DESCRIPTION OF H.R. 65, H.R. 1733, AND H.R. 1870

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON

SELECT REVENUE MEASURES

of the

HOUSE COMMITTEE ON WAYS AND MEANS

on May 21, 1992

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

May 19, 1992

JCX-18-92

CONTENTS

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of three bills (H.R. 65, H.R. 1733, and H.R. 1870) scheduled for a hearing before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means on May 21, 1992.

H.R. 65 ("What I Can Do for America Act") would allow taxpayers to designate on their Federal income tax returns that a refund otherwise due (or a cash contribution made with the return) be contributed to a Federal Program Enhancement Trust Fund for distribution to eligible Federal programs designated by the taxpayers on their tax returns. H.R. 65 also would allow a deduction from taxable income for contributions to the Trust Fund by individuals who do not itemize their deductions (as well as for itemizers). H.R. 1733 would allow tax-exempt private and community foundations to form tax-exempt cooperative service organizations for collective investment of their assets in stocks and securities.

H.R. 1870 would establish a Peace Tax Fund in the Treasury to receive tax payments (Federal income, estate, or gift taxes) designated by taxpayers to be spent only for nonmilitary purposes. H.R. 1870 also would authorize appropriations from the Peace Tax Fund for certain non-military activities approved by a Peace Tax Fund Board of Trustees, such as for retraining workers who are displaced by conversion from military production.

Part I is a summary of present law and the bills. Part II is a description of present law and the provisions of H.R. 65. Part III is a description of present law and the provisions of H.R. 1733. Part IV is a description of present law and the provisions of H.R. 1870. Parts II, III, and IV also include a discussion of issues related to the bills.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of H.R. 65, H.R. 1733, and H.R. 1870 (JCX-18-92), May 19, 1992.

I. SUMMARY OF BILLS

H.R. 65

Present law

For Federal income tax purposes, individual taxpayers who itemize deductions are allowed a deduction (subject to certain limitations) for contributions made to qualified charitable organizations or to Federal, State, and local governments. Currently, instructions to IRS income tax forms inform taxpayers that they may make a gift to the Federal Government by enclosing with their return a separate check made payable to the "Bureau of Public Debt." In addition, various public laws provide that contributions to specific Federal entities or programs are regarded as gifts to the United States. Such contributions to the Bureau of Public Debt and to specific Federal entities or programs are deductible if the donor itemizes deductions for the year the contribution is made.

Summary of bill

H.R. 65 would allow taxpayers to designate on their Federal income tax returns that a portion of any overpayment of tax (or a cash contribution made with the return) be contributed to a "Federal Program Enhancement Trust Fund." This Trust Fund would distribute funds to certain eligible Federal departments, agencies, and programs designated by contributing taxpayers. Overpayments designated (or cash contributions made with the return) to the Trust Fund would be deductible in computing taxable income, regardless of whether the donor itemizes deductions or claims the standard deduction.

H.R. 1733

Present law

Section 501(c)(3) requires that a organization be organized exclusively for a charitable, educational, or certain other exempt purposes in order to qualify as a tax-exempt public charity or private foundation under that section. Such tax-exempt organizations generally are exempt from Federal income tax on income they receive (other than income from an unrelated trade or business), including income from passive investment activities. An organization generally does not qualify for tax-exempt status if its primary purpose is to conduct a trade or business for profit and turn over the profits to a tax-exempt entity. However, section 501(f) provides that a common fund organized and comprised solely of members that are educational institutions is eligible for tax-exempt status under section 501(c)(3) if it is organized and operated solely to collectively invest in

stocks and securities on behalf of its members (and certain other criteria are met).

Summary of bill

H.R. 1733 would provide that an organization comprised of 20 or more members that are tax-exempt private foundations or community foundations would be treated as organized and operated exclusively for charitable purposes if it is organized and operated exclusively to collectively invest in stocks and securities on behalf of its members (and certain other criteria are met).

H.R. 1870

Present law

Other than the exception for taxpayers to designate that $1 of their income tax liability be paid to the Presidential Election Campaign Fund, taxpayers may not designate particular Federal programs to receive Federal tax payments for which they are liable. Taxpayers are not relieved from paying any portion of their Federal tax liability on the ground that they are conscientiously opposed to funding military activities of the Federal Government.

Summary of bill

H.R. 1870 would allow individual taxpayers (other than nonresident aliens) to designate that their income, estate, or gift tax payments for any taxable year be paid into a "Peace Tax Fund" to be established under the bill. Taxpayers eligible to make such a designation would be limited to individuals who demonstrate that, by reason of religious training and belief, they are conscientiously opposed to participation in war in any form. With respect to each fiscal year, certain amounts in the Peace Tax Fund would be appropriated for eligible nonmilitary purposes under the bill, and the remaining portion would be returned to the general fund of the Treasury but could not be used for military purposes. The bill also would establish a Board of Trustees to administer payments from the Peace Tax Fund as authorized in advance by appropriation Acts, by way of grants to public and private entities conducting eligible nonmilitary activities. In addition, H.R. 1870 would provide amnesty from civil or criminal penalties for conscientious objectors who, with respect to taxable years prior to 1992, make payment of delinquent tax (and interest) to be deposited into the Peace Tax Fund.

II. DESCRIPTION OF H.R. 65[2]

("What I Can Do for America Act")

Present Law

For Federal income tax purposes, individual taxpayers who itemize deductions are allowed a deduction, subject to certain limitations, for contributions made to qualified charitable organizations (sec. 170). In addition, an itemized deduction is allowed for contributions made to Federal, State, or local governments, provided the contribution is made for exclusively public purposes (sec. 170(c)(1)).[3]

No charitable contribution deduction is allowed to individual taxpayers who claim the standard deduction rather than itemize deductions.[4]

IRS publications inform taxpayers that they may make a gift to the Federal government to reduce the public debt. Page 29 of the Instructions for Form 1040 (1991) states:

> You may make a gift to reduce the public debt. If you wish to do so, enclose a separate check

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[2] H.R. 65 was introduced on January 3, 1991, by Mr. Bennett and Mr. Rangel. Mr. Hughes subsequently was added as a cosponsor.

[3] Cash contributions made by an individual to a public charity or governmental unit may be deducted in any one taxable year (along with other charitable contributions) in an amount generally up to 50 percent of the taxpayer's adjusted gross income (AGI) (computed without regard to any net operating loss carryback) for that year (sec. 170(b)(1)). Contributions in any one year in excess of the percentage limitation may be carried forward and deducted over the five succeeding taxable years (subject to percentage limitations in those years) (sec. 170(d)(1)).

[4] Prior to 1982 (as under present law), only taxpayers who itemized deductions ("itemizers") were allowed a deduction for charitable contributions. This deduction was extended to non-itemizers during 1982-1986, subject to differing limitations during those years. The maximum charitable deduction for non-itemizers was $25 for 1982 and 1983, and $75 for 1984. For 1985, 50 percent of the amount contributed was deductible (without a dollar cap) and, for 1986, 100 percent of the amount contributed was deductible (without a dollar cap).

> with your income tax return. Make it payable to "Bureau of the Public Debt." You may be able to deduct this gift on your 1992 tax return if you itemize deductions. Do not add your gift to any tax you may owe. If you owe tax, include a separate check for that amount payable to the "Internal Revenue Service."[5]

Thus, current IRS practice and forms do not permit taxpayers simply to designate on their income tax returns that overpayment amounts be contributed to the Federal Government. Instead, taxpayers who wish to make such a gift are instructed to write a separate check to the "Bureau of the Public Debt." The Instructions for Form 1040 clarify that a taxpayer making a gift to the Federal Government when filing the current year's tax return may claim a charitable contribution deduction on the tax return filed during the next year only if the taxpayer itemizes deductions on the return filed during the next year.

Although not expressly stated in IRS materials, taxpayers may make tax-deductible contributions (assuming the taxpayer itemizes) to the United States in many forms other than a direct gift to the Bureau of the Public Debt, provided that the contribution is made for exclusively public purposes. Various public laws specifically provide that contributions (in cash or other property) to various Federal entities or programs are regarded as gifts to the United States.[6]

Corporations (as well as trusts and estates) also are allowed a deduction for Federal income tax purposes, subject to certain limitations[7], for contributions made to qualifying charitable organizations or Federal, State, or local

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[5] Similar language is contained in the instructions for Forms 1040A and 1040EZ.

[6] For example, the following entities are expressly authorized to accept gifts on behalf of the United States: Secretaries of the Army, Navy, and Air Force, and the Department of Defense (10 U.S.C. sec. 2601(a)); United States Army Unit Funds (Rev. Rul. 73-296, 1973-2 C.B. 67); Managing Trustee of the Federal Old-Age and Survivors Insurance Trust Fund ("Social Security") (42 U.S.C. sec. 401(i), Rev. Rul. 82-169, 1982-2 C.B. 72); Department of Transportation (P.L. 89-670); Department of Commerce (P.L. 88-611, 1964-2 C.B. 655); Administrative Conference of the Courts (P.L. 92-526); Department of Health, Education, and Welfare for the benefit of a government insurance trust fund (P.L. 92-603); National Foundation on the Arts and Humanities (P.L. 89-209, 1965-2 C.B. 622, as amended by P.L. 93-133).

governments. A corporation (or trust or estate) making a charitable contribution will claim an itemized deduction for the contribution, because such entities are not allowed a standard deduction but must claim all deductions on an itemized basis.

Explanation of the Bill

Designation of tax overpayment or cash contribution to Federal Program Enhancement Trust Fund

Federal Program Enhancement Trust Fund.--H.R. 65 would allow taxpayers to designate on their Federal income tax returns that a portion of any overpayment of tax be contributed (or a cash contribution made with the tax return) to a "Federal Program Enhancement Trust Fund" ("Trust Fund").[8] Under the bill, the amount of the overpayment designated (or cash contribution made) to the Trust Fund would have to exceed $25 (or, if less, the amount of the overpayment of tax shown on the return).[9] The bill would establish the Trust Fund in the Department of the Treasury, which would distribute funds to eligible Federal departments, agencies, and programs designated by contributing taxpayers.[10]

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[7] Corporations generally may claim a charitable contribution deduction for the taxable year in an amount up to 10 percent of their taxable income (computed without regard to charitable contributions) (sec. 170(b)(2)). Contributions that exceed the percentage limitation generally may be carried forward and deducted over five succeeding taxable years (sec. 170(d)).

For Federal income tax purposes, trusts and estates generally are allowed to deduct charitable contributions up to any amount of their gross income without limitation, provided that the contribution is made pursuant to terms of the instrument governing the trust or estate (sec. 642(c)).

[8] The bill provides that, in the case of a joint return showing an overpayment, each spouse may designate that any portion of the overpayment be paid to the Trust Fund.

[9] Technical modification of the bill may be necessary to permit taxpayers to contribute the exact overpayment amount shown on the return.

[10] Amounts designated by taxpayers under the bill would be appropriated to the Trust Fund. Such amounts (minus certain administrative expenses of the Trust Fund) would be

(Footnote continued)

Under the bill, the designation of an overpayment (or cash contribution) to the Trust Fund could be made only at the time the taxpayer's income tax return is filed. The designation would be required to be made on the page of the return bearing the taxpayer's signature and would be irrevocable.

Eligible Federal programs.--The designation (or cash contribution) could be made only with respect to certain eligible Federal programs listed by the Secretary of the Treasury under authority granted by the bill. For any taxable year, a taxpayer could designate no more than two Federal programs to receive the designated overpayment (or cash contribution).

Under the bill, a list of Federal programs eligible to receive payments from the Trust Fund would be published annually by the Secretary of the Treasury.[11] The list of eligible Federal programs must include each department, agency, and instrumentality of the United States. In addition, the Secretary of the Treasury would be granted discretion to include on the list of eligible Federal programs any office within (or program administered by) a department, agency, or instrumentality of the United States.

H.R. 65 further would provide that amounts transferred to any Federal program under the bill would be under the control of the applicable department, agency, or instrumentality of the United States, and would remain available to such entity for the fiscal year in which the transfer is made and for the two succeeding fiscal years.

Deduction for nonitemizers

Under the bill, any overpayment designated (or cash contribution made with the return) to the Trust Fund would be treated as a charitable contribution made by the taxpayer to the United States.[12] In computing taxable income, individual

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[10](continued)
transferred before the end of each fiscal year to the eligible Federal programs designated by contributing taxpayers.

[11] The bill requires that the list of eligible Federal programs be included in the information made available by the IRS to taxpayers filing income tax returns.

[12] Any overpayment designated under the bill would be treated as refunded to the taxpayer and contributed to the United States on the last date prescribed for filing the return (determined without regard to extensions), or, if later, the date the return is filed.

taxpayers would be entitled to deduct the amount of overpayment designated (or cash contribution) to the Trust Fund, regardless of whether the individual taxpayer itemizes deductions or claims the standard deduction.[13] The amount of the deduction available for any one year under the bill, however, would be limited by the present-law percentage limitation (i.e., generally 50 percent of an individual's AGI) that applies to cash contributions to the United States. Any excess amount could be carried forward over the five succeeding taxable years and (subject to the percentage limitations) deducted in one or more of those succeeding years, regardless of whether the individual itemizes deductions at that time.

Effective date

The provisions of the bill would be effective for taxable years beginning after December 31, 1990.

Issues

As with any tax deduction or credit, the price of an activity that receives a tax incentive is reduced. For example, for a taxpayer in the 31-percent tax bracket, a $100 cash gift to charity reduces taxable income by $100 and thereby reduces tax liability by $31. As a consequence, the $100 cash gift to charity reduces the taxpayer's after-tax income by only $69. In this example, economists would say that the "price of giving" $100 cash to charity is $69.

For individuals who claim the standard deduction rather than itemize deductions, the proposal would reduce the price of making charitable contributions to the Federal Government. A dollar of charitable contributions to the Federal Government would cost the taxpayer only the amount of the contribution minus the tax savings from the contribution (i.e., the cost of giving would be $(1 - taxpayer's marginal tax rate)). This reduction in the price of giving would be expected to lead to an increase in donations of this type. The effect on charitable contributions of other types is uncertain. The overall effect would depend upon which effect

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[13] As under present law, corporate taxpayers (as well as trusts and estates) would be required to claim the charitable contribution deduction on an itemized basis.

Under the bill, if an individual taxpayer makes a contribution to the United States at any time other than when filing his or her income tax return, then such a contribution would not be within the scope of the bill's provisions and could be claimed as a deduction only if the taxpayer itemizes deductions for the year the contribution is made.

is larger: the substitution of charitable contributions to the Federal Government for other charitable contributions or the increase in charitable contributions to private organizations since donations to the government are less costly.[14]

For individuals who itemize deductions, the proposal would not have any effect on the cost of making charitable contributions to the Federal Government. Any increases in such contributions would have to occur from the promotional effect of advertising the donations on the tax form itself (rather than, as under current practice, simply notifying taxpayers in the instructions that a separate check can be written to reduce the public debt).

The proposal could create several administrative problems. Under the bill, the designation would be irrevocable and the taxpayer would be treated as having received a refund on the later of the last date prescribed for filing the return (without regard to extensions) or the date the return is filed. Consequently, if it is subsequently determined on audit (or the taxpayer files an amended return showing) that the taxpayer was not entitled to the overpayment amount initially claimed and contributed, then the taxpayer would have to pay that amount to the IRS, as well as interest and possible penalties. In addition, it may be difficult to provide the space on the tax forms required by the proposal. Moreover, it is unclear what the interaction of the proposal would be with the provisions of the Code that provide for offsets of tax refunds for certain past-due child support and unpaid Federal debts.

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[14] See, Charles Clotfelter, Federal Tax Policy and Charitable Giving (Chicago: University of Chicago Press), 1985, for a review of the literature.

III. DESCRIPTION OF H.R. 1733[15]

(Provide an Exemption From Income Tax for Certain Common Investment Funds)

Present Law

Tax-exempt status

Organizations described in section 501(c)(3) (commonly referred to as "charities") generally are exempt from Federal income tax and are eligible to receive tax-deductible contributions. Organizations described in section 501(c)(3) fall into one of two categories: (1) public charities, or (2) private foundations.[16] Private foundations typically are controlled and supported by a single source, such as one donor, family, or company. Private foundations are governed by Internal Revenue Code rules that generally are more stringent than rules applicable to public charities.[17]

Public charities and private foundations generally are exempt from Federal income tax on income they receive, other than income from an unrelated trade or business. The exemption from Federal income tax generally extends to income derived from passive investment activities (e.g., interest and dividends), unless derived from debt-financed property (sec. 512(b)).[18]

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[15] H.R. 1733 was introduced on April 11, 1991, by Messrs. Jacobs, Vander Jagt, Jenkins, and Gradison. Messrs. Pease, Dorgan, Guarini, Coyne, Rangel, Russo, and 56 other Members subsequently were added as cosponsors.

[16] A tax-exempt organization described in section 501(c)(3) is characterized as a "private foundation" unless it specifically qualifies as a "public charity" under section 509(a). Examples of public charities include: churches, schools, hospitals, and certain charitable organizations that normally receive a substantial part of their support from governmental units or contributions from the general public (secs. 509(a)(1) and 170(b)(1)(A)).

[17] Private foundations (and their managers) are subject to penalty excise taxes that may be imposed for certain transactions, such as self-dealing transactions, failure to distribute income, excess business holdings, investments which jeopardize charitable purpose, and making taxable expenditures (secs. 4941-4945).

[18] Although investment income earned by tax-exempt organizations generally is exempt from Federal income tax,

(Footnote continued)

Section 501(c)(3) requires that an organization be organized exclusively for a charitable, educational, or other exempt purpose listed in section 501(c)(3) in order to qualify for tax-exempt status under that section. An organization generally does not qualify for tax-exempt status if it is a so-called "feeder" organization, the primary purpose of which is to conduct a trade or business for profit and turn over the profits to a tax-exempt entity (sec. 502).[19]

Common Fund for educational organizations

Section 501(f) provides a special rule that an organization is treated as organized and operated exclusively for charitable purposes (and, thus eligible for tax-exempt status under section 501(c)(3)) if it is (1) organized and controlled by one or more members that are educational institutions, (2) comprised solely of members that are educational institutions, and (3) organized and operated solely to hold, commingle, and collectively invest (including arranging for investment services by independent contractors) in stocks and securities, the monies contributed thereto by members, and to collect income therefrom and turn over the entire amount thereof, less expenses, to such members. The only known active 501(f) organization is "The Common Fund."

Explanation of the Bill

H.R. 1733 would provide that an organization comprised exclusively of members that are tax-exempt private foundations or community foundations[20] shall be treated as

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[18](continued)
private foundations are subject to a two-percent excise tax on their net investment income (sec. 4940). In contrast, public charities are not subject to an excise tax on their net investment income.

[19] However, the Code does provide tax-exempt status to certain title-holding companies described in section 501(c)(2) (i.e., corporations organized for the exclusive purpose of holding title to property and turning over income therefrom to one or more related tax-exempt organizations) and section 501(c)(25) (i.e., corporations that hold title to real property on behalf of no more than 35 qualified tax-exempt shareholders).

[20] "Community foundations" are a form of charitable trust or fund (generally established to attract large contributions of a capital or endowment nature for the benefit of a particular community or area) which, technically, qualify as a public charity--not a private foundation--under sections 509(a)(1) and 170(b)(1)(A)(vi). See Treas. Reg. sec. 1.170A-9(e)(10).

organized and operated exclusively for charitable purposes if: (1) it has at least 20 members; (2) no one member holds (after the organization's second taxable year) more than 10 percent (by value) of the interests in the organization; (3) no one member controls the organization or any other member; (4) the members are permitted to dismiss the organization's investment advisor, following reasonable notice, upon a vote of the members holding a majority of interest in the organization; and (5) the organization is organized and operated exclusively to hold, commingle, and collectively invest (including arranging for investment services by independent contractors) in stocks and securities, the monies contributed by the members, and to collect income therefrom and turn over the entire amount thereof, less expenses, to such members.

Thus, under H.R. 1733, a common fund meeting the bill's criteria would be deemed to be operated exclusively for charitable purposes and would qualify for tax-exempt status under section 501(c)(3), provided that the other requirements of that section were satisfied.[21] If these requirements were met, the common fund generally would be exempt from Federal income tax and would be eligible to receive tax-deductible contributions.[22]

H.R. 1733 provides that a common fund meeting the bill's requirements would be subject to the present-law excise tax provisions applicable to private foundations (see footnote 17 supra), other than sections 4940 and 4942. In addition, each member's proportionate share (whether or not distributed) of the net income (including capital gains) of the common fund would be treated, for purposes of the excise tax imposed under present-law section 4940, as net investment income of the member for the taxable year of such member in which the taxable year of the common fund ends.

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[21] To qualify for tax-exempt status, the common investment fund would be subject to restrictions applicable to all organizations described in section 501(c)(3), such as prohibitions on private inurement, participation in political campaigns, and substantial lobbying activities.

[22] If such a common fund satisfied the present-law criteria for a public charity (see sec. 509(a)), then any contribution made to it (rather than directly made to one or more private foundation members) would be governed by the more liberal contribution rules applicable to public charities under section 170. If a common fund did not meet present-law criteria for a public charity, then under H.R. 1733 (as drafted) the common fund would itself have private foundation status.

Effective date.--The bill would apply to taxable years beginning after December 31, 1990.

Issues

Exemption for common investment funds

As discussed above, the Code generally exempts from Federal income tax the passive investment income of private foundations. The value of this exemption may be greater for large foundations than for small foundations because investment returns often are greater for foundations with more assets than for foundations with few assets. The returns may be greater because brokerage costs and advisory fees often are proportionally smaller for large foundations. One rationale for a common investment fund for foundations is to enable small foundations to pool their assets in order to earn returns comparable to large foundations.

There are, however, a number of different investment vehicles available under present law for small foundations to pool their assets with other investors. A foundation could, for example, invest in a mutual fund (i.e., a regulated investment company or "RIC"). Alternatively, a group of small foundations could get together to form their own RIC. A RIC is, in theory, not a tax-exempt entity but effectively receives tax-free treatment on income distributed to its shareholders. (A RIC is allowed to deduct dividends paid to members and, thus, is taxable only on the portion, if any, of its taxable income which is not distributed as dividends). However, a RIC is required to register under the Investment Company Act of 1940 and to satisfy certain income and distribution tests (secs. 851 and 852(a)).

Organization and control of the common investment fund

As noted in the present-law discussion, a common investment fund for educational institutions currently is provided tax-exempt status by section 501(f).[23] However, section 501(f) is limited to organizations formed and controlled by the investing educational institutions

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[23] Section 501(f) was enacted in 1974 to permit The Common Fund to retain its tax-exempt status, which was in danger of being lost after the expiration of start-up grants to the organization. As The Common Fund became increasingly reliant upon payments from member institutions to meet operational costs, the IRS took the position that the Fund would not be eligible for tax-exempt status if investment services were no longer provided to members at a charge substantially below cost. (See S. Rep. No. 93-888, 93rd Cong., 2d Sess. (1974) at 2-3.)

themselves and does not apply to any organization formed to promote the furnishing of investment services by private interests, even though those services might be made available only to educational organizations.[24] In contrast, under H.R. 1733, there is no requirement that a common fund for private foundations be formed or controlled by one or more of the participating private foundations.[25] Thus, H.R. 1733 would permit a tax-exempt common fund for private foundations to be organized (and effectively controlled) by entities formed to promote the furnishing of investment services by private interests. The bill does require, however, that the common fund's members must be permitted to dismiss the fund's investment advisor, following reasonable notice, upon a vote of the members holding a majority of interest in the fund.

Membership in the common investment fund

Another issue raised by the bill is the permissible membership of a common fund. H.R. 1733 requires that a common fund be comprised "exclusively" of private foundations and certain community foundations. By contrast, a common fund for educational institutions under present-law section 501(f) must be comprised "solely" of members that are educational institutions. The term "exclusively" is interpreted by the IRS to mean primarily, or substantially, for purposes of section 501(c)(3), whereas the term "solely" is interpreted literally as not allowing a de minimis exception.[26] For this reason, H.R. 4210,[27] which contained similar provisions granting tax-exempt status to private foundation common funds, required that such a common fund be comprised "solely" of private foundations and community foundations.[28]

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[24] See id at 3.

[25] H.R. 1733 specifically provides that the common fund cannot be controlled by any one member.

[26] See G.C.M. 36378 (May 21, 1976).

[27] H.R. 4210 (as reported by the committee of conference) was passed by the House of Representatives and the Senate on March 20, 1992, but was vetoed by the President on that date.

[28] The conference report to H.R. 4210 stated: "It is expected that members will present the organization with verification of their status as tax-exempt private foundations or community foundations at the time they become members (i.e., when they make an initial investment). Further, it is intended that a reasonable time period should be allowed for withdrawal by a member that subsequently

(Footnote continued)

In addition, establishment of a tax-exempt common investment fund for private (and community) foundations could encourage other tax-exempt organizations (e.g., hospitals) to likewise seek authority to form tax-exempt investment funds that would not be subject to requirements under the Investment Company Act of 1940 nor subject to certain other income and distribution rules (secs. 851 and 852(a)).

Investment activities of the common investment fund

Another issue presented by the bill is the nature of the allowable investments of a common fund. Under H.R. 1733, a common fund must be organized and operated "exclusively" to hold, commingle, and collectively invest and reinvest in stocks and securities. By contrast, a section 501(f) common fund for educational institutions must be organized and operated "solely" to engage in these investment activities. As described above, the term "exclusively" generally is interpreted under section 501 more liberally than is the term "solely." Here again, the language of H.R. 4210 parallels the provisions of section 501(f), so that a common fund for private foundations would have been required to be organized and operated "solely" to invest in stocks and securities.[29]

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[28](continued)
ceases to qualify as a tax-exempt private foundation or community foundation." H. Rept. 102-461, 102nd Cong., 2d Sess., at 601 n.1 (1992).

[29] The conference report to H.R. 4210 stated that an organization would be deemed to be organized and operated solely to collectively invest in stocks and securities if its income "is derived solely from investing in stocks and securities, and ordinary and routine investments in connection with a stock and securities portfolio." Id. at 601 n.2.

IV. DESCRIPTION OF H.R. 1870[30]

(Provide that Taxpayers May Elect to Have Tax Payments Designated for Nonmilitary Purposes and Establish a Peace Tax Fund)

Present Law

Taxpayers may not designate particular Federal programs to receive the Federal income, estate, or gift tax payments for which they are liable. An exception to this rule is that individuals may designate on their income tax returns that $1 of their tax liability be paid over to the Presidential Election Campaign Fund (sec. 6096). Other than this one exception, Federal income, estate, and gift tax payments are deposited into the general fund of the United States Treasury, from which amounts are appropriated by law to a variety of Federal agencies and programs.[31]

The IRS is required to include two pie charts in individual income tax form instruction booklets (based on data available for the most recent fiscal year) depicting sources of Government revenue and the relative sizes of the following major outlay categories: (1) defense, veterans, and foreign affairs, (2) social security, medicare, and other retirement, (3) physical, human, and community development, (4) social programs, (5) law enforcement and general government, and (6) interest on the debt (sec. 7523).

Courts have repeatedly held that taxpayers are not relieved from paying any portion of their Federal income tax liability, despite the taxpayers' claim that they are conscientiously opposed to funding military (or other) activities of the Federal Government.[32] Taxpayers who refuse on grounds of conscientious objection to make Federal tax payments otherwise due are subject to criminal and civil penalties under chapters 68 and 75 of the Internal Revenue Code.

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[30] H.R. 1870 was introduced on April 17, 1991, by Mr. Jacobs, Mr. Moody, and 31 other Members. In addition, 8 other Members subsequently were added as cosponsors.

[31] In contrast, taxpayers who make charitable contributions to the Federal Government generally may designate particular Federal agencies or programs to receive the contributions. (See note 6 supra.)

[32] See, e.g., United States v. Douglass, 476 F.2d 260 (5th Cir. 1973); United States v. Malinowski, 472 F.2d. 850 (3rd Cir. 1973).

Explanation of the Bill

Designation by individual taxpayers

H.R. 1870 would allow individual taxpayers (other than nonresident aliens) to designate that their income, estate, and gift tax payments for any taxable year be paid into a "United States Peace Tax Fund" (the "Peace Tax Fund") to be established under the bill. The designation may be made with respect to a taxable year at the time of filing the return for that year, or at any other time thereafter as specified in Treasury Department regulations.[33]

Eligible conscientious objectors

Under the bill, taxpayers eligible to make such a designation would be limited to individuals (1) who by reason of religious training and belief, are conscientiously opposed to participation in war in any form, and (2) who have (a) been exempted or discharged from combat service and training in the United States Armed Forces as a conscientious objector under section 6(j) of the Military Selective Service Act[34], or prior corresponding law, or (b) certified in a statement in a questionnaire filed with the tax return that they are conscientiously opposed to participation in war in any form within the meaning of section 6(j) of the Military Selective Service Act.[35]

In the questionnaire filed with the taxpayer's return,

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[33] In the case of an eligible individual filing a joint income tax return, upon the consent of such individual's spouse, the joint income tax payment may be designated to the Peace Tax Fund.

[34] Section 6(j) of the Military Selective Service Act provides that a person shall not be subject to combatant training and service in the armed forces if that person, by reason of religious training and belief, is conscientiously opposed to participation in war in any form. As used in that provision, the term "religious training and belief" does not include "essentially political, sociological, or philosophical views, or a merely personal moral code." (50 U.S.C. App. 456(j)).

Conscientious objector claims under section 6(j) of the Military Selective Service Act turn on the resolution of factual questions relating to the nature of the registrant's beliefs concerning war, basis of the objection in conscience and religion, and registrant's sincerity. See McGee v. United States, 402 U.S. 479 (1971).

the taxpayer would have to certify the taxpayer's beliefs about participation in war, the source or genesis of such beliefs, and how the beliefs affect the taxpayer's life. Under the bill, each IRS publication of general instructions for an income tax return (or questionnaire provided for by the bill) must include an explanation of the purpose of the Peace Tax Fund, the criteria for determining whether an individual is eligible to make a designation to the Peace Tax Fund, and an explanation of the process for making such a designation. In addition, upon receipt of the questionnaire, the IRS would be required to issue a receipt (originally attached to the questionnaire) to the taxpayer indicating timely filing of the questionnaire.

Estate and gift tax returns

H.R. 1870 also would apply to Federal estate and gift tax liability. In the case of estate tax payments, the bill would allow an election to be made by the executor or administrator of a taxable estate to have the Federal estate tax imposed by section 2001 transferred when paid to the Peace Tax Fund. The election could be made if the executor or administrator has the written authority of the decedent who qualified as an eligible conscientious objector (under the criteria discussed above). Similarly, the bill would allow eligible individuals to elect that the Federal gift tax imposed by section 2501 be transferred when paid to the Peace Tax Fund.[36]

United States Peace Tax Fund

Establishment of the Fund.--The bill would establish the Peace Tax Fund within the Department of the Treasury. On at least a monthly basis, amounts would be transferred from the general fund of the Treasury to the Peace Tax Fund on the basis of estimates by the Secretary of the Treasury of the

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[35] The Secretary of the Treasury may require any taxpayer who makes a designation under the bill to provide additional information as may be necessary to verify the taxpayer's status as an eligible individual. If the Secretary of the Treasury determines that an individual is not eligible under the bill to make a designation, then the Secretary must send written notice to the taxpayer stating the reasons for denial of the designation, and the taxpayer may challenge the Secretary's ruling by bringing a declaratory judgment action in the United States Tax Court or in United States district court.

[36] The elections in estate and gift tax cases would be made in the manner as prescribed by Treasury Department regulations.

amounts designated during the fiscal year by individuals of their Federal income, estate, and gift tax payments to be deposited into the Peace Tax Fund.[37]

Appropriations from the Fund.--H.R. 1870 would require that, with respect to each fiscal year, the Comptroller General shall determine the percentage of actual appropriations made by the Federal Government for military purposes.[38] This percentage would then be used to determine the portion of the Peace Tax Fund that would be authorized for appropriation for certain eligible nonmilitary purposes under the bill.[39] The remaining portion of amounts in the Peace Tax Fund (i.e., the surplus amount not appropriated for nonmilitary purposes under the bill) would then be returned back to the general fund of the Treasury. H.R. 1870 further provides that no part of the funds transferred from the Peace Tax Fund to the general fund could be appropriated for any expenditure (or otherwise obligated) for a military purpose.

Eligible nonmilitary activities.--Under the bill, activities eligible to receive funds from the Peace Tax Fund would include (but not be limited to): (1) retraining workers displaced by conversion from military production or activities; (2) research directed toward developing and

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[37] The bill provides that adjustments would be made in amounts subsequently transferred to the extent that prior estimates were in excess of, or less than, the amounts actually designated by individuals.

The Secretary of the Treasury would be required to report to Congress each year on the total amount transferred into the Peace Tax Fund during the preceding fiscal year.

[38] For purposes of the bill, the term "military purposes" means: "any activity or program conducted, administered, or sponsored by an agency of the Government which affects an augmentation of military forces, defensive and offensive intelligence activities, or enhances the capability of any person or nation to wage war."

The bill defines the term "actual appropriations made for a military purposes" as including (but not limited to) amounts appropriated by the United States in connection with: (a) the Department of Defense; (b) the Central Intelligence Agency; (c) the National Security Council; (d) the Selective Service System; (e) activities of the Department of Energy that have a military purpose; (f) activities of the National Aeronautics and Space Administration that have a military purpose; (g) foreign military aid, and foreign economic aid made available to any country for the purpose of releasing

(Footnote continued)

evaluating nonmilitary and nonviolent solutions to international conflict; (3) disarmament efforts; (4) special projects of the United States Institute of Peace; (5) international exchanges for peaceful purposes; (6) improvement of international health, education, and welfare; and (7) programs for providing information to and education of the public concerning such activities.[40]

Board of Trustees.--The bill would establish a Peace Tax Fund Board of Trustees (the "Board"). The Board would be composed of 11 members, nine of whom would be appointed by the President (not more than five from the same political party) with the advice and consent of the Senate.[41] The remaining two members of the Board (serving in an ex officio capacity) would be one Member of the Senate appointed by the President pro tempore of the Senate (upon recommendations of the majority leader and minority leader) and one member of the House of Representatives appointed by the Speaker of the House (upon recommendations of the majority leader and minority leader). The term of office for a member of the Board generally would be six years, and no member could serve on the Board for more than 12 years.[42]

Under the bill, it would be the responsibility of the

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[38](continued)
local funds for military activities; and (h) the training, supplying, or maintaining of military personnel, or the manufacture, construction, maintenance, or development of military weapons, installations, or strategies.

[39] The percentage of actual appropriations for military purposes determined by the Comptroller General with respect to a fiscal year would be multiplied by all the funds transferred to the Peace Tax Fund for that year, the product of which would be authorized for appropriation for the eligible nonmilitary purposes enumerated in the bill.

[40] H.R. 1870 further provides: "Funds nondesignated for the purpose of research may be directed to governmental or nongovernmental, national, or international organizations. Funds for domestic programs involving the providing of goods and services shall be restricted in distribution to the United Nations and associated agencies." (Introduced bill at 16.)

[41] The bill provides that such members would be selected from among "individuals who have demonstrated a consistent commitment to world peace, international friendship, and the peaceful resolution of international conflict."

[42] In addition, an executive director and staff of the Board
(Footnote continued)

Board to make payments from the Peace Tax Fund. Payments would be made as authorized in advance by appropriation Acts, by way of grant, loan, or other arrangement, under conditions and terms the Board considers necessary.[43] The Board would be required to publish regulations for the submission of applications for funds by public or private individuals, corporations, and other entities, and by Federal agencies. Before approving any such application, the Board would determine, after a comprehensive review of all the functions and activities of the entity requesting funds from the Peace Tax Fund, that such functions and activities have a nonmilitary purpose.[44]

In accordance with rules and procedures established by the Comptroller General, the Board would be required to submit a budget to Congress, to report to the President and Congress annually on the activities of the Board, and to provide a complete accounting of all funds received and disbursed from the Peace Tax Fund.

Amnesty program for taxable years ending before 1992

H.R. 1870 would provide that any civil or criminal penalty imposed on an individual for failing or refusing to pay all (or a part of) the taxpayer's income tax liability would be vacated and set aside if the individual (1) pays the tax due (with interest), and (2) establishes to the satisfaction of the Secretary of the Treasury that the individual was an eligible conscientious objector under the criteria of the bill (discussed above). Under the bill, delinquent amounts so paid by eligible individuals would be deposited into the Peace Tax Fund.

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[42](continued)
would be appointed, subject to the general rules governing appointment and compensation of Federal civil service employees (see chapter 51 and subchapter III of chapter 53 of title V of the U.S. Code). Members of the Board would be compensated on a per diem basis at the maximum rate permitted by law under the General Schedule for Government employees or consultants, and also would be reimbursed for travel and subsistence expenses incurred in performance of Board duties (subject to certain limitations).

[43] Any contract for property or services would be subject to Federal laws and regulations concerning the acquisition of property and services by a Federal executive agency.

[44] H.R. 1870 specifically provides: "It is the intent of this Act that the [Peace Tax] Fund shall not operate to release funds for military expenditures which, were it not for the existence of the Fund, would otherwise have been appropriated for nonmilitary expenditures."

Effective dates

The provisions of the bill generally would apply to taxable years beginning after (and estates of decedents dying after, and gifts made after) December 31, 1991.

Issues

In general

Money is fungible, including tax receipts received by the Federal Government. Thus, to the extent that tax receipts remaining in the general fund and not deposited into the Peace Tax Fund are sufficient to pay for the military activities, there would be no overall reduction in the Government's funding of military activities as a result of the bill. However, H.R. 1870 would result in a pool of tax revenues being set aside and appropriated for certain non-military purposes (i.e., the portion of taxes paid by conscientious objectors that is equivalent to the percentage of actual appropriations made for military purposes for that fiscal year). This portion of taxes paid by conscientious objectors would be disbursed from the Peace Tax Fund as authorized in advance by appropriation Acts, by way of grants approved by the Board of Trustees to fund eligible non-military activities conducted by public and private organizations. Thus, the bill would establish another grant disbursing agency of the Federal Government and a new spending category for the enumerated non-military programs eligible to receive Peace Tax Fund distributions under H.R. 1870.

The bill could produce better tax compliance in cases of individuals opposed to Government military activities to the extent they are satisfied with the bill's designation and appropriation procedures. However, establishment of a dedicated Peace Tax Fund could encourage requests from other groups for similar treatment of their Federal income, estate, and gift tax payments (and even requests for similar treatment of excise tax payments). For example, taxpayers opposed to income transfer programs might wish to dedicate their tax payments to Government expenditures for goods and services. A proliferation of such dedicated funds could increase the likelihood of future constraints on the Government's spending.

Administrative issues

The administrative process provided for by H.R. 1870 for certifying eligibility for a taxpayer's designation of tax payments to the Peace Tax Fund may be cumbersome for the IRS. Furthermore, in requiring judgments about ethical and religious motivations of taxpayers and the sincerity of their claimed beliefs (see footnotes 34 and 35 supra), the bill

could compel the IRS to operate in an area in which it may have little expertise. Certification decisions on conscientious-objector status for tax purposes could lead to court battles and could further raise concern about IRS-taxpayer relations. Administrative costs would result from processing claims of conscientious-objector status made by taxpayers and applications filed by private and public organizations for grants from the Peace Tax Fund. Moreover, accounting disputes could arise when the Comptroller General determines for a taxable year the percentage of actual appropriations made for military purposes, particularly with respect to appropriations to Federal agencies (e.g., NASA) that conduct activities that serve both military and non-military functions (see footnote 38 supra).

Using a prior election by an individual of conscientious objector status for selective service, military purposes as a qualification for the Peace Tax Fund may be perceived as presenting a higher burden of proof for women and those men who were not required to register for the draft and thus did not previously need to make an expression of conscientious-objector status. In addition, it could be difficult to limit the amnesty program provided for by H.R. 1870 to conscientious objectors and not allow other delinquent taxpayers to avoid civil and criminal penalties under the bill.

Other administrative issues raised by H.R. 1870 include the following: It is unclear whether the decision to contribute to the Peace Tax Fund is irrevocable with respect to a particular tax return (or amended return). If a taxpayer elects to pay into the Peace Tax Fund with respect to a particular return, would the designation also apply to penalties and interest assessed on an underpayment relating to that return? Because the bill appears to require that the election of conscientious-objector status be made on an annual basis, taxpayers could de facto choose to contribute to some military activities and not others by deciding whether to elect such status for a particular taxable year. In this regard, it may be desirable to deny election of conscientious-objector status if a taxpayer previously had elected such status but chose not to elect such status for one (or more) intervening years.[45]

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[45] However, such a rule might appear harsh in the case of a taxpayer who inadvertently fails to elect conscientious-objector status on a particular tax return.