

24 TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS

Contributions to nonoperating foundations, however, are often neither devoted to an active charitable program nor distributed to operating charities. Instead, such contributions are often retained by the foundation as principal, to be used to generate income which is to be distributed to operating charities as it is received. In such cases there is usually a significant lag between the time of the contribution, with its immediate effect upon tax revenues, and the time when the public benefits by having an equivalent amount of funds devoted to charitable activities.⁴ Many assert that the value of having a source of uncommitted funds which can easily move from one charitable area to another outweighs this delay. Under this approach it is sufficient if the private nonoperating foundation invests the contributions which it receives in assets which generate a reasonable amount of income and distributes such income to operating charities on a reasonably current basis.

Where, however, a nonoperating foundation invests its funds in assets which do not generate a reasonable amount of current income or retains the income generated by its investments (except for situations in which income is accumulated for a specific charitable purpose), the justification for the present treatment does not apply. In such a case the need for corrective action is evident.

While the causes of undesirable delay in benefit to charity are closely related, they can be more easily identified if they are examined separately. Therefore, this section of the Report will first consider whether existing law relating to the withholding from charity by private nonoperating foundations of their current realized income is adequate. The discussion will then proceed to a consideration of the desirability of rules which would deal with situations in which the managers of a private nonoperating foundation invest the foundation's funds in non-income-producing assets.

(2) *1950 legislation—existing law*

The undesirable delay in benefit to the public which results when a private nonoperating foundation is permitted to retain a substantial portion of its current income was recognized by the Congress when it enacted the Revenue Act of 1950. In considering the problems which arise when a foundation is permitted to retain its income, the Ways and Means Committee expressed its view that—

the tax-exemption privileges with respect to investment income should be restricted to that portion of the income which [foundations] demonstrate that they are using to fulfill their charitable, etc., purposes by actual distribution to charity as the income is received by them (H. Rept. 2319, 81st Cong., 40 (1950), 1950-2 Cum. Bull. 411).

The House in 1950 believed that the ability to accumulate income often delays the time when charity and hence the public can receive the benefits which preferential tax treatment is intended to foster. To eliminate this delay, the House version of the Revenue Act of 1950 would have generally taxed the portion of an exempt organization's investment income (excluding capital gains) which the organization did not currently distribute for the charitable purpose for which it was granted an exemption. One exception to this general rule would

⁴ The delay in benefit to charity which is inherent where the contributed funds are retained as principal has led to suggestions that since charity must wait for its benefit, the donor's benefit—the tax deduction for the amounts which he contributed to the foundation—should also be delayed. The adoption of this proposal, which would generally require a private nonoperating foundation to expend its principal, is not recommended by the Treasury Department.