More than 5 million Americans are living with Alzheimer’s, the nation’s sixth leading cause of death. It is the only cause of death among the top 10 in the U.S. that cannot be prevented, cured or even slowed. In 2016, the direct costs of caring for those with Alzheimer’s or other dementias in America will total an estimated $266 billion. As the leading voluntary nonprofit health organization in Alzheimer’s care and support, and the largest nonprofit funder of Alzheimer’s research, the Alzheimer’s Association is working each and every day to provide help and hope to all affected.

We are thankful for the support of our loyal donors and need more individuals to champion the cause as we work together to eliminate Alzheimer’s disease.

Your generosity allows us to:

* Enhance Care and Support
  The Alzheimer’s Association works on a global national and local level to enhance care and support for all those affected by Alzheimer’s disease and other dementias. We run support groups, provide caregiver and family care, with comprehensive online resources in many languages, offer information and advice through our professional staffed 24/7 Helpline, and deliver educational programs. We are here to help.

* Advance Research
  As the largest nonprofit funder of Alzheimer’s research, the Association is committed to accelerating progress toward new methods of treatment, prevention and, ultimately, a cure. Through our partnerships and focused projects, we have been part of every major research advancement over the past 30 years. Our research grant program has awarded more than $955 million in 2,300 scientific grants since 1982.

* Advocate
  The Alzheimer’s Association is the leading voice for Alzheimer’s disease advocates, fighting for critical Alzheimer’s disease prevention and care initiatives at the state and federal levels. We diligently work to make Alzheimer’s a national priority.

We are only able to continue to provide help and hope to those affected by Alzheimer’s disease and other dementias through your generous support. Learn more about how making a planned gift to the Alzheimer’s Association can fit into your budget, and provide a lasting legacy of hope to future generations.

www.alz.org/estates

alzheimer’s association
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Email: plannings@alz.org

Brian Galle, M.D.
Professor of Law
Georgetown University
Washington, D.C.

Philanthropy for Now

The costs of restricted spending

The U.S. philanthropic sector is by far the largest in the world, building roughly $1 trillion in assets at latest estimates. In fact, if U.S. philanthropy were a nation of its own, its gross domestic product would rank around 60th worldwide, just behind New Zealand—which, after all, has hobbits—and ahead of Hungary. Is that a stunning success story or the product of policy gone wrong? Some of both, I would say.

Law, in combination with American wealth and generosity, has driven the build-up of philanthropic endowments. Federal and state tax laws each encourage charitable giving, but tax laws—and some related state laws—do more than that. They give extra favors, over and above those available to more charitable contributions, for gifts that go to what I’ll call “restricted spending” charities. The restricted spending organization is bound, often by the terms of restricted gifts, to limit its expenditures so as to preserve the ongoing spending power of the individual gifts, and usually it must strive to do so in perpetuity.

I’ll argue that the costs of restricted spending greatly outweigh its benefits. Favoring restricted spending has reverse costs, of course. The social costs, especially the lost opportunities that fall victims to restricted spending, are likely larger still. Yet, the arguments in favor of our existing support for restricted spending are surprisingly thin. As I’ll suggest here (echoing a longer, more academic examination from my extensive work, "Pay It Forward? Law and the Problem of Restricted Spending: Philanthropy’s Donor Revolt" 92 Washington University L. Rev. (forthcoming 2016)), the rationale professed in the past by others are logically dubious and often rest on demonstrably inaccurate facts.

If it’s right that government should try to get out of the business of encouraging restricted spending, what should be the next policy step? Outreach repeal of some of the extra subsidies for restricted giving is tricky and not necessarily the best policy option. At a minimum, though, we should expect philanthropic organizations to do more to distribute their growing hoards of assets. My analysis of the data suggests, for instance, that private foundations (PFS) could distribute more than 15 percent of their annual assets without any reduction in the real value of the PP sector. We also should strongly consider repeal of a state law provision, enacted in 12 states as part of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which deems annual distributions in excess of 7 percent of firm assets to be an "improvident" use of resources.

Law Supports Restricted Spending

While federal tax law offers the biggest boost to restricted spending policies, state taxation, trust, and general charitable organization laws contribute as well. Federal and state charitable contribution deductions reduce donors’ income and estate taxes at the date of a qualifying gift, not the date when the gift is actually spent. This rule provides two important benefits. Most importantly, it shields any subsequent appreciation from taxation, granting a larger government bonus to donations the longer the period between donation and expenditure. In addition, with wise tax planning, many donors (or their heirs) can continue to make effective use of their donated assets long after collecting the tax bounty for giving them away. For example, the founders of a PP can sit on its board and direct how the shares it holds are voted, continuing to control the firm whose ownership they have in form surrendered. That result
When restricted spending policies prevent foundations from making grants, society loses out on any long-run appreciation on those projects.

American foundations are often viewed as bastions for the preservation of the long dead or, perhaps, for the glory of a family who carry on the name of the dead. Fundraising brings accountability, as any Silicon Valley start-up could testify. As law professors Mark Hall and John Colombo have argued, the ability to attract donations is also a key indicator of the value of an organization’s contribution to society. What does it say about the usefulness of the government’s subsidy if we give millions of dollars to a firm that can’t attract a dime from current donors?

While there may be other reasons we would want foundations to save some of their funds, none of these alternatives seem to justify restricted spending on its current scale. For instance, real options and countercyclical spending could justify some degree of savings. A “real option” is just the opportunity to wait for the best time to spend money. Why fund a vaccine now, when a better one might come along? Spending more during recessions and less during boom times is good fiscal policy; the government should be happy if organizations save some money when times are good for use in the lean years.

These savings rationalize don’t fit the facts of restricted spending as it now practiced. For one, both justifications actually imply that foundations should be free to spend very large amounts when the time is right. If the recession is deep or this year’s vaccine is very promising, a foundation should be able to spend more than a tiny fraction of its wealth. Further, as an empirical matter, foundations don’t appear to spend more during downturns, making this a dubious justification for existing law. If, however, laws were reformed to guarantee that spending would be more robust during recessions, that would justify some degree of savings at other times.

Finally, some argue that we should favor restricted spending policies because donors like them and thus might give more as a result. This argument may be true, but it is economically inconsistent as a justification for greater subsidies for restricted spending. Usually, we offer the public tax and other subsidies to get them to do things they wouldn’t do otherwise. The more people would do something on their own, the less sense it makes to spend government money encouraging them. In many cases, we’d end up wastefully awarding money to those who would have donated anyway.

Restricted Spending Costs
Against whatever thin benefits there might be from restricted spending, we also should weigh the possible costs. As many other writers have recognized, delayed charity is often less effective. As time passes, donors’ abilities to recognize what society needs most and their power to rein in potentially self-serving managers both diminish. Foundations also lack information about the best allocation of operating charities’ resources over time; this gap could be closed if money flowed directly to the operating charity. The opportunity costs of waiting are at least as important as these factors, but these costs are often overlooked. When restricted spending policies prevent foundations from making grants, society loses out on any long-run appreciation on those projects. The money might still be spent in the future, but we miss all the good that could have been built on the initial expenditure in the interim. What could that hungry kid on the street have accomplished if we had found him a good home and a good school? And, every foregone project sacrifices not only the benefits of the project itself, but also our opportunity to learn from that project how best to do the next one.

Opportunity costs show the falsity of the claim sometimes advanced by foundation advocates that, by investing instead of spending, foundations are able to spend more money on charity in the long run. Investing might return more dollars to be spent, but those future dollars produce less good than immediate spending would have yielded.

To see this concretely, let’s suppose that foundations average about a 10 percent real rate of return on their investments. That return implies their money’s buying power doubles around every seven years. Now, choose the richest school districts in the United States today. Would a donor spend there pay off more than four dollars’ worth of good for society in 2029? If you think so, restricted spending is wastes an opportunity. Studies of the returns on education report overall averages in the United States of about 10 percent, but much higher rates for early education, especially in low-income communities.

Holding foundation money for the future is also wasteful because the future will need the money less. Future generations will be richer than we are. And, as the foundation sector grows, it will have to spend its money on less and less needy projects. In my longer work, I examine tax returns for a large sample of foundations over a quarter-century. Foundation wealth grows steadily over that time. Indeed, as “Revenues and Expenditures” this page illustrates, the foundation sector never spent more than it brought in during any year, even during the largest recession in almost a century.
would be impossible if the property were given to a firm that would liquidate the asset for use in operations.

State charitable trust and corporation law also favor restricted spending. Most states presume that any gift with restricted uses is intended to last in perpetuity, and state attorneys general are charged with enforcing the terms of these and other provisions of the organiza-

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tional documents. As I mentioned, about a dozen states go even further and oblige managers to spend less than 7 percent of firm assets annually unless they can show good cause for doing otherwise.

Why Favor Restricted Spending? It's important to recognize that the argument against restricted spending is an argument against foundations. Foundations are a crucial source of social experiments and intellectual dynamism and a bulwark against pure bureaucratic control of policy-making. But, these important tasks, and others funded by foundations/defenders, can be accomplished without restricted spending.

Foundations can thrive even as they spend. Even if gifts to the organization are spent quickly, as long as the firm can replace old money with new contributions, the foundation can continue on. Or, in many cases, one foundation can close its doors, and another can open, with little lost in the exchange.

To be sure, there could be arguments that foundations shouldn't have to raise funds. Fundraising can take managers away from important tasks and, perhaps, encourage the firm to pursue goals that will appeal to new donors. The preferences of new donors won't always align perfectly with those of the earlier supporters.

For the most part, though, there are the benefits of fundraising, not the flaws. A longstanding criticism of American foundations is that they're irregular benefactors for the preferences of the long-dead elite or, perhaps, for the chance of a new hero or heroine on the name of the dead. Fundraising brings accountability, as any Silicon Valley start-up could testify. As law professors Mark Hall and John Colombo have argued, the ability to attract donations is also a key indicator of the value of an organization's contribution to society. What does it say about the usefulness of the government's subsidy if we give millions of dollars to a firm that can't attract a dime from current donors?

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If we continue to underestimate restricted spending, we should also implement policies that loosen or waive the restrictions during recessions.

Reforming the Law I argue that there's little reason government should be actively encouraging donors to attach restricted spending conditions to their gifts. On the other hand, I have to acknowledge that entirely eliminating some

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- IRS-PP-SCI 2011 Cumulative File

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of the rule that preference restricted spending would be difficult or unwise. For example, outright repealing the tax exemption for foundation investment earnings would likely have a number of unwanted side effects, including discouraging managers from investing aggressively.

An alternative approach would be to keep some of the existing subsidies in place, but take steps to limit the worst aspects of restricted spending. The most straightforward of these would be to impose a minimum payout rule that allows the philanthropic sector to maintain its current spending power without curtailing its unrestricted growth. 75% of course, already must spend at least 5 percent of their net investment assets each year, but some closely related organizational forms, such as donor advised funds, need not.

As "Revenues and Expenditures" suggests, a 5 percent floor, where it even exists, is much too low to prevent massive gains in foundation assets. Some prior studies, funded by foundation-industry trade organizations, have reported that 5 percent represents the maximum "sustainable" payout. These reports rely on unreliable data—for instance, most of them are based on a tiny, non-random, sample of foundations in Michigan. I attempted to replicate these studies using a large, weighted sample of foundation tax returns, compiled by the Internal Revenue Service itself. The industry studies also claim that foundation payout shouldn't exceed real investment returns, without explaining why payout levels can't also reflect new contributions. I therefore calculate potential growth rates based on real investment returns alone, as well as investment returns plus new contributions. "Foundation Asset Growth," p. 59, summarizes the results.

Sustainable industry-wide spending rates are much higher than 5 percent. The foundation sector is growing more rapidly than the U.S. economy. If foundation growth continues at its historic average over the last quarter century, we could set a payout rate as high as 18 percent without losing any of the sector's current spending power. Even if spending were only limited to investment returns, we could double the current minimum payout levels.

State laws could readily be changed as well. State law shouldn't presume that donors intend to establish a perpetual trust. Another readily change would be to repeal, in the dozen states that adopted it, UPMAF's optional 7 percent soft cap on endowment spending. My research finds that average foundation spending has dropped in states that adopted the cap, relative to other UPMMAF states that didn't. Given the social costs of restricted spending rates, state law shouldn't be encouraging, or requiring, the perpetual postponement of philanthropic spending.

Finally, the law should reflect the genuinely useful goal of transferring wealth from society's good times to its bad. If we continue to underwrite restricted spending, we should also implement policies that lessen or waive the restrictions during recessions. For example, I've seen simulations showing that raising the minimum payout requirement by just 2 percent during recessions—10 years would have increased foundation spending during recent recessions by more than 25 percent.

Final Thoughts

Foundations and other philanthropic giving organizations can do tremendous good for society. No one disputes that. My goal is only to ask whether they could be doing more. If our answer is an overwhelming "yes," as it seems to be, shouldn't the law take steps to improve our current, wasteful, policies?

Of course, foundations aren't the only charities that have large endowments. U.S. colleges and universities hold more than $500 billion in restricted assets, by some counts. My view is that endowments at operating charities can present different questions from the foundation context. In some ways, the case against restricted spending by universities is even stronger, but in others it's weaker. By focusing only on foundations, I don't mean to imply that massive wealth accumulation elsewhere should go unexamined.

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Endnotes
2. Private foundations and public charities account for 75 percent of all giving. Internal Revenue Service data for 2004-2006, out this is a large enough block of a publicly traded firm to give effective control in many instances. And, firms can exceed the cap for as long as 10 years after the gift. SEC filing 10-K, for example, page 64-65, notes that "any" flexibility is possible by using "contingent voting rights or by setting voting standards for major corporate actions in a way that gives the foundation effective veto." (Complete Information from our Contractors)
7. The Internal Revenue Service and other independent researchers have also found that rules are needed in areas of interest, although not always the areas of greatest concern.
of the rules that preference restricted spending would be difficult or unstable. For example, outright repealing the tax exemption for foundation investment earnings would likely have a number of unwanted side effects, including discouraging managers from investing aggressively.

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Endnotes:
2. Private foundations and limited partners invest 30 percent of their assets (Internal Revenue Service data April 5, 2005) but this is a large enough block of a public-private funded firm to affect effective control in many instances. And, firms can exceed the cap for as long as ten years after the gift. Dick 141 Sec. 10.16(403)(107). Even more flexibility is possible by using contingent voting rights or by setting voting thresholds for certain key corporate actions in a way that gives the foundation an effective veto. (see Non-Profit Organizations Section 21-1-013).
5. By and large, it is the generosity of endowing foundations that has driven much of the unrestricted spending in the postwar period.
6. The Internal Revenue Service and other independent researchers have also found that rates of return in excess of 10% have been modestly above the expected rate of 5%, for all but a few donors.