Key Debate: Should Foundation Payout be Higher?

Under current U.S. law, private foundations are required to pay out at least 5% of the value of their assets every year in grants and foundation operating expenses. They can hold on to the rest, invest it and watch it grow. Given the urgency of the problems we face today, some critics say the payout requirement should be higher. Those who want to maintain the status quo say anything more than 5% could mean foundation support won't be there when future generations need it.

U.S. foundations currently hold about $1 trillion in assets, for which their founders have already received tax deductions. While some foundations (including huge ones like the Walton Family Foundation and the Bill and Melinda Gates Foundation) choose to pay out more than 5% per year, overall, the average hovers pretty close to 5%. So if the payout requirement changed, it would vastly increase the amount of money circulating for issues, communities and causes of all kinds.

In the midst of the COVID-19 pandemic, the related economic crisis, and a national reckoning around racial justice, hundreds of funders and nonprofit leaders signed an open letter urging Congress to increase the foundation payout requirement to 10% for the next three years, which would move about $200 billion to nonprofits at a time when communities are struggling in the face of compounding crises.

But the push for increased payouts started way before the pandemic. For years, critics of the 5% minimum have pointed to the need for immediate resources for issues like climate change, among a host of other pressing issues. Why should foundations hold on to their assets forever—or for some future that humans might not even see if we don't act swiftly and substantially on climate issues?

Those who argue in favor of keeping the payout requirement at 5% say it's essential to foundations' ability to exist in perpetuity and is at the heart of *being* a foundation. Perpetuity, they say, means they will be there to resource the nonprofits of the future, and to respond to future needs and crises. Some also say perpetuity gives foundations independence, freeing them from the pressures of government and markets.

But perpetuity is not essential for a foundation. It's actually something that has been debated since the first foundations were formed, and it was at the heart of the debate that led to the establishment of the minimum payout requirement in 1969. At that time, the requirement was set at 6%; it was lowered to 5% in 1981 after lobbying by foundations.

Many critics also question the current situation for donor-advised funds, which in 2019, collectively held about $140 billion in assets and have no minimum payout requirement at all. Even so, according to DAF data, average annual payouts for DAFs substantially exceed 5%.

You may also want to check out:

- What is a private foundation?
- What is an endowment?
- What do the terms "perpetuity" and "spend down" mean?
- Inside the Foundation Payout Debate