the tax-exempt sector. The issues surrounding the argument were complex, and will be discussed in detail in the context of the 1969 legislation. Like the arguments surrounding appreciated property, they gave rise to significant changes in the law regarding tax-exempt organizations, changes which have had sweeping and damaging effects on philanthropy in America.

The debate on the alleged deficiencies of the voluntary sector resulted in major sections being incorporated into the 1969 Tax Reform Act. It was this act which brought about fundamental changes in the law concerning tax-exempt organizations, and the results of the measure are the principal concern of this study.

The 1969 act was of particular importance in its effects on foundations—especially private foundations. Its provisions influenced these charities in four broad ways. Firstly, it imposed a 4 percent tax on investment income obtained by private foundations. The aim of this tax was to raise sufficient funds to cover the cost of IRS scrutiny of the foundations. Foundations were also required to make available to the public annual reports showing assets, earnings, grants, and administrative costs.

The second provision of the 1969 act having an effect on foundations required non-operating foundations (i.e., those that exist to donate money to charitable activities and not to carry out their own programs) to pay out for charitable purposes each year either their total net income or a percentage of their asset value specified by the Treasury, whichever might be the greater. As an additional discouragement to the excessive holding of assets within a single corporation, the act put a

limit of 50 percent on the voting stock of a company held by a foundation.

Thirdly, the act began the continuing process of limiting the so-called lobbying activities of organizations, both at governmental and at "grass roots" levels. And finally, the act made key changes in the law regarding the tax deductibility of gifts of appreciated property.

The 1969 act altered the entire legal and tax framework affecting philanthropy. It has been followed by a number of federal measures and a host of state regulations and restrictions.

Donations To Charity

Appreciated Property—Individual Donors

Prior to the Tax Reform Act of 1969, the general rule was that an income tax deduction would be allowed for the full fair market value of property donated to a charity. Some restrictions did apply in certain cases, but these had only a minimal effect on giving.

The 1969 act, however, made substantial changes to the exemption basis for gifts of appreciated property (including stocks, etc.). The total market value write-off was retained only when the gift would result in long-term capital gain were it to be sold on the date of contribution. If, however, the property was to be used for a purpose unrelated to the donee's exempt activities, or if the donee were a private foundation,[13] only 50 percent of the gain could be deducted from taxable income under the act. This meant, of course, that the tax advantage of donating such a gift was drastically reduced.

The 1969 legislation further complicated the practice of giving by altering the proportions of income that could be given each year while claiming the deduction. On the one hand, the act raised the ceiling on total deductible charitable contributions from 30 percent to 50 percent of adjusted gross income. On the other hand, in cases when this involved property which would realize a long-term capital gain if sold, the 30 percent ceiling remained. Furthermore, if the donee were a private foundation, or if the property was for the use of the charity, a 20 percent limit was imposed.

The 1978 Revenue Act made certain adjustments to the clauses dealing with appreciated property in the 1969 act. If an individual now gives to a private foundation property on which a long-term gain could be realized, only 40 percent may be deducted from income tax (if the

[13] i.e. a foundation without wide public financial support, as defined by section 509 of the Internal Revenue Code.

asset is sold for personal gain, 40 percent of the gain is subject to income tax—the remainder to capital gains tax).[14] Previously 50 percent could be deducted from income tax, the remaining 50 percent being deductible from capital gains tax.

A taxpayer can avoid the 30 percent rule, however, if he elects to use a provision whereby a contribution of appreciated property is reduced by a proportion of the appreciation. In this case the 50 percent ceiling applies. Prior to November 1978, the proportion was 50 percent. For gifts made after November 1, 1978, the reduction is only 40 percent, in line with changes in the capital gains tax.

An example will illustrate the operation of the election. Say, after October 31, 1978, a donor contributed securities which cost him $20,000, but which had a present market value of $40,000. In addition, let his income base be $50,000. If he did not use the election, he would be able to deduct only the equivalent of 30 percent of his base income, i.e. $15,000, and he would have to carry the remainder, i.e. $25,000, into the following taxable years. If, however, he chooses to make the election, he must reduce his total deduction by 40 percent of the appreciation, or $8,000. In the year of contribution, therefore, he may deduct $25,000 (50 percent of his base income), and carry over the remaining $7,000 ($40,000 less $8,000 less $25,000). This election is only sensible when a contribution is so large that it cannot be spread over five years, taking into account possible future donations, or when future income is thought likely to decline to a level such that there would be a net tax saving.

These complex changes in the law have had important effects on the donation of property to charity by individuals—especially when the recipient is to be a private foundation. In the first place, the denial of a tax write-off at the full market price of property gifts to private foundations discourages gifts to that segment of philanthropy. This is particularly so in a period of high inflation, when the so-called capital "gain" is, in fact, largely a paper gain arising out of the fall in the value of money. As the rate of inflation accelerates, so this paper gain becomes an even larger proportion of the capital gain. Since tax rates are not indexed in the United States, the effect of the 1969 act was thus to apply an extra tax on those who choose to donate property rather than income (in general, the more affluent donor). The higher the rate of inflation, the more pronounced is this effect. In contrast, the donor who gives out of current funds finds giving relatively more attractive during a long

[14]The new 40 percent rule also applies when the 50 percent ceiling discussed in note 12 is used.

period of inflation, since money incomes tend to rise with inflation, pushing people into higher tax brackets and thereby reducing the "cost" of a charitable contribution.

A second effect, resulting from the 1978 changes, adds to the decline in attractiveness of giving property. As mentioned earlier, the act altered the proportion of a capital gain subject to income tax from 50 percent to 40 percent. Given the exclusions and *relatively* low rates of tax applying to gains (a maximum marginal rate of 28 percent), almost every taxpayer will now find it slightly more advantageous to realize a gain, rather than make a donation, than he did before. The higher the individual's tax bracket, the greater is this effect. Thus, while an easing in the tax situation regarding capital gains may be welcomed, a compensatory tax change is needed to prevent the reform inhibiting gifts to charity.

Appreciated Property—Corporate Donors

The federal income tax deduction for charitable gifts by corporations is limited to 5 percent of taxable income. Contributions in excess of this level can be carried over for up to 5 years. Unlike the law covering individual donors, there is no distinction in the tax treatment of contributions to private foundations rather than public organizations.

In addition to its effect on individual gifts of property, the 1969 act had significant implications for corporate donations, and has been a major factor in the stagnation of real support for charity by business. Before 1969, business corporations making contributions of property they had created (known as inventory donations), or which would realize a short-term gain if sold, were allowed a tax deduction equal to the fair market value of the asset. As a result of the act, however, a corporation making such a gift could only take a deduction on the basis of original cost. This was clearly a major disincentive to give—especially in a period of inflation—and so there was strong pressure to alter this aspect of the 1969 act. The 1976 Tax Reform Act amended the law so that an inventory gift could be deducted at cost plus one-half of the unrealized gain up to twice the original cost. In the case of property giving rise to a long-term capital gain which is not related to a charity's tax-exempt activities, the deduction which can be taken amounts to the fair market price less 62.5 percent of the net appreciation.

Although the law does not distinquish between private and public foundations or charities when dealing with corporate gifts of property, the net effect of the legislation is to discourage contributions made through company foundations and hence to the charitable sectors traditionally favored by business.

Bequests

The influence of recent tax law and of inflation on charitable bequests is less easy to determine. Decisions in this case are not only affected by existing economic and tax considerations, but also by the donor's view of the likely situation at the time of his death. And, of course, alterations in wills are not reflected in the pattern of giving for some time.

The attractiveness of alternative forms of bequest will be influenced by the relative cost (in tax terms) of giving to descendents rather than to charity. Gifts to descendents would be subject to estate tax. Charitable bequests, on the other hand, may be deducted from the taxable estate without limit. Since the estate tax is progressive, the larger the estate the greater is the tax advantage in bequeathing to charity: and as one might expect, charitable donations as a percentage of total bequests tend to rise with the size of the estate.[15] Periods of inflation will also have the effect of encouraging charitable bequests, since a paper gain in the value of an asset may incur tax if given to a descendent.

As can be seen from tables 1 and 3, there has been a decline in the level of bequests since 1970, in real terms, and in relation to total giving. Given the many factors influencing the decision to bequeath to charity, and the effect of the lag between the decision to give and the distribution of the state, it is difficult to discern precisely how much the law has reduced contributions to charity and to what degree donors have used other forms of donation, such as gifts from income or deferred gifts.

Foundation Payout Requirements

If foundations had only needed to contend with recent revisions in the tax code regarding contributions, their long-term prospects would have been bleak enough, since any measure which acts as a disincentive to potential donors poses a serious threat. But the 1969 act went on to jeopardize the existence of foundations from a quite different direction by forcing them to make distributions at a prescribed rate. Thus, not only do foundations now find their income in doubt, but in many cases they must also distribute their assets at such a rate that they are forced to slow down their growth or even reduce their total assets.

The payout requirement contained in the 1969 Tax Reform Act re-

[15]For empirical support for this conclusion, see Martin Feldstein, "Charitable Bequests, Estate Taxation and Intergenerational Wealth Transfers," in Filer Commission, *Research Papers*, vol. III, p. 1488.

sulted from criticisms leveled against the investment and distribution policies of private foundations. It was argued that the foundations were far too conservative in their approach, favoring preservation of capital to strong asset growth, and that they were slow to alter their portfolios of stocks. An article in the November 1968 *Institutional Investor* gives an idea of the feelings of many at the time:

> Is there a place as yet untouched by the revolution in money management? Where the winds of performance are not felt, where the opportuning cries of ambitious brokers are not heard, a last redoubt so quiet the clocks can be heard ticking?
>
> There is such a place, and it is called foundationland. There, tax-exempt, is twenty billion dollars, one of the biggest pools of capital in capitalism, and it is still run the way money used to be. The way it used to be, that is for Widows and Orphans, before currency began to depreciate. In foundationland the verities are Preservation of Capital and Yield, verities the current generation shies from. In foundationland the managers do not often buy their stocks, because they already have them—they were given them many years ago, and now they sit, quietly watching.

During the legislative progress of the 1969 Tax Reform Act, specific criticisms were made. It was claimed, in the first place, that the rates of return on foundation assets were extremely low when compared with those of mutual funds: the Peterson Commission, for example, reported to the Senate Finance Committee that the median rates of return for groups of foundation assets were "substantially lower."[16] An important reason for this state of affairs, it was suggested, was the tendency for foundations to hold their assets in a single class of stocks within a single company—in many cases, it was said, to allow continuing family control over the company. As a result of these investment policies, the argument went, the rate of disbursement of funds to charitable activities was correspondingly lower than should be expected. The best way to reform investment practices would be to require foundations to maintain a minimum rate of asset distribution each year. This would impel them to seek better investments, with higher yields, which in turn would force them to avoid concentrating their assets within a single company. The result would be a more efficient charitable sector with an increased turnover of funds.

Considered uncritically, this line of argument has a plausible ring to it, and it carried the day during the congressional debate on the 1969 act. But the assumptions behind the reasoning have been challenged,

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[16]Senate Report No. 91-522, 6179.

and as we shall see, the results of the payout that was eventually passed give support to the skeptics. A 1973 study by Norman Ture, for instance, cast grave doubt on the analysis of the Peterson Commission, which had been an influential factor in the discussion regarding the payout requirement.[17] Ture pointed out that the Commission had compared the *median* returns for foundations grouped by asset size with the *mean* rate of return for a group of unidentified mutual funds. By using two different statistical methods, the Commission rendered its findings highly suspect. Ture's own examination, using mean figures for a number of major foundations over several years (Peterson considered only a single year), showed a rate of return which compared far more favorably with mutuals.

Ture also noted that the Peterson Commission did not provide data to show what proportion of foundations held asset portfolios concentrated within a single corporation, nor did the Commission produce evidence to show that there was a significant correlation between asset concentration and poor rates of return. Similarly, the relationship between improved investment practices and a minimum payout rule was left obscure: the claim that increasing the payout rate by law would produce a dramatic change in foundation investments was by no means obvious. The reasoning assumed both that existing investments were not in the interests of charity, and that foundation managers were, simultaneously, so myopic and overcautious that they accepted low returns, yet that they had the will and ability to take very adventurous investment decisions. In fact the whole argument that a high payout rate would produce better yields on foundation assets was rather like suggesting that a legal requirement forcing corporations to maintain a minimum payout to shareholders would improve efficiency and reduce costs in the business world.

The 1969 act required private non-operating foundations to make minimum annual contributions to charitable operations equal to the foundation's actual investment income or, if greater, a specified percentage of the market value of its assets in the previous year. The applicable percentage, to be calculated each year by the Secretary of the Treasury, was to bear the same relation to 6 percent as money rates and investment yields bore to their respective levels in 1969.[18] To prevent

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[17]Norman B. Ture, *The Impact of the Minimum Distribution Rule on Foundations*, Report Prepared for the Ad Hoc Committee on Section 4942, Public Hearings on General Tax Reform, House Committee on Ways and Means, April 9th. and 10th., 1973, Part 14, commencing page 5888.

[18]The Treasury Department has tended to use the yield on five-year Treasury securities as a measure of money rates; but this formula has not always been used rigidly. In 1975, for instance, nominal yields arose. This would have suggested an increase in the payout

the payout provision from unduly disrupting existing foundations, a transition period was included in the legislation: no payout requirements were to be applied until 1972, and until 1975 these foundations faced a lower payout rate than new foundations created after 1969.

Table 5 shows the payout rates applying to both new and existing foundations between 1970 and the present time. For taxable years since 1969, each private foundation affected by the act has been required to distribute its entire investment income by the end of the following year in order to avoid tax on any undistributed income. If the minimum payout rate exceeds the foundation's income, then total distributions must reach that figure—even if there is no net investment income. The payout is calculated by assessing the fair market value of the foundation's assets and then multiplying this by the applicable annual distribution rate set by the Secretary of the Treasury (prior to 1977, when the rate was fixed at 5 percent for all years). For the purposes of calculating investment income, net long-term capital gains are not included, but net short-term gains are.

The payout provision has posed very serious problems for private foundations. In the first place, the method of computing income has a tendency to overstate a foundation's investment income. Actual income in based on an accounting concept of realization which ignores non-realized capital gains and losses, and so will be greater than economic income when the market value of the foundation's assets declines. In this case, the rule may force the organization to distribute more than the

Table 5
Minimum Payout Rates for Private Foundations, 1970–1979

	Foundations Created	
Year	**Before May 26, 1969**	**After May 27, 1969**
1970	Not applicable	6.0%
1971	Not applicable	6.0%
1972	4.125%	5.5%
1973	4.375%	5.25%
1974	5.5%	6.0%
1975	6.0%	6.0%
1976	6.75%	6.75%
1977-present*	5.0%	5.0%

Source: Filer Commission, *Research Papers*, vol. III, pp. 1664-1665.
Note: Foundations must distribute this percentage of net worth or actual income, whichever is higher.
*The Tax Reform Act of 1976 made the payout rate a permanent 5 percent.

requirement, but the volatility of asset values that year led the Treasury to avoid a large change in the payout rate.

payout rate, which is based only on asset value, and more than its economic income.

Because the rate is calculated on the market, rather than the book, value of the foundation's assets, it has the effect of requiring these organizations to pay out *unrealized* capital gains. This has put pressure on foundations to hold more liquid assets, and to pay closer attention to cash flow than to capital appreciation. This, in turn, has introduced distortions into the market for capital.

A more common situation, however, involves cases where a foundation's income is lower than the payout rate. The reason why this is so common is that the holdings of some private foundations tend to consist of limited market stocks, and stocks with a lower, but safer, return than those used by the Treasury as the benchmark for comparison. This is hardly surprising since their purpose is, after all, to make charitable donations and to protect their assets, not to engage in high-risk financial dealings. It might be possible for very large foundations to spread their holdings to allow the inclusion of some high-risk, high-yield stocks, but it would not be prudent for small foundations to do so, given the hazards involved.

The effect of the payout rule has been to pressure foundations into either adopting a more risky investment strategy, or reducing their rate of growth. In some cases, it has even forced foundations to reduce their size, and hence capacity for future charitable contributions. The law discourages investment in low dividend, high growth corporations, and encourages foundations to pay out larger amounts in the short-term, at the expense of long-term support for charity. The greater the payout requirement exceeds actual income, the more slowly the foundation grows (assuming it has sufficient contributions to cover the gap, and so avoid shrinking in asset size).[19]

The long-term danger to philanthropy implicit in the concept of a minimum payout has been aggravated by many of the other provisions of the 1969 act and later measures discussed above, which have had the effect of discouraging donations to private foundations. Hence, at the same time that the payout rule has forced foundations to distribute an unduly high proportion of the value of their assets, their ability to maintain a healthy pattern of growth by increasing their non-investment income has been severely inhibited.

[19]When the payout rate nears the foundation's total income, including contributions, the effect on growth is very severe. Thus, it is quite common for the payout requirement to produce only a modest increase in immediate gifts by the foundation, but bring about a major reduction in future giving.

It is clear from available empirical evidence that the 1969 act contributed to a dramatic increase in the "death rate" of private foundations (as have state regulations and other factors to be discussed later). The Council on Foundations, for example, examined the rate at which private foundations would up their activities, during the sample month of May, for the years preceding and following the 1969 legislation. As table 6 shows, there was a startling increase in the rate. Similar evidence was presented to the Filer Commission from several other sources. The New York State Attorney General's Office, for instance, reported that while 28 private foundations had dissolved in 1969, the figure for 1971 had risen to 91.[20] A survey of 12 states carried out by the Foundation Center showed that the New York figures were by no means atypical: in the states examined, the aggregate dissolution rate climbed from just under 100 per year in 1968 to about 750 per year in 1971.[21]

The proponents of the payout requirement, did, of course, foresee an increase in the death rate of foundations, and felt that it would be part of a healthy process which would have the effect of "weeding out" so-called inefficient foundations and replacing them with new organizations. It is difficult, however, to determine exactly what constitutes "efficiency" in the foundation sector; the criteria can hardly be the same as those which would be applied to profit-making businesses. But even if one were to accept this argument, and even if the post-1969 death rate was considered reasonable, the statistics on the "birth rate" of foundations shows the theory to be unsound. The replacement rate of foundations not only plummeted after the act, but it also fell to a level well below the death rate among foundations, resulting in a disturbing decline in the number of foundations.

Evidence to the Filer Commission shows this clearly. The Council on Foundations, for example, compared the number of new private foundations created in January–February 1969 with that of formations in

Table 6

Private Foundations Terminating Their Activities During Sample Months, 1968–1973

May 1968	11	May 1971	31
May 1969	23	May 1972	55
May 1970	29	May 1973	74

Source: (Internal Revenue Bulletins) Filer Commission, *Research Papers*, vol. III, p. 1623.

[20]Filer Commission, *Research Papers*, vol. III, p. 1623.
[21]*Ibid.*, vol. III, p. 1638.

January-February 1973. The Council found that the rate had fallen from 433 to just 181: even then some of the foundations listed in 1973 would have been set up under wills drawn up before the act.[22] Evidence from the Foundation Center showed the trend even more clearly. In the Center's study of 12 states, 1250 foundations were formed in 1968. Yet by 1970 the rate of formation had fallen below 200.[23]

The threat to the existence of private foundations arising from the payout provisions of the 1969 act was not confined to the level of payout required. As table 5 indicates, there has been a wide fluctuation in the distribution levels prescribed by the act. This has led to two major problems for foundations. Firstly, it has resulted in suboptimal planning. Since many projects need considerable time to develop, an accurate picture of future needs and funds available is essential if foundation support is to match the requirements of the recipients. But if a foundation is forced to distribute more funds in a particular year than it had planned, it must allocate them to what it feels to be less worthwhile causes. On the other hand, in a year with a relatively low payout requirement, the foundation may feel it necessary to reduce support to the legal minimum, to compensate for high distributions in previous years. In this case, worthy projects which the foundation intended to support will be denied funds.

A second effect of a variable payout based on the previous year's asset value is that the required distribution is both mechanical and volatile. Stock and bond prices depend to a great degree on general confidence in the political and economic climate, and are more often an appropriate reaction by the private sector to inadequate government policies than a measure of the health of the business world. Thus foundations may be forced to disburse their funds at a rate which is far in excess of a sensible level, due to the combination of a mechanical rule and a valuation of their stock based primarily on public confidence in the government.

The deficiencies of the changing payout rate became obvious even to supporters of the measure very soon after the implementation of the act. By November 1974, the Subcommittee on Foundations of the Senate Finance Committee had concluded that the basic 6 percent rule was unrealistic when compared with existing market conditions.[24] Similarly, in December 1975, the Filer Commission was arguing that the basic payout requirement was too high and recommended a flat payout of 5

[22] *Ibid.*, vol. III, p. 1624.
[23] *Ibid.*, vol. III, p. 1638.
[24] *Ibid.*, vol. III, p. 1665.

percent. The concept of a flat payout of 5 percent was also supported by the Treasury, on the grounds that it was simpler, a predictable element in foundation budgeting, and more in line with the long-term rate of return on foundation assets. As a result of this change of attitude, the 1976 Tax Reform Act included a provision to this effect, laying down a permanent rate of 5 percent. But although a flat rate may avoid some problems, by making the rate at least predictable, the basic flaws remain because the payout is still based on a fluctuating assessment of asset value. So the required disbursement of funds is still mechanical and largely unpredictable, and bears no relation to the needs of charity.

The continuing saga of the payout rule must serve as a classic example of how well-meaning government intervention can bring about exactly the opposite effect of that intended. The rule was designed to improve the efficiency of private foundations and to encourage them to increase both their earnings on assets and their disbursements to charitable projects. In practice, however, it has resulted in the decline in real giving by private foundations and discouraged the creation of new organizations. It has, in short, managed in a few years to threaten the very existence of a key sector of philanthropy in America.

The Tax on Investment Earnings

The 1969 Tax Reform Act imposed a 4 percent tax on the net investment income of private foundations. The tax was not, in the main, intended to regulate investment decisions, but rather was to be an excise tax to finance IRS monitoring of foundations. Gross investment income includes interest, dividends, rents and royalties, and net capital gains from the sale of property held from the production of such income or held to produce unrelated business income. The net investment income of a foundation would be this figure less deductions stemming from the production or collection of the income.

Many see this tax as objectionable in principle, and a dangerous precedent which could lead to the complete erosion of the principle of tax exemption for charities. In addition, of course, it reduces the amount of money available for charitable purposes by diverting funds to pay the salaries of tax officials.

In keeping with the grossly inaccurate forecasting on which the 1969 act was based, the revenue arising from the 4 percent tax greatly exceeded IRS costs. As table 7 shows, by 1973 the tax was yielding over six times the cost of monitoring the foundations and more than four times the cost of overseeing *all* tax-exempt organizations.

Table 7
Revenue from the 4 Percent Tax and IRS Monitoring Costs (1968–1974)

Government Fiscal Year Ending	Revenue From 4% Tax in millions	IRS Costs— (Foundations) in millions	IRS Costs— (All Exempt Organizations) in millions
1968	—	$ 1.6	$ 7.1
1969	—	2.1	7.5
1970	—	3.5	11.0
1971	$ 24.6*	8.6	15.4
1972	56.0	12.9	19.3
1973	76.6	12.3	18.6
1974	69.8	13.3	23.0
Total	$227.0	$45.3	$101.9

Source: Filer Commission, *Research Papers*, vol. III, p. 1566.
Note: *Due to the relationship between tax filing dates and the fiscal year end, this figure represents approximately 6 months' yield of tax.

Prior to the passage of the 1969 act, most foundation spokesmen took the view that a tax was far less desirable as a means of covering IRS costs than a filing fee, based on asset size. This idea was rejected by Congress, with the result that by 1974 the foundations have been forced to pay to the Treasury $181.7 million more than the cost of scrutinizing their accounts. This money was, of course, thereby denied to the charitable operations funded by the foundations.

Despite the clear inequity of the 4 percent tax, it was not until the Revenue Act of 1978 that it was altered. The 1978 measure reduced the levy to 2 percent, applicable to tax years after September 1977. Although this is a small step in the right direction, the effects of the change are mixed. It does reduce the proportion of foundation income which flows to the Treasury by an estimated $40 million per year.[25] On the other hand the act, by avoiding the option of a filing fee, continued the disturbing exception to the general principle of tax exemption for charitable organizations.

The Standard Deduction

One of the ironies surrounding the campaign for tax reduction and simplification is that certain charities have been adversely affected. Moves which have sought to reduce revenue to government have also had the result of making charitable donations less attractive. This has

[25]Senate Finance Committee Report on HR 13511, Report No. 95-1263, 95th Congress, 2nd Session, pp. 217-219.

also been the case with regard to tax simplification—in particular the wider use of the standard deduction. The 1976 Tax Reform Act alone shifted about 5 percent of the taxpaying public into the ranks of the non-itemizers. At present about 70 percent of taxpayers opt for the standard deduction, and their charitable contributions do not reduce their tax liability. This compares with about 50 percent using the standard deduction in 1970.

Since they do not itemize, these donors must pay the full cost of any contribution. The impact of this trend on charity has been considerable. Various estimates put the loss at about $5 billion between 1970 and 1977, with a current annual loss of around $1½ billion.[26] Since non-itemizers tend to be those with middle or low incomes, the effect of this loss is concentrated among charities drawing their income from these groups, such as the United Way and other welfare organizations.

The effects of tax reduction and simplification on charitable giving do, of course, pose a dilemma for those wishing both to advance private philanthropy while cutting taxation. The higher the marginal tax rate on income, the less "expensive" is a tax-deductible gift to charity relative to other uses of income. So any change which reduces marginal tax rates raises the cost of philanthropy to the donor, compared with non-deductible expenditures. Hence, while a reduction in tax rates does have an immediate income effect, in that the donor has a greater disposable income from which gifts can be made, the increase in "price" of the gifts reduces the attractiveness of giving. As studies carried out by Martin Feldstein and others have shown, the price effect exceeds the income effect at all levels of income—even at the lowest incomes.[27] It should be noted, however, that if a tax cut results in a significant stimulus to economic growth and incomes, the long-term income effect may totally offset the price effect and result in an increase in charitable donations. Thus a reduction in tax rates may well be in the long-term interests of philanthropy.

Restrictions on Lobbying

An aspect of law which is of increasing importance to charitable organizations is that covering so-called lobbying activities. These provi-

[26]For estimates see House remarks by Rep. Barber Conable, Jr., 31 January 1979: also *Fund Raising Management*, July/August 1978.

[27]See, for example, Martin Feldstein and Charles Clotfelter, "Tax Incentives in the United States"; Martin Feldstein and Amy Taylor, "The Income Tax and Charitable Contributions"; Michael Boskin and Martin Feldstein, "Effects of the Charitable Deduction on Contributions by Low-Income and Middle-Income Households"; all in Filer Commission, *Research Papers*, vol. III.

sions tend to be vague, and so make it very difficult for organizations to be sure whether or not certain of their practices are legal.

The IRS code specifies under section 501 (c) (3) that to remain tax-exempt, an organization must ensure that it is a body:

> no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Precisely what constitutes a "substantial part" of an organization's activities is not clear, and numerous legal cases have failed to clarify the position. In order to avoid doubt, some section 501 (c) (3) bodies now elect to substitute specific percentages of exempt expenditures toward lobbying activities (effective since 1977).[28] This option is only open to certain categories of institutions, however, and the very indefinite "no substantial part" rule applies to all others, including private foundations and private operating foundations.

The lack of exact definitions of "lobbying" and "influencing legislation" presents further problems It has been established that these terms would not include non-partisan analysis, study, research, technical advice or assistance provided for a governmental body at its request. When it comes to communication with a legislative body or representative regarding legislation the matter is far less clear.

Fundraising Limitations

The future of many public and private foundations has been jeopardized to an alarming degree by recent changes in the law dealing with fundraising. These laws have been enacted both by Congress and the states. Federal legislation passed in 1969 specifies the proportion of total funds raised by foundations which must come from individual donors. There is also a plethora of state laws, varying from state to state, regulating mail fundraising within each state's borders.

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[28]The permissible annual expenditure for lobbying for eligible organizations making the election is the *lesser* of $1,000,000 or the following percentages of exempt purpose expenditures:

20 percent of the first $500,000
15 percent of the next $500,000
10 percent of the next $500,000
5 percent of the balance

Further limits are applied to "grass roots" lobbying: such expenditures may not exceed 25 percent of permitted lobbying expenditures.

Federal Laws

Under section 170 of the IRS code, an organization may only retain its status as a public foundation if it obeys certain requirements regarding the composition of its contributions. If it fails to do so it will lose its "public" designation and its donors will be more limited in their ability to contribute property, etc. Furthermore, if an organization ceases to be a public organization, any private foundation making a grant to it is required to exercise "expenditure responsibility" under section 4945 (d) (4) of the IRS code. This means that the granting foundation must use all reasonable means to ensure that the grant is used for the purposes for which is made, and must obtain from the grantee full reports on the use of the money. These reports must be filed with the IRS. If the granting foundation fails to comply adequately with this provision, the grant would be considered as a prohibited expenditure, forbidden by law. Needless to say, private foundations are reticent about making grants which would involve them in complicated monitoring of any organization's activities.

Under section 170, at least 10 percent of a public foundation's donated income must come from five or more unrelated individuals. In addition, the foundation must receive not more than one-third of its total income each year from interest, dividends, rents and royalties, and must obtain at least one-third of its support from grants, contributions, membership fees and other gifts. New organizations are given up to four years to comply with these requirements.

Section 170 has had two important effects on foundations. Firstly, it forces those seeking public status to carry out fundraising campaigns to ensure wide support. This does not, of itself, present serious difficulties for the average foundation, since the regulations and compliance period are both reasonable. But it does induce foundations to mount mail fundraising drives in several states, and this has resulted in the need to comply with an array of state regulations.

A second difficulty involves the attitude of private foundations towards new foundations seeking public status (i.e., those operating within the grace period). When it receives a grant request from such a new foundation, the private foundation knows that it is always possible that public status may ultimately be denied, and the new foundation may have to terminate its programs. Given this risk, there has been a marked tendency recently for private foundations to be more conservative in their support, favoring established public organizations at the expense of new ones.

A survey conducted by the Council on Foundations during 1974 indi-

cates the degree to which section 170 has influenced the distribution of grants by private foundations. The survey showed that whereas 39 percent of respondents made grants to publicly supported organizations before 1970, only 16 percent were doing so in 1974. As the survey concluded:

> Half of the foundations that were making such grants before 1969 have drawn back from them. In other words, the new requirements appear to have been a real deterrent to some foundations that were formerly prepared to bet on new and often inexperienced grantees. Furthermore, there can be little doubt that foundations that previously had only given to traditional and safe agencies have been confirmed in the tendency by the expenditure responsibility requirements of the 1969 act; thus, the majority of the respondents continue to avoid such grants as a matter of course.[29]

State Laws

Thirty-seven states now have laws regulating charitable solicitations. The nature of these laws differs from state to state, as do the deadlines for compliance. Any foundation seeking funds must abide by the regulations in each state where it intends to raise funds; failure to do so can result in the withdrawal of its right to solicit funds in that state.

State laws fall into two broad categories—disclosure requirements and regulations concerning the activities of fundraisers. Normally, the charity is required to register, pay a fee, and file financial reports with the state attorney general each year. If it does not do so, the charity's license can be withdrawn, which prevents it from raising money in the state. 14 states use the same form for the annual financial disclosure, based on the New York state form, and so charities operating within these states can use the same method to complete each financial statement. The other states, however, have different forms and require different information. This is, of course, in addition to the disclosure necessary to comply with IRS regulations.[30]

Not only does the charity need to register in certain states in which it raises funds, but also it is necessary for professional fundraisers to register and obtain a license in these states. Unlike the financial disclosure form, there are no standard regulations applicable to a large number of states, although there are often similarities. The New York regulations, however, give an indication of the type of laws operating in most states.

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[29] Filer Commission, *Research Papers*, vol. III, pp. 1571-1572.

[30] It is intended to introduce a new IRS form for financial disclosure modeled on the New York form.

In New York, a fundraiser must register with the Secretary of State each year before he commences any activities. Contracts for professional services between the consultant fundraiser and each charity he assists must be lodged with the Board within 10 days and the receipts and expenditures involved in the contract must be properly documented. In addition, an annual fee of $100 and a bond of $5,000 is required.

The complexity and cost of compliance in each state is a major burden for many charities, particularly new or smaller organizations. If the charity uses its own staff to seek support, the registration costs alone could run into several thousand dollars, on top of which would be accounting fees for completion of the disclosure forms. All these costs must be incurred before a single piece of mail has been sent out or a single donation received.

Organizations have generally responded in one of two ways to this profusion of state laws. Often through ignorance, many simply do not comply—and this has led to charities being prosecuted. It is usual for one state to inform the others when a charity has broken its rules, and so, though a misunderstanding of the law, a charitable organization may suddenly find itself faced with dozens of expensive lawsuits and the termination of its right to raise funds throughout most of the United States. As an alternative means of dealing with the problem, many organizations have sought the use, often at high cost, of large mail fundraising companies who are already registered in each state and fully understand the complexities of each state's laws. This trend does raise some questions. If the purpose of insisting on a minimum proportion of small contributions is to prevent charities being controlled by small groups of people, but in order to meet this requirement *and* the state laws the charities are forced to rely on large fundraising companies, is not the effect of the law merely to replace the control of one small group by another? In addition, the cost implications of requiring foundations to seek support by mail from small donors must be considered, and balanced against the value of encouraging broader participation in philanthropy. The cost of fundraising by direct mail can be significantly higher than that of obtaining support from other sources, and thus, it is possible that a smaller proportion of each dollar contributed will be used for charitable purposes.

Disclosure Requirements

Nearly every tax-exempt organization described under section 501 (c) of the IRS code must file an annual return stating its income, receipts and disbursements. In addition to this, private foundations with assets

over $5,000 must also file an annual report with the IRS. The report must give very detailed information regarding the foundation's financial holdings and activities, together with a list of all the organization's managers who are also substantial contributors to its funds, or who own 10 percent or more of the stock of any corporation in which the foundation has more than a 10 percent interest. A copy of this annual report must be made available to any citizen for inspection at the foundation's principal office for at least 180 days.

While the disclosure of such information to the IRS, and its availability to the public, may be a reasonable requirement for a tax-exempt organization, recent proposals by the IRS indicate an interpretation of the law that is so loose as to raise serious questions. Section 6056 (d) (3) of the code specifies that the annual reports of private foundations must be furnished to "such State officials and other persons. . .as the Secretary or his delegate may by regulations prescribe." These regulations have the force of law, and have been used by every federal agency to extend and interpret Acts of Congress to imply restrictions beyond those intended by the legislature. In this case the IRS has indicated recently that it proposes to interpret "other persons" as including non-governmental organizations.

The proposed regulation would require all private foundations with assets of over $1 million, or who make grants of more than $100,000, to send copies of their reports to the Foundation Center, a non-profit, non-governmental body which provides information on foundations to fundraisers and the general public. Although many private foundations voluntarily furnish the Center with their reports, even among these organizations there is great concern over the proposal. In the first place, the proposal has the effect of requiring a private body to transmit its annual report to another non-governmental body which has no relationship with it. And secondly, it establishes a precedent whereby private foundations may in the future be required to send reports to any number of pressure groups, or self-appointed "consumerist" organizations, who seek to obtain control over private philanthropy under the guise of making it more "responsible."

The use of agency regulations to interpret and broaden legislation is by no means confined to cases involving philanthropy. But the use of the IRS code in this way is a disturbing example of back-door government regulation of private foundations.

3

The Implications of the Law for the Charitable Sector

The laws discussed above have brought about very profound changes within the charitable sector in America. Since most of the legislation dates only from 1969, and there have been many recent amendments, it is still too early to identify all the implications. But those that can be seen give rise to grave concern.

The Distribution of Donations

Individual Contributors

Legislation since 1969 has strongly inhibited contributions from more affluent donors, who give a much higher proportion of their gifts in the form of appreciated property and generally support longer-term capital projects—especially in the health and education sectors. This means that the law is likely to have a delayed but serious effect on the quality of educational and health facilities in America. Thus, measures which are aimed at removing tax "benefits" for the affluent by discouraging certain forms of charity will ultimately have their most damaging effect on the young and the sick.

Table 8 shows the distribution of contributions between different types of charity, according to donor income level. It will be seen that the higher the income, the stronger is the tendency to support education, health and cultural projects. Most charitable support by lower income donors, on the other hand, goes to religious organizations. The figures in the table are taken from a 1973 study presented to the Filer Commission, but similar trends are apparent in other surveys such as the thorough analysis by Martin Feldstein, using 1962 IRS returns.[31]

When one examines the receipts of various types of charity, the im-

[31]Martin Feldstein, "The Income Tax and Charitable Contributions," *National Tax Journal*, March 1975 (part I) and June 1975 (part II).

Table 8
Shares of Aggregate Dollars Given to Different Donee Types, by Income Level of Donor (1973)

	Annual Income of Donor				
Type of Donee	**Less than $10,000**	**$10,000—$19,999**	**$20,000—$49,999**	**$50,000 or more**	**All Incomes**
Religion	59%	67%	52%	13%	46%
Education	1	1	6	17	7
Combined Appeals	2	3	6	10	6
Health	3	3	4	10	5
Cultural	0	0	1	4	2
Others*	35	26	31	46	34
Total	100	100	100	100	100

Source: James Morgan, Richard Dye, Judith Hybels, "Results from Two National Surveys of Philanthropic Activity," Filer Commission, *Research Papers*, vol. III, p. 231.
Note: *Includes all gifts after the 4 largest.

pact of donations by high income contributors becomes very clear. In the Feldstein study, for instance, taxpayers earning over $100,000 (in 1962) contributed 33.1 percent of total deductible gifts to education, and 27.6 percent of those to hospitals.[32] In a survey of giving to higher education, carried out by the American Council on Education, a similar picture emerged. Of gifts made by individuals in 1973-1974, over 70 percent of total support came in gifts of over $5,000.[33]

Corporations

Legislation in 1969 and more recently has also produced important changes in the pattern of giving by corporations and their subsidiary foundations. The alterations in the tax deductibility of gifts of appreciated property and inventory have been a particular burden—as has the tax on investment income and the mounting costs of complying with IRS regulations.

Corporations are more sensitive than individuals to the cost of giving, given alternative tax advantages. A 1973 study by the Conference Board, for example, indicated that 29 percent of executives felt that the (then) 4 percent tax on foundation investment income was a major issue in considering donations, 21 percent considered the restrictions on gifts in kind to be a serious inhibition to giving, and 20 percent mentioned the tax situation regarding appreciated property as a problem. The survey found that over half of the corporations responding would increase

[32] *Ibid.*, part II, p. 214.
[33] American Council on Education, *Patterns of Giving to Higher Education III (1973-1974)*.

their charitable contributions if the tax incentives were to be improved.[34] In addition, corporate donations to their own foundations fell after 1969, and this has reduced the flexibility of the businesses still giving to charity.[35]

The 1969 act, in particular, had an immediate and dramatic effect on corporate giving. After a steady and substantial rise in donations during the 1960s, from under $500 million in 1960 to more than $1 billion in 1968–1969, corporate contributions tumbled in 1969–1970 to less than $800 million.[36] Although there has been some recovery during the 1970s, the rising trend of the 1960s has been stifled.

Any change in the policies of corporations regarding charitable donations is of particular importance to certain fields of charity. As table 9 shows, corporations give most of their support to education (especially higher education) and to welfare organizations. These gifts are of great importance to the recipients—higher education, for example, receives about 15 percent of all its contributions from business. Thus, the construction of the corporate sector results in a significant denial of funds to vital areas of philanthropy.

Foundations

Like corporations, foundations are major supporters of education: over 20 percent of all contributions to higher education come from foundations, and almost 30 percent of support for major private univer-

Table 9
The Percentage of Total Corporate Gifts to Each Major Field (1977)

Area	Percentage of Total
Health	5.7%
Welfare	32.6
Education	35.7
Culture and Arts	9.0
Civic Activities	11.5
Other	5.5
	100.0

Source: Conference Board, "Annual Survey of Corporate Contributions," *Giving USA 1979*, p. 16.

[34]Filer Commission, *Research Papers*, vol. III, pp. 1770, 1773.
[35]*Ibid.*, vol. III, pp. 1859, 1862.
[36]Figures from the Department of Commerce, Internal Revenue Service and the Conference Board. The fall between 1969 and 1970 also represented a decline in the percentage of net income given to charity from 1.26 percent to 1.11 percent, so it cannot be explained merely by the drop in business profitability during the period.

sities.[37] Table 10 shows the broad pattern of assistance from the foundation sector.

The many legislative changes that have affected the flow of money to and from foundations thus have serious implications for major areas of charity. In the case of higher education, for instance, foundation support has slipped during the last six years from 23.4 percent of total giving to only 20.5 percent.[38]

Decline of the Private Foundation

If there is one constant threat that runs throughout virtually all the legislation passed since 1969, it is that private foundations appear to have been selected as the principal targets of the mass of controls, regulations and tax changes emanating from Congress. They have been saddled with payout rates, taxes on investment income, and distribution requirements, and their contributors are presented with changes in the tax code which make it less and less attractive to donate to them. It is hardly surprising under these circumstance that foundation birthrates have collapsed and deathrates have soared. Whether or not private foundations can continue to survive as a significant segment of private philanthropy is in grave doubt.

The implications of a substantial decline in the level of philanthropy directed through private foundations could be serious and far-reaching, particularly in areas such as education, health and the arts. Foun-

Table 10
The Percentage of Foundation Grants to Each Major Field
(Cumulative, 1961–1973)

Area	Percentage of Total
Education	32%
Health	15
International Activities	14
Welfare	13
Science	13
Humanities (including the Arts)	9
Religion	4
	100

Source: (The Foundation Center), Filer Commission *Research Papers*, vol. III, p. 1562.

[37]American Council on Education, *Patterns of Giving*, p. 4.
[38]American Association of Fund-Raising Counsel, *Giving USA (1979)* (New York, 1979), p. 27.

dations act as clearing houses for charitable funds. If they are prevented from carrying out this important work, pressure will grow for a larger role for government bodies using tax money. This process has already begun in the arts and non-commercial television, with bodies such as the National Endowment for the Arts, and the Corporation for Public Broadcasting allotting public money at their own discretion. The Heritage poll shows clearly that the public does not approve of government intervention in such areas. Two thirds of the population have observed this trend taking place, and 70 percent are opposed to it (see appendix).

We have the situation in America where the foundation sector is being constricted by government controls and tax changes, and where the vacuum so created is being occupied by government itself. Combined with the inhibiting effects of legislation on other branches of the voluntary sector, the end result is the gradual, backdoor nationalization of philanthropy. As is so often the case when government acts in this way, some charities have welcomed the entry of government into areas previously funded by the voluntary sector. This is short-sighted, because government involvement brings with it the bureaucratic and monolithic approach, rather than the pluralistic, innovative attitude of private support. It is important that charities realize this before welcoming so much government support that they become dependent on it.

4

Restoring the Health of Private Philanthropy

As this study has attempted to show, private philanthropy in America is now subject to laws which may lead to a permanent decline in its importance and a reduction in the level of assistance it provides for many worthy causes. If this trend is to be reversed, it will be necessary to make major changes in the law dealing with the charitable sector. The following reforms are suggested as a basis for restructuring the law.

Appreciated Property

In order to restore the incentive for taxpayers to donate appreciated property to charities—in particular to private foundations—the full tax write-offs at market value should be reinstated. This is essential during a period of rapid inflation, when the paper gain element in the appreciation is unusually large. An alternative might be to index the assessment of the gain, i.e., to adjust it for inflation. This would improve the position, although it would still leave private foundations at a disadvantage compared with other institutions. Indexing, however, is probably not politically possible at the present time, since there would be enormous Treasury opposition to any correction for inflation in one aspect of taxation for fear that it would inevitably spread to others—and so deny the government the windfall tax gain it enjoys from inflation. So a full value tax write-off of charitable contributions of appreciated property would almost certainly involve a smaller loss to the Treasury than the indexing of capital gains for tax purposes.

Payout Requirements

The results of the payout requirement have been entirely negative and it should be abolished. There is now more than sufficient federal scrutiny of foundations to ensure that they are operated in the interests

of charity and not their contributors. All the payout law does, therefore, is distort the pattern of giving and cause foundations to reduce their potential for growth, and hence future support for charitable operations.

It is difficult to see how anything short of the total removal of the requirement would remove its defects. Calculating the rate on the basis of a moving average (over several years) of the market value of a foundation's assets might reduce the tendency for it to be countercyclical in terms of need, but it would still force foundations to reduce their rate of growth.

Taxes on Investments

The tax on investment earnings is a significant departure from the principle of tax exemption for charities. If the purpose of the tax is truly to finance IRS examination, a filing fee (possibly based on asset size) which bears a direct relation with actual IRS costs would be more appropriate. The Treasury has already managed to deny many millions of dollars to charity by miscalculating the yield of the tax. The investment earnings tax should therefore be abolished.

Contributions

The tax on investment earnings, and the tax discrimination against gifts of appreciated property to private foundations, is typical of the way in which private foundations receive second-class treatment under the law. Legislation has just been introduced to deal with another aspect of this, namely the difference in permitted contribution levels. Under existing law, individuals may contribute no more than 20 percent of their gross annual income to a private, nonoperating foundation. On the other hand, a 50 percent limitation applies for tax purposes when a gift is made to a public charity. A bill announced recently by Rep. Bill Frenzel (HR 6402) would remove this distinction. It would also allow private foundations to exclude capital gains income when calculating the net investment tax, and it would enable foundations to count investment expenses as part of the minimum distribution requirement.

Standard Deduction

In principle, moves to allow non-itemizers to deduct contributions to charity should be welcomed. But there are certain issues connected

with such a policy which should be given consideration. It could be argued, for instance, that a specific charitable deduction for taxpayers who do not itemize would be unfair to other recipients of deductible expenses and contributions who have also lost funds due to the tendency of people to take the standard deduction. But it could be said in response to this that if groups feel they have been seriously injured by the trend, it is up to them to press for similar amendments to the tax code.

A second problem could be the Treasury. In his criticism of the bill introduced to Congress last year by Reps. Fisher and Conable, which would have provided a special charitable deduction for non-itemizers, Treasury Secretary Blumenthal took pains to stress the "loss" to the government's tax revenue that would result from the deduction. A new version of the bill (HR 1785) has been introduced in the House, together with a Senate version (S 219) sponsored by Daniel Moynihan and Robert Packwood, and these bills have wide support in Congress. The Heritage poll indicates that over 70 percent of the population support the bill; only 10 percent oppose it (see appendix). Once again the Treasury and the Administration oppose the measure, based primarily on their assessment of the probable revenue loss. If the Administration were to accept the proposal in return for a reduction in tax breaks for larger contributors, to compensate for the loss due to a special deduction, it could be very damaging for education and for some other forms of charity. If the present Treasury position does alter in this way, support for the deduction should be more circumspect.

Lobbying

Clear and precise guidelines must be established on this issue as soon as possible. It is reasonable that individuals should not be able to band together as a foundation and then obtain a tax exemption for funds aimed at manipulating the legislative process. On the other hand, the lack of precision in the law is inhibiting the activities of many well-respected institutions. Until the question of definition is resolved, foundations will continue to operate under an IRS sword of Damocles.

Fundraising

States are free to pass laws regulating fundraising, but the complexity of these restrictions has become a serious handicap for many institutions. At the very least, the philanthropic sector should press the states to adopt broadly similar regulations to reduce the confusion. Ideally,

an attempt should be made to encourage the states to simplify their regulations to avoid the obstacle they present to small and new organizations.

A Supreme Court decision in February 1980 has had the effect of reducing the restrictive power of the states, however. The court struck down a city law which required charities raising funds in the area to spend at least 75 percent of the money for charitable purposes. Many states currently have laws very similar to this. Citing the First Amendment, the court ruled that limitations must be narrowly drawn and reasonably related to some specific abuse.

The decision could have important results for many charities. Organizations which are expanding their activities and seeking wider support usually find costs become a high proportion of income until they have established a group of regular contributors. Because of these high costs involved in "prospecting," many charities have found it impossible to comply with state laws. The decision should enable these organizations to raise money more freely.

Regulation

The principal reason for the introduction of much of the recent legislation dealing with tax-exempt foundations was the desire to improve their performance and to weed out questionable institutions. Undoubtedly, federal regulation has removed much of the bad in private philanthropy, but it has done so by destroying a great deal of the good and damaging that which remains. Furthermore, the accounting and legal costs incurred as a result of government regulation can be significant, especially for smaller foundations. Heavy expenses merely reduce the money available for charitable activities.

The growth of federal regulations has also gained its own momentum. As the regulations become more complex, it becomes more difficult for foundations to comply with them. Then groups hostile to private philanthropy can point to those who have not kept to the letter of the agency-made laws and press for even tighter restrictions and more extensive disclosure of information. And so the process continues, aiding the case of those who would replace genuinely private charity with a system controlled by bodies representing group interests.

Conclusion

As this study has explained, legislation passed within the last 10 years has posed major threats to American philanthropy from two

separate directions. Changes in the tax code have made donating more complicated and less attractive in many instances; and new federal and state regulations have served to constrict the charitable activities of foundations.

The new laws are often highly technical in nature, and almost incomprehensible to many foundation officers. But the pattern of the legislation is clear, and if the charitable sector does not respond strongly and quickly, private philanthropy could cease to play a significant role in American society.

Appendix

The following results are from a public opinion poll commissioned by The Heritage Foundation and carried out by Sindlinger & Company, Inc., of Philadelphia. The survey was conducted between February 21 and March 5, 1980, and involved a nationwide sample of 1,358 persons aged 18 years and older. Due to rounding, the percentages do not necessarily add up to 100.

Question 1

Congress is currently considering a proposal to allow a special tax deduction for charitable contributions for those people who take the standard deduction and do not itemize their income tax return.

Do you agree or disagree on this proposal for a special tax deduction for charitable contributions for those who take standard deductions?

	Total sample	Males	Females
Agree	72.3%	71.9%	72.7%
Disagree	10.5	11.1	10.0
Don't Know/Refused	17.2	17.0	17.3

Analysis

Although a substantial percentage of the sample had no opinion or refused to answer, of those expressing a view supporters of the measure outnumbered those opposed to it by nearly seven to one. Nearly three-quarters of the entire sample favored the proposal.

Question 2

Some years ago, most public services—such as welfare and the arts—were financed by private charitable organizations through public contributions. In recent years, the trend has been for the government to take over to finance welfare, education and the arts—rather than by charitable organizations.

Have you observed this trend?

	Total Sample	Males	Females
Yes	67.7%	66.0%	69.2%
No	29.8	31.0	28.8
Don't Know/Refused	2.5	3.0	2.0

Analysis

Two out of three people are aware of the trend towards taxpayer finance of welfare, education and the arts.

Question 3

When the government takes over as the provider of charitable welfare, education and the arts--this is with taxpayers' money. Do you agree or disagree with this trend?

	Total Sample	Males	Females
Agree	19.7%	18.4%	21.0%
Disagree	70.7	72.7	68.8
Don't Know/Refused	9.6	9.0	10.2

Analysis

The trend towards taxpayer financing of activities previously financed by private philanthropy meets with widespread public disapproval. Seven out of ten people were opposed to the trend, and only one in nine favored it.

Question 4

In your opinion, which is the better way to provide these charitable services—by private charitable organizations or by the government?

	Total sample	Male	Female
By Private Charitable Organizations	71.6%	71.6%	71.5%
By the Government	12.9	12.3	13.4
Both	8.8	9.9	7.7
Don't Know/Refused	6.8	6.2	7.3

Analysis

In line with the public's disapproval of taxpayer financing of charitable services, the vast majority of people believe these services can be

better provided by private charitable organizations. More than seven out of ten people thought private bodies provide better services, and only one in eight felt government provision is superior. About one in eleven thought participation by both government and private sectors would be best.

Question 5

In appraising past provisions for charitable services in this country—who do you think has done the better job—private charitable organizations or the government?

	Total Sample	Males	Females
By Private Organizations	68.9%	70.1%	67.7%
By the Government	18.0	17.6	18.5
Don't Know/Refused	13.1	12.3	13.9

Analysis

More than two-thirds of the sample felt that private bodies have historically done a better job in providing charitable services than the government. Fewer than one in five felt that government has provided the better service.

Question 6

Looking into the future, who do you think can do the better job in providing these public services—the government or private charitable organizations?

	Total Sample	Males	Females
The Government	25.4%	24.4%	26.3%
Private Charitable Organizations	64.1	66.0	62.4
Both	6.8	6.5	7.2
Don't Know/Refused	3.6	3.0	4.1

Analysis

Nearly two-thirds of the sample felt that private organizations would be best suited to providing charitable services in the future, while only one in five believed the government would be more effective. Nearly one in fourteen thought participation by both would be preferable. The

results indicate that the public has only a slight tendency to feel that government action would be more efficient in the future than it was in the past.

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Fiscal Issues 2

Philanthropy In America
The Need for Action

The philanthropic sector has been a vital part of American society since the birth of the Republic. Until recently charitable organizations remained free of tax and most regulations, but criticisms were voiced which led to major changes in the law dealing with tax exempt bodies.

In this study, Dr. Butler discusses the substance of the criticisms levelled against the philanthropic sector, and examines the effect of legislation passed to remedy the alleged shortcomings. He concludes that new regulations and tax changes have undermined philanthropy in America, and pose a serious threat to its continued existence as a valuable part of society. If the damage is not undone quickly, Dr. Butler argues, many of the functions now carried out by independent institutions, funded by voluntary donations, will be taken over by state and federal agencies, financed by taxation.

The study reviews the state of philanthropy, and considers the economic consequences of minimum distribution requirements, amendments to the tax code, the second-class treatment given to private foundations, and several other legislative changes. Finally, the study puts forward a program aimed at reversing the trend towards stagnation and decline in the voluntary sector.

Stuart M. Butler is a policy analyst with the Heritage Foundation. A Ph.D. from the University of St. Andrews, Scotland, Butler has taught economics at Hillsdale College, Michigan, and has studied public policy in both Britain and the United States.

$2.00