

6 TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS

II. MAJOR PROBLEMS

The Treasury Department's study of private foundations has revealed the existence of six categories of major problems.

A. SELF-DEALING

Some donors who create or make substantial contributions to a private foundation have engaged in other transactions with the foundation. Property may be rented to or from it; assets may be sold to it or purchased from it; money may be borrowed from it or loaned to it. These transactions are rarely necessary to the discharge of the foundation's charitable objectives; and they give rise to very real danger of diversion of foundation assets to private advantage.

Cognizant of this danger, the House of Representatives in 1950 approved a bill which would have imposed absolute prohibitions upon most financial intercourse between foundations and donors or related parties, and which would have severely restricted other such dealings. However, the measure finally adopted, which has been carried without material change into present law, prohibits only loans which do not bear a "reasonable" rate of interest and do not have "adequate" security, "substantial" purchases of property for more than "adequate" consideration, "substantial" sales of property for less than "adequate" consideration, and certain other transactions.

Fourteen years of experience have demonstrated that the imprecision of this statute makes the law difficult and expensive to administer, hard to enforce in litigation, and otherwise insufficient to prevent abuses. Whatever minor advantages charity may occasionally derive from the opportunity for free dealings between foundations and donors are too slight to overcome the weight of these considerations. Consequently, the Report recommends legislative rules patterned on the total prohibitions of the 1950 House bill. The effect of this recommendation would, generally, be to prevent private foundations from dealing with any substantial contributor, any officer, director, or trustee of the foundation, or any party related to them, except to pay reasonable compensation for necessary services and to make incidental purchases of supplies.

B. DELAY IN BENEFIT TO CHARITY

The tax laws grant current deductions for charitable contributions upon the assumption that the funds will benefit the public welfare. This aim can be thwarted when the benefits are too long delayed. Typically, contributions to a foundation are retained as capital, rather than distributed. While this procedure is justified by the advantages which private foundations can bring to our society, in few situations is there justification for the retention of income (except long-term capital gains) by foundations over extended periods. Similarly, the purposes of charity are not well served when a foundation's charitable disbursements are restricted by the investment of its funds in assets which produce little or no current income.

Taking note of the disadvantages to charity of permitting unrestricted accumulations of income, Congress in 1950 enacted the predecessor of section 504 of the present Internal Revenue Code, which denies an organization's exemption for any year in which its