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THE PRIVATE FOUNDATION RULES AT FIFTY: HOW DID WE GET THEM AND DO THEY MEET CURRENT NEEDS?

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THE PRIVATE FOUNDATION RULES AT FIFTY: HOW DID WE GET THEM AND DO THEY MEET CURRENT NEEDS?

*James J. Fishman**

“A perpetual charitable foundation is a completely irresponsible institution, answerable to nobody . . . the puzzle for economics is why these foundations are not total scandals.”

—Richard Posner¹

Reflecting upon the fiftieth anniversary of the 1969 Private Foundation legislation, one is struck with the similarities in the temper of the country today with that of fifty years ago. Then, as it is now, was a period of racial conflict and rigid partisanship. The increasing inequality and unfairness of the tax system were issues. There was an unpopular president, Richard Nixon² and an unpopular war, Vietnam.³ Private foundations were but one small issue in the movement for tax reform but came to reflect larger divisions in society.

This Article first examines the legislative process that resulted in a separate, more restrictive regulatory regime for private foundations than applied to public charities. It then discusses a contemporary flaw in foundation oversight of small foundations, those with assets under one million dollars, that are essentially unregulated because of the Internal Revenue Service’s lack of resources or interest. The Article recommends

* Professor of Law Emeritus, Elisabeth Haub School of Law at Pace University, © 2019 James J. Fishman. Special thanks to Vicky Gannon, head of collections services and reference librarian at the Haub School of Law Library for her assistance in retrieving fifty-year old congressional hearings and reports. I thank Ashley Rundell and the other editors of the Pittsburgh Tax Review for their editing prowess and Professor Philip Hackney of the University of Pittsburgh School of Law for his helpful comments during the writing and editing process.

¹ Richard Posner, *Charitable Foundations—Posner’s Comment*, THE BECKER-POSNER BLOG (Dec. 31, 2006, 11:51 PM), <https://www.becker-posner-blog.com/2006/12/charitable-foundations--posners-comment.html>.

² The author’s parents were liberal Democrats for whom Richard Nixon, well before Watergate, was evil incarnate. Watergate was a reaffirmation of what they always believed about him.

³ Today the United States is involved in at least two unpopular conflicts: Afghanistan and the war against undocumented immigrants. There are also secret conflicts in Africa and the Middle East.

legislation that may better assure these foundations are operating within the requirements of the law.

Normally, the consideration of tax legislation relating to the nonprofit sector is of interest to tax practitioners, government officials and employees, and various nonprofit constituencies. At most, the proposed legislation may get modest mention in the national press if at all. In contrast, the 1969 congressional hearings on private foundations were front page news, not only in the national press but in the tabloids as well. They were a public relations disaster that resulted in restrictions and mandates that shocked the philanthropic community.

In examining the 1969 private foundation legislation, one needs to extend the telescope even farther into the past to obtain a sense as to why, compared to the flexibility afforded public charities, Congress reacted to create such a rigid regime for private foundations. Was the legislation that emerged an evolutionary and justified response to abuses or was the final version exacerbated by the political atmosphere, the hearings or both?

I. A BRIEF HISTORY OF DISTRUST OF FOUNDATIONS

Foundations have long been equal opportunity offenders. They have been criticized by the left as a device to allow the affluent to maintain control of their businesses without the burdens of paying income and estate taxes and to use their wealth through the foundation form to influence politics, policy, and society. Those on the right have charged that foundations have been used for radical political purposes such as voter registration drives and support of civil rights. There is some truth in the charges from both sides. The distrust of foundations goes back decades. Occasionally, the conflicting views come together.

In 1909, when John D. Rockefeller Sr. decided to create a foundation to channel his philanthropy, he conferred 70,000 shares of Standard Oil stock worth \$50 million (roughly \$1.45 billion in 2019 inflation-adjusted dollars) to the Rockefeller Foundation with the promise of another \$50 million.⁴ When Rockefeller sought to obtain a congressional charter for his

⁴ ROB REICH, JUST GIVING: WHY PHILANTHROPY IS FAILING DEMOCRACY AND HOW IT CAN DO BETTER 3 (2018).

foundation, he came under fierce criticism.⁵ The incumbent president William Howard Taft, a conservative, asked Congress to oppose the creation of the foundation describing the chartering effort: “a bill to incorporate Mr. Rockefeller.”⁶ The American Federation of Labor president Samuel Gompers said: “The one thing that the world would gratefully accept from Mr. Rockefeller now would be the establishment of a great endowment of research and education to help other people see in time how they can keep from being like him.”⁷ In the political middle, former president Theodore Roosevelt commented: “No amount of charities in spending such fortunes can compensate in any way for the misconduct in acquiring them.”⁸

The fear and dislike of Rockefeller were so great that such disparate voices could agree. Other concerns were that the foundation’s scope was limitless and such organizations were anti-democratic, unaccountable and a menace to the welfare of society.⁹ Though the House passed a bill chartering the Foundation, it failed in the Senate.¹⁰ The Rockefeller Foundation was then incorporated in New York.¹¹

A. Congressional Scrutiny

1. The Walsh Commission

Over the years, foundations have been the subject of several congressional investigations. Beginning with the 1916 report of the Industrial

⁵ *Id.* at 4. The reason Rockefeller and his advisors sought a federal charter was the concern that a state incorporation would impose limits on the foundation’s size and purposes. Many states had limitations on the size of philanthropic endowments. *Id.* at 3.

⁶ *Id.* at 4.

⁷ *Id.*

⁸ Peter Dobkin Hall, *Philanthropy, the Nonprofit Sector & the Democratic Dilemma*, 142 DAEDALUS J. AM. ACAD. ARTS & SCI. 139, 147–48 (2013).

⁹ REICH, *supra* note 4, at 3 (quoting Rev. John Haynes Holmes testifying before the Commission on Industrial Relations); COMM’N ON INDUSTR. RELATIONS, FINAL REPORT AND TESTIMONY, S. DOC. NO. 415, 64th Cong. 7916–17 (1st Sess. 1916); Frank P. Walsh, *Perilous Philanthropy*, 83 THE INDEP. 262 (1915).

¹⁰ REICH, *supra* note 4, at 6–7.

¹¹ *Id.* at 7.

Relations Commission, the so-called Walsh Commission named after Senator Frank Walsh of Missouri, foundations came under a critical gaze.¹² Walsh opposed all large foundations. He thought “huge philanthropic trusts, known as foundations, appear to be a menace to the welfare of society.”¹³

The Industrial Relations Report, which covered a broad swath of labor relations, concluded that a small group of wealthy families not only controlled the major industries but were extending their control over education and social services through the creation of “enormous privately managed funds for indefinite purposes,” i.e. foundations.¹⁴ The report recommended that all such broad-functioned institutions with over a million dollars in assets be required to obtain a federal charter, which would provide for: (1) a limit on the size of a foundation’s assets, (2) a mandatory specification of functions and powers, (3) a prohibition against accumulation of unexpended income and a limitation on spending from principal, (4) rigid inspection of investments and expenditures, and (5) open reports to government officials.¹⁵ Senator Walsh and two other members expressed their hostility to the large foundations by appending a suggestion that the Rockefeller Foundation be dissolved.¹⁶

2. The Cox Commission

In the early 1950s at the height of the McCarthyite “Red Scare,” a House Select Committee to Investigate Foundations and Other Organizations, chaired by Representative Edward E. Cox of Georgia, held hearings and issued a report in 1953 that suggested foundations had been guilty of a little more than errors in judgment.¹⁷ The Committee noted that foundations

¹² COMM’N ON INDUSTR. RELATIONS, *supra* note 9.

¹³ REICH, *supra* note 4, at 5 (quoting Walsh, *supra* note 9, at 467).

¹⁴ COMM’N ON INDUSTR. RELATIONS, *supra* note 9.

¹⁵ Laurens Williams & Donald V. Moorehead, *An Analysis of the Federal Tax Distinctions Between Public and Private Charitable Organizations* (1974), reprinted in DEP’T OF TREAS., RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS: VOL. IV TAXES 2099, 2104 (1977).

¹⁶ *Id.* at 2104.

¹⁷ See generally FINAL REPORT OF THE SELECT COMMITTEE TO INVESTIGATE FOUNDATIONS AND OTHER ORGANIZATIONS, H. REP. NO. 2514 (1953) [hereinafter COMMITTEE REPORT]. The report noted that foundations’ “most significant function has been displayed in supplying the risk or venture capital expended in advancing the frontiers of knowledge” and that the need for foundations to fulfill such a role

currently were feared as antagonistic to capitalism whereas in the era of the Walsh Report they were of concern as instruments of vested wealth. It concluded neither of these fears was justified.¹⁸ The Report recommended greater disclosure by foundations of their finances and activities.¹⁹

3. The Reece Commission

The Cox Commission Report did not satisfy the “red hunters.” At the urging of Representative Carroll Reece of Tennessee, a new Committee examined foundations. The Reece Committee mounted an inquiry into both the motives for establishing foundations and their influence on public life. It had a completely different tone urged on by a staff member Harold Dodd, who prepared a report that was adopted by the Committee’s majority.²⁰ The Report described an “‘interlock’ of large private foundations, possessed of enormous influence over social science research and education, and exerting this influence to foster excessive ‘empiricism,’ ‘moral relativity,’ and leftist and ‘collectivist’ political opinions.”²¹

would increase in the future. *Id.* at 3–4. As to the charges that prompted the committee’s investigation, the report states:

The committee believes that on balance the record of the foundations is good. It believes that there was infiltration and that judgments were made which, in the light of hindsight, were mistakes, but it also believes that many of these mistakes were made without the knowledge of facts which, while later obtainable, could not have been readily ascertained at the time decisions were taken. It further believes that the foundations are aware of the ever-present danger and are exerting and will continue to exert diligence in averting further mistakes. WILLIAMS & MOOREHEAD, *supra* note 15, at 8.

¹⁸ *Id.* at 10.

¹⁹ *Id.* at 13–14. Under a proposed statutory amendment appended to the report, the annual information return then required of selected charitable organizations, including private foundations, would have been expanded to encompass (1) total year’s contributions, (2) amount, general purpose, and recipients of grants, (3) contributors and amounts contributed, and (4) a breakdown of expenses including administrative overhead and salaries, with all but the latter two items to be available to the public. The committee also recommended that the House Ways and Means Committee, rather than it, conduct any studies of tax abuse by private foundations. *Id.* at 13–15.

²⁰ Compare SPECIAL COMM. OF HOUSE OF REP. TO INVESTIGATE TAX EXEMPT FOUNDS., THE DODD REPORT TO THE REECE COMMITTEE ON FOUNDATIONS (1954) [hereinafter DODD REPORT], and COMMITTEE REPORT, *supra* note 17.

²¹ DODD REPORT, *supra* note 20, at 10–13; WILLIAMS & MOOREHEAD, *supra* note 15, at 2105.

The methods of the committee and its staff were challenged as being unfair to the foundations by both a minority of the committee and others.²² The Reece Commission Report was issued during the time that Senator McCarthy was censured by the Senate and essentially became another casualty. It had little influence and the extreme charges and recommendations were ignored.

4. The Patman Investigations

A principal antagonist of private foundations was Wright Patman (1893–1976), a populist, conservative Texas Congressman, who for three decades conducted a personal crusade against Wall Street, chain stores, monopolies, banks, the Federal Reserve, and private foundations. Commencing in 1961, Patman focused on foundations, admitting they did some good things but questioned the motives of some of their donors.²³ The next year, the House Small Business Committee authorized him to hire a staff, conduct studies and hold hearings on the impact of private foundations on the American economy.²⁴ He conducted several investigations of private foundations with vigor in a series of reports leading up to and beyond the 1969 legislation, ratcheting up his criticism charging financial misconduct as well as both capitalistic and communist bias.²⁵

Patman had a Trumpian ability to use inflammatory rhetoric to gain attention and support. His reports accumulated large amounts of data, some of which was inaccurate, that showed misdeeds of foundations including short sales of securities, speculation in commodities, manipulation of stock prices, and attempts to gain control of businesses.²⁶ What was missing from

²² WILLIAMS & MOOREHEAD, *supra* note 15, at 2105 (“The recommendations of the majority report included a limitation of a foundation’s existence of from ten to twenty-five years, mandatory distribution by foundations of all of each year’s income within two to three years, a categorical prohibition of all political activity by foundations, and restriction on corporate control of foundations. Recommendations were also made for increased foundation tax audits and for consideration by the tax writing committees of the Congress of a variety of alleged problem areas, such as the use of foundations to control businesses.”).

²³ WALDEMAR A. NIELSEN, *THE BIG FOUNDATIONS* 7–8 (1972).

²⁴ *Id.* at 7.

²⁵ *Id.* at 7–8; MARION R. FREMONT-SMITH, *FOUNDATIONS AND GOVERNMENT: STATE AND FEDERAL LAW AND SUPERVISION* 364–65 (1965).

²⁶ *Id.*

the reports was a sense of the extent of the misdeeds alleged.²⁷ Patman criticized the Treasury and the Internal Revenue Service for lax oversight and demanded that the Treasury study the foundation sector.²⁸

Although Patman garnered increasing publicity about foundation misconduct, he had little influence on or the respect of the tax writing committees in Congress.²⁹ However, his allegations of foundation wrongdoing did have a significant impact on public opinion and the development of the private foundation legislation.³⁰

II. THE EVOLUTION OF THE LEGAL FRAMEWORK OF FOUNDATION REGULATION

Most of the resulting private foundation legislation evolved from congressional concerns some of which dated back to the 1940s.³¹ In his January 1950 tax message to Congress, which recommended the first unrelated business income tax, President Harry Truman also referred to the use of “the exception accorded to charitable trust funds as a cloak for speculative business ventures” and consequent misuse of funds intended for charitable purposes.³² The Secretary of the Treasury, John W. Snyder,

²⁷ Patman’s reports consisted of a survey of 534 foundations from which Patman gathered information over a ten-year period. The files of the IRS were deemed inadequate. His study primarily focused on ownership by a foundation of 10% or more of any class of stock as reported on I.R.S. Form 990A. Patman called for a moratorium on foundation tax exemptions because of the laziness and irresponsibility on the part of the Service and the withdrawal of \$7 billion of foregone tax revenues. He warned of the rapidly increasing concentration of economic power by foundations and the impact of foundation-controlled businesses to eliminate small businesspeople. He wanted to limit foundation lifetimes to twenty-five years. Many of his statements and criticisms were subject to criticism in that they were not true congressional reports but the opinion of a single individual—Patman; the facts did not support the conclusions; his investigation was procedurally defective; and the facts produced were sometimes incorrect. *See* Fremont-Smith, *supra* note 25, at 366–72.

²⁸ *Id.* at 367–69.

²⁹ Thomas A. Troyer, *The 1969 Private Foundation Law: Historical Perspective on Its Origins and Underpinnings*, 27 EXEMPT ORG. L. REV. 55 n.19 (2000). Mr. Troyer worked at the Treasury in the mid-1960s as the private foundation legislation developed. *Id.* at 52.

³⁰ WILLIAMS & MOOREHEAD, *supra* note 15, at 2105.

³¹ Troyer, *supra* note 29, at 53. The tax writing committees are the House Ways and Means Committee and the Senate Finance Committee.

³² *Id.*

suggested a method of eliminating such abuses would be to require trusts and foundations to pay out substantially all net income within a specified period after the close of every taxable year.³³ Also recommended was a requirement against dealings between the trust or foundation and its creator or businesses under his control and a prohibition of the use of the trust for the personal advantage of the grantor.³⁴

In testimony before the House Ways and Means Committee Secretary Snyder elaborated on the problem:

Another . . . abuse of tax exemption involves the establishment of so-called charitable foundations or trusts which serve as a cloak for controlling businesses. The present law permits the transfer of business investments to tax-exempt trusts and foundations for these purposes without payment of estate or gift taxes. The income subsequently received from the business is exempt from income tax.

The abuse to which this type of device lends itself is the retention and reinvestment of a major share of the trust income in a manner which will benefit the grantor.³⁵

After hearings before the House Ways and Means Committee in June 1950, the Committee proposed legislation that generally would have: (1) precluded foundations from entering into financial transactions with their contributors, officers, directors, trustees, and certain related parties; (2) taxed investment income not currently distributed for charitable purposes; and (3) denied charitable deductions for contributions of family-controlled businesses to family foundations.³⁶ Tax-exempt investment income would be restricted to the portion of the income which the foundations could demonstrate they were using to fulfill charitable purposes by actual distribution to charity as the income was received.³⁷ The Committee Report also stated that where control existed after the gift to the foundation, denial of deductions recognized that

³³ *Id.*

³⁴ STAFF OF S. COMM. ON FIN., 89TH CONG., TREASURY DEPARTMENT ON PRIVATE FOUNDATIONS I (Comm. Print 1965) [hereinafter PRIVATE FOUNDATIONS].

³⁵ *Revenue Revisions of 1950: Hearings on H.R. 8920 Before the House Committee on Ways and Means*, Feb. 3, 1950, 81st Cong. 19 (1950) [hereinafter *Hearings on H.R. 8920*].

³⁶ H.R. REP. NO. 2319, at 42 (1950).

³⁷ *Id.* at 40.

no completed gift had been made.³⁸ The House approved the bill, and the legislation went to the Senate Finance Committee.³⁹

The Finance Committee weakened the self-dealing prohibitions to a lesser standard of arm's length dealing between foundations and insiders.⁴⁰ It deleted the investment income tax, and the denial of charitable deductions for contributions of family-controlled businesses to family foundations.⁴¹ The Conference Committee adopted the Senate provisions on self-dealing but denied exemptions where accumulations of income were unreasonable in amount or duration, used to a substantial degree for other than exempt purposes, or invested in such a manner as to jeopardize the carrying out of exempt functions.⁴²

Because of growing concern about the acquisition and operation of unrelated businesses by exempt organizations, and a lack of accurate data to deal with the problem, Congress first separated the equivalent of today's public charities from other tax exempt organizations in 1943.⁴³ The result was the addition of § 45(f) to the Internal Revenue Code (the "Code") of 1939 which first required annual information returns from most exempt organizations but excepted churches and other religious organizations, certain educational institutions, and publicly supported organizations.⁴⁴ It was in the Revenue Act of 1950⁴⁵ that Congress for the first time drew a significant distinction between public and private charities through the imposition of the Unrelated Business Income Tax (UBIT), restrictions on certain financial transactions and income accumulation by certain charitable organizations.⁴⁶ As the penalty for violating prohibited transactions was

³⁸ *Id.* at 43–44.

³⁹ *Hearings on H.R. 8920, supra* note 35, at 1.

⁴⁰ Troyer, *supra* note 29, at 53.

⁴¹ *See id.* at 53–54.

⁴² *Id.*

⁴³ *Id.* at 54 n.12.

⁴⁴ Revenue Act of 1943, Pub. L. No. 78-235, § 117(a), 58 Stat. 21, 37.

⁴⁵ Revenue Act of 1950, Pub. L. No. 81-814, 64 Stat. 906.

⁴⁶ WILLIAMS & MOOREHEAD, *supra* note 15, at 2101. Exempt "from coverage were (1) religious organizations, (2) educational institutions with a regularly enrolled body of students, (3) publicly

revocation of exempt status, a drastic penalty for a subjective determination, it was rarely invoked.⁴⁷

The 1950 reforms did little to stem the growth and popularity of foundations or to rein in the form's abuses. Foundations became a focus of tax and business planners as a method for wealthy individuals and families to retain control or transfer control to heirs without paying taxes. They offered income and estate tax deductions.⁴⁸ Though charity was always mentioned in the organizational documents, it was often absent from the minds and practices of donors.⁴⁹ In some cases the foundations were frauds.⁵⁰

A. The Revenue Act of 1964: Increasing the Differentiation between Private Foundations and Public Charities

The Revenue Act of 1964 sharpened the distinction between private foundations and public charities by excluding foundations from the expansion of the class of organizations that could receive charitable contributions that were deductible by individuals up to 30% (from 20%) of their adjusted gross income.⁵¹ According to the 1964 Senate Finance Committee report, the reason private foundations were excluded from the increase was the delay in contributions from foundations to operating

supported organizations, (4) organizations operated by, or principally supported by, religious organizations, and (5) organizations providing medical or hospital care or medical education or medical research." *Id.* at 2102. The exemptions were justified in the words of the Senate Report "[t]he organizations excluded from the application of these provisions are in general what might be called 'public' organizations and because of this characteristic are not believed likely to become involved in any of these prohibited transactions." S. REP. NO. 2375, at 38 (1950).

⁴⁷ See S. REP. NO. 81-2375, at 122 (1950).

⁴⁸ See Troyer, *supra* note 29, at 54 (citing articles from BUSINESSWEEK and other periodicals praising the tax advantages of foundations).

⁴⁹ *Id.*

⁵⁰ One egregious example involved the Public Health Foundation for Cancer and Blood Pressure Research, created by James H. Rand, Jr. of the Remington-Rand Corporation, a maker of typewriters and office equipment. Rand allegedly sold his Connecticut home to his foundation for more than \$230,000 for use as a research center—and then continued to live in it, with the foundation paying the household expenses and salaries of Rand's servants. Nearly \$160,000 was spent to construct a research laboratory in Stuart Florida, to grow vegetables, which were consumed by Rand and his friends. NIELSEN, *supra* note 23, at 8. Remington-Rand was purchased by the Sperry Corporation in 1955. *Id.*

⁵¹ See Revenue Act of 1964, Pub. L. No. 88-272, § 209(a), 78 Stat. 19, 43.

charities for extended periods of time.⁵² Instead foundations used the funds contributed for investment purposes. The extra 10% deduction would encourage contributions for charitable organizations that more readily benefitted the public.⁵³

B. The 1965 Treasury Report

The Treasury Department attempted to interest the Senate Finance Committee in a proposal made in President Kennedy's 1963 tax message to repeal the unlimited charitable deduction.⁵⁴ The Treasury particularly pointed to foundations as undeserving of its benefits.⁵⁵ The Finance Committee was more interested in the state of private foundations than the unlimited charitable deduction. According to Thomas Troyer, who worked at Treasury at the time, to avoid sidelining the 1965 Revenue Act, "Treasury promised . . . to conduct a thorough study of private foundations and report findings, conclusions, and recommendations by early 1965."⁵⁶ The Senate Committee on Finance and the House Ways and Means Committee thereupon directed the Treasury Department to undertake a comprehensive study of private foundations and to report its findings and recommendations for legislative changes.⁵⁷

⁵² S. REP. NO. 88-830, at 58 (1964).

⁵³ *Id.*

⁵⁴ Troyer, *supra* note 29, at 55. The unlimited charitable deduction, I.R.C. § 120 added in 1924, provided: "if the taxes paid by an individual in the current taxable year and in each of the ten preceding years, plus the amount of his charitable contributions during such years, exceeded 90 percent of his net income, then the twenty percent limitation on the deduction for charitable contributions was not applicable." If the taxpayer met the conditions, an unlimited deduction for charitable contributions was permitted in the determination of taxable income. The theory of the unlimited charitable deduction was to encourage large contributions to worthy charities, which otherwise a taxpayer might hesitate to make because of the 20 or 30% limit upon the deductibility for tax purposes. Clyde W. Wellen, *The Unlimited Deduction for Charitable Contributions*, 7 SMU L. REV. 38-39 (1953).

⁵⁵ Troyer, *supra* note 29, at 55.

⁵⁶ *Id.* at 55-56.

⁵⁷ *See generally id.* (explaining that the Treasury promised to both committees that they would conduct the report and subsequently did so).

Treasury examined a sample of 1,300 private foundations, including all with assets of \$10,000,000 or more.⁵⁸ The Treasury Report was issued in early 1965 and was generally supportive of the role foundations played in society. It gave credit for their capacity and ability to constitute a powerful instrument for evolution, growth and improvement in the shape and direction of charity.⁵⁹ The Treasury Report identified three criticisms of private foundations: (1) The use of foundations, as opposed to direct contributions by individuals resulted in a delay between the tax benefit and the funds entering the charitable stream;⁶⁰ (2) foundations had become a disproportionately large segment of the economy; and (3) foundations represented dangerous concentrations of social and economic power. It also noted that these “contentions . . . led to proposals that a time limit be imposed on the life of private foundations.”⁶¹ The Treasury Report concluded that analysis of the criticisms demonstrated that the first could be solved by a measure of specific design and limited scope, the second lacked factual basis, and the third was being amply met by foundations themselves.⁶² Treasury concluded that prompt and effective action to end the specific abuses extant among foundations was preferable to a general limitation upon foundation lives.⁶³

Treasury did find serious abuses among a minority of foundations and offered legislative recommendations to cure them. It discussed six problem areas:

⁵⁸ *Id.* (providing information as to how the Treasury obtained data for the Treasury Report); see generally PRIVATE FOUNDATIONS, *supra* note 34, at 30–31.

⁵⁹ PRIVATE FOUNDATIONS, *supra* note 34, at 1–3.

⁶⁰ If a private foundation invested in assets that produced no current income, it needed to make no distributions for charitable purposes. As a result, the donor might receive substantial tax benefits from his contribution, but charity may have received nothing. In other cases, even though income was produced by the assets contributed to charitable organizations, no current distribution was required until the accumulations became “unreasonable,” a markedly subjective standard that might lead to a particularly harsh result (revocation of exemption) or no penalty at all. STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, at 30–31 (1969).

⁶¹ PRIVATE FOUNDATIONS, *supra* note 34, at 5.

⁶² *Id.* at 13–14.

⁶³ *Id.*

(1) Self-Dealing: The Treasury recommended a proscription on all acts of self-dealing between private foundations and related parties, without regard to whether such transactions were carried on at arm's-length.⁶⁴ As mentioned, the existing prohibitions used a too subjective standard—"arms-length" and the penalties were difficult of application. In many situations revocation of exemption would be unduly harsh.

(2) The delay of donated funds reaching the charitable stream: Treasury recommended that all foundations be required to spend or distribute their income annually and that grantmaking foundations be required to distribute an amount, whether or not in excess of income, at least equal to a specified percentage of the value of investment assets.⁶⁵

(3) Percentage interest limitations on foundation holdings in corporations and other business enterprises⁶⁶: the Treasury Report proposed that foundations be prevented from owning more than 20% of combined voting power or 20% of the value of entire equity.⁶⁷

⁶⁴ The lack of a prohibition against self-dealing led some donors to believe that although the foundation had legal title to assets, which they had contributed, the assets still belonged to them. Because the donor feels he can call on the foundation's assets, it may affect what investments the foundation makes and how much enters the charitable stream. *Id.* at 15. The Treasury Report's recommendation of prohibition of self-dealing became I.R.C. § 4941 in 1969.

⁶⁵ *Id.* at 23–30. Treasury recommended a mandatory payout of 3–3.5%. *Id.* at 29. The 1969 legislation incorporated the mandatory payout recommendation in I.R.C. § 4942, but at the rate of 5% of the fair market value of their net investment assets.

⁶⁶

Of approximately 1,300 private foundations . . . surveyed by the Treasury Department, about 180 reported ownership of ten percent or more of at least one class of the outstanding stock of a corporation. [Out of this group,] 109 foundations owned twenty percent or larger interests; forty held 100 percent interests. Forty-three foundations reported that they [possessed] ten percent, or larger interests in two or more corporations.

One of the Patman reports stated that of 543 foundations studied, 111 owned 10% or more of at least one class of stock of a corporation. "Together, these 111 foundations held interests of not less than the described magnitude (most were in fact considerably larger than ten percent) in 263 separate corporations. In other cases, foundations owned and operated businesses directly." PRIVATE FOUNDATIONS, *supra* note 34, at 31.

⁶⁷ *Id.* at 36. The Treasury Report recommended that rules similar to those of I.R.C. § 513 be used to distinguish businesses which are substantially related to the foundation's exempt operations from those which were not. *Id.* at 37.

(4) Deferral of tax deductions: Treasury recommended deferral of tax deductions for gifts of property to a private foundation where the donor retained control.⁶⁸

(5) Financial transactions unrelated to exempt purposes: The Treasury Report recommended prohibiting foundation borrowings for investment purposes, restrictions on loans by foundations, and prohibitions on speculative trading practices and investments.⁶⁹

(6) Legislation to limit family control of foundations: The Treasury Report urged requirements that after the first twenty-five years of a foundation's existence, the donor and related parties could not constitute more than 25% of the foundation's governing body.⁷⁰

The Treasury Report provided a partial template for the 1969 legislation, but when published it received substantial criticism from Representative Patman and Senator Al Gore Sr.⁷¹ for being too lenient on foundations.⁷² In the four years after 1965, little changed concerning foundation behavior. Nor was there congressional legislation, but foundations' perception by Congress and the public grew harsher. However, there emerged a movement for tax reform against the unfairness of the tax laws, particularly the loopholes for the affluent.

⁶⁸ *Id.* at 37–45.

⁶⁹ *Id.* at 45–54. The recommendations in this section resulted in I.R.C. § 4944, the prohibition on investments that jeopardize charitable purpose, the so-called jeopardy investments section.

⁷⁰ The rationale for this recommendation was that donors maintained a substantial influence over management of their private foundations which could lead to a variety of problems discussed in the Report. Treasury assumed that while dangers of donor influence would decline over time, the increasing number of foundations added to the difficulties of regulatory oversight. Additionally, the narrowness of the base of foundation management—friends and family of the donor typically—might lead to a hardening of views and an inability to see the need for change in program focus or new initiatives.

Though the Treasury did not believe a general limitation on the lives of foundations was desirable, it recommended that provision be made to convert private foundations that were in existence for twenty-five years to management that was independent of their donors and parties related to donors. The donor and related parties could not comprise more than 25% of the board of the foundation. *Id.* at 54–57. Nothing came of this proposal.

⁷¹ Father of the former Vice President.

⁷² Troyer, *supra* note 29, at 58.

In January 1969, Joseph W. Barr, the Secretary of the Treasury, stated to a congressional committee that there had been 155 individual tax returns filed with adjusted gross income above \$200,000 on which no income tax had to be paid, and twenty-one returns filed with incomes above \$1 million on which no tax had to be paid.⁷³ Foundations came to be seen as institutions of questionable character. They were regarded by many as mere devices by which the wealthy could avoid taxes. A series of disclosures prompted concerns about the relationship of foundations to members of the government, questionable grants that suggested foundations were involved with politics and influencing governments at all levels.⁷⁴

Less than a week before the congressional hearings on tax reform, the *New York Times* reported that the Ford Foundation had given essentially bereavement grants totaling \$131,000 (over \$1,062,000 inflation adjusted in 2019) for travel up to one year or any other activity the grantees wished pursue to eight former staffers of Senator Robert F. Kennedy, who had been assassinated in 1968.⁷⁵

C. Nightmare in Washington: The 1969 Tax Reform Hearings Before the Ways and Means Committee

On February 18, 1969, the hearings before the House Ways and Means Committee commenced. The first witness was Representative Patman who came with a list of foundation shortcomings.⁷⁶ Patman introduced his own bill that would deal with alleged foundation deficiencies in three ways. First, every private foundation would pay a tax in the amount of 20% of its gross

⁷³ NIELSEN, *supra* note 23, at 9. Barr, appointed by President Lyndon Johnson served only from December 21, 1968 to January 29, 1969.

⁷⁴ Troyer, *supra* note 29, at 58–59; WILLIAMS & MOOREHEAD, *supra* note 15, at 2107.

⁷⁵ *Ex-Kennedy Men Got \$131,000 in Ford Grants, Panel Reports*, N.Y. TIMES, Feb. 13, 1969, at 32.

⁷⁶ Patman’s detailed areas of concern included: (1) the sheer size of private foundations, (2) the use of foundations to perpetuate control of business corporations, (3) grants by private foundations for use outside the United States, (4) their influencing political campaigns through voter registration drives and otherwise, (5) grants and other payments to public officials, (6) grants to individuals for questionable purposes and for “esoteric research,” (7) the use of foundations for private benefit of donors and their families, and (8) questionable investment practices. *Hearings on the Subject of Tax Reform Before the House Committee on Ways and Means*, 91st Cong. 12–78 (1969) [hereinafter *House Hearings*].

income, including capital gains.⁷⁷ Second, a privately-controlled tax-exempt foundation would not be permitted to own more than 3% of the outstanding shares of any class of stock of a corporation or profits of a partnership.⁷⁸ Third, the net income of every private foundation would have to be disbursed annually for the purposes for which it was organized.⁷⁹

His testimony offered several cringing examples of foundation misdeeds and questionable activities, but some of it reflected his general hostility to foundations, nativism, and pettiness over certain expenditures.⁸⁰ He played to the American public by noting that the Rockefeller Foundation spent over \$1.6 million in India but not a penny in Arkansas and offered similar disparities between other foreign grantees and American states. Patman seemed to be particularly outraged by the Mellon family's foundations.

The Bollingen Foundation of New York City, a creation of the Mellon banking family of Pittsburgh, spends tax-free dollars on such esoteric research subjects as “The works of Hugo von Hofmannsthal,” “the phenomenology of the Iranian religious consciousness,” “The origin and significance of the decorative types of medieval tombstones in Bosnia and Herzegovina”

Congress certainly cannot complain if the entire Mellon banking family assembles in one of their Pittsburgh mansions each evening for a round-table discussion on the origin and significance of the decorative types of medieval tombstones in Bosnia and Herzegovina

If the Mellons are more interested in medieval tombstones than in Pittsburgh poverty, and care to spend their money studying 12th and 13th Century church construction, that is the Mellons' affair. However, there is no obligation upon either the Congress or the American citizenry to give the Mellons' tax free dollars to finance their exotic interests. In sum: The foundation programs contain ample

⁷⁷ *Id.* at 12–13.

⁷⁸ *Id.* at 13.

⁷⁹ *Id.* at 12–13.

⁸⁰ Patman criticized such expenditures as Ford's \$446,262.46 and Rockefeller's \$31,546.00 for public relations. He complained about their legal and printing expenses, their excess of employees in foreign countries compared to the United States (Ford, 327 domestic employees; 920 foreign; Rockefeller 211 domestic, 112 in foreign countries excluding nationals hired locally). He was outraged that Rockefeller sent 75% more money out of the country in 1966 than it spent in the United States and noted that Ford and Rockefeller lost money from their cafeterias and dining room operation costing taxpaying restaurant owners potential customers. *Id.* at 14–15, 17.

fat that could and should be trimmed, and the Federal government can find better uses for the money than studies of medieval tombstones.⁸¹

This was incendiary but effective in the court of public opinion.

On the second day of the hearings John J. Rooney, a long-serving representative from New York's fourteenth congressional district in Brooklyn appeared before the Committee. He offered testimony chilling to every member of Congress saying, "I am the first known Member of Congress to be forced to campaign for reelection against the awesome financial resources of a tax-exempt foundation This time, Mr. Chairman, it happened in my district. It can—and probably will—happen in your districts."⁸²

An industrialist and philanthropist, Frederick Richmond, challenged Representative Rooney in a primary. New York's fourteenth congressional district was a gritty mosaic of middle and working class ethnic, racial, and religious groups. Richmond did not reside in the district but in Sutton Place, a posh neighborhood on Manhattan's Upper East Side. To finance his campaign and to woo voters, he used his private foundation, the Frederick W. Richmond Foundation. When he visited community groups, churches, or synagogues, Richmond would conveniently announce a grant to the

⁸¹ *Id.* 16–17. The Bollingen Foundation was founded in 1940 by Paul Mellon and his wife Mary who said: "our intention was to create an example of what could be done by foundations publishing in the humanities." It produced a series of studies in esthetics, cultural and art history, archeology, philosophy, poetry, criticism, psychology, mythology and religion. It sponsored the first English translations of a number of works of poetry, philosophy and other subjects. While many of the studies were of arcane subjects (think Patman's *bete noir*, Bosnian and Herzegovinian tombstones), it attracted some prominent writers and world-renowned scholars, and sponsored a few best sellers. Its roster of authors included Isaiah Berlin, Joseph Campbell, Kenneth Clark, Andre Malraux, Jacque Maritain, and Vladimir Nabokov. Bollingen published the complete works of C.G. Jung, the psychiatrist and psychoanalyst, who founded analytical psychology. The name Bollingen is the Swiss town where Jung built his house. Bollingen distributed complete sets of its publications to 300 libraries at no cost and sold the remainder at low prices. The Bollingen publishing series was turned over to the Princeton University Press in 1965. The Foundation became inactive in 1968. Books in the series were published until 1982. WILLIAM MCGUIRE, BOLLINGEN: AN ADVENTURE IN COLLECTING THE PAST (1982). See generally D.J.R. Bruckner, *The Bollingen Adventure*, N.Y. TIMES 12, June 20, 1982.

⁸² BERNARD D. REAMS, TAX REFORM 1969: A LEGISLATIVE HISTORY OF THE TAX REFORM ACT OF 1969 (PUBLIC LAW 91-172) WITH RELATED AMENDMENTS 213–32 (1991).

organization from the Richmond Foundation. Rooney, who was born in the district, turned back the challenge.⁸³

On the third day, MacGeorge Bundy, President of the Ford Foundation testified.⁸⁴ After becoming president of Ford, he redirected the Foundation's emphases into controversial areas of civil rights, voter registration, and seemingly political activities. Ford's voter registration grants were not to the League of Women Voters, but to organizations that enabled African Americans and other underrepresented groups to vote, a definite challenge to Southern political leaders whose seniority controlled the committees and leading positions in the Congress.⁸⁵

Both Patman and the House Committee cited an article in the *New York Times* published in late December 1968 that stated Ford had become a promoter for social change and an agent for the resolution of civic conflict, and that Bundy did not recoil from politics. As a result, Ford was accused of entering in public matters beyond the legitimate purposes of foundations.⁸⁶ Ford's grants went to the Southern Regional Council to enlarge its voter

⁸³ After Rooney retired, Richmond succeeded him in 1974. His congressional career ended in 1982 when he was convicted on federal corruption charges, which included possession of marijuana and payment of an illegal gratuity to a Brooklyn Naval Yard employee and was sentenced to a year and a day in federal prison. Joseph P. Fried, *Richmond Sentenced to a Year and a Day and Fined \$20,000*, N.Y. TIMES, Nov. 11, 1982, at A1.

⁸⁴ MacGeorge Bundy (1919–1996) was born into a prominent Boston family. His father, a lawyer, had been a law clerk to Justice Oliver Wendell Holmes and Assistant Secretary of State from 1931–1933. His mother was a Lowell and her father, A. Lawrence Lowell president of Harvard. Bundy graduated from Groton, and Yale where he was first in his class and elected to the secret society Skull and Bones. Upon graduation he was named a junior fellow in Harvard's Society of Fellows who were envisioned as scholars so pure they did not acquire advanced degrees. He served in the Second World War and after the war, he was an assistant to Henry L. Stimson, who had served as Secretary of War under President Franklin D. Roosevelt from 1940 to 1945, collaborating with Mr. Stimson on his autobiography, which was published in 1948. He rejoined the Harvard faculty as a lecturer in government in 1949 and quickly began rising through the academic ranks. Bundy became dean of the faculty of arts and sciences in 1953 at age 34, the youngest dean in Harvard's history. Louis Auchincloss, the lawyer and author, recalled of his Groton schoolmate that "he was ready to be dean of the faculty at Harvard when he was 12 years old." Bundy was known as being brilliant, tart, aggressive, with a tendency toward impatience. He joined the Kennedy Administration in 1961 as national security advisor and favored escalating the war in Vietnam. He became president of the Ford Foundation in 1966. John Kifner, *McGeorge Bundy Dies at 77: Top Adviser in Vietnam Era*, N.Y. TIMES, Sept. 17, 1996, at A1.

⁸⁵ *Id.*

⁸⁶ M.A. Farber, *Ford Fund Widens Role and Draws Mounting Criticism*, N.Y. TIMES, Dec. 23, 1968, at 1.

registration drive for African Americans; in the Southwest, Ford assisted a militant Mexican American organization, which used radical slogans, and entered local politics bringing criticism even from liberal democrats in the area.⁸⁷

In 1967, Ford gave a large grant to the Cleveland branch of the Congress of Racial Equality (CORE), which used the funds for a voter registration drive in African American areas of the city to elect Carl Stokes as the first black mayor of Cleveland.⁸⁸ In New York City, the Foundation financed community school boards and a desegregation experiment in the Ocean-Hill, Brownsville section of Brooklyn, which led to a teacher's strike by the United Federation of Teachers, confrontation with the African American community, and a sundering of a long-time Jewish and black political alliance.⁸⁹

The Committee initially focused on the travel grants to the former Robert F. Kennedy staffers. According to a Foundation press release issued after the news stories appeared “the grants were provided under a foundation program of long standing that aim[ed] to ease the transition from public to private life. They provided up to a year of leisure and freedom from immediate financial concerns.”⁹⁰

Representative John Byrnes of Wisconsin asked where these grants fit in with the Foundation's charter of educational, scientific, or charitable purposes.⁹¹ Bundy claimed they were educational in nature, of the normal type—a feeble argument. Representative Byrnes responded that stretched the meaning of educational too far, that the grants seemed more like severance pay.⁹² “We are left with a situation where the judgment of a handful of people determines the use of what might otherwise be public funds.”⁹³

⁸⁷ NIELSEN, *supra* note 23, at 11.

⁸⁸ *Id.*

⁸⁹ *Id.*; JERALD E. PODAIR, *THE STRIKE THAT CHANGED NEW YORK* 38–39, 79, 145–49 (1982).

⁹⁰ *House Hearings*, *supra* note 76, at 373.

⁹¹ *See id.*

⁹² *Id.* at 376.

⁹³ *Id.* at 373–79.

The Committee moved on to voter registration and Ford's grant to Cleveland CORE for a voter registration drive. Bundy stated that Ford never examined the question of the relations between any voter registration campaign and the election of any candidate, an answer that brought disbelief.⁹⁴ Bundy's testimony was unyielding, unconvincing, and defensive. While no one ever claimed MacGeorge Bundy had a common touch, he came across as supercilious and condescending. As one member of the House Committee said: "I walked into that hearing this morning basically friendly to the foundations; I came out feeling that if Bundy represents the prevailing attitude among them, they are going to have to be brought down a peg. For all their Ph.D.'s they are not above the law."⁹⁵

Thomas Troyer, who attended the Hearings and was a witness said of Bundy's testimony:

Bundy's appearance in the Ways and Means hearings doubtless had its part in stimulating committee member antagonism toward foundations. He was smarter and more articulate than most people—by a considerable distance—and if he made any effort to conceal his sense of those capacities in his testimony, its effect was limited. By the end of his day at the witness table some members of the committee made no secret of their displeasure with him It would be quite wrong, though, to attribute the committee's mounting distrust of, and hostility toward foundations to Bundy alone.⁹⁶

Many members of the Ways and Means Committee assumed that the tax-exempt status of foundations was a tax expenditure, though they did not use that term.⁹⁷ One can envisage tax expenditures as large underground streams of taxable dollars flowing away from the Treasury, in this example to private

⁹⁴ *Id.* at 411.

⁹⁵ NIELSEN, *supra* note 23, at 12.

⁹⁶ Troyer, *supra* note 29, at 61.

⁹⁷ Under traditional theory, tax exemptions and charitable deductions are viewed as government subsidies to the organizations and their donors. This form of financial support has been called a "tax expenditure" in modern tax policy parlance. As first defined by the Congressional Budget and Impoundment Control Act of 1974, "tax expenditures" are "revenue losses attributable to exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." Congressional Budget and Impoundment Control Act, Pub. L. No. 93-344, § 3(3), 88 Stat. 299 (1974). Proponents of this mode of analysis contend that tax expenditures are analogous to direct outlay programs and thus are an alternative means by which the government spends its money. JAMES J. FISHMAN, STEPHEN SCHWARZ & LLOYD HITOSHI MAYER, *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 276 (5th ed. 2015).

foundations. Committee members repeatedly questioned witnesses: why should some pay taxes and others with a large amount of wealth avoid taxes by putting assets into foundations? There was an unfairness to people who paid taxes compared to those who controlled corporations that were donated to foundations but under the law at the time did not have to pay taxes. The foundation tax exemption increased the burdens on middle class Americans who were heavily taxed.⁹⁸

The Committee also felt that foundations had too much control over what were really government tax revenues once removed that was not subject to supervision. There was concern that foundations through their grants were making decisions for elected bodies. Representative Martha Griffiths of Michigan, home of the Ford Motor Company, questioned the right of Ford and other foundations to hold so much stock of the motor company, even though the stock was non-voting. She did not believe the Ford Foundation was set up for charitable purposes but to avoid taxes and maintain family control of the company.⁹⁹ Nor did she believe the Foundation should have an indefinite existence.¹⁰⁰ Griffiths and Bundy got into a contentious debate over the real purpose of foundations. Griffiths believed few were set up for charitable purposes and many were doing what government did.¹⁰¹ Foundation representatives seemed to ignore these concerns.

Several days after Bundy's testimony the Chairman of the philanthropic establishment, John D. Rockefeller III, testified. Rockefeller was a cheerleader for the importance of philanthropy as a unique social force and on encouraging its forward motion in the public interest. He was against any proposal that might discourage gifts to foundations. Rockefeller also gave support in his testimony to the existing provision that enabled the unlimited charitable deduction as an important incentive for the most affluent donors to give large amounts to charity.¹⁰² He casually mentioned that he had qualified for the unlimited deduction privilege since 1961, meaning he paid

⁹⁸ *House Hearings, supra* note 76, at 417.

⁹⁹ *Id.* at 379–80.

¹⁰⁰ *See id.* at 379–84.

¹⁰¹ *Id.*

¹⁰² *House Hearings, supra* note 76, at 1567–78.

no income tax.¹⁰³ He added that he had voluntarily paid a 5 to 10% tax in those years, a rate substantially below the tax rate of almost all taxpayers.¹⁰⁴ In a time of substantial tax protest, for a Rockefeller to have no tax bill because he is giving money to projects that interested him, and for the rest of American taxpayers to bear the costs of government with no choice where their tax dollars are spent, seemed outrageous and unfair to the Committee. Rockefeller's testimony did little to promote the foundation cause and reaffirmed the Committee's mistrust of foundations in general.

The position of the foundation community as expressed by its witnesses was there should be no impairment of foundations' flexibility, initiative and freedom of experimentation, the vast majority of which had not engaged in the abuses uncovered by Patman or in the Treasury Report. There was also support for all of the existing rules that made private foundations such an attractive vehicle for the wealthy. The problems involving foundations that had been raised were of a very few bad apples, which could be fixed by more rigorous Internal Revenue Service (IRS) enforcement and by the state attorneys general. Independent foundation boards of directors (which only the largest foundations were beginning to create) and more detailed information returns were the only changes needed. The foundation witnesses were blind to the level of hostility and distrust of foundations in the Ways and Means Committee and later in the Senate Finance Committee.¹⁰⁵

III. FOUNDATIONS AND THE JUDICIARY

As if the Ways and Means hearings were not enough bad publicity for the private foundation sector, a few weeks before the Committee's report was issued it became known that Supreme Court Justice Abe Fortas had received a secret lifetime retainer of \$20,000 (over \$136,000 in 2018 dollars) from the Louis Wolfson family foundation.¹⁰⁶ Wolfson, a Wall Street financier and

¹⁰³ *Id.* at 1567.

¹⁰⁴ *Id.* In 1969, the highest federal tax rate for individuals was 70%. The highest corporate tax rate was 52.8%.

¹⁰⁵ See Troyer, *supra* note 29, at 62.

¹⁰⁶ Fred P. Graham, *Douglas Announces Intention to Remain on Court*, N.Y. TIMES (Dec. 17, 1970), <https://www.nytimes.com/1970/12/17/archives/douglas-announces-intention-to-remain-on-court.html?login=email&auth=login-email>.

former client of the justice, was later imprisoned for securities fraud violations. It was alleged that Wolfson expected Fortas would help him stave off criminal charges and if necessary, assist in obtaining a presidential pardon. On May 15, 1969, Fortas resigned from the Court.

It also became public knowledge that Justice William O. Douglas had received an annual \$12,000 stipend as president of the Parvin Foundation, a family foundation of Albert Parvin, who owned casinos and hotels in Las Vegas.¹⁰⁷ Parvin had been named a co-conspirator in a stock manipulation case with Wolfson. Douglas resigned from the Parvin Foundation but not from the Court.¹⁰⁸ And so, a new charge was added against philanthropic foundations—as instruments for corruption of public officials.

A. The Ways and Means Report and the Accompanying Bill

On May 27, 1969, the Ways and Means Committee issued its Report and an accompanying bill, which became the template for the 1969 legislation.¹⁰⁹ The Ways and Means Report's tone reflected the tenor of the country's demand for tax reform, the anger of the Committee over some of the witness testimony and reaffirmed a deep distrust of private foundations.¹¹⁰ The proposed bill shocked the philanthropic community.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*; Fred P. Graham, *Fortas Quits the Supreme Court, Defends Dealings with Wolfson; Fee Is Explained*, N.Y. TIMES 1, May 16, 1969; NIELSEN, *supra* note 23, at 13.

¹⁰⁹ H.R. REP. NO. 91-413, pt.1, at 1 (1969) [hereinafter *Ways and Means Report*].

¹¹⁰ On the first page of the report the Committee stated:

Increasingly, in recent years taxpayers with substantial incomes have found ways of gaining advantages from provisions placed in the code primarily to aid some limited segment of the economy. In fact, in many cases they have found ways to pile one advantage on top of another. Your committee believes that this is an intolerable situation. It should not have been possible for 154 individuals with adjusted gross incomes of \$200,000 or more to pay no income tax. Ours is primarily a self-assessment system. If taxpayers are generally to pay their taxes on a voluntary basis, they must feel that these taxes are fair.

Ways and Means Report, *supra* note 109, at 1. A few pages later, the Report summed up the new stricter regime:

The permissible activities of private foundations desiring to preserve the benefits of tax exemption, as well as the benefits to their contributors, are substantially tightened to prevent self-dealing between the foundations and their substantial contributors, to require the distribution of income for charitable purposes, to limit their holdings of private businesses,

While many of the recommendations echoed the Treasury's views, the Ways and Means Report contained unexpected surprises resulting in restrictions on foundations' programmatic activities and a more visible separation of private foundations from public charities. The bill also required more information to be submitted to the IRS, so that it would have the information necessary to oversee private foundations.

Three of the main recommendations of the Treasury Report were included in the bill. First, there was a complete prohibition of self-dealing and a provision for graduated sanctions replacing the arm's-length standard and the revocation of exemption penalty.¹¹¹ Second, a mandatory minimum distribution requirement ended the former standard of "unreasonable accumulation, which was deemed too subjective."¹¹² Third, limits were placed on excess business holdings by foundations to 20% of the combined ownership of a corporation's voting stock by a foundation and all disqualified persons.¹¹³ Excess holdings had to be disposed of within ten years.¹¹⁴ This would end the practice of foundations retaining control of businesses and in some cases purposely ignoring producing income that could be used by the foundation for charitable purposes.

to give assurance that their activities are restricted as provided by the exemption provisions of the tax laws, and to be sure that investments of these organizations are not jeopardized by financial speculation.

Id. at 4.

¹¹¹ *Id.* at 20–24 (codified as I.R.C. § 4941).

¹¹² *Id.* at 26–27 (codified as I.R.C. § 4942).

¹¹³ I.R.C. § 4946. A "disqualified person" includes substantial contributors to a foundation, trustees and officers of a foundation, members of their families, some of their business associates and related business entities such as corporations and partnerships. *Id.*

¹¹⁴ *Ways and Means Report*, *supra* note 109, at 27–31. This became I.R.C. § 4943. In general, a private foundation is permitted to hold 20% of the voting stock in a corporation, reduced by the amount of voting stock held by all disqualified persons. If it is established that no disqualified person has effective control of the corporation, a private foundation and disqualified persons together may own up to 35% of the voting stock of a corporation. Similar rules apply with respect to holdings in a partnership and to other unincorporated enterprises. Private foundations are not permitted to have holdings in a proprietorship. Foundations generally have a five-year period to dispose of excess business holdings (acquired other than by purchase) without being subject to tax. I.R.C. § 4943(c)(6). This five-year period may be extended an additional five years in limited circumstances. I.R.C. § 4943(c)(7).

Other sections of the House bill surprised the private foundation sector. The equivalent of a user fee of 7.5% of the investment income of private foundations was to be imposed toward the cost of government, presumably for oversight of private foundations, though the sums raised would go directly into the Treasury without specific designation.¹¹⁵ Troyer suggests that this user tax resulted from the Ways and Means Committee's deep distrust and displeasure with private foundations.¹¹⁶

Witness testimony that angered the Committee also led to § 4945 of the Code, the prohibition against taxable expenditures. The Committee concluded that an excise tax should be imposed upon prohibited private foundation expenditures such as lobbying, electioneering, and grassroots campaigning or activities more appropriately carried on by other organizations.¹¹⁷ The Ford Foundation's bereavement awards to Kennedy staff members led to restrictions on grants to individuals for travel, study or similar purposes, unless the award fulfilled a number of restrictions, including the requirements of achieving a specific objective, producing a report or improving or enhancing the skill or talent of the grantee. Foundations would have expenditure responsibility for certain grants so that they were spent solely for the purposes for which they were given. Foundations would have to obtain full and complete accounting of funds expended and make a full report to the Secretary of the Treasury.¹¹⁸

Representative Rooney's bombshell led to a prohibition against any foundation expenditure "to influence the outcome of any specific public election campaign."¹¹⁹ The Ford grant to Cleveland CORE, which was used to register voters in support of Carl Stokes, resulted in restrictions on voter registration drives unless they were run by nonpartisan organizations active

¹¹⁵ *Id.* at 19–20. The income subject to the tax included interest, dividends, rents, and royalties less the expenses paid or incurred in earning such income. This became I.R.C. § 4940 though at a lower percentage rate.

¹¹⁶ Troyer, *supra* note 29, at 61.

¹¹⁷ *Ways and Means Report*, *supra* note 109, at 33.

¹¹⁸ These requirements became I.R.C. § 4945(d)(3), (f), (g).

¹¹⁹ *See* I.R.C. § 4945(d)(2), (f).

in at least five states and not confined to just one election.¹²⁰ The grants to the Ocean Hill-Brownsville School District that created enormous controversy over decentralization of the New York City school system and local control of education as well as some questionable accounting, led to the requirement of expenditure responsibility rules for grants to organizations other than public charities as well as limitations on foundations influencing legislation.¹²¹

IV. FOUNDATIONS AS EQUAL OPPORTUNITY OFFENDERS

After the disclosures involving the two members of the Supreme Court, the seeming validation of Patman's charges over the years, and the Ways and Means hearings, private foundations found themselves in a defensive position. The times were turbulent. Racial animosities and civil rights issues were prominent. Segregationist former Alabama Governor George Wallace running as a third-party candidate in the 1968 election won five Southern states. The evidence of grants for African American voter registration and foundation activism in the inner cities brought hostility from conservatives. The opposition of the AFL-CIO to foundations as tax shelters for the wealthy caused some loss of support from liberal Congress members.¹²² Those who opposed the Vietnam War had not forgotten Bundy's role in the escalation of the conflict. Politically influential state universities were no friends of foundations, who generally favored the Ivy League and elite private colleges and universities with their grants.

A. The Senate Finance Committee

As the tax reform bill that foundations were a part of moved to the Senate, larger and more politically powerful interests took precedence. The oil and real estate interests lobbied to protect their tax benefits, such as the

¹²⁰ *Id.*

¹²¹ *Ways and Means Report*, *supra* note 109, at 35. This became I.R.C. § 4945(d)(1) and (e). Troyer suggests that the Committee members thought that school decentralization was an issue for New York City municipal legislation, and that Ford grantees attempted to influence the outcome of the controversy. Troyer, *supra* note 29, at 60. The last observation was surely accurate.

¹²² NIELSEN, *supra* note 23, at 13–14.

oil depletion allowance and the generous depreciation rules for real estate.¹²³ Foundation lobbying efforts paled compared to the industry lobbyists. The foundations put together a group of the good and great from universities, research centers, civil rights groups, and business leaders, who paid individual calls on members of the Senate and House. A coordinated series of statements was prepared defending the foundation position and prominent witnesses were recruited to testify in the Senate.¹²⁴ A problem with the foundation witnesses was they were largely people of the upper classes and members of the “establishment” and could not hide it or did not try. Most members of Congress were not part of that establishment and were less than impressed by individuals who were.

A private study group, the Commission on Foundations and Private Philanthropy, chaired by investment banker Peter G. Peterson, presented its preliminary findings to the Finance Committee. Contemporaneous with congressional consideration of foundations, this body was organized in 1968 by John D. Rockefeller III and consisted of fifteen prominent citizens as members. Unsurprisingly, its conclusions were more upbeat than those of the Ways and Means Committee. The Commission’s final report was not issued until after the private foundation legislation had become law.¹²⁵ Principal preliminary conclusions were the need for more reliable information about private foundations and “an expression of concern over the quality of foundation investment performance and distribution levels.”¹²⁶ In response to the preliminary findings, the Senate increased the distribution requirements imposed on private foundations, which appeared in the final legislation.¹²⁷

¹²³ *Id.* at 14.

¹²⁴ *Id.*

¹²⁵ See COMM. ON FOUNDS. & PRIVATE PHILANTHROPY, FOUNDATIONS, PRIVATE GIVING, AND PUBLIC POLICY, REPORT AND RECOMMENDATIONS OF THE COMMISSION ON FOUNDATIONS AND PRIVATE PHILANTHROPY (1970).

¹²⁶ WILLIAMS & MOOREHEAD, *supra* note 15, at 2107.

¹²⁷ The Commission’s principal conclusions were (1) Contributions to foundations were more susceptible of abuse—overvaluation and false claims for gifts never made—than in the case of gifts to other charitable organizations; (2) There was a lack of hard evidence to support claims of widespread financial abuses (for example, self-dealing type transactions) among foundations; (3) Only a minority of foundations owned a controlling block of stock in a business corporation, and most of those who did were

The 1965 Treasury Report considered foundations an important complement to governmental action and a vehicle for experimenting with new and untried initiatives with the ability to shift focus quickly because of their flexibility.¹²⁸ By 1969 the Treasury Department, now under the Nixon Administration, was much less supportive. Tax reform was not high on the new administration's agenda until it became a major political issue that required a response, which the Treasury made hurriedly. The principal Treasury official in the technical work of the Ways and Means Committee, Assistant Secretary of the Treasury Edwin Cohen, displayed such a prominent anti-foundation bias that it caused a split in the administration with Robert Finch, the Secretary of Health, Education and Welfare writing a public letter saying the House bill threatened to undermine and even destroy American foundations. The Treasury Secretary David M. Kennedy responded that he was certain that the IRS would maintain sound discretion as it had in the past.¹²⁹

In this atmosphere the House bill was considered by the Senate. There were relatively few changes. One dealt with the tax on foundation income—the audit fee, which was reduced from 7.5% of the investment income of private foundations to .002% of the noncharitable assets of the foundation.¹³⁰ A major addition by the Finance Committee was the insertion of a lifetime limit for foundations. Senator Gore pressed for Representative Patman's twenty-five year life expectancy, but after resistance in the Finance Committee, a compromise of a forty year life limit on the tax-exemptions on income, estate and gift tax for private foundations was agreed upon.¹³¹ The

larger foundations (assets in excess of \$10 million). However, roughly a quarter of the larger foundations held "control stock"; (4) Foundation investment performance, using total rate of return on assets as the measurement, was substantially worse than that of mutual funds; (5) In general, foundation grants have been to recognized exempt organizations, rather than to individuals or for purposes that could be considered as involving social or political activism. WILLIAMS & MOOREHEAD, *supra* note 15, at 2107–08.

¹²⁸ PRIVATE FOUNDATIONS, *supra* note 34, at 12–13.

¹²⁹ NIELSEN, *supra* note 23, at 14–15.

¹³⁰ S. REP. NO. 91-552, at 27–28 (1969) [hereinafter *Senate Finance Committee Report*]. In the Conference Committee this was increased to 4% then later reduced to 2% or even 1% depending on the foundation's distribution. See I.R.C. § 4940(e).

¹³¹ *Senate Finance Committee Report*, *supra* note 130, at 25–27. The Committee concluded that if a private foundation should continue to maintain tax-exempt status it should derive sufficient support to become a public charity. By the end of the forty-year period unless it is to become a taxable entity, the

justification was if tax-exemption was in perpetuity, foundations' economic power might increase to such an extent they would have an undue influence both on the private economy and on governmental decisions.¹³² There was no empirical confirmation of this danger, and the presumption had been rejected in the 1965 Treasury Report.¹³³ The foundation life expectancy limit was rejected on the floor of the Senate and has not reappeared in the subsequent decades.

The Senate passed the bill by a vote of 69 to 22 on December 11, 1969. It was sent to the Conference Committee, which reported it out four days later. The Conference Report was approved on December 22nd by votes of 381 to 2 in the House, and 71 to 6 in the Senate. President Nixon signed the bill into law on December 30, 1969.¹³⁴ Aside from the amendments discussed above and a few other tweaks, the bill as presented by the Ways and Means Committee became the final law. In subsequent years there have been a few amendments and changes, but the 1969 Tax Reform Act has remained the framework of private foundation regulation for fifty years.

V. AN EVOLUTIONARY, REVOLUTIONARY OR REACTIONARY STATUTE?

Most of the significant changes in the 1969 Tax Reform Act emanated from the 1965 Treasury Report or were generated from prior concerns dating back to the 1940s. Despite the revelations, controversies, and headlines from the hearings, the most direct result by the Ways and Means and the Finance Committees was the addition of § 4945 of the Code, the prohibition of taxable expenditures, but even here many of the changes consisted of clarifying ambiguous or incomplete language of the pre-existing law. An example is the prohibition on carrying on propaganda or attempting to

private foundation would have to either have distributed its assets to public charities or must itself become one. If the foundation did neither it would be taxed as a corporation or trust. No new contributions or bequests to the foundation would be eligible for charitable contribution or gift tax deductions.

¹³² *Id.* at 25.

¹³³ PRIVATE FOUNDATIONS, *supra* note 34, at 13.

¹³⁴ *See* Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 (codified as amended in scattered sections of 26 U.S.C.).

influence legislation.¹³⁵ The previous law required “no *substantial* part of the activities of a private foundation could consist of carrying on propaganda or attempting to influence legislation.” Larger foundations could engage in such activities by slipping under the substantial test. Other foundations could evade the no substantial part test, knowing they would not have their tax-exempt status revoked.¹³⁶

The hearings, however, changed the tenor of the discussion and led to a regulatory framework that was far more restrictive than would have resulted in a less volatile and partisan era. The restrictions on the private benefits accruing to foundation donors and board members had long been a concern. The prohibitions on foundation activities in controversial areas such as civil rights and school desegregation can be seen and were viewed in the African American community as a racist backlash to remove gains achieved from the Civil Rights Act of 1964¹³⁷ and other efforts to remove barriers based on race or ethnicity.¹³⁸ Whitney Young, Executive Director of the National Urban League, testified at the Senate Finance Committee hearings:

There are features in [the bill] that clearly have had the direct result of making the black community particularly feel that it is a hostile bill, a bill . . . with a purpose as much to intimidate as to legislate, a bill designed to discourage foundations who belatedly have found the field of social reform to be one in which they might tenderly tread, a bill to sort of caution and warn them. [A]lready . . . there is some evidence that foundations will become again very cautious, very conservative, turn only toward those absolutely noncontroversial things that they feel will remove them from any threat of reprisal, of punitive action, on the part of the Federal Government

[F]or years the white community has been able to organize different ethnic groups and regional groups, vested interest groups, and they have been able to use the resources of the private sector through foundations, to address themselves to their problems as they saw them It has only been in very recent years that we have managed to acquire in our black community the kind of sophistication and know-how to make it possible to organize and to make our requests for resources to help ourselves and to meet our needs. And to have at this point in the game

¹³⁵ I.R.C. § 4945(d)(1), (e). There are exceptions if a governmental body requests assistance or nonpartisan analysis and research.

¹³⁶ *Senate Finance Committee Report*, *supra* note 130, at 46–48.

¹³⁷ Civil Rights Act of 1964, Pub. L. 88–352, 78 Stat. 241.

¹³⁸ REAMS, *supra* note 82, at 5405–06.

suddenly to be told that the rules are changing seem to us—again to say to black people—that the rules are changing only when you are about to be benefited.

While grants for the study of Bosnian and Herzegovinian headstones remained possible, grants for civil rights and legislative and political activities were circumscribed.

A. The Excise Tax Regulatory Regime

One of the most unique innovations was the adoption of a graduated penalty scheme of taxes placed on foundations and their managers (trustees, officers, and other insiders) if they engaged in prohibited activities or failed to meet the minimum annual distribution or the excise tax on investment income requirements.¹³⁹ Previously the only remedy was loss of tax-exemption, which was rarely used. Under the excise tax regime, there is an initial tax, but an opportunity to seek mitigation of the tax (“correction” in the statute’s language).¹⁴⁰ Those who do not correct or are repeat offenders are subject to a much higher secondary tax. Only the most egregious violators of the private foundation rules face loss of tax-exempt status and possibly the confiscation of assets.

1. The Private Foundation/Public Charity Distinction

Under the prior law, private foundations were not specifically defined. Instead, the words “private foundation” referred to an organization, contributions to which could be deducted only up to 20% of an individual donor’s adjusted gross income. Also, under prior law deductions up to 30% could be taken for contributions to churches, schools, hospitals, states and subdivisions and publicly supported charities. For the first time under the 1969 Act, private foundations were specifically defined. Rather than say what private foundations were, the Act assumed that all charities were private foundations unless they could prove otherwise.¹⁴¹ Those organizations that

¹³⁹ The provisions in question span I.R.C. §§ 4940–4945.

¹⁴⁰ See, e.g., I.R.C. §§ 4945(a)–(b), 4944(a)–(b).

¹⁴¹ I.R.C. §§ 509(a), 4948.

could show they were not private foundations were eligible to receive contributions up to 50% of an individual's adjusted gross income.¹⁴²

The first group that escaped the private foundation designation were charities that traditionally were supported by the public and under prior law were 30% charities: churches or conventions or associations of churches,¹⁴³ educational institutions that offered formal instruction, hospitals and medical research organizations, support organizations for state colleges and universities, and governmental units.¹⁴⁴ These organizations escaped private foundation designation because their inherent nature is public.¹⁴⁵

A second exception is based on publicly supported activities. If a charity can meet certain complicated tests of public support showing that a certain portion of its total support comes from governmental units or direct or indirect contributions from the public and gross receipts from admission charges, gifts, grants membership fees, and fees from performance of exempt functions and normally does not receive more than one-third of its support from gross investment income and unrelated business income, it will avoid private foundation status.¹⁴⁶ A third exception to private foundation status is for organizations that are organized and operated for the benefit of one or more specified public charities and are controlled by or in connection with specified public charities and not controlled by one or more disqualified persons other than foundation managers and the public charities it supports.¹⁴⁷

¹⁴² This figure has been increased to 60% under the Tax Cuts and Jobs Act of 2017. I.R.C. § 170(b)(1)(G). This increase expires at the end of 2025.

¹⁴³ *Id.* § 170(b)(1)(A).

¹⁴⁴ *Id.* §§ 509(a)(1), 170(b)(1)(A)(i)–(vi).

¹⁴⁵ The theory of public status of these “traditional charities” as they are known is that each institution could not survive without continually convincing a reasonably large segment of the public that its operations were worthwhile.

¹⁴⁶ I.R.C. § 509(a)(1), (2).

¹⁴⁷ *Id.* § 509(a)(3). Other organizations that escape from private foundation status are organizations organized and operated for testing for public safety, I.R.C. § 509(a)(4); private operating foundations, I.R.C. §§ 4942(j)(3), 170(b)(1)(F)(i); and pass through foundations, I.R.C. § 170(b)(1)(F)(ii) and pooled common funds, I.R.C. § 170(b)(1)(F)(iii).

2. Information Reporting and Disclosure Requirements

One aspect about the oversight deficiencies of private foundations that all agreed upon was the lack of accurate information available to the government. There was no verifiable count of the number of private foundations, let alone the necessary information to oversee them. This criticism dated back to the forties, through Patman and the 1969 hearings. The inability of the IRS to gather the necessary information to evaluate the foundation community or to oversee and discipline wayward foundations was one reason Patman's reports received a credibility they may not have deserved.

Under the pre-1969 law, charities other than religious organizations and certain of their affiliates, schools and colleges, publicly supported charitable organizations, certain fraternal beneficiary societies, and federally-owned congressionally chartered exempt organizations were required to file annual information returns, which were available for public scrutiny.¹⁴⁸ This meant private foundations had to file but there were no sanctions for failure to do so, though criminal provisions could be applied in extreme cases.

The 1969 Act broadened those required to file information returns and expanded the amount of information required.¹⁴⁹ Every private foundation must file a Form 990-PF information return within four and one-half months after the end of its tax year.¹⁵⁰ There are monetary penalties for failure to file in a timely fashion.¹⁵¹ Private foundations have more detailed disclosure

¹⁴⁸ *Id.* § 501(A). The information returns had to contain the organization's showing its gross income, expenses, disbursements for exempt purposes, accumulations, the balance sheet and the total amount of contributions and gifts received by it during the year. The information returns were in addition to the unrelated business income returns that had to be filed in certain situations.

¹⁴⁹ Still exempted were churches, their integrated auxiliaries, and conventions or associations of churches; organizations except for private foundation for which the gross receipts were not more than \$5,000, and the exclusive religious activities of any religious order I.R.C. § 6033(a)(3).

¹⁵⁰ I.R.C. § 6033.

¹⁵¹ *Id.* § 6652(c)(1)(A) provides for a penalty of \$20 for each day during which such failure continues. The maximum penalty for failure to file with respect to any one return shall not exceed the lesser of \$10,000 or 5% of the gross receipts of the organization for the year. In the case of an organization having gross receipts exceeding \$1,000,000 for any year, the amount of the penalty for each day during which a failure continues shall be \$100 per day in lieu of the amount otherwise specified, and the maximum penalty shall not exceed \$50,000. If any foundation manager fails to comply with a demand by the government for an information return, the penalty paid by the person responsible for failing to comply

requirements than public charities.¹⁵² The information return and the foundation's application for exemption must be made available to state officials and the public. Individuals have the right to request a take-home copy of the last three years of returns, which is usually unnecessary as they are now available over the Internet through *GuideStar*.¹⁵³

In the 1970s and 1980s, the IRS increased its audits of private foundations, but this activism waned in the 1980s and 1990s.¹⁵⁴ More recently, the IRS has been under siege by certain elements of Congress, its budget cuts, and its resources incapable of the necessary scrutiny of the nonprofit sector. There have been calls by scholars to decouple oversight of exempt organizations from the agency.¹⁵⁵

is \$10 for each day after the expiration of the time specified in such demand during which such failure continues. The maximum penalty imposed on all persons for failures with respect to any one return shall not exceed \$5,000.

¹⁵² Private foundations must include an itemized statement of all grants made or approved for future payment, with the name and address of grantees and the purpose and amount of each grant, and they must complete a detailed schedule showing that they have complied with the 5% payout requirement. Unlike private foundations public charities must disclose the names and addresses of their contributors but do not have to disclose those names to the public. *Id.* § 6104(d)(3)(A). For each year in which it has made an expenditure responsibility grant, it must list it on the Form 990-PF. In addition, it must add a schedule to the tax return, providing a brief summary paragraph on each expenditure responsibility grant's status.

¹⁵³ See generally GUIDESTAR, www.guidestar.org (last visited June 18, 2020). There are detailed regulations for meeting the delivery requirements. Treas. Reg. § 301.6104(d)-1 (as amended in 2003).

¹⁵⁴ Troyer, *supra* note 29, at 64.

¹⁵⁵ Evelyn Brody & Marcus Owens, *Exile to Main Street: The I.R.S.'s Diminished Role in Overseeing Tax-Exempt Organizations*, 91 CHI.-KENT L. REV. 859, 859–60 (2016); Terri Lynn Helge, *Policing the Good Guys: Regulation of the Charitable Sector Through a Federal Charity Oversight Board*, 19 CORNELL J.L. & PUB. POL'Y 1, 70–71 (2009); Elizabeth K. Keating & Peter Frumkin, *Reengineering Nonprofit Financial Accountability: Toward a More Reliable Foundation for Regulation*, 63 PUB. ADMIN. REV. 3, 12–16 (2003); Lloyd Hitoshi Mayer, *'The Better Part of Valour Is Discretion': Should the IRS Change or Surrender Its Oversight of Tax-Exempt Organizations?*, 7 COLUM. J. TAX LAW 80 (2016); Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the Twenty-First Century: An Institutional Choice Analysis*, 85 CHI-KENT L. REV. 479 (2010); Marcus S. Owens, *Charity Oversight: An Alternative Approach* 3 (Harvard University Hauser Center for Nonprofit Organizations, Working Paper No. 33.4, 2006), http://www.hks.harvard.edu/hauser/PDF_XLS/workingpapers/workingpaper_33.4.pdf.

VI. THE INITIAL IMPACT OF THE 1969 TAX REFORM ACT ON FOUNDATIONS

The legislation's initial impact on private foundations was a sharp decrease in their birth rate and an increase in their death rate (termination).¹⁵⁶ According to congressional testimony in 1973 by Professor John Simon, the negative impact resulted from two provisions that directly discouraged contributions to private foundations.¹⁵⁷ The first was the rule pertaining to contribution of appreciated property in Code § 170(e), which permitted all charitable organizations save non-operating foundations to receive gifts of appreciated property without subjecting the donor to the tax on the long-term capital gains.¹⁵⁸ The second cause was the excess holdings provision, which in effect prevented foundations from receiving a gift of the donor's corporate control stock unless the combined voting interest of the donor was brought below the 20% threshold within the periods mentioned in the statute.¹⁵⁹

Professor Simon tabulated the number of foundations from the *Internal Revenue Bulletin*, the New York State Attorney General, and the Council of Foundation's compilation of the IRS's cumulative list of foundations, but there was no systematic study available. The incomplete data showed a definite trend in the increased termination of foundations. Some observers thought the death rate was primarily among smaller foundations, who may have been daunted by the complexity of the new regulatory regime and the additional administrative costs to adhere to it.¹⁶⁰

The decline in the birthrate was understandable. Prior to the 1969 Tax Reform Act, 80% of gifts to foundations of more than \$1 million were composed of gifts of appreciated property, and more than half of foundations with more than \$10 million in assets had, at one time, held stock of

¹⁵⁶ "Birthrate" is used to include the formation of new foundations and contributions of capital to existing but not fully funded foundations.

¹⁵⁷ *The Role of Foundations Today and the Effect of the Tax Reform Act upon Foundations: Hearings Before the Subcomm. on Foundations of the S. Fin. Comm.*, 93rd Cong. 173 (1973) (statement of Professor John G. Simon) [hereinafter *Simon Testimony*].

¹⁵⁸ The provision was changed in 1984 to allow gifts of publicly traded stock to be deductible at the full fair market value, rather than at a reduced level. I.R.C. § 170(e)(1)(B)(ii), (e)(5).

¹⁵⁹ *Id.* § 4943(c)(5)-(7).

¹⁶⁰ *Simon Testimony*, *supra* note 157, at 175-81.

companies in which the foundation and donor together held a 20% or more interest to which the divestment provision of § 4943 of the Code would apply.¹⁶¹ An early study by the Council on Foundations and the Yale Program on Nonprofit Organizations revealed that wealthy donors were deterred by the increased regulation, the tax disincentives for lifetime gifts, administrative burdens, and the availability of alternative philanthropic vehicles such as community foundations, donor-advised funds, and supporting foundations. According to the study, attorneys played a major role in discouraging the formation of foundations during the 1970s and early 1980s. Overreacting to the 1969 legislation, they conveyed the message that foundations were expensive, time consuming, inefficient and complicated: “a mine field for somebody who doesn’t know what they are doing.”¹⁶² The prognostications about the death of private foundations turned out to be premature.

More recently, private foundations have enjoyed a resurgence as Congress relaxed some of the disincentives and philanthropists and their advisors adapted to the regulatory regime.¹⁶³

¹⁶¹ *Id.* at 181–82.

¹⁶² Francie Ostrower, *The Role of Advisors to the Wealthy, in THE FUTURE OF FOUNDATIONS* 247 (Teresa Odendahl ed., 1987).

¹⁶³ In 1984, Congress created more favorable incentives for creation of private nonoperating foundations by allowing donors to deduct the full fair market value of appreciated stock of public companies. Deficit Reduction Act of 1984, Pub. L. 98-369, § 301(b), 98 Stat. 494, 777.

TABLE 1		
Increase in Private Non-Operating Foundations by Returns filed with IRS 1985-2015 ¹⁶⁴		
Year	Returns	Percentage Increase from Previous 5 Years
2015	90,699	20.7%
2010	75,158	17.7%
2005	63,844	9.6%
2000	61,501	39.8%
1995	43,966	19.2%
1990	36,880	0.29%
1985	28,599	

Financial services companies, wealth management advisors, and sophisticated estate planners also played a role by including foundations in their list of attractive “products.” Publicity surrounding several enormous gifts to new and existing foundations has contributed to a bandwagon effect among the actual and aspiring affluent. All these developments have confirmed the emergence of the family foundation as a growth industry.¹⁶⁵ Additionally, for extremely wealthy individuals, a private foundation can offer substantial savings for those with assets over the lifetime exclusion amount (\$11.58 million per person in 2020),¹⁶⁶ allowing avoidance of the 40% federal estate tax rate on wealth transfers¹⁶⁷ and the use of a 100% charitable deduction,¹⁶⁸ enabling a family to control large resources for generations.

¹⁶⁴ *SOI Tax Stats—Domestic Private Foundation and Charitable Trust Statistics*, INTERNAL REVENUE SERVICE, <https://www.irs.gov/statistics/soi-tax-stats-domestic-private-foundation-and-charitable-trust-statistics#2> (last visited June 18, 2020).

¹⁶⁵ FISHMAN ET AL., *supra* note 97, at 665–66.

¹⁶⁶ Rev. Proc. 2019-44, 2019-47 I.R.B. 1093.

¹⁶⁷ I.R.C. § 2001.

¹⁶⁸ I.R.C. §§ 2055, 2522.

A. Was the 1969 Tax Reform Unfair to Private Foundations?

Virtually every investigation of private foundations found some wrongdoing. What was missing was empirical evidence of the extent of the problems highlighted. The actual evidence offered was overwhelmingly anecdotal. The foundation community made this the first principle of their defense, and as discussed it was ineffective, not the least because there was no valid data to prove otherwise. All sides could agree that the IRS had neither the capability nor the resources to obtain such information.

In contrast to private foundations, public charities in 1969 and before did not seem to have the same number of bad actors, a view that would not hold today as the nonprofit sector is scrutinized more closely through the Internet, social media, and the news. There also was the mistaken belief that charities supported by the public were more transparent than foundations and when problems arose, they would be fixed by angry donors. Today there is a greater focus on public charities by the press because of the availability of public information and the impact of social media. This can make the public or press monitors of public charity wrongdoing.¹⁶⁹ Scrutiny of foundations is less prominent unless they have substantial assets. Family foundations are often controlled by one person or a family and more likely to act in the donor's interest without any independent checks or balances.

1. The Audit Fee: I.R.C. Section 4940

Some assumptions underlying certain parts of the legislation were misguided or just plain wrong. An example cited by several commentators is the so-called audit fee, the tax on investment income in § 4940 of the Code.¹⁷⁰ The audit fee was supposed to assist the government in meeting the costs of overseeing exempt organizations. Why should only private foundations be burdened with that tax? Public charities and other tax-exempt organizations incur costs of oversight too, yet they pay no equivalent of the audit fee.

¹⁶⁹ See Linda Sugin, *Strengthening Charity Law: Replacing Media Oversight with Advance Rulings for Nonprofit Fiduciaries*, 89 TUL. L. REV. 869, 884–96 (2015).

¹⁷⁰ Troyer, *supra* note 29, at 64; WILLIAMS & MOOREHEAD, *supra* note 15, at 2113–55.

In fact, § 4940 of the Code tax raised far more than necessary and was reduced from 4% to 2% in 1978.¹⁷¹ Then in 1984, Congress again reduced that rate to 1% if the foundation increased its annual qualifying distribution for charitable purposes over its historic distribution rate.¹⁷² The provision relating to reduction of the audit tax was extremely complicated, and there were repeated calls for it to be simplified. In late 2019, Congress finally acted to simplify the § 4940 tax on net investment income by imposing a single rate of 1.39% and repealing the special reduced rate for private foundations that exceeded their five-year historical level of qualifying distributions.¹⁷³

The sums raised are not allocated to oversight of the exempt organization branch of the Service or even to the IRS, though the original intention seems to have been to the contrary.¹⁷⁴ They go directly into the general treasury. Given the underfunding of the IRS and the sums raised by the audit fee, if it is retained, should be earmarked for use by the Service for enforcement and oversight.

2. The Minimum Distribution Requirement

The minimum distribution requirements were added to assure foundations gave a minimum amount of their assets for charitable activities. The 5% minimum, unfortunately, has for a great many foundations become the standard spending rate.¹⁷⁵ However, public charities often hoard money

¹⁷¹ Revenue Act of 1978, Pub. L. 95-600, § 520(a), 92 Stat. 2884. I.R.C. § 4940(a).

¹⁷² Deficit Reduction Act of 1984, Pub. L. 98-369, § 303(a), 98 Stat. 779, 781 added I.R.C. § 4940(e). However, this provision may have discouraged a private foundation from making large distributions in a single year, because it was harder to beat their historic average and qualify for the lower tax rate in subsequent years. In December 2019, Congress amended I.R.C. § 4940(a) to apply a uniform 1.39% rate. 2020 Appropriations Act, Pub. L. 116-94, § 206(a), (b), 133 Stat. 3246.

¹⁷³ Further Consolidated Appropriations Act, 2020, Pub. L. No. 116-94, Div. Q, § 206, 132 Stat. 2534, 3246 (2019). The change is effective for taxable years beginning after the December 20, 2019 enacted date of the Act.

¹⁷⁴ Troyer *supra* note 29, at 64.

¹⁷⁵ A large percentage of private foundations seem to consider the 5% payout a maximum rather than a minimum. A 2012 study of independent endowed foundations found that 45.6% spent 5–5.9% of their net assets annually. Only 20% had payout of 10% or above. See LOREN RENZ, UNDERSTANDING AND BENCHMARKING FOUNDATION PAYOUTS 5 (2012), <https://foundationcenter.issuelab.org/resources/14076/14076.pdf>; Alex Daniels, *What's So Special About 5%*, CHRON. PHIL. (Mar. 7, 2017), <https://www.philanthropy.com/article/Big-Foundations-Give-Little/239383?cid=rclink> (explaining that most big foundations give little more than the law requires, while critics say they should do better).

at the expense of the beneficiaries of their charitable mission. An example is the building of immense billion-dollar endowments at some colleges and universities that have average spend rates of 4.6%, a figure below the private foundation mandate.¹⁷⁶ The failure of donor advised funds to spend sufficient amounts has been frequently criticized.¹⁷⁷ These vehicles have no duty to spend anything at all yet give their donors an immediate deduction.

Since 1969, foundations have escaped from the distrust and hostility that had surrounded them in the legislative hearings and the public's mind. By almost any measure, the 1969 Tax Reform Act has been a success. The excise tax procedure has an *in terrorem* effect. The amounts it raises are relatively small. Because of the impact of these penalties, private foundations and their managers generally are the most compliant of taxpayers. In the words of Professor Richard Schmalbeck:

Perhaps the most compelling evidence of the success of the 1969 Act reforms is simply that they have endured. Modest changes have been made in the 34 years since passage, but the overall 1969 framework of the tax law governing private foundations remains remarkably intact to this day. Further, while the trend in virtually every other area of the tax law has been to tighten the applicable rules in an effort to reduce abuses, the pattern in the private foundation area has been to relax, albeit only slightly, the tight grip of the 1969 reforms.¹⁷⁸

Of course, there are contemporary criticisms of private foundations: too few spend more than the minimum mandatory distribution requirement, their administrative expenses are higher than they should be, and their grant policies reinforce the existing hierarchies and privileges of the wealthy.¹⁷⁹ Too many foundations are indifferent to issues of inequality and poverty. Still, the vitriol and hostility to the private foundation structure is gone.

¹⁷⁶ NACUBO-TIAA, 2018 NACUBO-TIAA STUDY OF ENDOWMENTS (NTSE) RESULTS, AVERAGE ANNUAL EFFECTIVE SPENDING RATES FOR U.S. COLLEGE AND UNIVERSITY ENDOWMENTS AND HIGHER EDUCATION FOUNDATIONS, FISCAL YEARS 2018 TO 2009 (2018), <https://www.nacubo.org/Research/2019/Public-NTSE-Tables>.

¹⁷⁷ Roger Colinvaux, *Donor Advised Funds: Charitable Spending Vehicles for 21st Century Philanthropy*, 92 WASH. L. REV. 39, 72–73 (2017); Ray D. Madoff, *5 Myths About Payout Rules for Donor-Advised Funds*, CHRON. PHIL. (Jan. 13, 2014), <https://www.philanthropy.com/article/5-Myths-About-Payout-Rules-for/153809>.

¹⁷⁸ Richard Schmalbeck, *Reconsidering Private Foundation Investment Limitations*, 58 TAX L. REV. 59, 63 (2004).

¹⁷⁹ See REICH, *supra* note 4, at 69, 92.

B. A Remaining Issue: The Small Private Foundation Problem

Over time some of the more unfair and ineffective sections of the Act have been amended or softened, yet some issues remain. Now as in the past the IRS seems to know little about a large swath of the foundation community, specifically smaller foundations, defined under the IRS's criteria as those with assets under \$1 million. Audits and oversight are virtually non-existent. According to the IRS's own data only 0.3% of foundations with under \$125,000 in assets, 0.8% of foundations with \$125,000 to \$400,000 in assets and 1.9% of foundations with assets from \$400,000 to \$1,000,000 in assets have their Form 990-PFs sampled.¹⁸⁰ Larger foundations have much greater percentages of sampling of Form 990-F returns. As Table 2 below indicates, the number of actual examinations of private foundations annually is miniscule compared to the number of returns filed, demonstrating that particularly for foundations assets of \$1 million or less (58.35% of all private foundations in 2015 of the total returns filed), audits and oversight are non-existent.¹⁸¹

TABLE 2	
Number of Returns examined by Internal Revenue Service by Fiscal Year¹⁸²	
2018	263
2017	302
2016	231
2015	119
2014	246
2006	423

The IRS defines small foundations as those with under \$1 million in assets. Medium-sized foundations range from \$1 to \$50 million in assets, and

¹⁸⁰ MELISSA LUDLUM, DATA INTERPRETATION ACROSS SOURCES: A STUDY OF FORM 990-PF INFORMATION COLLECTED FROM MULTIPLE DATABASES 7 (2004).

¹⁸¹ See *id.* tbl.1 (showing Statistics of Income 2018, Domestic Private Foundations).

¹⁸² I.R.S., *SOI Tax Stats—Returns of Tax-Exempt Organizations, Employee Retirement Plans, Government Entities, and Tax-Exempt Bonds Examined, by Type of Return: Tax Years 2018, 2017, 2016*,

large foundations are those in excess of \$50 million.¹⁸³ Small foundations, though a declining percentage of the total number because of inflation and the creation of numerous large foundations still remain a majority of all reporting foundations.

TABLE 3				
Number of Small Foundations (Assets under \$1 Million) as a Percentage of All Returns Filed with I.R.S. 1985-2015 ¹⁸⁴				
Year	Number of Non-Operating Foundations (by return)	Asset size \$1-\$99,000	Asset size \$100,000-\$999,000	Percentage of Small Foundations out of total number of foundations
2015	90,699	20,967	31,501	58.0%
2010	75,158	14,848	29,785	59.3%
2005	63,844	12,917	25,509	60.1%
2000	61,501	15,849	24,586	65.7%
1995	43,966	13,535	16,722	68.8%
1990	36,880	13,146	14,091	73.8%
1985	28,599	11,852	10,814	79.3%

2015, 2014, 2006, <https://www.irs.gov/statistics/soi-tax-stats-returns-of-tax-exempt-organizations-employee-retirement-plans-government-entities-and-tax-exempt-bonds-irs-data-book-table-13> (last visited June 18, 2020). Note the figures include examinations of certain trusts and political organizations as well as foundations. *Id.* Total Includes I.R.S. Form 990-PF (private foundation information return); I.R.S. Form 1041-A (information returns of charitable contribution deductions by certain trusts); I.R.S. Form 1120-POL (income tax return for certain political organizations) and I.R.S. Form 5227 (split interest trust information return).

¹⁸³ *Id.*

¹⁸⁴ *Id.*

TABLE 4		
Percentage of Nonoperating Foundations by Size 2015 ¹⁸⁵		
Assets	Number	Percentage of Total
\$0 or unreported	2,805	3.1%
Small Foundations		
\$1 to \$99,000	20,967	23.1%
\$100,000 to \$999,000	31,960	35.2%
Medium Sized Foundations		
\$1,000,000 to \$9,999,999	27,112	30.0%
\$10,000,000 to \$24,999,999	4,279	4.7%
\$25,000,000 to \$49,999,999	1,714	1.8%
Large Foundations		
\$50,000,000 to \$999,999,999	927	1.0%
\$100,000,000 or more	935	1.0%

Smaller foundations are susceptible to many of the problems detailed in the 1965 Treasury Report and the 1969 hearings—self-dealing between donors and the foundation, inexperienced, inappropriate, or non-existent investment strategies, ignorance of the requirements, over reliance of the minimal required distributions as a maximum expenditure guideline, and a lack of oversight by state or federal authorities.¹⁸⁶ Family foundations often have no competent professional investment advice, legal counsel knowledgeable in the complexities of the private foundation regulatory regime, or accounting services familiar with the private foundation legal regime. This has led to serious problems.

¹⁸⁵ *Id.*

¹⁸⁶ The IRS in charts defines smaller foundations as those with assets under \$1 million. A better definition might expand the small foundation cohort to foundations under \$2 million in assets.

C. The Madoff Ponzi Scheme

The boards of smaller foundations may not have investment skills or sophistication to manage, protect and enable the endowment to grow. In 2009, approximately 150 small foundations learned they had invested in a Ponzi scheme rather than with a fund that provided constant returns over many years. The scheme was run by a supposed investment wizard named Bernard Madoff, who collected an estimated \$65 billion over thirty years before the fund's inevitable collapse.¹⁸⁷ To be fair, the victims also included colleges and universities, philanthropists, and large charities.¹⁸⁸

According to a report by the National Committee for Responsive Philanthropy, most of the private foundations that invested with Madoff were small family foundations and lacked adequate board size or diverse leadership, which contributed to their becoming victims. A majority of more than 100 foundations that lost 30% to all of their assets in the Madoff scandal had four or fewer board members and thirty-eight of the foundations that invested with Madoff had only one or two trustees, while forty-six had only three or four. Many small family foundations do not use professional investment managers, nor do they have systems in place to prevent such

¹⁸⁷ See Diane B. Henriques, *Madoff Scheme Kept Rippling Outward, Across Borders*, N.Y. TIMES (Dec. 20, 2008), <https://www.nytimes.com/2008/12/20/business/20madoff.html>.

A Ponzi scheme is an investment fraud that pays existing investors with funds collected from new investors. Ponzi scheme organizers often promise to invest your money and generate high returns with little or no risk. But in many Ponzi schemes, the fraudsters do not invest the money. Instead, they use it to pay those who invested earlier and may keep some for themselves. With little or no legitimate earnings, Ponzi schemes require a constant flow of new money to survive. When it becomes hard to recruit new investors, or when large numbers of existing investors cash out, these schemes tend to collapse. Ponzi schemes are named after Charles Ponzi, who duped investors in the 1920s with a postage stamp speculation scheme.

Ponzi Scheme, U.S. SEC. & EXCH. COMMISSION, <http://www.investor.gov/protect-your-investments/fraud/types-fraud/ponzi-scheme> (last visited on June 18, 2020).

¹⁸⁸ Henriques, *supra* note 187. Madoff's "innovation" was not to promise extraordinary profits, such as "double your money in six months," but steady returns of 10 to 12%. There was a lack of transparency of Madoff's investment approach. He was unwilling to disclose his investment strategy. The size of Madoff's fund exceeded the total trading in the securities his investors purportedly owned. In fact, Madoff never traded at all. His auditor was a two-partner accounting firm located in a suburban strip mall. Who is to blame for so many charities investing in this scheme? The foundation board that did not do due diligence. *See id.*

losses.¹⁸⁹ There was substantial overlapping among the accountants who prepared the tax returns of the foundations invested with Madoff. Generally, they were generally smaller firms. Would larger firms have looked more skeptically at the kinds of trades that supposedly were being placed on the foundations' behalf?¹⁹⁰

D. The Trump Foundation

One might think that a sophisticated businessperson and putative billionaire would be knowledgeable about the legal parameters of his private foundation. That has not been the case with Donald J. Trump, though in 2016 he tweeted: "I know our complex tax laws better than anyone who has ever run for president."¹⁹¹ The private foundation rules are complex even for attorneys familiar with them. To lay persons they are traps for the well-meaning and for those who might wish to game them to their advantage or use their "smarts" or common sense as a guide, they are a minefield as the Trump Foundation's experience demonstrates.

Investigative reporting by David Farenthold of the *Washington Post*, who won a Pulitzer Prize for his efforts, uncovered that the Donald J. Trump Foundation was involved in self-dealing violations because they benefitted Mr. Trump personally.¹⁹² It also engaged in impermissible political

¹⁸⁹ See NIKI JAGPAL & JULIA CRAIG, LEARNING FROM MADOFF: LESSONS FOR FOUNDATION BOARDS 2 (2009), <https://www.issueab.org/resource/learning-from-madoff-lessons-for-foundation-boards.html>; see also Stephanie Strom, *Study Ties Madoff Loss to Charity's Board Size*, N.Y. TIMES, June 24, 2009, at B3.

¹⁹⁰ Interestingly Madoff's two sons, Mark and Andrew, each had a family foundation, but did not invest with their father. The also used Big Four accounting firms. See Nicholas Kristof, *Madoff and America's (Poorer) Foundations*, N.Y. TIMES (Jan. 29, 2009), <https://kristof.blogs.nytimes.com/2009/01/29/madoff-and-americas-poorer-foundations>. Voyeurs can find the foundations affected and the amounts they lost through a Benefit Technology compiled resource. Daniel E. Smith, *Private Foundations Preliminary Estimates of Madoff Exposure*, BENEFIT TECH., https://static01.nyt.com/packages/pdf/opinion/madoff_exposure_7.pdf (last visited on June 18, 2020).

¹⁹¹ Philip T. Hackney, Opinion, *Why the I.R.S. Should Go After Trump*, N.Y. TIMES (June 15, 2018), <https://www.nytimes.com/2018/06/15/opinion/trump-foundation-new-york-attorney-general.html> (arguing for criminal tax fraud for the allegations against the Trump Foundation).

¹⁹² David A. Farenthold, *Donald Trump Used Money Donated for Charity to Buy Himself a Tim Tebow-signed Football Helmet*, WASH. POST (July 1, 2016, 6:00 AM), <https://www.washingtonpost.com/news/post-politics/wp/2016/07/01/donald-trump-used-money-donated-for-charity-to-buy-himself-a-tim-tebow-signed-football-helmet/>. Other possible self-dealing issues were whether the Trump Foundation

activity.¹⁹³ The Trump Foundation came under renewed scrutiny in 2018, when the New York Attorney General filed a lengthy petition alleging improper activities by the Foundation and its managers, especially now-President Trump.¹⁹⁴ Many of the activities were those identified in 2016 but added to them were allegations that the Foundation benefited Trump's presidential campaign by facilitating a fundraiser to support veterans' charities that Trump held in place of participating in a Republican presidential candidate debate.¹⁹⁵ According to the Attorney General, the campaign organized the event, and the campaign, rather than the Foundation, controlled the distribution of the contributions received even though they were made to the Foundation.¹⁹⁶

In November 2018, as part of a settlement resolving the attorney general's lawsuit, President Trump admitted to misusing foundation funds and was ordered to pay \$2 million of his money to agreed-upon charities, because of his breach of fiduciary duty and the use of the foundation to further personal and political interests.¹⁹⁷ President Trump also agreed that

made grants to charities in exchange for them booking events at Trump properties or made grants that benefited Trump by being to charities selected by the celebrities who were winners on his Celebrity Apprentice television show. See David A. Fahrenthold & Rosalind S. Helderman, *Missing from Trump's List of Charitable Giving: His Own Personal Cash*, WASH. POST (Apr. 10, 2016), https://www.washingtonpost.com/politics/a-portrait-of-trump-the-donor-free-rounds-of-golf-but-no-personal-cash/2016/04/10/373b9b92-fb40-11e5-9140-e61d062438bb_story.html. There were allegations that the Trump Foundation spent \$258,000 to settle lawsuits involving Trump's for-profit businesses. David A. Fahrenthold, *Trump Used \$258,000 from His Charity to Settle Legal Problems*, WASH. POST (Sept. 20, 2016), https://www.washingtonpost.com/politics/trump-used-258000-from-his-charity-to-settle-legal-problems/2016/09/20/adc88f9c-7d11-11e6-ac8e-cf8e0dd91dc7_story.html?utm_term=.ea00f56c0afe.

¹⁹³ Maggie Severns, *Trump Foundation Admits Error in Donation to Florida Attorney General Campaign*, POLITICO (Mar. 22, 2016, 2:00 PM), <http://www.politico.com/story/2016/03/trump-foundation-irs-complaint-221098>.

¹⁹⁴ Press Release, New York State Office of the Attorney General, AG James Secures Court Order Against Donald J. Trump, Trump Children, and Trump Foundation (Nov. 7, 2019), <https://ag.ny.gov/press-release/2019/ag-james-secures-court-order-against-donald-j-trump-trump-children-and-trump>.

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ Severns, *supra* note 193. The final settlement of the Trump Foundation's problems required President Trump himself to pay \$2 million to go to charities named by the New York Attorney General. Announcing that settlement, Mr. Trump said that he was making a "donation" of \$2 million. In fact, those funds are not eligible for a federal income tax deduction, per Rev. Rul. 79-148, 1979-1 C.B. 93; *Stephen D. Ruddel v. Commissioner*, T.C. Memo. 1996-125; *Nunzio Lombardo v. Commissioner*, T.C. Memo 1985-552. Hat tip to Professor Harvey Dale for that insight. Should President Trump's tax returns become

any charity he became involved with in the future would have a majority of independent directors with expertise in nonprofit law and an accounting firm to monitor its grants and expenses.

Over a period of nearly two decades from 1999 through November 2018, the Trump Foundation's board never met. According to the Stipulation of Final Settlement, the board did not provide oversight, set policy, or approve the direction, operations or acts of the foundation. It did not promulgate written criteria for the consideration, approval or monitoring of grants, or protocols for assuring compliance with the organization's governing documents and charitable mission, and did not adopt a conflict of interest policy after July 2014 when such policy was required.¹⁹⁸ This ignorance of the fundamentals of nonprofit governance led to the problems targeted in the Attorney General's lawsuit.

Despite this scope of violations of the private foundation rules, it did not seem the Trumps intentionally attempted to violate the law. They were ignorant of it. This is no excuse, but one can imagine that the mind set was if it seemed in anyway related to charity, no matter how far-fetched to a knowledgeable attorney or nonprofit professional, it was permissible. The casual violation of the private foundation rules relating to insiders and other disqualified persons, though probably not as extensive as the Trump Foundation's is more widespread than generally recognized. Given the IRS's lack of scrutiny of small family foundations, should not be a surprise.

E. Dealing with the Small Foundation Problem

Judge Posner's comment that perpetual charitable foundations are completely irresponsible institutions is incorrect.¹⁹⁹ From a law and economics perspective, there is a greater sin: they are inefficient. The administrative costs of maintaining a foundation with \$1 million or less in assets and hiring the lawyers, accountants, and investment managers to run

public, it will be interesting to note whether IRS auditors took note of that fact when they audited his income tax returns!

¹⁹⁸ So Ordered Stipulation of Final Settlement at 3, *People v. Trump*, No. 451130/2018 (N.Y. Sup. Ct. 2019), https://iapps.courts.state.ny.us/fbem/DocumentDisplayServlet?documentId=JLJih9v_PLUS_EKSuJs36THzexg==&system=prod.

¹⁹⁹ Posner, *supra* note 1.

it efficiently and within the mandates of the private foundation rules and regulations makes little sense.

The primary attractions of family foundations are donor control of grants and investment policy, and the ability to pass on family wealth and asset control to ones' heirs. The family attorney and accountant may not be professionally knowledgeable about private foundation law. It is unlikely that the IRS will increase its focus on small foundations on an ongoing basis if at all. Given the IRS's cutbacks in scrutiny, small foundations are virtually unregulated. Yet, it is in the public interest that small foundations operate efficiently, effectively and distribute dollars in appropriate amounts to public charities.

One thing that could assure small foundations were operating according to the rules would be for the IRS to require foundation counsel and accounting firms to be authorized to practice before the IRS. The quality of representation would rise, but this would add to the administrative costs of maintaining a private foundation, adding to the inefficiency of the form. What might be more useful would be to nudge these small foundations to terminate their private foundation status and to become donor advised funds (DAF).²⁰⁰ What incentives could encourage donors of small foundations to convert to DAFs?

One might be a tax incentive: Assume a donor contributed \$1 million in cash to a private foundation and in that same year the donor's adjusted gross income was \$1 million. The donor could deduct 30% of that sum or \$300,000. If the donor had given to a donor advised fund, 50% or \$500,000 would be deductible.²⁰¹ Suppose the Code allowed a retroactive credit of 20% of the cash original donation if the donor terminated the foundation and gave the funds to a DAF? Further assume the legislation required that a donor could only do that with one foundation and one time. The credit would only

²⁰⁰ A nudge is an intervention that steers people in particular directions but that also allows them to go their own way. See RICHARD THALER & CASS SUNSTEIN, *NUDGE* 6 (2008). In the context of small private foundations, the donor could avoid the recommendations here if they wish, but some may take the options offered.

²⁰¹ I.R.C. § 170(b)(1)(H). The Tax Cuts and Jobs Act raised the charitable contribution deduction for cash contributions to public charities, private operating foundations, flow-through foundations and certain governmental units of up to 60% of the taxpayer's adjusted gross income for any taxable year beginning after December 21, 2017, and before January 1, 2026. *Id.* § 170(b)(1)(G).

apply when the funds given to the DAF had been distributed to public charities. Since the estate and gift tax regimes have no percentage limitations, this approach would not apply to foundations created by individuals who left their wealth to a private foundation controlled by the family.

DAFs currently have substantial problems. There are numerous DAF critics and almost as many offering suggestions to remedy their perceived inadequacies.²⁰² In some ways the situation of DAF's today mirrors some of the complaints about private foundations pre-1969, particularly the delay of funds reaching the charitable stream. While analysis of the weaknesses of DAFs is beyond the scope of this Article, there are certain changes that should be made to encourage smaller private foundations to terminate their private foundation status and become a DAF. The advantage to the donors and the public should be lower administrative costs, quicker financial flow to public charities, additional resources for distribution to public charities and hopefully, enhanced supervision of grantees by sponsoring organizations. For donors, the disadvantages are loss of absolute control of investment policy and the status of having ones' own foundation.

Some basic changes in the operation of DAFs are needed. Congress should prohibit private foundations from meeting their 5% minimum distribution requirement through granting that amount to a DAF unless the full 5% is distributed in the same fiscal year as donated. If there is to be a mandatory minimum DAF distribution requirement, it should be more than 5%. DAFs are often essentially checking accounts. Assets entering a DAF should be distributed within five years. The rules relating to contributions of non-cash appreciated assets need to be tightened and overseen more closely by the IRS. This may mean lengthening the period before the full deduction benefits are granted to the donor.

²⁰² See, e.g., James Andreoni, *The Benefits and Costs of Donor-Advised Funds* (NBER, Working Paper No. 23872, 2017), <https://www.nber.org/papers/w23872>; Roger Colinvaux, *Donor Advised Funds: Charitable Spending Vehicles for 21st Century Philanthropy*, 92 WASH. L. REV. 39 (2017); Roger Colinvaux & Ray D. Madoff, *A Donor-Advised Fund Proposal That Would Work for Everyone*, CHRON. PHIL. (Sept. 23, 2019), <https://www.philanthropy.com/article/A-Donor-Advised-Fund-Proposal/247204>; Ray D. Madoff, *Three Simple Steps to Protect Charities and American Taxpayers from the Rise of Donor-Advised Funds*, NONPROFIT Q. (Jan. 25, 2018), <https://nonprofitquarterly.org/three-simple-steps-to-protect-charities-and-american-taxpayers-from-the-rise-of-donor-advised-funds/>; CHUCK COLLINS ET AL., WAREHOUSING WEALTH: DONOR-ADVISED CHARITY FUNDS SEQUESTERING BILLIONS IN THE FACE OF GROWING INEQUALITY, INSTITUTE POL'Y STUD. (2018) <https://ips-dc.org/wp-content/uploads/2018/07/Warehousing-Wealth-IPS-Report-1.pdf>.

National Sponsoring Organizations should have additional responsibilities aside from writing checks and investing donors' contributions. They should develop a registry for the charities that donors advise the NSO to give a grant, which would contain relevant information from the charity's 990 and a recommendation as to the soundness of the gift in the sponsoring organization's estimation.

These proposals may be Pollyannaish or just plain wrong, but when one considers how far the private foundation has risen in the public esteem in the last fifty years thanks to the private foundation rules, is it inconceivable that the DAF offshoot might alleviate the IRS's oversight deficiencies and provide a more effective vehicle for distributing funds to public charities than small foundations?