

**DESCRIPTION OF H.R. 4691,  
A BILL TO MODIFY THE TAX RATE FOR EXCISE TAX ON  
INVESTMENT INCOME OF PRIVATE FOUNDATIONS**

Scheduled for Markup  
by the  
HOUSE COMMITTEE ON WAYS AND MEANS  
on May 29, 2014

Prepared by the Staff  
of the  
JOINT COMMITTEE ON TAXATION



May 27, 2014  
JCX-56-14

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## INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup of H.R. 4691, a bill to modify the tax rate for excise tax on investment income of private foundations, on May 29, 2014. This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 4691, a Bill to Modify the Tax Rate for Excise Tax on Investment Income of Private Foundations* (JCX-56-14), May 27, 2014. This document can also be found on our website at [www.jct.gov](http://www.jct.gov).

**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)<sup>2</sup> 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.<sup>3</sup> 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 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.<sup>4</sup>

**Description of Proposal**

The proposal replaces the two rates of excise tax on tax-exempt private foundations with a single rate of tax of one percent. Thus, under the proposal, 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

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<sup>2</sup> Sec. 4942(g).

<sup>3</sup> Sec. 4940(e).

<sup>4</sup> Sec. 4942(d)(2).

foundation. The proposal repeals the special reduced excise tax rate for private foundations that exceed their historical level of qualifying distributions.

**Effective Date**

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

## B. Estimated Revenue Effects

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Fiscal Years [Millions of Dollars]												
<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2014-19</u>	<u>2014-24</u>
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**NOTE:** Details do not add to totals due to rounding.