



ISSUE GUIDE

What's the Issue?

FEDERAL

Simplifying the Excise Tax on Private Foundations

Background:

Each year, private foundations are required to pay an annual tax to the federal government equal to 2 percent of their net investment income. If a foundation's distributions (measured as a percentage of assets) in a given year exceeds the average payout rate of the foundation in the preceding five years – by an amount at least as much as the 1 percent tax savings the foundation will enjoy – then the tax due is reduced to 1 percent.

Senate and House legislative proposals have been introduced that would amend the IRS Code of 1986 to simplify the excise tax on the investment income that private foundations pay by removing the current two-tiered tax and replacing it with one flat tax rate. The current proposals set this flat rate at 1.39 percent, which was designed to be revenue neutral, but according to the Joint Committee on Taxation in the 112th Congress would slightly raise tax revenue by \$86 million over ten years.

Arguments FOR:

- ✓ The current two-tier system serves as a disincentive to increased giving, especially in times of crisis or economic turmoil. It creates an incentive to reduce contributions in difficult times because high distribution makes it more difficult to qualify for the lower rate during the next 5 years. In the current scenario, when a foundation's assets are reduced, they subject themselves to higher tax rates in future years unless they also reduce the dollar amount of their giving.
- ✓ A flat excise tax will simplify tax planning, especially for smaller foundations that may lack resources for complex financial planning.
- ✓ Simplifying the rate will reduce monitoring and enforcement costs to the Treasury Department, increasing efficiency for foundations and government alike.

Arguments AGAINST:

- Some foundations are able to successfully manage their distributions in order to qualify for the 1 percent rate year after year. For those foundations, the flat tax would slightly increase their tax liability.
- Some Congressional staff assert that the current two-tiered rate incentivizes increased giving above the minimum 5 percent distribution rate required by law.

Philanthropy New York's Position:

Philanthropy New York supports simplifying the federal excise tax on private foundations.

Philanthropy New York's Public Policy Committee recommended this position on July 23, 2012, which was followed by an open comment period for members August 1-8, 2012 and the official approval of its Board of Directors on September 21, 2012. The Council on Foundations and the Forum of Regional Associations of Grantmakers also support the simplification of the private foundation excise tax on net investment income to a flat rate.

Check out these additional information sources:

[Council on Foundations Excise Tax Issue Paper](#)

[Obama Administration position on supporting simplification of excise tax](#) (see page 187)

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