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Collection/Office of Origin: Science and Technology Policy, Office of (OSTP)
Series: Bromley, D. Allan, Files
Subseries: General Science Files

OA/ID Number: 62040
Folder ID Number: 62040-005

Folder Title:
Life Sciences: Indirect Costs [2 of 2] [1991]

Stack:	Row:	Section:	Shelf:	Position:
	0	0	0	0

"CORRESPONDENCE TRACKING"

TYPE: ACTION DOCUMENT NUMBER: 9121706
ORIGINATOR: 02 STATUS I DIRECTORATE STATUS

FROM: ROBINSON, Dorothy K.: YALE UNIVERSITY

TO: DR. D.A. BROMLEY

DATE OF CORRESPONDENCE: 06/04/91

SUBJECT: A NOTE OF APPRECIATION FOR MEETING WITH HER AND A REQUEST FOR SUGGESTIONS AS TO ANY PARTICULAR ACTION YALE SHOULD TAKE TO PLAY A CONSTRUCTIVE ROLE IN THE RESOLUTION OF THE INDIRECT COST CONTROVERSY.

DIRECTORATE ASSIGNED: LIFE SCIENCES STAFF ASSIGNED:

ACTION REQUIRED: FOR DAB SIGNATURE STAFF ACTION:

SENDER'S DUE DATE: OSTP DUE DATE: 06/24/91 STAFF DUE DATE: 7/5
DATE COMPLETED: DATE COMPLETED/DEPT: DAB has
taken care of by phone!
m

COPIES TO: D. Allan Bromley

WHITE HOUSE TRACKING #:

CONTACT PERSON: PHONE:

REMARKS:

EXT:

MS Original pink missing. However pls. close out as indicated DAB 7/8

OSTP RECEIVED: 06/10/91 DEPT RECEIVED:

FILE: LIFE SCIENCES-INDIRECT COST

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ASSIGNED: LIFE SCIENCES ASSIGNED:

ACTION STAFF
REQUIRED: FOR DAB SIGNATURE ACTION:

SENDER'S DUE DATE:
OSTP DUE DATE: 06/24/91 STAFF DUE DATE
DATE COMPLETED: DATE COMPLETED/DEPT:

COPIES TO: D. Allan Bromley

WHITE HOUSE TRACKING #: CONTACT PERSON:
REMARKS: PHONE: EXT:

OSTP RECEIVED: 06/10/91
DEPT RECEIVED:

FILE: P- LIFE SCIENCES-INDIRECT COST

"LIFE SCIENCES (CORRESPONDENCE TRACKING)"

TYPE: ACTION DOCUMENT NUMBER: 9121706
ORIGINATOR: 02 STATUS I DIRECTORATE STATUS C

FROM: ROBINSON, Dorothy K.: YALE UNIVERSITY

TO: DR. D.A. BROMLEY

DATE OF
CORRESPONDENCE: 06/04/91

SUBJECT: A NOTE OF APPRECIATION FOR MEETING WITH HER AND A
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RESOLUTION OF THE INDIRECT COST CONTROVERSY.

DIRECTORATE STAFF
ASSIGNED: D. Allan Bromley ASSIGNED:

ACTION STAFF
REQUIRED: AS NECESSARY ACTION: None

SENDER'S DUE DATE:
OSTP DUE DATE: 06/24/91 STAFF DUE DATE
DATE COMPLETED: DATE COMPLETED/DEPT:06/12/91

COPIES TO: LIFE SCIENCES D.A. Henderson
Jack C. Chow

WHITE HOUSE TRACKING #: CONTACT PERSON:
PHONE: EXT:
REMARKS: Re-assigned to DAB on 06/12/91; Robinson is General Counsel for
Yale and met Bromley alone.

OSTP RECEIVED: 06/10/91 FILE: LIFE SCIENCES-INDIRECT COST
DEPT RECEIVED: 06/12/91

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DIRECTORATE STAFF
ASSIGNED: LIFE SCIENCES ASSIGNED:

ACTION STAFF
REQUIRED: FOR DAB SIGNATURE ACTION:

SENDER'S DUE DATE:
OSTP DUE DATE: 06/24/91 STAFF DUE DATE
DATE COMPLETED: DATE COMPLETED/DEPT:

COPIES TO: D. Allan Bromley

WHITE HOUSE TRACKING #: CONTACT PERSON:
REMARKS: PHONE: EXT:

OSTP RECEIVED: 06/10/91
DEPT RECEIVED:

FILE: LIFE SCIENCES-INDIRECT COST

Yale University

RECEIVED

91 JUN 10 P 2: 47

OFFICE OF THE
DIRECTOR

9121706
DOROTHY K. ROBINSON
General Counsel
451 College Street
P.O. Box 1074 Yale Station
New Haven, Connecticut 06520-1074

Telephone: 203 432-4949

June 4, 1991

The Honorable D. Allan Bromley
The Assistant to the President for Science and Technology
Old Executive Office Building, Room 360
corner of 17th and Pennsylvania Avenue, NW
Washington, DC 20506

Dear Allan:

I just wanted to let you know how much I appreciated your having taken the time to see me during my recent trip to Washington.

As we discussed, Yale's figures on major giving that bear out our concerns about the effect of the alternative minimum tax on gifts of appreciated property. In short, we have seen a dramatic decline in the number and total dollar of gifts to the University of appreciated property since the Tax Reform Act of 1986 which has not been compensated for by increases in cash giving by major donors. I enclose those figures and a letter that President Schmidt wrote last summer to the Chronicle of Higher Education responding to arguments that reported increases in overall giving to education indicated that the problem anticipated had not materialized. Recent testimony by Pat McGuire, President of Trinity College in Washington, before the House Ways and Means Committee also addressed that issue. I have enclosed a copy for your information.

I should add that we are equally concerned about the effect of the \$150 million cap on tax-exempt bonds enacted in 1986. That provision has forced many institutions -- Yale soon to be among them -- to resort to taxable borrowing at interest rates up to one-third higher than those available on the exempt market to finance the refurbishment of research and other facilities. On \$100 million in newly taxable borrowing that difference alone would translate into an incremental operating budget burden of approximately \$2 million per year, or roughly the equivalent of salaries of 30 faculty over the life of the loan.

We are working hard to obtain relief on both of these issues in this session of Congress. Any support you can offer would be extremely important. I have enclosed some information on the bills that have been introduced to provide relief.

Finally, we are assessing the anticipated impact of the recently announced revisions to OMB Circular A-21. As you know, the negative financial impact on Yale of fixing reimbursement for the three administrative components of the indirect cost rate at 26% of modified total direct costs is significant even with library expense excluded -- a decision which we are pleased to see. It is even greater at several other schools. We remain extremely concerned that there be adequate time for transition to the new system, which unfortunately is coinciding with a period of severe financial strain on universities generally.

Related to the issue of transition, we urge that as Circular A-21 is revised to reflect the fixed 26% component, institutions not be barred from adjusting to the change by recategorizing certain expenses in an approved manner. This will ensure that schools are treated fairly at the same time that greater uniformity is achieved and the system made more

The Honorable D. Allan Bromley
June 4, 1991
Page 2

rational and understandable. Correction of the problems in defining indirect costs should not be regarded as a panacea for agency research budgets. On the contrary, the opportunity for reform should be seized as an occasion for reaffirming the federal policy of cost-based reimbursement that has served the nation so well in building the post-World War II government-university research partnership.

As I mentioned, Yale would like to play a constructive role in the resolution of the indirect cost controversy. Please let me know if you have any suggestions as to any particular action you think would be useful for us to take.

I hope your trip to Siberia was a success. The record-breaking heat in Washington hardly makes a welcome return!

With all best wishes,

Sincerely,



Dorothy K. Robinson

enclosures

cc: Benno C. Schmidt, Jr.

GIFTS OF APPRECIATED PROPERTY*

Yale University

1985 - 1990

<u>Year</u>	<u>All Giving by Individuals</u>		<u>Appreciated Property Gifts</u>	
	<u>Number of Gifts</u>	<u>Dollar Amount</u>	<u>Number of Gifts</u>	<u>Dollar Amount</u>
1985	10,902	\$30,974,600	298	\$15,693,900
1986	10,661	30,742,100	325	17,616,300
1987	11,541	24,309,100	239	5,666,000
1988	12,028	25,675,200	161	4,046,300
1989	12,029	29,677,000	141	4,635,600
1990	12,284	27,032,942	190	9,826,502**

* Figures exclude gifts to the Yale Alumni Fund, bequests and income or principal received through deferred giving vehicles.

** Includes a single \$5.2 million capital campaign nucleus fund gift.

Source: Office of Institutional Research
Yale University

May, 1991

LETTERS TO THE EDITOR

*Taxes on college gifts
threaten future giving*

TO THE EDITOR:

I must take issue with the overly optimistic portrayal in your article on the state of giving in higher education ("Gifts to Colleges Rise 8.8 Per Cent in Year, Reach Record \$8.9-Billion," May 30). Reporting on survey results of the Council for Aid to Education (C.F.A.E.) for 1989, the article concludes that the "worst may be over" and that "changes in tax laws had only a temporary effect on contributions."

These conclusions, however, overreach the data and ignore long-term trends. Despite the increase in giving reported for 1988-89, previous C.F.A.E. surveys show that for the years 1982-83 to 1985-86, overall individual giving rose an average of 10.2 per cent a year but slowed to only 2.8 per cent in constant dollars for the years 1985-86 to 1988-89 after tax reforms.

It is not in the national interest for tax policy to throttle back on giving to higher education and other charities at this time. Our nation's prosperity and integrity depend as never before on the quality of education at all levels. Colleges and universities today are seeking to stay at the forefront of teaching and research in a time of revolution in most areas of knowledge. The United States looks to its educational institutions for its future leaders and for the advances in basic knowledge that will determine our nation's standing in the world. Colleges and universities face today unprecedented demands with a physical infrastructure of facilities, instrumentation, and collections that is sadly dilapidated. They need a vast infusion of voluntary support if they are to fulfill their responsibilities.

The cost of refurbishing deteriorating college and university facilities far exceeds all available resources. A 1988 report by Coopers & Lybrand estimated that it would cost \$60- to \$70-billion to complete necessary renewal of facilities on our nation's campuses.

The excellent 1986 Report of the White House Science Council, co-chaired by David Packard and Allan Bromley, pointed to the urgent necessity of renewing the physical infrastructure for research and teaching at our leading universities. Since federal support for these purposes has diminished, private institutions, and increasingly public institutions as well, must rely on the generosity of donors to meet the need. Gifts of appreciated property, especially securities, serve as the cornerstone of most capital-fund-raising efforts.

Yet, an ill-considered provision of the Tax Reform Act of 1986 severely inhibits such gifts, reducing greatly major gifts to educational institutions, museums, libraries, hospitals, and other charitable organizations, and producing negligible revenue gains for the government.

Many institutions, Yale included, have experienced drastic declines in both the number and value of gifts of appreciated property. Museums and libraries have suffered similar declines. Unfortunately, C.F.A.E. data do not analyze this specific effect because they do not separately track gifts of appreciated property, but C.F.A.E. data reveal a disproportionate negative impact on capital giving from the 1986 Tax Reform Act, which brought gifts of appreciated property under the alternative minimum tax. In constant dollars, the average increase of 14.4 per cent in capital giving for the three years before 1985-86 diminished to almost no growth (0.96 per cent) for the three years after. At this level of capital giving, the physical foundation of the teaching and research programs in our colleges and universities will turn to quicksand.

Educational institutions must join other charitable institutions in pressing Congress to revoke the self-defeating treatment of gifts of appreciated property hurried into law in 1986.

BENNO C. SCHMIDT, JR.
President
Yale University
New Haven, Conn.

STATEMENT OF

Patricia McGuire, President
Trinity College
Washington, D.C.

on behalf of the

American Council on Education

before the

COMMITTEE ON WAYS & MEANS

UNITED STATES HOUSE OF REPRESENTATIVES

Hearing on Expiring Tax Provisions

APRIL 10, 1991

The following associations join ACE in this statement:

American Association of Community and Junior Colleges
American Association of Dental Schools
American Association of State Colleges and Universities
Association of American Universities
National Association of Independent Colleges and Universities
National Association of State Universities and Land-Grant Colleges

Mr. Chairman:

On behalf of the American Council on Education, an organization representing over 1,600 colleges, universities and organizations in higher education, and the associations listed on the cover sheet of this testimony, I am pleased to present our views on present law provisions regarding gifts of appreciated property and on H. R. 1557, a bill which would permanently remove gifts of appreciated property from the list of preference items that are subject to taxation under the alternative minimum tax (AMT). I am here to request both an extension of current law treatment of gifts of tangible personal property and an expansion to all gifts of donated assets.

Since enactment of the Tax Reform Act of 1986, the appreciation element of a gift of appreciated property to an otherwise eligible charitable organization has been subject

to the AMT. Prior to that time, gifts were fully deductible in both the regular and minimum tax. Individual taxpayers are entitled to a deduction for the value of donated property of up to 30% of their adjusted gross income. Gifts of appreciated property, such as stocks, real estate, and art works constitute an important part of all charitable giving, not only as a percentage of total dollars, but also as lead gifts in major campaigns. These gifts provide crucial financial support for the public service functions of charitable organizations.

Last year, the Congress voted to provide a one year exception from the AMT for gifts of tangible personal property, such as works of art and manuscripts, related to the donee charity's exempt purposes. I applaud that decision. The fact that early reports show that this temporary provision has already stimulated significant increased giving of tangible property to museums, both large and small, illustrates the importance of extending and expanding this provision.

In the meantime, however, for those institutions that depend on gifts of securities and real property such as colleges and universities, hospitals and conservation, social welfare and cultural organizations, the threat as well as the actuality of the AMT continues to cause a decline in the value of appreciated property gifts. The erosion of resources represented by this decline comes at a time when educational institutions and other nonprofit organizations are being asked to fill the gap in services resulting from reductions in federal, state and local government funding.

For example, according to a 1990 report from the Independent Sector, from Fiscal Year 1982 to Fiscal Year 1990, Federal support to private, nonprofit organizations declined by an estimated cumulative total of \$32.8 billion had Fiscal Year 1980 spending levels been maintained. This report also revealed that, from Fiscal Year 1982 to Fiscal Year 1988, the latest period for which data are available, private giving had offset only 41 percent of the cumulative reductions in Federal support.

This year and the next several years will be very difficult ones for institutions of higher education. Due to severe revenue shortfalls, state support for higher education is being significantly curtailed. A survey conducted by the American Association of State Colleges and Universities found that 26 states had reduced aid to higher education including California, Connecticut, Florida, Georgia, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, Tennessee, Texas and Wisconsin. (See Attachment I.)

Fortunately, however, total charitable giving has continued to increase; but, unfortunately, this increase threatens to obscure the loss of important charitable support from gifts of appreciated assets because of the AMT. Our experience has been that in major fundraising efforts approximately 90 percent of the funds raised will come from 10 percent of the donors and some institutions indicate that close to 50 percent of their individual support comes from one percent of their donors. While it may be the case that including the appreciation element of property gifts in the AMT affects a minority of donors, the fact is that it affects many of the major donors on whom the higher

education community is so heavily dependent.

Each of the following examples represents a gift of appreciated property lost or in doubt because of the AMT and illustrate the fundraising difficulties created by current law:

- A donor to a university in the Southwest was contemplating a gift of almost zero-basis stock valued at approximately \$2.5 million for the construction of a student center. This donor hoped to persuade other family members to contribute an additional \$2.5 million in zero-basis stock. Under prior law, this \$2.5 million gift would have resulted in a tax savings of \$600,000, but under current law, there would be no tax benefit. If this taxpayer sells the stock, the resulting capital gains tax would be \$600,000, leaving the taxpayer with \$1.9 million after taxes. As a result of the tax ramifications, the gift is presently in jeopardy.

- One potential donor to a college in the Midwest decided against making a gift of securities valued at \$500,000 because of the AMT. The gift would have funded in perpetuity the operating expenses of a language lab at the college, a need which still remains unmet.

- One potential donor to a college in the South decided not to contribute his intended gift of stock valued at \$100,000, which was to have been used for scholarships. Since the school has a small endowment of only \$5 million, this gift would have been extremely valuable.

- Because of the tax consequences, a potential gift valued at \$3.5 million may not be made to a university in the Northeast. If completed, the proceeds are to be used for the medical college's department of cardiology, one of the leading heart research centers in the country.

- One potential donor to a university in the Northeast intended to make a gift valued at more than \$1 million to establish a chaired professorship in the engineering college. The gift is now "on hold" because of concerns about the impact of the AMT, and it is unclear if the gift will ever be made.

- The veterinary school of a university in the Mid-Atlantic states would have supported two endowed chairs, in immunology and in large animal medicine. The donor, upon determining that his proposed gift would have triggered payment of the AMT, is considering sale of the land and donation of the after-tax proceeds, which would reduce the value of the gift by \$1 million and allow funding for only one endowed chair. However, even that cash gift is not certain. Attachment 2 contains additional examples for your consideration.

Clearly, colleges and universities depend on gifts of appreciated assets to provide financing for such things as scholarships, endowed chairs, and for the construction and renovation of campus libraries, research and classroom buildings.

Particularly well documented is the need for buildings and equipment needed to train the next generation of scientists, engineers and teachers.

The National Science Foundation's recently released survey, "Scientific and Engineering Research Facilities at Universities and Colleges: 1990," reports that for every \$1.00 spent to maintain research facilities in 1990-91, an additional \$4.25 will be deferred. The amount of deferred repair and renovation work is now estimated to reach \$4 billion by the end of 1991. Additionally, for every \$1.00 planned for construction of needed new science facilities, \$3.11 will be deferred. Current deferred construction is estimated to be \$8 billion, an increase of 38 percent since 1988.

As illustrated by the case studies, it is precisely this type of gift which could help alleviate the pressing capital needs of colleges and universities which is being lost. Further, these losses seem likely to increase due to the tax code changes adopted in 1990 that increased the AMT rate to 24 percent. As a result, many more potential donors may be subject to the alternative minimum tax.

As you may know, since the AMT was revamped in 1986, appreciated property gifts are one of the more frequently encountered tax preference items. In addition, the effect of subjecting charitable gifts to the alternative minimum tax is to bring into the AMT individuals who might not otherwise be subject to these complex technical rules. The uncertainty this creates for individuals contemplating a charitable contribution is a significant disincentive to giving.

The Conference Report to the 1986 Tax Reform Act of the Tax Committees stated that the overriding purpose of the alternative minimum tax is to "require taxpayers with substantial economic income to pay some tax." The Committees also expressed concern about the inherent unfairness of allowing high income taxpayers to pay little or no tax due to the existence of tax preference items.

However, the 30 percent of adjusted gross income annual limitation on the deduction for contributions has been effective in preventing zeroing out by donors and is attested to by planned giving officers around the country. More importantly, in 1985 the Treasury Department, in a study of the major causes of tax avoidance, found in general that itemized deductions, including the deduction for charitable contributions, are not important causes of tax avoidance.

This conclusion is strongly supported by a more recent examination of whether a taxpayer could, through charitable gifts of appreciated property, zero out tax liability if the appreciated property preference were to be repealed, but the regular tax limitation retained. I understand that the practical answer to this question is no. Safeguards in the Internal Revenue Code already prevent the charitable deduction alone from zeroing out tax. Since I am not a tax lawyer, I refer you to Attachment 3 for more details on this question.

With regard to the fairness issue, I think that a more appropriate way to examine

this issue is to consider the leverage that is created by the Federal investment in the fair market value deduction for gifts of appreciated property.

To return to the first case study, under pre-1986 tax law, a \$2.5 million gift would have been made to support public purposes. Further, since it is virtually impossible to zero out through charitable giving, some tax would have been paid to the Federal Government. Thus, the private donor is \$1.9 million poorer (\$2.5 million gift minus \$600,000 in tax savings) and the public can look forward to \$2.5 million plus in additional services from the donee charity and the Federal Government. On the other hand, if the gift is not made and the donor sells the stock and pays the tax, \$600,000 in tax revenue will go to support public needs and the private donor will keep \$1.9 million.

In other words, appreciated property giving contributes in a real way to wealth redistribution. Certainly some taxes are foregone. However, the loss to the donor when personal assets are given to charity, combined with the taxes the donor pays to the government, are always more than the tax that would have been paid if the gift had not been given. The net result is increased funding for public purposes and substantial reduction in the private wealth of the donor.

With regard to the cost of extension of current law, the Joint Committee on Taxation has estimated a revenue loss of \$87 million over five years. If the provision is expanded to include all gifts, Joint Tax predicted a revenue loss of \$15 million in 1991 and \$289 million over five years. However, generally accepted economic research has shown that every \$1.00 of Federal revenue lost because of the charitable deduction generates \$1.23 in gifts to charitable organizations.

The higher education community understands well the extraordinary financial pressures faced by the country. However, I submit that by making it more difficult for the charitable sector to raise money from private sources to carry out its public service missions that the Federal government only intensifies these pressures.

We respectfully urge you to extend and modify the current law provision on appreciated property to exclude all gifts of appreciated property from the AMT, as would occur under H. R. 1577.

STATEMENT OF

Patricia McGuire, President
Trinity College
Washington, D.C.

on behalf of the

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before the

COMMITTEE ON WAYS & MEANS

UNITED STATES HOUSE OF REPRESENTATIVES

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This conclusion is strongly supported by a more recent examination of whether a taxpayer could, through charitable gifts of appreciated property, zero out tax liability if the appreciated property preference were to be repealed, but the regular tax limitation retained. I understand that the practical answer to this question is no. Safeguards in the Internal Revenue Code already prevent the charitable deduction alone from zeroing out tax. Since I am not a tax lawyer, I refer you to Attachment 3 for more details on this question.

With regard to the fairness issue, I think that a more appropriate way to examine

this issue is to consider the leverage that is created by the Federal investment in the fair market value deduction for gifts of appreciated property.

To return to the first case study, under pre-1986 tax law, a \$2.5 million gift would have been made to support public purposes. Further, since it is virtually impossible to zero out through charitable giving, some tax would have been paid to the Federal Government. Thus, the private donor is \$1.9 million poorer (\$2.5 million gift minus \$600,000 in tax savings) and the public can look forward to \$2.5 million plus in additional services from the donee charity and the Federal Government. On the other hand, if the gift is not made and the donor sells the stock and pays the tax, \$600,000 in tax revenue will go to support public needs and the private donor will keep \$1.9 million.

In other words, appreciated property giving contributes in a real way to wealth redistribution. Certainly some taxes are foregone. However, the loss to the donor when personal assets are given to charity, combined with the taxes the donor pays to the government, are always more than the tax that would have been paid if the gift had not been given. The net result is increased funding for public purposes and substantial reduction in the private wealth of the donor.

With regard to the cost of extension of current law, the Joint Committee on Taxation has estimated a revenue loss of \$87 million over five years. If the provision is expanded to include all gifts, Joint Tax predicted a revenue loss of \$15 million in 1991 and \$289 million over five years. However, generally accepted economic research has shown that every \$1.00 of Federal revenue lost because of the charitable deduction generates \$1.23 in gifts to charitable organizations.

The higher education community understands well the extraordinary financial pressures faced by the country. However, I submit that by making it more difficult for the charitable sector to raise money from private sources to carry out its public service missions that the Federal government only intensifies these pressures.

We respectfully urge you to extend and modify the current law provision on appreciated property to exclude all gifts of appreciated property from the AMT, as would occur under H. R. 1577.

MOYNIHAN-DANFORTH/MATSUI TAX-EXEMPT BOND BILLS

Colleges and universities are eligible to use tax-exempt financing for the construction, repair, and renovation, of educational and research facilities. Before enactment of the Tax Reform Act of 1986, this financing generally was available to all colleges and universities, without regard to the amount of outstanding debt.

The Tax Reform Act of 1986 changed this in two important ways. First, it disregarded the basic nature of the public services provided by private nonprofit colleges and universities and recharacterized their bonds as "private activity bonds"—the characterization for industrial development bonds used, for example, to finance for-profit manufacturing plants. Second, it precluded additional tax-exempt financing for some private colleges and universities by limiting tax-exempt financing to \$150M in outstanding nonhospital bonds.

Moynihan-Danforth/Matsui Tax-Exempt Bond Bills

To conform the treatment of tax-exempt financing for private colleges and universities and other 501(c)(3) organizations with governmental users including public institutions, Senators Moynihan and Danforth introduced S. 150. The Moynihan-Danforth bill is co-sponsored by Finance Committee Senators Boren (D-OK), Pryor (D-AR), Daschle (D-SD), Chafee (R-RI), Symms (R-ID), and Heinz (R-PA).

In 1989 the measure was approved by the Senate Finance Committee as part of the budget reconciliation bill, but was removed on the Senate floor along with all other revenue-losing provisions.

A companion bill, H.R. 150, has recently been introduced by Congressman Robert Matsui (D-CA), a member of the House Ways & Means Committee.

The principal technical aspects of these bills are as follows: tax-exempt bonds for section 501(c)(3) organizations would no longer be treated as private activity bonds. The \$150M per institution limit on nonhospital qualified 501(c)(3) bonds would be repealed. Governmental units and section 501(c)(3) organizations, when engaged in exempt activities, would be defined as "exempt persons" as under pre-1986 law, and would be subject to the same loan restrictions that apply to governmental bonds. Internal Revenue Code Section 145, establishing requirements for "private activity" qualified 501(c)(3) bonds, would be repealed. The two percent cost of issuance limit would no longer apply to bonds for 501(c)(3) organizations. Certain restrictions now imposed on qualified 501(c)(3) bonds would be retained. These are the income-targeting rules for certain qualified 501(c)(3) rental housing bonds, the change-in-use restrictions of present law, and the maturity limit and public approval requirements for qualified 501(c)(3) bonds.

The Joint Committee on Taxation has estimated that enactment of this legislation

would reduce Treasury revenues by \$79 million over 5 years. The revenue estimate provides the following breakdown: a loss of \$4 million for FY 90, \$9 million for FY'91, \$15 million for FY'92, \$22 million for FY'93, and \$29 million for FY'94.

Arguments in Support of the Moynihan-Danforth/Matsui Bills

The \$150M limit was intended to eliminate perceived endowment arbitraging, that is, borrowing at a lower rate and investing for profit at a higher rate. However, other tax rules enacted in 1986 prevent this perceived abuse, notably a requirement that bond profits be rebated to the federal government. The \$150M cap was also intended to limit tax-exempt financing by wealthier institutions. Yet, other service providers have access to tax-exempt financing without demonstrating need, and endowment principal is not an accurate indicator of wealth. More than 50 percent of endowment income nationally is subject to restrictions on use. Without endowment income, tuition and current gifts would be the only source of funding and many poor and middle-class students would be unable to afford resulting increases in tuition.

Public and private institutions support these bills because education is a public responsibility, exempt from federal taxation. To force certain nonprofit educational institutions to operate without tax-exempt financing simply raises the cost of their research. There are now 24 institutions at or near the \$150M cap, as indicated on the attached list.

The nation's research universities must have the buildings and equipment necessary to train the next generation of scientists, engineers, and teachers. The National Science Foundation's just-released survey, "Scientific and Engineering Research Facilities at Universities and Colleges: 1990," reports that for every \$1.00 spent to maintain research facilities in 1990-91, an additional \$4.25 will be deferred. The amount of deferred repair and renovation work is now estimated to reach \$4 billion by the end of 1991. Additionally, for every \$1.00 planned for construction of needed new science facilities, \$3.11 will be deferred. Current deferred construction is estimated to be \$8 billion, an increase of 38% since 1988.

Debt financing is listed by the NSF survey as one of the major sources of funding for these types of expenditures. Clearly, the \$150M limit denies a core source of needed capital funds to a number of key research universities.

January 17, 1991

DOWNEY-GRADISON AND BOREN-DANFORTH BILLS REMOVING GIFTS OF APPRECIATED PROPERTY FROM THE ALTERNATIVE MINIMUM TAX

For a number of charitable organizations, gifts of appreciated property have declined since enactment of the Tax Reform Act of 1986, which included the appreciated portion of these gifts as a tax preference item in the alternative minimum tax (AMT).

S. 359, a bill to permanently remove all gifts of appreciated property from the alternative minimum tax, has been introduced in the Senate by Senators David Boren (D-OK), John Danforth (R-MO), Daniel Patrick Moynihan (D-NY) and John Chafee (R-RI). A companion measure, H.R. 1557, has been introduced by Congressmen Thomas Downey (D-NY) and Willis Gradison (R-OH) and other tax committee members.

Legislative History

In the 101st Congress, two bills were introduced to restore gifts of appreciated property to their pre-1986 treatment. H.R. 173 was introduced by Congressmen Bill Frenzel (R-MN) and Thomas Downey (D-NY), while S. 1577 was sponsored by Senators David Boren (D-OK) and John Danforth (R-MO). According to an estimate of H.R. 173 (Frenzel-Downey bill) and S. 1577 (Boren-Danforth bill) done in late 1990 by the Joint Committee on Taxation, these bills were projected to reduce revenues by \$289 million over 5 years.

At the conclusion of the 101st Congress, there were 90 cosponsors of H.R. 173, including 14 House Ways and Means Committee members. In addition to Mr. Frenzel (R-MN) and Mr. Downey (D-NY), they were: Bill Archer (R-TX), Philip Crane (R-IL), Bill Thomas (R-CA), Don Sundquist (R-TN), Nancy Johnson (R-CT), Hank Brown (R-CO), Mike Andrews (D-TX), Robert Matsui (D-CA), J.J. Pickle (D-TX), Andrew Jacobs (D-IN), Harold Ford (D-TN), and Frank Guarini (D-NJ). Cosponsors of the Boren-Danforth bill included Senate Finance Committee members Daniel Moynihan (D-NY), David Pryor (D-AR), Thomas Daschle (D-SD), and John Chafee (R-RI).

In 1989 the Finance Committee approved removal of all gifts of appreciated property from the AMT for calendar year 1990. However, this amendment was removed on the Senate floor along with all other provisions which lost revenue.

The budget reconciliation bill signed into law by the President on November 5, 1990, removes gifts of tangible personal property, such as art objects and manuscripts, from the alternative minimum tax for calendar year 1991 only.

Rationale

Analyses of property giving suggest that the recent decline in donations of appreciated property is real, even taking into account a predictable increase in giving in response to tax rate changes at the end of 1986, and a decline due to the stock market

debacle of 1987. For example, according to a recent analysis based on data collected by the Council for Aid to Education (CFAE), estimated gifts for capital purposes, which are often in the form of appreciated property, while increasing an average 14.4 percent in the years 1982-1986, have fallen to an average increase of a mere 0.96 percent in 1985-1989 in terms of 1982 constant dollars.

The collections in many museums throughout this country are the result of gifts of appreciated property. However, the 1986 Tax Reform Act has severely affected the ability of museums and art galleries to add to their collections. It has become increasingly evident that many art objects which had been on loan to museums and galleries with the expectation that they would eventually be donated are likely to be sold because of the tax implications of the 1986 law. At the Brooklyn Museum, for example, acquisitions declined 40 percent. And, as Senator Moynihan noted at the time of consideration of the 1990 tax bill, no serious manuscript had been donated to the Library of Congress since enactment of the 1986 statute.

The impact of the 1986 law is also felt by conservation groups. According to the Land Trust Alliance, anecdotal evidence indicates that many gifts of land and conservation easements are being lost because of the alternative minimum tax. Unlike other kinds of appreciated property gifts, the timing of a gift of conservation land is crucial. When the gift of open space is not made, it is very likely that the open space itself is irretrievable because the competing alternative is almost always development.

Safeguards

Congress included the charitable contribution of appreciated property as a tax preference in the AMT among other 1986 changes designed to prevent high-income taxpayers from avoiding income tax. However, even before the 1986 tax law changes, a 1985 Treasury study found that itemized deductions such as charitable contributions were not important causes of tax avoidance. Then, as now, taxpayers cannot use property giving to avoid taxes altogether, because the deduction for charitable gifts of appreciated property cannot exceed 30 percent of adjusted gross income (AGI).

Overvaluation of gifts was addressed by Congress in 1984 when a series of strict new rules designed to result in careful and accurate valuation of donated property was enacted. These new rules apply to certain gifts over \$5,000, while other gifts remain subject to general substantiation requirements. The new requirements include appraisal and overvaluation penalties for the donor and the appraiser.

Conclusion

Including the appreciated portion of property giving in the AMT has unduly hampered philanthropic fundraising. The AMT achieves its intended purpose—ensuring that no taxpayer can “zero out,” that is, avoid paying any federal income tax—without the inclusion of donations of appreciated property as a tax preference item. Restoring the incentive to give appreciated property to educational, cultural, and other

charitable institutions is sound tax policy for the simple reason that it is a proven method of ensuring that private wealth will provide a benefit for the public at large. At a time of significant federal, state and local government deficits, charitable institutions of all types must turn increasingly to private donors to help them sustain their services. Time and again, the AMT has been an impediment to giving. It is hoped that this obstacle to charitable giving can soon be removed.

"LIFE SCIENCES (CORRESPONDENCE TRACKING)"

TYPE: ACTION DOCUMENT NUMBER: 9121607
ORIGINATOR: 02 STATUS C DIRECTORATE STATUS C

FROM: BENNETT, Joan W., Kenneth I. Berns and Gail H. Cassell:
AMERICAN SOCIETY FOR MICROBIOLOGY

TO: Dr. D. Allan Bromley

DATE OF
CORRESPONDENCE: 06/04/91

SUBJECT: CONCERN OVER RECENT ACTIONS AND DISCUSSIONS RELATED
TO INDIRECT COSTS FOR RESEARCH.

DIRECTORATE STAFF
ASSIGNED: LIFE SCIENCES ASSIGNED: D.A. Henderson

ACTION STAFF
REQUIRED: AS NECESSARY ACTION: Comments to DAB

SENDER'S DUE DATE:
OSTP DUE DATE: 06/18/91 STAFF DUE DATE 06/18/91
DATE COMPLETED: DATE COMPLETED/DEPT:06/25/91

COPIES TO: D. Allan Bromley Jack C. Chow
Carl Bretscher

WHITE HOUSE TRACKING #: CONTACT PERSON:
PHONE: EXT:
REMARKS: Originally sent to DLS for necessary action; on 06/10/91 Bromley
asked for comments from Henderson; Henderson asked Jack to draft
response for his signature to all three.

OSTP RECEIVED: 06/04/91
DEPT RECEIVED: 06/06/91

FILE: *P*- LIFE SCIENCES-INDIRECT COST

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF SCIENCE AND TECHNOLOGY POLICY
WASHINGTON, D.C. 20506

June 25, 1991

Dear Dr. Bennett:

Thank you for your recent letter expressing your concerns over the indirect cost issue in research. Dr. Bromley asked that I reply to you on the issues that you raised. I wholeheartedly agree with you that a "quick fix", as you mentioned, is not a desired, nor workable, solution. The Office of Science and Technology Policy has worked closely with the Office of Management and Budget and the cognizant agencies to reform OMB Circular A-21.

As you know, the Administration has already acted to increase the number of unallowable items and to strengthen enforcement measures. The Administration is also proposing an additional series of reforms intended to both enhance accountability of indirect costs and sustain the research enterprise. This series of reforms includes a OMB-led Task Force, which includes OSTP, charged with looking at ways to reform and improve the A-21 system.

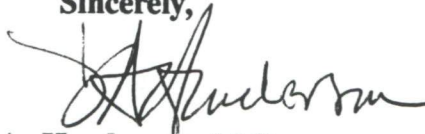
Your point of having more input from the bench scientist community is well taken. A variety of groups have expressed their concern over indirect costs. FASEB recently convened a consensus meeting on this matter and suggested some very good ideas. (examples) You may be well served by perhaps having your own meeting and talking with other groups who share your interest and concern. As for the more immediate aspects of A-21 reform, I should point out that once the proposed changes are published in the Federal Register there will be a public comment period in which you and your membership can express your concerns. I would encourage you to make use of this opportunity to register your views about these changes.

The task force will certainly consider most, if not all, of the issues that concern your organization. Your letter indicated the importance of protecting our national research infrastructure. I could not agree with you more. With regards to buildings and equipment, there has been strong evidence that there is considerable need for updated facilities. Both the Packard-Bromley report and the Pings report recommended a more realistic depreciation/use allowance rate than is currently in effect. I am hopeful that a workable solution can be found in this area.

Your point as to "who shall pay" is certainly a most relevant, yet difficult, problem to resolve. Since indirect costs are real, incurred costs borne by the institution in support of Federal research, it is a reasonable principle that government ought to bear its share of that cost. However, the complexity and ambiguity of many of the A-21 regulations often makes it difficult to determine what those real costs are, or should be. That is why a long-term solution must include a better cost-accounting system which would standardize the method by which indirect costs are tabulated and reimbursed. A stronger cost accounting system should produce a higher degree of efficiency and accountability. Such savings would help funding for direct research overall.

Thank you for bringing your views on indirect costs to my attention. As we continue our efforts to reform the indirect costs recovery system, I certainly will take heed to your advice.

Sincerely,



D.A. Henderson, M.D.
Associate Director for the Life Sciences

cc: Dr. Berns
Dr. Cassell

Joan W. Bennett, Ph.D.
President
American Society for Microbiology
1325 Massachusetts Avenue, N.W.
Washington, DC 20005

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF SCIENCE AND TECHNOLOGY POLICY
WASHINGTON, D.C. 20506

June 25, 1991

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Thank you for bringing your views on indirect costs to my attention. As we continue our efforts to reform the indirect costs recovery system, I certainly will take heed to your advice.

Sincerely,



D.A. Henderson, M.D.
Associate Director for the Life Sciences

cc: Dr. Bennett
Dr. Cassell

Kenneth I. Berns, M.D., Ph.D.
Chairman, Public and Scientific Affairs Board
American Society for Microbiology
1325 Massachusetts Avenue, N.W.
Washington, D.C. 20005

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF SCIENCE AND TECHNOLOGY POLICY
WASHINGTON, D.C. 20506

June 25, 1991

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Sincerely,



D.A. Henderson, M.D.
Associate Director for the Life Sciences

cc: Dr. Berns
Dr. Bennett

Gail H. Cassell, Ph.D.
Chairman, Committee on Medical Microbiology
and Immunology
American Society for Microbiology
1325 Massachusetts Avenue, N.W.
Washington, D.C. 20005

9121607

PUBLIC AND SCIENTIFIC AFFAIRS BOARD
AMERICAN SOCIETY FOR MICROBIOLOGY

1325 MASSACHUSETTS AVENUE, N.W.
WASHINGTON, D.C. 20005
TEL. (202) 737-3600
FAX. (202) 737-0233

91 JUN 4 A10:44

OFFICE OF THE DIRECTOR

May 31, 1991

Dr. D. Allan Bromley
Science Advisor
Office of Science and Technology Policy
Old Executive Office Building #360
Washington, D.C. 20506

Dear Dr. Bromley:

The American Society for Microbiology (ASM) is concerned by recent actions and discussions related to indirect costs for research. The ASM has a membership of over 38,000 and is the largest single biological society in the world. ASM members include scientists in medical microbiology (infectious and immunological disease), molecular biology and genetics, industrial and food microbiology, biotechnology and public health, agriculture, water purification and waste treatment, environmental science, dental microbiology, veterinary medicine, as well as education and regulatory activities.

Research is the cornerstone of all microbiology and is, therefore, of major importance to our members. The ASM strongly supports funding of the full costs of sponsored research, both direct and indirect. Indirect costs are legitimate costs of research. However, we agree that the present system of indirect cost recovery needs careful review and reforms may be necessary.

Obviously, abuses in reimbursements of indirect costs must be stopped. Allowable indirect costs must be reevaluated and more clearly defined. Those that are not allowable should be made absolutely clear and these should be consistent across governmental agencies. Currently, indirect cost rates result from individual negotiations between each university and the different cognizant federal agencies. More uniformity in policy and practices for determining indirect cost rates should be developed among government agencies and applied universally to all institutions. Indirect costs in general should be controlled, but not on an arbitrary basis; rather it should be done on a sound accounting basis and with attention to those components which directly relate to the support of research. Currently, there are no incentives for efficiency. Positive incentives should be developed to encourage rigorous accountability and control of rising indirect costs.

While these and other reforms in indirect cost recovery should be considered, the ASM urges the Administration and Congress to avoid a "quick fix" to this complex issue. In considering changes, we strongly believe that the following points should be taken into account:

1. Input from Bench Scientists is Critical to Discussions Involving Changes in Indirect Costs

New guidelines for indirect costs should not be issued without substantial input from working bench scientists. In addition, university administrators, NIH, other research agencies, OSTP, OMB and members of Congress are essential participants in determining our research agenda. Indirect cost recovery for research is a complex process. We must seek ways to understand each other's problems, restrictions, language, and objectives. Many current issues arise from poor communication, not divergent objectives. Well informed bench scientists can make important contributions to the process, including identifying ways in which costs can be contained without affecting productivity. Since bench scientists are ultimately the ones to be most affected by these changes, they should have input.

2. Changes in Indirect Costs Should Protect the Research Infrastructure

Because of recent advances in molecular biology and genetics, the potential for major advances in biomedical research have never been greater. However, the new biology is more expensive, uses more sophisticated equipment, and places an increased need for communal institutional research facilities. These needs impact on both the direct and indirect components of research costs at a time when both our facilities and equipment are aging. Reimbursement for building use and depreciation should be allowed. Furthermore, monies must be provided for maintenance of shared equipment. Never before has this been so important. In the President's 1992 budget for NIH, Biomedical Research Support Grants (BRSG) have been deleted. These are the very funds in part used to purchase equipment for new investigators and to replace worn equipment on an emergency basis. Any further reductions would be intolerable. To maintain the competitive edge of the United States, the research infrastructure must be preserved. Changes in the indirect cost recovery system must be approached carefully to avoid potential damage to the biomedical research enterprise.

3. Reforms in Indirect Costs Will Likely Result in Increased Direct Costs. Who Will Pay?

Reforms in indirect costs will likely result in increased direct costs for two reasons. First, some items currently charged to indirect costs would be better charged to direct costs. Some components of the indirect cost pool, such as energy, are subject to close review. Others, such as service functions (stock room and animal care, etc.), do not receive the vigorous scrutiny employed by peer review groups for direct costs. No doubt the efficiency of these services would be better monitored by transferring the charges to the direct costs (provided funds are transferred from the indirect pool to the direct pool to cover these costs). This would have the further advantage of identifying costs with functions.

In current practice, costs that are charged directly at one university may be recovered through the indirect cost rate at another. Thus, attempts to reduce variability in indirect cost rates between institutions will likely require transfer of items into the direct pool, increasing the funds needed for direct costs. Because

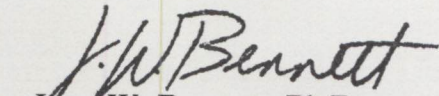
of differences in current practice, even a proposed cap in administrative expenses will have an impact on direct expenses charged to individual grant projects at some institutions.

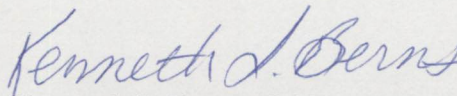
Who will pay for the increase in direct costs? To impose additional unexpected direct costs upon individual investigators who have already had their budgets reduced by as much as 16% through "downward negotiations" would cripple most research projects. Universities should not be expected to subsidize federally sponsored research, nor are they in a position to do so. Reductions in indirect costs are being considered at a time when institutions are facing significant reductions in state support. In fact, many budgets are currently being prorated. The impact of both these reductions will be enormous.

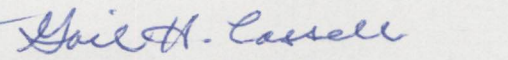
Changes in indirect costs should be made carefully with a full understanding of the costs which will be shifted to "direct costs" of individual grants. Provision should be made for increasing direct costs resulting from these shifts. Consequently, the ASM strongly urges Congress not to reallocate funds which might appear to have been saved from indirect cost adjustments but rather to return them to the respective science agencies. Likewise, Congress should explore a legal mechanism that would return the recovery of funds from inappropriate charges in indirect costs to future funding of science rather than being returned to the U.S. Treasury.

The ASM supports government funding of the real costs of research, including appropriate indirect costs. We believe that changes in the complex issue of indirect cost policy will have important and immediate consequences for biomedical research, and should, therefore, be approached with careful review and analysis by all interested parties to achieve the most effective result.

Sincerely,


Joan W. Bennett, Ph.D.
President, American Society
for Microbiology


Kenneth I. Berns, M.D., Ph.D.
Chairman, Public and Scientific
Affairs Board, ASM


Gail H. Cassell, Ph.D.
Chairman, Committee on Medical
Microbiology and Immunology,
PSAB, ASM

"CORRESPONDENCE TRACKING"

rec'd 5/15/91

TYPE: INFORMATION

DOCUMENT NUMBER: 9121411

FROM: PACKARD, David: HEWKETT-PACKARD COMPANY

TO: DR. BROMLEY

DATE OF CORRESPONDENCE: 05/06/91

SUBJECT: LETTER TO CHAIRMAN BOUCHER AND MEMBERS OF THE COMMITTEE ON SCIENCE, SPACE AND TECHNOLOGY'S SUBCOMMITTEE ON SCIENCE REGARDING THE HEARING ON 4/25/91.

ASSIGNED TO:

ACTION REQUIRED:

SENDER'S DUE DATE:

OSTP DUE DATE:

DATE COMPLETED: -----

COPIES TO: D. A. Ken Carl LIFE

Dr Henderson to see & comment
DAB

WHITE HOUSE TRACI

REMARKS:

DATE RECEIVED: 05/13/91

FILE: LIFE SCIENCES-INDIRECT COST

C O P Y

DAVID PACKARD
26580 TAAFFE ROAD
LOS ALTOS HILLS, CALIFORNIA 94022

91 MAY 13 12:34

May 6, 1991

OFFICE OF THE
DIRECTOR

U. S. House of Representatives
Committee on Science, Space and Technology
Subcommittee on Science
Suite 2320, Rayburn House Office Building
Washington, DC 20515

Dear Chairman Boucher and Members of the Subcommittee:

There were several issues discussed at the hearing on April 25 that need clarification.

There seemed to be general agreement that a fixed rate for administrative overhead would be desirable. There was a suggestion that it should contain a cost of living factor.

This fixed percentage will be applied to the adjusted direct cost base which will be the actual direct costs at the various universities. These direct costs will have the variations in the costs caused by cost of living automatically built in.

It follows that this fixed-cost rate should not have a cost of living bias of any kind.

There was also the suggestion that this fixed rate should be subject to negotiation by universities which considered it unfair. I would strongly oppose this position. One of the most important arguments for a fixed rate is to eliminate the extensive auditing and negotiating about administrative overhead costs and charges. This would save both the Federal Government and the universities millions of dollars every year; dollars that are spent under the present system and are a total waste.

The fixed administrative overhead rate might be set a bit on the high side because it will save money even then. It should be reviewed after the first three years and probably every five years thereafter.

The direct costs of university research should be defined to be as specific as possible. All federal agencies awarding contracts for university research should be required to use the same precise definition of direct costs.

May 6, 1991

The most serious problem comes from the fact that federal contracts provide for depreciation whereas most universities have no depreciation costs. There are exceptions in cases where universities borrow money for buildings and equipment. In these cases the Federal Government should, and I believe generally does, pay its fair share of the cost of interest and amortization of the money borrowed.

The depreciation allowances on government contracts are generally paid into the general funds of the university. As one Stanford study admitted, ".....these funds play an extremely important role as a source of income to the Operating Budget." I do not think Stanford's situation is different from most universities. Furthermore, this has been done with the cooperation of the ONR as well as other funding agencies.

This committee should not consider it fundamentally wrong for the Federal Government to underwrite some of the operating costs of our universities. That is a subject you must address. If you agree, the only issue is whether there is a better way for this to be done.

If you agree, I would make this recommendation. All depreciation allowances which do not go to debit service should be allocated to a special building account and should not go to the general fund account. Allocations from this building fund account should be applied to new research buildings and equipment or major renovations of research facilities. Ten percent of this special building fund account could be allocated to buildings or equipment that are used primarily for administrative activities rather than research.

The need for operating costs subsidies should then be addressed as a separate issue. It could be a surcharge on all federal funding. It could be a special allocation from the special building account I have recommended. If the depreciation periods were reduced to twenty years for buildings and five to ten years for equipment, and the cost base brought up to a realistic level, there would be a substantial increase in the depreciation allowances. This would allow more room to make specific allocations for routine operating costs.

Anything that can be done to deal with this problem in a realistic way will cost the Federal Government more money. If the Federal Government is not willing to provide more

Subcommittee on Science
Page three

May 6, 1991

money to support this nation's universities, there is only one possible outcome. American universities will have to retrench.

This is the basic decision this committee has to address. Should the Federal Government provide more money to support our universities or not. I personally do not think retrenchment would necessarily be a disaster.

I am quite sure that implementing the recommendations I have given you will allow the American taxpayer to receive more value for the federal dollars that are provided, and my recommendations are more important if the overall decision is not to increase the funding.

A satisfactory solution will be difficult at best. It will be impossible if the pork barrel propensities of the members of the Congress cannot be brought into control.

I hope this communication will be helpful to the important work of your committee.

Sincerely,



David Packard
Chairman of the Board
Hewlett-Packard Company

DP/gd

"CORRESPONDENCE TRACKING"

TYPE: INFORMATION

DOCUMENT NUMBER: 9121411

FROM: PACKARD, David: HEWKETT-PACKARD COMPANY

TO: DR. BROMLEY

DATE OF
CORRESPONDENCE: 05/06/91

SUBJECT: LETTER TO CHAIRMAN BOUCHER AND MEMBERS OF THE
COMMITTEE ON SCIENCE, SPACE AND TECHNOLOGY'S
SUBCOMMITTEE ON SCIENCE REGARDING THE HEARING ON
4/25/91.

ASSIGNED TO:

ACTION REQUIRED:

SENDER'S DUE DATE:

OSTP DUE DATE:

DATE COMPLETED:

COPIES TO: D. Allan Bromley
Ken Yale
Carl Bretscher
LIFE SCIENCES

WHITE HOUSE TRACKING #:

CONTACT PERSON:

REMARKS:

DATE RECEIVED: 05/13/91

FILE: LIFE SCIENCES-INDIRECT COST

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF SCIENCE AND TECHNOLOGY POLICY
WASHINGTON, D.C. 20506

July 12, 1991

MEMORANDUM FOR D. ALLAN BROMLEY

FROM:


D.A. HENDERSON

SUBJECT:

PACKARD LETTER

David and I had discussed the contents of this letter prior to his sending it and, from our discussions, we had identified specific areas of his testimony needing clarification. Except for paragraph 5 on page 2, it is an eminently sound statement, in my view. The paragraph in question simply makes no sense to me and, even with our earlier discussions as background, I can make no sense out of it. I would suggest a simple letter to David expressing your thanks for the letter and his interest.

Attachment

THE WHITE HOUSE

WASHINGTON

July 31, 1991

Dear David:

Many thanks for sending me a copy of your letter to Chairman Boucher and members of his subcommittee. You make a whole series of excellent points and this input will be extremely helpful in all that we are trying to do.

There is one paragraph, the second from the bottom on page 2, that addresses the need for operating costs subsidies which leaves me slightly puzzled and when next we get together I would look forward to discussing it with you.

As things now stand, I expect to arrive in Palo Alto late on Wednesday, September 4 and will be present for the entire meeting with the Packard Fellows. I very much look forward to seeing you and to hearing from them and I hope that you will be able to join us for the PCAST meeting scheduled for September 12 and 13.

I plan to be in Europe for the first week in August meeting with the Science Advisors in Bonn, Paris, and Rome and then expect to take the last two weeks of August as vacation when, for the first time in a long while, I will get all my family together at our place up in Canada.

With warmest best wishes,

Sincerely yours,



D. Allan Bromley
The Assistant to the President
for
Science and Technology

Mr. David Packard
26580 Taaffe Road
Los Altos Hills, California 94022

"CORRESPONDENCE TRACKING"

TYPE: INFORMATION

DOCUMENT NUMBER: 9121308

FROM: STEGER, Joseph A.: UNIVERSITY OF CINCINNATI

TO: DR. BROMLEY

DATE OF
CORRESPONDENCE: 04/24/91

SUBJECT: RE: THE CONGRESSIONAL HEARINGS ON INDIRECT COSTS.

ASSIGNED TO:

ACTION REQUIRED:

SENDER'S DUE DATE:

OSTP DUE DATE:

DATE COMPLETED:

COPIES TO: D. Allan Bromley
LIFE SCIENCES

WHITE HOUSE TRACKING #:

CONTACT PERSON:

REMARKS:

DATE RECEIVED: 05/02/91

FILE: *p*- LIFE SCIENCES-INDIRECT COST



91213086
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91 MAY 2 P 5: 07

OFFICE OF THE
DIRECTOR

April 24, 1991

Dr. D. Allan Bromley
Assistant to the President
for Science and Technology
Old Executive Office Building, Room 358
1700 Pennsylvania Avenue
Washington, D.C. 20506

Dear Dr. Bromley:

The discussions that have resulted from the Congressional hearings on indirect costs, especially in the popular press, have created the potential for a significant loss of confidence by the public regarding the effectiveness of the use of federal funds to support research at our nation's colleges and universities. This has been caused by the perception that the current federal rules and their application by universities are flawed and are not serving the nation well.

The University of Cincinnati strongly supports a thorough review of the federal rules and their application to reestablish a consensus regarding a sound and equitable policy base for the support of research at our universities. Furthermore, we endorse and support the attached Policy Statement developed by the Council on Governmental Relations to review the applicable policies and regulations and make the necessary revisions to assure that the research efforts are not seriously and irreparably damaged. We firmly believe that the statement that was issued in 1986 by the White House Science Council is as true today as it was then. Specifically:

"America has a unique dependence on its colleges and universities both for new knowledge and for young minds trained to use this knowledge in innovative ways; the excellence of our colleges and universities has been a cornerstone of our economic well-being, our national security, and the health and quality of life of our citizens."

D. Allan Bromley

-2-

April 24, 1991

It is time we address this issue in a forthright and ethical manner to ensure that the research enterprise at our universities is not further impeded.

We stand ready to assist you in this effort.

Sincerely,

A handwritten signature in blue ink that reads "JA Steger". The initials "JA" are written in a large, stylized cursive font, followed by the name "Steger" in a smaller, more legible cursive script.

Joseph A. Steger
President

Enclosure

CC: Frank R. Tepe, Jr.

COGR

an organization of research universities

COUNCIL ON GOVERNMENTAL RELATIONS

One Dupont Circle, N.W., Suite 670
Washington, D.C. 20036
(202) 861-2595
(202) 331-8483 FAX

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FRANK R. TEPE, Jr.
University of Cincinnati

EXECUTIVE DIRECTOR
MILTON GOLDBERG

ASSOCIATE EXECUTIVE
DIRECTOR
KATHARINA PHILLIPS

STATEMENT ON REEXAMINATION OF UNIVERSITY COST PRINCIPLES COGR BOARD OF MANAGEMENT

Recent hearings held by the House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations have raised questions about university stewardship of public funds. The COGR Board recognizes the need for change in the system which is used to reimburse colleges and universities for the indirect costs of research. Any loss of public confidence in financial management at our institutions is particularly serious. Therefore, a comprehensive reexamination of the university cost principles, including the definition of allowable costs, is necessary at this time.

Recommendations contained in the report of the White House Science Council in 1986 (Packard-Bromley Report) and the 1988 "Pings Committee" report offer thoughtful suggestions for change. COGR reiterates its endorsement of those reports.

The COGR Board urges its member universities to affirm their responsibility to provide internal controls and where necessary make investments to improve procedures to safeguard public funds.

It is time to address these issues. COGR is ready to assist in any effort to restore public confidence in our colleges and universities.

April 12, 1991

"CORRESPONDENCE TRACKING"

TYPE: INFORMATION DOCUMENT NUMBER: 9121190
ORIGINATOR: 02 STATUS C DIRECTORATE STATUS

FROM: GRAY, Paul E.: MIT

TO: DR. BROMLEY

DATE OF
CORRESPONDENCE:

SUBJECT: A THANK YOU LETTER FOR THE DISCUSSION ON INDIRECT
COSTS ISSUES AND AN ENCLOSURE ON THE RA/TA TUITION
RECOVERY ISSUE.

DIRECTORATE STAFF
ASSIGNED: LIFE SCIENCES ASSIGNED:

ACTION STAFF
REQUIRED: COMMENT TO DAB ACTION:

SENDER'S DUE DATE:
OSTP DUE DATE: STAFF DUE DATE
DATE COMPLETED: 05/06/91 DATE COMPLETED/DEPT:

COPIES TO: D. Allan Bromley Tom Ratchford
D.A. Henderson

WHITE HOUSE TRACKING #: CONTACT PERSON:
PHONE: EXT:

REMARKS:

OSTP RECEIVED: 04/22/91
DEPT RECEIVED:

FILE: P- LIFE SCIENCES-INDIRECT COST

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF SCIENCE AND TECHNOLOGY POLICY
WASHINGTON, D.C. 20506

May 6, 1991

MEMORANDUM FOR ALLAN BROMLEY

FROM:


D.A. HENDERSON

SUBJECT:

COMMENTS ON THE MIT TUITION REMISSION PLAN --
YOUR REQUEST

The Office of Naval Research (ONR) has agreements with perhaps 3 or 4 schools to charge tuition costs for research assistants to the fringe benefit pool (Note: not indirect cost budget). This represents a creative piece of bookkeeping which is doubtfully applicable to other than a comparatively few research universities, deriving a large proportion of revenues from sponsored research. It has the advantage of giving the University immense flexibility in being able to grant tuition scholarships to any project or department irrespective of the quantity or nature of the sponsored research.

How does it work? Fringe benefits are an added charge to every salary and, for those salaries supported by sponsored research, represent a direct charge to grants and contracts. The fringe benefit rate is adjusted annually to assure that revenues balance the expenditures (which include such as hospitalization, employers contribution to Social Security, retirement benefits, etc.). If tuition charges are paid from such a pool, the fringe benefit rate is simply increased to assure an adequate flow of funds. (I am told, for example, that the MIT fringe benefit rate approximates 35% compared to other research universities which are in the 25% range. The figure may be off but it makes the point.)

The "savings" to government represent that portion of the fringe benefit pool which are paid from non-government funds, i.e., tuition, endowment, industry revenues. This probably represents 35-40% of the total (data are not shown). Presumably, if the fringe benefit pool mechanism were not in place, the university would employ more post-docs under direct costing and fewer doctoral-candidate research assistants (RAs).

There is little enthusiasm among any of us for retaining this special arrangement. Basically, it gives the university license to recruit RAs for any discipline and any research area irrespective of the funding patterns. In principle, this may be argued as desirable, but it departs significantly from a more important principle (in our view) of more specifically relating all possible costs to funded programs and projects each of which must bear the scrutiny of peer review.

D.H.

Comment please

D.H.

912117

RECEIVED

01 APR 22 AM 11:23



OFFICE OF
THE CHAIRMAN OF THE CORPORATION
ROOM 5-205, 77 MASSACHUSETTS AVENUE
OFFICE OF THE
DIRECTOR

CAMBRIDGE, MASSACHUSETTS 02139
TELEPHONE 617-253-4665

April 17, 1991

The Honorable D. Allan Bromley
Special Assistant to the President
for Science and Technology
Old Executive Office Building
17th Street & Pennsylvania Avenue N.W., Suite 358
Washington, DC 20506

Dear Allan:

Thank you very much for taking time to talk with me on Monday about indirect cost issues.

I recognize that the present climate is not conducive to full discussions between the research universities, OMB, and the agencies about the whole range of cost issues. Nevertheless, I hope that tolerance of the wide range of specific applications of the cost principles which have existed will continue, and that there will continue to be appreciation of causes of public-private differences and of the consequences of debt funding of research facilities. Your understanding of these matters is very comforting!

Enclosed is a copy of a letter President Charles M. Vest recently sent to Mr. Francis Hodsoll of OMB. It addresses the RATA tuition recovery issue I mentioned to you.

As conversations about indirect costs develop, I would be glad to try to help in any way that seems appropriate.

With warmest regards and best wishes,

Sincerely yours,

Paul E. Gray

PEG:fg

Enclosure

xc: Dr. Charles M. Vest

"CORRESPONDENCE TRACKING"

TYPE: INFORMATION

DOCUMENT NUMBER: 9121190

FROM: GRAY, Paul E.: MIT

TO: DR. BROMLEY

DATE OF
CORRESPONDENCE:

SUBJECT: A THANK YOU LETTER FOR THE DISCUSSION ON INDIRECT
COST ISSUES AND AN ENCLOSURE ON THE RA/TA TUITION
RECOVERY ISSUE.

ASSIGNED TO:

ACTION REQUIRED:

SENDER'S DUE DATE:

OSTP DUE DATE:

DATE COMPLETED:

COPIES TO: D. Allan Bromley
Dr. Henderson

Thomas Ratchford

WHITE HOUSE TRACKING #:

CONTACT PERSON:

REMARKS:

DATE RECEIVED: 04/22/91

FILE: ~~EDUCATION~~

LIFE SCIENCES - INDIRECT COST

9121190

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91 APR 22 AM : 23



OFFICE OF
THE CHAIRMAN OF THE CORPORATION
ROOM 5-205, 77 MASSACHUSETTS AVENUE
OFFICE OF THE
DIRECTOR

CAMBRIDGE, MASSACHUSETTS 02139
TELEPHONE 617-253-4665

April 17, 1991

The Honorable D. Allan Bromley
Special Assistant to the President
for Science and Technology
Old Executive Office Building
17th Street & Pennsylvania Avenue N.W., Suite 353
Washington, DC 20506

Dear Allan:

Thank you very much for taking time to talk with me on Monday about indirect cost issues.

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Enclosed is a copy of a letter President Charles M. Vest recently sent to Mr. Francis Hodsoll of OMB. It addresses the RA/TA tuition recovery issue I mentioned to you.

As conversations about indirect costs develop, I would be glad to try to help in any way that seems appropriate.

With warmest regards and best wishes,

Sincerely yours,

Paul E. Gray

PEG:fg

Enclosure

xc: Dr. Charles M. Vest



CHARLES M. VEST, PRESIDENT

ROOM 3-208
77 MASSACHUSETTS AVENUE
CAMBRIDGE, MASSACHUSETTS 02139-4307
617-253-0148

March 21 1991

Mr. Francis S.M. Hodson
Executive Associate Director &
Chief Financial Officer
Office of Management and Budget
260 Old Executive Office Building
17th Street and Pennsylvania Avenue, N.W.
Washington, D.C. 20503

Dear Mr. Hodson,

Thank you very much for speaking with me by telephone yesterday regarding policy matters associated with tuition remission for research assistants (RAs) who work on federally funded grants and contracts. This is an issue of substantial concern to MIT and to several other major research universities. I am therefore most appreciative of the opportunity to outline MIT's perspective on the matter in this letter.

Since World War II, the United States has explicitly fostered a system of research universities that comprise the major research infrastructure of the nation. It is a system in which the functions of basic research and teaching, particularly at the graduate level, have been purposefully integrated and intertwined, a system which has produced research results and well-trained graduates which are the envy of the world. If those trained graduates are to enter the mainstream of U.S. industry and commerce and contribute to the nation's technological competitiveness, they must first enter the mainstream of the research programs being undertaken in the nation's universities.

At MIT the involvement of graduate students in research has depended on a number of critical factors:

- The size and breadth of the Institute's research program has provided an opportunity for students to spend a significant amount of time in the dual role of working directly on federal and other sponsored research grants and contracts while at the same time

Mr. Francis S.M. Hodson
March 21, 1991
Page Two

attending class and preparing doctoral theses. The theses not only provide degree credit but serve as journal articles and technical reports on the results of the research. In return the student's tuition is paid and he or she receives a salary for services rendered. The supervisors of research projects may, however, choose to hire postdoctoral research associates or other non-student research staff to work on the research, individuals for whom tuition is not a factor. In some of the larger interdisciplinary laboratories, there is little student presence, and research is conducted primarily by full-time, career researchers.

- Since project supervisors may choose between hiring graduate student research assistants and non-student research personnel, there should be an incentive for them to employ the RAs. That incentive was seriously diminished during the 1970's as it became apparent that the costs of the RAs were increasing significantly in relation to the costs of postdoctoral associates and other non-student researchers. The incentive was restored in 1983 when the RAs' tuition, which had before then been charged directly to the research grant or contract, was shifted instead to the total employee benefit pool to be charged to all Institute accounts. The result was that the 1,700 RAs engaged in research in 1983 increased to 2,100 in 1990.

- The applicable cost principles must provide the flexibility to encourage and provide those incentives for student participation which are best suited to an institution's particular needs. The change instituted in 1983 was predicated on two principles stated in OMB Circular A-21; first, the principle that "each university ... be encouraged to conduct research in a manner consonant with its own academic philosophies and institutional objectives" and, secondly, "The dual role of students engaged in research and the resultant benefits to sponsored agreements are fundamental to the research effort and should be recognized in the application of these principles." The change made in the method of charging RA tuition in 1983 was approved by ONR on the basis of those principles coupled with the fact that it resulted in an over-all cost saving to the Federal government.

We understand that there are pressures to revise or interpret OMB Circular A-21 to require that RA tuition no longer be charged as an employee benefit but be charged as a direct cost to the specific grant or contract on which the individual RA is employed. To the best of my knowledge the arguments for revision are based largely on accounting uniformity. Whatever areas of university accounting might benefit from such uniformity, it would

Mr. Francis S.M. Hodsoll
March 21, 1991
Page Three

in my view be a tragedy if accounting orthodoxy prevailed at the expense of a principle as vital to the universities as the participation of graduate students in their research programs. The recognition of institutional diversity and of the benefits resulting from the dual use of students as it is currently reflected in Circular A-21 should not be abandoned.

Even if these principles are abandoned in favor of accounting uniformity, the results will be far from uniform. The consequences will vary between private and state institutions (and at the latter it will vary depending on whether an RA is paying resident or out of state tuition). It will impact differently at those institutions which have the endowment or other sources of income sufficient to subsidize tuition for some graduate students or for the later graduate years. It will also impact differently on the different federal agencies.

The impacts of the greatest significance and concern to me, however, are those which MIT would experience if it is compelled to revert to the practice which prevailed in the 1970s. Among them are the following:

- The cost of a Research Assistant to a project, including applicable indirect costs, would increase from approximately \$30,000 to \$50,000 per year. Incentives for the use of RAs on research projects, and consequently their participation, would be substantially diminished.
- The savings to the government, calculated at \$800,000 in 1983 and now estimated at over \$3 million a year, would be translated into increased costs on research projects which continued to employ graduate student RAs.
- The redistribution of costs among the MIT departments and laboratories would benefit those activities which hire relatively fewer graduate student RAs and significantly increase costs for those projects which employ the greatest number of RAs. This would, in effect, penalize those research projects in which the integration of research and teaching had been achieved - the projects making the greatest contribution toward developing graduates trained in the most advanced science, engineering, and state-of-the-art technology.

We have in the attachment elaborated on some of the points summarized above and the cost savings to the government. If there is any further information we can provide to assist you in reaching a decision, please let us know.

Mr. Francis S.M. Hodsoll
March 21, 1991
Page Four

In conclusion, MIT adopted its current practice after a prolonged period of debate and numerous analyses of the impact it was likely to have on individual departments and laboratories and on the Institute as a whole. In addition, it was necessary over time to make various adjustments in our management and financial structure in order to moderate the impact of the change on some research activities.

Equally important was the process by which the various constituencies within the MIT community reached a consensus that the involvement of graduate students in Institute research was not only an essential and defining characteristic of MIT, but constituted a benefit the cost of which could equitably be shared by the entire community through the mechanism of including the RAs' tuition cost in the employee benefit pool.

I hope that it will not be necessary to reverse this process and abandon the philosophy which underlies it. I urge that those principles in OMB Circular A-21 which recognize the diversity of research universities and the benefits derived from the participation of graduate students in research not be ignored in favor of arguments based on accounting practice. The federal funding of university research is not simply a matter of procurement; it is a critical investment in our future through the development of human talent and capability.

Thank you for your consideration of this important matter.

Sincerely yours,



Charles Vest

CMV/sls
Attachment

Cost Savings and Cost-effectiveness of Present Method of Charging Graduate Assistant Tuition in Employee Benefit Rate at MIT

Cost Savings:

The cost saving to the government at the time of the change in 1983 was documented at approximately \$800,000. This savings to the government was possible because research assistants' tuition was "pooled" as an employee benefit and charged to all university accounts instead of charging each research grant and contract the tuition for each of its research assistants. At the same time, the tuition of teaching assistants, which had previously been charged totally to university funds, was also "pooled" as an employee benefit and charged to all accounts in the same manner. The result was that approximately 70% of the tuition cost of the research and teaching assistants was allocated to federal and other sponsors, and at least 30% to general accounts paid through university funds. Since the number of research assistants significantly exceeded the number of teaching assistants, the cost of research assistant tuition charged to university funds exceeded the cost of teaching assistant tuition charged to research sponsors, and resulted in an \$800,000 cost saving to federal and other sponsors. This was the basis on which ONR and MIT agreed to charge the tuition of both research and teaching assistants as part of the employee benefit rate.

Because of the growth in the number of research assistants, compared to teaching assistant growth, and tuition increases since 1983, MIT can now show an even more significant cost savings to the government. In 1990, for example, the cost to MIT operations of "pooling" all graduate staff tuition is on the order of \$6.5 million. The effective cost of a research assistant at MIT to each project and contract is approximately \$31,000 (including stipend, employee benefits and overhead). While some research assistants are now charged to funds other than research, the savings to the government is in the order of \$3-5 million per year, and that will grow if graduate research continues to grow.

A reversal would reduce the sharing of cost to MIT funds by the \$3-5 million mentioned above, but would involve a substantial redistribution of costs between departments and laboratories at MIT. Total costs would increase for those research activities with the greatest student involvement, whereas those research activities with the least student involvement, or projects with a higher percentage of students who work on grants as "trainees" (such as the NIH training grants), would have a net reduction in costs. The cost of a research assistant to a project would increase to approximately \$50,000 including applicable indirect costs, which would unfortunately provide once again a strong incentive for use of postdoctoral and other research staff in place of research assistants. It also seems highly unlikely that sponsors are prepared to augment budgets to the degree necessary to cover the redistribution of costs required.

Cost-effectiveness and Management Objectives:

Prior to the change made in 1983, a great deal of attention and discussion occurred within the administrative structure of MIT explaining the rationale for the "support of graduate education" and the value in spreading graduate student costs over a large number of MIT activities. Particular attention was given to those research areas with a small number of student staff where the cost of research would be increasing because of this policy change. In a number of cases, financial relief and accommodation was made through the transfer of certain costs to the central administration. Needless to say, the process of implementing such a change required initiatives and extensive effort by all members of the senior leadership of MIT.

A similar kind of redistribution occurred between sponsors. As an example, prior to the change, NIH benefited from lower costs relative to most other agencies since many of the graduate students participating in NIH sponsored research are not charged to the project, but are funded through NIH training grants which provide stipend, tuition and fees, with a reduced indirect cost applied only to stipends. To MIT, the important aspect of "savings" in any decision should be to the government overall, and not to particular agencies depending on the mix of graduate assistants/trainees. We hope that this would also be the attitude of OMB.

While the process of implementation and accommodation was lengthy and difficult, the MIT community, and our many agency sponsors, understood and accepted the cost sharing because of the beneficial aspects which were to be gained by continued emphasis on graduate staff research. It was generally accepted that the sharing of these costs among the many operations of MIT was worthwhile and cost-effective for MIT as a major educational institution. The many laboratories and centers performing research for a number of different sponsors (including such premier laboratories as the Research Laboratory for Electronics, the Plasma Fusion Laboratory, Lincoln Laboratory, the Center for Space Research, etc.), are all well aware of the obligation to provide support for the researchers of the future.

Reversing the process would require all the initiatives and restructuring as with the original change, although it would now be more complicated because of growth in numbers of students, the degree to which this cost is shared by many administrative and research units, and the loss of the major rationale to make such a change, that of encouraging graduate student participation in an integrated research and teaching environment.

A move from a shared to a direct cost could appear to some to be an easily managed process since the savings/cost appears to be only in the \$3-7 million range. This is not the case, however, in that the major difficulty in moving from a shared cost to a direct charge would be the "redistribution" process involving allocating a significant cost element now spread over a large number of diverse

units to a much smaller number of research areas heavily involved in graduate student research. This smaller number of graduate student areas would be seriously impaired, as evidenced from the estimated increased cost of a research assistant from \$31,000 to \$50,000.

Aside from the redistribution process, there would be a significant period required in transition to make a change of this sort in any orderly manner. As an example, many grants and contracts run for 3-4 years. Also, as mentioned, the process to begin charging tuition in the employee benefit pool began in the late 1970s and was not fully implemented until 1983. At a minimum, to avoid a major crisis and disruption, MIT would need at least two years notice prior to the first day of the Fiscal Year change - but even more importantly to us, it would reverse a trend of government-university support for incentives for graduate education.