

# Simplification of the Excise Tax

## SIMPLIFY THE EXCISE TAX ON PRIVATE FOUNDATIONS

We urge Congress to support simplifying the private foundation excise tax on net investment income to a flat 1% rate and dedicate use of the revenue raised for its original purpose—to provide funds for the IRS to regulate the nonprofit sector.

### Rationale

The Tax Reform Act of 1969 provided the first legal classification of a "private foundation," and established the excise tax requirement for investment income. Revenues from the excise tax were intended to fund IRS oversight of the nonprofit sector, but have been used for other purposes.

Each year, private foundations are required to pay an annual excise tax equal to 2% of their net investment income. If a foundation's distributions (measured as a percentage of assets) in a given year exceed the average payout rate of the foundation over the preceding five years—by an amount at least as much as the 1% tax savings the foundation will enjoy—then this tax is reduced to 1%. This "maintenance of effort test" was intended to ensure that the tax savings be used for additional charitable expenditures and not just "pocketed" by the foundation.

The current private foundation excise tax is complicated to administer and, because of its overly complicated, two-tier structure, it often creates a disincentive when foundations consider increasing giving for unanticipated grants, such as the Hurricane Sandy relief efforts. Under the two-tiered rate, foundations can actually be penalized with higher taxes when they give more during times of extraordinary need. In addition, calculating the tax rate requires foundation staff to constantly monitor and adjust their investments and spending—time and money that would be better spent serving their communities.

## *Simplification of the Excise Tax continued*

### **Simplify the excise tax for private foundations**

Simplification of the excise tax has been a part of recent discussions regarding strengthening philanthropy and included in several bill packages of charitable tax provisions. H.R. 1, Tax Cuts and Jobs Act, simplified the current private foundation excise tax rate to a flat rate of 1.4%. The CHARITY ACT of 2017 would reduce the rate from 2% to 1%. Some in the sector have expressed concern about a 1.4% flat rate because it would be a tax increase for many foundations. While IPA supports a flat rate overall, a 1% rate is preferred.

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#### **Sources**

*Council on Foundations*