

FOUNDATIONS

Their Power and Influence

RENE A. WORMSER



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BY

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PREFACE

THE MOST DIFFICULT assignment of my thirty years in the Congress of the United States was the chairmanship of the Special Committee to Investigate Tax Exempt Foundations, informally referred to as the "Reece Committee." This investigation required embarrassingly close scrutiny of the intellectual activities supported by the great and highly respected American names of Carnegie, Rockefeller, and Ford. As a minority member of the Cox Committee, which in the previous Congress had attempted but virtually abandoned this project, I had sensed the power that would spring up in opposition to a complete investigation.

The obstacles were obvious from the first. We knew that the influential "liberal" press, characterized by *The New York Times*, the *New York Herald Tribune*, and the *Washington Post-Times Herald*, would throw its editorial power against the Committee. We knew that even the bulk of the conservative press could not be unmindful of the enormous power of these foundations. We knew that many prominent educators, regardless of what they felt, could not be unmindful of the dependency of their institutions upon continued largess from the foundations involved. We knew that the group of prominent men whose decisions would have to be judged extended even to intimates of the White House.

But I felt that the work of the Cox Committee left several important unanswered questions, of which the gravest was: *to what extent, if any, are the funds of the large foundations aiding and*

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abetting Marxist tendencies in the United States and weakening the love which every American should have for his way of life?

So we set out to find the answers. We wanted to explore the problems of foundations by examining their actions, not their statements for the public. We felt that there are involved in the concepts under which foundations operate and grow in the United States certain dangers for the public welfare. We were not blind to the undoubted merits of the contributions of numerous tax-exempt foundations to worth-while causes. It was our intention to find the factual basis for preserving their constructive functions and at the same time for supplying guidance for future legislation and administrative action against the use of foundation power for political ends. The story of that adventure, of what we found, and of the harassments to which we were subjected, is included in this book by René A. Wormser, who was general counsel to the committee of which I was chairman and is widely recognized in America and Europe as outstanding in the field of estate planning and taxation. The book contributes essentially, however, the philosophical and juridical reflections of this distinguished lawyer, based upon the material our committee disclosed and upon other data which have appeared since the closing of our inquiry. He discusses problems of foundation administration and control which are grave indeed and has rendered a great service in preparing this sober and thoughtful work.

BRAZILLA CARROLL REECE

INTRODUCTION

IN HIS COLUMN in the *New York Daily News* of December 21, 1954, John O'Donnell said that the Reece Committee had the "almost impossible task" of telling "the taxpayers that the incredible was, in fact, the truth." "The incredible fact," he continued "was that the huge fortunes piled up by such industrial giants as John D. Rockefeller, Andrew Carnegie, and Henry Ford were today being used to destroy or discredit the free-enterprise system which gave them birth."

It is not easy to investigate foundations, not even for Congress to attempt it: the giant foundations are powerful and have powerful friends. A special committee was created by the House of Representatives of the 83rd Congress to investigate tax-exempt organizations. It is generally referred to as the "Reece Committee" after its chairman, Congressman B. Carroll Reece of Tennessee. It was successor, in a way, to the "Cox Committee," created by the previous Congress. The Reece Committee had perhaps the most hazardous career of any committee in the history of Congress.* It survived its many perils, however, to bring to the attention of Congress and the people grave dangers to our society.

These dangers relate chiefly to the use of foundation funds for political ends; they arise out of the accumulation of substantial economic power and of cultural influence in the hands of a

* See Appendix B for the Story of the Reece Committee. The Committee's findings are quoted in Appendix A.

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class of administrators of tax-exempt funds established in perpetuity. An "élite" has thus emerged, in control of gigantic financial resources operating outside of our democratic processes, which is willing and able to shape the future of this nation and of mankind in the image of its own value concepts. An unparalleled amount of power is concentrated increasingly in the hands of an interlocking and self-perpetuating group. Unlike the power of corporate management, it is unchecked by stockholders; unlike the power of government, it is unchecked by the people; unlike the power of churches, it is unchecked by any firmly established canons of value.

This book grew out of my conviction that some of the materials examined by the Reece Committee, for which I acted as general counsel, deserve broader circulation. My own reflections, based upon the committee's work and upon additional material and continued studies, might also contribute to a sharpening of the issues, which deserve wide public consideration.

The "foundations" which the Committee investigated did not all carry that label. In addition to primary sources of foundation grants, such as The Ford Foundation, The Rockefeller Foundation, and The Carnegie Corporation of New York, the Committee examined secondary distributors of grant moneys, especially organizations such as The Social Science Research Council, The Institute of Pacific Relations, and The American Council on Education, which are supported by the major foundations and used in selecting ultimate recipients. A dictionary definition of the term "foundation" might run: "an endowed institution, corporation or charity." This would include colleges, hospitals, churches, and other institutions of a character far different from that of the foundations with which we are dealing. These are essentially recipients of money for their own use and not in the business of handing out grants to others. They are, in relation to the foundations, mentioned above what the consumer is in relation to his supplier.

Limited to the types of organization we have in mind, the total number now existing in the United States can be estimated at

over 7,000. Most were created under state corporation laws; some as trusts; a very small number by Federal charter. Accurate statistics are impossible to obtain, but the aggregate capital of these foundations seems to be about nine billion dollars, their income running into hundreds of millions per year. Total foundation wealth is generally underestimated. Some foundations (among them The Duke Foundation, The Ford Foundation, The Ford Motor Company Fund, the Guggenheim foundation and The Rockefeller Brothers Fund) report their assets on a book-value basis—market value usually being much higher. In the case of The Ford Foundation, the actual value of its assets turned out to have been six times their book value. Moreover, many foundations are vehicles for continued donations, whether by gift or legacy—they are in a state of growth. Indeed, some have only nominal capital today but will contain vast sums on the deaths of those who created them.

While there is much overlapping, foundations might be divided into three classes: those which are purely granting foundations; those which use their money for their own research and operations (operating foundations); and those which might be called "intermediaries," "clearing houses," or "retailers" for other foundations. Some of the intermediaries have no endowment and thus, strictly speaking, may not be "foundations"; however, they came within the committee's scope as "tax-exempt organizations," because of the practice of major foundations of delegating to them the selection of beneficiaries.

Other classifications are possible, such as those foundations which have special purposes and those which are concerned with general research. In his recent book, *Philanthropic Foundations*,* Mr. F. Emerson Andrews, an executive of The Russell Sage Foundation, says: "Although the foundations that can now be classified as 'general research' probably do not exceed 150 in number, they control more than half the assets of all foundations and are the ones most in the public eye. To a large degree they are the leaders and standard setters for the foundation movement."

* Russell Sage Foundation, 1956.

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The birth rate of foundations is rapidly accelerating. The Commissioner of Internal Revenue so testified, as would any expert in estate and business planning. The chief motivation in the creation of foundations has long ceased to be pure philanthropy—it is now predominantly tax avoidance or minimization.* The charitable tax exemptions were intended to advance the public welfare by offering exemption for philanthropic purposes. The increasing tax burden on income and estates has greatly accelerated a trend toward creation of foundations as instruments for the retention of control over capital assets that would otherwise be lost. The Internal Revenue Service, according to a press report,† says it sometimes receives up to 10,000 applications a month for tax-free status!

The creation of a new foundation very often serves the purpose of contributing to a favorable public opinion for the person or corporation that endows it. Among public-relations consultants the practice of publicly establishing the virtue of a previously despised person or institution by forming a tax-exempt foundation and beating the drum for it is quite common. Some of our largest foundations, established before the introduction of Federal income and estate taxes, were created largely to glamorize a name not previously identified as conspicuously charitable.

Mr. Andrews, in his *Philanthropic Foundations*, speaks of the mushroom growth of foundations in the past decade (1945-1956). He attributes truly charitable motivation to many donors, and mixed motives to others, but admits that many foundations are created for primarily selfish reasons and sometimes for fraudulent purposes. He sees it as obvious enough that tax reasons should stimulate the creation of foundations, pointing out that, to the very rich, whose income is taxed at the highest brackets, a donation to a charitable purpose would cost in some instances only nine cents per dollar. If gifts are made in the form of appreciated assets instead of money (stocks, land, or other property that has gained in

* See *The Charitable Trust (The Foundation) As an Instrument of Estate Planning*. René A. Wormser, 18 *Ohio St. L. J.* 219 (1957).

† Scripps-Howard, March 13, 1957, from Washington.

value since its acquisition), the donor in the highest tax brackets will have more money left after the donation than if he himself had liquidated the asset, paid a 25% capital-gains tax, and given nothing away!

Perhaps the best example of the use of foundations in estate and business planning is offered by the largest, The Ford Foundation. This foundation received about 90 percent of the stock of the Ford Motor Company, all nonvoting stock. Had not the Ford family created this foundation, it would have had to dispose of a large part of its ownership in the Ford Company to the public, for it is hardly possible that the family had enough liquid capital to pay the hundreds of millions of estate taxes which would have been due upon the deaths of two proprietors, Henry Ford and his son Edsel. It might have been difficult to make such a public sale without endangering their control of the company.

The foundation, however, offered a way out. The family, by transferring about 90 per cent of its Ford holdings to a foundation, escaped estate taxes on approximately 90 percent of its fortune. At the same time, it retained voting control of the company and had the satisfaction of knowing that even the nonvoting stock was in friendly hands. When part of the foundation's holdings of Ford stock was sold in 1956, after being converted into voting stock, the distribution was carefully controlled to make sure that no large blocks would be held by any one investor. One reason behind this might have been the conviction that the more Ford stockholders there were, the more Ford customers and enthusiasts there would be. Another motivation might have been the simple one of not wishing any minority stockholder to acquire enough stock to make him too interested in challenging the management.

In this manner, and by other uses of foundations, control of an enterprise is often retained by a family, while a huge part of a decedent's fortune is removed from death taxes. A direct donation to an existing philanthropic institution, like a college or a church, would save the same tax, but the creation of a foundation enables the family itself to have the pleasure, power, and satisfaction of managing the wealth donated to "charity."

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There have been "business" abuses of the tax law, of course. The Reece Committee report gave one rather shocking example of a type of tax avoidance. This was the case of The Reid Foundation, which holds millions of dollars in notes of the publishing company which owns and publishes the New York *Herald Tribune*. These notes were transferred to the Reid Foundation partly by direct donation of the late Ogden M. Reid and partly by his will, the estate thus saving a large sum in death taxes. As the committee report said:

It is the conclusion of this Committee that what was intended was a business arrangement. We conclude that the Foundation was not to be engaged solely in charitable work. . . . It was to exercise charity in behalf of the New York *Herald Tribune*. It was to subordinate whatever philanthropic work had been planned to the welfare of that newspaper and the interest of the Reid family in it. It was a business deal. There was no free gift of the notes. They were transferred pursuant to a contract under which the Foundation agreed to assist the publishing company in its financial problem and, by inference, but clear inference, to make this objective superior to its presumed charitable function.*

It was the committee's opinion that no charitable exemption should have been allowed The Reid Foundation.

The extent to which foundations are today being used—in a manner generally similar to that of The Ford Foundation—to solve the problem of paying death taxes when a major part of the assets of the estate consist of stock in a closely held corporation, largely prompted me to include this comment in an address at the University of Chicago in 1952:

It seems to me that the ingenious legal creatures developed by tax experts to solve the unusual social, economic, and legal problems of the past several generations will become

* *Report of the Special Committee to Investigate Tax-Exempt Foundations (Reece Committee)*, p. 9. Reference to *Report* throughout this book will concern the report of this committee.