The 1969 Tax Reform Act and Charities: Fifty Years Later

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Recommended Citation
Available at: https://scholarship.law.pitt.edu/fac_articles/283

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Fifty years ago, Congress enacted the Tax Reform Act of 1969 to regulate charitable activity of the rich. Congress constricted the influence of the wealthy on private foundations and hindered the abuse of dollars put into charitable solution through income tax rules. Concerned that the likes of the Mellons, the Rockefellers, and the Fords were putting substantial wealth into foundations for huge tax breaks while continuing to control those funds for their own private ends, Congress revamped the tax rules to force charitable foundations created and controlled by the wealthy to pay out charitable dollars annually and avoid self-dealing. Today, with concerns of similar misuse of philanthropic institutions to further wealthy interests, it is worthwhile to reconsider this significant legislation fifty years later.

Natural questions arise. What was the goal of Congress with respect to charity and with respect to tax? Did it accomplish these goals? Are those goals still relevant? What goals might suggest themselves today? Do we have the ability to modify the law to support those new goals? On November 1, 2019, the *Pittsburgh Tax Review* hosted a symposium to examine the 1969 Tax Act.

Pittsburgh was a fit and proper place to ask these questions. Andrew Carnegie founded Carnegie Steel along the three rivers of Pittsburgh and...
penned what Benjamin Soskis refers to as the urtext of modern philanthropy,\(^3\) *The Gospel of Wealth*, in 1889.\(^4\) There Carnegie said the “gospel of wealth” called “upon the millionaire to sell all that he hath and give it in the highest and best form to the poor, by administering his estate himself for the good of his fellows, before he is called upon to lie down and rest upon the bosom of Mother Earth.”\(^5\) The 1969 Tax Act did not deny the “millionaire” their right to do as Carnegie directs and gain tax benefits. But Congress structured the Act with distrust that the millionaire would take such actions out of the goodness of their heart. This distrust was aimed to stop the millionaire from taking advantage of the tax benefits derived from charitable organizations. It had the practical effect though of regulating the millionaire engaging in charity in this private foundation form.

Pittsburgh is also the city of Frick, Mellon, Heinz, and Westinghouse. This city once of steel, coal, banking, ketchup, and electrical generation is now a city of higher education, high tech, and cutting-edge health care all backed in part by the philanthropy generated from these past acts. It thus presents an ideal environment to explore the issue of philanthropy carried out by the wealthy in the past and continuing today. Its five biggest private foundations by assets in 2017 include the Richard King Mellon Foundation at $2.5 billion, Heinz Endowments at $1.6 billion, Sarah Scaife Foundation at $827 million, Dietrich Foundation at $795 million, and Hillman Family Foundation at $791 million.\(^6\)

Though we could not possibly address all matters within the 1969 Tax Act within the five Articles that are part of this symposium, I think these five Articles raise some of the most important, current, and challenging issues

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\(^5\) Id.

presented by the 1969 Tax Act and what it means for wealth and philanthropy today.

The 1969 Tax Act adopted rules to separate charities for income tax purposes into either public charities or private foundations. Public charities on the one hand are generally made up of institutions like churches, hospitals, and schools, and by those institutions that build a broad public base by seeking donations from a large percentage of the public. Private foundations on the other hand are those charities primarily supported through donations by one person or one family. The Bill and Melinda Gates Foundation, the John D. and Catherine T. MacArthur Foundation, and the Ford Foundation are all private foundations started up by one wealthy family without a public constituency to exercise power over the decisions of the charity. Congress distrusted private foundations because control lay with a creator or family and not a broad public. It saw them as undemocratic institutions.

After a major Treasury study and significant hearings discussed in Professor James Fishman’s Article, Congress enacted rules to ensure private foundations would work to further charitable purposes. Those rules included a prohibition on self-dealing between the foundation and its primary donors, a requirement that the organization annually pay out to charitable purposes 5% of assets, a prohibition on holding a significant interest in a private company, a limitation on investments that might jeopardize the

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7 I.R.C. § 509. This distinction had existed prior to this time, but not in as stark a way. See Ellen P. Aprill, The Private Foundation Excise Tax on Self-Dealing: Contours, Comparisons, and Character, 17 PITT. TAX REV. 297, 301 (2020).
8 I.R.C. §§ 170(b), 509.
9 Id. § 509.
10 S. COMM. ON FINANCE, 89TH CONG., TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS 5 (Comm. Print 1965) [hereinafter TREASURY REPORT].
11 I.R.C. § 4941.
12 Id. § 4942.
13 Id. § 4943.
endowment of the foundation,14 and taxes applied to noncharitable expenditures.15

Professor Fishman’s Article, *The Private Foundation Rules at Fifty: How Did We Get Them and Do They Meet Current Needs?*, starts this symposium by navigating the history leading up to the 1969 Tax Act.16 His Article leaves me at once optimistic and depressed. It leaves me optimistic because of the substantial research that went into developing the 1969 Tax Act suggesting Congress can and has engaged in real deliberative acts that might be models for those who advocate for deliberative democracy. It leaves me depressed because it demonstrates that congressmen engaged in much demagoguery to pass the Act. Fishman, nevertheless, concludes that the 1969 Tax Act mostly worked, at least with respect to large foundations. By work, Professor Fishman means these organizations largely have legitimacy within society today because of the rule-based system ensuring that they work towards the public interest. Still, he thinks these rules are not working properly as to smaller foundations and perchance we need new rules for them ensuring that the public interest is furthered.

Professor Fishman provides a tremendous service here by telescoping this historical view further into the past than just the immediate acts that led to the 1969 Tax Act. He gives a richness to the development of this legislation. In its own way, his Article is a picture of why sometimes law can get made and how it ends up being made. It suggests lawmaking is often constructed on a mythologized factual foundation, but that mythology is critical to the passing of legislation.

In *The Private Foundation Excise Tax on Self-Dealing: Contours, Comparisons, and Character*, Professor Ellen P. Aprill looks at the 1969 Tax Act provision prohibiting self-dealing.17 Though the paper’s focus may seem narrow, it is anything but. She uses this fiftieth anniversary to consider the excise tax limitation on self-interested transactions in light of U.S. Supreme

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14 Id. § 4944.
15 Id. § 4945.
17 Aprill, supra note 7.
Court precedent in *National Federation of Independent Businesses v. Sebelius*18 on the nature of a tax versus a penalty within constitutional jurisprudence. She also looks at whether the tax is intended to be a Pigouvian tax.

These two lenses lead to some interesting insights. First, there could be some constitutional infirmity with this regime if the *NFIB* precedent were to apply to treat this “tax” as a penalty. Professor Aprill cautions though that the self-dealing tax passed constitutional muster in the past and the potential constitutional infirmity is far from clear under the *NFIB* precedent. Second, Professor Aprill considers whether the excise tax is intended to be a Pigouvian tax in order to correct some market failure and if that is the case whether the IRS has the capacity to use this Pigouvian tool well. She concludes that the design of the tax and the capability of the IRS are unsuited to correcting the market failure involved. To Professor Aprill, it may be impossible for the IRS to serve as a regulator of the charitable sector. The IRS simply does not have the knowledge necessary nor the latitude to set these penalties to accord with the harm associated with self-dealing acts. It leads her to back a growing position within the charitable world—we should consider replacing the IRS with some other agency in its charitable regulatory duty.19

Professor Aprill’s analysis is powerful. If indeed the IRS’s primary tools are nothing but Pigouvian taxes to regulate charitable activity, it is likely a poor regulator of the sector because of the inability to calculate the harm involved. Because I do not think the primary harm of private foundation self-dealing lies in the use of a nonprofit for selfish reasons, but in the misuse of federal tax benefits, I think that the tax code likely still needs these protections as long as we are to maintain significant tax benefits for charitable contributions. It makes sense to broadly stop self-dealing transactions because it makes it possible to use a simple rule rather than a complex standard to regulate private foundations.20 Of course, Professor

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19 Aprill, supra note 7, at 336.

Aprill raises the fair counter that it is possible this highly strict regime is less than optimal in obtaining compliance.

Professor Ray Madoff in *The Five Percent Fig Leaf* focuses implicitly upon a conundrum of the charitable world and one Congress seems to have considered as it contemplated enacting the 1969 Tax Act.\(^{21}\) Can you meet a charitable purpose by managing investments and paying out some portion of those investments to charity? If you can, what is the amount of money you must pay out? Must the entirety be spent over a certain defined period of time? One part of this conundrum, that an organization can demonstrate its charitable nature by managing investment funds and granting dollars to charitable causes, has always given me pause because of the mixed purposes involved. Is the primary purpose to manage funds, to hold funds for future charitable activity, or to grant funds to actual charitable purposes? The 1969 Tax Act made clear that such a combined activity indeed met the charitable purpose test found in § 501(c)(3).

While Professor Madoff, like Professor Fishman, believes that the 5% payout has been successful in legitimizing private foundations in the larger culture of the United States, she argues we have been conned into this belief by what she refers to as the “five percent fig-leaf.” The payout is a fig-leaf because a significant portion of the 5% payout can so easily be utilized for selfish purposes.

Professor Madoff does not take an explicit stand on whether 5% is the right amount to justify the tax exemption of private foundations. However, she in effect argues that such an amount is at least a minimum. Though it is a minimum, at least three rules undermine the sufficiency of that charitable payout. First, administrative expenses count toward the payout. This allows a donor’s family to be well compensated. Secondly, program-related investments (PRIs) are counted toward the payout. PRIs are investments that are considered charitable in nature.\(^{22}\) In a PRI, a private foundation makes a “charitable” investment that is considered to be charitable in nature; in theory no investor would make, in order to hopefully correct some ill of society. These are thought to further a charitable purpose. Professor Madoff argues that while this category of “charitable” investment was once narrow, its bounds have expanded to include many traditional investments. This expansion erodes the duty to contribute to real

\(^{21}\) See Ray D. Madoff, *The Five Percent Fig Leaf*, 17 PITT. TAX REV. 341 (2020).

\(^{22}\) I.R.C. § 4944(c).
charitable purposes. Finally, private foundations can meet their payout with a payment to a donor-advised fund. A donor-advised fund (DAF) is an account maintained at a public charity referred to as a sponsoring organization. The sponsoring organization generally invests DAF funds until the donor of a particular fund advises the sponsoring organization as to which charity it ought to make grants.

It seems hard to argue with the claim that payouts to DAFs should not count. Congress in the 1969 Tax Act directed private foundations to make a payout to charity annually, and DAFs are no more than middlemen. If I am given pause by the ability of private foundations to invest funds and pay grants for charitable purposes, I simply cannot at all accept the legitimacy of investing funds to pay “charitable” grants to another fund to pay “charitable” grants. Similarly, the allowance of big salaries and cushy trips for donor children to count as payout appears problematic on its face. The richest discussion at the symposium ensued regarding PRIs. That conversation returns us to Carnegie’s urtext encouraging philanthropic investment over direct payment to those in charitable need. While we did not solve that conundrum, if you read Professor Madoff’s and Professor Brakman’s Articles together, I think you will have a much stronger sense of the debate.

Reading Professor Madoff’s Article suggests to me that we need a better dataset of how private foundations are used. Work is being done, such as that by Professor Brian Galle. Nevertheless, it is odd that we can have so much information from reporting to the IRS on Form 990-PF, the tax information return of a private foundation, and still feel poor in good data to make decisions about the efficacy of the laws and regulations applicable to private foundations. Perhaps there are two problems: (1) the data collected is not all of the right data, and (2) the data is misleading because of a failure to require private foundations to report in a uniform manner. We could use more scholarship examining how to generate better data in this realm through a more thoughtfully designed Form 990-PF.

23 See, e.g. Brian D. Galle, Why Do Foundations Follow the Law? Evidence from Adoption of the Uniform Prudent Management of Institutional Funds Act, 36 J. OF POL ANALYSIS & MGT. (2016) (using IRS data on private foundations to determine whether private foundations were complying with UPMIFA).

24 I.R.S. Form 990-PF, Return of Private Foundation.
In her Article, *Foundation Regulation in Our Age of Impact*, Professor Dana Brakman Reiser inspects the idea that investments by charity today must have “impact.” By this, people mean that a private foundation investment ought to align with its mission. The philanthropic community has recently taken great interest in searching for such investments of impact. While philanthropic institutions might seem to be a natural place to pursue such a portfolio, Professor Brakman Reiser notes private foundations have been hesitant to pursue these strategies. They apparently fear violating the rule prohibiting private foundations from making jeopardizing investments. Professor Brakman Reiser provides helpful pragmatic suggestions on how we might modify the rules to make such activity possible.

Professor Brakman Reiser’s Article highlights that the 1969 Tax Act was enacted at a certain place in time with a very particular understanding of investment and charitable acts. Those notions look dated now. That lack of connection to today’s circumstances augurs for a remodel of our legal structure regulating the space of philanthropy. Maybe it even needs a complete restructuring. Professor Brakman Reiser focuses first on impact through what are known as mission-related investments (MRIs). In MRIs, foundations invest with goals other than total return in mind, such as environmental, social, and governance factors, but the investment is not considered charitable for tax purposes.

If this current of mistrust regarding investing to further a charitable purpose is latent in MRIs, it is at the forefront of discussions regarding PRIs. However, Professor Brakman Reiser advances this discussion by proposing some potential solutions to this impasse. Her Article, and her work generally, highlights the way the world may simply move past the charitable regulatory architecture created in the 1969 Tax Act if it is not modified to conform to the demands of today’s social justice-minded donor. If we want that architecture to have continuing importance, some changes are almost surely needed to permit greater flexibility to foundation boards.

Professor Brakman Reiser’s Article operates as a counterpoint to Professor Madoff’s Article. Professor Brakman Reiser sees investing dollars

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with charity in mind to be an important part of a charitable institution. While it is not fair to say Professor Madoff is against thoughtful foundation investment, I think it fair to say that Professor Madoff is skeptical about the idea that the expanded world of private foundation PRI charitable investments are all genuinely charitable. Charities show their charitability primarily by their acts through grants, not through investments. The “charitable investing” idea is seen in the Carnegie urtext and imbued by the old adage “give a man a fish, and he will eat for a day; teach the man to fish, and he will eat for a lifetime.” The skepticism to this investing approach perhaps grows with experience over years watching U.S. inequality increase year after year, all while we are told that the investors will be the solution to social problems spurred on by that same inequality.

Professor Khrista McCarden writes on private operating foundations that establish and maintain art museums, such as the J. Paul Getty Foundation.\(^{27}\) She is concerned that these foundations are highly private in nature. Written before the start of the racial justice revolution spurred on by the killing of Mr. George Floyd, her Article presciently investigates whether a charitable purpose can be furthered in a private way, and whether charitable organizations should be regulated to provide more to systematically disempowered communities. This is an interesting area to review and it highlights some of the challenges of dealing with defining a charitable purpose in the first place.

As Professor Fishman demonstrated, many of the senators considering the 1969 Tax Act highlighted to good political effect how wealthy individuals like the Mellons utilized charitable dollars to further abstruse interests like art and scholarly endeavors.\(^{28}\) As someone who is deeply engaged and invested in the art world, I particularly appreciate the importance of the preservation of art. I believe the preservation of art and antiquities is important to our humanity in and of itself and is worth doing. However, I believe it critical that that preservation come with broad public access, and Professor McCarden’s Article speaks very clearly to this point. Crucially, her position is that art museums must not just be open to the public but should

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\(^{28}\) Fishman, *supra* note 16, at 262.
demonstrate the ways in which their reach extends to disempowered communities.

One technical challenge to Professor McCarden’s Article is the very nature of the 1969 Tax Act. It legitimized “private” foundations. In that vein, I think the presumption that private art museums fail as a tax exemption matter because they are private and not public misses a part of the 1969 Tax Act. A “private” foundation is very much the opposite within charity of a public charity. While I agree that private nature is deeply problematic from a normative standpoint, Congress sanctioned private charity, private control, and private investment. To be fair, private foundations are by law required to meet the requirements of § 501(c)(3) by primarily furthering charitable purposes that must be public in nature. 29 The problem is that the wealthy contributor is the primary arbiter of that purpose and there is little chance the IRS will challenge that purpose privately determined. Still, this criticism does not take any power away from Professor McCarden’s Article as it interrogates that private nature of this type of philanthropy.

Professor McCarden also suggests that these private operating foundations might be uniquely likely to be infected with bad acts (actors). My guess is that these concerns run across private foundations, but perhaps there is greater potential for operating foundations like the Getty Trust discussed in her Article that focus on collecting expensive art to engage in more private acts benefitting their founders. I laud her call to open access to these institutions to not just the “public” but to systemically disempowered populations.

CONCLUDING REFLECTIONS

I am excited to share this set of Articles with you. They confirm that the 1969 Tax Act responded to real concern and real need, but that the architecture needs some reconsideration today, fifty years later. These Articles help move that conversation forward about what a new private foundation architecture might look like, or if perhaps that architecture simply cannot do the task that it has been asked to accomplish.

As I reflect on this symposium that took place in 2019 before the origination of COVID-19 and the racial justice revolution ignited by the killing of Mr. George Floyd in Minneapolis, I think about the great potential of well-democratically-harnessed philanthropy and seriously doubt that can be accomplished within the space of “private” philanthropy. I lean strongly towards eliminating tax benefits for this private “philanthropy” by denying tax exempt status to those organizations that are not public charities.

Why do I say this? Fundamentally, I believe the effort of philanthropy should not be publicly supported if it is not collectively determined. To me, Professor McCarden makes the beginnings of a persuasive case that the values inculcated and supported through the private foundation system are likely predominately exclusive ones rather than public ones. I think that lack of a public nature should matter. Oddly, the private foundation tax architecture not only supports these wealthy exclusive preferences, but as Professor McCarden points out, it forces the private foundation to spend a lot of money every year into the future furthering those preferences of the wealthy. To be clear, the problem with this form of philanthropy is not that it might support abstruse interests such as senators complained about with respect to the Mellons, but that it works to provide significant and lasting governmental benefits to the private, perhaps well meaning interests, of people simply because they happen to be wealthy. The private foundation tax architecture provides this support, lifts these efforts up, in the name of supporting collective efforts, but they are far from collectively led.

I believe deeply in the power of a fiercely independent and courageous civil society that empowers the voices of all in our communities, particularly those voices that have been and continue to be disempowered. But, the private foundation tax architecture even at its best likely can never really support such a vision because it is defined privately. And, as Professor Aprill shows, the lack of IRS enforcement capability likely makes this architecture weak anyway and unlikely to be able to ever ensure such a democratically based vision. The private foundation community is imbued with some important social justice voices such as Darren Walker of the Ford

Foundation\textsuperscript{31} and Elizabeth Alexander of the Mellon Foundation.\textsuperscript{32} Still, I believe its predominate ethic is that of Carnegie from \textit{The Gospel of Wealth}: that the wealthy man is the savior of the rest of us, both in terms of their ability to invest their dollars and to spend them in ways that improve all lives. I think that wrong and harmful. That vision is not just antithetical to democracy, but it is antithetical to racial, gender, sexual orientation, and social justice. Given this, I think we ought to eliminate tax benefits for the private foundation form.

But this is only one view. I have enormous admiration for the work carried out by our philanthropic community. The voices included here do too and each presents a different approach to the challenge taken on by Congress fifty years ago. I expect we will still be struggling with this same challenge fifty years from now. Please read on and consider the voices that follow.
