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second—and basic—objection to foundation investment borrowing: It enables the foundation to convert its tax exemption into a self-sufficient device for the production of capital. By borrowing, the foundation can extend the function of its exemption beyond the protection of income stemming from charitable gifts; it can use the exemption to develop funds even where there are no charitable gifts. Commentators have referred to this activity as trading upon or capitalizing upon the tax exemption. The foundation which makes such use of its exemption can sever itself from reliance upon contributors and eliminate the healthful scrutiny of its purposes and activities which that reliance implies.³² By this expansion of its exemption privilege to borrowed assets and this divorce from dependence upon contributors, the foundation begins a multiplication of its holdings which bears no relation to the community's evaluation of its charitable works; it embarks upon an extension of its economic empire which is limited only by the financial acumen and commercial skills of its managers. The foundation described in example 4, which began with a net worth of \$1,000 and within 5 years had increased its domain to include a 34-acre tract of industrial real property worth \$1,150,000, is an extreme, but not atypical, illustration of the consequences of unrestricted foundation borrowing for investment purposes.

In 1950 Congress recognized the impropriety and danger inherent in such exploitation of the tax exemption privilege. Concerned with a proliferation of situations in which exempt organizations were purchasing commercial property with borrowed funds and utilizing future rents from the property to pay the purchase loan, both the House Committee on Ways and Means and the Senate Finance Committee offered the following observations:

The fact that under present law an exempt institution need not use any of its own funds in acquiring property through leasebacks—borrowed funds may represent 100 percent of the purchase price—indicates that there is no limit to the property an exempt institution may acquire in this manner. Such acquisitions are not in any way limited by the funds available for investment on the part of the exempt institution. This explains why particular attention should be given to leasebacks which involve the use of borrowed funds. Where an exempt organization uses its own funds, expansion of its property holdings through the leaseback device must necessarily proceed at a much slower pace, H. Rept. No. 2319, 81st Cong., 2d sess., p. 39 (1950), 1950-2 Cum. Bull. 410; S. Rept. No. 2375, 81st Cong., 2d sess., p. 31 (1950), 1950-2 Cum. Bull. 506.

To deal with the problem, the Revenue Act of 1950 provided, generally, for the taxation of a portion of the rent which foundations received from property acquired with borrowed funds. The measure (continued without material change in the present Internal Revenue Code) has proved to possess two defects. It has, first, been crippled by the presence of an exception which permits rents from leases whose terms are not longer than 5 years to be received without tax. The cases set out in examples 4 and 5 typify a growing body of transactions in which foundations have been able to frame their acquisitions of productive property to take advantage of this exception. More

³² It is, of course, true that many foundations ultimately develop funds of sufficient size to free themselves from reliance upon contributors. Foundations created by large testamentary gifts may never have to seek money from others. In all of these situations, however, the foundation's basic endowment stems from persons who have sufficient regard for its aims to give it property; its structure and purposes are framed or evaluated by those who have a direct economic concern in the matter. The bootstrap foundation, on the other hand, can be organized with little or no capital. It proceeds to grow from within, independent of outside review. Even though no member of the public ever has sufficient interest in any of the organization's endeavors to contribute to it, the personal motivations of its managers can, where investment borrowing is permitted, be enough to build it to very large proportions.