October 21, 1996

Memo to: Board of Trustees

From: Ranny Riecker, Chair
Government Relations Committee

Re: Current Issues

I. Legislative Goal Statement

Resolved: The attached revisions to the **Council of Michigan Foundations (CMF) Legislative Goal Statement** be approved.

The Government Relations Committee proposes that the changes on the attached statement be made and circulated to the CMF membership. In summary form the following changes have been made:

- Goals Accomplished — Three goals
- Goals - Progress Made — Three goals
- Proposed New Goals — Four goals
- Goals Eliminated — Two Goals

For your convenience, all proposed changes have been underlined.

II. Washington D.C. Visitation
Date: Wednesday, February 12th @ 7:00 p.m. through Thursday, February 13th

We hope many of you will join us for the Annual Capitol Hill Visitation. The Meeting will be held with Michigan's two Senators and sixteen Congressmen. Seven members of the Government Relations Committee are planning to attend. Last year, twelve Council of Michigan Foundation members participated. As before, we will be discussing issues important to philanthropy, and distributing Edition X of the Michigan Foundation Directory, as well as a computerized print-out of all the foundations located in the Congressmen's districts.

III. Lansing Visitation

Plans are underway for the bi-annual legislative seminar. The Government Relations Committee is also exploring the possibility of a December 1997 seminar for new legislators. Interestingly, 71 of the 110 members of the Michigan House will be new to the responsibilities due to term limits. It is estimated that the turnover in the Senate could be as high as 50%. CMF has been advised that a seminar about grantmaking and public policy issues could be extremely useful. We will keep you advised as plans develop.

Attachment

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Proposed Changes Underlined

Completed - Goal Accomplished

* - Progress Made

** - Eliminate; no longer an issue.

COUNCIL OF MICHIGAN FOUNDATIONS
Legislative Statement
October 1996

Philanthropy in America

Foundation and corporate giving has long been a unique part of American society. In 1995, foundations and corporations donated more than $17.8 billion for charitable causes and services, including the arts, United Way, colleges and universities, libraries, and programs for the elderly, and the needy. Today, foundations and corporations are being challenged to increase their support and charitable donations in the face of major cutbacks by local, state, and federal governments.

In the face of this challenge, it is apparent that much can and should be done to encourage the creation and growth of new foundations and corporate giving programs. Unfortunately, the 1969 Tax Act, while introducing a number of reforms, also erected a number of major barriers to foundation philanthropy. These include the provisions that serve as disincentives for the creation of new foundations, as well as provisions that discourage charitable donations to foundations.

After more than 27 years of experience, it is also apparent that a number of Internal Revenue Service Code regulations, based on the 1969 Tax Act, have proven to be unnecessarily restrictive on the grantmaking effectiveness of Michigan's more than 1,200 foundations, as well as the more than 38,807 other foundations in communities across the United States.

If foundations and corporations are to expand their support of important social needs and programs, the Council of Michigan Foundations must work actively to inform the general public, as well as state and federal legislators and other policy-makers, on these important issues. It must seek support for legislative changes that encourage the role and effectiveness of foundation and corporate philanthropy. That is the purpose of the following Council of Michigan Foundations' Government Relations Program.

Background: CMF Government Relations Program

In 1977, the Council of Michigan Foundations' (CMF) Members directed the Board of Trustees to develop a public information program that would support and encourage Michigan foundation philanthropy. This program was to include a plan to communicate with public policy-makers. A Conference Mandate (Government Relations) Committee was established to implement the program.

Since then, the Government Relations Committee has surveyed the CMF Members in their legislative interests and priorities on a timely basis. In 1980, CMF also launched a "Developing Good Will Program" to assist in this public information effort.

CMF has worked with foundation and corporate Members, the Council on Foundations, and other regional associations of grantmakers to enhance the understanding of public policy-makers about foundation philanthropy and to bring about appropriate legislative changes in laws and regulations.

As a result of these efforts by CMF and others, the mandatory payout requirement has been lowered by Congress to a flat five percent of foundation assets, the excise tax on foundations has been reduced, the .65 limit on grant administrative expenses has terminated, fair regulations on lobbying have been issued, and at the state level, a tax credit for individual and corporate contributions to community foundations has been enacted. The 1984 Tax Bill relaxed limitations on gifts to private foundations.

Other changes since then include amending the law, whereby the gain portion of gifts of appreciated property is not subject to the alternative minimum tax reduction and an affidavit process for simplifying private foundation grants to non-U. S. charities. In the last year, two regulatory items have been resolved, and legislation has been passed relating to gifts of publicly-traded stock to private foundations and ownership of S-Corporation stock. On a state level, CMF has been instrumental in helping to limit the tort liability of volunteers of nonprofit corporations, to repeal the state inheritance tax to keep donors and their foundations in Michigan, and to support the repeal of the Michigan Intangibles Tax.

The CMF Board of Trustees approved the initial Legislative Statement on March 1, 1979. Revised statements were approved September 19, 1980; January 27, 1982; May 10, 1983; June 14, 1985; April 12, 1988; February 25, 1992; November 4, 1992; <u>and November 8, 1995</u>. A <u>ninth</u> revision is being recommended to the Board of Trustees, <u>October 30, 1996.</u>

Goal: Support the continuation and expansion of tax incentives for the creation of new foundations and gifts to existing foundations.

National Legislative Issues

1. **Goal:** Make permanent the full deductibility of publicly-traded stock given to private foundations.

* Progress made

Explanation: The Tax Reform Act of 1984 changed the law to permit living donors to make gifts of publicly-traded stock to private foundations and to be able to deduct the full fair market value. Unfortunately, the change expired at the end of 1994. <u>Legislation was</u>

passed (August 1996) allowing gifts of appreciated stock to new or existing public foundations at fair market value between July 1, 1996 and May 31, 1997. It is CMF's goal to make this legislation permanent.

2. **Goal:** Change the limitation on gifts to a private foundation from 20 percent to 50 percent.

   Explanation: Under existing law, the amount deductible by an individual taxpayer for contributions to private non-operating foundations is computed as a percentage of the donor's contribution base (in most cases, his or her adjusted gross income). An individual may deduct only 20 percent of the gifts of appreciated property or 30 percent of gifts of cash. On the other hand, an individual taxpayer can deduct up to 50 percent of his contribution base for gifts to public charities.

3. **Goal:** Increase the deduction allowed a taxpayer for a gift to a private foundation of certain capital gain property.

   Explanation: Currently, individual taxpayers may deduct the full fair market value of a gift of appreciated property in the form of publicly-traded stock, if the gift is less than 10 percent of the outstanding stock of the company. However, in other cases, such as privately-held stock, the amount of deduction continues to be limited to the donor's cost or basis in the stock if the gift is to a private non-operating foundation. The same gift to a public charity entitles the taxpayer to a full fair market value deduction.

4. **Goal:** Pursue legislation which would allow the establishment of a common fund for private and community foundations.

   Explanation: Currently, foundations are not allowed by law to pool their assets. Ideally, private and community foundations could have an investment vehicle which would allow for pooling with potentially greater investment returns and administrative efficiencies. Such a fund is allowed for colleges and universities.

5. **Goal:** Maintain the private foundation payout rate at not more than 5 percent to protect the real value of foundations' grantmaking capability.

   Explanation: In order to preserve the "real" grantmaking capacity of a private foundation, it is important that inflation be taken into consideration. A portion of the annual return should be returned to principal.

6. **Goal:** Reduce excise tax to flat 1 percent instead of the present complicated formula which permits, in some cases, a reduction from 2 to 1 percent.

   Explanation: The 1984 Tax Act allows the excise tax on investment income to be reduced from 2 to 1 percent if a foundation's payout for the year in question equals or exceeds an amount equal to the year's assets, times the average payout percentage for the five years, plus 1 percent of the foundation's net investment income.

7. **Goal:** Prevent further efforts to reduce the usefulness of the charitable deduction and repeal the 3 percent floor on itemized deductions.

   Explanation: In 1990, after initially considering a cap on all itemized deductions, the Congress approved a 3 percent floor in deductions. This floor was scheduled to expire at the end of 1995 but was made permanent effective in 1993.

8. **Goal:** Establish a small grant rule which would allow grants for charitable purposes of less than $25,000 to be free of "expenditure responsibility."

   Explanation: Currently, if a private foundation makes a grant for a charitable purpose to an organization without IRS tax classification as a public charity, the foundation must assume "expenditure responsibility." This is a costly and time consuming function for private foundations, and most will not undertake the responsibility. Others are discouraged about the amount of paperwork necessary for a grant less than $25,000.

9. **Goal:** Limit lineal descendants who are "disqualified persons" at the level of grandchildren.

   Explanation: In 1984, the law was amended to limit "disqualified persons" to substantial contributors to a foundation and their children, grandchildren, great grandchildren, and their spouses. The amendment provided that substantial contributors will no longer be considered "disqualified contributors" if over a ten-year period, they make no further contributions to the foundation and do not manage it, and their total contributions are insignificant in light of substantial growth in foundation assets. However, there is still no logical rationale - - or examples of abuse - - to justify the inclusion of lineal descendants beyond the level of grandchildren.

10. **Goal:** Exclude from the formula used to compute the excise tax on private foundation net investment income, any capital gain realized in the fiscal year in question.

    ** <u>Eliminate - No longer an issue to CMF Members as it is connected with other tax policy pertaining to capitol gains.</u>

11. **Goal:** Modify the law to permit the "out of corpus" requirement to be met by a foreign grantee if sufficient documentation is provided showing that the full amount of the grant was spent for the specified purposes within 12 months after the year the grant was made.

    Explanation: When making grants to some foreign charities, private foundations are required to treat them as private foundations. Any grant from a private foundation to another private foundation requires that the amount granted "flow through" the grantee and out as qualifying distributions that are made "out of corpus" by the end of the following year. The purpose for this rule is to prevent a foundation from avoiding the payout rule by having one private foundation give to another who then simply adds the grant to its endowment (corpus), with charitable grantees receiving no benefit. In the foreign grant context, the grantee rarely has any endowment and totally misunderstands the concept of "out of corpus."

12. **Goal:** Protect charitable gift annuities.

    * Progress made.

    Explanation: Many public charities, including community foundations, offer donors the opportunity to contribute through charitable gift annuities. Under these arrangements, donors make a substantial gift of property to the charity and receive a fixed income from that gift for life. At death, the balance of the gift passes to the charity. Legislation was passed favorable to protecting charitable gift annuities, however, it is being challenged in court.

13. **Goal:** Amend the generation-skipping transfer tax law to extend the predeceased parent exclusion to charitable lead and remainder trusts.

    Explanation: The Internal Revenue Code levies a substantial tax, called the Generation-Skipping Transfer Tax (GSTT), on a donor who distributes property to a grandchild while the donor's child is still living. This tax is in the 55 percent range, and is levied on top of the regular estate or gift taxes which may be applicable...a combination which can total almost 80 percent. Similarly, a donor may not under current law leave the lead or remainder interest from a charitable trust to a grandchild without incurring this tax. Current law does include a "predeceased parent exclusion" which eliminates the GSTT in cases where the donor desires to leave property to his or her grandchild, and the grandchild's parent (the child of the donor) is deceased at the time of the transfer. But this exclusion now applies only to direct gifts and bequests and not to any type of transfer from a charitable trust. Charitable lead and remainder trusts have become important sources of support for many charitable organizations, and the impact of the GSTT is a huge disincentive for donors who would otherwise create such charitable vehicles.

14. **Goal:** Allow private and community foundations to own S-Corporation stock.

    Explanation: There are more than 1.9 million S-Corporations in the United States. Many individuals, having achieved success in the business world, have expressed interest in contributing S-Corporation stock to public charities and foundations in order to donate a portion of their private wealth to the public good. The small business bill, as passed by Congress (August 1996) permits charitable organizations to be shareholders of S corporation stock. All gain at the time of sale, and all income from shares will be taxable to the organization as unrelated business income, however.

    COMPLETED

15. **Goal:** Change the due date of the first estimated tax payment so that it coincides with the due date of the Form 990-PF.

    Explanation: Private foundations now must pay estimated taxes on their investment income in quarterly payments. However, the first payment each year is due three and a half months after the tax year while the tax return is not due until a month later.

16. **Goal:** Clarify legislation that preserves the principle of full deductibility from U. S. source income for corporate gifts to U. S. charities operating in the United States and provide rules for securing such deductions that are responsible and easy to administer.

    ** Eliminate - No longer an issue to corporations.

    Explanation: The IRS announced regulations that would require charitable gifts and grants by multinational corporations to be allocated between U. S. and non-U. S. sources for purposes of charitable deductions. While such regulations have not been promulgated in final form, it appears that such an allocation is the eventual administrative intent. If applied in this manner, the allocation will severely reduce the value of charitable contributions by many multinational corporations.

17. **Goal:** Secure passage of legislation providing a charitable deduction for non-itemizers.

    Explanation: Most taxpayers no longer file the long tax form which permits itemized deductions; instead they file the short form which allows only a standard deduction. From 1983 to 1986 non-itemizers were permitted to take the standard deduction plus itemize charitable contributions within certain limits.

18. **Goal:** Support reasonable limits on the degree to which foundations and charities can lobby or otherwise influence public policy decisions and oppose unreasonable limits that adversely affect grantmaking.

    * Progress made.

    Explanation: Oppose unreasonable and unnecessary regulatory burdens placed on charitable and nonprofit grantees of foundations and corporate giving programs and unreasonable limits which adversely impact grantmakers' ability to fund research and evaluation. <u>While progress has been made, continuous monitoring is essential</u>.

19. **Goal:** Support legislation to eliminate the classification of realized gains and income, derived from leveraged real estate investments by foundations, as unrelated business taxable income.

    Explanation: Foundations and non-profit organizations are significant investors in the real estate market. Income derived from leveraged real estate investments, owned directly or through partnerships, is currently taxed as unrelated business taxable income

(UBTI). Legislation would have private foundations treated in the the same manner as educational organizations and qualified pension plans, which since 1980 have been exempt from the debt-financed property rules with respect to the acquisition of certain real property.

National Regulatory Issues

1. **Goal:** Return to the old rule for grants by U. S. foundations to nonresident aliens, where such payments are taxable depending on the place where the research or study takes place.

   Explanation: In 1989, Treasury published Revenue Ruling 89-67 which revised a long-standing position involving payments to nonresident aliens for scholarships, fellowships, prizes, and awards. The old rule said that the source of such payments for tax purposes was determined according to where the research or study activities take place. Problems developed when the 1986 Tax Reform Act changed the rules for scholarships, fellowships, etc., so that such payments were taxable except for tuition and related fees. Thus, many foreign students in the U. S. became subject to U. S. tax. The universities sought relief. The 1989 ruling reversed the old rule by stating that the source of the payment--for tax purposes--shall now be determined according to the residence of the payer. As a result, such payments by U. S. foundations to nonresident aliens working or studying outside the U. S. became subject to 30 percent withholding.

2. **Goal:** Obtain a Treasury ruling stating that no part of the premiums paid for directors and officers liability insurance need be treated as compensation for any charitable organization.

   Explanation: Existing rulings indicate that some small portion of the premiums paid for directors and officers liability insurance for private foundations must be treated as compensation to those covered to avoid self-dealing. In December 1995, final regulations were issued by the Treasury Department that conclude "In general....indemnification by a private foundation or provision of insurance for purposes of covering the liabilities of the person in his/her capacity as a manager of the private foundation is not self-dealing. Additionally, the amounts expended by the private foundation for insurance or indemnification generally are not included in the compensation of the disqualified person for purposes of determining whether the disqualified person's compensation is reasonable." While each foundation will want to examine the facts of its own circumstances, in most cases, the issue has been resolved.

   COMPLETED

3. **Goal:** Permit community foundations to administer pooled income funds with the remainder interest at the donor's death going to the local charity either by a) establishing a designated fund, or b) turning the corpus directly over to the local charity designated by the donor at the time of contribution of the fund.

   COMPLETED

Explanation: A pooled income fund is a form of deferred giving whereby a living donor may contribute assets to the fund and receive income payments during his or her lifetime. The donor is eligible for a limited charitable deduction in the year of the gift, and at the donor's death, the charity receives title to the endowment. By pooling such contributions, a charity can more efficiently administer this type of program. Revenue Ruling 96-38 allows a Community Foundation to create a pooled income fund that pours into designated funds for local charities (although not directly to the charity at donor's death.)

Goal: Support tax incentives for contributions to charitable organizations.

State Legislative Issues

1. **Goal:** Monitor changes to tax policy pertaining to community benefits as it relates to non-profits.

   Explanation: Legislation has been proposed in Colorado, Pennsylvania and Texas which threatens the tax exemption of charitable organizations. CMF, working with others, will closely monitor any related efforts in Michigan.

2. **Goal:** Support legislation encouraging a tax-deduction for charitable contributions from individuals.

   Explanation: Other states have found a tax deduction favorable to encouraging additional gifts to charities, educational institutions, churches, etc., by individuals. A limited tax deduction is proposed.

3. **Goal:** Support continuation of the State Community Foundation Tax Credit.

   Explanation: Since 1988, individual and corporate donors to a certified community foundation have been eligible for a state tax credit from the state income or single business tax.

4. **Goal:** Support legislation allowing gifts and bequests received by units of local government to be gifted to community foundations.

   Explanation: While a number of community foundations have funds established by local public libraries and school systems for scholarships, Michigan law is currently "grey" on this issue. New legislation, similar to that passed in Indiana, is being proposed to allow such gifts to community foundations. This will assist particularly with partnerships needed to sustain community foundations in rural communities.

5. **Goal**: Support legislation further defining a community foundation in the State Tax Code.

   Explanation: A community foundation is currently defined in the State Tax Code pertaining to the state community foundation tax credit. It is important to further define a community foundation in order to promote permanency and accountability while avoiding duplication of effort in communities and regions of the state.

6. **Goal**: Amend the State Insurance Code to allow a charitable organization, as described in Section 501(c) 3 of the Federal Internal Revenue Code, to have an insurable interest in the life of an individual who gave written consent to the ownership or purchase of a policy on his or her life

   Explanation: Currently state law does not allow charitable organizations to have an insurable interest in the ownership or purchase of life insurance. Some individuals wish to benefit a charitable organization by use of this vehicle.

CMF Activity

1. Regularly communicate with elected officials of federal, state, and local levels about foundation activities and concerns.

2. Encourage Member foundations to report grants and activities to government officials.

3. Encourage Members in each Michigan Congressional District to meet as a group with their legislator, when the legislator is in District, to discuss the local contributions of community and private foundations and corporate giving.

4. Support public reporting for foundations, beyond the reports required by law, and provide technical assistance for those foundations seeking to print an annual report or guidelines. Assist in distribution efforts.

5. Expand efforts to explain foundations and their problems to the grantee organizations and the general public.

6. Encourage meetings with local editorial boards and the media about foundation activities and concerns.

7. Develop state legislative network by House and Senate districts and enhance communication with key committee leadership.

8. Continue discussions with the Michigan Attorney General's Office regarding community and private foundation concerns.

9. Encourage meetings with Executive Branch of state government.

10. Sponsor periodic seminars for state legislators, department chiefs and their staffs.

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