

fundamentally, the 1950 provision suffers from the narrowness of its scope. Operative only where the property purchased with borrowed money is rental property, it affords no solution to the same problems of diversion of exemption benefits to private parties and financial empire building which exists where borrowed funds are invested in royalties, oil payments, securities, or loans.

The recommendations made by other sections of this report will not provide satisfactory answers to these problems. The proposal to restrict the participation of private foundations in active business does not apply where the foundation's return from its investment is passive. Even if the purchased assets are business assets, when the foundation detaches itself from the conduct of the commercial enterprise by entering into a passive lease to an independently controlled operating entity, the abuses become essentially different from those with which the recommendation of Part II-C is designed to deal; and that recommendation is, properly, inapplicable. The lending proposal of the following section would leave substantial areas in which foundations could continue to make loans, without reference to the source from which the loaned funds stem. The income payout and income equivalent rules suggested in Part II-B are similarly, of little assistance here. Since the payout rule applies only to the net income of foundations, depreciation or depletion would ordinarily shield much of the profit of property purchased with borrowed funds from the thrust of the requirement. Further, under the report's recommendation the "income equivalent" would be determined by reference to a foundation's net equity, rather than its gross asset value; and, as a consequence, this rule also would have limited impact upon assets acquired with borrowed money.

Without supplementation, then, both existing law and other sections of this report would still permit dangerous abuses through foundation borrowing. To foreclose the continuation of these abuses and to forestall the development of new ones, the Treasury Department recommends that, for the future, all borrowing by private foundations for investment purposes be prohibited. This recommendation would not prevent foundations from borrowing money to carry on their exempt functions: it would have no effect upon borrowing to make gifts to other charitable organizations, to defray the expenses of active charitable operations, or to acquire assets for use in the conduct of such operations. It would not, again, apply to investment transactions which are already in progress. For the future, however, it would confine foundation investments to funds stemming from contributions or from income produced by contributions.³³

A proscription of foundation investment borrowing would have no practical effect upon the activities of the great majority of private foundations; for, as has been pointed out, they have not borrowed to invest even when they were free to do so. Indeed, the fact that these foundations have found no difficulty in carrying on their affairs and accomplishing their objectives without investment borrowing constitutes convincing evidence that foundations need not borrow for

³³ In doing so, the proposal would in the future, for private foundations, supersede both the partial attack upon this problem made in the 1950 legislation and the much-criticized 5-year exception embodied in that legislation. The business limitation proposed in Part II-C of this Report would require either disposition or appropriate modification of existing foundation leases which do not qualify as passive. A number of the leases now in effect which have been drawn to take advantage of the 5-year exception would be subject to this requirement.