

## Winter 2004

### Private Foundation Payout Controversy: Larger Implications of the Dispute

*By Bruce R. Hopkins*

The House of Representatives, on Sept. 17, passed the Charitable Giving Act of 2003. That measure is headed to a Conference Committee, presumably to be reconciled with the Senate-passed Charity Aid, Recovery, and Empowerment (CARE) Act.

The most controversial of the many proposals in this legislation to change and add to the law of tax-exempt organizations is in the House bill: the rules defining *qualifying distributions* for grant-making private foundations would be altered, by excluding certain administrative expenses from qualifying for the payout.

Under existing law, these private foundations are required to expend, for each year, an amount equal to 5% of their investment assets. This law requires a minimum payout for charitable purposes and includes payments that are termed *administrative expenses*. Originally, the proposal in the House bill was to entirely eliminate these expenses from qualification for the payout requirement.

A compromise was developed, by which qualifying distributions would include the portion of reasonable and necessary administrative expenses directly attributable to charitable, grant selection, grant monitoring and administrative activities, compliance with law, and furthering public accountability of the private foundation. Allocations of expenses may be required.

#### **Certain Expenses Not Allowed**

The following administrative expenses would not be allowed as qualifying distributions: (1) compensation paid to disqualified persons in excess of \$100,000 annually (indexed for inflation), (2) air transportation expenses unless for regularly scheduled commercial air transportation, and (3) such air transportation expenses to the extent they exceed the cost of coach class accommodations.

Like many compromises, the one struck in this instance is, overall, preferable to the original proposal. Still, many in the foundation community hope that any limitation on the qualification of reasonable administrative expenses for the private foundation payout will be dumped by the House-Senate Conference Committee.

Those who champion this type of limitation fall into three groups, with some overlap: those who (1) do not understand that the underlying problem (such as it is) is resolvable by existing law, (2) are using this issue to increase the amount private foundations must pay directly to charitable organizations (the hidden agenda crowd), and (3) generally do not like the concept of private foundations.

The nature of the private foundation payout rules has been misunderstood throughout this battle.

The New York Times, for example, which has been crusading for the original proposed limitation, stated in its Sept. 9, 2003, issue that foundations have been

trying to "thwart a proposed change in tax law that would force them to spend more of their assets each year on charity."

In addition to the fact that organizations do not spend assets, but rather income, this statement is untrue.

Existing law requires foundation expenditures for charitable *purposes*; it does not require payments directly to charitable *organizations*. Thus, payments in the nature of administrative outlays (a misnomer) can, and almost always are, for charitable purposes.

Private foundations that oppose these limitations are not trying to avoid payments for charitable objectives; they simply want to preserve existing-law flexibility that enables them to best decide how to further those ends.

### **Always Unreasonable?**

This compromise contains some traps. It communicates the message that, generally, expenses for noncommercial and first class air travel are always unreasonable. Likewise, the potential exists for a standard that compensation exceeding \$100,000 is always excessive (or at least suspect).

If there are to be rules like this (and there ought not to be, this being the stuff of facts and circumstances), they should be formulated out in the open and made generally applicable. This compromise contains elements that are just as clumsy and inelastic as the original proposal.

From the larger perspective, these standards could be imported into the charitable area in general and perhaps into other aspects of exempt organization law. Are the costs of noncommercial and first class air travel always excessive? Is compensation in excess of \$100,000 always unreasonable?

The answers to these questions is no — yet legislation like this could introduce some difficult and nonsensical standards or presumptions.

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