

26 TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS

generated by the foundation's assets during a 10-year period. The Internal Revenue Service contended that such an accumulation was unreasonable. A Federal district court, however, felt that the accumulation of income for the purpose of increasing the amount of income which could be distributed for exempt purposes in the future did not constitute an unreasonable accumulation. *Truscott v. United States*, 58-1 USTC ¶9515 (E.D. Pa. 1958) (CCH). The reasoning of the court's decision has been interpreted by some as sanctioning a 10-year accumulation of income merely to increase the size of a foundation's corpus.

These court decisions, in effect, tend to frustrate the present ban on "unreasonable" accumulations except in the most blatant cases. They also indicate that existing law does not provide the results intended by Congress in 1950.

The survey of tax-exempt foundations recently completed by the Treasury Department indicated that in 1962 approximately one-fourth of all private foundations did not expend for charitable purposes an amount equal to their net ordinary income.⁵ For example, the A foundation accumulated virtually all of its 1962 net ordinary income of approximately \$600,000. The B foundation accumulated virtually all of its 1962 net ordinary income of \$2 million. The C foundation accumulated approximately \$900,000 of its 1962 net ordinary income of approximately \$1.6 million. The D foundation accumulated approximately \$1.3 million of its 1962 net ordinary income of approximately \$2.5 million. The retention of income in situations such as these deprives the public of the benefit expected in exchange for the amount of current tax revenue which has been given up; namely, the expectation that an offsetting current charitable benefit would be provided by the foundation.

(4) Possible solution

(a) *Distribution of realized income.*—Because of the inadequacy of existing law and the Service's difficulty in administering the present permissive rules, it would be appropriate to adopt a rule which would give both taxpayers and the Service workable objective standards. It is therefore recommended that all private nonoperating foundations be required to distribute all of their current net income on a reasonably current basis. Such a requirement would insure that the interposition of a private nonoperating foundation between the donor and charitable activities will not result in undue delay in the transmission of benefits to their charitable destination.

Under this proposal a private nonoperating foundation would generally be required to expend the full amount of its current net income by the end of the year following the year such income is received. For this purpose income would include investment income such as rents, interest, dividends and short-term capital gains.⁶ Long-term capital gains (including capital gain dividends paid by regulated investment companies) and contributions received by the foundation would not have to be distributed on a current basis. The purposes for which the income would have to be expended would be (1) contributions to publicly supported charitable organizations,

⁵ For these purposes net ordinary income was defined as total income (excluding capital gains) less expenses incurred in earning such income.

⁶ Net income would be total income after deduction of expenses of earning such income. Current operating expenses would be treated as a current expenditure for charitable purposes.