

E. FINANCIAL TRANSACTIONS UNRELATED TO CHARITABLE FUNCTIONS

Private foundations necessarily engage in many financial transactions connected with the investment of their funds. Experience has, however, indicated that unrestricted foundation participation in three classes of financial activities which are not essential to charitable operations or investment programs can produce seriously unfortunate results.

Some foundations have borrowed heavily to acquire productive assets. In doing so, they have often permitted diversions of a portion of the benefit of their tax exemptions to private parties, and they have been able to swell their holdings markedly without dependence upon contributors. Certain foundations have made loans whose fundamental motivation was the creation of unwarranted private advantage. The borrowers, however, were beyond the scope of reasonable and administrable prohibitions on foundation self-dealing, and the benefits accruing to the foundation's managers or donors were sufficiently nebulous and removed from the loan transactions themselves to be difficult to discover, identify, and prove. Some foundations have participated in active trading of securities or speculative practices.

The Treasury Department recommends special rules to deal with each of these three classes of unrelated financial transactions. First, it proposes that all borrowing by private foundations for investment purposes be prohibited.³ Second, it recommends that foundation loans be confined to categories which are clearly necessary, safe, and appropriate for charitable fiduciaries. Third, it proposes that foundations be prohibited from trading activities and speculative practices.

F. BROADENING OF FOUNDATION MANAGEMENT

Present law imposes no limit upon the period of time during which a donor or his family may exercise substantial influence upon the affairs of a private foundation. While close donor involvement with a foundation during its early years can provide unique direction for the foundation's activities and infuse spirit and enthusiasm into its charitable endeavors, these effects tend to diminish with the passage of time, and are likely to disappear altogether with the donor's death. On the other hand, influence by a donor or his family presents opportunities for private advantage and public detriment which are too subtle and refined for specific prohibitions to prevent; it provides no assurance that the foundation will receive objective evaluation by private parties who can terminate the organization if, after a reasonable period of time, it has not proved itself; and it permits the development of narrowness of view and inflexibility in foundation management. Consequently, the Treasury Department recommends an approach which would broaden the base of foundation management after the first 25 years of the foundation's life. Under this proposal, the donor and related parties would not be permitted to constitute more than 25 percent of the foundation's governing body after the

³ This recommendation would not prevent foundations from borrowing money to carry on their exempt functions.