(3) Prior attempt to solve problem—1950 legislation

The abuses which may exist where a donor is able to enter into financial transactions with his private foundation were recognized by the House of Representatives in 1950. In that year the Ways and Means Committee approved, and the House adopted, a provision which, generally, would have prohibited foundations from entering into financial transactions with (1) its contributors, (2) its officers, directors, and trustees, and (3) certain parties related to its contributors, officers, directors, and trustees.

The Senate Finance Committee, after considering this problem, agreed that there were abuses under the law as it had existed prior to the Revenue Act of 1950. However, the committee believed that the abuses could be prevented without prohibiting transactions which are at arm's length. Therefore, the Finance Committee approved, and the Senate adopted, a provision which would only prohibit a foundation from—

(1) lending any part of its income or corpus without receipt of *adequate security* and a *reasonable rate of interest;*

(2) paying any compensation *in excess of a reasonable allowance* for salaries or other compensation for personal services actually rendered;

(3) making any part of its services available on a *preferential basis;*

(4) making any *substantial purchase* of securities or any other property for *more than adequate consideration* in money or money's worth;

(5) *selling any substantial part* of its securities or other property for *less than adequate consideration* in money or money's worth; and

(6) engaging in any other transaction which results in a *substantial diversion* of its income or corpus.

These prohibitions applied only to transactions between a foundation and its donor (and certain related parties); they were not made applicable to transactions between a foundation and its officers, directors, or trustees.

In conference, the Senate version was adopted. The rules adopted in 1950 can presently be found in sections 503 and 681 of the Internal Revenue Code.

It is now almost 15 years since the enactment of the Revenue Act of 1950. At this time, it is appropriate—indeed necessary—to reexamine the action taken in 1950.

(4) Evaluation of existing law

A careful study of the self-dealing transactions which take place under existing law indicates that the 1950 legislation—which only prohibits donor-foundation transactions which violate an arm's length standard—provides unsatisfactory results.

When a person is asked to represent two conflicting interests in the same transaction it is likely that he will, consciously or unconsciously, favor one side over the other. Where one of the interests involved is his own, and if his action will not be questioned by a charitable beneficiary, it is likely that the donor will resolve all close questions in his own favor. For example, it is likely that a donor would be willing to give himself the benefit of the doubt as to "reasonableness"