

Three kinds of dangers are inherent in foundation trading and speculation. Obviously enough, operations of this character ordinarily entail greater risk of loss than do prudently chosen long-term investments. Assets which have been committed to charity should not be subjected to that hazard. Conversely, these practices may be spectacularly successful; and where they are, they make possible both the financial empire building and the severance of a foundation from dependence upon contributors which have been criticized in the section of the Report dealing with foundation borrowing. A third danger is less obvious but equally significant. Foundation trustees or directors who attempt to predict hourly, daily, or weekly market fluctuations, who purchase puts, calls, and straddles in an effort to profit from those fluctuations, who shift their positions in securities frequently, and who endeavor to assay the potentialities of untried businesses, the worth of untested mineral land, or the future value of unproven building locations must necessarily expend considerable amounts of their time and attention in those endeavors. Little scope is likely to remain for charity. Charitable enterprises deserve—indeed, they require—analysis, evaluation, planning; they are not matters to be lightly undertaken or perfunctorily carried on; they merit the genuine interest and undivided attention of the persons to whom society has entrusted their accomplishment. Consequently, the efforts of the speculator or the trader—whether successful or unsuccessful—are intrinsically inconsistent with the proper management of the affairs of a foundation.

The present law on this subject contains several deficiencies. Section 504(a)(3) of the Internal Revenue Code proscribes investment of—

amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year * * * in such a manner as to jeopardize the carrying out of the charitable, educational, or other purpose or function constituting the basis for exemption under section 501(a) of an organization described in section 501(c)(3).⁴⁰

One basic weakness of the section, of course, is that it applies only to income accumulations; it does not govern the manner in which corpus is managed. A second defect is that, by its reference to "jeopardy," the provision tends to make the success of a venture decisive of its permissibility: undertakings which turn out well are, with the benefit of hindsight, quite likely to seem sound, whatever risks they may have presented while they were in progress. Hence, the section affords only an imperfect device for dealing with the foundation which successfully utilizes trading or speculative practices to multiply its holdings and extend its financial domain. Third, as we have seen, speculation and trading entail an unfortunate consequence which has no relationship to the presence or absence of jeopardy: even where they involve no unusual hazards, they are likely to make greater demands upon the time, interest, and abilities of foundation trustees and directors than is consistent with the attentive and informed conduct of the affairs of charity. For this problem the present section 504 provides no solution.

In view of these considerations, the Treasury Department recommends that private foundations be directly prohibited from participating in any kind of trading or speculation with any of their assets, whether derived from corpus or from income. The prohibition

⁴⁰ Section 681(c) contains a similar provision.