

36 TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS

It is quite true that, occasionally, beneficial consequences have stemmed from the business activities of a particular foundation. The Internal Revenue Service has, for example, discovered several instances in which foundation businesses have been profitable, their proceeds have been applied to charitable operations without undue delay, and private benefits for the foundation's donors or controllers have been avoided. In these situations it may well be true that charity has been advanced, and no one else harmed, by the ability of the foundation to carry on business endeavors.

On the other hand, the fact that the large majority of private foundations do not own businesses—and that their charitable endeavors suffer no noticeable disadvantage from the lack of business ownership—suggests persuasively that foundations have no real need to engage in business. Other sources of income and other kinds of investments, less inimical to the accomplishment of their charitable objectives, are available to them. Indeed, the Treasury Department has encountered widespread opinion, among foundations themselves and those familiar with their affairs, that business participation is altogether inappropriate for private foundations. Hence, the obvious, fundamental, and common abuses which attend the involvement of foundations in commercial endeavors would appear far to outweigh the minor and occasional benefits which particular foundations have sometimes derived from business ownership.

(3) *Possible solution*

For these reasons, the Treasury Department recommends the imposition of an absolute limit upon the involvement of private foundations in active business. Since effective control of a corporation very frequently resides in a body of stock representing 20 percent of its voting power,²² and since ownership of a 20-percent interest almost necessarily entails close involvement in the affairs of the business whether or not the interest possesses control of the enterprise, it would seem appropriate to fix the limit at that level. This proposal would, then, prevent foundations from owning 20 percent or more of the total combined voting power, or 20 percent or more of the total value of the equity, of a corporation conducting a business which is not substantially related (other than through the production of funds) to the exempt functions of the foundation. A similar prohibition should apply to the ownership by a foundation, either directly or through a partnership, of a 20-percent or larger interest in the capital or profits of such a business. In determining the quantum of a foundation's stock or business ownership, interests held for the benefit of the foundation (whether by trusts, corporations, or others) should be attributed to it, but interests owned by donors, officers, directors, trustees, or employees for their own benefit should not.

Three carefully restricted forms of income production which are of a passive character should be excluded from the definition of "business." Except where active commercial lending or banking is involved, the earning of interest should not be considered to constitute a business. The holding of royalties and mineral production payments as inactive investments should be accorded similar treatment. Appropriate standards should be developed to identify leases of real property (and

²² Indeed, in special situations a much smaller share of voting power may constitute control. Large publicly held corporations may be controlled by blocks of stock which represent 2, 3, or 4 percent of the voting shares.