

*Example 8.*—The H foundation borrowed money from banks and used the proceeds to make loans to three trusts and several individuals. The borrowers were, in some instances, closely enough related to the corporate creator of the foundation to be within the ambit of the expanded self-dealing rules suggested in Part II-A of this Report; in other instances, no identifiable relationship appeared. The interest rates for most of the loans were fixed from 1 to 2 percent higher than the rates which the foundation was obligated to pay the banks. One loan, however, bore interest at only 3 percent, and another at 4 percent.

The facts surrounding these transactions make it evident that the fundamental motivation for at least most of the loans was not the desire to find a secure and profitable investment for charitable funds but, rather, the wish on the part of the foundation's managers to assist parties whom they had some particular, private reason to benefit. Yet, with the exceptions noted in example 8, the borrowers were beyond the reach of any administrable and reasonable self-dealing prohibitions and the benefits accruing to the foundation's managers or donors were sufficiently nebulous and removed from the loan transactions themselves to be difficult to discover, identify, and prove. The task of isolating and demonstrating private benefit or noncharitable purpose—the only avenues of attack open to the government under existing law—becomes arduous and uncertain when the interest rate and the other terms of the loan accord with the standards of ordinary commercial practice. The advantages to the borrower of such a loan by a foundation—and the corollary value of the favor done by the foundation to the director or donor who arranged the loan—can, nevertheless, be considerable. The delays, inconveniences, and formalities of applying for a bank loan can be eliminated; embarrassing questions can be avoided; the assurance that one's obligation resides in friendly hands can be secured.

Charity may suffer two very real detriments from the absence of an effective proscription against privately motivated foundation lending. Because the safety of the obligation is not among the primary considerations leading the foundation to make the loan, charitable funds can be put to unusual and unnecessary hazard. Indeed, the same personal considerations which impel the foundation director or donor to cause the loan will quite probably dissuade him from enforcing its terms with vigor and dispassion when collection difficulties arise. But whether or not the foundation loses money on a particular loan, the very fact that such loans can be made may lead foundation managers to a broad range of decisions which do not comport with the interests of charity. Funds may be retained in liquid form, rather than being placed in more productive investments, so that they will be available for lending when the occasion arises. Charitable programs may be rejected because they would draw too heavily upon lending capital. Expenditures for the charitable projects undertaken may be restricted parsimoniously for the same reason.

To free foundation assets from the dangers inherent in privately motivated lending and to protect foundation decisions from the improper pressures which the availability of such lending may generate, the Treasury Department recommends that, for the future, the loans of private foundations be confined to categories which are clearly necessary, safe, and appropriate for charitable fiduciaries. Loans