

important that it warrants the high cost of administering existing law. However, after a careful review of this subject, it is clear that while there may be a few isolated cases in which charity does benefit by allowing a foundation to enter into financial transactions with its contributors, the benefit which may accrue to charity from such transactions is far outweighed by the inherent potential for private benefit (with a corresponding loss to charity), by the cost of enforcing an arm's-length standard, and by the damage to the confidence of all taxpayers in the fairness of the tax laws.

(5) *Possible solution*

Since examination of this area has revealed that the public does not receive an over-all benefit from allowing a donor to deal with his private foundation, it is recommended that a general prohibition on self-dealing be adopted, applicable to future transactions. This rule would not only eliminate the undue burden of administering an arm's-length test but would also eliminate the potential for abuse which exists under present law. It would also be desirable from the standpoint of over-all tax policy since it would eliminate the ability of a person who presently enters into financial transactions with his private foundation to obtain an immediate charitable deduction without fully parting with his property.

Moreover, such a rule would eliminate the undesirable influences which the ability to engage in self-dealing may have upon a foundation's charitable activities. Such a prohibition would be consistent with the long-established nontax law which bans all self-dealing between a trustee and the trust with respect to which it is a fiduciary. Such a rule would also be consistent with the trend of tax provisions enacted by the Congress since 1950 relating to exempt organizations.

More specifically, it is recommended that private foundations be prohibited from engaging in any transaction with a donor or parties related to the donor involving the transfer or use of the foundation's assets.² Illustrative of the self-dealing transactions which a private foundation would be prohibited from entering into under this general rule (though the rule would not be limited to these transactions) would be—

- (1) lending any part of its income or corpus to;
- (2) paying compensation (other than reasonable compensation for personal services actually rendered) to;
- (3) making any of its services available on a preferential basis to;

¹ In 1962 the Congress, concerned with the possibility of self-dealing in the case of pension trusts established by self-employed taxpayers, placed a general prohibition on self-dealing between the self-employed person and his pension trust. Briefly, this provision prevented such a trust from—

- (1) lending any part of its income or corpus to;
- (2) paying any compensation for personal services to;
- (3) selling any of its property to; and
- (4) acquiring any property for the trust from—

a self-employed person covered by the trust or certain parties connected with such persons (sec. 503(j)).

The Revenue Act of 1964 also imposed a general prohibition on self-dealing transactions in the case of private foundations eligible to receive "unlimited contributions." Under these rules such a private foundation may not—

- (1) lend any part of its income or corpus to;
- (2) purchase more than a minimal amount of property from; or
- (3) sell more than a minimal amount of property to—

the donor and certain parties connected with the donor (sec. 170(g)(4)).

² The definition of a private foundation should include a trust which makes distributions to charitable and noncharitable parties. The absolute prohibition on donor-foundation transactions would not, of course, prevent such a trust from making distributions to the donor or members of his family which are required under the terms of the trust instrument.