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PRIVATE FOUNDATION EXCISE TAX SIMPLIFICATION ACT OF 2014

JUNE 26, 2014.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. CAMP, from the Committee on Ways and Means, submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 4691]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 4691) to amend the Internal Revenue Code of 1986 to modify the tax rate for excise tax on investment income of private foundations, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Private Foundation Excise Tax Simplification Act of 2014".

SEC. 2. MODIFICATION OF THE TAX RATE FOR THE EXCISE TAX ON INVESTMENT INCOME OF PRIVATE FOUNDATIONS.

(a) IN GENERAL.—Section 4940(a) of the Internal Revenue Code of 1986 is amended by striking "2 percent" and inserting "1 percent".

(b) ELIMINATION OF REDUCED TAX WHERE FOUNDATION MEETS CERTAIN DISTRIBUTION REQUIREMENTS.—Section 4940 of such Code is amended by striking subsection (e).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

Similar to a provision contained in the discussion draft of the "Tax Reform Act of 2014" released on February 26, 2014, the bill, H.R. 4691, reported by the Committee on Ways and Means, provides that the excise tax rate on the net investment income of private foundations is reduced to 1 percent. The bill repeals the alternative rules that reduce the current-law excise tax rate from 2 percent to 1 percent for a private foundation with qualifying distributions that exceed the average historical level of its charitable distributions.

B. BACKGROUND AND NEED FOR LEGISLATION

While the Committee continues actively to pursue comprehensive tax reform as a critical means of promoting economic growth and job creation, the Committee also believes that it is important to provide permanent, immediate tax relief to encourage faster economic growth and job creation, while fostering charitable giving. By simplifying and reducing the private foundation excise tax on net investment income, H.R. 4691 eliminates a source of confusion and frustration, especially for smaller foundations, which can have endowments that vary in size significantly from year to year. Private foundations, both large and small, recommended to the Committee's 2013 Tax Reform Working Group on Charitable/Exempt Organizations that the net investment tax be reduced to a flat 1 percent to ease compliance. By adopting this recommendation to ease the administrative burden on all private foundations, H.R. 4691, which is similar to a provision contained in the February 26, 2014, discussion draft of the "Tax Reform Act of 2014," will encourage private

foundations to provide more funding of charitable activities to benefit local communities across the nation.

C. Legislative History

Background

H.R. 4691 was introduced on May 20, 2014, and was referred to the Committee on Ways and Means.

Committee action

The Committee on Ways and Means marked up H.R. 4691, the Private Foundation Excise Tax Simplification Act of 2014, on May 29, 2014, and ordered the bill, as amended, favorably reported (with a quorum being present).

Committee hearings

The need for permanent rules simplifying the excise tax on investment income of private foundations was discussed at a full Committee hearing on Tax Reform and Charitable Contributions (February 14, 2013).

II. EXPLANATION OF THE BILL

A. Simplification of Excise Tax on Private Foundation Investment Income (Sec. 4940 of the Code)

PRESENT LAW

Under section 4940(a), a private foundation (other than an exempt operating foundation) that is exempt from tax under section 501(a) for a taxable year is subject to a two-percent excise tax on its net investment income. Net investment income generally includes interest, dividends, rents, royalties (and income from similar sources), and capital gain net income, and is reduced by expenses incurred to earn this income. The two-percent rate of tax is reduced to one-percent in any year in which a foundation exceeds the average historical level of its charitable distributions. Specifically, the excise tax rate is reduced if the foundation's qualifying distributions (generally, amounts paid to accomplish exempt purposes)[1] equal or exceed the sum of (1) the amount of the foundation's assets for the taxable year multiplied by the average percentage of the foundation's qualifying distributions over the five taxable years immediately preceding the taxable year in question, and (2) one percent of the net investment income of the foundation for the taxable year.[2] In addition, the foundation cannot have been subject to tax in any of the five preceding years for failure to meet minimum qualifying distribution requirements in section 4942.

Private foundations that are not exempt from tax under section 501(a), such as certain charitable trusts, are subject to an excise tax under section 4940(b). The tax is equal to the excess of the sum of the excise tax that would have been imposed under section 4940(a) if the foundation were tax exempt and the amount of the tax on unrelated business income that would have been imposed if

[1] Sec. 4942(g).
[2] Sec. 4940(e).

the foundation were tax exempt, over the income tax imposed on the foundation under subtitle A of the Code.

Private foundations are required to make a minimum amount of qualifying distributions each year to avoid tax under section 4942. The minimum amount of qualifying distributions a foundation has to make to avoid tax under section 4942 is reduced by the amount of section 4940 excise taxes paid.[3]

REASONS FOR CHANGE

Under the present-law, two-tier private foundation excise tax rate structure, a foundation must carefully manage the timing and amount of its grant making to minimize its excise tax burden. Compliance can be costly and consume resources that otherwise would have been used for grant making or other charitable activity.

In addition, to qualify for the lower, one-percent tax rate in a year, a foundation must ensure that its distributions for the year exceed a historical, average level of distributions. This structure creates an incentive for foundations to limit distributions in any one year, because a significant increase in distributions will raise the foundation's average level of distributions, making it more difficult to qualify for the reduced rate in future years. As a result, a foundation that might have been inclined to distribute an unusually large amount in a time of public need, such as during the response to a natural disaster, has a disincentive to do so.

For these reasons, the Committee believes it is appropriate to replace the present-law, two-tier private foundation excise tax rate structure with a simplified structure that uses a single tax rate of one percent.

EXPLANATION OF PROVISION

The provision replaces the two rates of excise tax on tax-exempt private foundations with a single rate of tax of one percent. Thus, under the provision, a tax-exempt private foundation generally is subject to an excise tax of one percent on its net investment income. A taxable private foundation is subject to an excise tax equal to the excess (if any) of the sum of the one-percent net investment income excise tax and the amount of the tax on unrelated business income (both calculated as if the foundation were tax-exempt), over the income tax imposed on the foundation. The provision repeals the special reduced excise tax rate for private foundations that exceed their historical level of qualifying distributions.

EFFECTIVE DATE

The provision is effective for taxable years beginning after the date of enactment.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means in its consideration of H.R. 4691, the Private Foundation Excise Tax Simplification Act of 2014, on May 29, 2014.

[3] Sec. 4942(d)(2).

The bill, H.R. 4691, was ordered favorably reported as amended by a rollcall vote of 23 yeas to 10 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Camp	X			Mr. Levin		X	
Mr. Johnson	X			Mr. Rangel			
Mr. Brady	X			Mr. McDermott		X	
Mr. Ryan	X			Mr. Lewis			
Mr. Nunes	X			Mr. Neal			
Mr. Tiberi	X			Mr. Becerra		X	
Mr. Reichert	X			Mr. Doggett		X	
Mr. Boustany	X			Mr. Thompson		X	
Mr. Roskam	X			Mr. Larson		X	
Mr. Gerlach	X			Mr. Blumenauer			
Mr. Price	X			Mr. Kind		X	
Mr. Buchanan	X			Mr. Pascrell			
Mr. Smith	X			Mr. Crowley			
Mr. Schock	X			Ms. Schwartz		X	
Ms. Jenkins	X			Mr. Davis		X	
Mr. Paulsen	X			Ms. Sánchez		X	
Mr. Marchant	X						
Ms. Black	X						
Mr. Reed	X						
Mr. Young	X						
Mr. Kelly	X						
Mr. Griffin	X						
Mr. Renacci	X						

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the bill, H.R. 4691, as reported.

The bill, as reported, is estimated to have the following effect on Federal budget receipts for fiscal years 2014–2024:

Fiscal years, in millions of dollars——												
2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014–19	2014–24
—	−118	−166	−174	−182	−190	−198	−207	−215	−224	−233	−831	−1,909

Note: Details do not add to totals due to rounding.

B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue-reducing tax provision does not provide an increase or decrease in tax expenditures.

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. Congress,
Congressional Budget Office,
Washington, DC, June 5, 2014.

Hon. Dave Camp,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4691, the Private Foundation Excise Tax Simplification Act of 2014.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Logan Timmerhoff.

Sincerely,

Douglas W. Elmendorf.

Enclosure.

H.R. 4691—Private Foundation Excise Tax Simplification Act of 2014

H.R. 4691 would amend the Internal Revenue Code to restructure the excise tax on net investment income of private foundations from a dual-rate system (tax rates of 1 percent and 2 percent) to a single-rate system with a rate of 1 percent. Under current law, the calculation of the amount of excise tax differs depending on whether the foundation is exempt from income taxes or not, but in both cases a foundation faces a general excise tax rate of 2 percent on its net investment income. The rate of tax is reduced to 1 percent when a foundation has made charitable distributions in a year that exceed an amount based largely on its historical rate of distributions relative to its assets.

The staff of the Joint Committee on Taxation (JCT) estimates that enacting H.R. 4691 would reduce revenues, thus increasing federal budget deficits, by about $1.9 billion over the 2014–2024 period.

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending and revenues. Enacting H.R. 4691 would result in revenue losses in each year beginning in 2015. The estimated increases in the deficit are shown in the following table.

JCT has determined that the bill contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act.

The CBO staff contact for this estimate is Logan Timmerhoff. The estimate was approved by David Weiner, Assistant Director for Tax Analysis.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR H.R. 4691, AS ORDERED REPORTED BY THE HOUSE COMMITTEE ON WAYS AND MEANS ON MAY 29, 2014

	By fiscal year, in millions of dollars—												
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014–2019	2014–2024
NET INCREASE IN THE DEFICIT													
Statutory Pay-As-You-Go Effects	0	118	166	174	182	190	198	207	215	224	233	831	1,909

Source: Staff of the Joint Committee on Taxation.
Note: Components may not sum to totals because of rounding.

D. Macroeconomic Impact Analysis

In compliance with clause 3(h)(2) of rule XIII of the Rules of the House of Representatives, the following statement is made by the Joint Committee on Taxation with respect to the provisions of the bill amending the Internal Revenue Code of 1986: the effects of the bill on economic activity are so small as to be incalculable within the context of a model of the aggregate economy.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was as a result of the Committee's review of the provisions of H.R. 4691 that the Committee concluded that it is appropriate to report the bill, as amended, favorably to the House of Representatives with the recommendation that the bill do pass.

B. Statement of General Performance Goals and Objectives

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104–4).

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

D. Applicability of House Rule XXI 5(b)

Rule XXI 5(b) of the Rules of the House of Representatives provides, in part, that "A bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present." The Committee has carefully reviewed the bill, and

states that the bill does not involve any Federal income tax rate increases within the meaning of the rule.

E. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (the "IRS Reform Act") requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code and has widespread applicability to individuals or small businesses.

Pursuant to clause 3(h)(1) of rule XIII of the Rules of the House of Representatives, the staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Code and that have "widespread applicability" to individuals or small businesses, within the meaning of the rule.

F. Congressional Earmarks, Limited Tax Benefits, and Limited Tariff Benefits

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

G. Duplication of Federal Programs

In compliance with Sec. 3(j)(2) of H. Res. 5 (113th Congress), the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program, (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Public Law 95–220, as amended by Public Law 98–169).

H. Disclosure of Directed Rule Makings

In compliance with Sec. 3(k) of H. Res. 5 (113th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires no directed rule makings within the meaning of such section.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omit-

ted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is shown in roman):

SECTION 4940 OF THE INTERNAL REVENUE CODE OF 1986

SEC. 4940. EXCISE TAX BASED ON INVESTMENT INCOME.

(a) TAX-EXEMPT FOUNDATIONS.—There is hereby imposed on each private foundation which is exempt from taxation under section 501(a) for the taxable year, with respect to the carrying on its activities, a tax equal to [2 percent] *1 percent* of the net investment income of such foundation for the taxable year.

* * * * * * *

[(e) REDUCTION IN TAX WHERE PRIVATE FOUNDATION MEETS CERTAIN DISTRIBUTION REQUIREMENTS.—

[(1) IN GENERAL.—In the case of any private foundation which meets the requirements of paragraph (2) for any taxable year, subsection (a) shall be applied with respect to such taxable year by substituting "1 percent" for "2 percent".

[(2) REQUIREMENTS.—A private foundation meets the requirements of this paragraph for any taxable year if—

[(A) the amount of the qualifying distributions made by the private foundation during such taxable year equals or exceeds the sum of—

[(i) an amount equal to the assets of such foundation for such taxable year multiplied by the average percentage payout for the base period, plus

[(ii) 1 percent of the net investment income of such foundation for such taxable year, and

[(B) such private foundation was not liable for tax under section 4942 with respect to any year in the base period.

[(3) AVERAGE PERCENTAGE PAYOUT FOR BASE PERIOD.—For purposes of this subsection—

[(A) IN GENERAL.—The average percentage payout for the base period is the average of the percentage payouts for taxable years in the base period.

[(B) PERCENTAGE PAYOUT.—The term "percentage payout" means, with respect to any taxable year, the percentage determined by dividing—

[(i) the amount of the qualifying distributions made by the private foundation during the taxable year, by

[(ii) the assets of the private foundation for the taxable year.

[(C) SPECIAL RULE WHERE TAX REDUCED UNDER THIS SUBSECTION.—For purposes of this paragraph, if the amount of the tax imposed by this section for any taxable year in the base period is reduced by reason of this subsection, the amount of the qualifying distributions made by the private foundation during such year shall be reduced by the amount of such reduction in tax.

[(4) BASE PERIOD.—For purposes of this subsection—

[(A) IN GENERAL.—The term "base period" means, with respect to any taxable year, the 5 taxable years preceding such taxable year.

[(B) NEW PRIVATE FOUNDATIONS, ETC.—If an organization has not been a private foundation throughout the base period referred to in subparagraph (A), the base period shall consist of the taxable years during which such foundation has been in existence.

[(5) OTHER DEFINITIONS.—For purposes of this subsection—

[(A) QUALIFYING DISTRIBUTION.—The term "qualifying distribution" has the meaning given such term by section 4942(g).

[(B) ASSETS.—The assets of a private foundation for any taxable year shall be treated as equal to the excess determined under section 4942(e)(1).

[(6) TREATMENT OF SUCCESSOR ORGANIZATIONS, ETC.—In the case of—

[(A) a private foundation which is a successor to another private foundation, this subsection shall be applied with respect to such successor by taking into account the experience of such other foundation, and

[(B) a merger, reorganization, or division of a private foundation, this subsection shall be applied under regulations prescribed by the Secretary.]

VII. DISSENTING VIEWS

The six bills approved by the Republicans at the markup would add $304 billion to the deficit. Combined with the $310 billion that the six bills approved by Republicans on the Committee in April added to the deficit, Republicans have added $614 billion to the deficit in two short months—and there does not appear to be an end in sight. Even though some of these bills were introduced individually with some bipartisan support, the opposition to these bills was based on the position that these tax provisions should not be made permanent by adding to the deficit without any revenue offset.

To put the combined cost ($614 billion) into context, it is 25 percent more than the entire projected federal deficit this year and $86 billion more than *total* non-defense domestic discretionary spending (*e.g.,* medical research, education, veterans' pensions and health care, transportation, etc.) will be in 2014. It is almost seven times what we spend annually on education, job training, and social services. It is ten times more than we spend on veterans. And, it is eleven times more than we spend on medical research and public health.

Public charities and private foundations serve an important role in our society. We all support the good works of the charitable community and strive to provide charities with the resources they need to carry out their charitable mission. The markup was not to debate the good works of charities across this country, or the merits of H.R. 4691 which provides a single rate of tax on private foundations' investment income.

The consideration of this tax bill should be part of comprehensive tax reform. It should not take priority over other reforms for the charitable sector.

SANDER M. LEVIN.

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