

have permitted tax-free accumulations of current income to the extent such accumulations were placed into special 5-year trusts which specified the purpose for which the accumulated funds were to be used. Another exception would have allowed a tax-free accumulation equal to 1 year's investment income.

The Senate, although recognizing that some organizations had abused the privilege of tax exemption by accumulating large amounts of income, rejected the direct tax on accumulations favored by the House. Instead it adopted a rule requiring that information disclosing the extent of an exempt organization's accumulations be made available to the public.

In conference, the present rules were adopted as a compromise. These rules, which are now contained in sections 504 and 681 of the code, provide that exempt status shall be denied to an otherwise qualifying organization for the year that its accumulated income is—

- (1) *unreasonable* in amount or duration,
- (2) used to a *substantial* degree for purposes other than those constituting the basis for the organization's exemption, or
- (3) invested in such a manner as to *jeopardize* the carrying out of the function constituting the basis for the organization's exemption.

The regulations implementing these provisions generally exclude a foundation's capital gains in determining whether its accumulated income is unreasonable.

(3) *Evaluation of existing law*

Fourteen years of experience have indicated that in this context standards such as "unreasonable," "substantial," and "jeopardize" are inadequate as well as difficult and expensive to administer. The lack of definite rules leads to uncertainty, not only in the minds of those charged with the responsibility of administering this provision, but also in the minds of foundation managers who are aware that departure from the uncertain path of "reasonable" accumulations may result in loss of exemption.

The difficulty in administering current law can be illustrated by a recent Tax Court case in which a foundation with a net worth of approximately \$1,000 purchased a 34-acre tract of industrial real property for \$1.15 million. This purchase was financed with advance rentals of \$154,000 received from a lessee and by loans of \$1 million. Since the foundation used approximately 80 percent of its income for the 5 years following the purchase of the property to retire its debt the Service revoked the foundation's exemption ruling on the grounds of an "unreasonable" accumulation. However, the Service's revocation was reversed by the court which held that the accumulation was neither "unreasonable in amount or duration" nor used to any "substantial degree for purposes or functions other than those constituting the basis for such organization's exemption." *Shiffman v. Commissioner*, 32 T.C. 1073 (1959).

Another litigated case involved a foundation which was established to provide pensions to the employees of an investment company in which the donor was a minority shareholder. If the income generated by the donated assets would have been used to provide an immediate benefit to eligible employees, payments of approximately \$15 per month could have been provided. To increase the benefits to \$60 per month, the trustees decided to retain and add to corpus the income