

income accumulations are (a) "unreasonable" in amount or duration for accomplishing its exempt purposes, (b) used to a "substantial" degree for other purposes, or (c) invested in a way which "jeopardizes" the achievement of its charitable objectives.¹ The indefiniteness of the section's standards, however, has rendered this provision difficult to apply and even more difficult to enforce. Two changes in the law are needed for private foundations which do not carry on substantial active charitable endeavors of their own.

First, such private foundations should be required to devote all of their net income² to active charitable operations (whether conducted by themselves or by other charitable organizations) on a reasonably current basis. To afford flexibility, the requirement should be tempered by a 5-year carryforward provision and a rule permitting accumulation for a specified reasonable period if their purpose is clearly designated in advance and accumulation by the foundation is necessary to that purpose.

Second, in the case of nonoperating private foundations which minimize their regular income by concentrating their investments in low yielding assets, an "income equivalent" formula should be provided to place them on a parity with foundations having more diversified portfolios. This result can be accomplished by requiring that they disburse an amount equal either to actual foundation net income² or to a fixed percentage of foundation asset value, whichever is greater.

C. FOUNDATION INVOLVEMENT IN BUSINESS

Many private foundations have become deeply involved in the active conduct of business enterprises. Ordinarily, the involvement takes the form of ownership of a controlling interest in one or more corporations which operate businesses; occasionally, a foundation owns and operates a business directly. Interests which do not constitute control may nonetheless be of sufficient magnitude to produce involvement in the affairs of the business.

Serious difficulties result from foundation commitment to business endeavors. Regular business enterprises may suffer serious competitive disadvantage. Moreover, opportunities and temptations for subtle and varied forms of self-dealing—difficult to detect and impossible completely to proscribe—proliferate. Foundation management may be drawn from concern with charitable activities to time-consuming concentration on the affairs and problems of the commercial enterprise.

For these reasons, the Report proposes the imposition of an absolute limit upon the participation of private foundations in active business, whether presently owned or subsequently acquired. This recommendation would prohibit a foundation from owning, either directly or through stock holdings, 20 percent or more of a business unrelated to the charitable activities of the foundation (within the meaning of sec. 513). Foundations would be granted a prescribed reasonable period, subject to extension, in which to reduce their present or subsequently acquired business interests below the specified maximum limit.

¹ Section 681 imposes similar restrictions upon nonexempt trusts which, under section 642(c), claim charitable deductions in excess of the ordinary percentage limitations on individuals' deductible contributions.

² Except long-term capital gains.