

Foundations and the estate tax

If you give more than \$12,000 a year to your children or grandchildren, then you will owe the IRS a gift tax. If you give the money to total strangers, on the other hand, you are entitled to a tax deduction. The tax rules get even stranger when you die.

If you end up having saved too much, then your heirs will effectively bear the estate tax on those assets plus an endless stream of future taxes on any interest, dividends and capital gains from those assets. If you give those assets to a foundation, however, then the assets will be completely removed from the U.S. tax base — forever. Foundations are the ultimate tax loophole.

By Alan Reynolds

Like Bill Gates Sr., Warren Buffett is an outspoken advocate of steep estate taxes — for you and me, not for himself. The Buffet and Gates families have no intention of paying estate taxes. Hypocrisy is one of the rights and privileges of affluence.

Warren Buffett instead decided to leave \$37 billion of his Berkshire Hathaway stock to family foundations — doubling the size of the \$30 billion Bill and Melinda Gates Foundation and adding over \$6 billion to Buffett family foundations. Neither Mr. Buffet nor his family will owe any capital gains taxes on the enormously appreciated Berkshire Hathaway stock transferred to the Gates and Buffet foundations. Ordinary folks' taxes will have to be higher to make up for that perpetual, endless loss of tax revenue.

People commonly confuse foundations with charities. Actually, nearly all foundations are grant-making, rather than operating, foundations. That means they simply dispense funds to other tax-exempt organizations, paying for programs and projects that others have designed. Foundations do not deliver charitable services. They deliver money. This makes foundation managers and trustees a uniquely popular species, with many friends and no natural enemies.

In a 1997 study for the Philanthropy Roundtable, "Death, Taxes and the Independent Sector," I found that foundations

devote a significantly smaller portion of their giving to human services than individual donors do and a much larger share to "public/society benefit" (which is often aimed at influencing public policy and perhaps elections). Some giving defined as public affairs includes grants to state and local governments. Foundations also allocate relatively more than individual donors do to international affairs, environmental, and wildlife groups, performing arts, museums and universities.

Does the grantsmanship game really justify permanent tax exemption for foundation assets? Those receiving the grants have no complaints, of course. But the taxpayer is, in this case and others, the forgotten man. As more and more of the nation's assets are channeled into permanently tax-free institutions, other taxpayers will have to take up the slack.

One of the worst arguments for the estate tax is to assert that it encourages more charitable giving. In reality, the estate tax

affects the timing of gifts (later rather than sooner) and the choice of legal organization (placing appreciated assets in foundations rather than making direct gifts). There is no basis in theory or fact for expecting such changes in the timing or form of lifetime giving to have any effect on the total amount given. Only increases in income and wealth appear to have much impact on the long-term growth of total giving.

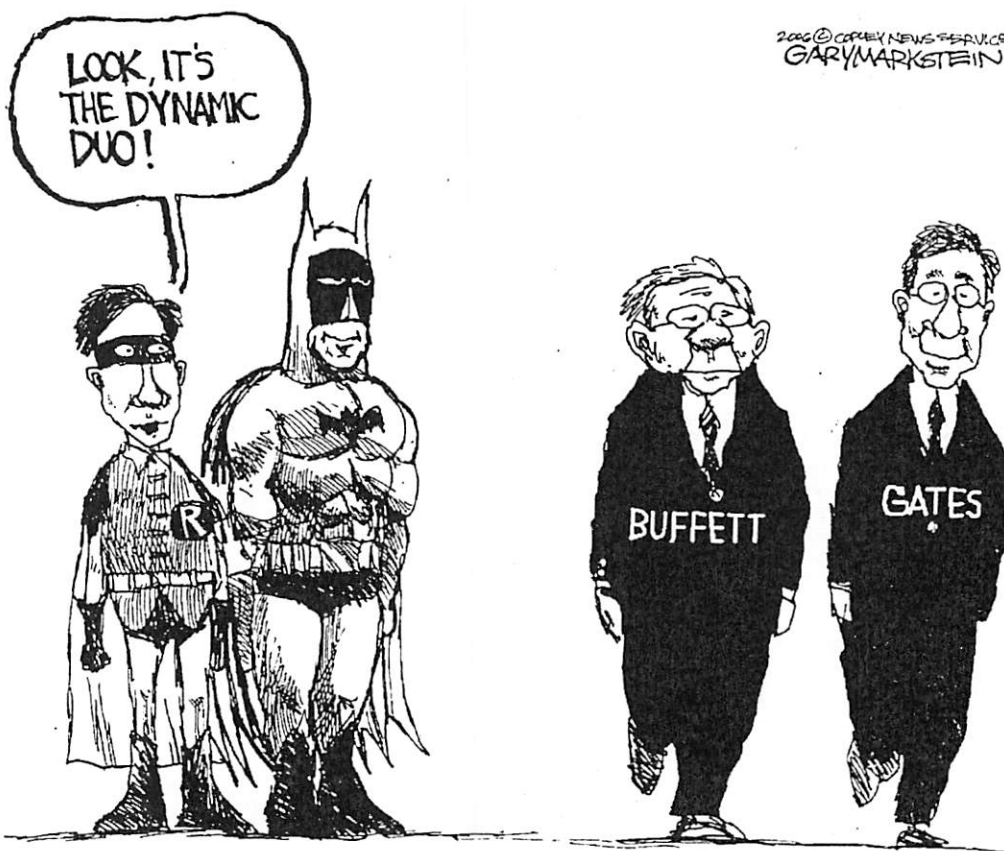
Unfortunately, the estate tax discourages accumulation of assets beyond the exempt amount, which means there is less to give away than would have been the case in the absence of death taxes. That also makes capital more scarce than otherwise, slowing the growth of productivity and real wages. Since charitable giving is a remarkably constant 2 percent of GDP, anything that makes the economy grow more slowly (including the estate tax) must also make charitable giving grow more slowly.

Reducing the gift and estate taxes to the same bearable level as

the capital gains tax would not make affluent people any less charitable, but it would alter the lifetime timing of giving away from delayed grants (gradually dribbled out through bureaucratic foundations after death) toward *inter vivos* gifts directly to charities. Because sooner is better than later, and direct donor supervision is wiser than letting politically correct professionals dole out the grants, this would be a colossal improvement over the presently overexploited foundation loophole for financial dynasties.

In 1969, Congress considered limiting the duration of foundations' tax exemption to 40 years. After that period, any interest, dividends, rent and capital gains from foundation assets would eventually be taxed, just as they are for everyone else. This seems an idea well worth reconsidering.

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