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TREASURY DEPARTMENT REPORT
ON
PRIVATE FOUNDATIONS

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES



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LETTER OF TRANSMITTAL

THE SECRETARY OF THE TREASURY,
Washington, February 2, 1965.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

Hon. WILBUR C. MILLS,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMEN: I am transmitting herewith the report of the Treasury Department on private foundations. This report responds to requests by the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives that the Treasury Department examine the activities of private foundations for possible tax abuses and report its conclusions and recommendations to the committees. The report contains the results of an extensive study made by the Department pursuant to such requests and contains proposals for correction by legislation of inadequacies of the law disclosed by the study.

Sincerely yours,

DOUGLAS DILLON.

TABLE OF CONTENTS

	Page
Introduction	1
Summary of report	5
Part I. Appraisal of private foundations	11
A. Philanthropic values and private foundations	12
B. Evaluation of general criticisms of foundations	13
Part II. Major problems	15
A. Self-dealing	15
1. The existing situation	15
2. Consequences of existing situation	15
3. Prior attempt to solve problem—1950 legislation	17
4. Evaluation of existing law	17
5. Possible solution	21
B. Delay in benefit to charity	23
1. Introduction	23
2. 1950 legislation—Existing law	24
3. Evaluation of existing law	25
4. Possible solution	26
a. Distribution of realized income	26
b. Income equivalent	28
C. Foundation involvement in business	30
1. The existing situation	30
2. Evaluation	31
3. Possible solution	36
D. Family use of foundations to control corporate and other property	37
1. Two widely practiced tax devices	37
2. Evaluation	39
3. Possible solution	41
4. Possible restriction of this solution	43
E. Financial transactions unrelated to charitable functions	45
1. Foundation borrowing	45
2. Foundation lending	50
3. Trading and speculation by foundations	52
F. Broadening of foundation management	54
1. Abuse potentialities of donor influence	54
2. Perpetual existence of foundations	55
3. Possibilities for narrowness of foundation management	56
4. Possible solution	56
Part III. Additional problems	58
A. Contributions of unproductive property	58
B. Contributions of section 306 stock and other ordinary income assets	60
1. Section 306 stock	60
2. Other ordinary income assets	62
C. Correction of computation of estate tax martial deduction	63
D. Sanctions for failure to file information returns	64
Appendixes	65
A. Statistical appendix	65
1. Historical pattern of total contributions	65
2. Contributions by type of recipient	69
3. The size and growth of foundations	72
4. 1964 survey of foundations	76
5. The income of foundations	78
6. The wealth of foundations	82
7. Certain ratios with respect to foundations	84
8. Frequency of certain transactions	88
9. Foundation payout ratios to assets	92
10. Foundation involvement in business	96
11. Foundations and type of charity	100
B. Internal Revenue Service administrative activity	109

U.S. TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS

INTRODUCTION

Because of the importance which this Nation attaches to private philanthropy, the Federal Government has long made generous provision for tax exemptions of charitable [1] organizations and tax deductions for the contributors to such organizations. Since the Federal tax laws in this way encourage and, in substantial measure, finance private charity, it is altogether proper—indeed, it is imperative—for Congress and the Treasury Department periodically to reexamine the character of these laws and their impact upon the persons to which they apply to insure that they do, in fact, promote the values associated with philanthropy and that they do not afford scope for abuse or unwarranted private advantage.

This Report responds to requests by the Committee on Finance of the U.S. Senate and the Committee on Ways and Means of the House of Representatives that the Treasury Department examine the activities of private foundations for tax abuses and report its conclusions and recommendations. Both the Congress and the Treasury Department have investigated these problem areas in the past. A major study resulted in important legislation in 1950, when opportunities for self-dealing and the accumulation of income were restricted and, in addition, the income of feeder organizations and the unrelated business income of certain classes of organizations were subjected to tax. The Revenue Act of 1964 imposed further restrictions on foundations seeking to qualify as recipients of unlimited charitable contributions. However, the major revisions of 1950 have not been comprehensively reviewed since their enactment. In its present study, the Treasury Department has sought to determine whether existing legislation has eliminated the abuses with which it was designed to cope, and whether additional abuses have developed which require correction by legislative action.

In keeping with the congressional requests which prompted it, the scope of this Report is limited to private foundations. The discussion of problems and proposed solutions, thus, is confined to that context. The restriction of the Report to private foundations does not indicate any judgment upon whether or not similar or other types of problems may exist among other classes of exempt organizations. For purposes of this Report, the term "private foundation" designates:

(1) Organizations of the type granted tax exemption by section 501(c)(3) (that is, generally, corporations or trusts formed and

[1] The terms "charity" and "charitable" are used in their generic sense in this Report, including all philanthropic activities upon which the relevant portion of the Internal Revenue Code of 1954 (sec. 501(c)(3)) confers exemption. Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended.

operated for religious, charitable, scientific, literary, or educational purposes, or for testing for public safety or the prevention of cruelty to children or animals), with the exception of—

(*a*) Organizations which normally receive a substantial part of their support from the general public or governmental bodies;[2]

(*b*) Churches or conventions or associations of churches;

(*c*) Educational organizations with regular faculties, curriculums, and student bodies;[3] and

(*d*) Organizations whose purpose is testing for public safety;[4] and

(2) Nonexempt trusts empowered by their governing instruments to pay or permanently to set aside amounts for certain charitable purposes.

In carrying forward its study, the Treasury Department has conducted an extensive examination of the charactistics and activities of private foundations. It has investigated and evaluated the experience of the Internal Revenue Service and the Department of Justice in the administration of the laws governing the taxation of foundations, their contributors, and related parties. Its study has drawn upon pertinent information assembled in investigations conducted by other groups.[5] It has conducted a special canvass of approximately 1,300 selected foundations. From these and other sources, it has compiled and tabulated a variety of classes of relevant statistical data. It has discussed the area with an Informal Advisory Committee on Foundations appointed by Secretary Dillon.[6] It has, further, considered a broad range of proposals for reform, extending from remedies narrowly tailored to end specific abuses to sweeping recommendations for the elimination or restriction of tax exemptions and deductions for certain classes of foundations.

The Department's investigation has revealed that the preponderant number of private foundations perform their functions without tax abuse. However, its study has also produced evidence of serious faults among a minority of such organizations. Six major classes of problems exist; other problems are also present. While the Internal Revenue Service has taken vigorous action in recent years to improve its administration of the existing laws which govern foundations and their contributors,[7] additional legislative measures appear necessary to resolve these problems.

This Report seeks first to place private foundations in general perspective, by considering the values associated with philanthropy and the part played by private foundations in realizing those values. Against this background, it explores the major problems in detail and

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[2] Described in sec. 503(b)(3).

[3] Described in sec. 503(b)(2).

[4] While organizations within this minor category are exempt from tax, contributions to them are not deductible; and they would therefore appear to be more closely analogous to business leagues, social welfare organizations, and similar exempt groups than to foundations.

[5] E.g., Subcommittee No. 1, Select Committee on Small Business of the House of Representatives, whose chairman is Representative Wright Patman. The reports of the investigations of this subcommittee, entitled "Tax-Exempt Foundations and Charitable Trusts: Their Impact on Our Economy," have been published in three installments (dated, respectively, Dec. 31, 1962, Oct. 16, 1963, and Mar. 20, 1964) and are hereinafter referred to as the "Patman Reports." A transcript of hearings held by the group in 1964 has been published recently. See "Tax-Exempt Foundations: Their Impact on Small Business," hearings before subcommittee No. 1 on Foundations, 88th Cong., 2d sess., 1964.

[6] This Committee met with Treasury officials on several occasions, and was a valuable source of informed opinion; but the conclusions and recommendations of this Report are those of the Treasury Department, and are, of course, based on facts and views drawn from many additional sources.

[7] Appendix B summarizes the administrative improvements which have been effected by the Internal Revenue Service.

presents possible solutions.[8] In a separate part it describes additional problems of less general significance and recommends approaches to deal with them.[9] Appendixes present tables of relevant statistics and other information.

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[8] The Report does not deal with the problem of distinguishing between permissible educational activities of foundations and dissemination of propaganda. The distinction is drawn by existing law. The Internal Revenue Service has been investigating situations of questionable operations and taking the action appropriate under presently applicable rules. This program will continue.

[9] The provisions designed to insure compliance with existing law will have to be reexamined to determine their adequacy to the task of securing compliance with the rules proposed in this Report. The fundamental objective of such provisions should be to make certain that funds which have been committed to charity and for which tax benefits have been granted will in fact be devoted to charitable ends. Also, effective enforcement of the rules recommended here will require the filing of information returns by the organizations to which the rules apply. Since certain private foundations are not now required to file such returns, suitable revisions will have to be made in the relevant provisions of existing law.

SUMMARY OF REPORT

I. An Appraisal of Private Foundations

While private foundations have generally been accorded the same favorable tax treatment granted other philanthropic organizations—exemption from tax and the privilege of receiving donations deductible by the donors—previous legislation has placed several special restrictions upon them. To determine whether additional restrictions are necessary, one must first inquire into the character of the contribution which private foundations make to private philanthropy and the validity of the general criticisms which have been leveled at them.

A. PHILANTHROPIC VALUES AND PRIVATE FOUNDATIONS

Private philanthropy plays a special and vital role in our society. Beyond providing for areas into which government cannot or should not advance (such as religion), private philanthropic organizations can be uniquely qualified to initiate thought and action, experiment with new and untried ventures, dissent from prevailing attitudes, and act quickly and flexibly.

Private foundations have an important part in this work. Available even to those of relatively restricted means, they enable individuals or small groups to establish new charitable endeavors and to express their own bents, concerns, and experience. In doing so, they enrich the pluralism of our social order. Equally important, because their funds are frequently free of commitment to specific operating programs, they can shift the focus of their interest and their financial support from one charitable area to another. They can, hence, constitute a powerful instrument for evolution, growth, and improvement in the shape and direction of charity.

B. EVALUATION OF GENERAL CRITICISMS OF PRIVATE FOUNDATIONS

Three broad criticisms have been directed at private foundations. It has been contended that the interposition of the foundation between the donor and active charitable pursuits entails undue delay in the transmission of the benefits which society should derive from charitable contributions; that foundations are becoming a disproportionately large segment of our national economy; and that foundations represent dangerous concentrations of economic and social power. Upon the basis of these contentions, some persons have argued that a time limit should be imposed on the lives of all foundations. Analysis of these criticisms, however, demonstrates that the first appears to be susceptible of solution by a measure of specific design and limited scope, the second lacks factual basis, and the third is, for the present, being amply met by foundations themselves. As a consequence, the Treasury Department has concluded that prompt and effective action to end the specific abuses extant among foundations is preferable to a general limitation upon foundation lives.

II. Major Problems

The Treasury Department's study of private foundations has revealed the existence of six categories of major problems.

A. SELF-DEALING

Some donors who create or make substantial contributions to a private foundation have engaged in other transactions with the foundation. Property may be rented to or from it; assets may be sold to it or purchased from it; money may be borrowed from it or loaned to it. These transactions are rarely necessary to the discharge of the foundation's charitable objectives; and they give rise to very real danger of diversion of foundation assets to private advantage.

Cognizant of this danger, the House of Representatives in 1950 approved a bill which would have imposed absolute prohibitions upon most financial intercourse between foundations and donors or related parties, and which would have severely restricted other such dealings. However, the measure finally adopted, which has been carried without material change into present law, prohibits only loans which do not bear a "reasonable" rate of interest and do not have "adequate" security, "substantial" purchases of property for more than "adequate" consideration, "substantial" sales of property for less than "adequate" consideration, and certain other transactions.

Fourteen years of experience have demonstrated that the imprecision of this statute makes the law difficult and expensive to administer, hard to enforce in litigation, and otherwise insufficient to prevent abuses. Whatever minor advantages charity may occasionally derive from the opportunity for free dealings between foundations and donors are too slight to overcome the weight of these considerations. Consequently, the Report recommends legislative rules patterned on the total prohibitions of the 1950 House bill. The effect of this recommendation would, generally, be to prevent private foundations from dealing with any substantial contributor, any officer, director, or trustee of the foundation, or any party related to them, except to pay reasonable compensation for necessary services and to make incidental purchases of supplies.

B. DELAY IN BENEFIT TO CHARITY

The tax laws grant current deductions for charitable contributions upon the assumption that the funds will benefit the public welfare. This aim can be thwarted when the benefits are too long delayed. Typically, contributions to a foundation are retained as capital, rather than distributed. While this procedure is justified by the advantages which private foundations can bring to our society, in few situations is there justification for the retention of income (except long-term capital gains) by foundations over extended periods. Similarly, the purposes of charity are not well served when a foundation's charitable disbursements are restricted by the investment of its funds in assets which produce little or no current income.

Taking note of the disadvantages to charity of permitting unrestricted accumulations of income, Congress in 1950 enacted the predecessor of section 504 of the present Internal Revenue Code, which denies an organization's exemption for any year in which its

income accumulations are (a) "unreasonable" in amount or duration for accomplishing its exempt purposes, (b) used to a "substantial" degree for other purposes, or (c) invested in a way which "jeopardizes" the achievement of its charitable objectives.[1] The indefiniteness of the section's standards, however, has rendered this provision difficult to apply and even more difficult to enforce. Two changes in the law are needed for private foundations which do not carry on substantial active charitable endeavors of their own.

First, such private foundations should be required to devote all of their net income[2] to active charitable operations (whether conducted by themselves or by other charitable organizations) on a reasonably current basis. To afford flexibility, the requirement should be tempered by a 5-year carryforward provision and a rule permitting accumulation for a specified reasonable period if their purpose is clearly designated in advance and accumulation by the foundation is necessary to that purpose.

Second, in the case of nonoperating private foundations which minimize their regular income by concentrating their investments in low yielding assets, an "income equivalent" formula should be provided to place them on a parity with foundations having more diversified portfolios. This result can be accomplished by requiring that they disburse an amount equal either to actual foundation net income[2] or to a fixed percentage of foundation asset value, whichever is greater.

C. FOUNDATION INVOLVEMENT IN BUSINESS

Many private foundations have become deeply involved in the active conduct of business enterprises. Ordinarily, the involvement takes the form of ownership of a controlling interest in one or more corporations which operate businesses; occasionally, a foundation owns and operates a business directly. Interests which do not constitute control may nonetheless be of sufficient magnitude to produce involvement in the affairs of the business.

Serious difficulties result from foundation commitment to business endeavors. Regular business enterprises may suffer serious competitive disadvantage. Moreover, opportunities and temptations for subtle and varied forms of self-dealing—difficult to detect and impossible completely to proscribe—proliferate. Foundation management may be drawn from concern with charitable activities to time-consuming concentration on the affairs and problems of the commercial enterprise.

For these reasons, the Report proposes the imposition of an absolute limit upon the participation of private foundations in active business, whether presently owned or subsequently acquired. This recommendation would prohibit a foundation from owning, either directly or through stock holdings, 20 percent or more of a business unrelated to the charitable activities of the foundation (within the meaning of sec. 513). Foundations would be granted a prescribed reasonable period, subject to extension, in which to reduce their present or subsequently acquired business interests below the specified maximum limit.

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[1] Section 681 imposes similar restrictions upon nonexempt trusts which, under section 642(c), claim charitable deductions in excess of the ordinary percentage limitations on individuals' deductible contributions.

[2] Except long-term capital gains.

D. FAMILY USE OF FOUNDATIONS TO CONTROL CORPORATE AND OTHER PROPERTY

Donors have frequently transferred to private foundations stock of corporations over which the donor maintains control. The resulting relationships among the foundation, corporation, and donor have serious undesirable consequences which require correction. Similar problems arise when a donor contributes an interest in an unincorporated business, or an undivided interest in property, in which he or related parties continue to have substantial rights. In all of these situations, there is substantial likelihood that private interests will be preferred at the expense of charity. Indeed, each of the three major abuses discussed thus far may be presented in acute form here. The problems here are sufficiently intensified, complex, and possessed of novel ramifications to require a special remedy.

To provide such a remedy, the Treasury Department recommends the adoption of legislation which, for gifts made in the future, would recognize that the transfer of an interest in a family corporation or other controlled property lacks the finality which should characterize a deductible charitable contribution. Under this recommendation, where the donor and related parties maintain control of a business or other property after the contribution of an interest in it to a private foundation, no income tax deduction would be permitted for the gift until (*a*) the foundation disposes of the contributed asset, (*b*) the foundation devotes the property to active charitable operations, or (*c*) donor control over the business or property terminates. Correlatively, the recommended legislation would treat transfers of such interests, made at or before death, as incomplete for all estate tax purposes unless one of the three qualifying events occurs within a specified period (subject to limited extension) after the donor's death. For the purposes of this rule, control would be presumed to exist if the donor and related parties own 20 percent of the voting power of a corporation or a 20 percent interest in an unincorporated business or other property. This presumption could be rebutted by a showing that a particular interest does not constitute control. In determining whether or not the donor and related parties possess control, interests held by the foundation would be attributed to them until all of their own rights in the business or other underlying property cease.

The Treasury Department has given careful consideration to a modification of this proposal which would postpone the donor's deduction only where, after the contribution, he and related parties control the business or other underlying property and, in addition, exercise substantial influence upon the foundation to which the contribution was made. Such a rule would permit an immediate deduction to a donor who transfers controlled property to a foundation over which he does not have substantial influence. Analysis of this modification indicates that it possesses both advantages and disadvantages. Congressional evaluation of the matter, hence, will require careful balancing of the two.

E. FINANCIAL TRANSACTIONS UNRELATED TO CHARITABLE FUNCTIONS

Private foundations necessarily engage in many financial transactions connected with the investment of their funds. Experience has, however, indicated that unrestricted foundation participation in three classes of financial activities which are not essential to charitable operations or investment programs can produce seriously unfortunate results.

Some foundations have borrowed heavily to acquire productive assets. In doing so, they have often permitted diversions of a portion of the benefit of their tax exemptions to private parties, and they have been able to swell their holdings markedly without dependence upon contributors. Certain foundations have made loans whose fundamental motivation was the creation of unwarranted private advantage. The borrowers, however, were beyond the scope of reasonable and administrable prohibitions on foundation self-dealing, 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. Some foundations have participated in active trading of securities or speculative practices.

The Treasury Department recommends special rules to deal with each of these three classes of unrelated financial transactions. First, it proposes that all borrowing by private foundations for investment purposes be prohibited.[3] Second, it recommends that foundation loans be confined to categories which are clearly necessary, safe, and appropriate for charitable fiduciaries. Third, it proposes that foundations be prohibited from trading activities and speculative practices.

F. BROADENING OF FOUNDATION MANAGEMENT

Present law imposes no limit upon the period of time during which a donor or his family may exercise substantial influence upon the affairs of a private foundation. While close donor involvement with a foundation during its early years can provide unique direction for the foundation's activities and infuse spirit and enthusiasm into its charitable endeavors, these effects tend to diminish with the passage of time, and are likely to disappear altogether with the donor's death. On the other hand, influence by a donor or his family presents opportunities for private advantage and public detriment which are too subtle and refined for specific prohibitions to prevent; it provides no assurance that the foundation will receive objective evaluation by private parties who can terminate the organization if, after a reasonable period of time, it has not proved itself; and it permits the development of narrowness of view and inflexibility in foundation management. Consequently, the Treasury Department recommends an approach which would broaden the base of foundation management after the first 25 years of the foundation's life. Under this proposal, the donor and related parties would not be permitted to constitute more than 25 percent of the foundation's governing body after the

[3] This recommendation would not prevent foundations from borrowing money to carry on their exempt functions.

expiration of the prescribed period of time. Foundations which have now been in existence for 25 years would be permitted to continue subject to substantial donor influence for a period of from 5 to 10 years from the present time.

III. Additional Problems

Review of the practices of private foundations and their contributors discloses the existence of several problems which have less general significance than those discussed in Part II of the report. Part III of the report draws the following conclusions about these problems:

A. Gifts to private foundations of certain classes of unproductive property should not be deductible until the foundation sells the property, makes it productive, applies it to a charitable activity, or transmits it to a charitable organization other than a private foundation.

B. Charitable deductions for the contribution to private foundations of section 306 stock (generally, preferred stock of a corporation whose common stock is owned by the donor) and other assets should be reduced by the amount of the ordinary income which the donor would have realized if he had sold them.

C. Reforms of a technical nature should be made in certain estate tax provisions which govern tax incidents of contributions to private foundations.

D. A sanction less severe than the criminal penalty of existing law should apply for the failure to file a return required of a private foundation.

* * * * * * *

These Treasury Department proposals are based upon a recognition that private foundations can and do make a major contribution to our society. The proposals have been carefully devised to eliminate subordination of charitable interests to personal interests, to stimulate the flow of foundation funds to active, useful programs, and to focus the energies of foundation fiduciaries upon their philanthropic functions. The recommendations seek not only to end diversions, distractions, and abuses, but to stimulate and foster the active pursuit of charitable ends which the tax laws seek to encourage. Any restraints which the proposals may impose on the flow of funds to private foundations will be far outweighed by the benefits which will accrue to charity from the removal of abuses and from the elimination of the shadow which the existence of abuse now casts upon the private foundation area.

PART I. APPRAISAL OF PRIVATE FOUNDATIONS

The Internal Revenue Code provides very significant preferential treatment for philanthropic organizations. Not only does it exempt such organizations from income tax (a status they share with many other nonprofit organizations), but it grants income, gift, and estate tax deductions to persons contributing funds to them. The allowance of these deductions results in a very sizable reduction in tax revenues. In 1963, for example, the charitable deductions claimed by individuals, corporations, and estates diminished Federal revenues by a total of approximately $2,800 million.[1]

While private foundations have, in general, received the same favorable treatment accorded all philanthropic organizations, several noteworthy qualifications have been made for them. In 1950 rules concerning prohibited transactions (now secs. 503 and 681(b)) and unreasonable accumulation of income (now secs. 504 and 681(c)) were applied to foundations. In 1964, when Congress increased the general limitation upon the amount of deductible charitable contributions which individuals can make each year from 20 percent of adjusted gross income to 30 percent, it excluded donations to private foundations from the increase (continuing the 20 percent ceiling on them). At the same time, Congress placed special limitations upon the kinds of foundations which can qualify to receive the unlimited charitable contributions permitted to individuals in certain instances. The limitations were designed, generally, to confine this privilege to foundations which do not engage in financial transactions with their donors or related parties, and which actively engage in charitable operations or which pass funds on to active charities without undue delay. A third differentiation between private foundations and other classes of philanthropic organizations occurred in 1964 legislation: in initiating a provision allowing individuals a 5-year carryover of charitable contributions which, in a particular year, exceed deductible limits, Congress did not extend this benefit to contributions made to foundations.

The 1964 decisions by Congress restricting the favorable tax treatment accorded private foundations represent a carefully considered balancing of the relative needs and values of foundations against those of other kinds of charitable organizations. The Treasury Department concurs in the judgment of Congress on these matters; it should be allowed to stand. The vital present question is whether or not additional restrictions are necessary.

To provide an informed response to this question, one must inquire into several fundamental problems. What are the values of private philanthropy? Do private foundations contribute to them? If so, what is the character of that contribution? Is it likely to be attended by undesirable consequences? Are specific measures available to

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[1] This total does not, of course, represent a net loss to the Government. As is pointed out in greater detail below, private charitable expenditures reduce the need for Government spending.

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forestall such consequences, or can they be dealt with only by provisions of general scope?

A. PHILANTHROPIC VALUES AND PRIVATE FOUNDATIONS

The income tax deduction for individuals' gifts to charity was added to the law in 1917, at a time when income tax rates were being raised to meet the expense of war. The addition was justified on the ground that heavy income taxes might cause reductions in donations to charity. Similar considerations subsequently led to the enactment of gift and estate tax deductions for charitable transfers and the extension of the income tax deduction to corporations.

It is impossible accurately to assess the gain or loss in Government funds resulting from the charitable deduction. We cannot know by what amount charitable contributions would be reduced if there were no tax deductions for them. Similarly, we cannot know what increase in Government spending would be required to compensate for reduced charitable spending.

A more important imponderable exists—the distinctive value of private philanthropy. Such philanthropy plays a special and vital role in our society; Government services cannot provide a satisfactory substitute. Religious activity is perhaps unique, because Government is constitutionally barred from undertaking it. Here, private freedom of choice is the preeminent consideration. But in other fields, too, Government is best restricted to a partial and, perhaps, minor role. Research in some of the more controversial areas of the social sciences is an example. Even with respect to activities in which Government must take a major part today—such as education, social security, relief and elimination of poverty—charitable organizations may make vital and unique contributions.

Private philanthropic organizations can possess important characteristics which modern government necessarily lacks. They may be many-centered, free of administrative superstructure, subject to the readily exercised control of individuals with widely diversified views and interests. Such characteristics give these organizations great opportunity to initiate thought and action, to experiment with new and untried ventures, to dissent from prevailing attitudes, and to act quickly and flexibly. Precisely because they can be initiated and controlled by a single person or a small group, they may evoke great intensity of interest and dedication of energy. These values, in themselves, justify the tax exemptions and deductions which the law provides for philanthropic activity.

Private foundations play a significant part in the work of philanthropy. While the foundation is a relatively modern development, its predecessor, the trust, has ancient vintage. Like its antecedent, the foundation permits a donor to commit to special uses the funds which he gives to charity. Rather than being compelled to choose among the existing operating organizations, he can create a new fund, with its own areas of interest and emphasis. His foundation may encourage existing operating organizations to develop in new directions, or it may lead to the formation of new organizations. Even if it does neither, it reflects the bents, the concerns, and the experience of its creator; and it thereby increases the diversity of charitable works. In these ways, foundations have enriched and strengthened the pluralism of our social order.

Private foundations have also preserved fluidity and provided impetus for change within the structure of American philanthropy. Operating charitable organizations tend to establish and work within defined patterns. The areas of their concern become fixed, their goals set, their major efforts directed to the improvement of efficiency and effectiveness within an accepted framework. Their funds are typically consigned to definite—and growing—budgets. The assets of private foundations, on the other hand, are frequently free of commitment to specific operating programs or projects; and that freedom permits foundations relative ease in the shift of their focus of interest and their financial support from one charitable area to another. New ventures can be assisted, new areas explored, new concepts developed, new causes advanced. Because of its unique flexibility, then, the private foundation can constitute a powerful instrument for evolution, growth, and improvement in the shape and direction of charity.

B. EVALUATION OF GENERAL CRITICISMS OF FOUNDATIONS

Several serious general criticisms have been leveled at the private foundation. Some argue that the interposition of the foundation between the donor and active charitable pursuits entails undue delay in the transmission of the benefits which society should derive from charitable contributions. Others contend that foundations are coming to constitute a disproportionately large share of our national economy and hence, among other things, are biting deeply into our tax base. Still others urge that foundations represent dangerous concentrations of uncontrolled economic and social power. Such contentions have led to proposals that a time limit be imposed on the life of private foundations.

The Treasury Department does not believe that a case for this proposal has been made. Its investigation has indicated that most private foundations act responsibly and contribute significantly to the improvement of our society. Because of the very nature of their activities and aims, precise judgment is impossible upon the extent to which foundations have realized their potentialities for creative and dynamic charitable works. It seems quite clear, however, that their endeavors have been conducive to important advancements in education, health, science, the arts, religion, and assistance to the needy and unfortunate.

The argument that foundations can occasion unwarranted delay in benefits to charity possesses considerable force; for, in particular situations, there have been aggravated instances of such delay. But the appropriate solution would appear to be a measure specifically designed to deal directly with this problem—not a rule, like the proposal for limiting foundation life, whose impact would extend well beyond the boundaries of the problem itself. Part II–B of the report outlines a recommendation framed to meet the specific exigencies of the delay problem; and the Treasury Department believes that the measure will prove adequate to its task.

The contention that foundation holdings have become an excessively large part of the national economy in recent years finds little support in the relevant data. Appendix A explores this matter in some detail. While the available information is far from definitive, it suggests that,

since 1950, foundation wealth has not grown appreciably faster than other segments of the economy which have substantial investments in common stocks. The existing restrictions on charitable deductions for contributions to foundations would seem to provide a significant restraint upon abnormal growth. Hence, there would appear to be little present factual basis for the assertion that foundation lives should be limited because foundation wealth has become disproportionate.

To be sure, the powers of foundations present potential dangers. Many foundations have recognized that fact themselves. The larger foundations have acknowledged and responded to their obligations to the public. They have, in the main, established boards of independent, disinterested trustees, and have attracted skilled professional staffs. They have developed procedures which safeguard the independence of their grantees. Quite generally, they have accepted—and often encouraged—public scrutiny of their operations. Undoubtedly there have been individual instances of questionable expenditure; but, upon the whole, the record of foundation disbursements is one of solid accomplishment.

Serious abuses do exist among a minority of private foundations, and they require correction and restraint. They interfere with the application of the funds of some foundations to their proper charitable purposes. Since the Federal tax laws have played a significant part in the growth of foundations, an unavoidable responsibility rests upon the Federal Government to do what it reasonably can to insure that these organizations operate in a manner conducive to the fulfillment of their purposes. The Treasury Department does not, however, recommend that any separate Federal regulatory agency be created to supervise foundations. Rather, the Department is of the view that the effort should be made to frame the tax laws themselves to curb abuses.

Succeeding Parts of this report analyze the character of the abuses which have arisen and recommend remedies for them. The Treasury Department believes that vigorous and fully effective action can and should be taken to end these abuses. It considers such action to be preferable to measures of broader scope and more fundamental impact, such as some limitation upon the lives of all private foundations.

PART II. MAJOR PROBLEMS

A. SELF-DEALING

(1) The existing situation

Existing law does not prohibit donor-foundation transactions. As a result, it is presently possible for a donor to enter into a number of transactions with a foundation to which he has made substantial contributions. For example, he may borrow the foundation's funds or have the foundation lend its funds to a business which he controls. He may have the foundation use its liquid assets to purchase either his property or property owned by others which he wishes to keep from being acquired by competitors or other unfriendly parties. He may have his foundation rent its property to him. He may purchase the foundation's assets.

The lack of a prohibition upon donor-foundation transactions has led some donors to believe that although the foundation has legal title to assets which they have contributed, such assets still "belong" to them. Such a donor often thinks of a foundation as "his" foundation and feels free to engage in any transaction with it that does not shock the conscience—and even some that do. This same belief may be shared by some foundation officials who do not object when the donor wishes to engage in financial transactions with "his" own foundation. These officials apparently feel that the foundation's funds belong to the donor and should be handled in the manner which the donor wishes, rather than in the manner which would benefit the public.

(2) Consequences of existing situation

The ability of a donor to deal with his foundation has several undesirable consequences. First, the donor's knowledge that he may call upon his foundation's assets for his personal purposes will often affect the exercise of his discretion as an official of the foundation in determining how much of the foundation's income and corpus should be distributed to charity on a current basis. The extent to which the failure of some private foundations to distribute their entire income to public charities is traceable to the desires of their trustees to have funds available for the needs of the donor is unascertainable. However, it is likely that it is not an unimportant consideration in some cases.

Second, transactions between a donor and his foundation often provide subtle private advantages to the donor. For example, even if a donor who borrows the foundation's funds is willing to pay the same rate of interest and to provide the same security as would be required by a bank, he usually can be sure that the foundation would not request a detailed financial statement or ask the personal and often embarrassing questions, such as the use to which the funds will be put, that are usually asked when one borrows from a bank. In addition, it is likely that the foundation will always be willing to lend its funds to the donor and process the donor's "loan application" without any of the delay which might take place if the donor were to

borrow from a bank. Thus existing law can provide a donor with a certain source of capital upon which he can call in time of need. Furthermore, the foundation might be more willing to withhold collection of the loan at its maturity—especially if it would embarrass the donor—than would be the case if the loan were made by a bank whose obligation to protect its depositors and shareholders would not permit an extension merely to accommodate the borrower. While all of these advantages are intangible, they do provide the donor who takes advantage of the opportunity with a substantial and valuable benefit.

Third, the knowledge that his foundation can be used as a source of capital—even at the prevailing interest rates—can influence the decisions of the donor in his capacity as an official of the foundation as to the assets which the foundation should hold in its portfolio. A donor who thinks that he may want to call upon his foundation for funds at some future date may have the foundation keep its funds in a form readily convertible into cash so as to be immediately available for his use, rather than placed in an investment which would be more appropriate for the production of income, but which would not be readily convertible into the liquid funds which the donor may need. Such action would, in many cases, decrease the amount of income which the foundation would be able to expend for charitable purposes.

Fourth, the ability of a donor to engage in financial transactions with his foundation results in discrimination between taxpayers. For example, if taxpayer A wants to make his funds available to his business he must do so out of after-tax dollars. However, if taxpayer B, who has established a private foundation, wishes to do the same thing he may "donate" cash (or appreciated property) to his foundation and have the foundation immediately lend the "contribution" to B's business. Assuming that B is in the 50-percent bracket, he can place twice as much cash at the disposal of his business as A, even though both have decreased their disposable funds by the same amount. It is true that the amount borrowed by the B company will have to be paid to the B foundation and not to B. However, the present value to B of being able to put twice as much capital into his business than would otherwise be possible may often exceed the value of the right to collect the debt at some time in the future. Similarly, taxpayer C cannot claim as a deduction an amount which he has pledged to his favorite charity, even though the pledge may be enforceable by the charity. On the other hand, taxpayer D, who has established a private foundation, can "contribute" the same amount to his foundation and then borrow the "contribution" from the foundation. Under these facts D could deduct the contribution but C could not, even though in both cases charity has received the same thing—an obligation of the donor.

Finally, the ability of donors to engage in financial transactions with their foundations is adversely affecting taxpayer morale. Many feel that allowing contributions to a foundation to be deductible in situations in which the donor has not irrevocably parted with the "donated" property is improper. The belief is becoming more widespread that the creation of a private foundation is a tax dodge used by some taxpayers to obtain tax advantages, much as expense account living was regarded. Under our self-assessment tax system it is important that the public have confidence in the fact that every taxpayer is paying his fair share of the cost of government.

(3) Prior attempt to solve problem—1950 legislation

The abuses which may exist where a donor is able to enter into financial transactions with his private foundation were recognized by the House of Representatives in 1950. In that year the Ways and Means Committee approved, and the House adopted, a provision which, generally, would have prohibited foundations from entering into financial transactions with (1) its contributors, (2) its officers, directors, and trustees, and (3) certain parties related to its contributors, officers, directors, and trustees.

The Senate Finance Committee, after considering this problem, agreed that there were abuses under the law as it had existed prior to the Revenue Act of 1950. However, the committee believed that the abuses could be prevented without prohibiting transactions which are at arm's length. Therefore, the Finance Committee approved, and the Senate adopted, a provision which would only prohibit a foundation from—

(1) lending any part of its income or corpus without receipt of *adequate security* and a *reasorable rate of interest;*

(2) paying any compensation *in excess of a reasonable allowance* for salaries or other compensation for personal services actually rendered;

(3) making any part of its services available on a *preferential basis;*

(4) making any *substantial purchase* of securities or any other property for *more than adequate consideration* in money or money's worth;

(5) *selling any substantial part* of its securities or other property for *less than adequate consideration* in money or money's worth; and

(6) engaging in any other transaction which results in a *substantial diversion* of its income or corpus.

These prohibitions applied only to transactions between a foundation and its donor (and certain related parties); they were not made applicable to transactions between a foundation and its officers, directors, or trustees.

In conference, the Senate version was adopted. The rules adopted in 1950 can presently be found in sections 503 and 681 of the Internal Revenue Code.

It is now almost 15 years since the enactment of the Revenue Act of 1950. At this time, it is appropriate—indeed necessary—to reexamine the action taken in 1950.

(4) Evaluation of existing law

A careful study of the self-dealing transactions which take place under existing law indicates that the 1950 legislation—which only prohibits donor-foundation transactions which violate an arm's length standard—provides unsatisfactory results.

When a person is asked to represent two conflicting interests in the same transaction it is likely that he will, consciously or unconsciously, favor one side over the other. Where one of the interests involved is his own, and if his action will not be questioned by a charitable beneficiary, it is likely that the donor will resolve all close questions in his own favor. For example, it is likely that a donor would be willing to give himself the benefit of the doubt as to "reasonableness"

of the interest and "adequacy" of the security provided for in donor-foundation loans. Anglo-American trust law has long recognized the impossibility of insuring that a trustee who is permitted to deal with himself will act fairly to the trust. As a result, the courts have refused to inquire as to the fairness of dealings between a trustee and a trust and have generally barred such transactions.

Because of the potential private benefit which may result from self-dealing, it is imperative that the Internal Revenue Service examine such transactions in detail in order to determine whether there has been a violation of the existing rules. However, such examinations require the skill of highly trained revenue agents and are both time consuming and expensive. The Internal Revenue Service has estimated that the "cost" (both direct costs and the amount of revenue which would be produced if the agent were free to spend his time on matters involving the collection of taxes) of 1 man-year of an experienced revenue agent's time exceeds $320,000.

Much of the Service's problem in policing self-dealing transactions is traceable to concepts such as "reasonableness" and "adequacy" and measures such as "substantial" which are contained in the existing self-dealing rules. The administrative problems created by the use of such terms are severe in the foundation area. This is largely attributable to the fact that often no one is looking over the shoulder of the trustee of a private foundation to make sure that the transaction is, in fact, at arm's length. Indeed, the "arms" involved may both belong to the same person who is both donor and trustee. Moreover, the possibility of arranging transactions with a foundation to suit the needs of the donor are more numerous than in other areas. For example, if a donor wishes to obtain the use of the foundation's funds at a minimum cost he will arrange for the loan to bear a low rate of interest. On the other hand, if a donor wishes to make a deductible contribution to his foundation which is in excess of the generally applicable percentage limitation, it would be possible for him to set a high rate of interest.

The following examples indicate the types of self-dealing cases which are being entered into and the difficulty which the Internal Revenue Service has in applying the arm's length test contained in existing law:

Example 1.—The A foundation made a loan to a business corporation controlled by its donor. The security for the loan consisted of an oral promise made by the donor as an officer of the corporation to execute a mortgage on certain of the real property owned by the corporation, but only if the foundation requested such a mortgage. The foundation, however, never requested the donor's corporation to execute such a mortgage. The Internal Revenue Service challenged the exemption of the foundation on the grounds that the organization had made a loan without the receipt of "adequate" security. The Service argued that if the corporation were to become insolvent, the foundation, with only an unrecorded promise to execute a mortgage in the future, would be in the same position as any other unsecured creditor. However, the court, although recognizing that the security interest of the foundation would be ineffective if the corporation disposed of the real property, felt that a mere promise to execute a mortgage in the future constituted "adequate" security. Thus,

the foundation's exemption was upheld. *William Clay, Jr. Foundation* v. *United States* (64–2 USTC ¶ 9650 (N.D. Tex. 1964) (CCH).

Example 2.—The B foundation was able to make 12 loans totaling over $200,000 to the donor, his relatives, and corporations controlled by the donor without losing its exempt status. *Griswold* v. *Commissioner* 39 T.C. 620 (1962).

Example 3.—The donor contributed $65,000 to the C foundation. These funds were immediately lent to a corporation owned by the donor. Thus, the donor was able to claim an immediate deduction for funds which were invested in his business.

Example 4.—The D foundation lent a substantial portion of its cash to its donor on negotiable demand notes bearing interest at 5½ percent. The collateral for this loan was common stock in one of the donor's closely held corporations. The examining agent stated that the donor was using the foundation "as a bank or checking account."

Example 5.—The E foundation, during the 5-year period 1955–59, made 29 loans to its donor. These loans, totaling approximately $145,000, bore interest at the rate of 4 percent and were secured by stock in a closely held corporation. Although each of these loans were repaid by the end of the foundation's accounting period, some of the funds were "relent" to the donor in the opening days of the following year. Since there were no open loans as of the last day of the foundation's accounting period, the presence of such loans was not disclosed by its balance sheet.

Example 6.—The donor to the F foundation organized a separate corporation for the purpose of manufacturing an article on which he owned the patent. He borrowed money from a bank, lent it to the corporation, and received secured promissory notes as evidence of the debt. Shortly thereafter, the donor contributed (and deducted) certain of these notes—amounting to $27,500—to the foundation. The corporation subsequently abandoned the attempt to manufacture the patented article and the notes became worthless. This transaction permitted the taxpayer to obtain a large contribution deduction for what was essentially "risk capital" for his new business. If the corporation had proved to be successful, the donor, as its stockholder, would have benefited from the additional capital which was made available. However, since the corporation did not prove to be successful, it was only the charity that suffered—the donor had already obtained a deduction for his gift of the corporation's notes.

Example 7.—A donor contributed real estate to the G foundation. Shortly thereafter the foundation leased these properties back to the donor for rentals of approximately $10,000 and $12,000 for 1960 and 1961, respectively. The donor then sublet these properties to third parties for approximately $12,000 and $20,000 for 1960 and 1961, respectively. The donor alleged that the gain which he received was attributable to management services which he performed.

Example 8.—The H foundation received approximately $400,000 in deductible contributions from the owners of a retail and wholesale grocery concern. The foundation distributed a small portion of these contributions to operating charitable

organizations. The remainder of the contributions were used to construct buildings which were leased to the donors' retail grocery.

Example 9.—In 1950 the corporate donor to the I foundation purchased land adjacent to its property for future plant expansion. In 1951 the company donated to the foundation the portion of this land which it did not need in the near future. This gave the company a deduction of approximately $10,000. Some 11 years later, consistent with the company's expansion plans, the property was sold back to the company for an amount equal to approximately $900 more than the amount claimed as a contribution.

Example 10.—The J foundation purchased 20,000 shares of common stock in a publicly held corporation from its donor at $20 per share. On the date of the sale, the stock traded on the New York Stock Exchange at $18 per share. However, because of the number of shares involved and the fact that four brokerage houses stated that $20 per share was not more than adequate consideration, a violation of the arm's-length standard could not be proved.

Example 11.—The K foundation received gifts of "blue chip" stocks valued at $1.2 million from its principal donor. Immediately after receipt the securities were sold by the foundation and all but approximately $50,000 of the proceeds were used to purchase stock in a closely held corporation from members of the donor's family.

Example 12.—The L foundation received stock in a family corporation which was subject to a 10-year option exercisable by the donor's children to repurchase the stock. At the time of the gift the stock was worth approximately $500,000 and the option price was approximately $700,000. Six years later the value of stock had risen to approximately $5,500,000 and the donor's children exercised their right to purchase the stock for $700,000. The use of a repurchase option permitted the donor to divert any substantial appreciation in the value of the donated asset to private parties. Since the foundation could not have received more than $700,000 for the stock, the retention of the stock—in order to accommodate the donor's children—tied up its funds and prevented it from investing in assets which might provide more income for charity. The foundation, at the same time, bore the risk of loss on the stock.

Under existing law, some of these transactions may jeopardize the deductibility of the donor's contribution or the foundation's exemption. Others have received the approval of the courts. However even with respect to those which are not permitted under existing law, the problems of obtaining all of the facts surrounding these transactions often make it extremely difficult, if not impossible, for the Internal Revenue Service to administer the existing law in a manner which prevents foundations from engaging in self-dealing transactions providing a special benefit to the donor at the expense of charity.

Presumably the only justification for continuing to pay the high cost of a rigorous enforcement program which the existing self-dealing rules require would be that charity benefits from allowing a donor to deal with "his" foundation and that this benefit is so substantial and

important that it warrants the high cost of administering existing law. However, after a careful review of this subject, it is clear that while there may be a few isolated cases in which charity does benefit by allowing a foundation to enter into financial transactions with its contributors, the benefit which may accrue to charity from such transactions is far outweighed by the inherent potential for private benefit (with a corresponding loss to charity), by the cost of enforcing an arm's-length standard, and by the damage to the confidence of all taxpayers in the fairness of the tax laws.

(5) Possible solution

Since examination of this area has revealed that the public does not receive an over-all benefit from allowing a donor to deal with his private foundation, it is recommended that a general prohibition on self-dealing be adopted, applicable to future transactions. This rule would not only eliminate the undue burden of administering an arm's-length test but would also eliminate the potential for abuse which exists under present law. It would also be desirable from the standpoint of over-all tax policy since it would eliminate the ability of a person who presently enters into financial transactions with his private foundation to obtain an immediate charitable deduction without fully parting with his property.

Moreover, such a rule would eliminate the undesirable influences which the ability to engage in self-dealing may have upon a foundation's charitable activities. Such a prohibition would be consistent with the long-established nontax law which bans all self-dealing between a trustee and the trust with respect to which it is a fiduciary. Such a rule would also be consistent with the trend of tax provisions enacted by the Congress since 1950 relating to exempt organizations.[1]

More specifically, it is recommended that private foundations be prohibited from engaging in any transaction with a donor or parties related to the donor involving the transfer or use of the foundation's assets.[2] Illustrative of the self-dealing transactions which a private foundation would be prohibited from entering into under this general rule (though the rule would not be limited to these transactions) would be—

(1) lending any part of its income or corpus to;
(2) paying compensation (other than reasonable compensation for personal services actually rendered) to;
(3) making any of its services available on a preferential basis to;

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[1] In 1962 the Congress, concerned with the possibility of self-dealing in the case of pension trusts established by self-employed taxpayers, placed a general prohibition on self-dealing between the self-employed person and his pension trust. Briefly, this provision prevented such a trust from—
(1) lending any part of its income or corpus to;
(2) paying any compensation for personal services to;
(3) selling any of its property to; and
(4) acquiring any property for the trust from—
a self-employed person covered by the trust or certain parties connected with such persons (sec. 503(j)).
The Revenue Act of 1964 also imposed a general prohibition on self-dealing transactions in the case of private foundations eligible to receive "unlimited contributions." Under these rules such a private foundation may not—
(1) lend any part of its income or corpus to;
(2) purchase more than a minimal amount of property from; or
(3) sell more than a minimal amount of property to—
the donor and certain parties connected with the donor (sec. 170(g)(4)).

[2] The definition of a private foundation should include a trust which makes distributions to charitable and noncharitable parties. The absolute prohibition on donor-foundation transactions would not, of course, prevent such a trust from making distributions to the donor or members of his family which are required under the terms of the trust instrument.

(4) purchasing or leasing its property from; and
(5) selling or leasing its property to—

the donor and certain parties who are so closely connected with the foundation as to lead to potential abuse. Indirect transactions, such as a loan by the donor to a corporation which he controls—followed by a gift of the corporation's note to the foundation, would also be prohibited.

A permissible exception to this rule would allow a foundation to purchase incidental supplies from the donor or business organizations with which he may be connected. This would, for example, allow a foundation to purchase its office supplies from a stationery concern owned by a contributor.

A second exception which may be appropriate would permit the donor and certain donor-related parties to purchase at fair market value those assets which the foundation would be required to dispose of under the recommendations set forth in subsequent portions of this report.

The only other exception which should be made would allow a donor to make an interest-free loan to a foundation if such a loan were to be used for bona fide charitable purposes. Such a transaction would not appear to raise a danger of abuse.

The desirability of permitting a foundation to purchase property from a donor where the market value of the property can clearly be established and the purchase price is substantially less than such market value has been considered. Such an exception, however, would be unwise. First, it would encourage a donor to sell appreciated property to a foundation for an amount equal to his cost and claim as a charitable contribution the difference between his cost and market value. Such transactions, commonly referred to as "bargain sales," allow a donor to contribute only the portion of the value of the property which represents unrealized (and untaxed) appreciation and to obtain cash equal to his cost without the imposition of any tax on the untaxed appreciation. Such transactions give unusual benefits to the donor and, at least in the area of private foundations, should not be encouraged. Second, and perhaps more important, it is not always possible to distinguish between property whose value can be readily ascertained and property whose value it is difficult to ascertain. Such a rule, therefore, would be difficult to administer. Furthermore, a distinction between stocks which are traded on a stock exchange or in an over-the-counter market and stocks which are not, as such a rule would probably entail, would introduce a discriminatory feature into the law of private foundations. For these reasons the exception would not be desirable.

To make these suggested rules fully effective, the existing definition of parties who are considered to be related to the donor should be expanded somewhat to include corporations in which the donor and the members of his family own 20 percent or more of the stock. Directors, officers, and persons who hold 20 percent or more of the stock of a corporation which is a substantial contributor to a foundation should also be considered donor-related parties. This would, in effect, prevent a company foundation from lending its funds to an officer of its major contributor. In addition, a donor to a private foundation should not be permitted to enter into financial transactions with a business corporation which the foundation controls. Thus, if

a foundation owns a building, the donor should not be able to avoid the self-dealing rules by having the foundation place the building in a separate corporation which would then rent the building to the donor. Furthermore, this prohibition of financial transactions should be applied with respect to officials (directors, officers, trustees, etc.) of the foundation and parties who are related to such officials.

The imposition of a general prohibition of self-dealing, to be applied only to future transactions, would eliminate an unduly burdensome portion of the Internal Revenue Service's responsibility in auditing private foundations. Such a general prohibition would avoid the invitation to abuse now inherent in the present permissive standards and, coupled with strict sanctions for filing false information returns, would tend to be self-policing. Finally, the lessening of the opportunity to use charitable funds for personal purposes should speed the flow of funds into the charitable stream.

These suggested rules would introduce into the tax law the concept which is fundamental to the law of private trusts: it is better to forbid self-dealing and to strike down all such transactions rather than to attempt to separate those transactions which are harmful from those which are not by permitting a fiduciary (as is the donor when he is dealing with charitable funds) to justify his representation of two interests.

From the standpoint of society as a whole, little if anything would be lost if a general ban upon self-dealing were adopted and much would be gained. A private foundation, especially if it is in corporate form, is usually not limited to the "legal list" from which trustees must choose their investments. Since a foundation may choose from a wide range of possible investments, it is not necessary for it to invest in the business of its donor, or to lend him any money. Similarly, a party who engages in transactions with the foundation on a truly arm's-length basis could, by definition, engage in the same transactions, on the same terms, with strangers.

Accordingly, there appears to be no sound reason to allow donor-private foundation transactions. The imposition of a general prohibition of self-dealing properly limits the deduction for charitable donations to only those situations in which the donor has completely parted with the donated property and thus has committed it without reservation to charitable purposes.

B. DELAY IN BENEFIT TO CHARITY

(1) *Introduction*

Under existing law an immediate deduction is allowed for gifts to both operating [3] and nonoperating private foundations. In the case of contributions to operating foundations, an immediate deduction is considered appropriate because the funds generally find their way into the charitable stream within a short period after they are received by the foundation. Thus the delay between the loss of tax revenue and the benefit which accrues to the public from having an equivalent amount of funds devoted to an active charitable program is often not substantial.

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[3] The Revenue Act of 1964 contains special rules for "unlimited gifts" to private operating foundations For the purpose of such rules a private operating foundation is defined as a privately supported organization which has substantially more than one-half of its assets directly devoted to active charitable activities (sec. 170(g)(2)(B)). Such an organization must also expend substantially all of its income for charitable purposes on a current basis. This definition could also be used to distinguish between operating and nonoperating private foundations for purposes of this section.

Contributions to nonoperating foundations, however, are often neither devoted to an active charitable program nor distributed to operating charities. Instead, such contributions are often retained by the foundation as principal, to be used to generate income which is to be distributed to operating charities as it is received. In such cases there is usually a significant lag between the time of the contribution, with its immediate effect upon tax revenues, and the time when the public benefits by having an equivalent amount of funds devoted to charitable activities.[4] Many assert that the value of having a source of uncommitted funds which can easily move from one charitable area to another outweighs this delay. Under this approach it is sufficient if the private nonoperating foundation invests the contributions which it receives in assets which generate a reasonable amount of income and distributes such income to operating charities on a reasonably current basis.

Where, however, a nonoperating foundation invests its funds in assets which do not generate a reasonable amount of current income or retains the income generated by its investments (except for situations in which income is accumulated for a specific charitable purpose), the justification for the present treatment does not apply. In such a case the need for corrective action is evident.

While the causes of undesirable delay in benefit to charity are closely related, they can be more easily identified if they are examined separately. Therefore, this section of the Report will first consider whether existing law relating to the withholding from charity by private nonoperating foundations of their current realized income is adequate. The discussion will then proceed to a consideration of the desirability of rules which would deal with situations in which the managers of a private nonoperating foundation invest the foundation's funds in non-income-producing assets.

(2) 1950 legislation—existing law

The undesirable delay in benefit to the public which results when a private nonoperating foundation is permitted to retain a substantial portion of its current income was recognized by the Congress when it enacted the Revenue Act of 1950. In considering the problems which arise when a foundation is permitted to retain its income, the Ways and Means Committee expressed its view that—

> the tax-exemption privileges with respect to investment income should be restricted to that portion of the income which [foundations] demonstrate that they are using to fulfill their charitable, etc., purposes by actual distribution to charity as the income is received by them (H. Rept. 2319, 81st Cong., 40 (1950), 1950-2 Cum. Bull. 411).

The House in 1950 believed that the ability to accumulate income often delays the time when charity and hence the public can receive the benefits which preferential tax treatment is intended to foster. To eliminate this delay, the House version of the Revenue Act of 1950 would have generally taxed the portion of an exempt organization's investment income (excluding capital gains) which the organization did not currently distribute for the charitable purpose for which it was granted an exemption. One exception to this general rule would

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[4] The delay in benefit to charity which is inherent where the contributed funds are retained as principal has led to suggestions that since charity must wait for its benefit, the donor's benefit—the tax deduction for the amounts which he contributed to the foundation—should also be delayed. The adoption of this proposal, which w0uld generally require a private nonoperating foundation to expend its principal, is not recommended by the Treasury Department.

have permitted tax-free accumulations of current income to the extent such accumulations were placed into special 5-year trusts which specified the purpose for which the accumulated funds were to be used. Another exception would have allowed a tax-free accumulation equal to 1 year's investment income.

The Senate, although recognizing that some organizations had abused the privilege of tax exemption by accumulating large amounts of income, rejected the direct tax on accumulations favored by the House. Instead it adopted a rule requiring that information disclosing the extent of an exempt organization's accumulations be made available to the public.

In conference, the present rules were adopted as a compromise. These rules, which are now contained in sections 504 and 681 of the code, provide that exempt status shall be denied to an otherwise qualifying organization for the year that its accumulated income is—

(1) *unreasonable* in amount or duration,

(2) used to a *substantial* degree for purposes other than those constituting the basis for the organization's exemption, or

(3) invested in such a manner as to *jeopardize* the carrying out of the function constituting the basis for the organization's exemption.

The regulations implementing these provisions generally exclude a foundation's capital gains in determining whether its accumulated income is unreasonable.

(3) Evaluation of existing law

Fourteen years of experience have indicated that in this context standards such as "unreasonable," "substantial," and "jeopardize" are inadequate as well as difficult and expensive to administer. The lack of definite rules leads to uncertainty, not only in the minds of those charged with the responsibility of administering this provision, but also in the minds of foundation managers who are aware that departure from the uncertain path of "reasonable" accumulations may result in loss of exemption.

The difficulty in administering current law can be illustrated by a recent Tax Court case in which a foundation with a net worth of approximately $1,000 purchased a 34-acre tract of industrial real property for $1.15 million. This purchase was financed with advance rentals of $154,000 received from a lessee and by loans of $1 million. Since the foundation used approximately 80 percent of its income for the 5 years following the purchase of the property to retire its debt, the Service revoked the foundation's exemption ruling on the grounds of an "unreasonable" accumulation. However, the Service's revocation was reversed by the court which held that the accumulation was neither "unreasonable in amount or duration" nor used to any "substantial degree for purposes or functions other than those constituting the basis for such organization's exemption." *Shiffman* v. *Commissioner*, 32 T.C. 1073 (1959).

Another litigated case involved a foundation which was established to provide pensions to the employees of an investment company in which the donor was a minority shareholder. If the income generated by the donated assets would have been used to provide an immediate benefit to eligible employees, payments of approximately $15 per month could have been provided. To increase the benefits to $60 per month, the trustees decided to retain and add to corpus the income

generated by the foundation's assets during a 10-year period. The Internal Revenue Service contended that such an accumulation was unreasonable. A Federal district court, however, felt that the accumulation of income for the purpose of increasing the amount of income which could be distributed for exempt purposes in the future did not constitute an unreasonable accumulation. *Truscott* v. *United States*, 58–1 USTC ¶9515 (E.D. Pa. 1958) (CCH). The reasoning of the court's decision has been interpreted by some as sanctioning a 10-year accumulation of income merely to increase the size of a foundation's corpus.

These court decisions, in effect, tend to frustrate the present ban on "unreasonable" accumulations except in the most blatant cases. They also indicate that existing law does not provide the results intended by Congress in 1950.

The survey of tax-exempt foundations recently completed by the Treasury Department indicated that in 1962 approximately one-fourth of all private foundations did not expend for charitable purposes an amount equal to their net ordinary income.[5] For example, the A foundation accumulated virtually all of its 1962 net ordinary income of approximately $600,000. The B foundation accumulated virtually all of its 1962 net ordinary income of $2 million. The C foundation accumulated approximately $900,000 of its 1962 net ordinary income of approximately $1.6 million. The D foundation accumulated approximately $1.3 million of its 1962 net ordinary income of approximately $2.5 million. The retention of income in situations such as these deprives the public of the benefit expected in exchange for the amount of current tax revenue which has been given up; namely, the expectation that an offsetting current charitable benefit would be provided by the foundation.

(4) Possible solution

(a) Distribution of realized income.—Because of the inadequacy of existing law and the Service's difficulty in administering the present permissive rules, it would be appropriate to adopt a rule which would give both taxpayers and the Service workable objective standards. It is therefore recommended that all private nonoperating foundations be required to distribute all of their current net income on a reasonably current basis. Such a requirement would insure that the interposition of a private nonoperating foundation between the donor and charitable activities will not result in undue delay in the transmission of benefits to their charitable destination.

Under this proposal a private nonoperating foundation would generally be required to expend the full amount of its current net income by the end of the year following the year such income is received. For this purpose income would include investment income such as rents, interest, dividends and short-term capital gains.[6] Long-term capital gains (including capital gain dividends paid by regulated investment companies) and contributions received by the foundation would not have to be distributed on a current basis. The purposes for which the income would have to be expended would be (1) contributions to publicly supported charitable organizations,

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[5] For these purposes net ordinary income was defined as total income (excluding capital gains) less expenses incurred in earning such income.

[6] Net income would be total income after deduction of expenses of earning such income. Current operating expenses would be treated as a current expenditure for charitable purposes.

(2) contributions to privately supported operating organizations (but not privately supported nonoperating organizations), (3) direct expenditures for charitable programs, and (4) purchases of assets which the foundation uses as part of its program of charitable activities.

This proposal is illustrated by the following example: In 1966 the X foundation received dividend and interest income of $100,000, realized a long-term capital gain of $50,000 and received contributions of $25,000. The foundation would be required to expend $100,000 for the purposes described in the preceding paragraph. This expenditure could be made in 1966 or 1967, or part in each year. However, if all or a part of the expenditure is made in 1967, such expenditure could not be treated as satisfying the expenditure requirement for that year. Thus, if the foundation made no distributions in 1966 but expended $100,000 in 1967, such expenditure could not be used to satisfy the expenditure requirement for both 1966 and 1967. Assuming that the foundation received investment income of $110,000 in 1967, the foundation would have to expend an additional $110,000 (making a total of $210,000) in 1967 or $100,000 in 1967 and $110,000 in 1968.

The allowance to private nonoperating foundations of an additional year after receiving income in which to make the necessary expenditures will permit such foundations to budget their expenditures and to investigate various uses for their funds before having to make the required outlays.

Two exceptions to this rule seem desirable. The first would allow a foundation to treat as an expenditure amounts which are set aside for a definite charitable purpose which the organization must identify at the time the funds are set aside, provided the purpose requires accumulation by the foundation for its accomplishment rather than, for example, by the intended charitable recipient. Such earmarked funds, however, would have to be actually expended within a specific period—such as 5 years—with an extension to be granted if the organization can demonstrate good cause.

A second exception would allow a private nonoperating foundation to accumulate its income to the extent that it had, during a prior specified period—such as 5 years—expended amounts in excess of its income for such period. This exception, which would act as an averaging mechanism, would allow a foundation to make an immediate gift to an operating charity out of corpus and recoup its expenditure out of future earnings. In an appropriate case, both exceptions could be combined.

A requirement that all private nonoperating foundations distribute their income on a reasonably current basis would be consistent with those provisions in the Revenue Act of 1964 relating to private nonoperating foundations which can receive unlimited contributions.[7] Such a rule would not require most foundations to change their existing distribution patterns. As noted above, approximately three-fourths of all foundations would have met the requirement suggested above in 1962. Some of the remaining one-fourth would have met the test if they were allowed to treat earmarked accumula-

[7] The abuse which exists when a private nonoperating foundation does not distribute all of its ordinary income on a reasonably current basis was recognized by the Congress when it enacted rules dealing with unlimited contributions to such organizations. The approach contained in the 1964 act requires private nonoperating foundations receiving unlimited contributions to distribute not only all their income but one-half of such unlimited contributions as well. [Sec. 170(g)(3).] The recommendation explained above would not require a foundation to expend funds received as contributions.

42-663—65——3

tions and charitable expenditures made in 1963 as distributions made in respect of 1962, as would be permitted under the recommendation discussed above. Of those who would not have met the requirement, many would have had to increase their charitable expenditures only by relatively small amounts. While this recommendation, therefore, would not affect the vast majority of foundations, its adoption would prevent extreme accumulation situations (unless they involved the exceptions noted above) such as those described earlier in this section.

(*b*) *Income equivalent.*—The ability of foundation directors to withhold current charitable benefits from the public merely to build a larger fund of capital—even though the purpose of the accumulation is to increase the amount of income which the foundation will receive (and distribute to charity) at some date in the future—constitutes an abuse. The recommendation described above is designed to eliminate this abuse when it takes the form of a direct accumulation—the building up of corpus out of retained interest, rents, dividends, and so forth. However, that recommendation in itself will not prevent foundation officials from engaging in indirect accumulations—the building up of a foundation's capital by investing in or retaining assets such as unimproved real estate, growth stocks and other assets which may not generate substantial amounts of current income but which often compensate for the forbearance of current income in the form of future capital appreciation.[8] The ability to increase the size of a nonoperating foundation's corpus by withholding a current benefit from the public is as much an abuse when it takes the form of an indirect accumulation as when it takes the form of a direct accumulation. In order to eliminate the problems in this area, therefore, it is also necessary to prevent indirect accumulations.

To insure that all private nonoperating foundations provide at least a minimum current benefit to charity it is recommended that there be established a "floor" below which the current benefits provided by the foundation to the public would not be permitted to drop. Such an approach could provide that if a private nonoperating foundation's income, and therefore its required payment to charity under the direct-accumulation proposal, falls below a specified percentage of the value of its holdings, the foundation would have to pay to charity, from its corpus, an amount which would approximate the income which it would have received had it invested its funds in the type of assets held by comparable organizations. If the foundation's current income (and therefore the amount required to be distributed to charity) exceeded this income equivalent, no distributions out of corpus would be required. Thus, the combination of the direct accumulation and the indirect-accumulation proposals would generally require a private nonoperating foundation to currently distribute its actual ordinary income or the foundation's "income equivalent," whichever is higher.

The minimum level of charitable expenditures—i.e., the income equivalent—should be comparable to the yield on investment funds held by comparable organizations—such as universities. To provide

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[8] It has been suggested that assets such as growth stocks increase in value faster than income securities and therefore will, in the long run, produce more income for charity than income securities. Recent stock market history, however, has indicated that all growth stocks do not necessarily increase in value faster than blue-chip income securities. Moreover, even if growth stocks do increase in value faster than income securities, the proceeds which the foundation would receive upon the disposition of growth stocks would usually represent long-term capital gains which could be retained by the foundation under the direct-accumulation proposal. Finally, even if growth stocks do increase in value faster than income securities and the trustees of the foundation distribute the proceeds from the sale of the growth stocks to charity, the benefit to charity would be delayed until some indefinite date in the future when the trustees decided to sell the appreciated growth stock. This indefinite postponement of benefit to charity is inconsistent with the principle that charity should receive some current benefit from gifts made to private nonoperating foundations.

for changing market conditions, the Secretary of the Treasury should be given regulatory authority to determine this rate on an annual basis. Based upon existing market conditions, it would appear that a reasonable income equivalent would be in the range of 3 to 3½ percent.

The income equivalent would only be applied against a foundation's investment assets.[9] It would not be applied against assets which the foundation uses for its own charitable program. Assets which can be valued by reference to regularly available sources, such as quotations on a stock exchange or in an over-the-counter market, would be valued at their market value at the beginning of the foundation's annual accounting period. For other assets it will be necessary initially to use the value of the asset at the time it was acquired by the foundation. In the case of contributed assets, this value will be the same as the amount claimed by the donor as a contribution deduction. However with the passage of time such value is typically less than market value where the foundation continues to hold the asset. Therefore it will be necessary to revalue such assets periodically—perhaps every 5 years—and to use the value determined at such time until the next required revaluation. By using the market value as of the beginning of the year for assets which can easily be valued and a relatively constant value for all other assets, a foundation would always be able to determine well in advance of the end of its accounting period the amount which it would have to expend.

An exception for situations in which the foundation wishes to set aside its income equivalent for a definite charitable purpose which it can identify at that time should also be adopted. Such an exception would be similar to the exception suggested earlier with respect to accumulations of realized income.

Both the direct accumulation and income equivalent recommendations should apply to private nonoperating foundations which are presently in existence, as well as those created in the future. Existing organizations, however, should be permitted a reasonable period in which to adjust their investments in order to avoid having to spend corpus to satisfy the income equivalent requirement.[10]

It is recognized that the income equivalent proposal does not provide an adequate solution in all cases.[11] The fact that this proposal does not always assure that charity will receive a current benefit merely points out the need for special rules, such as those recommended in parts II(D) and III(A) of this Report, where the asset contributed to the foundation often does not generate any current income.

The two approaches described in this section are complementary and both are needed to prevent inappropriate delay in charitable benefits. These recommendations, together with those dealing with the treatment of specific types of assets, would provide a moderate and generally effective solution to the problems in this area. The combination of these approaches would impress upon the trustees of foundations the principle that fiduciaries should not ignore the present needs of charity in favor of concentrating on an increase in the size of the fund under their control merely to provide for some

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[9] The income equivalent would not be applied against assets with respect to which, under the recommendations set forth in subsequent portions of this report, the donor's contribution deduction has been postponed.

[10] Provisions for existing organizations whose underlying instruments require an accumulation of current income or prohibit an invasion of corpus may be desirable.

[11] For example, one asset may provide enough income to completely shelter a nonincome producing asset. In such a case charity would only receive funds generated by the income producing asset. Charity would not benefit from the nonincome producing asset, even though the public has paid for the receipt of that asset through a contribution deduction.

MAY 13 1965

unnamed cause at some indefinite time in the future. These approaches would go far in reminding trustees that foundations are expected to provide a source of current funds for charity and that they should not be used as vehicles to further delay the flow of funds from the original donor to operating charities.

C. FOUNDATION INVOLVEMENT IN BUSINESS

(1) The existing situation

A number of private foundations have become deeply involved in the conduct of active business enterprises. Ordinarily, the involvement takes the form of ownership of a controlling interest in one or more corporations which operate businesses; occasionally, a foundation owns and operates a business directly. Interests which do not constitute control may nonetheless be of sufficient magnitude to involve foundations in the affairs of businesses.

Example 1.—The A foundation holds controlling interests in 26 separate corporations, 18 of which operate going businesses. One of the businesses is a large and aggressively competitive metropolitan newspaper, with assets reported at a book value of approximately $10,500,000 at the end of 1962 and with gross receipts of more than $17 million for that year. Another of the corporations operates the largest radio broadcasting station in the State. A third, sold to a national concern as of the beginning of 1965, carried on a life insurance business whose total assets had a reported book value of more than $20 million at the end of 1962. Among the other businesses controlled by the foundation are a lumber company, several banks, three large hotels, a garage, and a variety of office buildings. Concentrated largely in one city, these properties present an economic empire of substantial power and influence.

Example 2.—The B foundation controls 45 business corporations. Fifteen of the corporations are clothing manufacturers; seven conduct real estate businesses; six operate retail stores; one owns and manages a hotel; others carry on printing, hardware, and jewelry businesses.

Example 3.—The C foundation has acquired the operating assets of 18 different businesses, including dairies, foundries, a lumber mill, and a window manufacturing establishment. At the present time it owns the properties of seven of these businesses. Its practice has been to lease its commercial assets by short-term arrangements under which its rent consists of a share of the profits of the leased enterprise. By means of frequent reports and inspections, it maintains close check upon its lessees' operations.

Example 4.—The D foundation owns a crude oil refining company to which it assigns a book value in excess of $32 million.

Example 5.—The E foundation controls a corporation which operates a large metropolitan department store. For its fiscal year ended January 31, 1963, the store reported gross sales of $78,395,052, gross profit of $32,062,405, and paid wages and salaries of $17,488,211. It stated the book value of its assets at that time to be $55,091,820.

Example 6.—Among the business interests owned by the F foundation is a substantial holding in a corporation which constructs machines for the manufacture of concrete blocks. The corporation has approximately 800 employees; its annual sales have ranged from $12 to $15 million in recent years.

These striking illustrations of foundation participation in business are not isolated phenomena, peculiar to a limited group of very unusual private foundations. On the contrary, the available information indicates that the involvement of foundations in business activities is frequent. Of approximately 1,300 private foundations recently surveyed by the Treasury Department, about 180 reported ownership of 10 percent or more of at least one class of the outstanding stock of a corporation. One hundred and nine foundations in this group own 20 percent or larger interests; [12] 40 hold 100 percent interests. Forty-three foundations reported that they possess 10 percent or larger interests in two or more corporations. A recent report on foundations states that, of 543 foundations studied, 111 owned 10 percent or more of at least one class of stock of a corporation.[13] Together these 111 foundations held interests of not less than the described magnitude (most were in fact considerably larger than 10 percent) in 263 separate corporations. In other cases, of course, foundations own and operate businesses directly.[14]

(2) Evaluation

Examination of any broad sampling of the commercial ventures of foundations reveals that several kinds of undesirable results frequently follow from them. In the first place, taxable businesses are often placed at a serious competitive disadvantage. Congress recognized this problem in 1950, and, by the Revenue Act of that year, aimed at solving it. The statute which resulted subjects the so-called unrelated business income of foundations and certain other exempt organizations to tax at ordinary rates and removes the immunity formerly enjoyed by "feeder" organizations—entities primarily engaged in business, whose sole claim to exemption is the turning over of profits to exempt entities.

Fourteen years of experience under these rules, however, has demonstrated that organizations which pay careful heed to the exceptions prescribed by the 1950 act and retained in the 1954 code can frequently shield their commercial enterprises from tax. Because of the fact that the unrelated business income tax does not, for example, apply to rents derived from property with respect to which the lessor has no outstanding indebtedness, foundations are able to lease business assets owned free of debt to operating subsidiaries, siphon off most or all of the business profits by means of rent which is deductible by the subsidiary but not taxable to the parent foundation, and thereby accumulate large reservoirs of untaxed capital which can be used to support the future operations of the business. Another exception to the unrelated business income tax immunizes rents stemming from a lease whose term is not longer than 5 years even if the lessor has an outstanding indebtedness with respect to the leased assets. The C foundation, referred to in example 3, is typical of the private foundations which have tailored their acquisitions of businesses to make use

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[12] Further information about the business ownership of those of these foundations which have assets valued in excess of $10 million is set forth in Appendix A.

[13] Patman Report, 1st installment, supra, p. 8.

[14] The transfer of businesses to foundations and other exempt organizations has been encouraged by decisions of several courts that, under the arrangements ordinarily employed for these transfers, the transferors are entitled to treat the proceeds which they receive as capital gains. E.g., *Union Bank* v. *United States*, 285 F. 2d 126 (Ct. Cls.); *Anderson Dairy, Inc.* v. *Commissioner*, 40 T.C. 172; *Commissioner* v. *Brown* 325 F. 2d 313 (C.A. 9th). The Supreme Court now has under consideration the question of whether or not, after such a transaction, the former owners of the business receive capital gains treatment where the exempt organization makes no downpayment other than from the assets of the business itself, has no fixed personal obligation to pay a purchase price, and is required simply to turn over a specified proportion of the future earnings of the business. *Commissioner* v. *Brown, supra*, certiorari granted June 8, 1964. Whatever the outcome of that case, however, it seems clear that substantial inducements for the transfer of businesses to foundations will remain.

of this exception. In the ordinary pattern of these acquisitions, the foundation contracts to purchase the stock of a business corporation for future payments, liquidates the corporation, leases its assets to a newly formed operating company for a 5-year term,[15] and applies the rents—usually fixed at 80 percent of the before-tax profits of the business—to the discharge of the stock purchase obligation. The ability of the foundation to receive the proceeds of the business operations in the form of tax-free rent enables it to pay a much higher price for the corporation than a nonexempt purchaser could afford.[16] A third and rather elaborate exception to the unrelated business income tax immunizes rental income which foundations realize in certain sorts of situations not qualifying for the first two exceptions.[17] All of these foundations compete with similar businesses owned by nonexempt taxpayers, who must pay for their acquisitions, finance their operations, and support their expansion programs with the funds which remain after taxes have been paid.

Moreover, even if the laws governing the taxation of unrelated business income of foundations and feeder organizations contained no avenues permitting business profits to escape tax, commercial enterprises conducted or controlled by private foundations would still possess significant competitive advantges over those owned by taxable entities. Because contributions to foundations may be deducted by the contributors for Federal income tax purposes, the capitalization of foundation businesses is accomplished with tax-free dollars, rather than after-tax dollars. A corporation which wishes to allocate $1 million of its gross earnings to the establishment of a taxable business subsidiary, for example, would be able to contribute only $500,000 of capital to the subsidiary after Federal income taxes have been paid; but the same corporation could create a foundation to operate the business, deduct its capital contribution, and have a full $1 million available for the business operation. Again, the tax immunity of dividends, interest, and other proceeds stemming from passive sources enables foundations to supply capital to their business endeavors with exempt income. Neither of these benefits is available to nonexempt commercial enterprises. Both benefits contribute materially to the ability of a foundation to subsidize its businesses during periods of difficulty and to expand them during periods of growth.

Example 7.—When modernization of its textile mill facilities appeared desirable in 1958, the G foundation had sufficient funds available to make an additional $4 million capital contribution to its operating subsidiary.

Example 8.—The H foundation has been able to sustain the operations of one of its department store subsidiaries with a 1956 loan of $1,400,000 (at 4½ percent interest) and a currently outstanding loan of $200,000 (which bears no interest).

Example 9.—The I foundation has advanced more than $3 million to support the business of one of its foreign subsidiaries.

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[15] The foundation may or may not control the lessee corporation; the C foundation's practice is to lease to an independent corporation. In either event, the connection of the foundation with the business remains a close one. Since the lease bases the determination of rent upon the profits of the business, the foundation has a direct financial reason to be concerned with the conduct of the enterprise. Because of this interest, the foundation customarily reserves and exercises a right to maintain close supervision over the management of the business. The C foundation typically retains the additional right to approve the holders of a majority of the lessee's stock.

[16] Transactions of this kind have received widespread attention—and recommendation—in tax literature and other publications. See e.g., "Boosting Profits: Have You Put a Price on Your Business? You May Be Able To Double It—By Selling to a Charity," Prentice-Hall Executives Tax Report, June 24, 1963, p. 6; "Recent Cases Show How Best To Sell a Business to a Tax-Exempt Organization," Journal of Taxation, November 1963, p. 302.

[17] Internal Revenue Code of 1954, sec. 514 (b)(3)(B).

Example 10.—A recent report on foundations sets forth details of the numerous loans which the J, K, and L foundations made during the period from 1951 through 1961 to various of the business corporations in which they held controlling or substantial interests. [18] The total of this indebtedness on December 31, 1956, was $1,897,605. These foundations appear to have entered into at least 36 separate loan transactions with their corporations during the designated period, many involving sums in excess of $100,000.[19]

Another advantage which foundation businesses have over their taxable competitors is their freedom from the demands of shareholders for current distributions of earnings. A remarkable number of foundation-owned enterprises proceed from year to year realizing substantial profits, but making negligible or no distributions to their parent organizations.

Example 11.—The A foundation, referred to in example 1, received no dividends for either 1961 or 1962 from its newspaper corporation, its lumber company, or its S, T, or U real estate corporations, despite the fact that all of those companies earned substantial profits during both years.

Example 12.—The M company, a department store, entered its fiscal year ending in 1961 with a retained earned surplus of almost $4 million. During that year and the 2 following years it enlarged this surplus with earnings of $365,819, $193,450, and $149,320, respectively. It paid no dividends to its parent foundation during any of these years.

Example 13.—The dividends which the E foundation, referred to in example 5, has received from its department store subsidiary for the years 1960 through 1963 have ranged from less than 1 to 1½ percent of the book value of its equity in the corporation, as reflected on the corporation's February 1, 1962, balance sheet. In each of these years the store's after-tax net income has been considerably more than twice as much as the total dividends paid.

This common willingness of foundations to defer indefinitely the realization of profits from their commercial operations—an attitude frequently not shared by the shareholders of other businesses—makes it possible for the profits to be invested in modernization, expansion, and other programs which improve the competitive posture of the foundation-owned business.[20]

The various advantages of foundation-held businesses can make them formidable and successful competitors.

Example 14.—The X evening newspaper, owned by a foundation, has one competitor, the Z morning newspaper. Z has been in operation for a number of years and has very substantial financial resources. X, however, appears to have made competitive efforts which neither Z nor other newspapers of com-

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[18] Patman Report, 2d installment, supra, pp. 44–45.

[19] The recommendation of Part II–E(2) of this report—that restrictions be imposed upon foundation lending practices—deals with problems fundamentally different from that of unfair competition, and would have limited effect in the area of the present inquiry. Foundation loans to affiliated businesses could frequently be brought within exceptions to that recommendation (as, for example, private placements or obligations secured by first mortgages), and if, in a particular situation, the proposed limitations appeared troublesome, the foundation might well simply decide to furnish funds to its business by means of a capital contribution, rather than a loan.

[20] The requirement recommended in the preceding section of this report—that foundations make annual charitable disbursements at least equivalent to a prescribed percentage of the value of their assets—would not remove this advantage of foundation businesses. In many cases foundations will be able to comply with this requirement by making payments from contributions, income derived from nonbusiness assets, or proceeds arising from the liquidation of other holdings. Such foundations will have no greater reason to make demands upon their commercial subsidiaries for the distribution of business earnings.

parable size elsewhere in the country have been able to duplicate. X utilizes seven wire services; other newspapers of similar size have from one to three. X publishes seven separate editions each day; Z publishes five; no comparable evening newspaper in the country publishes seven. X's normal subscription rate is $2 a month; Z's has been forced down to $2.25; those of newspapers in comparable cities range from $2.20 to $3. X recently purchased the only other evening newspaper in the city. Its advertising rates appear to remain substantially lower than those of any similar newspaper in the country.

In addition to having adverse effects upon competitors, foundation involvement in business may occasion other, equally objectionable results. Opportunities for abuses of the kind with which parts II A and B of this report deal specifically are frequently greatest where a foundation conducts or controls a business. Temptation for subtle and varied forms of self-dealing proliferate in such a situation. Remote relatives may be employed in the business; friends may be assisted; business acquaintances may be accommodated. However broadly drawn the restrictions upon self-dealing may be, many of the conflicts of interest arising in this area are likely to be sufficiently obscure or sufficiently beyond the realm of reasonable definition to escape the practical impact of the limitations. Making certain that none of the 800 employees of the F foundation's manufacturing business receive special benefits because of a relationship to one of the foundation's donors, or that none of the D foundation's $32 million oil refining business involves the transfer or use of money or property to or by parties related to the creator of the foundation, would entail enormous administrative burdens in itself, even if the danger of less definable abuses were not present.

Again, the problem of deferral of charitable benefits has been particularly pronounced in the foundation business setting. We have already noted the competitive advantage which foundation-controlled businesses commonly derive from the willingness of their owners to forego distributions of current profits. That same unconcern with the present realization of business earnings, manifested by many foundations, often delays the progress of funds to charity even when accumulation has no reasonable relation to business needs. The restrictions of existing law upon accumulations of income by businesses become operative only where a corporation is "formed or availed of for the purpose of avoiding the income tax with respect to its shareholders"; where the shareholders of the business are themselves tax exempt, the limitations may not apply. Similarly, the statute which prohibits unreasonable accumulations of income by foundations applies only to accumulations within the foundation itself; it does not prevent retention of earnings in a separate, though controlled, entity.[21] As a consequence, many foundations have permitted large amounts of income to accumulate in their business subsidiaries.

Example 15.—In 1962 the Y foundation had amassed almost $9,700,000 of undistributed earnings in one of its business subsidiaries, and more than $5,800,000 in another.

Example 16.—By the end of 1963 the O foundation had accumulated profits of $3,808,957 in its department store subsidiary.

When these funds will find their way to charity is, at best, a matter of conjecture. The moderate pressure provided by the payout re-

[21] Even if the accumulation restrictions of existing law were extended to these situations, their enforcement would require an arduous, case-by-case examination of each separate set of facts.

quirement recommended in the preceding section of this report—which, after all, merely fixes a basic floor for foundation performance in distributions—affords only a partial solution to the aggravated deferral problem which exists in the foundation business context.

The problem has another facet. A number of foundations have revealed a willingness to commit charitable funds to business operations which are failing or, at least, producing consistent losses.

Example 17.—The P foundation continues a printing and lithographing business which lost $66,000 in 1959, $36,000 in 1960, $142,000 in 1961, $150,000 in 1962, and an additional amount in 1963.

Example 18.—Twenty-four of the 53 business corporations controlled by the B foundation referred to in example 2, in 1956 lost money in that year, and most of those 24 showed net earnings deficits from previous years' operations. Fifteen of the 45 corporations which the foundation controlled in 1963 either had net losses in that year or had net operating loss carryovers to that year.

Example 19.—A construction subsidiary of the F foundation referred to in example 6, lost $22,920 in 1960, $17,133 in 1961, $41,023 in 1962, and $49,408 in 1963. At the end of 1962 the corporation's earned surplus account showed a net deficit of $199,818.

In all of these situations, charity bears the loss.

Participation by foundations in active business endeavors may also give rise to a problem of a different character. As the Introduction to this Report has pointed out, the private foundation is uniquely qualified to provide a basis for individual experimentation and the exercise of creative imagination. The framework of institutionalized charities can, in the nature of things, afford only limited scope for the development of individual insights, the testing of new approaches, the exploration of uncharted areas. But the private foundation—easily established, inherently flexible, and available even to those with relatively restricted means—can be utilized for precisely these ends. Indeed, many would argue that the private foundation derives the principal justification for the favorable tax treatment accorded it from its particular suitability for use by those who are concerned with, and devoted to the development of, new areas for social improvement. This special virtue of the foundation assumes that the individual or group in control will, in fact, be devoted to the development of these new areas; that the primary concern will be with social aims. But where a foundation becomes heavily involved in business activities, the charitable pursuits which constitute the real reason for its existence may be submerged by the pressures and demands of the commercial enterprise. The directors of a foundation which owns 26 widely diverse businesses must of necessity devote a very considerable portion of their time and energies to the supervision of business affairs; and charity's claim upon their attention may well suffer. Business may become the end of the organization; charity, an insufficiently considered and mechanically accomplished afterthought. Little may remain to distinguish the directors of such a foundation from the self-perpetuating management of a publicly owned business corporation, without the balance supplied by watchful shareholders. Unrestricted involvement in business may, then, undermine the very ability of the private foundation to make its unique contribution to our society.

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.

associated personal property) which are of a clearly passive nature; and rent arising from such leases should not be deemed to derive from the conduct of a business.[23]

Rules similar to those of section 513 of the present Internal Revenue Code should be used to distinguish businesses which are substantially related to the foundation's exempt operations from those which are not. The three specific exceptions of section 513 should be continued: a business should not be considered unrelated if (1) substantially all of the work in carrying it on is performed without compensation; (2) it is carried on primarily for the convenience of the members, officers, or employees of the foundation; or (3) it consists of selling merchandise substantially all of which has been received as gifts or contributions to the foundation. Under the section 513 rules, a number of activities would fall beyond the ambit of the recommended prohibition. A foundation which solicits and receives as contributions old clothes, books, or furniture, for example, could conduct a business of selling those articles to the general public. A foundation engaged in the rehabilitation of handicapped persons could maintain a store to sell items made in the course of the rehabilitation training. Foundations would be permitted to operate cafeterias or restaurants primarily for the convenience of their employees.

Foundations should be afforded a specified reasonable period of time in which to reduce their unrelated business interests below the prescribed maximum limit. To provide flexibility to deal with situations in which the specified disposition period might work hardship, the Secretary of the Treasury should be given power to extend the period for a limited additional time in appropriate cases. Similar periods for disposition, similarly subject to extension, should apply in the future when a foundation receives a gift, devise, or bequest which involves business ownership beyond the permissible level. An exception to the general disposition requirement would seem advisable for existing foundations whose governing instruments, as presently drawn, compel them to hold specified business interests, if relevant local law prevents suitable revision of the controlling document. Foundations created in the future should, to qualify for tax exemption, be required to include appropriate prohibitions against business ownership in the documents under which they are organized.

D. FAMILY USE OF FOUNDATIONS TO CONTROL CORPORATE AND OTHER PROPERTY

(1) Two widely practiced tax devices

Foundations have commonly been established as convenient vehicles for maintaining control of a private corporation within a family while substantially diminishing the burden of income, gift, and estate taxes for the family. Two somewhat different techniques have been used to accomplish this result. Some taxpayers have contributed voting stock in a corporation which their family controls to a foundation which the family also controls. In this way, they obtain income- and gift-tax deductions for the donations, eliminate the impact of the estate tax upon the value of the contributed stock, and achieve tax-free transfer of dominion over the corporation to the younger members of

[23] A specific exception would also seem advisable for the incidental rental of assets (real or personal) used primarily in a foundation's charitable operations.

the family by subsequently shifting control of the foundation to them. Other taxpayers have caused family corporations to be capitalized or recapitalized with substantial blocks of nonvoting stock. By contributing that stock to a foundation, the older generation secures the current income and gift tax advantages of the contribution and then transmits the voting stock—now representing a diminished proportion of the value of the equity of the corporation and, therefore, largely or entirely sheltered from gift or estate taxes—to the younger generation.

The availability of these devices has received widespread attention in tax and business publications. An excerpt from the May 7, 1960, issue of Business Week magazine (p. 153) is illustrative:

> *Have you ever thought about setting up a "family foundation"?*
>
> * * * * * *
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> However, before you get serious, there are two prime questions: First, are there certain philanthropies (religious, educational, medical, etc.) that you'd willingly devote considerable time and money to in later years? And second, *do you have a sizable family business that you want to pass control of to your heirs, despite crippling Federal estate taxes?* If your answers are "yes," then a private foundation could be a way to give your "estate plan" an entirely new outlook.
>
> *What is a foundation?* It's a nonprofit organization with its own capital fund, that uses its resources solely for public welfare. It can be a State-chartered corporation, or a trust, or an unincorporated association. *If properly set up (with special Treasury-approved tax status) it pays no Federal taxes at all; yet it can be kept entirely under the control of its founder and his family.*
>
> *The real motive* behind most private foundations is keeping control of wealth (even while the wealth itself is given away).
>
> Take the typical case: Say the bulk of your property is in a family business. When you die, if you have a high-bracket estate, the estate tax could cause a forced sale of part or even all of the business—your children might lose control of the company, as well as have to sell their shares at a poor price.
>
> A foundation can prevent this. You set it up, dedicated to charity. *Year by year, you make gifts of company stock to it, until the value of your remaining holdings is down to the point where eventual estate taxes could be paid without undue strain, or until the foundation's holdings constitute firm control of the company.* You maintain control of the foundation while you live; you direct its charitable activities—and so, indirectly, you control the shares in your company that have been donated. When you die, control of the foundation passes from you to your family or other persons youtrust and thus they, in turn, keep reins on the business.
>
> * * * * * *
>
> [The italics are those of the original.]

Recurrent advice of this kind appears to have led many taxpayers to establish and utilize private foundations for the purposes suggested. The recent Treasury Department survey described in Appendix A disclosed a large number of foundations whose principal asset consists of stock in a corporation in which the foundation's donors, officers, or related parties retain substantial interests. Of the approximately 180 surveyed foundations [24] which hold 10 percent or more of at least 1 class of stock of a corporation, 121 reported ownership of family corporation stock.[25] Such ownership appears to be particularly concentrated among foundations of medium size—those whose total asset value is between $100,000 and $1 million. Of the 39 such foundations canvassed which have stock holdings of the noted magnitude, 32 own family corporation stock.

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[24] A total of approximately 1,300 foundations were covered by the survey.

[25] The term "family corporation stock" is used here in a sense consistent with the recommendation outlined later in this section. The situations to which the text refers, hence, are those in which both the foundation and a donor (and/or related parties) own stock in a given corporation and, together or separately, they hold at least 20 percent of the corporation's voting power.

Example 1.—The A foundation holds approximately 21 percent of the common stock of the A corporation, possessing a book value of more than $2 million. Substantial contributors to the A foundation and related parties own approximately 60 percent of the corporation's common stock.

Example 2.—By both inter vivos and testamentary transfers, the B foundation has received substantial holdings of the nonvoting common stock of two corporations which continue to be controlled by the B family.

Example 3.—The C and D foundations' principal donor owns all of the voting stock of the C corporation. Members of his family and he have given 106,000 shares of that corporation's class B nonvoting stock to the C foundation; they have given 80,000 shares of this stock to the D foundation.

(2) Evaluation

The use of private foundations to perpetuate family dominion over business creates situations which frequently contain, in their most aggravated form, problems of the sort which have been discussed in the preceding sections of this part. Plainly enough, the dangers of foundation involvement in business are at least potentially present in all of these situations. Moreover, because of the donor's retention of control over the dividend distribution policy of the corporation, the benefits which charity ought to receive from the contribution of stock to the foundation are frequently deferred indefinitely or absent altogether. Since the stock is closely held and ordinarily unmarketable, the foundation—even if it is not subject to the donor's influence—has little choice but to hold the shares and hope for dividends; and the donor often proves unwilling—or the corporation unable—to pay them. Yet, by arranging redemption of token amounts of the stock or by causing an atypical, but strategically timed dividend distribution, the donor may very well be able to sustain his claim that the stock has substantial value and entitles him to a large deduction on its contribution to the foundation.

Example 4.—The recent Tax Court case of *Pullman* v. *Commissioner*, T.C. Memo. Dec. 1964–218, affords an excellent illustration of these problems. The taxpayers there, in control of a clothing corporation, arranged the recapitalization of the corporation with 8 percent preferred stock, nonvoting common stock, and voting common stock. They then made gifts of the preferred stock to various relatives and donated large portions of the nonvoting common stock to a family foundation. They also donated small blocks of the nonvoting common stock to two independent charities, and had the corporation redeem these blocks shortly after the contributions at approximately book value. In its 19-year history the corporation had paid dividends of more than 8 percent only once: in 1959—which was one of the years in which a major contribution of stock was made to the foundation—8 percent was paid on the preferred stock and an additional 3 percent was paid on the nonvoting common stock. Nonetheless, despite the existence of the preferred stock, with its large prior claim upon the profits of the corporation and the consequent unlikelihood that the common stock would ever receive significant dividends, the Tax Court held that the trans-

fers to the foundation qualified for charitable deductions only slightly smaller in amount than the book value of the transferred stock.

Example 5.—Members of the A family claimed deductions of almost $2 million for their contributions of A corporation stock to the A foundation, referred to in example 1. The stock of this corporation paid no dividends from 1948 through 1957, and none for 1962 or 1963.[26] While small dividends were declared in the years 1958 through 1961, they appear to have produced less than $5,000 a year for the foundation.

Example 6.—Beyond the immediate members of the B family, no market exists for the stock owned by the B foundation (referred to in example 2) in two family corporations, and the foundation has never received any dividend on either holding.

Example 7.—In only 1 of the last 6 years have the C and D foundations, referred to in example 3, received dividends on their large holdings of nonvoting stock in a corporation controlled by their principal donor.

Extreme delay or entire absence of benefit to charity, then, is common in family corporation cases.

Also present in these cases—often with unusual severity and complexity—are the conflicts of interest characteristic of the self-dealing problems discussed in part IIA of the Report. Where the donor exercises decisive influence over both the foundation and the corporation, he faces difficult divisions of responsibility. When the corporation encounters financial difficulties, for example, his duty to the foundation may dictate efforts to dispose of its shares without delay; but liquidation of the foundation's interest may occasion adverse market consequences and thereby run counter to his obligation to other shareholders or his own self-interest.

Example 8.—The E foundation suffered heavily from the divided loyalties of its creators and managers. In 1953 substantially all of its assets were invested in the preferred stock of a corporation 50 percent of whose common stock was owned by these persons. The corporation's prospects appear even then to have been far from bright. As matters grew worse, the foundation maintained its holdings. In 1962, at the time of the last available information, the preferred stock had never paid any dividends, the corporation was on the verge of bankruptcy, and the assets of the foundation had become virtually worthless.

The donor's retention of a personal interest in the corporation may place him at odds with the welfare of the foundation in other ways. If he is in a high personal tax bracket, he may wish to have the corporation accumulate its earnings so that he can realize his gains by future sale of his stock and confine his tax to the rate prescribed for capital gains; but the foundation may require present funds for its charitable program. He may wish the corporation to employ his relatives; it may be best for the foundation that they not be employed. The donor will generally find it in his interest to have the corporate salary levels of family members fixed as high as is consistent with the requirement of the tax law that deductible compensation be "reasonable," for it makes little difference to them whether they receive the earnings of the corporation as dividends or salary, and the corpora-

[26] The foundation received its stock in the latter 1950's, 1960, and 1961.

tion may deduct only the latter. The interest of the foundation, on the other hand, lies in keeping salaries as low as is consonant with the employment of competent personnel. The requirements of charity may dictate current expenditures by the foundation; the donor may be tempted to have the foundation retain its funds to meet the possible future needs of the business. In all of these situations it is unrealistic to expect the donor, as director of the foundations, to bring to bear upon problems which involve his personal interest the same judgment which an independent party, concerned only with the welfare of charity, would employ.

Problems of the same nature arise where the donor contributes to a private foundation an interest in an unincorporated business, or an undivided interest in property, in which he or those related to him retain substantial rights. Current tax deductions have been claimed, for example, for contributions of rights in the air space over the donor's land, water rights adjacent to a private beach which the donor owns, or fractional interests in vacant land which the donor controls. Here again, because of the donor's close continuing connection with the property, it is hardly realistic to expect the foundation to make independent decisions about its use and disposition of the property.

While the abuses generated by family dominion over foundation property in many respects are similar to those dealt with by other portions of this Report, the problems here are sufficiently intensified, complex, and possessed of novel ramifications to require a special remedy. This Report elsewhere recommends that foundations be required to pay out annually at least a minimum approximation of a normal return upon their assets; but that requirement cannot obviate the need for foundations to have sufficient independent command over their assets to enable them to realize—whether by sale, conversion to more productive investments, or otherwise—the means to exceed the minimum when their charitable objectives demand it. Indeed, the payout rule may create pressures upon a foundation to liquidate other, useful assets in order to preserve its holdings of unproductive family corporation stock; or the rule may be satisfied simply by the donor employing the foundation as a conduit for his ordinary annual charitable giving—while charity continues to derive no benefit from the foundation's family corporation stock. Similarly, rules concrete enough to possess real efficacy in the prohibition of specific self-dealing practices cannot cope successfully and decisively with the subtle and continuing conflicts of interest which arise in the family stock situation. Finally, a foundation which is itself under the influence of a donor and which holds stock in a corporation controlled by the donor will, even where its stock holdings amount to less than 20 percent of the corporate equity, almost necessarily find itself involved in the business affairs of the corporation: for the foundation's stock will be used in combination with that of the donor and related parties to govern the commercial enterprise.

(3) Possible solution

To deal directly with the problems in this area, the Treasury Department recommends consideration of an approach which, for gifts made to private foundations in the future, would recognize that the transfer of an interest in a family corporation or other controlled property lacks the finality which should characterize a deductible

charitable contribution. Under this recommendation, where the donor and related parties maintain control of a business or other property after the contribution of an interest in it to a private foundation, no income tax deduction would be permitted for the gift until (*a*) the foundation disposes of the contributed asset, (*b*) the foundation devotes the property to active charitable operations, or (*c*) donor control over the business or property terminates. If disposition, application to active charitable uses, or cessation of control occurs after the donor's death but within 3 years of the date of death, the deduction would be granted for the donor's last taxable year; if none of the three qualifying events takes place within that period, the contribution would not be deductible for income tax purposes. Correlatively, this approach would treat transfers of such interests, made at or before death, as incomplete for all estate tax purposes unless one of the qualifying events occurs within 3 years after the donor's death (or an extension of that period determined by the Secretary of the Treasury to be appropriate). Absent such a post-transfer qualification, the contributed asset would be included in the donor's gross estate and would not give rise to an estate tax charitable deduction. Such transfers, similarly, would not be deemed to constitute gifts, within the meaning of the gift tax statute, until a qualifying event occurs.

For the purposes of this recommendation, control of an incorporated business would be presumed to consist of ownership of 20 percent or more of the total combined voting power of the corporation; control of an unincorporated business or other property would be presumed to consist of ownership of a 20 percent or larger interest in it. The presumption could be rebutted by a showing that a particular interest does not constitute control. In determining whether or not the donor and related parties possess control, interests held by the foundation should be attributed to them until all of their own rights in the business or other underlying property cease. A qualifying disposition of contributed property by a foundation could consist of a gift to another organization, in harmony with the foundation's own purposes, or a sale; but it would not include a gift to another private foundation, since the donor could not have secured a deduction by making a direct contribution of the controlled interest to such an organization. An application of contributed property to active charitable operations would occur through the permanent and direct commitment of the asset to use in the conduct of the active charitable pursuits for which the foundation was organized, if it was organized for such pursuits. Water rights or land, for example, would be applied to charitable uses when they are employed in the activities of a foundation which operates a beach or a park. Because of the rule requiring attribution of ownership from the foundaton to the donor, a termination of control, in the relevant sense, could come about by a reduction in the holdings of either the foundation or the donor and related parties; but the termination would be recognized only where no offsetting reacquisition by one of the specified parties occurs within a prescribed subsequent period. The value of the contributed property at the time of disposition, devotion to charitable use, or cessation of control would determine the amount of the income tax deduction to which the donor would become entitled. The amount deductible for estate tax purposes would be the value of the property on the date of

the donor's death or other governing date under the ordinary principles of estate tax law. If only a portion of the controlled property is disposed of or devoted to active charitable use, the donor would receive a deduction *pro tanto*.

Since they are designed to deal with different problems, the rule suggested here differs in a number of respects from the rule recommended in section C of this Part. The rule of section C would become operative where a foundation owns, in its own right, a 20 percent or larger interest in a business; the rule of the present section would be applicable even where the foundation's own interest in the business is less than 20 percent, if the total interests of the foundation, donor, and related parties constitute control. The two rules would overlap where a foundation has a 20 percent or greater interest in the business and a donor and related parties also have interests in it which, when combined with the foundation's ownership, amount to control. The rules would, however, have different consequences: the section C rule would require the foundation to reduce its ownership below 20 percent within a specified period of time; the section D rule would simply defer the donor's deduction for the contribution of an interest in the business until the foundation disposes of the contributed interest or donor control of the business terminates. The section C provision would apply both to the existing holdings of foundations and to those acquired in the future. The section D rule would apply only to contributions made to foundations in the future.

(4) Possible restriction of this solution

A possible modification of the proposal of the present section would postpone the donor's deduction only where, after the contribution, he and related parties control the business or other underlying property and, in addition, exercise substantial influence upon the foundation to which the contribution was made. Such a rule would permit an immediate deduction to a donor who transfers controlled property to a private foundation if he and related parties do not constitute more than a specified percentage of the foundation's governing body. Since many of the most troublesome problems in the family corporation-controlled property area are traceable to the conflicts of interests which result where the donor both dominates the corporation and has significant influence upon foundation decisions, this rule would confine the corrective measure to situations in which both of those elements are present.

The Treasury Department has analyzed this variation of the proposal with considerable care. Its examination of the matter has indicated that the modification would have the advantage of permitting immediate deductions in a limited number of situations in which gifts of controlled property to private foundations produce clear charitable benefits and appear to be accompanied by no concomitant abuses. On the other hand, two rather serious difficulties are inherent in the modification.

First, the task of achieving a satisfactory definition of "substantial donor influence" presents formidable problems. In proposing the imposition of a 25-year limit upon substantial donor influence over private foundations, Part II–F of this report suggests that a foundation be considered subject to such influence where a donor, members of his family, those with whom he has a direct or indirect employment

relationship, and those with whom he has a continuing business or professional relationship compose more than 25 percent of the group which manages the foundation. The approach employed by this definition has a number of advantages over others which have been considered. Yet, as the discussion in section F recognizes, it leaves open significant avenues for the exertion of donor influence. By appointing friends, neighbors, business acquaintances, or other persons beyond the enumerated categories to the foundation's board, a donor may be able to elude the impact of the rule even while he maintains real and effective influence upon foundation decisions. The availability of these techniques for avoidance does not constitute a substantial defect in a rule whose aim, like that of the Part II–F proposal, is to broaden the base of participation in the affairs of the foundation, bring fresh views to its councils, and, over time, remove it from the wing of the donor and his family. Even where the newly appointed board members are the donor's friends and neighbors, some of these objectives are likely to be attained immediately. With the passage of time, others will follow: neighbors and friends do not remain subject to the will of one's family permanently. Equally important, a donor who has been permitted to shape the nature of a foundation by specifying the terms of its organizational instruments and supervising its activities for 25 years will ordinarily have little motivation to circumvent the rule: with the advance of age and the imprint of his personality firmly fixed upon the foundation, he will be quite likely to follow the easier course of taking the law at its word and passing the management of the foundation to independent parties.

The considerations which make this definition adequate for the purposes of the Part II–F recommendation, however, possess diminished vitality when one turns to the family corporation situation. Here the tax benefits to be derived from avoidance of the deduction-deferral rule are considerable; and the motivation for avoidance is correspondingly great. To sustain this rule against manipulation, therefore, a definition of "substantial donor influence" would have to be capable of bearing greater stress than the time limitation provision could be expected to generate. Because of its inapplicability to the less easily identified areas of donor influence, the definition of part II–F might prove only partially sufficient to withstand the pressures created by inventive planners. Further, as the preceding discussion has suggested, the conflict-of-interest abuses in the family corporation area have been acute and aggravated; and a measure which requires an indeterminate period of time to reach complete effectiveness might permit some of those abuses to continue in the interim. Upon both of these grounds, the adequacy of the Part II–F definition to the needs of the remedy under this section appears subject to some question.

A second problem confronts the restriction of the controlled property rule to situations in which the recipient foundation is under donor influence. While conflict of interest is one of the arguments in favor of the controlled property rule, it is not the only one. Of equal force is the argument that retention of donor control over the corporation whose stock has been contributed makes the real value of what has passed to the foundation too subject to the continuing volition of the donor, too far within his future discretion, too completely within his persisting power, to justify the grant of an immediate tax benefit.

Since the donor has not yet conferred a clear and definite present benefit upon charity—so the argument proceeds—he has done nothing to warrant a present tax deduction. To this contention—based, as it is, upon a considerable body of experience to the effect that charity very frequently benefits little or not at all from gifts of controlled corporation stock—the suggested modification provides no answer; for the donor's continuing power over the corporation exists whether the foundation to which he gives the stock is subject to his influence or not. To limit the impact of the remedial measure to gifts to influenced foundations, then, may confine the remedy to only a part of the abuse.

The existence of these problems does not compel the conclusion that such a limitation is unworkable. After deliberation, Congress may determine that the possibilities for avoiding the definition of donor influence are not serious. A somewhat stricter definition than that used in Part II–F—perhaps restricting the donor and related parties to a smaller percentage of participation in the foundation's governing body—may reduce those possibilities significantly. Consideration of specific instances of the controlled property abuse may lead Congress to conclude that the portion of the problem to which the restricted rule would apply is the portion of major practical importance, and that the disadvantage of the broader rule—which may, concededly, defer deductions in a limited number of situations where no abuse is present—outweighs the advantage to be achieved by seeking to cover the remaining part of the problem. The controlled property rule should not, however, be restricted to gifts to influenced foundations without complete awareness of the difficulties which that restriction may entail and without clear assurance that adoption of the restriction will cause no serious impediment to the operation of the rule itself.

E. FINANCIAL TRANSACTIONS UNRELATED TO CHARITABLE FUNCTIONS

Private foundations necessarily engage in a number of financial transactions connected with the investment of their funds. However, experience has indicated that unrestricted participation by foundations in three classes of transactions which are not essential to their charitable or investment activities can produce seriously unfortunate results.

(*1*) *Foundation borrowing*

The great majority of private foundations appear to borrow very little money. The Treasury Department's survey of the character and value of foundation assets and liabilities has disclosed that, at the end of 1962, while foundations held assets reported to have a total book value of approximately $10,713 million, they had total liabilities [27] of only $244 million. Borrowings, in other words, accounted for less than 2½ percent of total foundation assets.

On the other hand, a limited number of private foundations have borrowed heavily, for a wide range of purposes not related to the conduct of their charitable functions.

Example 1.—In the years 1951 through 1962 the A, B, and C foundations, established and dominated by one person, borrowed

[27] Other than liabilities with respect to grants payable. The latter class of liabilities does not, of course, represent borrowing in any usual sense of the term.

money from 17 different institutions and a variety of individuals to acquire investment assets. On December 31, 1956, the total outstanding indebtedness which the foundations had incurred for this purpose appears to have been approximately $14,200,000. A recent report indicates that, during the 12-year period covered, the foundations entered into 130 separate investment borrowing transactions. Many of the transactions involved amounts of more than $100,000; several involved more than $1 million.[28]

Example 2.—The D foundation has also engaged in extensive borrowing. On March 29, 1957, the foundation borrowed $550,000 from a trust company at 4½ percent interest and used the proceeds to make a loan of the same amount to a corporation at an interest rate of 10 percent. On November 18, 1957, the foundation borrowed $450,000 from a trust company at 4½ percent interest to make a $500,000 loan to two corporations at 10 percent interest. A three-page schedule in a recent report on foundations lists the other borrowing transactions into which this foundation entered from 1951 to 1962 to obtain funds for investment.[29]

Example 3.—In one jurisdiction a number of foundations, organized with little or no capital funds of their own, have carried on extensive practices of purchasing oil payments with funds borrowed from banks. Liens on the oil payments secure the loans. The foundations retain, as their fee for acting as intermediary, the excess of the gross proceeds of the production payments over the principal and interest required to be paid to the banks. The E foundation is typical of this group. Organized in 1954 with no funds of its own, E had by 1961 incurred indebtedness of more than $14 million in connection with its oil payment transactions. Its net income from these ventures was $58,352 in 1959 and $68,510 in 1960.

Example 4.—A foundation involved in recent Tax Court litigation was established in 1948 with a $1,000 contribution. Its net worth remained at approximately that figure until 1951. In the latter year the foundation contracted to purchase a 34-acre tract of industrial real property for $1,150,000, and borrowed virtually all of the purchase price. Leasing the property back to the former owners and 11 other tenants under an arrangement carefully fashioned to protect all of its rental proceeds from tax, the foundation was able to discharge its purchase obligation in 5 years. In that span, therefore, the foundation had expanded the value of its holdings from a thousand dollars to more than a million dollars—without the necessity of seeking or receiving contributions. *Shiffman* v. *Commissioner*, 32 T.C. 1073.[30]

Example 5.—The F foundation typifies the private foundations which have acquired productive properties by means of so-called bootstrap transactions. In their usual form, F's bootstrap acquisitions have consisted of an agreement by the owners of productive property to transfer the property to the foundation for a price payable entirely, or almost entirely, from a specified share of the

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[28] Patman Report, second installment, supra, pp. 46–47, 54, 59.
[29] Patman Report, second installment, supra, pp. 61, 63–65.
[30] In the cited litigation the Tax Court upheld the foundation's claim to exemption against the Government's contention that, in applying approximately 80 percent of the rental proceeds from the property to the satisfaction of its loan obligation, the foundation had accumulated its income improperly.

future earnings of the property. The foundation ordinarily makes little or no down payment from its own assets and has no independent personal obligation for the unpaid portion of the price: If earnings are insufficient to enable it to make the payments required by the contract, the transferors' only rights are against the property itself. The foundation contrives to realize the earnings in tax-exempt form, commonly by leasing the property to an operating entity under terms intended to shelter the rent from unrelated business income tax. The F foundation has employed this technique to acquire most or all of the underlying assets of 18 separate commercial enterprises.[31] By arrangements of this sort, other foundations have been able to swell their holdings without risk to themselves or dependence upon contributors.

Foundation borrowing to secure funds for investment may have several unfortunate consequences. In many of the transactions of this class, private parties are able to shift a substantial measure of the financial benefit of the foundation's tax exemption to themselves. A foundation which can amortize a purchase obligation with tax-free proceeds from the purchased property, and which therefore will be able to acquire the property with little or no expenditure from its own assets, can frequently be induced to agree to a much higher purchase price than a taxable buyer would accept. Indeed, in the typical bootstrap sale of productive property to a foundation, where the foundation has no personal obligation for the purchase price and the only security for payment is the transferred property itself, the only contribution which the foundation makes to the arrangement is its tax exemption. The seller, already possessed of complete ownership of the property and an unrestricted right to all of its future earnings, would not enter into the transaction at all if tax considerations were absent; and the foundation can have only marginal bargaining power. Quite naturally, the resultant agreement diverts to the seller—by means of an inflated purchase price or, where a lease-back is involved, reduced rentals—a significant share of the advantage which the foundation derives from its ability to receive the income produced by the property free of tax. In other situations, one who lends money to a foundation may be able to insist upon an abnormal interest rate because of the foundation's power to realize a greater net return upon the money than a taxable borrower could. In these ways, foundation borrowing for investment uses can deflect, to the personal benefit of private parties, a portion of the advantage which tax exemption was intended to produce for charity.

But, though a part of the benefit of its exemption may escape the foundation, much remains. The foundation, after all, will ultimately secure unencumbered ownership of the property if a bootstrap operation works; it will earn the differential between the proceeds of a production payment purchased with borrowed funds and the cost of the loan which provided those funds; it may realize substantial profit from securities purchased on margin. These facts are the source of a

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[31] While F has pursued a practice of leasing the acquired assets to operating organizations in which it has little or no direct ownership interest, the terms of the leases in at least many instances have given the foundation sufficient connection with the business enterprises to bring the arrangements within the scope of the business limitation recommended in Part II-C of this Report. The connection does not, however, appear to have been an indispensible element of the transactions; and appropriate modifications of the lease relationships would seem to make it possible for F to accomplish these acquisitions even if a restriction upon foundation participation in business were in effect. F has also used the bootstrap technique to acquire productive assets which were not parts of a business enterprise.

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.

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

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[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.

such purposes. A number of persons familiar with the operations of private foundations have indicated precisely that view to the Treasury Department. To curtail abuses by the minority of foundations, however, legislative adoption of the recommended rule is necessary.

(2) Foundation lending

Many private foundations put portions of their funds to use in the making of loans which are not secured by mortgages and not evidenced by government or other bonds.[34] While much of this lending represents altogether proper and legitimate investment of foundation funds, some does not.

Example 6.—The A, B, and C foundations, referred to in example 1, all controlled by a single individual, made many loans to that individual's friends and business acquaintances. On December 31, 1956, one businessman owed these foundations $6,571,448. At the end of the years 1951 through 1961 another owed the foundations amounts ranging from $1,193,000 to $2,057,000. The indebtedness of various other businessmen to the foundations was, on the dates noted, as follows:

Individual A, Dec. 31, 1954	$138,000.00
Individual B, Oct. 27, 1954	1,519,000.00
Individual C, Dec. 31, 1961	39,210.00
Individual D, Dec. 31, 1962	80,246.92
Individual E, Dec. 31, 1962	39,027.50
Individual F, Dec. 31, 1953	247,084.75
Individual G, Dec. 31, 1962	54,000.00
Individual H, Dec. 31, 1962	50,154.32

The loans to these and other businessmen ordinarily arose through transactions in which the foundations purchased and carried (often for several years) large amounts of securities for the accounts of the borrowers. Where the documents recording the arrangements specified interest rates, the rates prescribed were sometimes as low as 3, 3½, or 4 percent. In other cases, however, the rates were higher; and in many situations the foundations were entitled to share in the profits of sales of the securities.[35]

Example 7.—The G foundation had the following loans to various individuals outstanding at the end of each of the indicated years:[36]

Year ending Dec. 31	Makers	Interest rate (percent)	Amount
1952	Individual I	4	$11,600
1953	do	4	11,050
1954	do	4	10,600
1955	do	4	9,400
1956	Individuals J and K	4	1,111,500
	Individual I	4	8,800
1957	do	4	7,900
1958	do	4	6,200
1959	do	4	5,000
	Individuals L and M	0	15,900
1960	do	0	10,300
	Individual I	4	4,000
1961	Individuals L and M	0	3,700
	Individual I	4	1,000

[34] Table 11 of the Statistical Appendix to the report presents information on the total amounts of various classes of foundation loans outstanding at the end of 1962.

[35] Patman Report, 2d installment, supra, e.g., pp. iv, 24–27, 29, 31, 32.

[36] Patman Report, 2d installment, supra, p. 12.

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

made by foundations in pursuance of their exempt functions—such as loans to students—should, of course, be permitted. Similarly, foundations should be allowed to make bank deposits, loans which are evidenced by securities of a type regularly traded upon an exchange or in an over-the-counter market, loans to governmental units, loans fully secured by first mortgages upon real estate, and other loans determined, under regulations prescribed by the Secretary of the Treasury, to be of substantially similar quality and character.[37] Examples of loans of the latter class would be short-term loans represented by the marketable commercial paper of prime borrowers and loans forming parts of sound private placements. Reference to the accepted lending practices of educational institutions and comparable organizations could furnish guidelines for the standards to be developed in the regulations. Beyond areas of the enumerated character, however, lending by private foundations ought to be prohibited.

(3) Trading and speculation by foundations

Certain private foundations have engaged in active trading of securities or have participated in speculative investments.

Example 9.—The A, B, and C foundations carried on lively, extensive, and often speculative securities dealings. They entered into puts and calls, purchased a large volume of unlisted securities, and frequently acquired stock on margin. They agreed to a number of arrangements under which they carried securities for the accounts of individuals in exchange for the right to share in any profits which might be realized upon disposition of the securities. They sometimes sold stock within a period of from one to several days after acquiring it.[38]

Example 10.—The I foundation reported securities sales in 1963 which amounted to a turnover of approximately 20 percent of its stockholdings in that year. A recent Securities and Exchange Commission report [39] indicates average rates of turnover for foundations to be from 1 to 2 percent. All but four of the positions liquidated by the I foundation's 1963 sales had been purchased by the foundation after 1960; approximately half had been held for less than 6 months. The foundation realized a total gain of $2,342,067 from the sales.

Example 11.—The J foundation invested in a syndicate formed by several taxable corporations to purchase a ranch, hoping to profit from a sharp rise in land values which might take place if an adjacent city happened to expand in the direction of the property. The urban expansion did not occur. The syndicate operated the ranch at a loss for several years, and finally disposed of it. The foundation sustained a substantial loss on the transaction.

While it is difficult to assemble information upon the precise extent of trading or speculation among private foundations, the Treasury Department has encountered a substantial body of opinion, among persons familiar with the activities and practices of foundations, to the effect that the problem is of sufficient importance to require legislative attention.

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[37] Of course, where foundation lending activities constitute a business, the recommendation of Part II-C would become applicable.

[38] Patman Report, 2d installment, supra, e.g., pp. 23, 25, 26, 33, 34, 37, 38, 40.

[39] Securities and Exchange Commission Report of Special Studies of the Securities Market, July 17, 1963, pp. 864 and 1062.

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 simiiar provision.

should include specific interdiction of devices ordinarily deemed inherently speculative—as, for example, the purchase of "puts," "calls," "straddles," "spreads," "strips," "straps," and "special options," selling short, and trading in commodity futures.[41]

Like the borrowing and lending recommendations of the two preceding portions of the present section, this measure would exclude foundations from a class of financial transactions in which they ought not to be engaged. When combined with the business and self-dealing restrictions proposed elsewhere in the report, these rules would confine the unrelated financial activities of private foundations to areas which are appropriate for organizations whose assets have been committed to the advancement of the public welfare and whose concerns should be exclusively with the attainment of charitable aims.

F. BROADENING OF FOUNDATION MANAGEMENT

The Treasury Department's study of private foundations has revealed the existence of a group of interrelated problems which are at once more pervasive and more fundamental, but less concrete, less easy to identify, and less susceptible of isolation, than those with which the preceding sections of this Part have dealt. By their very nature, these problems evade precise definition and quantitative analysis. One cannot compile statistics which demonstrate their character and extent. In the main, one cannot report individual instances of their effect. For all of these attributes, however, they possess both reality and significance.

For the purposes of discussion, one may separate these problems into three general categories.

(1) Abuse potentialities of donor influence

The ability of a donor to wield substantial influence over the management of a private foundation which he has established or endowed presents continuing opportunities for the diversion of the foundation to purposes which are not wholly charitable. General prohibition of financial intercourse between donor and foundation, as Part II–A of this Report recommends, would, it is true, foreclose the most palpable abuses which have arisen in this area. Restrictions of foundation ownership of businesses and postponement of deductions for contributions of interests in controlled property would further reduce the possibilities for diversion and conflicts of responsibility. Nonetheless, the modes of human satisfaction have almost infinite diversity; and the ways in which wealth can be employed for personal advantage are, consequently, multiple and highly varied. Many donors, too, have manifested a common and deep-seated tendency to regard foundations which they have created as their own, to be availed of for their own ends where a contemplated use does not involve obvious and direct deflection of assets from charity and where no specific statutory prohibition lies in the way. Combination of these facts makes it difficult to escape the conclusion that real danger of abuse through substantial donor influence—albeit in forms less straightforward and apparent than those which have thus far occupied the attention of the Treasury Department and the Congress—will survive the restrictions proposed by other portions of this Report.

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[41] The suggestions advanced in Part II–E (1) above for the restriction of foundation borrowing would prevent margin purchases of securities.

Accurate appraisal of this problem is complicated by the fact that, as Part I of the Report has explained, the private foundation can derive important values from donor influence. The donor can bring imagination and creativity to the foundation, infuse spirit and drive into its operations, give unique focus to its efforts. But the fact that donor influence contains potentialities both for benefit and for detriment does not present a permanent dilemma: for its dangers and its values do not subsist equally throughout the life cycle of the foundation. While possibilities for abuse remain relatively unchanged, advantages tend to decline sharply with the passage of time. The donor can frame the fundamental structure of the foundation in its organizational documents; he can set the pattern for its activities and interests in the early years of its operations; he can establish its character by example, custom, and usage as it matures. Thereafter the magnitude of his contribution must, almost necessarily, diminish. In view of these facts, the present problem would seem capable of solution by a rule which confines substantial donor influence to the developmental and maturation stages of foundation life: such a rule would preserve the primary benefits of influence, and would eliminate a large measure of its possible detriments.

(2) Perpetual existence of foundations

A different, but related problem arises from the proliferation and perpetual existence of private foundations. By 1962 there appear to have been approximately 15,000 foundations in the United States. Current information indicates that an average of about 1,200 new foundations are being formed every year. The Foundation Library Center estimates that, of the foundations in existence in 1962, 72 percent of those with assets of less than $100,000 had been established since 1950, and 56 percent of those with assets of more than $100,000 had been created since 1950. Most of these foundations are established under organizational documents which place no limitation upon the period of their existence; and while satisfactory data upon foundation terminations is not available, it seems relatively clear that deaths are a good deal less frequent than births.

The continued existence of foundations whose number is constantly increasing generates a number of administrative burdens. Returns must be processed; questionable transactions must be investigated; compliance with legal requirements must be secured, sometimes through litigation. All of these activities cost the Federal Government considerable sums of money. Part I of this Report has explored at some length the reasons why, despite these facts, the imposition of a general limitation upon the lives of foundations is inadvisable. In specific situations, however, it may be far from clear that the perpetuation of an individual foundation justifies the attendant administrative burdens. It seems plain, at least, that many foundations continue in existence year after year without achieving any of the external indicia of unique advancement of philanthropy. They attract no public attention; their endeavors gain no public support; they appear to open no new areas, develop no new vistas, create no rearrangements or alterations of focus among charitable enterprises generally. Hence, while a universal restriction upon foundation lives is undesirable, a method of winnowing the useful from the superfluous—of evaluating the accomplishments, nature, and status of each private

foundation at some point in its existence, with a view to a judgment upon the advisability of continuing it—would possess real utility.

Such a task would require a multitude of difficult and delicate value judgments, and should, therefore, not be undertaken by a governmental body without grounds considerably more pressing than those which obtain in the present situation. On the other hand, a foundation's creator, or those related to him, may not approach an endeavor of this kind with detachment. Consequently, satisfactory solution of this problem would seem to demand a rule permitting independent private parties to examine a foundation after it has had a reasonable period of time within which to prove itself. If their review leads them to conclude that the organization's record and capabilities do not justify its continuation, they should have power to wind up its affairs, distribute its assets in accordance with its purposes, and dissolve it.

(3) Possibilities for narrowness of foundation management

Under present law it is possible for an individual to establish a private foundation, dominate its affairs throughout his life, and pass its management to members of his family upon his death. In such a system supervision of the activities of a foundation may remain within the power of a very limited and homogenous group for an indefinite period of time; there is, indeed, no assurance that persons more broadly representative of the public will ever be introduced into the organization's governing body.

The disadvantages of the system are apparent. All of the dangers of narrowness of view and parochialism can persist in perpetuity. A foundation's motive force can, over time, become dissipated; and it is not guaranteed a source of replenishment. Attitudes may harden into prejudices; approaches may solidify; the responsiveness which this branch of philanthropy should have to the changing needs of our society may suffer. Projects which were useful and desirable when when they were undertaken may be continued long after they have become outmoded.

Recognizing the dangers intrinsic in narrowness of base, many of our colleges and universities take pains to secure personnel who have been trained at other institutions or who have drawn experience from different academic communities. Some of our great corporations have, in their hiring policies, manifested a consciousness of the same problem. Consequently, it would seem altogether inappropriate to permit this defect to insinuate itself into the management of one of the important areas of private philanthropy.

(4) Possible solution

To resolve these three problems, the Treasury Department recommends that provision be made to convert private foundations, after they have been in existence for 25 years, to management which is independent of their donors and parties related to donors. Without the harshness of requiring a complete severance of the donor from the foundation, this result can be accomplished by placing a limit upon the part which the donor and related parties can play in the management of the foundation. For several reasons, however, the fixing of the quantitative level of this limit requires some care.

The level should be set high enough to permit the donor significant representation on the foundation's governing body. On the other hand, imperfections necessarily inherent in the definition of the class of donor-related parties—parties who have sufficient connection with the donor to be likely to be subject to his influence—make it essential to confine donor participation to a relatively small percentage if effective prevention of substantial donor influence upon foundation decisions is to be attained. Administrative considerations make it impracticable to include, within the category of donor-related parties, more than the following: (1) members of the donor's family, (2) persons with whom the donor has a direct or indirect employment relationship, and (3) persons with whom the donor has a continuing business or professional relationship. Yet substantial areas of practical donor influence lie beyond the boundaries of this definition. Friends, neighbors, business acquaintances, and others may well be willing to accept the donor's judgment on matters pertaining to a foundation which he has established and whose assets he has contributed. Hence, if an approach is to be made to workable and effective prohibition of substantial donor influence over a foundation, the limit upon participation of the donor and related parties on the foundation's governing body should be fixed no higher than 25 percent.[42]

A rule which, after the first 25 years of the existence of a private foundation,[43] would prevent the donor and related parties from composing more than 25 percent of the managing board of the foundation would deal effectively with each of the three problems which have been described in the present section. It would limit the time period within which abuses could occur through the exercise of substantial donor influence; and, by assuring the donor that his actions would ultimately be subject to independent review, it would tend to protect the foundation from abuse even during its first 25 years. By enabling independent private parties to evaluate the performance and potentiality of the foundation after 25 years of operation and granting them power to terminate the organization, then or later, the measure would provide a method for eliminating foundation which have doubtful or minimal utility. Finally, in broadening the base of foundation management, the recommendation would bring fresh views to the foundation's councils, combat parochialism, and augment the flexibility of the organization in responding to social needs and changes.

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[42] Even with the limit upon identifiable donor representation set at this level, passage of control to independent parties may not be immediate. The donor may, for a time, be able to retain effective control through persons who do not fall within the definition of donor-related parties. But friends, neighbors, and others are unlikely to remain subject to the influence of the donor and his family indefinitely; and, with a 25-percent ceiling upon participation by more closely related parties, actual independent dominion over the foundation should ensue without undue delay.

[43] To avoid possible disruption of foundation affairs by requiring an abrupt, unanticipated change in management, foundations which have already been in existence for 25 years or more should be permitted to continue subject to substantial donor influence for an additional period of from 5 to 10 years.

PART III. ADDITIONAL PROBLEMS

In the course of its review of private foundations and the tax laws which apply to them, the Treasury Department has encountered several problems which, while possessing less general significance than the problems discussed in part II of the report, are sufficiently serious to warrant remedial action. Some donors have been able to secure substantial deductions for contributing to foundations assets which produce no benefit whatever for charity. Other donors have reduced their personal taxes by accomplishing tax-free bailouts of corporate earnings to foundations or by making contributions of other property which would have generated ordinary income upon sale. A defect in the computation of the estate tax marital deduction has permitted taxpayers unjustifiable enlargements in the tax benefits of bequests to their spouses through various devices involving foundations. Proper enforcement of reporting rules has been hampered by the absence of an effective sanction for failure to file the information returns required of foundations.

This Part of the Report sets forth illustrations of these problems, analyzes them, and suggests appropriate remedies.

A. CONTRIBUTIONS OF UNPRODUCTIVE PROPERTY

The Internal Revenue Service has discovered a number of situations in which very substantial income tax deductions have been claimed for contributions to private foundations of property which does not produce income and which the foundation does not, or cannot, devote to charitable uses.

Example 1.—One taxpayer, for example, claimed a charitable deduction of $39,500 for the gift of family jewelry to her husband's foundation. The jewelry was placed in a safe deposit box listed in the name of the foundation, and at last report it has been held there for more than 6 years.

Example 2.—Other taxpayers have secured significant tax savings by contributing paintings and other artworks to controlled foundations which do not maintain museums.

Example 3.—A company donated vacant land adjoining its plant facilities to its foundation. During the 11 years for which the foundation held the property, it produced no income whatever.

Example 4.—A man and his wife contributed the remainder interest in their personal residence to a foundation.

Difficult valuation problems frequently attend the donor's assertion of a right to a charitable deduction in these cases. More fundamental, however, is the criticism that the donor obtains a current tax advantage for a transfer which confers no concomitant benefit upon charity. The Government, in effect, pays the donor for his act; but the jewelry remains in the safe deposit box, the painting in the warehouse, and the land unused. As other portions of this report have noted, the presupposition of the tax statute is that the cost of the charitable

deduction to the Government will be justified by its correlative benefit to charity. Here, plainly, the result is not worth the price.

The recommendations of other sections of this Report bear upon the present problem; but, designed to deal with difficulties of broader thrust, they do not provide an entirely satisfactory solution to it. A requirement that foundations disburse annually at least a minimum approximation of a normal return upon their property cannot convert an unproductive asset into a productive one. A foundation utilized as a conduit for its donor's normal annual charitable gifts may well be able to comply with this requirement year after year without ever being compelled to apply an unproductive asset to uses which benefit charity. Again, many contributions of unproductive property would appear to be made only because the donor has practical assurance that he will continue to enjoy the use of the property; and this Report's self-dealing recommendations, which would proscribe such use, might be expected to inhibit these contributions.[1] But the Internal Revenue Service should not be compelled to assign revenue agents to make certain that the jewels remain in the safe deposit box, or the painting in the storeroom, when their former owner entertains. And self-dealing rules can, by their very nature, have no impact upon those situations in which the unproductive asset is transferred to the foundation precisely because the donor has no further use for it. Hence, the Part II–A proposals will not, in themselves, be sufficient to eliminate abuses of the sort with which we are presently concerned. Similarly, while the rules suggested in Part II–D of the report cope adequately with the major abuses which have arisen through contributions of unproductive interests in property over which the donor maintains control (principally stock in controlled corporations), they do not apply to gifts of other kinds of unproductive assets.

Where property unproductive of income is transferred to a private foundation, the policy reason underlying the grant of the charitable deduction does not become operative until the asset is (*a*) made productive, (*b*) disposed of, or (*c*) applied to charitable uses. Consequently, the Treasury Department recommends that, with the limited exceptions described below, the donor's income tax deduction for such a contribution be postponed until one of those three events occurs. This measure would defer the deduction to the point in time at which it becomes justified, and, in addition, would resolve a number of complex valuation problems.[2] Rules similar to those explained in Part II–D in connection with the controlled property provision should, for this purpose, govern the definition of "disposition" and "application to charitable use"; the determination of the amount of the donor's deduction when he becomes entitled to one; and the length of the period within which qualification for a deduction could occur. An asset should be considered unproductive of income unless substantial income is regularly derived from it. Since the controlled property rule of Part II–D affords ample solution for the problems to which it

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[1] Sec. 170(f), added to the Internal Revenue Code in 1964, might also be expected to have this effect for similarly motivated donations of tangible personal property. That section provides that contributions of future interests in such property shall become deductible only upon the expiration of intervening rights held by the donor or related parties. Where the donor retains a real ability to use the contributed property, whether or not his power is set forth in any of the legal documents governing the transfer, the arrangement can be argued to constitute, in substance, the gift of a future interest. But the criticisms of the utility of the self-dealing rules in this area, explained in the text above, would seem to apply with equal force to the usefulness of sec. 170(f) here.

[2] Where the foundation sells the property, valuation would, of course, present no difficulty; where it makes the property productive, valuation should be easier; and where it does nothing with the property, valuation would never have to be undertaken.

42–663—65——5

applies and since, beyond the situations governed by that rule, there would appear to be little room for abuse through gifts of stock, evidences of indebtedness, or cash, these areas should be excepted from the proposed measure.

For estate tax purposes, this recommendation would not require unproductive property which has been the subject of a completed inter vivos transfer to a private foundation to be included in the donor's gross estate; but it would permit the testamentary transfer of such property to a foundation to qualify for an estate tax deduction only under rules similar to those suggested in the controlled property section of the Report. Gift tax treatment would complement that prescribed by the estate tax statute: a completed lifetime conveyance of unproductive property would constitute a taxable gift, accorded a charitable deduction only upon the occurrence of one of the three qualifying events within a specified period after the transfer.

In its discussion of the problems presented by contributions of family controlled property, Part II–D of the report has indicated that valid arguments exist both for and against restricting the measure directed at those problems to the context of donor-influenced foundations. The problems of the present section are, in many ways, analogous to those of controlled property. Consequently, if the Congress concludes that it is desirable to limit the scope of the controlled property remedy to contributions made to donor-influenced foundations, it may also wish to consider such a restriction of the rules recommended in the present section.

B. CONTRIBUTIONS OF SECTION 306 STOCK AND OTHER ORDINARY INCOME ASSETS

(1) Section 306 stock

In 1954 Congress addressed itself directly and specifically to the problem of the so-called preferred stock bailout. Concerned with the obvious tax avoidance inherent in situations in which the shareholders of a corporation distributed preferred or other special stock to themselves as a tax-free dividend, realized capital gains upon selling this stock to a third party, and then had the corporation redeem the stock with earnings and profits—thereby accomplishing the distribution of corporate profits at the tax rate prescribed for capital gains—Congress determined to withdraw the favorable treatment accorded the earnings bailout. To that end, it adopted legislation providing, generally, that the amount which a shareholder realizes upon the sale, redemption, or other disposition of certain types of stock—designated "section 306 stock"—will be taxed to him as ordinary income. The typical situation covered by the legislation involves distribution of a preferred stock dividend to the holders of a corporation's common stock.

Since 1954 it has become apparent that, while this provision seals off avoidance possibilities for those who wish to sell or redeem section 306 stock, it does not foreclose the bailout device for taxpayers who contribute such stock to charity. Judicial authority has held that a person does not "realize" anything, within the technical meaning of the tax statute, when he makes a deductible charitable contribution. Hence, because the terms of section 306 become operative only where a disposition of stock occasions a "realization" for its former owner, they do not apply where the owner donates the stock to charity. As a

consequence, a shareholder in a corporation which has substantial undistributed earnings can, without tax, receive a dividend of re-redeemable preferred stock, secure a deduction for the full value of the stock by contributing it to a private foundation, and, if no prearranged plan for redemption exists, experience no tax consequences when the corporation redeems the stock from the foundation. The corporate profits have thus traveled a route leading from the corporation, through the shareholder, to the foundation; but the shareholder has never been taxed on them, and he has been able to reduce his taxable income by the entire amount of their value.

Indeed, if the stockholder is in a relatively high income tax bracket, he may well find significantly more cash in his pocket after the donation of section 306 stock to a foundation than he would be able to retain if he sold the stock for its full value. If, for example, a taxpayer in the 60 percent bracket sold section 306 stock for $20,000, he would pay a tax of $12,000 on the proceeds and be able to retain a net profit of $8,000.[3] If, on the other hand, he were to donate his stock to a foundation, his $20,000 deduction would diminish the tax which he would otherwise have to pay by $12,000. He would, then, be $4,000 richer if he gave the stock to a foundation than if he sold it.

The bailout potentialities of charitable contributions of section 306 stock have not escaped the notice of tax planners and advisers. A recent article in Taxes magazine describes the advantages to be derived from such contributions with clinical particularity. Rabinowitz and Dick, "Charitable Contributions of Section 306 Stock," Taxes, April 1964, page 220. Other articles describing the device are abundant.[4]

The Treasury Department's recent survey of private foundations suggests that a substantial number of taxpayers have made practical use of the often-repeated advice that the antibailout statute can be circumvented by giving section 306 stock to charity. Among the approximately 180 surveyed foundations which own 10 percent or more of at least 1 class of stock in a corporation, there are 74 separate holdings of what, from the reported information, appears to be section 306 stock.

The continued availability of the bailout device in the charitable contribution area has evoked criticism from a number of independent commentators. See Bittker, "Federal Income Taxation of Corporations and Shareholders" (1959 ed., p. 251). In its revised report of December 11, 1958, the House Ways and Means Committee Advisory Group on Subchapter C of the Internal Revenue Code of 1954 described the disposition of section 306 stock by donation to charity as an "abuse," and recommended that the problem be dealt with by reducing the donor's allowable charitable deduction by the amount which, under section 306, would have been taxed as ordinary income if the donor had sold the stock for fair market value. The working view developed on this subject by the American Law Institute Tax Project was to the same effect. 14 Tax Law Review 1, 5 (1958).

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[3] This example assumes that the stock's ratable share of the earnings and profits of the corporation at the time of distribution was at least equal to the proceeds of the sale.

[4] Cutler, "Various Aspects of Contributions to Charity," 17 New York University Annual Institute on Federal Taxation 1117, 1136 (1959); Lowndes, "Tax Advantages of Charitable Gifts," 46 Virginia Law Review 394, 413 (1960); Merritt, "The Tax Incentives for Lifetime Gifts to Charity," 39 Taxes—The Tax Magazine 104, 118 (1961); Quiggle and Myers, "Tax Aspects of Charitable Contributions by Individuals," 28 Fordham Law Review 579, 604–605 (1960); Ray and Oliver, "How to Choose Right Property and Method of Giving to Benefit from Gifts to Charity," 10 Journal of Taxation 118 (1959); Rudick and Gray, "Bounty Twice Blessed: Tax Consequences of Gifts of Property to or in Trust for Charity," 16 Tax Law Review 273, 280 (1961); Sugarman, "Charitable Giving Development in Tax Planning," 39 Taxes 1027, 1029 (1961); "Estate Planners Note: Contributions of Section 306 Stock Not Taxable," 7 Journal of Taxation 133 (1957).

The Treasury Department is of the opinion that the recommendation of the Ways and Means Committee Advisory Group is a sound one. Restriction of the charitable deduction which a donor receives on the contribution of section 306 stock to a private foundation [5] is consonant with the particular concern which Congress has, by the adoption of section 306, manifested for the earnings bailout problem. Measuring the reduction in the allowable charitable deduction by the amount of the ordinary income upon which the donor would have been taxed if he had sold the contributed stock makes the approach consistent with the provisions of section 306 itself. Furthermore, this approach is precisely that which Congress recently twice applied to analogous problems. In its 1962 enactment of section 1245 of the Internal Revenue Code, providing rules to insure ordinary income treatment of gain attributable to post-1962 depreciation of tangible personal and certain other property, and in its 1964 enactment of section 1250, prescribing rules of broadly the same direction for depreciable real property, Congress took care to specify that deductions for charitable contributions of such property should be diminished by the amounts which the new sections would characterize as ordinary income if the property were sold at fair market value.[6]

For these reasons, the Treasury Department recommends application of the Advisory Group proposal to contributions of section 306 stock to private foundations.

(2) Other ordinary income assets

When donors secure deductions for contributing to private foundations other classes of property which would have produced ordinary income upon sale, problems fundamentally analogous to those present in the section 306 stock context arise. Items includible in the donor's inventory and stock in collapsible corporations afford examples. In all of these cases the full amount of value which the donor would normally have had to include in his ordinary income is permitted both to escape taxation itself and to reduce the amount of his other taxable income. In many of these situations there exists the same anomaly pointed out above in connection with section 306 stock: the donor can make more profit by giving the asset to a foundation than he would have been able to retain if he had sold it.

Because of the basic similarity of the present problems to those generated by section 306 stock and because of the direct relevance here of the recent congressional action on the closely related ordinary

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[5] The Advisory Group proposal is not limited to situations in which the recipient charitable organization is a private foundation: the group's recommendation would apply wherever a donation of sec. 306 stock gives rise to a charitable deduction. The American Law Institute Tax Project working view and Professor Bittker's discussion, similarly, treat the problem as one whose nature does not depend upon the character of the charitable organization involved. By its observation that the problem exists within the area to which the present report applies, the Treasury Department intends no implication that these views are in error.

[6] The American Bar Association in 1959 offered two objections to the Advisory Group proposal. Hearings on Advisory Group recommendations on Subchapters C, F, and K of the Internal Revenue Code, House Ways and Means Committee, 86th Cong., 1st sess., pp. 923, 931–933 (1959). One, advanced by some members of the Committee on Corporate Shareholder Relationships, was that the contribution of sec. 306 stock to charity represents only one facet of the broad problem presented by donations of appreciated property. The members who entertained this view were of the opinion that all aspects of the general question should be examined before action is taken upon any particular portion of it. This objection has, in a large measure, been undercut by the congressional decisions with respect to secs. 1245 and 1250. In both instances, Congress recognized that specific restriction of the charitable deduction affords an appropriate method of dealing with the problems posed by particular classes of assets. A second objection, made by other members of the Bar Association committee, was that the proper method of curbing abuses in this area is to grant a full charitable deduction for the donation of sec. 306 stock, but to tax the donor as though he had realized the entire fair market value of the stock at that time. Such a rule would be more stringent than that recommended by the advisory group: it would, like the Advisory Group proposal, cancel that portion of the donor's charitable deduction attributable to corporate earnings at the time of the distribution of the stock; but, in addition, it might occasion a capital gains tax where the stock has appreciated in value after its distribution to the donor. Without passing on the merits of this proposal, the Treasury Department is of the view that the less rigorous approach of the Advisory Group is sufficient to foreclose the sec. 306 stock abuse in the private foundation area.

income situations arising under sections 1245 and 1250, the Treasury Department recommends that the rule proposed for section 306 stock be applied to this area also. Under this recommendation, the income tax deduction accorded for the gift of any asset to a private foundation would be diminished by the amount of the ordinary income which the donor would have realized if he had sold the asset for fair market value at the time of the contribution.

C. CORRECTION OF COMPUTATION OF ESTATE TAX MARITAL DEDUCTION

When a donor makes an unrestricted contribution of property to a private foundation whose selection of charitable beneficiaries he has power to influence, he secures a current income tax deduction for the full value of the property. The existence of his power over the foundation confers an additional benefit upon him: under existing estate tax law, the value of the asset remains in the base upon which his marital deduction is computed.[7] Its presence in that base increases, by a sum equal to one-half the asset's value, the amount which the donor can bequeath to his wife free of estate tax—even while the asset itself escapes estate tax through the operation of the charitable deduction. On the other hand, the donor who contributes to a foundation over which he has no power receives no such enlargement of his marital deduction: the property which he has contributed does not bear upon his estate tax computations, and the tax advantage of his contribution is limited to the deduction provided by the income tax law.

This differentiation in the estate tax law between charitable donors who possess power to influence the foundations to which they contribute and donors who do not is quite inadvertent: it arises from the application, to the situation of the donor-influenced foundation, of principles designed to deal with entirely different problems. More significantly, it creates a preference which there is no reason for the tax laws to create. It establishes, through the mechanism of the estate tax, an artificial inducement, which has no necessary relationship to charitable inclinations or interests, for the retention of donor influence over private foundations.

Certain other sections of the estate tax law give rise to analogous incongruities. Under them, transfers which produce current charitable income tax deductions can be arranged to maintain sufficient donor involvement with the contributed property to increase the donor's marital deduction. The section dealing with life insurance has, in particular, been the subject of considerable manipulation designed to produce such double tax benefits.[8] The provisions governing retained life estates and transfers in contemplation of death may occasion similar problems.[9] In all of these situations, lifetime chari-

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[7] Secs. 2036 and 2038 of the present Internal Revenue Code require that property transferred intervivos be included in the transferor's gross estate if he retains for life the power to designate the beneficiaries of its income or corpus. Both sections apply whether the transferor may exercise his power alone or in conjunction with other parties, and whether he possesses the power in a fiduciary capacity or not. Hence, in the usual situation, where at the time of his death a donor has a power to control or influence the decisions which a private foundation makes about the amounts and recipients of its distributions, all property which he has contributed to the foundation during his life would be required to be included in his gross estate. The so-called "adjusted gross estate"—which provides the base for the computation of the marital deduction—is determined from the gross estate without subtraction of the charitable deduction. As a consequence, the marital deduction base would include the value of the property contributed to the foundation. (The discussion here assumes that the contributed assets are not community property.)

[8] The effectiveness of the various life insurance devices has not yet been tested by litigation.

[9] The recommendation of Part III–A would postpone the income tax deduction for the gift of a remainder interest to a private foundation until the interest becomes possessory and productive or is disposed of by the foundation. By doing so, that proposal would, in the private foundation area, eliminate most possibilities for using retained life interests to achieve the described double tax benefits.

table transfers, treated as incomplete for estate tax purposes, gain an entirely unintended tax advantage over outright gifts.

To remove these unjustified and incongruous tax preferences, the Treasury Department recommends that, where a donor secures an income tax deduction for the transfer of an interest in property to a private foundation, the value of the property be excluded from the base upon which his estate tax marital deduction is computed.[10] By placing contributions to donor-influenced foundations upon the same estate tax footing as those to foundations which the donor does not influence, such legislation would confine the tax reward for both classes of transfers to the income tax benefits which they were specifically intended to receive. Similarly, where the recipient charitable organization is a private foundation, it would eliminate the advantage which lifetime charitable transfers, framed to retain donor connection with the contributed asset, have over outright and unrestricted gifts.

D. SANCTIONS FOR FAILURE TO FILE INFORMATION RETURNS

To proceed with effective administration of the tax laws governing private foundations, the Internal Revenue Service must obtain completed copies of the annual information returns required of foundations. Unfortunately, not all foundations comply with the reporting rules prescribed by the Internal Revenue Code and the implementing regulations. While the Internal Revenue Service has taken what steps it can to cope with this problem—it has, among other things, undertaken the compilation of a master list of tax-exempt organizations which will permit use of automatic data processing equipment to facilitate identification of the nonfilers—its efforts have been hampered by the absence of an effective sanction for noncompliance.

Under present law, the willful failure to file any return required by law is a criminal offense. The penalty provided is imprisonment not exceeding 1 year and a fine not exceeding $10,000. This criminal penalty is the only sanction available in cases involving the failure to file foundation information returns. Plainly, its severity makes it inappropriate in most such cases.

To overcome this defect of existing law, the Treasury Department recommends that private foundations which fail, without reasonable cause, to make timely and complete filing of a required information return be subjected to a penalty of $10 for each day of delay beyond the prescribed filing date. The penalty should be subject to a maximum limit of $5,000. A similar penalty, with a similar maximum limit, should be imposed upon officers, directors, or trustees responsible for filing private foundation returns if, after notice from the Internal Revenue Service of failure to make a complete and timely return, they omit (without reasonable cause) to remedy the defect within a specified reasonable time. Measured by the seriousness of the noncompliance in individual cases and sufficiently moderate to be appropriate in situations not warranting criminal treatment, these sanctions would afford the Internal Revenue Service considerable assistance in securing adherence to private foundation reporting requirements.

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[10] Commentators upon the problems of the present section have treated them ln a context wider than that of private foundations. By restricting its recommendation to the area of the present Report, the Treasury Department intends no implication that such views are in error.

APPENDIX A

Statistical Appendix

This appendix presents statistical estimates of the operation of the charitable contribution provisions of present law. It also contains information on the growth, the present size, and operations of foundations.

1. Historical pattern of total contributions

It is not easy to determine just what has been the effect of the tax provisions relating to charitable organizations. One would naturally look first at the size of the contribution deduction. This is summarized in table 1 for selected years.

The difficulty of year-to-year comparisons from the data in table 1 is the differing coverage of income tax returns in various years. In the 1920's, tax returns covered a far smaller portion of the population than they did in the 1950's. Also, when the standard deduction was introduced or increased, many contributors stopped listing contributions. But with any given standard deduction a smaller portion of taxpayers use it, more itemize each year, and thus itemized contribution deductions go up more than contributions.

Table 2 shows several long-term comparisons of the contributions of living individuals. So far as the tax-deductible contributions are concerned, the table shows the figures adjusted to include estimated contributions of nonfilers and of individuals using the standard deduction. These adjustments have been estimated by C. Harry Kahn for earlier years.[1] The 1956 and 1962 adjustments were made following Kahn's technique. To provide conceptual correspondence with estimated contributions received by operating charities, the table also includes charitable bequests and corporate contributions.

[1] C. Harry Kahn, "Personal Deductions in the Federal Income Tax," National Bureau of Economic Research, Princeton University Press, 1960. Kahn's technique on nonfilers involved applying to their estimated income the ratio of contributions to income of the low-income filers. The estimate of contributions by standard deduction takers was based on changes in reported contributions at times when the standard deduction was expanded.

TABLE 1.—*Amount of charitable deductions on tax returns of individuals, corporations, and estates, selected years*

[Millions of dollars]

Year	Individuals	Estates [1]	Corporations	Total
1962	$7,516	(2)	(2)	(2)
1961	(2)	(2)	$512	(2)
1960	6,750	$951	482	$8,183
1958	5,694	669	395	6,758
1956	4,878	[3] 534	415	5,827
1954	3,891	398	314	4,603
1952	3,114	[3] 336	398	3,848
1950	2,260	274	252	2,786
1948	1,881	296	239	2,416
1946	1,639	186	211	2,036
1944	1,258	202	234	1,694
1942	1,450	155	98	1,703
1940	740	143	38	921
1938	414	200	27	641
1936	390	128	30	548
1934	280	146	27	453
1932	317	191	31	539
1930	434	223	35	692
1929	540	154	32	726
1924	533	116	(2)	649

[1] Estate tax deductions listed for the year in which the estate return was filed.
[2] Not available.
[3] Interpolated.

Source: "Statistics of Income," except corporations before 1936 which are taken from "National Income," 1954 edition, Department of Commerce.

TABLE 2.—*Estimates of contributions to charity, derived from donor and recipient reports, in relation to adjusted gross income, selected years 1924–62*

Year	Estimated contributions from donor reports					Estimated contributions from recipient reports		Adjusted gross income	Ratio of contributions to AGI based on—		
	Living individuals	Charitable bequests on estate tax returns	Corporate giving	Other, i.e., income from endowments including foundations	Total	Nelson	American Association of Fund Raising Counsel		Living individuals	Total contributions	
										Donor estimate	Recipient estimate
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
	Millions	*Millions*	*Millions*	*Millions*	*Millions*	*Millions*	*Millions*	*Billions*	*Percent*	*Percent*	*Percent*
1962	$9,843	(1)	(1)	(1)	(1)	(1)	$9.3	$385.0	2.55	(1)	(1)
1956	7,317	$534	$418	$627	$8,896	$7,458	6.5	309.0	2.37	2.88	2.41
1950	4,359	274	252	410	5,295	4,344	(1)	201.0	2.17	2.63	2.17
1945	2,762	192	266	262	3,482	2,625	(1)	140.0	1.97	2.49	1.88
1940	1,254	143	38	188	1,623	1,235	(1)	70.1	1.79	2.31	1.76
1935	828	106	28	148	1,110	1,018	(1)	48.4	1.71	2.29	2.10
1930	969	223	35	177	1,404	1,530	(1)	62.2	1.55	2.26	2.46
1929	1,084	154	32	(1)	(1)	(1)	(1)	75.6	1.44	(1)	(1)
1924	973	(1)	(1)	(1)	(1)	(1)	(1)	62.0	1.57	(1)	(1)

[1] Not available.

SOURCES

Col. 1: 1924–50, "Personal Deductions in the Federal Income Tax," C. Harry Kahn, p. 66; 1956–62, estimated using Kahn's technique of adding 2 percent of estimated AGI of nonfilers and 1.66 percent of AGI on returns with standard deduction.

Col. 2: 1929–35, "National Income," 1954 edition, Department of Commerce, pp. 212–213. 1940–62, "Statistics of Income."

Col. 3: "Statistics of Income."

Col. 4: Includes principally an estimate of endowment income of foundations and of operating charities, i.e., income made available for charitable purposes.

Col. 5: "Annual Report of the National Bureau of Economic Research," 1962, p. 59, interim report of a research project on estimates of private giving by Ralph Nelson.

Col. 6: Ibid., p. 59. Estimates of contributions drawn from recipients have previously been made by various authors. Cf. discussion in Kahn op. cit., pp. 62–4. Nelson's estimates are based upon a more exhaustive coverage of types of recipients, and appear to be more reliable. For overlapping years Nelson's estimates are higher than the previous estimates.

Col. 7: From "Giving U.S.A.," 1963 edition.

Col. 8: This is adjusted gross income as reported on tax returns plus an estimate of unreported AGI including AGI of nonfilers.

The other statistical difficulty involves the accuracy of contributions reported on tax returns. ("Statistics of Income for Individuals" includes unaudited data.) Several authorities in the field have attempted to estimate charitable contributions received by collecting this information from the charities. In some cases estimates have to be reconstructed from estimated expenditures of charitable organizations and changes in endowments. The most reliable of these estimates is a series prepared by Ralph Nelson from which preliminary figures have been published by the National Bureau of Economic Research. Table 2 shows that there has been some relative growth in contributions over time. The ratio of contributions of living individuals based on tax return data shows a growth from the 1920's to recent years from about 1.5 percent of adjusted gross income to about 2.5 percent, roughly an increase of two-thirds. The other series suggest much less growth. The recipient estimate for 1930 is conspicuously high and probably overstates the actual figure. The donor figure is inflated relative to AGI for 1930 because it includes bequests from persons whose deaths occurred (and whose wills were written) in the different atmosphere of the 1920's.

Table 3 presents more detail on estate tax charitable deductions. Here the raw data show little trend because of two offsetting tendencies. By 1959–61, due to growing wealth levels, the United States reached the point where estate tax returns were filed with respect to about 3½ percent of all decedents. The number of returns filed in the 1920's and 1930's covered on the average about 0.9 percent of the decedents. At the same time charitable bequests account for a significantly greater part of the estate for large estates compared to small estates. The broadening of the estate tax coverage brought in relatively more small estates where charitable bequests were less common, thus holding down the contribution ratio.

TABLE 3.—*Charitable bequests reported on estate tax returns*

[Dollar amounts in millions]

Filing year	Gross estate	Charitable bequests					Ratio to gross estate of—	
		Total	Educational, scientific or literary institutions		Religious	Other	Total charitable bequests	Other charitable bequests
			Publicly owned	Privately owned				
							Percent	*Percent*
1961 [1]	$9,362	$850				$683	9.1	7.3
1961	14,622	951	$33	$81	$89	748	6.5	5.1
1959	11,648	669	31	117	86	435	5.7	3.7
1955	7,467	398	(2)	(2)	(2)	(2)	5.3	(2)
1954	7,411	354	(2)	(2)	(2)	(2)	4.8	(2)
1951	5,505	274	(2)	(2)	(2)	(2)	5.0	(2)
1950	4,918	206	17	38	22	129	4.2	2.6
1949	4,933	296	16	98	35	147	6.0	3.0
1948	4,774	223	19	30	25	151	4.7	3.2
1944	2,907	202	18	32	16	135	6.9	4.6
1939	2,746	178	7	44	16	111	6.5	4.0
1934	2,244	146	(2)	(2)	(2)	(2)	6.5	(2)
1929	3,844	154	(2)	(2)	(2)	(2)	4.0	(2)
1924	2,350	66	(2)	(2)	(2)	(2)	2.8	(2)

[1] Top quarter of returns.
[2] Not available.

Source: "Statistics of Income", various years.

The top line of table 3 shows a computation for estate tax returns filed in 1961 where the gross estate was over $200,000. This accounts for about 0.9 percent of all decedents and is thus roughly comparable to the data for the 1920's and 1930's. On this basis the charitable bequests, as a percentage of estates, show an appreciable growth. Robert Lampman's data [2] show that the share of total wealth of the top 1 percent of estate holders declined slightly from the 1920's through 1956.[3] This share is, however, quite sensitive to common stock prices. The fact that common stock prices have risen more than other prices since 1956 would roughly serve to restore the relative share of wealth held by the top 1 percent. On balance it is likely that a larger portion of the property changing hands at death goes into charitable hands via bequests now than was the case in the 1920's. In 1929 the portion might have been 1.5 percent. Presently, it might be 3 percent. The growth is sharper when comparison is made with the early 1920's.

2. Contributions by type of recipient

The data on the types of recipients of charitable contributions are extremely scarce. Table 3 shows a breakdown by broad categories for estate tax deductions for various years. Presumably, the category "other" charitable bequests is made up to a significant extent by bequests to foundations. Kahn, on the basis of very skimpy data, guessed that the bequests to foundations in 1952 may have been in the vicinity of $40 million.[4] A special tabulation of estate tax returns filed in 1957 and 1959 suggests that the annual bequests to "private" organizations might have been about $150 million. The size of "other" bequests has risen from about 60 percent of charitable bequests in 1939 and 1944 to about 80 percent in 1961. All one can say is that this is consistent with a growing tendency to leave property to foundations, but the evidence is not conclusive.

The only tabulation of individual income tax charitable contributions by type of recipient was made for 1962 returns. It is summarized in table 4 which shows the increasing importance of the contribution deduction in the upper brackets, and particularly, the increasing importance of the contributions to "other organizations." This category covers literary, educational, and scientific foundations, libraries, museums, zoos, and other such institutions, including charitable foundations in general.

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[2] Lampman has made the principal analysis of changes in the size distribution of wealth holdings over time. (Robert Lampman, "The Share of Top Wealth Holders in National Wealth," 1922–56, National Bureau of Economic Research, Princeton University Press.)

[3] From about 33 percent to 26 percent, ibid, p. 204.

[4] Kahn, op. cit., p. 225.

TABLE 4.—*Individual income tax deductions for contributions for 1962 by type of recipient and by AGI class*

AGI class	AGI on returns with itemized deductions (billion dollars)	Amount of deductions (million dollars)						Ratio of deductions to AGI, returns with itemized deductions (percent)					
		Total	Religious organizations	Other charitable organizations	Educational institutions	Hospitals	Other organizations	Total	Religious organizations	Other charitable organizations	Educational institutions	Hospitals	Other organizations
Under $5,000	24.9	1,202	850.0	139.0	8.0	5.0	200.0	4.8	3.4	0.6	(1)	(1)	0.8
$5,000 to $10,000	88.4	2,906	2,033.0	402.0	29.0	11.0	432.0	3.3	2.3	.5	(1)	(1)	.5
$10,000 to $20,000	55.6	1,719	1,124.0	264.0	38.0	15.0	277.0	3.1	2.0	.5	0.1	(1)	.5
$20,000 to $50,000	24.1	806	409.0	134.0	56.0	29.0	179.0	3.3	1.7	.6	.2	0.1	.7
$50,000 to $200,000	10.3	509	136.0	84.0	76.0	31.0	182.0	4.9	1.3	.8	.7	.3	1.7
$200,000 to $1,000,000	1.94	200	18.0	22.0	42.0	14.0	103.0	10.3	.9	1.1	2.2	.7	5.3
Over $1,000,000	.66	91	2.6	5.1	16.2	5.2	61.8	13.8	.4	.8	2.5	.8	9.4
Total	206.4	7,516	4,578.0	1,066.0	274.0	113.0	1,485.0	3.6	2.2	.5	.1	.1	.7

[1] Less than 0.05 percent.

NOTE.—Totals will not add due to rounding.

Source: Internal Revenue Service, Statistics Division.

TABLE 5.—*Estimated total amount of philanthropic contributions by individuals, classified by area of service, 1952 and 1954*

[In millions of dollars]

Area of service	1952	1954
1. Religion	2,281	2,776
2. Education	114	143
3. Health and hospitals	259–303	283–369
4. Social welfare	323	465
5. Private foreign aid	44–91	60–139
6. Foundations	153	160
7. Miscellaneous	122–138	156–187
Total	3,296–3,403	4,043–4,239

Source: C. Harry Kahn, Personal Deductions in the Federal Income Tax, National Bureau of Economic Research, 1960, p. 218.

Table 5, taken directly from C. Harry Kahn, provides an estimate of the breakdown by type of recipient of charitable contribution deductions of living individual donors in 1952 and 1954. These estimates were pieced together by Kahn from material drawn from the charitable organizations. His estimate of contributions to foundations is $160 million, or 3 percent of total contributions.[5] This figure is made up of an estimated $47 million channeled through foundations and $106 million added to foundation capital.[6]

Kahn's estimate of contributions received by foundations in 1952, $40 million from bequests, and $153 million from living donors, also includes an estimated $24 million from corporations. This is Kahn's breakdown of $221 million of contributions to foundations in 1952, a figure estimated by Emerson Andrews (Philanthropic Foundations, p. 17). This total is only one-fourth the size of the $833 million of contributions received by foundations in 1962 based on the Treasury survey in 1964 (cf. discussion infra and table 10). The higher Treasury survey figure is due in part to the broader coverage. This remarkable growth over 10 years, however, is an indication of increasing use of foundations.

This estimate of contributions to foundations in 1962 may be broken down by sources, as follows:

	Millions
Bequests	[1] $175
Corporations	[2] 200
Living individuals	[3] 450

[1] Based on a special tabulation (unpublished) of estate tax returns filed in 1957 and 1959. The figure tabulated from those returns was contributions to organizations that did not appeal to the general public for funds. The figure was scaled up to 1962 levels and rounded. It is a figure particularly subject to erratic year-to-year changes.

[2] This is the Foundation Library Center's estimate of contributions received by "company-sponsored" foundations ("foundations known to have been organized by a business corporation or partnership or to have such an organization as a direct contributor"). Foundation Directory 2, pp. 29–30. The statistic includes some individual contributions, but the definition also has the result of excluding some corporate contributions to noncompany sponsored foundations.

[3] Obtained by subtracting line 1 and 2 from the total contributions received in 1962, as estimated by the Treasury survey.

These components pooled from various sources are extremely rough since the foundation reports themselves do not indicate type of donor. The pattern is roughly consistent with the patterns that Professor Kahn found for 1952, except that this estimate would mark corpora-

[5] Kahn's estimate in turn is based mostly on Andrew's Philanthropic Giving, cf. Kahn, op. cit., pp. 224–5

[6] Ibid., p. 225.

tions as more important contributors than they appeared to be in the earlier year.

Table 6 contains a breakdown of total private giving for 1956 by both sources and uses. This is Ralph Nelson's estimate. Foundation income, as well as the income of endowments of operating charities, is here shown as a source of charitable funds.

TABLE 6.—*The composition of private giving, 1956, donors and recipients, preliminary estimate*

[Dollar values in millions]

Sources (donors)	Amount	Percent	Uses (recipients)	Amount	Percent
Living donors (persons and families)	$7,317	82.3	Religious organizations [1]	$3,569	47.9
Bequests	534	6.0	Private primary and secondary schools	802	10.8
Corporations	418	4.7	Higher education	929	12.5
Foundation endowment income	407	4.6	Secular health	808	10.8
Other endowment income	220	2.5	Secular welfare	1,015	13.6
			Miscellaneous	335	4.5
	8,896	100.0		7,458	100.0

[1] Includes church-supported health and welfare, and excludes parochial schools.

Source: Annual Report of the National Bureau of Economic Research, June 1962, p. 59.

3. The size and growth of foundations

There are no reliable estimates of the growth of the total wealth of charitable organizations including foundations. (Such an estimate would involve, for example, an estimate of the current value of church buildings.) As to the specific subject of this study, private foundations, there are only isolated pieces of information about the accumulated financial holdings; that is, their endowments. One piece is provided by the periodic surveys of share ownership of listed stocks, undertaken by the New York Stock Exchange. Another is provided by studies of total assets of foundations.

It is, of course, rather meaningless to point out that foundations and endowments have been growing. The more important point is how this growth compares with that of the total economy; that is, has the position of foundations grown relative to other charitable organizations, or relative to the total private wealth?

The total asset data on foundations are the result of periodic surveys undertaken by private researchers. The early foundation surveys were based upon information that the surveyors could glean from newspaper reports, correspondence, guessing at the importance of small foundations, and the like. This kind of approach is quite likely to include the large well-known organizations, but it becomes very spotty as an estimate of the small ones. Since 1950, these data have been strengthened by the availability of annual information returns under the Internal Revenue Code from many foundations.

Table 7 contains some information on the available survey-type information on total asset holdings of foundations. For comparison these are shown along with an estimate of endowments of institutions of higher education and of the total value of assets of individuals, including nonprofit institutions.

The figures in table 7 indicate considerable growth of foundations relative to the aggregate individual total wealth. The size of foundations since 1930 would seem to be increasing 17 times while the

aggregate individual wealth was increasing 4 times. The faster growth of foundations appears to persist throughout the period. The real question is how reliable the early figures are. Two conspicuous defects are coverage and valuation methods.

Coverage.—The Treasury's 1964 survey indicated that in the aggregate the small foundations do not make much contribution to the size of total foundation assets. The 1930 study, for example, grossly underestimates the number of foundations, giving a figure of 122. The 1964 Foundation Directory, however, lists 165 foundations which had assets over $1 million in 1962 and were organized before 1930. The procedure followed in 1930, presumably, should have identified and included the large well-known foundations. If the excluded ones were equivalent to the aggregate of the medium and small groups in the 1964 figures, it would be reasonable to raise the $950 million estimate to $1,100 million; that is, by 15 percent, to cover the additional foundations.

Valuation.—The 1930 study requested only ledger values of assets. The 1931 study requested market values as well, but only eight foundations gave both ledger and market values. For these eight, the aggregate market value was about 12 percent below ledger value. Market values of stocks in 1931, however, were only two-thirds of values in 1930. Assuming that most of the assets were in stocks, it is a guess that the market value of all foundations (i.e., including the above adjustment for the small foundations) was about $1,300 million.

These adjustments have been very rough. It would be better to conclude that the value of foundation assets in 1930 was $1–$2 billion. Even if we take the top of this range, foundation assets in the aggregate have multiplied eight times in value since 1930 while total wealth has increased four times. From the lower end of this range the increase was 16 times for foundations.

Table 7 would indicate that since 1930 foundations have increased their share of the total wealth of individuals from 0.25 percent to about 0.8 percent. If we use the previously derived estimate of $1.3 billion as the market value of foundation wealth in 1930, the share of foundations was then 0.33 percent. Higher education endowments increased roughly in proportion to total individual wealth.

Table 8 shows some information on the holdings of stock registered on the New York Stock Exchange (NYSE). In the aggregate the portion of total stocks registered on the NYSE owned by foundations is 2.6 percent.[7] The figure would seem to be high in relation to the indication of table 7 that foundations own slightly under 1 percent of the total wealth of individuals. The principal explanation is that foundations hold over twice as high a proportion of their wealth (about two-thirds) in the form of common stock than is the case for all individuals (about one-third). Further, foundations have a higher proportion of their stockholdings in the form of stocks listed on the NYSE (after the inclusion of Ford stock) than is true of individuals generally.[8]

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[7] The Ford Motor Co. stock held by the Ford Foundation is a special class of nonvoting common which is not listed on the NYSE. When the Ford Foundation sells any stock, the shares to be sold are exchanged for the listed common stock and delivered. Since the concern of the immediate inquiry is the wealth of foundations, rather than voting power, it is useful to add the Ford Foundation holdings of Ford stock to the listed holdings. Both figures are shown in table 8. The Ford figures were obtained from the Ford Foundation.

[8] An SEC study indicated that in a sample of foundations, covering 56 percent of foundation holdings, 87 percent of foundation stock investments was in shares listed on the NYSE. "Report of Special Study of Securities Markets," pt. II, p. 838.

Two striking indications from the stockholding data should be noted: (1) There has been no significant growth in the stockownership of foundations relative to the total market since 1949; and (2) there has been a small decline in the share of college and university endowments. The total share of all tax-exempt organizations (other than pension funds) was almost unchanged but down slightly.

TABLE 7.—*Data on total assets of foundations and higher education endowments*

[Dollar amounts in billions]

Year	Number (1)	Assets of foundations (2)	Endowments of colleges and universities [1] (3)	Total assets of individuals (4)
1930	122	$0.95	$1.3	$380
1944	505	1.82	----------	600
1950	1,007	2.57	2.4	921
1954	4,164	4.52	----------	1,200
1959	5,202	11.52	5.0	1,670
1962	6,007	14.51	6.4	1,930
1962 [2]	15,000	16.26	6.4	1,930

[1] This refers only to the endowment in investment assets. Physical plant of colleges and universities also serves as endowments, yielding services rather than cash. If these were included, higher education endowments would exceed those of foundations.

[2] 1964 Treasury Department Survey of Private Foundations.

SOURCES

Cols. (1) and (2):

1930: "American Foundations and Their Fields," Twentieth Century Fund. The tabulation contained in this report lists foundations with assets of $853,000,000, but 17 of the 122 foundations did not submit asset figures. The report contains the estimate that for all 122 foundations an asset figure of $950,000,000 "is probably not wide of the mark."

1944: "American Foundations for Social Welfare," Harrison and Andrews, Russell Sage Foundation, 1946, p. 58.

1950: "Philanthropic Giving," Andrews, Russell Sage Foundation, 1953, p. 93.

1954: "American Foundations and Their Fields," 7th ed.

1959: "Foundation Directory 1," Russell Sage Foundation, 1960.

1962: "Foundation Directory 2," Russell Sage Foundation, 1964.

Col. (3):

1930–59: Office of Education.

1962: "Giving U.S.A.," 1963 ed., p. 14, American Association of Fund Raising Counsel.

Col. (4):

1930–54: "Studies in National Balance Sheet of United States," Goldsmith, vol. II, pp. 124–125. The 1930 figures were interpolated between Goldsmith's estimates for 1929 and 1932 on the basis of aggregate value of corporate shares.

1959–62: "Flow of Funds Accounts," FRB. Total assets were estimated using observed trend of ratio of total to intangible in Goldsmith's data.

TABLE 8.—*Estimated holdings of New York Stock Exchange listed stocks by certain exempt institutions*

[Dollar amounts in billions]

DOLLAR HOLDINGS

	1949	1956	1960	1961	1962	1963
Foundations:						
Listed stocks	$1.1	$4.1	$5.3	$7.2	$6.7	$8.0
Ford stock held by Ford Foundation	.9	2.1	2.3	3.1	2.1	2.7
Total	2.0	6.2	7.6	10.3	8.8	10.7
College and university endowments	1.1	2.4	2.9	3.7	3.3	4.0
Other nonprofit organizations	1.0	3.1	4.4	5.6	5.0	5.9
Noninsured pension funds	.5	5.8	(1)	18.9	18.2	23.4
Market value of all listed stocks [2]	77.2	221.3	309.3	390.1	347.9	414.0

PERCENTAGES [2]

Foundations (including Ford stock)	2.6	2.8	2.5	2.6	2.5	2.6
College and university endowments	1.4	1.1	.9	.9	.9	1.0
Other nonprofit organizations	1.3	1.4	1.4	1.4	1.5	1.4
Total nonprofit organizations	5.3	5.3	4.8	5.0	4.9	5.0
Noninsured pension funds	.7	2.6	(1)	4.8	5.2	5.7

[1] Comparable figure not available.
[2] Includes Ford stock held by Ford Foundation.

Source: "NYSE Fact Book," 1963 and 1964. Ford figures obtained from Ford Foundation. The 1949 figure was obtained using the book equity of the Ford Motor Co.

The two sets of data in tables 7 and 8 seem to suggest two different conclusions about the relative growth of foundations. The total estimates in table 7 suggest a growth in the relative share continuing through the 1950's. The stockholding data in table 8, however, suggest a cessation in the growth in the relative share of foundations after 1950.

The quality of the data available does not admit of any precise reconciliation of these two sets of statistics. The early survey was admittedly incomplete as to coverage of foundations, and this coverage gradually improved. Also, the later surveys reflected a mixture of market values and ledger values. The stockholding data are based on a limited sample.

A large part of the discrepancy is accounted for by the fact that foundations have a very large portion of their investment in common stock compared to individuals and even compared to higher education endowments. Common stock has advanced far more in price in the last 15 years than other assets. This has been caused by both the growth in dividends and an increase in the price-earnings ratio. The implications of the stockholding data are that stock investments of foundations were not growing faster than the stock investments of other stock investors. All stock investors were gaining compared to people who owned just bonds, bank accounts, and insurance. Since foundations are heavily invested in stocks, this resulted in better than average growth for foundations, compared to total individual wealth.

If foundations were growing faster than other investors due to either an increasing flow of contributions or due to a parsimonious policy of distribution to charity, this should show up in the NYSE data as growth relative to other stock investors. It is significant that there is so little growth of this sort in the NYSE data.

Another evidence of foundation growth is afforded by recording the organization dates of presently large foundations. This serves to identify the 1940's and 1950's as the period of rapid foundation growth, although it is striking that the foundations established since 1950 are relatively small compared to those established before 1950. These data are contained in table 9.

On the basis of the meager evidence available, the following conclusions are suggested about private foundation growth:

(*a*) There was some growth of foundations relative to the rest of the economy in the 1930's and 1940's. This can be associated with the adoption of increased progressivity in estate and income taxes in the early 1930's plus the charitable contribution deduction under each tax.

(*b*) Since 1950, the total wealth of foundations has grown faster than the rest of the economy, but in this period the faster growth was probably due to the fact that their principal assets and corporate stocks were increasing in price faster than other assets. In terms of values of shares owned, the proportion owned by foundations appears to have been quite stable.

TABLE 9.—*Period of establishment of 5,050 foundations, by decades after 1900: by latest asset classes* [1]

Period	Number	Percent	Latest asset classes					
			$10 million or more		$1 million under $10 million		Less than $1 milion	
			Number	Percent	Number	Percent	Number	Percent
Total	5,050	100	175	100	800	100	4,075	100
Before 1900	18	(2)	1	1	9	1	8	(2)
1900 to 1909	18	(2)	8	5	5	1	5	(2)
1910 to 1919	76	2	14	8	36	4	26	1
1920 to 1929	173	3	27	15	65	8	81	2
1930 to 1939	288	6	45	26	100	12	143	3
1940 to 1949	1,638	32	54	31	299	38	1,285	32
1950 to 1959 [3]	2,839	56	26	15	286	36	2,527	62

[1] The 5,050 foundations tabulated here are those that had at least $100,000 of assets in 1962 and were thus included in the "Foundation Directory" and which also provided information to the Foundation Library Center as to date of organization.

[2] Less than 0.5 percent.

[3] Record incomplete; the fragmentary 1960—record (45 foundations) not included in table.

Source: "Foundation Directory," ed. 2, p. 13.

4. 1964 survey of foundations

In 1964 the Treasury Department conducted a survey of certain financial aspects of private foundations.[9] The survey involved initially selecting a sample of approximately 1,300 organizations whose Form 990–A was available (principally at the Foundation Library Center office in Washington, D.C.).

Certain parts of the information return, Form 990–A, are required by law to be made available to the public. The Foundation Library Center, a private, nonprofit organization, maintains a file of copies of this public part of the tax return for those exempt organizations which meet their definition of a foundation. The "Foundation Directory,"

[9] In the conduct of this survey assistance was obtained from the Internal Revenue Service and the Foundation Library Center offices in Washington, D.C., and New York City.

edition 2, page 9, published in 1964, explains the definition of a foundation used by the Center as follows:

> For purposes of this directory a foundation may be defined as a nongovernmental, nonprofit organization having a principal fund of its own, managed by its own trustees or directors, and established to maintain or aid social, educational, charitable, religious, or other activities serving the common welfare. Both charitable trusts and corporations are included. As previously, the new directory excludes "foundations" which make a general appeal to the public for funds; which act as trade associations for industrial or other special groups; which are restricted by charter solely to aiding one or several named institutions; or which function as endowments set up for special purposes within colleges, churches, or other organizations and are governed by the trustees of the parent institution. Obviously, many "foundations" fall in a gray area, with most of the characteristics of regular foundations but some disqualifications; edition 2 interprets the exclusions more rigidly than did its predecessor.

The "Foundation Directory" published by the Foundation Library Center omits "very small" foundations. The files of the Foundation Library Center do, however, contain copies of the Form 990–A for many of these very small foundations.

Since the word "foundation" is not technically defined for tax purposes, there is no ready way to separate those organizations called foundations from other tax-exempt organizations so far as tax information returns are concerned. As a means of obtaining a body of statistical information, it seemed necessary to utilize the classification which had been established by the Foundation Library Center. Data have been added for certain very large organizations which one might want to define as a foundation where these could be identified.[10] No effort was made to expand the center's definition in the other size categories. The Foundation Library Center indicates that their records show that there were approximately 15,000 foundations, according to their definition, in existence around the end of 1962. Of these, an estimated 9,000 were below $100,000 in total assets.

A stratified sampling design was adopted that would produce a sample of about 1,300 foundations. It developed that the 1962 Form 990–A was available in the Foundation Library Center for only about one-half of the total number of foundations. This was principally due to delays involved in obtaining and reproducing the returns. The sampling rates for the foundations below $1 million in size were accordingly doubled, and in the group of foundations with assets size of over $10 million other sources were utilized to obtain the Forms 990–A for the year 1962 in order to carry out the plan to have 100 percent coverage in this area. Information was taken from the Form 990–A, and a supplementary questionnaire was sent to each of the foundations whose return was selected.[11] In the aggregate a response rate of close to 98 percent was realized.[12]

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[10] Since the particular concern of the present study was private foundations, several community foundations which could be readily identified were omitted from the tabulation.

[11] Copies of the Form 990–A (including instructions) and the supplemental questionnaire are attached as exhibits 1 and 2, respectively.

[12] When the initial machine tabulation of results was run, the response rate to the questionnaire was about 96 percent. Those organizations from which a questionnaire was not received were tabulated in a special category called unclassified. The results of the initial run were adjusted in the very large category so as to shift several foundations from unclassified to the appropriate donor influence category on the basis of the questionnaire when it was received. Further, for several tabulations of market value asset data, the 2 percent of questionnaires received after the initial tabulations were taken into account. In the remaining cases where negligible effects would be involved, these last 2 percent of questionnaires received were not reallocated from the unclassified category tabulated. The total market value of assets of the unclassified category was calculated, where necessary, by raising the ledger values on stockholdings on the basis of market to ledger ratios for stockholdings on those foundations reporting market values.

The discussion in the following sections is based upon a tabulation of the return forms and questionnaire results. The statistics collected in the sample have been blown up to provide an estimate of the data for all 15,000 foundations. In the tables the small foundations are those whose assets at the beginning of 1962 were under $100,000. The medium foundations had assets of $100,000 to $1 million. The large foundations had assets of $1 million to $10 million. The very large foundations had assets over $10 million.

5. The income of foundations

In 1962 foundations in the aggregate had $1,065 million of total income after investment expenses, but including capital gains. Some material on the aggregate income of foundations is given in table 10.

TABLE 10.—*Aggregate income of foundations*

[Dollar amounts in millions]

	Total	Asset size				Percent of donor-related influence over investment policy				
		Very large over $10,000,000	Large, $1,000,000 to $10,000,000	Medium, $100,000 to $1,000,000	Small under $100,000	50 percent or more	Over 33 percent but not over 50 percent	Over 20 percent but not over 33 percent	Not over 20 percent	Unclassified
Number of foundations	14,865	175	800	4,910	8,980	11,000	810	100	2,430	525
RECEIPTS										
1. Gross profit from business activities [1]	$8	$3	$3	$1	$1.7	$1	$1	$1	$6	(2)
2. Interest	159	104	35	18	2.1	47	12	8	91	$1
3. Dividends	374	268	67	36	3.1	125	28	18	197	6
4. Rents	43	21	16	5	.7	18	1	9	14	(2)
5. Other ordinary income	57	39	5	12	1.2	30	5	3	20	1
6. Less expenses of earning gross income	62	35	13	11	2.6	28	5	8	20	1
7. Net ordinary income	580	400	113	61	6.2	194	42	31	307	6
8. Gains from sale of assets, excluding inventory	484	434	33	15	1.0	45	14	3	419	2
9. Total net ordinary income plus gains	1,065	834	146	76	7.2	239	56	34	726	10
10. Contributions received (net)	833	290	251	235	57.4	536	30	18	238	13
11. Total receipts (ordinary income, capital gains and contributions received)	1,898	1,124	397	311	64.6	775	86	52	964	23
GRANTS FROM INCOME										
12. Net	693	478	139	68	8.1	233	40	30	381	8
13. Cost of distribution	64	36	16	11	.8	20	4	2	38	1
14. Gross	757	514	155	79	8.9	253	44	32	418	9
GRANTS FROM PRINCIPAL										
15. Net	239	32	68	111	28.1	174	11	6	41	8
16. Cost of distribution	16	1	5	7	2.5	4	2	3	5	5
17. Gross	255	33	73	118	30.6	178	12	8	46	13
18. Total grants	1,012	547	228	197	39.5	431	56	40	464	21

[1] Gross sales or receipts from related and unrelated business activities less cost of goods sold or of operations.

[2] Less than $500,000.

Details may not add to totals due to rounding.

Source: 1964 Treasury Department Survey of Private Foundations.

Some summary figures on income and outgo of all foundations are given below. The total is shown with and without the Ford Foundation.

[Dollar amounts in millions]

	Total, including the Ford Foundation	Total, excluding the Ford Foundation
Net ordinary income	$580	$444
Capital gain	$484	$157
Total income	$1,065	$601
Grants out of current and accumulated income [1]	$757	$534
Contributions received	$833	$833
Grants out of principal [1]	$255	$255
Net worth (ledger values)	$10,856	$8,480
Rate of return (ordinary income) on ledger values (average beginning and end of year) (percent)	5.6	5.4
Net worth (market values)	$15,470	$12,430
Rate of return on market values (excluding capital gain) (percent)	3.7	3.6
Rate of grants to market net worth (end of year) (percent)	6.5	6.3

[1] Includes direct expenditure on charitable purposes and costs of making grants.

The total income of all foundations in 1962 was greatly affected by the large capital gains realized by the Ford Foundation.

If the Ford Foundation had realized capital gains only in the same relationship to total assets as all the other foundations, the aggregate income of foundations would have been reduced by almost $300 million to about $780 million.

In the aggregate Foundations made grants of $693 million which were reported as coming out of income. These grants involved a distribution cost of $64 million, and consequently, $757 million was spent in making distributions to charitable beneficiaries from current and accumulated income, about $320 million less than the current income including capital gains. (About $230 million of this excess of current income including capital gains over distributions came from the Ford Foundation, where there were relatively larger capital gains as defined above of about $300 million.)

During 1962, foundations received additional gifts of $833 million. In addition, the returns indicate that $239 million of grants were made to charitable beneficiaries from principal. These grants involved a distribution cost of $16 million, and thus, $255 million was spent making distributions from principal. In the aggregate, all grants including distribution costs exceeded current ordinary income by about $430 million.

The following is offered as a way of getting these aggregate statistics into some general perspective; other perspectives are possible. In 1962, if capital appreciation is temporarily left aside, foundations earned ordinary income of $580 million. At the same time the total outlay on grants, including distribution costs, was about $1,100 million, or about $520 million more than the total ordinary income. At the same time, foundations received contributions from outsiders of $833 million. Out of current ordinary income and contributions (i.e., excluding capital appreciation and realization of capital gains) about $300 million was set aside for growth of the foundations. This amounted to just about 2 percent of the net worth at the beginning of 1962.

In addition to this current income, foundations were able to enjoy some appreciation of their wealth holdings. To take a longrun view of this, the matter of how much of this appreciation occurred or was realized in 1962 may be put aside in order to concentrate on the expected value of the appreciation itself. About two-thirds of the current market value of the assets of foundations was represented by investment in corporate stock. Over the long run, it is not unrealistic to expect corporate stock to appreciate in value at a rate of about 5 percent a year.[13] With about two-thirds of the assets invested in common stock, the annual appreciation on total assets in the long run ought to be about two-thirds of 5 percent or about 3 percent a year. This when combined with the previously calculated 2 percent of net worth addition from current operations and contributions would indicate a rate of growth for the existing foundations of about 5 percent a year. This is itself in line with the common expectation of the growth in the gross national product, and if all foundations taken together grew at this rate, they would simply maintain their present relative importance compared to other wealthholders. They would neither get comparatively larger nor smaller. Foundations with their heavy investment in common stock would still gain if stock prices advance relative to other prices, or would lose ground if stock prices fall.

As was seen in the prior analysis of the New York Stock Exchange data, foundations do not appear to have changed their relative share of stockholdings since 1950. It was also argued that much of the growth of foundations' share of total wealth relative to the rest of the society could be explained by the abnormal capital appreciation in their major investment, stocks, since World War II. The foregoing analysis of the 1962 income account does not purport by itself to show that foundations will not expand relative to the rest of the economy. It indicates that in a general way the 1962 income account seems to be consistent with the New York Stock Exchange data suggesting no significant growth of foundations in the aggregate relative to the rest of the economy. With the kind of investment portfolio foundations have, normal capital appreciation will be about 3 percent a year. Foundations in the aggregate, by retaining in 1962 out of new contributions and income (other than capital gains) about 2 percent of their net worth, grew at a rate equivalent to the rest of the society.[14]

It should be quickly added that much of the annual contribution is for newly established foundations. If foundations, taken in the aggregate, are not to grow at a faster rate than the rest of the society while new foundations are being formed, then existing foundations will have to grow at well under 5 percent a year.

Also, it should be added that it is not here proposed that foundations in the aggregate should grow at exactly the same rate as the private sector. This analysis only goes to throwing some light on the rate of growth that does exist.

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[13] This is consistent with the aggregate value of corporations increasing in proportion to the aggregate profit of corporations, which ought to increase in proportion to the gross national product, which is commonly expected to increase at about 5 percent a year.

[14] Clearly, many foundations accumulated more of this out of ordinary income and contributions. If we examine all foundations except Ford, the accumulation out of ordinary income plus contributions was 4 percent of market value.

As will be seen from table 10, about two-thirds of the ordinary income of foundations came from dividends. The bulk of the remainder came from interest. Only 10 percent came from rents, and only 1 percent from the direct conduct of business activities. The relative shares of different sources were about the same for various size foundations with the exception of the small foundations where the dividend portion of the ordinary income was only about one-half, and the profit from direct business activity was about one-quarter. It should be observed in table 10 that the data with respect to small foundations are given in tenths of millions of dollars compared to the other statistics which are given in round millions of dollars. An additional decimal point is carried for the small foundation data only to give a better perspective of the relative size of various entries.

6. The wealth of foundations

Table 11 summarizes some balance sheet and related wealth information for foundations on the basis of the 1964 Treasury survey. In terms of the values which foundations carry on their books, generally the value when contributed or cost if acquired later, but sometimes market, the total assets of foundations were $11.6 billion, and the net worth was $10.9 billion at the end of the 1962 reporting year. In terms of the foundations' estimates of market values of their assets, the total assets were $16.3 billion and net worth was $15.5 billion. About two-thirds of this wealth was owned by the largest 175 foundations each of which exceeded in size $10 million measured by total assets at book (or ledger) value. The small foundations, those with assets under $100,000, comprising about 60 percent of all foundations, held slightly less than 2 percent of the assets of all foundations.

TABLE 11.—*Assets of foundations, beginning of tax year 1962*

[Dollar amounts in millions]

	Total	Asset size				Percent of donor-related influence over investment policy				
		Very large, over $10,000,000	Large, $1,000,000 to $10,000,000	Medium, $100,000 to $1,000,000	Small, under $100,000	50 percent or more	Over 33 percent, not over 50 percent	Over 20 percent, not over 33 percent	Not over 20 percent	Unclassified
Number of foundations	14,865	175	800	4,910	8,980	11,000	810	100	2,430	525
	LEDGER VALUES, END OF THE YEAR									
ASSETS										
1. Cash	$443	$110	$124	$166	$43	$268	$31	$21	$109	$14
2. Accounts receivable	50	12	9	25	4	32	1	(1)	14	4
3. Notes receivable	189	118	30	35	6	117	32	18	21	(1)
4. Mortgage loans	149	63	61	19	6	60	13	(1)	77	1
5. Corporation stock	6,529	4,409	1,237	783	100	2,620	488	249	3,072	103
6. Other assets [2]	5,119	3,174	1,095	744	106	1,728	351	266	2,737	35
7. Total assets	11,648	7,583	2,332	1,527	206	4,348	839	515	5,809	138
LIABILITIES										
8. Accounts payable	17	8	6	3	(1)	8	1	1	7	1
9. Grants payable	524	488	31	5	(1)	75	10	20	419	(1)
10. Bonds, etc., payable	137	73	32	27	5	101	4	11	22	(1)
11. Other liabilities	114	53	42	15	4	44	3	2	64	1
12. Net worth (L)	10,856	6,961	2,221	1,477	197	4,120	821	481	5,297	136
	MARKET VALUES, END OF THE YEAR									
13. Corporation stock (M)	10,896	8,050	1,783	955	108	3,880	860	668	5,331	159
14. Total assets (M)	16,262	11,331	2,940	1,773	218	5,666	1,270	945	8,180	201
15. Net worth (M)	15,470	10,709	2,829	1,723	209	5,438	1,252	911	7,668	199

[1] Less than $0.5 million.
[2] This is almost all bonds.

Source: 1964 Treasury Department Survey of Private Foundations.

In slightly over two-thirds of all foundations by number, the donor or persons related in some way to the donor made up 50 percent of those trustees who take some voice in investment policy, including the decision of how much of the currently available funds will be reinvested and how much will be applied to charitable purposes. (A trustee whose sole participation involves selecting which charitable activity gets the money was not taken into account.) Foundations were classified by the portion of trustees who participated in investment policy, as defined above, who were related in any way to the donor, including his lawyers, his accountant, distant relatives, and employees. The number in each classification would be affected very little if a narrower definition of donor-related trustee were utilized, since in most cases the influence was exercised through immediate family members on the board. In dollar terms the foundations with less than 20 percent influence were slightly more important than the foundations with 50 percent or more donor influence because of the presence of some very large foundations, such as Ford in the former category.

Foundations have extremely little indebtedness. Excluding grants payable, the total liabilities of foundations amount to barely more than 2 percent of ledger assets.

7. Certain ratios with respect to foundations

Table 12 classifies the foundations by certain ratios involving grants, income, and assets. The table gives estimated figures for all foundations, that is, the sample portion of the survey was blown up. The first four banks of the table show the ratio of grants to various sources of income. The next four banks deal with various ratios of income to net worth. The last two show ratios of grants made to net worth. In the aggregate the average ratio of ordinary income (net) to book value was 5.6 percent and to market value 3.7 percent. The average rates of total income (ordinary income plus capital gains) to book and market values, respectively, were 10.6 percent and 6.8 percent. Grants were on the average 172 percent of ordinary income and 94 percent of total income. They were equal to 120 percent of contributions received and 53 percent of total sources (total income plus contributions received). On the average, grants were 10 percent of book net worth and 6.4 percent of market net worth.

TABLE 12.—*Distribution of number of foundations by various ratios*

	All foundations	Percent of donor-related influence over investment policy					Asset size			
		50 percent or more	Over 33 percent, not over 50 percent	Over 20 percent, not over 33 percent	Not over 20 percent	Unclassified	Very large, over $10,000,000	Large, $1,000,000 to $10,000,000	Medium, $100,000 to $1,000,000	Small, under $100,000
Total [1]	14,850	10,990	810	100	2,420	530	164	800	4,910	8,980
Ratio of grants (gross) to total income (ordinary income plus capital gains)										
Below 25 percent	880	410	50	10	380	30	5	30	230	620
25 to 50 percent	430	240	30	0	160	1	14	60	220	140
50 to 100 percent	2,070	1,290	180	20	520	60	74	260	960	780
100 to 150 percent	1,680	1,140	120	20	360	50	51	170	840	620
Over 150 percent	5,810	4,680	200	50	670	220	19	260	3,170	3,360
No computation (total income zero or negative)	3,980	3,241	230	10	320	170	1	40	490	3,460
Ratio of grants (gross) to ordinary income										
Below 25 percent	700	310	40	10	320	20	3	20	140	540
25 to 50 percent	260	130	30	0	100	10	3	20	160	80
50 to 100 percent	1,990	1,220	180	10	520	40	62	240	920	760
100 to 150 percent	1,720	1,110	120	20	410	60	63	190	870	600
Over 150 percent	6,690	5,440	210	50	740	250	33	320	2,500	3,840
No computation (ordinary income zero, or negative)	3,500	2,780	230	10	330	150	0	20	320	3,160
Ratio of grants (gross) to total sources (total income plus contributions received)										
Below 25 percent	2,920	2,020	160	20	640	80	16	100	950	1,860
25 to 50 percent	2,260	1,750	110	0	340	60	19	110	970	1,160
50 to 100 percent	4,100	3,010	200	60	700	140	85	340	1,440	2,240
100 to 150 percent	2,010	1,430	150	20	340	70	33	140	610	1,220
Over 150 percent	2,350	1,820	130	10	260	120	10	90	770	1,480
No computation (total sources zero or negative)	1,220	960	60	0	130	60	1	20	170	1,020

See footnotes at end of table, p. 87.

TABLE 12.—*Distribution of number of foundations by various ratios*—Continued

	All foundations	Percent of donor-related influence over investment policy					Asset size			
		50 percent or more	Over 33 percent, not over 50 percent	Over 20 percent, not over 33 percent	Not over 20 percent	Unclassified	Very large, over $10,000,000	Large, $1,000,000 to $10,000,000	Medium, $100,000 to $1,000,000	Small, under $100,000
Total [1]	14,850	10,990	810	100	2,420	530	164	800	4,910	8,980
Ratio of grants to contributionsreceived										
Below 25 percent	2,010	1,530	60	10	360	50	6	60	620	1,320
25 percent to 50 percent	1,770	1,370	130	1	240	40	7	60	680	1,020
50 percent to 100 percent	2,620	2,220	80	20	230	70	7	70	850	1,700
100 percent to 150 percent	1,550	1,240	100	4	150	50	8	80	840	1,020
Over 150 percent	2,060	1,460	100	20	390	80	58	250	730	1,020
No computation (no contributions received)	4,850	3,180	330	40	1,060	230	78	280	1,590	2,900
Ratio of total income to book net worth										
Total income negative	990	800	70	10	50	50	1	20	370	600
0 to 1 percent	3,600	2,940	160	10	360	140	7	30	400	3,160
1 to 3 percent	2,830	2,095	150	10	470	110	11	100	1,060	1,660
3 to 6 percent	4,730	3,350	260	50	950	110	63	360	2,040	2,260
6 to 10 percent	1,260	890	90	20	260	10	55	180	520	500
Over 10 percent	1,150	730	60	10	270	90	26	100	460	560
No computation (no book net worth)	310	190	20	0	80	20	1	10	60	240
Ratio of total income to market net worth										
Total income negative	990	800	70	10	50	50	1	20	370	600
0 to 1 percent	3,640	2,920	190	10	370	140	7	40	390	3,200
1 to 3 percent	3,270	2,440	160	20	530	110	28	140	1,280	1,820
3 to 6 percent	4,620	3,240	270	50	950	120	89	420	1,990	2,120
6 to 10 percent	930	690	50	3	180	3	27	100	390	420
Over 10 percent	1,150	720	50	4	300	80	11	70	450	620
No computation (no market net worth)	260	170	20	0	50	20	1	20	40	200

Total [1]	14,850	10,990	810	100	2,420	530	164	800	4,910	8,980
Ratio of ordinary income to book net worth										
Ordinary income negative	440	260	50	10	60	30	0	10	220	180
0 to 1 percent	3,840	3,160	170	10	370	130	9	20	430	3,380
1 to 3 percent	3,600	2,720	160	50	550	160	15	140	1,330	2,120
3 to 6 percent	5,280	3,720	310	15	1,070	140	87	460	2,330	2,400
6 to 10 percent	840	550	80	5	170	30	40	110	310	380
Over 10 percent	570	400	20	10	120	20	12	50	230	280
No computation (no book net worth)	310	190	20	0	80	20	1	10	60	240
Ratio of ordinary income to market net worth										
Ordinary income negative	440	260	50	10	60	30	0	10	220	180
0 to 1 percent	3,880	3,150	200	20	390	130	10	30	420	3,420
1 to 3 percent	4,140	3,120	190	50	640	160	44	220	1,540	2,340
3 to 6 percent	4,990	3,500	280	2	1,020	140	90	460	2,260	2,180
6 to 10 percent	570	390	50	4	100	30	16	40	210	300
Over 10 percent	620	420	10	10	160	20	3	30	220	360
No computation (no market net worth)	260	170	20	0	50	20	1	20	40	200
Ratio of grants to book net worth										
0 to 1 percent	1,370	730	120	20	450	50	9	20	280	1,060
1 to 3 percent	1,470	1,000	110	20	280	60	14	90	630	740
3 to 6 percent	2,810	1,890	190	10	670	60	66	280	1,420	1,040
6 to 10 percent	1,820	1,410	80	10	250	70	44	170	860	740
Over 10 percent	7,070	5,780	300	40	680	270	30	220	1,660	5,160
No computation (no book net worth)	310	190	20	0	80	20	1	12	60	240
Ratio of grants to market net worth										
0 to 1 percent	1,440	730	120	20	510	50	9	30	280	1,120
1 to 3 percent	1,820	1,200	160	20	380	60	39	160	810	280
3 to 6 percent	2,750	1,850	190	10	630	60	76	280	1,350	1,040
6 to 10 percent	1,710	1,380	40	2	220	60	28	140	810	740
Over 10 percent	6,880	5,660	270	40	670	280	11	190	1,620	5,060
No computation (no market net worth)	260	170	20	0	50	20	1	20	40	200

[1] Differs slightly from number in Tables 10 and 11 because this table excludes about 10 large foundations for which data were not available when this table was prepared.

Source: 1964 Treasury Department Survey of Private Foundations.

8. Frequency of certain transactions

Table 13 summarizes the answers to a number of questions asked on the Form 990–A concerning the occurrence of various transactions between the foundation and a substantial donor, and various persons related to the donor.

Under present law, the transactions involved in question 2 might be considered prohibited transactions, a cause for denial of the charitable exemption, only if the price involved in the transaction was not an arm's-length price. The question is designed to call the attention of a revenue agent to a particular transaction that might need to be investigated further. A foundation answering "yes" to any part of this question does not indict itself as having forfeited its exemption, but it is possible that some of these transactions go unreported in order to avoid having questions raised by revenue agents. Because of this possibility the answers to question 2 on table 13 may understate the frequency of these transactions.

The answers to question 3 on table 13 are in response to a question on the supplemental questionnaire, relating to the occurrence of transactions between the foundation and its officials (and parties related to such officials). Present law does not contain a specific prohibition on these types of transactions. Occurrence of one of the listed transactions between a foundation and an official, or a party related to an official of the foundation would be indicated by a "yes" answer to that part of question 3.

Question 4 dealing with holdings of 10 percent or more of any class of stock was also taken from the supplemental questionnaire.

TABLE 13.—*Responses to questions concerning certain transactions, etc.*

1. Did you hold any real property for rental purposes with respect to which there is an indebtedness incurred in acquiring the property or in making improvements thereto or which was acquired subject to a mortgage or similar lien?

[In percent]

	Yes	No	No answer
Total	1.2	97.1	0.7
Very large	3.7	92.1	4.3
Large	3.5	95.5	1.0
Medium	2.6	96.4	1.0
Small	.2	99.4	.4
Donor influence 50 percent or over	1.1	94.6	4.3
Donor influence under 50 percent, over 20 percent	.4	98.3	1.2
Donor influence not over 20 percent	2.1	96.0	1.9
Unclassified	2.3	97.7	0

2. After July 1, 1950, did—
The creator of your organization, or
A contributor to your organization, or
A brother or sister (whole or half blood), spouse, ancestor, or lineal descendant of such creator or contributor, or
A corporation owned (50 percent or more of voting stock or 50 percent or more of value of all stock) directly or indirectly by such creator or contributor
(*a*) Borrow any part of your income or corpus?

[In percent]

	Yes	No	No answer
Total	0.9	98.2	0.9
Very large	1.2	94.4	4.3
Large	1.5	96.0	2.5
Medium	1.6	97.2	1.2
Small	.4	99.2	.4
Donor influence 50 percent or over	1.3	98.1	.6
Donor influence under 50 percent, over 20 percent	.1	98.7	1.2
Donor influence not over 20 percent	.8	97.0	2.1
Unclassified	0	100.0	0

(*b*) Receive any compensation for personal services from you?

[In percent]

	Yes	No	No answer
Total	1.4	97.7	1.0
Very large	5.5	90.3	4.3
Large	4.0	94.0	2.0
Medium	2.4	96.4	1.2
Small	.4	99.0	.6
Donor influence 50 percent or over	1.4	98.0	.7
Donor influence under 50 percent, over 20 percent	3.8	94.9	1.2
Donor influence not over 20 percent	.7	97.2	2.1
Unclassified	.2	99.8	0

(*c*) Have any part of your services or assets made available to him?

[In percent]

	Yes	No	No answer
Total	0.2	98.8	1.0
Very large	1.2	93.9	4.9
Large	1.0	97.0	2.0
Medium	.4	98.4	1.2
Small	0	99.3	.7
Donor influence 50 percent or over	.2	99.1	.7
Donor influence under 50 percent, over 20 percent	.4	98.3	1.2
Donor influence not over 20 percent	(1)	97.9	2.1
Unclassified	0	100.0	0

[1] Less than 0.05 percent.

(*d*) Purchase any securities or other property from you?

[In percent]

	Yes	No	No answer
Total	1.4	97.7	0.8
Very large	2.4	92.7	4.9
Large	4.5	93.5	2.0
Medium	2.6	96.4	1.2
Small	.4	99.2	.4
Donor influence 50 percent or over	1.9	97.5	.6
Donor influence under 50 percent. over 20 percent	.5	98.3	1.2
Donor influence not over 20 percent	0	97.9	2.1
Unclassified	.2	98.2	0

2. (*e*) Sell any securities or other property to you?

[In percent]

	Yes	No	No answer
Total	4.2	94.9	0.9
Very large	4.9	90.2	4.9
Large	7.5	92.5	2.0
Medium	5.9	92.7	1.4
Small	2.9	96.7	.4
Donor influence 50 percent or over	5.0	94.3	.7
Donor influence under 50 percent, over 20 percent	5.3	93.5	1.2
Donor influence not over 20 percent	.8	97.0	2.1
Unclassified	.2	99.8	0

(*f*) Receive any of your income or corpus in other transactions?

[In percent]

	Yes	No	No answer
Total	0.4	98.7	0.9
Very large	1.8	93.3	4.9
Large	1.5	96.0	2.5
Medium	1.0	97.6	1.4
Small	.0	99.6	.4
Donor influence 50 percent or over	.4	98.9	.7
Donor influence under 50 percent, over 20 percent	.4	98.3	1.2
Donor influence not over 20 percent	.6	97.3	2.1
Unclassified	0	100.0	0

3. During the period covered by your 1962 Form 990–A, did—

Any of the officials of your organization, or

The brothers, sisters, spouses, ancestors, or lineal descendants of the officials, or

Corporations owned (50 percent or more of voting stock or 50 percent or more of value of all stock) directly or indirectly, by the officials, or

Partnerships of other unincorporated business ventures in which the officials owned 50 percent or more of the capital interests or profits interests—

(*a*) Borrow any part of your cash, securities, or other property?

[In percent]

	Yes	No	No answer
Total	0.3	94.7	[1] 5.0
Very large	3.0	94.5	2.4
Large	0	97.0	3.0
Medium	.4	95.1	4.5
Small	.2	94.2	5.6
Donor influence 50 percent or over	.4	98.2	1.4
Donor influence under 50 percent, over 20 percent	.2	99.8	0
Donor influence not over 20 percent	.1	96.9	3.1
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

(*b*) Lend any cash, securities, or other property to you?

[In percent]

	Yes	No	No answer
Total	1.6	93.5	[1] 5.0
Very large	.2	97.4	2.4
Large	1.5	95.5	3.0
Medium	2.0	93.3	4.7
Small	1.3	93.4	5.3
Donor influence 50 percent or over	2.0	96.7	1.3
Donor influence under 50 percent, over 20 percent	1.1	89.9	0
Donor influence not over 20 percent	[2]	96.9	3.1
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.
[2] Less than 0.05 percent.

3. (*c*) Have any part of your services or assets (other than compensation for personal services reported on schedule A of your 1962 Form 990–A) made available to them?

[In Percent]

	Yes	No	No answer
Total	0.2	94.7	[1] 5.1
Very large	.1	97.5	2.4
Large	.5	96.5	3.0
Medium	.4	94.9	4.7
Small	0	94.4	5.6
Donor influence 50 percent or over	.2	98.5	1.3
Donor influence under 50 percent, over 20 percent	.4	99.6	0
Donor influence not over 20 percent	0	96.1	3.9
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

(*d*) Purchase any securities or other property from you?

[In percent]

	Yes	No	No answer
Total	0.6	94.3	[1] 5.0
Very large	0	97.6	2.4
Large	1.5	95.5	3.0
Medium	.6	94.5	4.9
Small	.4	94.3	5.3
Donor influence 50 percent or over	.7	97.8	1.5
Donor influence under 50 percent, over 20 percent	0	100.0	0
Donor influence not over 20 percent	.4	96.9	2.6
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

(*e*) Sell any securities or other property to you?

[In percent]

	Yes	No	No answer
Total	1.1	93.9	[1] 5.0
Very large	3.0	94.6	2.4
Large	0	97.0	3.0
Medium	1.6	93.5	4.9
Small	.9	93.8	5.3
Donor influence 50 percent or over	1.2	97.3	1.5
Donor influence under 50 percent, over 20 percent	.2	99.8	0
Donor influence not over 20 percent	1.2	96.1	2.6
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

(*f*) Receive any of your cash, securities, or other property in other transactions?

[In percent]

	Yes	No	No answer
Total	0.5	94.5	[1] 5.0
Very large	1.2	96.4	2.4
Large	.5	96.5	3.0
Medium	.2	94.9	4.9
Small	.7	94.0	5.3
Donor influence 50 percent or over	.7	97.9	1.4
Donor influence under 50 percent, over 20 percent	.1	99.9	0
Donor influence not over 20 percent	0	96.9	3.1
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

42–663—65——7

4. During the period covered by your 1962 Form 990–A, did your organization hold 10 percent or more of any class of stock in any corporation?

[In percent]

	Yes	No	No answer
Total	7.3	88.9	3.8
Very large	44.6	53.0	2.4
Large	20.4	77.5	2.0
Medium	11.0	85.1	3.9
Small	3.3	92.7	4.0
Donor influence 50 percent or over	8.5	91.2	.3
Donor influence under 50 percent, over 20 percent	6.9	93.1	0
Donor influence not over 20 percent	3.0	96.2	.7
Unclassified	0	0	100.0

Source: 1964 Treasury Department Survey of Private Foundations.

9. Foundation payout ratios to assets

Tables 14 and 15 expand upon the information contained in table 12 as to the relationships between grants and net worth of foundations and between ordinary income and net worth. Table 14 shows the percentage of foundations whose total grants are equal to or less than various percentages of net worth. In the top line, for example, the table shows that 10 percent of all foundations in 1962 paid out as grants, including the cost of distributing grants, 1 percent or less of their market net worth. An additional 12 percent of foundations paid out more than 1 percent but less than 3 percent of market net worth. Combining these groups, as is done in the table, 22 percent of all foundations paid out 3 percent or less of their market net worth. Forty percent of all foundations paid out as grants 6 percent or less of their market net worth. It would appear reasonable to interpolate between these figures, and thus it could be estimated that 25 percent of all foundations paid out as grants less than 3½ percent of market net worth. These ratios of grants to net worth are tabulated for various degrees of donor influence and for various sizes of foundations.

Table 15 provides similar information about the relationship between ordinary income and net worth. Of all foundations, 3 percent had no ordinary income. An additional 26 percent had ordinary income between zero and 1 percent of market net worth, making 29 percent that had an ordinary income rate of return of 1 percent or less. A total of 57 percent had a rate of 3 percent or less, and only 10 percent had a return of over 6 percent. Generally, foundations with high donor influence had lower rates of return than other foundations. Similarly, large foundations had better rates of return than small ones. (Many small foundations, which operate as conduits, normally hold their assets in cash.)

TABLE 14.—*Percent of foundations in various categories whose total grants were less than certain percentages of net worth*

	Foundations whose grants were less than—							
	1 percent—	3 percent—	6 percent—	10 percent—	1 percent—	3 percent—	6 percent—	10 percent—
	of market net worth				of book net worth			
All foundations	10	22	40	[1] 52	9	19	38	50
Foundations with donor-related influence—								
Over 50 percent	7	18	34	47	7	16	33	46
33 percent to 50 percent	15	35	59	64	15	28	51	61
20 percent to 33 percent	21	43	57	59	21	41	52	58
0 to 20 percent	21	37	63	72	19	30	38	68
Very large	5	29	76	93	5	14	54	81
Large	4	24	57	76	2	14	49	70
Medium	6	22	50	66	6	19	48	65
Small	12	21	33	41	12	20	32	40
All foundations except small:								
Total	5	22	51	68	5	18	48	66
Foundations with donor-related influence—								
Over 50 percent	4	20	48	67	4	16	45	64
20 percent to 50 percent	10	39	68	74	10	26	57	72
0 to 20 percent	8	25	60	72	8	19	56	71

[1] The remaining 48 percent of foundations contibuted 10 percent or more of their market net worth, 60 percent contributed 6 percent or more, 78 percent contributed 3 percent or more, etc.

Source: 1964 Treasury Department Survey of Private Foundations.

TABLE 15.—*Percent of foundations in various categories whose ordinary incomes were less than certain percentages of market net worth*

	Foundations whose ordinary incomes were less than—				
	0 percent—	1 percent—	3 percent—	6 percent—	10 percent—
	of market net worth				
All foundations	3	29	57	90	94
Foundations with donor-related influence—					
Over 50 percent	2	31	59	91	94
33 percent to 50 percent	7	31	58	90	96
20 percent to 33 percent					
Under 20 percent	3	19	45	87	93
Very large foundations	0	6	31	89	98
Large foundations	1	5	32	89	93
Medium foundations	4	13	44	91	95
Small foundations	2	40	66	90	93

Source: 1964 Treasury Department Survey of Private Foundations.

A certain number of foundations are so-called conduit foundations which are organized simply to receive contributions and more or less immediately distribute these to charitable recipients. These foundations are likely to have very little in the way of net worth, and almost necessarily their ratio of total grants to net worth would be very high. One device for separating out many of the conduit foundations is to eliminate from consideration all foundations with total assets of less than $100,000. The resulting calculations are shown on the bottom four lines of table 14. Looking at the line for the total of all foundations with assets of over $100,000, it will be seen that the percentage of foundations that distributed in grants less than 1 percent

of market net worth is only 5 percent. The percentage of foundations distributing less than 3 percent of market net worth is 22 percent whether or not the small foundations are included. The percentage of foundations distributing less than 6 percent of net worth rises from 40 to 51 percent when the small foundations are excluded. The percentage distributing less than 10 percent of net worth rises from 52 to 68 percent when the small foundations are excluded.

Another attempt was made to eliminate the influence of conduit foundations on asset payout ratios. This was done by preparing an analysis of the data limited only to those foundations that reported no contributions received in 1962. As in the prior tabulations, the sample results for large, medium, and small foundations with no contributions have been blown up. It is estimated that about one-third of foundations had no contributions received in 1962. Since the Ford Foundation would be included in this category, and would tend to dominate the figures, table 16, which presents some summary figures on foundations receiving no contributions in 1962, contains the data excluding the Ford Foundation. This subsample, even though it is based only on about 400 foundation returns, is quite useful in illustrating the behavior pattern of foundations with respect to the handling of income.

TABLE 16.—*Aggregate data on foundations reporting no contributions received in 1962*

[Dollar amounts in millions]

	Foundations with no contributions received in 1962		Percent of donor-related influence over investment policy		
	All except Ford	Ford	Over 50 percent	Over 33 percent—not over 50 percent	Uncer 30 percent, all except Ford
Number of foundations	4,595	1	3,155	333	1,107
Net ordinary income (after expenses)	$149.8	$136.4	$56.4	$10.7	$82.7
Capital gain	45.7	327.2	20.4	4.9	20.3
Total income	195.5	463.6	76.8	15.6	103.0
Grants from current and accumulated income [1]	158.7	233.4	66.8	12.6	79.4
Grants from capital [1]	26.5	----------	15.0	1.2	10.3
Total grants	185.2	233.4	81.8	13.8	89.7
Net worth (ledger)	2,723.0	2,217.0	1,051.0	234.0	1,437.0
Net worth (market)	4,010.0	3,114.0	1,612.0	342.0	2,056.0

[1] Includes cost of making grants.

Source: 1964 Treasury Department Survey of Private Foundations.

It is interesting that in the aggregate, foundations that received no contributions still made grants in excess of current income. An appreciable amount of grants were presumably in excess of accumulated income and were therefore marked as coming from capital. In the aggregate, grants were not as large as the sum of ordinary income and capital gains. In the aggregate figures the volume of grants relative to income was higher for those foundations where donor influence exceeded 50 percent than it was for others.

Table 17 shows some percentage calculations based on the calculation of ratios between grants to net worth and ordinary income to net worth for those foundations receiving no current contributions in 1962. As would be expected, a higher percentage of these foundations would be affected by a requirement that grants be a certain percentage of net worth than was true when this requirement was tested against all foundations. In this case about 40 percent of these foundations would be affected by a 3½ percent payout requirement while the percentage was about 25 percent for all foundations. It might be noted also that the earnings experience is somewhat better when one looks at foundations without contributions because, by and large, less of the assets tend to be invested in highly liquid forms as might be appropriate where the foundation is serving only as a conduit. Most likely about 40 percent of these foundations have a current earnings rate in terms of ordinary income in excess of 3½ percent of market net worth. It would be expected that those foundations whose rate of return on net worth was relatively high should pretty much correspond to those foundations whose ratio of grants to net worth was also high. Nevertheless there would be some of the foundations whose rate of return was in excess of 3½ percent who would not have made a correspondingly high ratio of grants to net worth. The combined test of a volume of grants equal to the higher of 3½ percent of market net worth or ordinary income might affect about 50 percent of these foundations.

TABLE 17.—*Percent of foundations receiving no current contributions whose total grants and ordinary income were less than certain percentages of net worth*

	Foundations whose grants were less than—				Foundations whose ordinary income was less than—				
	1 percent—	3 percent—	6 percent—	10 percent—	0	1 percent—	3 percent—	6 percent—	10 percent—
	of market net worth				of market net worth				
All foundations receiving no current contributions	19	35	59	69	2	24	49	87	92
Foundations with no contributions received whose donor related influence was—									
over 50 percent	17	29	49	61	2	29	53	88	92
33 percent to 50 percent	27	39	67	82	6	20	40	88	94
0 to 33 percent	24	49	84	98	1	11	41	84	92
Foundations with assets over $100,000 with no contributions received whose donor related influence was—									
over 50 percent	8	24	62	77	3	10	36	91	94
33 percent to 50 percent	5	38	74	79	0	5	42	99	100
0 to 33 peacent	10	33	78	87	2	5	25	87	94

Source: 1964 Treasury Department Survey of Private Foundations.

Even in this group of foundations with no contributions received in 1962, it is likely that some conduit foundations are included, that is, foundations which were distributing contributions received in 1961. Including these in the tabulations continues to distort the relationship between capital and payout. (Nearly half of the small foundations with donor influence over 50 percent distributed over 10

percent of net worth in grants and thus apparently got contributions in previous years. None of the small foundations with donor influence less than 33 percent without contributions showed this pattern of contributions over 10 percent of net worth.) A more revealing set of figures on the relationship of grants to market net worth for foundations not receiving contributions is shown in the bottom bank of table 17 which eliminates foundations receiving contributions in 1962 and foundations with assets under $100,000. In these figures foundations with high donor-related influence show a slightly better payout performance, despite showing a somewhat poorer record on earning income. The differences in payout, however, are quite small, and at this point the sample of foundations receiving no contributions in 1962 and having assets over $100,000 is fairly small. The sample includes 142 foundations in the over-50-percent category, 31 in the 33- to 50-percent category, and 117 in the under-33-percent category.

It is not clear why, in these various sets of ratios, the foundations with a high proportion of donor-related trustees appear to show a somewhat better payout performance. It may be that this group contains many situations where future contributions from the donor or his family are still expected which induces the trustees to be more liberal with available assets.

10. Foundation involvement in business

Table 18 lists those foundations with assets of $10 million or more which own 20 percent or more of the stock of business corporations. The table sets forth the foundations' holding of the stock of the businesses as of the end of 1962, cash dividends paid on such stock in 1962, yield, and the total assets of the foundations as of the end of 1962. This table was prepared from data obtained from the Form 990–A and supplemental questionnaire.

TABLE 18.—*Ownership of more than 20 percent of the stock of business corporations by foundations with assets $10 million or more* [1]

[In millions of dollars]

Name of foundation	Stockholding, end of 1962	Approximate value of stock, end of 1962	1962 cash dividends	Yield	Total assets of foundation, end of 1962
I. Donor and donor-related parties represent ½ or more of foundation's trustees, etc., who control investment policy:				*Percent*	
Alcoa foundation	24 percent of Nalco Chemical Co. common stock	[2] $26.1	$0.58	2.2	[2] $43.3
Winfield Baird foundation	24 percent of Skyline Oil Co. common stock	[3] 2.1	0	0	[3] 17.5
Charles Ulrick and Josephine Bay Foundation	73 percent of voting power (through common and voting preferred stock) of Connecticut Railway and Lighting Co.	[3] 6.6	.36	5.5	[3] 10.1
Cannon foundation	39 percent of Imperial Cotton Mills Co. common stock	[3] .6	.01	1.7	[2] 25.2
	42 percent of Social Circle Cotton Mills Co. common stock	[3] .6	.01	1.7	----------
	46 percent of Amazon Cotton Mills Co. common stock	[3] 1.0	.03	3.0	----------
	Preferred and nonvoting common stock of Concord Telephone Co.; foundation's holding represents 33 percent of value of all shares of Concord Telephone Co. stock.	[3] 1.0	.06	6.0	----------
Amon G. Carter Foundation	100 percent of Carter Foundation Production Co. common stock.	[2] 1.5	0	0	[2] 33.2
	50 percent of Citizens Hotel Corp. common stock	[2] .6	0	0	----------
Danforth Foundation	23 percent of Ralston Purina Co. common stock	[2] 97.4	2.43	2.5	125.2
De Rance, Inc	47 percent of Miller Brewing Co. common stock	[2] 15.0	.44	2.9	[2] 15.0
El Pomar Foundation	100 percent of common stock and 86 percent of preferred stock of El Pomar Investment Co.	[2] 50.8	.66	1.3	[2] 60.5
	100 percent of Broadmoor Drug Co. common stock	[2] .1	0	0	----------
General Electric Foundation	30 percent of Stevens Paper Mills, Inc., common stock	[3] 1.3	.04	3.1	[2] 25.0
Herrick Foundation	23 percent of Tecumseh Products Co. common stock	[2] 25.1	1.0	4.0	[2] 25.2
Houston Endowment, Inc	100 percent of Commercial & Industrial Life Insurance Co. common stock.	[2] 1.5	.03	2.0	[2] 90.4
	100 percent of Commerce Co. common stock	[2] 15.2	.12	.8	----------
	94 percent of Commerce Co. preferred stock	[2] 2.8	.11	3.9	----------
	51 percent of Airline State Bank, Houston, common stock	[2] .5	0	0	----------
	42 percent of Reagan State Bank, Houston, common stock	[2] .5	0	0	----------
	26 percent of National Bank of Commerce, Houston common stock.	[2] 27.8	.42	1.5	
Kresge foundation	100 percent of Kresge-Newark, Inc. common stock	[3] 3.0	.00	0	----------
	34 percent of S. S. Kresge Co. common stock	[2] 40.1	2.84	7.1	
LeTourneau foundation	86 percent of R. G. LeTourneau, Inc. common stock	[3] 4.7	0	0	[3] 11.6
Lilly Endowment, Inc	45 percent of Eli Lilly and Co. common stock	[2] 108.1	3.39	3.1	[2] 151.5
	Nonvoting common stock of Eli Lilly and Co.; foundation's holding of nonvoting common stock represents 7 percent of value of all shares of Eli Lilly and Co. stock.	[2] 42.0	1.32	3.1	----------

See footnotes at end of table, p. 99.

TABLE 18.—*Ownership of more than 20 percent of the stock of business corporations by foundations with assets $10 million or more* [1]—Continued

Name of foundation	Stockholding, end of 1962	Approximate value of stock, end of 1962	1962 cash dividends	Yield	Total assets of foundation, end of 1962
I. Donor and donor-related parties, reprcsent ½ or more of foundation's trustees, etc., who control investment policy.—Continued				*Percent*	
Moody foundation	50 percent of Gal-Tex Hotel Corp. common stock	[3] $1.4	0	0	[2] $189.3
	50 percent of Silver Lake Ranches Co. common stock	[3].7	0	0	----------
	100 percent of Texas National Hotel Co. common stock	[3] 1.3	0	0	----------
	35 percent of American National Insurance Co. common stock	[2] 167.3	$2.42	1.4	----------
	44 percent of Hotel Wade Hampton, Inc., common stock	[3].3	.00	0	----------
	40 percent of Moody National Bank common stock	[3].8	.01	1.3	----------
	35 percent of National Hotel Co. common stock	[3] 2.5	.00	0	----------
Charles Stewart Mott Foundation	100 percent of D. M. Christian Co. common stock	[3].4	.00	0	[2] 112.3
	100 percent of J. W. Knapp Co. common stock	[3] 4.7	.00	0	----------
	100 percent of Smith Bridgman & Co. common stock	[3] 3.2	.00	0	----------
	100 percent of L. W. Robinson Co. common stock	[3] 1.0	.00	0	----------
	61 percent of Wayne Oakland Bank common stock	[2] 7.6	.00	0	----------
	48 percent of U.S. Sugar Corp. common stock	[2] 23.7	.75	3.2	----------
Sid W. Richardson Foundation	100 percent of Richardson Oils, Inc. common stock	[3] 11.7	0	0	[2] 95.0
	75 percent of Sid W. Richardson Carbon & Gasoline Co. common stock.	[3] 7.4	0	0	----------
	69 percent of Texas State Network, Inc., common stock	[3] 1.3	0	0	----------
	49 percent of Citizens Hotel Co. common stock	[3].7	0	0	----------
Rogosin Foundation	23 percent of Beaunit Corp. common stock	[2] 9.7	.53	5.5	[2] 10.5
Scriven Foundation	100 percent of Leatherstocking Corp. capital stock	[2] 3.0	0	0	[2] 14.4
William Volker Fund	23 percent of Joanna Western Mills Co. common stock	[3] 1.5	.08	5.3	[2] 14.3
William K. Warren Foundation	34 percent of Natural Gasoline Co. common stock	[3] 2.3	.01	.4	[2] 35.5
Woods Charitable Fund	24 percent of Sahara Coal Co. common stock	[3] 2.1	.48	22.9	[2] 13.4
	Preferred stock of Sahara Coal Co.; foundation's holding of preferred stock represents 14 percent of value of all shares of Sahara Coal Co. stock.	[3] 2.3	.12	5.2	----------
II. Donor and donor-related parties represent more than ⅛, but less than ½ of foundation's trustees, etc., who control investment policy:					
Louis Calder Foundation	30 percent of Perkins-Goodwin common stock	[2] 9.1	.02	.2	[2] 46.1
John A. Hartford Foundation	33 percent of Great A & P Tea Co. common stock	[2] 314.3	10.34	3.3	[2] 360.2
William Randolph Hearst Foundation	Nonvoting common stock of Hearst Corp.; foundation's holding represents 54 percent of value of all shares of Hearst Corp. stock.	[3] 43.6	.15	.3	[3] 43.8
Charles F. Kettering Foundation	30 percent of C. F. Kettering, Inc., common stock	[2] 62.8	2.79	4.4	[2] 74.0
Samuel Roberts Noble Foundation	100 percent of Noble Drilling Corp. common stock	[2] 7.3	0	0	[2] 32.8
	100 percent of Samedan Oil Co. common stock	[2] 17.0	0	0	----------
	100 percent of B. F. Walker, Inc., common stock	[3].5	0	0	----------
	50 percent of Lenox Square, Inc., common stock	[2] 1.0	0	0	----------
	75 percent of preferred stock of Lenox Square, Inc.; foundation's holding of preferred stock represents 25 percent of value of all classes of Lenox Square, Inc., stock.	[3].8	0	0	----------

III. Donor and donor-related parties represent more than ⅕, but not more than ⅓ of foundation's trustees, etc. who control investment policy:					
Blakely-Braniff Foundation	100 percent of Girard Insurance Group common stock	[3] 12.0	0	0	[3] 37.1
Duke Endowment	57 percent of Duke Power Co. common stock	[2] 366.6	11.1	3.0	[2] 475.4
	82 percent of Duke Power Co. preferred stock	[2] .4	.02	5.0	----------
	22 percent of Piedmont & Northern Ry. Co. common stock	[2] 2.3	.13	5.7	----------
Fred L. Emerson Foundation	100 percent of Duncar Corp. common stock	[2] .9	.02	2.2	[2] 20.6
	100 percent of Enna Jettick Corp. capital stock	[2] .4	0	0	----------
Lettie Pate Evans Foundation	42 percent of Whitehead Holding Co. common stock	[2] 7.5	.58	7.7	[2] 12.2
Louis W. & Maud Hill Family Foundation	100 percent of Hill Foundation Co. common stock	[2] 1.5	0	0	[2] 59.4
Samuel H. Kress Foundation	42 percent of S. H. Kress & Co. common stock	[2] 18.0	.25	1.4	[2] 28.5
Olin Foundation	100 percent of Federal Cartridge Corp. common stock	[3] 14.3	1.02	7.1	[2] 54.7
IV. Donor and donor-related parties represent ⅕ or less of foundation's trustees, etc. who control investment policy:					
Altman Foundation	95 percent of B. Altman & Co. capital stock	[2] 35.1	.46	1.3	[2] 39.6
Callaway Foundation	100 percent of Callaway Mills Co. common stock	[2] 37.7	.00	0	[2] 42.1
Samuel S. Fels Fund	86 percent of Fels & Co. common stock	[2] 2.9	.02	.7	[2] 19.2
Ford Foundation	Class A (nonvoting) stock of Ford Motor Co.; foundation's holding of class A stock represents 46 percent of the value of all shares of Ford Motor Co. stock.	[2] 2,095.2	91.15	4.4	[2] 3,320.4
Josephine E. Gordon Foundation	100 percent of Gordon Baking Co. common stock	[3] 9.0	.03	.3	[3] 9.0
Gulf Oil Foundation	100 percent of Pontiac Refining Co. common stock	[3] 32.2	.75	2.3	[3] 32.6
Charles Hayden Foundation	100 percent of Hayfund, Inc., capital stock	[3] .6	.00	0	[2] 76.2
Independence Foundation	Preferred nonvoting stock in Band-It, Inc.; foundation's holding of preferred stock represents 79 percent of value of all shares of Band-It, Inc., stock.	[3] .8	.05	6.3	[2] 20.3
W. K. Kellogg Foundation (and W. K. Kellogg Foundation Trust).	45 percent of Kellogg Co. preferred stock	[2] 4.6	.19	4.1	[2] 380.3
	51 percent of Kellogg Co. common stock	[2] 334.6	7.2	2.2	----------
Pew Memorial Trust	100 percent of Minerals Development Co. common stock	[3] 1.5	.99	66.0	[2] 141.5
	21 percent of Sun Oil Co. common stock	[2] 138.2	3.10	2.2	----------
Pittsburgh Plate Glass Foundation	46 percent of Cavanaugh Co. common stock	[3] .4	0	0	[2] 16.1
Research Corp	100 percent of Research Cottrell, Inc. common stock	[3] 2.9	0	0	[2] 11.4
Alexander & Margaret Stewart Trust	47 percent of Midland Building Industries, Inc., common stock.	[2] 1.2	0	0	[3] 7.9
	50 percent of Midland Building Industries, Inc., preferred stock.	[3] .3	.01	3.3	----------
Robert A. Welch Foundation	70 percent of Mound Co. common stock	[3] 1.2	.05	4.2	[2] 55.8
	64 percent of the preferred stock of Mound Co.; foundation's holding of preferred stock represents 28 percent of value of all shares of Mound Co. stock.	[3] .8	.04	5.0	----------

[1] This table excludes stock of corporations which, it appears, hold assets, such as real estate, the income from which would not be treated as unrelated business income if the asset were owned directly by the foundation. It also excludes stock of corporations where the value of the stock in excess of 20 percent of the corporation's outstanding stock is less than $100,000.

[2] Market value.
[3] Value on foundation's books (value of assets at date of acquisition by foundation).

Source: 1964 Treasury Department Survey of Private Foundations. Similar information may be found in the Patman Report, 1st installment, supra, See pp. 35–50.

11. Foundations and type of charity.

Table 19 provides some estimates of the grants of foundations by philanthropic field involved. The estimates are by the Foundation Library Center. These are strikingly different in distribution from individual contributions in the aggregate, involving a much lower contribution to religion and higher contributions to education and international activities. This cannot be taken directly as a measure of the redirection effect of foundations. Foundations handle the contributions of the wealthy, by and large, and the pattern of reduced contribution to religion and increased contribution to education among the wealthy is seen in table 4.

TABLE 19.—*Grants of 6,007 foundations, by major fields in 1962* [1]

[Dollar figures in millions]

Fields	176 large foundations [2]	847 intermediate foundations [3]	4,984 small foundations [4]	6,007 total foundations
Education	$201	$76	$38	$315
Percent	46	46	21	40
International activities	$74	$28	$4	$106
Percent	17	17	2	14
Welfare	$26	$10	$60	$96
Percent	6	6	34	12
Health	$44	$16	$30	$90
Percent	10	10	17	12
Sciences	$61	$23	$3	$86
Percent	14	14	1	11
Religion	$9	$3	$34	$46
Percent	2	2	19	6
Humanities	$22	$8	$10	$40
Percent	5	5	6	5
Total	$436	$165	$179	$779
Percent of grants	56	21	23	100

[1] Possessing assets of $10,000,000 or more.
[2] Possessing assets between $1,000,000 and $10,000,000.
[3] Possessing assets under $1,000,000.
[4] The 6,007 foundations included in the 1962 directory. Generally, these had assets over $100,000.

Source: "The Foundation Directory," ed. 2, p. 44.

NOTE.—Detail may not add to totals because of rounding.

APPENDIX A—EXHIBIT 1

FORM ›990–A
U.S. Treasury Department
Internal Revenue Service
PART II

RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX

Section 501(c)(3) of the Internal Revenue Code

For Calendar Year 1962—or other taxable year beginning , 1962, and ending , 19

1962

Part II information required pursuant to Section 6033(b) and other applicable sections of the Internal Revenue Code must be submitted in duplicate as part of your return. This part will be made available to the public.

Legal name of organization — Address (number, street, city or town, postal zone, and State)

Please type or print clearly

This return must be filed on or before the 15th day of the fifth month following the close of the annual accounting period. Return must be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization.

Employer Identification No.

Line No.			
1.	Gross sales or receipts from business activities	$	
2.	Less: Cost of goods sold or of operations (**Attach schedule**)		
3.	Gross profit from business activities		$
4.	Interest		
5.	Dividends		
6.	Rents		
7.	Royalties		
8.	Gain (or loss) from sale of assets, excluding inventory items (See Instruction 8)		
9.	Other income (**Attach schedule.—Do not include contributions, gifts, grants, etc. (See line 17.)**)		
10.	Total gross income (lines 1 to 9, inclusive)		$
11.	Expenses of earning gross income from column 3, Schedule A		
	DISBURSEMENTS MADE WITHIN THE YEAR OUT OF CURRENT OR ACCUMULATED INCOME FOR PURPOSES FOR WHICH EXEMPT, AND ACCUMULATION OF INCOME		
12.	Expenses of distributing current or accumulated income from column 4, Schedule A		$
13.	Contributions, gifts, grants, scholarships, etc. (See Instruction 13)		$
14.	Accumulation of income within the year (line 10 less the sum of lines 11, 12, and 13)		$
15.	Aggregate accumulation of income at beginning of the year	($)	
16.	Aggregate accumulation of income at end of the year	($)	
	RECEIPTS NOT REPORTED ELSEWHERE		
17.	Contributions, gifts, grants, etc., received		$
18.	Less: Expenses of raising and collecting amount on line 17, from column 5, Schedule A		
19.	Net contributions, gifts, grants, etc.		$
	DISBURSEMENTS MADE OUT OF PRINCIPAL FOR PURPOSES FOR WHICH EXEMPT		
20.	Expenses of distributing principal from column 6, Schedule A		$
21.	Contributions, gifts, grants, scholarships, etc.: (a) Paid out in prior years ($)		
	(b) Paid out within the year (See Instruction 21)		$

Schedule A—Allocation of Expenses (See Instructions)

1. Item	2. Total	3. Expenses of earning gross income	4. Expenses of distributing income	5. Expenses of raising and collecting principal	6. Expenses of distributing principal
(a) Compensation of officers, etc.					
(b) Other salaries and wages					
(c) Interest					
(d) Taxes					
(e) Rent					
(f) Depreciation (and depletion)					
(g) Miscellaneous expenses (**Attach sch.**)					
(h) Totals		Enter on line 11	Enter on line 12	Enter on line 18	Enter on line 20

Form 990-A—1962 **Schedule B.—BALANCE SHEETS (See Instructions)** Page 4

ASSETS	Beginning of Year Amount	Beginning of Year Total	End of Year Amount	End of Year Total
1. Cash				
2. Accounts receivable				
Less: Reserve for bad debts				
3. Notes receivable				
Less: Reserve for bad debts				
4. Inventories				
5. Investments in governmental obligations				
6. Investments in nongovernmental bonds, etc.				
7. Investments in corporate stocks (See Instructions)				
8. Mortgage loans				
9. Other investments (**Attach schedule**)				
10. Depreciable (and depletable) assets (**Attach schedule**)				
Less: Reserve for depreciation (and depletion)				
11. Land				
12. Other assets (**Attach schedule**)				
13. Total assets				
LIABILITIES AND NET WORTH				
14. Accounts payable				
15. Contributions, gifts, grants, etc., payable				
16. Bonds, notes, and mortgages payable				
17. Other liabilities (**Attach schedule**)				
18. Capital stock: (a) Preferred stock				
(b) Common stock				
19. Membership certificates				
20. Principal or other capital				
21. Reserves (**Attach schedule**)				
22. Accumulated income or earned surplus:				
(a) Attributable to ordinary income				
(b) Attributable to gains from sale of assets				
23. Total liabilities and net worth				

1. Date of current exemption letter .....

2. Attach a detailed statement of the nature of your business, charitable, and all other activities.

3. Was a Form 990-A filed for the preceding year? ☐ Yes ☐ No
If "Yes," where filed? .....

4. Have you filed a tax return on Form 990-T for this year? ☐ Yes ☐ No
If "Yes," where filed? .....

5. What is the legal form of your organization (corporation, trust, unincorporated association, etc.)? .....

6. In what year was your organization formed? .....
In what State or country? .....

7. If successor to previously existing organization(s), give name(s) and address(es) of the predecessor organization(s) .....

8. If you have capital stock issued and outstanding, state with respect to each class of stock—
(a) The number of shares outstanding .....
(b) The number of shares held by individuals .....
(c) The number of shares held by organizations .....
(d) The number of shareholders at end of year .....
(e) Whether any dividends may be paid ☐ Yes ☐ No

9. If you acquired capital assets out of income, attach itemized list and amount thereof.

10. Have any changes **not previously reported** to the Internal Revenue Service been made in your articles of incorporation or bylaws or other instruments of similar import? ☐ Yes ☐ No
If "Yes," attach a copy of the amendments.

11. Have you had any sources of income or engaged in any activities **not previously reported** to the Internal Revenue Service? ☐ Yes ☐ No
If "Yes," attach detailed statement.

12. Did you hold any real property for rental purposes with respect to which there is an indebtedness incurred in acquiring the property or in making improvements thereto or which was acquired subject to a mortgage or similar lien? ☐ Yes ☐ No
If "Yes," attach detailed statement.

13. Have you during the year either advocated or opposed (including the publishing or distributing of statements) any legislation, national, State, or local? ☐ Yes ☐ No
If "Yes," attach a detailed description of such activities and copies of any such statements.

14. Have you during the year participated in, or intervened in (including the publishing or distributing of statements) any political campaign on behalf of any candidate for public office? ☐ Yes ☐ No
If "Yes," attach a detailed description of such activities and copies of any such statements.

15. After July 1, 1950, did—
The creator of your organization, or
A contributor to your organization, or
A brother or sister (whole or half blood), spouse, ancestor, or lineal descendant of such creator or contributor, or
A corporation owned (50 percent or more of voting stock or 50 percent or more of value of all stock) directly or indirectly by such creator or contributor
(a) Borrow any part of your income or corpus? ☐ Yes ☐ No
(b) Receive any compensation for personal services from you? ☐ Yes ☐ No
(c) Have any part of your services or assets made available to him? ☐ Yes ☐ No
(d) Purchase any securities or other property from you? ☐ Yes ☐ No
(e) Sell any securities or other property to you? ☐ Yes ☐ No
(f) Receive any of your income or corpus in other transactions? ☐ Yes ☐ No
If answer to any question is "Yes," attach detailed statement unless previously reported.

16. Do you hold 10 percent or more of any class of stock in any corporation? ☐ Yes ☐ No
If "Yes," you must submit the information required by the instructions for Schedule B.

INSTRUCTIONS FOR FORM 990-A (1962)

RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX

Section 501(c)(3) of the Internal Revenue Code

GENERAL INSTRUCTIONS

A. Who must file Form 990-A.—An annual statement, Part I of this form, of gross income, receipts, disbursements, etc., is required by law of every organization which is exempt from tax as described in section 501(c)(3) of the Code, excepting only (1) a religious organization; (2) an educational organization if it normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; (3) a charitable organization, or an organization for the prevention of cruelty to children or animals, if supported in whole or in part by funds contributed by the United States or any State or political subdivision thereof, or primarily supported by contributions of the general public; (4) or an organization operated, supervised, or controlled by or in connection with a religious organization described in section 501(c)(3). In addition to Part I, such organizations are also required by law to file certain information on Part II of this form which is made available to the public. In connection with Part II of this form all required information must be submitted except that the organization may omit any information relating to a trade secret, patent, process, style of work, or apparatus which would adversely affect the organization, or any information which would adversely affect the national defense. In such cases, the organization must submit this type of information only with Part I, together with a statement identifying which items are being withheld from Part II and the reasons for doing so. The law provides penalties for failure to furnish the information required by this form.

B. Signature and verification.—The return must be signed either by the president, vice president, treasurer, assistant treasurer or chief accounting officer, or other corporate officer (such as tax officer) who is authorized to sign. A receiver, trustee, or assignee must sign any return which he is required to file on behalf of a corporation. The return must also be signed by any person, firm, or corporation who prepared the return. If the return is prepared by a firm or corporation, it should be signed in the name of the firm or corporation. The verification is not required if the return is prepared by a regular, full-time employee of the organization.

C. Form 990-T.—Section 511 of the Code imposes a tax in case of certain organizations described in sections 401(a) and 501(c)(2), (3), (5), (6), and (17), on income derived (a) from operation of a business enterprise which is unrelated to the purpose for which such organization received an exemption or (b) from certain rentals from property leased to others on a long-term basis. (Use Form 990-T.)

D. Form 1099.—Every organization engaged in a trade or business (which includes for this purpose all exempt functions) making payments in the course of such trade or business of interest, rents, commissions, salaries or wages (not reported on Form W-2), or other fixed or determinable income (including allowances for expenses) of amounts of $600 or more during the calendar year to an individual, a partnership, or a fiduciary shall make returns on Forms 1096 and 1099. (See section 1.6041-1 of the regulations.) Effective January 1, 1963 Forms 1099 and 1096 are required to be submitted for payments of interest aggregating $10 or more. A copy of any information return (Form 1099) is required to be furnished to the payee.

E. Attachments.—The schedules contained on the official form should be used unless the entry spaces provided are not sufficient for your needs. Attachments must contain the name and address of the organization as well as the required information and must follow the format of the schedules and must be presented in the same sequence as the lines of the form.

SPECIFIC INSTRUCTIONS

(References are to lines or schedules on form)

8. Attach a schedule to pages 1, 3, and 5 showing with respect to each asset sold or exchanged: (a) Date acquired, manner of acquisition, date sold, and to whom sold; (b) Gross sales price; (c) Cost, other basis, or value at time of acquisition if donated (state which); (d) Expense of sale and cost of improvements subsequent to acquisition; (e) Depreciation since acquisition; and (f) Gain or loss—(b) plus (e) minus the sum of (c) and (d).

13. Attach a schedule to pages 1, 3, and 5 in support of contributions, gifts, grants, scholarships, etc., showing: (a) each class of activity; (b) separate total for each activity; (c) name and address of donee and amount of distribution to donee; and (d) relationship of donee, if related by blood, marriage, adoption, or employment (including children of employees) to any person or corporation having an interest in the organization such as

creator, donor, director, trustee, officer, etc. Activities should be classified according to purpose in greater detail than merely charitable, educational, religious, or scientific. For example, payments for nursing service, for laboratory construction, for fellowships, or for assistance to indigent families should be so identified.

Although the actual distribution of cash, securities or other property is to be entered on this line the expenses in connection with the distributions and those expenses incurred for philanthropic programs operated by the organization itself are not to be included on this line but should be entered on line 12 and in column 4 of Schedule A.

Where the fair market value of the property at the time of disbursement is the measure of the contribution and is used in arriving at the amount to be entered on this line the schedule must also show: (1) description of the contributed property; (2) book value of the contributed property; and (3) the method used to determine the book value. In such case the difference between fair market value and book value should be reflected in the books of account.

17. In all cases where money, securities or other property aggregating $100 or more is received directly or indirectly from one person in one or more transactions during the year attach an itemized schedule to page 1 showing the name, address, date received, and the total amount received from each such person. If the contribution is in the form of property the description and the fair market value of such property shall also be furnished. (The term "person" includes individuals, fiduciaries, partnerships, corporations, associations, and other organizations.)

21. Attach a schedule to pages 1, 3, and 5 for contributions, gifts, grants, scholarships, etc., which were paid out within the year, showing the same information required in instruction 13. For those disbursements made in prior years only the total need be shown.

Schedule A.—Attach a schedule in support of line (a) to pages 1, 3, and 5 for compensation of officers, directors, trustees, etc., showing name, position, time devoted to position, salary, and expense account allowances.

For depreciation attach a schedule to pages 1, 3, and 5 showing: (a) kind of property; (b) date acquired; (c) cost or other basis (exclude land); (d) depreciation taken in prior years; (e) method of computation; (f) rate (%) or life (years); and (g) depreciation this year.

Expenses to be entered in column 2 of Schedule A should be extended to columns 3 through 6 on the basis of accounting records. If such records do not provide for this division, expenses may be divided on any reasonable basis, such as an approximation of the use of a facility or the time spent by an individual.

Schedule B.—The balance sheet should agree with the books of account or any differences should be reconciled.

In all cases where investments in corporate stocks at the close of the taxable year include 10 percent or more of any class of stock of any corporation, attach a schedule to pages 2, 4, and 6 showing: (a) name of corporation, class of stock and whether the stock is voting or nonvoting; (b) number of shares owned of each class at beginning and end of the taxable year; (c) total number of shares outstanding of each class; (d) value of stock as recorded in the books and included in line 7; (e) date acquired; and (f) manner of acquisition.

APPENDIX A—EXHIBIT 2

Bureau of Budget Approval
No. 48-6403
Expires Dec. 31, 1964

QUESTIONNAIRE

TAX-EXEMPT FOUNDATION SURVEY

NAME.....
ADDRESS..

Officials, etc.

1. List below the name and position of each official (officer, director, or trustee, etc.), whether or not compensated, of your organization at the end of the period covered by your 1962 Form 990-A. (Please list all officers first, then directors, then trustees, etc.) Use additional sheet if necessary.

	Name	Position	Relationship (see #2 below) None	Relationship (see #2 below) Type	Investment Policy (see #3 below) Yes (1)	Investment Policy (see #3 below) No (2)
1.			☐		☐	☐
2.			☐		☐	☐
3.			☐		☐	☐
4.			☐		☐	☐
5.			☐		☐	☐

2. For each official listed, indicate by entering the appropriate letter in the column "Relationship - Type" which, if any, of the relationships listed below he bears to the creator of the organization or to a substantial contributor (any person who has contributed $1,000 or more to the organization). If none, check the column "Relationship - None."

(a) He is the creator or a substantial contributor.
(b) He is related by blood, marriage, or adoption to the creator or to a substantial contributor.
(c) He is an employee of the creator or of a substantial contributor.
(d) He is an attorney or accountant of the creator or substantial contributor.
(e) He is an employee of a corporation owned (50 percent or more of voting stock or 50 percent or more of the value of all stock), directly or indirectly, by the creator and/or substantial contributor.
(f) He is an employee of a partnership or other unincorporated business venture in which the creator and/or substantial contributor owns 50 percent or more of the capital interests or profits interests.
(g) He is a person who holds 20 percent or more of the voting stock or 20 percent or more of the value of all stock in any corporation in which the creator and/or substantial contributor (and the wife and children of the creator and/or substantial contributor) holds 20 percent or more of the voting stock or 20 percent or more of the value of all stock.

(Question 2 continued on page 2.)

(h) He is a person who holds 20 percent or more of the capital interests or profits interests in any partnership or other unincorporated business venture in which the creator or substantial contributor (and the wife and children of the creator or substantial contributor) holds 20 percent or more of the capital interests or profits interests.
(i) He has another significant business relationship with the creator or a substantial contributor.

(If the relationship (i) is indicated, please describe briefly on an attached sheet. Such other significant business relationship would, for example, exist where the official is an employee of a corporation or partnership in which the creator or substantial contributor owns 20 percent or more of the stock or capital or profits interests.)

3. Indicate by checking "yes" or "no" in the "Investment Policy" column whether the individual official was authorized to participate in decisions relating to the handling of investments of your organization, or decisions relating to the total amount of income, contributions, and corpus to be invested.

Question 15 on Form 990-A asks whether or not your organization engaged in certain transactions with the creator of the organization, with a substantial contributor to the organization, or with certain parties related to either the creator or a substantial contributor. The following question (4) asks about such transactions with officials of the organization and certain parties related to such officials and deals only with transactions that were not involved in question 15 on Form 990-A. In aswering this question do not take account of any transactions involving individuals who are both creators or contributors (or related to creators or contributors) and officials or related to officials.

4. Transactions with Officers, etc.

During the period covered by your 1962 Form 990-A, did -

-any of the officials of your organization;
-the brothers, sisters, spouses, ancestors, or lineal descendants of the officials;
-corporations owned (50 percent or more of voting stock or 50 percent or more of value of all stock), directly or indirectly, by the officials; or
-partnerships or other unincorporated business ventures in which the officials owned 50 percent or more of the capital interests or profits interests:

	(1) Yes	(2) No
(a) Borrow any part of your cash, securities, or other property?	☐	☐
(b) Lend any cash, securities, or other property to you?	☐	☐
(c) Have any part of your services or assets (other than compensation for personal services reported on Schedule A of your 1962 Form 990-A) made available to them?	☐	☐
(d) Purchase any securities or other property from you?	☐	☐
(e) Sell any securities or other property to you?	☐	☐
(f) Receive any of your cash, securities, or other property in other transactions?	☐	☐

If the answer to any of the questions is "yes," attach a detailed explanation. (Please mark this explanation "Schedule 4.")

NAME.....
ADDRESS..

5. Contributions Received During the Period Covered by Form 990-A for 1962

(a) Enter the amount of contributions received during the period covered by your 1962 Form 990-A (line 17, page 1). $ _____

(b) Enter the amount of such contributions which were in the form of cash. $ _____

(c) Enter the amount of such contributions which were in the form of stock in any corporation with respect to which, at the end of the period covered by your 1962 Form 990-A, your organization held 10 percent or more of any class of stock. $ _____

6. Market Value of Assets at End of Period Covered by Form 990-A for 1962

(Where no market quotations or detailed valuations are available to establish market value of assets, an approximation will be satisfactory.)

(a) Total Assets $ _____

(b) Corporate Stock $ _____

7. Certain Stock

(a) During the period covered by your 1962 Form 990-A, did your organization hold 10 percent or more of any class of stock in any corporation? Yes (1) ☐ No (2) ☐

If the answer is "yes," answer question 8 on page 4.

8. If you answered "yes" to question 7, on page 3, answer questions (a) through (e) for each corporation in which your organization held 10 percent or more of any class of stock during this period. If your organization held more than one class of stock in such corporation, answer questions (a) through (e) with respect to each class of stock in which your corporation held 10 percent or more. Note that questions (d) and (e) refer to holdings at the end of the period. If your organization held 10 percent or more during the period but reduced this percentage (even below 10 percent) by sales during the period, answer questions (d) and (e) with reference to the end-of-period holdings. (Use additional sheets if necessary.)

(a) Name of corporation. (Abbreviate)	_____	_____	_____
(b) Class of stock held (e.g. common, 6 percent preferred, etc.).	_____	_____	_____
(c) Did your organization sell, or otherwise dispose of, any of this stock during the period covered by your 1962 Form 990-A? (Answer "yes" or "no.")	1. Yes ☐ 2. No ☐	1. Yes ☐ 2. No ☐	1. Yes ☐ 2. No ☐
(d) End of year holding -- For the shares of this class held by your organization at the end of the period covered by your 1962 Form 990-A give -			
(i) - Book value.	$_____	$_____	$_____
(ii) - Market value.	$_____	$_____	$_____
(iii) - Approximate percentage of total voting power.	_____%	_____%	_____%
(iv) - Approximate percentage of total value of all classes of stock in the corporation.	_____%	_____%	_____%
(v) - The total annual cash dividend on shares held at the end of the period.	$_____	$_____	$_____
(e) Give the approximate percentage of the total value of stock in the corporation held at the end of the period covered by your 1962 Form 990-A by the creator and substantial contributors to your organization and their brothers, sisters, spouses, ancestors, lineal descendants; corporations owned (50 percent or more of voting stock or 50 percent or more of the value of all stock), directly or indirectly, by such creator or substantial contributors; and partnerships or other unincorporated business ventures in which the creator or substantial contributor owns 50 percent or more of the capital interests or profits interests. (If this information is unknown and not ascertainable, so indicate.)	_____%	_____%	_____%

APPENDIX B

Internal Revenue Service Administrative Activity

The Internal Revenue Service has taken significant administrative measures directed at insuring that private foundations, and also other types of exempt organizations, operate in a manner consistent with the provisions of existing law. These additional efforts have taken five forms.

The first has been to increase the number of exempt organization returns which are audited each year. Whereas only approximately 2,000 of such returns per year were audited in the 1950's, over 10,000 exempt organization returns were examined in fiscal year 1964. As part of its increased examination program, the Service has improved the quality of each audit. Special classes to teach selected agents to deal with the special problems which are raised in an examination of a tax-exempt organization have been held. Special audit guidelines, which will permit agents to complete a thorough examination of a foundation's activities in a reasonable period of time, have also been prepared.

The Revenue Service's second major effort has been to increase the amount of available information concerning foundation behavior. This information will be useful to determine whether foundations are operating within the principles of existing law and, if not, the type of abuses which exist. The additional information will also be used to select certain returns for examination as well as for future statistical studies.

Consistent with the objective of obtaining more information, the Service has made substantial revisions in the information returns (Form 990–A) which private foundations are required to file. For example, the 1964 return requires private foundations to supply information with respect to the market value of their assets and detailed schedules of their accounts (and notes) receivable and payable. This information was not previously available from a foundation's return. The new form also substantially increases the amount of data which foundations must supply with respect to situations in which a foundation owns a significant—5 percent or more—portion of a corporation's stock. To the extent permitted by existing law, this new information will be made available to the public.

Third, improvements have been made in the Service's internal controls and procedures in the exempt organization area. For example, a check on delinquent and incomplete returns is now being performed in all district offices. This has contributed to the increase in the quality and quantity of exempt organization returns which are currently being filed. Similarly, an Exempt Organization Master File system—which will contain a list of the names and addresses of all exempt organizations—is presently being established. This list, which will be placed on magnetic tape, will permit the use of electronic data

processing equipment to facilitate the administration of the tax laws dealing with exempt organizations.

The fourth major administrative effort being undertaken is to determine the scope of existing law through litigation. Appropriate cases are being diligently litigated by the Office of Chief Counsel of the Internal Revenue Service and by the Tax Division of the Department of Justice. A survey conducted during the spring of 1964 indicated there were approximately 250 cases involving exempt organizations in various stages of litigation. One of these is a case pending before the Supreme Court relating to the purchases of business corporations by private foundations. The decisions which will be rendered by the courts in these cases may help to provide valuable guidelines.

Fifth, the Service has increased its efforts to improve voluntary compliance with existing law. It was felt that many of the unintentional violations found upon audit are attributable to the organization not knowing what was expected of it. In order to educate the public the Service during 1964 published 25 Revenue Rulings, Revenue Procedures, and announcements relating to exempt organizations. Many others are currently under study. In addition, the Service has published a booklet entitled "How To Apply for Exemption for Your Organization," which is made available for distribution to interested parties. A more detailed booklet, similar to "Your Federal Income Tax," is now under active consideration. It is intended to provide more comprehensive guidance in complying with the law, and to do so in as simplified a style as is consistent with the complexities of the subject. It is hoped that these measures will sufficiently educate exempt organizations as to what is expected of them and will decrease the number of unintentional and technical violations of the law. This will permit the Service to devote its main efforts to cases involving intentional violations.

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