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A Plea for Higher Foundation-Payout Rules

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The usually humorous nonprofit blogger Vu Le (writing at his blog, Nonprofit AF), takes on a more somber tone in *The ethical argument for foundations to increase their annual payout rate beyond 5%* (August 4, 2019). It's the day after the deadly mass shootings in El Paso, Texas, and Dayton, Ohio. "The last few years," he writes, "have been hellish on all fronts…."

"Nonprofits have been especially hard hit," being asked to meet the "increased challenges" that "especially marginalized communities, have been facing." But the nation's philanthropic organizations have to "… do it with the same level of resources provided, the same desperate pleas, the same exhaustion of never having enough to carry out our missions."

He swivels immediately to a factor he believes is a major contributing cause of this chronic underfunding for charitable needs: the meager 5% payout rule for foundations.

The Foundation Payout Rule

Vu Le is part of a growing chorus of experts and observers who argue that this "payout rule" – in effect for decades – should be higher.

In 1969, the federal tax code was overhauled, adding beefed-up rules for private foundations. "Before the Tax Reform Act of 1969, there was little legal pressure on private foundations to distribute income to charity," according to the IRS website's section on the payout rule. Under prior law, the only restriction was the ineffective, all-or-nothing, hard-to-enforce rule "that a private foundation would lose its exemption if its aggregate accumulated income was unreasonable in amount or duration for carrying out its exempt purposes." It was "rarely applied."

Congress took action by passing a complex set of new excise taxes and other reform rules including Internal Revenue Code section 4942 designed to mandate a "current return to charity." The rate was first set at 6% in TRA '69; among other changes over the years, it was revised downward to 5% in 1976.

Unfortunately, this figure – intended as a *floor*, not a ceiling – has become "the default position" for foundations.

Current Payout Figure is Unethical

"…In light of the horrors around us," Vu Le writes, the "hoarding of 95%" of foundation assets makes no "sense" and "has starved nonprofits' abilities to do our work, which has allowed injustice to go on unchecked and has led to the death and suffering of thousands. This makes it unethical."

He addresses head-on the argument advocated by many foundations that they must hold onto and grow their endowments to be able to fund the needs of future generations. Advocates of this viewpoint generally also hold a favorable view of so-called "perpetual foundations." See, for instance, *Higher Foundation Payout Requirement Would Be a Mistake* (November 30, 2017) by Sean Parnell, vice president for public policy at the Philanthropy Roundtable. "Perpetual foundations … are the mainstays of many charities," he writes, "providing steady support year after year for local community needs including homeless shelters, arts programs, conservation efforts, youth sports programs, and other important pillars of civil society."

Mr. Le's response and plea to foundations: "…Please stop saving for some future rainy day when there is currently a monsoon of death and injustice drenching our communities. You need to at least double your annual payout rate." To solve society's myriad problems, the blogger adds, "we can no longer be guided by the same ineffective philosophies and practices that are complicit in allowing these issues to proliferate. We cannot sacrifice the present to protect the future, because there might not be a future to protect…."

Conclusion

The notion of "perpetual foundations" is the majority position in American philanthropy today. But "…the idea of spending down a foundation's assets, rather than establishing it to exist in perpetuity," is not new, according to Heidi Waleson, in *Beyond FIVE PERCENT: The New Foundation Payout Menu.* She discusses the interesting history of this "sunsetting" concept that "dates back at least to the 1920s and 1930s." She cites as a key example, Sears founder Julius Rosenwald. He "devoted the lion's share of his philanthropic resources to building schools for black students in the South, and was publicly vehement in his opposition to permanent endowments."