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Foundations Used as Business Devices

Howard L. Oleck*

IN RECENT YEARS the multiplication of charitable foundations in the United States has been phenomenal. Everyone knows of the fine work being done by such great organizations as the Ford Foundation, the Carnegie Foundation, and many others. Not quite so well known is the multiplication of smaller foundations endowed primarily for tax and business advantages—the hypocritical use of the mantle of “charity” to cover basically selfish motives. In 1930 there were less than 250 foundations in the United States.¹ In 1944 there were over 500, with combined assets of \$1.8 billion and annual expenditures of \$72 million.² In 1955 there were about 5000 foundations with combined assets of about \$5.5 billion.³ How many there are today is known only to God, and to some extent to the Bureau of Internal Revenue.

Any discussion of foundations is a delicate matter. Most foundations probably are established and operated for worthy and noble purposes. Criticism of any kind of charitable organization is likely to be viewed almost as an attack on virtue (or as subversive), even when the particular organization’s charitableness is very doubtful. Therefore, the author addresses these preliminary words to every interested settlor, founder, trustee, director, officer, agent, and employee of every foundation:

“In what follows, I do not mean you. This discussion applies only to the ones to whom it applies—and you are not one of them. And I love the grand old American way of life.”

Moreover, this paper is only a sketch of the subject, which would require (and much needs) a massive volume in order to treat it fully.

Business Purposes

Chief among the business purposes involved in use of charitable foundations are these:⁴

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¹ Berman and Berman, *Tax Advantages of Foundations and Exempt Organizations*, 4 Clev.-Mar. L. R. 124 (1955); 1 Oleck, *Modern Corporation Law*, Chap. 14 (1958). See also, Keppel, *The Foundation* (1930); Andrews, *Philanthropic Foundations* (1956); Kiger, *Operating Principles of the Larger Foundations* (1954); Wormser, *Foundations* (1958).

² Oleck, *Non-Profit Corporations and Assns.* 398 (1956).

³ *Ibid.* And see Andrews, *Philanthropic Foundations* (New York: Russell Sage Foundation, 1956); *American Foundations and Their Fields* (New York: Raymond Rich Associates, 1946); *Philanthropic Foundations and Higher Education* (New York: Columbia Univ. Press, 1938); *Yearbook of Philanthropy* (New York: Inter-River Press, 1943); *National Associations of the United States*, 606-610 (Washington, D. C.: U. S. Dept. of Commerce, Govt. Printing Office, 1949). And see *infra*, n. 4.

⁴ Berman, *supra* note 1. See the story of foundation use to finance the growth of the Textron industrial complex, in, Comment, *The Modern Phil-*

(Continued on next page)

- (1) *Tax avoidance.* The corporation tax of 52% and the individual income tax of up to 91% are so severe that high-bracket taxpayers can give to charity at small cost. As a result the family and corporate foundation is the fastest growing type. Inheritance and income taxes are avoided.
- (2) *Perpetuation of control.* The controlling stockholder of a close corporation, for example, may rule the corporation from the grave; or family control may be maintained.
- (3) *Public relations.* "But the greatest of these is charity."⁵
- (4) *Research and product development.* For public and industry benefit (and first use by the founder's organization is only fair).
- (5) *Systematizing normal charity gifts.* Orderly and businesslike charitable contribution, instead of hit-or-miss giving.
- (6) *Prestige.* Puts the founder's name in the same category with Ford and Carnegie.
- (7) *Competitive advantage.* Obviously, over competitors who pay normal taxes.
- (8) *Little regulation.* The lack of government supervision is a fact, despite the "public" nature of foundations.

(Continued from preceding page)

anthropic Foundation: A Critique and a Proposal, 59 Yale L. J. 477, 492 (1950); and see Reiling, Federal Taxation: What Is a Charitable Organization?, 44 A. B. A. J. 525 (1958); Merritt, Tax Incentives for Charitable Giving, 36 Taxes 646 (1958); Hudson, Giving Through Private Charitable Organizations, 103 J. Account. 31 (1959); Note, "Private" Charitable Trusts, 103 Sol. J. 404 (May 22, 1959); Note, Bequests for Mixed Charitable and Non-Charitable Objects, 21-22 Ir. Jur. 1 (1955-6); Baldwin, Charitable Foundations, 26 Detroit Law 15 (1958); Symposium on Charitable Trusts, 18 Ohio St. L. J. 149 (1957); Friedman, Corporate Power, Government by Private Groups and the Law, 57 Col. L. R. 155 (1957); Brown and Coblenz, Charitable Trust in California, 30 Calif. St. B. J. 425 (Sept.-Oct. 1955); Vestal, Critical Evaluation of the Charitable Trust as a Giving Device, 1957 Wash. U. L. Q. 195 (1957); Young, Planning and Management of Charitable Foundations, 35 Trust Bull. 36 (1956); Martin, Trust and the Fundatio, 15 Jurist 11 (1955); Marshall, When Is Charitable Not Charitable?, 19 Modern L. R. 92 (1956); Headly, Four Family Situations for Using the Community Foundation, 96 Trusts & Est. 328 (1957); Dwight, Objections to Judicial Approval of Charters of Non-Profit Corporations, 12 Bus. Law 454 (1957); Wham, Reece Report on Foundations, 36 Chi. B. Rec. 447 (1955); Barr, Tax-Exempt Foundations, 101 J. Account. 38 (1956); Note, Taxation—What Is Exempt from Taxation as Public Charity Under the Texas Constitution?, 7 Baylor L. R. 494 (1955). See also the extensive bibliography in Oleck, Non-Profit Corporations and Assns. 333-334 (1956), 2 Oleck, Modern Corporation Law 104, 632 (1959), and Vol. 1, *supra*, n. 1. And the English literature is full of material on foundations. See Index to Legal Periodicals, any issue of recent years. England long has had at least 20,000 foundations.

⁵ 1 Cor. 13:13 "And now abideth faith, hope, charity, these three; but the greatest of these is charity."

Business purposes now so often are dominant in the formation of "charitable foundations" that the importance of that motive hardly needs to be emphasized. It is enough to point out that tax experts and others now speak of foundations as a major type of "business device," of which "their range has barely been touched" despite revisions of the tax laws.⁶ Some say that "the only interests which appear to be adversely affected by such (non-profit) incorporation are those of creditors and the governmental interest in tax revenues."⁷ This latter is almost charming in its frank amorality.

More specifically, however, the foundation (e.g., a family foundation) "will be able to accumulate significantly more dollars in a foundation than in a corporation, in a trust, or in a personal portfolio . . . [While] tax privileges . . . make it possible to conserve assets and to build up funds more easily than in a profit-making corporation . . . Rents [in under-5-year leases, with some limitations], dividends, interest, royalties, capital gains, are received tax free . . . [And] we get full exemption . . . for gifts to it—if its income is of the investment type . . . [And] taxpayer or his family are not prohibited from dealing with a foundation."⁸

The advantages have been summed up thus:⁹

What can be accomplished by creating a foundation?

1. Keep control of wealth.
2. Can keep for the donor many attributes of wealth by many means.
 - (a) Designating the administrative management of the foundation.
 - (b) Control over its investments.
 - (c) Appointing relatives (and of course the founder) as directors of foundation.
 - (d) Foundation's assets can be used to borrow money to buy other property that does not jeopardize its purposes. Thus, foundation funds can be enhanced from the capitalization of its tax exemption.
3. The foundation can keep income in the family.

⁶ Berman, *supra*, note 1. A recent article speaks of foundations as "venture capital," with no apparent sense of disturbance about the morality implicit in that view. Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 Harv. L. R. 433, 483 (1960). And see *infra*, note 9.

⁷ Note, *Permissible Purposes for Non-Profit Corporations*, 51 Col. L. R. 889, 898 (1951).

⁸ Berman, *supra* note 1. As to lack of government supervision, see, Karst article *supra* n. 6, and discussion below.

⁹ Berman, *supra* note 1, and see *supra* note 4. See also, Flechner, *Charitable Foundations and their Benefits*, 34 Nebr. L. R. 630, 631 (1955); Latchen, *Private Charitable Foundations: Some Tax and Policy Implications*, 98 U. Pa. L. R. 617 (1950); Casey, *How to Use Charitable Trusts and Foundations*, *Handbook of Tax Techniques*, 1011 at 1028 (1951).

4. Family foundations can aid employees of the donor's business.
5. Foundations may be the method of insuring that funds will be available for use in new ventures in business.
6. We can avoid income from property while it is slowly being given to a foundation by a combination of a trust and the charitable foundation.
7. We can get the 20% charity deduction in other ways:
 - (a) By giving away appreciated property to the foundation, we escape a tax on the realization of a gain.
 - (b) We can give funds to a foundation to get charitable deduction currently in our most advantageous tax year.
 - (c) Very often local personal and real property taxes can be avoided.
 - (d) We can avoid speculative profits.
 - (e) We can give away valuable "frozen assets," white elephant estates, residences, valuable works of art, and collections of all sorts.

Plan of Typical Foundation

Just what is contained in the complete structure of a foundation (e.g., its charter, by-laws, deed of trust, or etc.) would require too much space to permit setting forth here. We can, however, set up an outline of the usual contents of such an instrument. This will serve as our "typical plan"—the strawman which we will proceed to pick apart.

In general terms, the deed of trust and/or articles of incorporation of a charitable foundation now typically provide as follows:¹⁰

1. Introductory formalities; the gifts; designations of trustees, etc.
2. Declaration of purpose; or Purpose Clause (or clauses). Dedicating the foundation to public welfare purposes in general, and stated specific charitable purposes (often, erroneously, for the benefit of employees—which is not exempt for such small and private group purposes, tax-wise).
3. Provisions for transfer of the founder's and other shares of stock to the foundation, payment of dividends, etc. to it; and also grants of funds, other property, etc. (Corporate consent to provisions that affect corporate management, by simple resolution, is strong supporting material).

¹⁰ For full sets of such articles see, Oleck, *Non-Profit Corporations and Assns.* (1956); 5 Oleck, *Modern Corporation Law* (Forms; 1960), now in press. See also, Andrews, *Legal Instruments of Foundations* (1958).

4. Trustees' powers, duties, limitations, succession, etc. (and their covenants).
5. Provisions for managing the corporation or corporations whose stock is turned over. (Again, corporate consents—easy for a controlling shareholder to give—are employed).
6. Provisions for managing the foundation (often very detailed).
7. Irrevocability provision.
8. Acceptance of trust or gift.
9. Miscellaneous provisions.
10. Severability clause.
11. Acknowledgments.
12. Schedule of endowment gifts (appendix).
13. Settlor's or Founder's Will, reaffirming the arrangement.

Sometimes the grant is made in the form of a deed of trust, with instructions to incorporate later when that becomes desirable. Sometimes the grant is made to a corporation specifically organized to take it; or with instructions at once to organize a corporation to take it. Either way, foundations set up substantially as sketched in the foregoing "Plan" have been upheld by the courts.¹¹

The View That Foundations Are Valid, Generally

The view that all foundations are valid unless clearly unlawful in their purposes (e.g., such as to foment revolution) is usually supported by arguments such as the following:¹²

It is axiomatic that charities are favorites of the law, and courts will try to support a doubtful instrument in order to sustain a charitable gift.¹³ Valid portions will be sustained, while invalid portions are severed.¹⁴ Or equity courts will reform a deed of trust in order to carry out the intent of the settlor when he made a mistake.¹⁵ Or they will freely allow him to amend the instrument.¹⁶

¹¹ *In re Trust of Frederick C. Scholler*, Orphans' Court of Philadelphia County, Pa., No. 210 of 1959, decided Mar. 25, 1960, is the most recent illustration known to the writer.

¹² Based on the Attorney-General's brief in the Scholler decision, *supra* note 11.

¹³ *Kinike's Estate*, 155 Pa. 101; *Anderson Estate*, 269 Pa. 535 (1921), *Funk's Estate*, 353 Pa. 321 (1946).

¹⁴ *Restatement of Trusts*, Sec. 398 (2); *Manners v. Philadelphia Library Co.*, 93 Pa. 165, 174 (1880); *In re Coxen*, 1948 Ch. 747 (Engl.).

¹⁵ *Irish v. Irish*, 361 Pa. 410; *Spiegel Estate v. Commissioner*, 335 U. S. 701 (1948); *Miller v. National Bank*, 38 N. W. 2d 863 (Mich., 1949); *Flagg v. Flagg*, 80 D. & C. 544 (1952); *Kunkel v. Kunkel*, 267 Pa. 163, 172 (1920).

¹⁶ *Restatement of Trusts*, Sec. 367, Comment c; Par. 333, Comment (e).

In addition it is argued that no member of the public nor relative of the settlor has standing to attack the trust.¹⁷ Even claims of legal heirs of the settlor are given little consideration when they attack it. It is reasoned that abuses are correctable only at the instance of the attorney-general.¹⁸

Not only events contemporaneous with the establishment of the foundation, but also subsequent events will be considered in seeking to uphold the grant.¹⁹ General expressions of charitable intent will prevail.²⁰

If detailed control of business corporations is involved (i.e., sterilizing the board of directors, contrary to corporation law and public policy), it is solely the attorney-general (not the court) that may attack the grant.²¹ "If such provisions in the deed are illegal, they do not avoid the trust."²² (This last quotation, stated by the Pennsylvania court so very recently, is extraordinary. It seems to mean that practically no illegality is enough to make a foundation illegal!)

The Real Problem of Abuse of the Foundation Device

Most discussions of foundations treat them as inherently charitable uses (trusts) in nature, governed by trust law—which tries to preserve charitable gifts almost at all costs. This means that the old trust law is viewed as basic—law that crystallized long before modern corporate or tax devices even existed. That old law never knew the modern devices of close corporation control agreements, modern anti-trust policy, modern income tax pressures, and above all modern corporate entity policies. Treatment of foundations which are used as business devices thus has consistently started with false premises—premises of trust law.

¹⁷ Weigand v. The Barnes Foundation, 374 Pa. 149, 97 A. 2d 81 (1950).

¹⁸ See, Scott, Trusts § 391, p. 2761 (2d ed., 1956); Tudor, Charitable Trusts 341 (5th ed., 1929); and see Murphy v. Dalton, 314 S. W. 2d 726 (Mo., 1958); Gredig v. Sterling, 47 F. 2d 832 (5th Cir., 1931), cert. den. 284 U. S. 629; Stoner Mfg. Corp. v. Y. M. C. A., 13 Ill. 2d 162, 148 N. E. 2d 441 (1948); Claim of Art Institute of Chicago, 16 Ill. App. 2d 84, 147 N. E. 2d 415 (1958); In re Vassar's Estate, 27 N. E. 394 (N. Y., 1891); Trustees of Alexander Linn Hospital Assn. v. Richman, 46 N. J. Super. 594, 135 A. 2d 221 (1957); Anno., 124 A. L. R. 1237. But see State ex rel. Tennessee Children's Home Soc. v. Hollinsworth, 193 Tenn. 491, 246 S. W. 2d 345 (1952), that district attys. have the power; and Hedin v. Westala Luth. Church, 59 Idaho 241, 250, 81 P. 2d 741, 745 (1938), that an interested party has the power. And cases still in the courts are Ames v. Attorney General, 332 Mass. 246, 124 N. E. 2d 511 (1955), Mass. Supr. Jud. Ct. Equity No. 68735, and the Scholler case, *supra* note 11, for which the 3 month period for commencing appeal has not yet expired as of the date of this writing.

¹⁹ Scholler case, *supra* note 11, at p. 2.

²⁰ Scholler case, *supra* note 11, at p. 3.

²¹ Scholler case, *supra* note 11, at p. 4, and note 18.

²² Scholler case, *supra* note 11, at 4; citing Manners v. Phila. Library Co., *supra* note 14.

Moreover, the mixture of trust, corporation and tax law makes for involved and tortuous reasoning in case decisions.

In the interpretation of any trust, charitable or otherwise, the polestar is the intent of the settlor as defined by the language he used.²³

Usually the instrument involved is long and complex and must be considered in its entirety in order to understand its real purpose. Although concededly there are many cases which have held that instruments are to be construed liberally in order to sustain a charitable gift,²⁴ a reading of the modern foundation instrument often results in the inevitable conclusion that many parts are self-serving statements designed to protect and disguise the fact that the settlor intended the trust to be non-charitable in operation. If the court sustains such trusts, it gives blanket approval to non-charitable perpetuities so long as they are accompanied by minimal apparent charitable incidents and lip-service to charity.

Truly charitable trusts enjoy a special status in our society, justified because they perform valuable services for the community, and thereby decrease the general tax burden. The case of *Bennet Estate*²⁵ emphasized this very point²⁶ thus:

. . . charitable trusts perform some public functions which a governmental body should perform . . . deducting money from the charitable trust for tax purposes, which would then be applied to the same or some other charitable use, would only result in a waste of funds because the process of collecting taxes is costly . . .

However, only true charities have any claim to this special status. Since purported charities are often of substantial benefit to the creator under our tax laws, the temptation to accomplish private ends by the establishment of a trust, labelled a "charity," is great. If, in fact, it is not a charity, the result is to grant the tax benefit to the grantor without any corresponding benefit to the community.

Use of "charitable" foundations as devices for evasion of tax and corporation law long has been viewed with growing alarm by many authorities. So widespread has this abuse become that a recent work on corporation law in straight faced seriousness devotes an entire chapter to use of "charitable" foundations as a type of *business* organization.²⁷ The same work elsewhere goes

²³ *Britt Estate*, 369 Pa. 450, 455 (1952).

²⁴ E.g., *Anderson Estate*, and *Funk's Estate*, *supra*, note 13.

²⁵ 18 D. & C. 2d 595 (O. C. Luz., Pa., 1959).

²⁶ *Id.* at 609. But there must be an actual, and direct, benefit to the public, to justify classification as a charity with all the privileges of that status. *Massachusetts Medical Society v. Assessors of Boston*, 164 N. E. 2d 325 (Mass. 1960). Compare with this the view that taxation is better than private beneficence, fiscally and for reducing inequality: Wedgwood, *The Economics of Inheritance* 91 (1920).

²⁷ 1 Oleck, *Modern Corporation Law*, chap. 14 (1958), and see other such "hard-boiled" approaches, *supra* notes 4, 9.

on to say: "A growing and useful device for controlling funds of a closely held business, while minimizing the tax strain, exists in the creation of tax-exempt corporations (or trusts) and foundations."²⁸ Again, it quotes: "A motive at least equal to that of providing a suitable mechanism for philanthropy and tax free reservoir for an otherwise highly taxable income is the power which the foundation gives to the controller of a business or industry to perpetuate his control."²⁹ It then adds³⁰ that the foundation also is used as "a relatively new method of voting control . . . peculiarly adaptable to the closely held family corporation . . . dependent upon the stock structure of the corporation . . . (and also as) a vehicle for the accumulation of capital . . . (and so on)."³¹

Few better examples of the abuses adverted to above can be found than the typical plan of a charitable foundation outlined above. The tax law objections to such a trust pale when compared with the utter perversion of corporation law which it embodies. Of the tax and general corporation aspects, it may suffice to refer to the Pennsylvania Non-Profit Corporation Law,³² which provides that activities of a non-profit corporation must result in no pecuniary profit "incidental or otherwise, to its members."³³ Incorporation of such a trust is thus more dangerous than operation without incorporating, under Pennsylvania and other states' statutes, as it invites scrutiny and probable rejection. A trust device often therefore seeks to do indirectly what cannot be done directly. The tax benefits to the settlor and his family, alone, under the guise of "charitable" tax exemption, are obvious, not to mention the other obvious incidental benefits.³⁴ During the

²⁸ *Id.*, Vol. 2, at 104 (1959); cf., Liggett, "Comment in panel discussion before Subcommittee on Tax Policy of the Joint Committee on the Economic Report," in *Federal Tax Policy for Economic Growth and Stability* (Dec., 1955).

²⁹ 2 Oleck, *Modern Corporation Law* 632 (1959); cf., Friedman, *Corporate Power, Government by Private Groups, and the Law*, 57 *Colum. L. R.* 155 (1957).

³⁰ 3 Oleck, *Modern Corporation Law* § 1471 (1959).

³¹ For an extensive bibliography of articles on "charitable trusts and corporations," see, Oleck, *Non-Profit Corporations and Assns.*, 333-334 (1956), and *supra* notes 3, 4, 9.

³² 15 Pa. St., Sec. 2851-2.

³³ *In re Incorporation of Automatic Phonograph Owners Assn.*, 45 D. & C. 551 (C. P. Phila., 1942); *In re Fayette Gasoline Retailers Assn.*, 32 D. & C. 165 (C. P. Fayette, 1938); see also, Eaton, *Charitable Foundations, Tax Avoidance, and Business Expediency*, 35 Va. L. R. 809, 987 (1949).

³⁴ See, *Commissioner, v. Edw. Orton Jr. Ceramic Foundation*, 173 F. 2d 488 (6th Cir., 1949), affg. 9 T. C. 533 (upholding a foundation that gave income to the testator's wife for 5 years); *Randall Foundation, Inc. v. Riddell*, 244 F. 2d 804 (9th Cir., 1957) (Unreasonable accumulation of income); *Home Oil Mill v. Willingham*, 68 F. Supp. 525 (D. C. Ala., 1946), appeal dismissed, 181 F. 2d 9 (5th Cir., 1950) (upholding benefits to the founder's

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life of the settlor the trust often is, in fact, no more than a personal holding company.

The House of Lords in Great Britain recently pointed out that an unreasonable extension of the kinds of transfers which will gain the benefits and privileges of a charity will only result in making available these privileges to private parties for private or selfish ends without any public benefit. This would be a total perversion of the concept of charity. The Law Lords said in *Oppenheim v. Tobacco Securities Trust Co.*:³⁵

It must not, I think, be forgotten that charitable institutions enjoy rare and increasing privileges, and that the claim to come within the privileged class should be clearly established. (Emphasis added)

This is not to say that a true charity should be denied the status of a charity simply because of a technical error in draftsmanship. It does mean that a trust which clearly is intended to benefit a limited, specific class of persons and a few selected business corporations, does not conform to or even approximate the mould of a charity. Therefore it should not receive the privileges of a charity.

Violation of Corporation Law by Foundations

The basic concepts of *corporate entity and directors' control* usually are the legal principles most thoroughly violated by the use of foundations as business devices. It is axiomatic that public policy requires that a corporation be an entity distinct from its shareholders, and managed and governed by its board of directors (who often even are actually denominated "trustees").³⁶ This fundamental public policy is declared by statute in most states.³⁷ Only in a small, private "incorporated partnership business" is this principle sometimes varied, when no one but the "partners" will be affected.

"Sterilization" of the board of directors of a corporation is strictly forbidden, as a host of statutes and decisions make crystal

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sister—\$15,000 yr. salary from earnings or corpus); *Otto T. Mallery v. Commissioner*, 40 B. T. A. 778 (1939) (upholding benefits to a needy relative); *Estate of Agnes C. Robinson*, 1 T. C. 19 (1942) (upholding benefits to family servants); *Havemeyer v. Commissioner*, 98 F. 2d 706 (2d Cir., 1938) (upholding benefits to employees of the founder's corporation). But note that such free and easy personal use has been limited by the Revenue Act of 1950 and Int. Rev. Code of 1954 §§ 501(c)(3), 503(c).

³⁵ (1951) A. C. 297, (1951) 1 All. E. R. 31, 34.

³⁶ *Ray v. Homewood Hospital*, 223 Minn. 440, 27 N. W. 2d 409 (1947), that the (trustees) directors must direct; and, *Ashman v. Miller*, 101 F. 2d 85 (6 Cir., 1939); *Continental Securities Co. v. Belmont*, 206 N. Y. 7, 99 N. E. 138 (1912).

³⁷ See list of statutes in 2 Oleck, *Modern Corporation Law*, Chap. 39 (1959), including N. J. Rev. St. Ann. Sec. 14:7-1; Pa. (Purdon's) St., tit. 15, Sec. 2852-401.

clear. Preemption of the essential powers of the directors, by a stockholders' agreement or by any other device (such as a foundation) is unlawful.³⁸ A relation of directors to majority stockholders in which the directors are mere puppets in a "puppet-puppeteer" situation is improper and contrary to public policy.³⁹ Statutes and cases permitting stockholders to *limit* the powers of directors to manage the corporation, in the case of an incorporated partnership, do not change the basic public policy as to control of corporate affairs by directors.⁴⁰ Such a revolutionary change of public policy as permits stockholders to manage the corporation, as has been adopted in Puerto Rico (by incorporation of eleven or less shareholders, who will exercise the powers of directors) is for the legislature alone to decide.⁴¹ No other jurisdiction has yet seen fit to adopt such a policy for small "incorporated partnerships," let alone corporations generally.⁴² Yet such "trusts" or "corporate foundations" repeatedly seek indirectly to vest management control of several corporations (not merely one) in the stockholder-trust, *in perpetuity*.

In such a "trust instrument," the cumulative effect of the provisions in violation of corporation law and principles sometimes is almost breathtaking. Taken page by page, they may add up as follows:

"Voting trust" type provisions, ordinarily limited by statutes to a ten year maximum duration, often are perpetual in effect; nor is the "voting trust" open to other stockholders as the law ordinarily requires.

Control of salaries, a major power of corporate directors, is taken from them—a "sterilizing" provision.

Control of bonuses and/or profit sharing, a major power of corporate directors, is taken from them—a "sterilizing" provision.

"Compulsory" contributions by the corporations to the "foundation," normally a major management decision for directors, are effectively forced on them—a "sterilizing" provision.

Control of stock transfer or sale, a major aspect of directors' managerial power, is taken from them—a "sterilizing" provision.

³⁸ Long-Park, Inc. v. Trenton-New Brunswick Theatres Co., 297 N. Y. 174, 77 N. E. 2d 633 (1948); Abbey v. Meyerson, 274 A. D. 389, 83 N. Y. S. 2d 503, affd. without opinion 299 N. Y. 557, 85 N. E. 2d 789 (1949); Ray case, *supra* n. 36; Note, The Charitable Corporation, 64 Harv. L. R. 1168, 1175 (1951).

³⁹ Zahn v. Transamerica Corp., 162 F. 2d 36 (3 Cir., 1947); cases *supra* n. 38.

⁴⁰ Long-Park case, *supra* note 38 and Hornstein, Stockholders' Agreements in the Closely Held Corporation, 59 Yale L. J. 1040 (1950); Hoban, Voting Control Methods, 1958 Univ. of Ill. L. F. (1) 110; 2 Oleck, Modern Corporation Law, Chap. 39 (1959) (digests of statutes of all states).

⁴¹ Puerto Rico Gen. Corp. L. (1956) tit. 14, Sec. 501.

⁴² See 3 Oleck, *supra*, note 40, Chap. 57, listing digests of voting control statutes of all American jurisdictions, and several Canadian ones.

- Domination of corporation management, articles of incorporation, and by-laws, are taken from directors, for the "trust"—a "sterilizing" provision.
- Power to decide on "unusual" outlays, purchases, debts, investments, and salary increases, all distinctly management powers of directors, are taken from them—a series of "sterilizing" provisions.
- Control of annual audit and loan powers, which also are inherently directors' managerial decisions, are effectively taken from directors—a "sterilizing" provision.
- Removal and replacement of directors who dare to independently exercise their lawful management powers, fundamental rights and *duties*, are taken over by the "trust"—not merely a "sterilizing," but actually an "emasculating" provision.
- Control of corporate subsidiaries, a basic power of directors, is taken from them—a "sterilizing" provision.

And all these inherent powers of corporate management sometimes are taken from the corporations and their boards of directors without even pretense of corporate agreement to the emasculation of the corporate powers of each affected corporation. Such supine submission by the corporations' respective boards of directors, of course, warrants (but rarely results in) *quo warranto* action by the Secretary of State or Attorney General. Law and public policy are for legislatures and courts to declare—not to be written by any individual as he happens to desire them to be at any time or for any personal motive or purpose. If such a "trust" is permitted to stand, *there is no corporation law*, and we might as well junk all the corporation statutes and decisions so painfully built up for a century and a half.

Domination of one corporation (let alone several) by a shareholder or other outside "owner," if so complete that the corporation "had . . . no separate mind, will or existence of its own," requires disregard of the corporate entity.⁴³ "One-man incorporation," where it is allowed⁴⁴ represents a legislative change of policy, for corporations, and subject to corporation law regulation, not for one-man-trust-operation of several corporations. Use of corporate entity to defeat governmental policy will be struck down.⁴⁵ Such attempts usually involve a close or one-man corporation.⁴⁶ If the corporation is "a mere agent, or instru-

⁴³ *Lowendahl v. B. & O. R. Co.*, 247 A. D. 144, 287 N. Y. S. 62 (1936), *affd.* 272 N. Y. 360, 6 N. E. 2d 56 (1936), *rearg. den.* 273 N. Y. 584, 7 N. E. 2d 704 (1937).

⁴⁴ Iowa Code Ann. Sec. 491; Ky. Rev. St. 271.025; Mich. Comp. L. Sec. 450.3; Wis. Stat. Ann. Sect. 180.44.

⁴⁵ *Northern Securities Co. v. U. S.*, 193 U. S. 197, 24 S. Ct. 436, 48 L. Ed. 679 (1904) ("mere instrumentality," tax case); *Southern Pacific Co. v. Lowe*, 247 U. S. 330, 38 S. Ct. 540, 62 L. Ed. 1142 (1918) (tax case).

⁴⁶ *Higgins v. Smith*, 308 U. S. 473, 60 S. Ct. 355, 84 L. Ed. 406 (1940).

mentality or department" of the "owner," and is used to evade a statute, the court will look through the form to see the real substance.⁴⁷ And mere stock-ownership control may suffice for such purpose, though ordinarily not fatal in itself.⁴⁸

Reasons Why Abuses Are Tolerated

All this is basic corporation law. Why then have attorneys-general as well as the tax and other courts permitted abuse of the concept of "charity" and misuse of corporation principles and law to accomplish purposes improper under that law? We submit that some of the reasons are these: (1) Solicitude for truly charitable projects has permitted gradual and deliberate confusion of the concept of what is truly a charitable organization. (2) Corporate management and "owners" have persistently employed highly skilled (and paid) counsel to achieve "owners'" purposes, with no adequate counterbalancing force to protect the interests and viewpoints of the public. A statement is attributed to Elihu Root that: "The client never wants to be told he can't do what he wants to do, and it is the lawyer's business to tell him how." This may be apocryphal, but there is a core of truth in it—as witness the typical foundation plan outlined above. (3) Treasury Department investigators are usually accountants rather than lawyers, and assistant attorneys-general are lawyers rather than accountants; both being out of their depth in matters involving corporation law as well as tax and trust law and complex accounting practices.

Motive as the Chief Test

Certainly, deliberate abuse of legal classification should be held to a minimum.⁴⁹ "Classification . . . as 'charitable' rather than as 'for profit' depends on the actual nature of its activities rather than on its name, purpose clause or other formal indicia of character."⁵⁰

"Motive as the test. When ethical, moral or social motives are the dominant ones in an enterprise, that enterprise is non-profit . . . If an enterprise is to be viewed as non-profit, it is not enough that it merely subordinate the profit motive. It must

⁴⁷ *United States v. Reading Co.*, 253 U. S. 26, 40 S. Ct. 425, 64 L. Ed. 760 (1920); *Fuller, The Incorporated Individual*, 51 Harv. L. R. 1373 (1938).

⁴⁸ *Corsican Bank v. Johnson*, 251 U. S. 68, 40 S. Ct. 82, 64 L. Ed. 141 (1919).

⁴⁹ *Lightfoot v. Poindexter*, 199 S. W. 1152 (Tex. Civ. App. 1918).

⁵⁰ 1 *Oleck, Modern Corporation Law*, 15 (1958); cf., *Gilbert v. McLeon Infirmary*, 219 S. C. 174, 64 S. E. 2d 524 (1951); *Leeds v. Harrison*, 7 N. J. Super. 558, 72 A. 2d 371 (1950); *Kubik v. American Composers Alliance, Inc.*, 54 N. Y. S. 2d 764 (1945); *In re Estate of Bailey*, 19 Cal. App. 2d 135, 65 P. 2d 102 (1937); *Federal Chem. Co. v. Paddock*, 264 Ky. 338, 94 S. W. 2d 645 (1936). For the broader view of what is "private charity" see, *Karst, The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 Harv. L. R. 433, n. 2 (1960).

entirely eliminate profit-making from its basic purposes . . . (Though) it is not necessary that profit be eliminated from all the *activities* of an organization . . ." ⁵¹ "The fact that a corporation or association styles itself as a non-profit organization does not make it one." ⁵² "Some tax experts have utterly confused the very real distinction between charity or public-benefit purposes and merely not-for-profit purposes (not to mention business purposes). Naturally, such a confusion of terms and purposes is highly desirable for tax avoidance, but it is also highly undesirable from the point of view of society." ⁵³

Of course, the testing of such a complex device as the modern foundation with the acid reagent of *motive* is a very difficult task for an attorney general or for a court. It is much easier to point to a statute, tax regulation, or case decision, and comfortably to rest on that. Application of fundamental principles (e.g., the principle and public policy of "corporate entity" and of management by a board of directors) is far more difficult than that. It is all too easy to say that there are abuses but that the legislature should deal with them, not the courts. But how many legislators understand the complexities of corporation, tax and trust law and finance? And how many people can or will sacrifice time, effort and money to counter the lobbying of paid (and/or "interested") professional persuaders of legislation?

I submit that it is time to call a halt to the misuse of corporations, trusts, and "foundations" for ostensibly charitable but actually private business purposes. This national scandal is a symptom of moral rot, too long tolerated. Use of a simulacrum—of a pious form—to conceal the real inner motive of power grasping, with cynical disregard of public policy and welfare, must be checked, before this Nation degenerates into a society governed by hypocrisy—with one law for the rich and "clever" and another law for the poor and simple. Just for example, the clause in the typical plan (above) that speaks of "severability" is a minor but pointed illustration. "Severability" is a typical modern "boilerplate" clause found in legal form books. It sometimes says (to those not bemused by form and ritual), in real effect: "I know that this instrument is illegal and improper in some respects, and wish to save what can be saved if and when the illegalities are exposed and rejected." When the whole instrument is a tissue of concealed (and improper) motives and provisions, as it sometimes is, that clause points up the utter cynicism of the entire instrument.

⁵¹ Oleck, *Non-Profit Corporations and Associations* 1 (1956); and Penna. Stat. Ann., tit. 15, Sec. 2851-2 (1938).

⁵² Oleck, *supra* note 51, at 3.

⁵³ Oleck, *supra* note 51, at 6. And see, *Massachusetts Medical Soc. v. Assessors of Boston*, 164 N. E. 2d 325 (Mass. 1960), that merely indirect benefits to the public from a medical society do not suffice to warrant recognition as a "charity," and tax exemption.

The epidemic hypocrisy of the kind of "foundations" that piously proclaim themselves to be "charities" but that actually are intricate devices to evade and pervert the basic law of the land—typified in the plan outlined above—must be cured, by a court with the intestinal fortitude to declare that such fraudulent devices no longer will be tolerated. A hypocritical foundation is a pious fraud.

Illegality and Unseverability of "Business Foundation" Trust Purpose Clauses

"In the sense of legal or formal organization of a non-profit group the word *purpose* has a special meaning, identical to the meaning of that word in corporation law."⁵⁴ Statutes in almost all States require that non-profit corporations or associations shall state in their articles a definite purpose or purposes.⁵⁵

A "trust instrument" includes any form of grant or devise for charitable or public purposes.⁵⁶ This indicates that most states can apply the non-profit corporation law to any non-profit organization which in effect amounts to a corporate group.

"For a non-profit organization, the very approval of incorporation depends largely on the purpose clause . . . The purpose clauses give public notice of the nature of the organization for those who deal with it. They also indicate to the corporation (or foundation) directors (or trustees) . . . their proper activities . . . Vagueness may result in refusal of approval. And deceptiveness may result in withdrawal of approval after it has been granted . . ." ⁵⁷ "Approval of incorporation usually will be refused if the purposes stated in a proposed charter are contradictory."⁵⁸

In other words, purpose clauses are supposed to tell the public authorities, the members, the officers and trustees or directors, creditors, and other persons, precisely what the organization is authorized to do and what it is not authorized to do.⁵⁹ The typical "business foundation's" deed of trust, or purpose clause often states a bewildering variety of vague objects and purposes, ranging from "alleviation of poverty" to any "charitable purposes as in the discretion of the trustees may seem desirable." In the bargain it sometimes specifies the purpose of providing hospital, medical, educational, etc. facilities for employees of the

⁵⁴ Oleck, Non-Profit Corporations and Associations, Sec. 39 (1956); cf., 6 Fletcher, Cyc. Law of Private Corporations, Sec. 2475 (perm. ed.); Oleck, N. Y. Corporations, Chap. 17 (1954 with 1959 cum. supp.).

⁵⁵ Purdon's Pa. Stat. Anno., tit. 15, Chap. 49A, Secs. 2851-1 et seq.; Deering's Calif. Rev. Statutes, tit. 3, Part I, Secs. 21,000-21,401; Del. Code Anno., tit. 8; Smith-Hurd Ill. Rev. Stat., Chap. 32, Secs. 163a-163 a 100; N. Y. Memb. Corp. Law, Art. II; etc.

⁵⁶ Pa. Stat. 2851-2.

⁵⁷ Oleck, Non-Profit Corporations and Associations Sec. 41 (1956).

⁵⁸ *Id.* Sec. 42.

⁵⁹ 1 Oleck, Modern Corporation Law 864 (1958).

corporation(s) (which today is invalid for tax exemption). Often the purposes are stated as follows:

In general, without in any way restricting the charitable purposes for which this grant may be distributed, for the alleviation of poverty, distress and destitution, for the promotion of scientific research, especially research in the various branches of enameling, for assistance to persons under a physical or mental disability, for enabling needy and worthy students to obtain college educations, for the benefit of schools, colleges, institutes, universities, asylums, churches, and hospitals, and for such other charitable purposes as in the discretion of the trustees may seem desirable, the distribution to be world-wide in scope.

Such a purpose clause often begins with the sweeping object of "alleviation of poverty and destitution." Then it oddly includes scientific research especially in enameling or some other specific subject (e.g., the founder's business), provides for aid to physically handicapped persons, for grants to needy college students, and then for gifts to colleges and universities and churches and hospitals. Then in a final burst of generosity it often provides also for "such other charitable purposes as in the discretion of the trustees may seem desirable." Finally, carried away by its own nobility, the purpose clause often states that such assistance is to be world-wide in range, and not merely confined to the United States and its one hundred and eighty million people.

Not even such vast foundations as the Ford, Rockefeller, Carnegie, or other foundations of enormous endowment claim such universal objects and purposes. In truth such a purpose clause amounts to *reductio ad absurdum* of a non-profit foundation's purpose clause. Where found, it is sheer hogwash, and patently so. Obviously the draftsman there threw in "everything but the kitchen sink," on the theory that if you are going to create a smoke screen, you may as well create a thick one.

The law is well settled in all jurisdictions that the purpose clause of a certificate of incorporation or deed of trust is illegal unless it states precisely what the purpose is. A provision in effect "to do anything noble that the trustees desire to do" is improper and invalid. A vague purpose clause is the traditional cloak for the hiding of real purpose. If the purpose clause is so vague that it does not precisely state what is to be done, and by implication thus what is not to be done, that purpose clause is illegal and must be rejected.⁶⁰

A typical statute⁶¹ states that articles of incorporation must set forth "a precise and accurate statement of the purpose or

⁶⁰ The Pennsylvania State Sportsmen's Association, 11 C. C. 576, 4 Dauph. 229 (1892), *In re Council for Small Business, Inc.*, 155 N. Y. S. 2d 530 (1956); 2 Op. N. Y. Atty. Gen. (1911) 69; Op. N. Y. Atty. Gen. (May 14, 1940); Op. N. Y. Atty. Gen. (June 6, 1952).

⁶¹ Pa. Stat. Sec. 2851-203(3).

purposes for which it is to be formed." The statement must be definite and exact.⁶² Application for a non-profit charter may be refused if purposes stated are so unrelated as to fall within different clauses of the statute.⁶³ A charter may not be granted for purposes which are distinct and unrelated to each other *inter sese*.⁶⁴

The typical "business foundation" purpose clause falls directly under the ban of the law above cited. This is just as true of a "charitable trust" as of any other non-profit corporation. The deed of trust usually speaks of incorporation, and as earlier pointed out, consists of what amounts to a corporation without benefit of corporate form. The purported "purpose clause" then is truly seen as nothing more than a mass of unrelated, noble-sounding, glittering generalities, none of which is necessarily the real purpose actually intended by the settlor.

It should be pointed out that fraudulent statement of purpose, or the misleading of supervisory authorities is a serious crime in many states.⁶⁵ In a number of states special approvals by supervisory authorities must be obtained for many "public welfare" activities. Thus hospital-type aid must be approved by the Department of Health in Pennsylvania, and by the State Board of Social Welfare in New York; hospital-expense aid must be approved by those agencies and also by the Commissioner of Insurance in both states.⁶⁶ Public assistance and funds must be supervised by state authorities.⁶⁷ Many of the purposes stated in the usual business foundation instrument are "public welfare" in nature (as well as being utterly inconsistent and contradictory) and must be approved and supervised by various public authorities. No incorporation ordinarily is permitted, for example, for an organization which will merely duplicate the work already being done by another non-profit organization.⁶⁸

The requirement of non-profit purpose approval by supervisory authorities is illustrated in Pennsylvania by the requirement of basic approval, besides that of the secretary of state, by the Court of Common Pleas of the County where the registered

⁶² In re Application for Jocard Club, 85 D. & C. 88 (1954); Citizens League of Wheatfield Tp., 65 D. & C. 70 (1949); In re Betz, Jr., Voters League, 21 D. & C. 357 (1934).

⁶³ Pa. Stat. Sec. 2851-201. Charter Application, 21 Dist. 1135, 8 Sch. 179 (1912).

⁶⁴ In re Charter of Evangelical Lutheran Church, 4 Del. 154 (1892); Pa. State Sportsmen's Association, *supra*, note 60.

⁶⁵ N. Y. Penal Law, Sec. 660, 661 (ten year prison term).

⁶⁶ Pa. St., Secs. 2851-219, 2851-317; N. Y. Memb. Corp. Law, Secs. 11(1), 11(1-b).

⁶⁷ In re Gold Star Parents Association, 67 N. Y. S. 2d 73 (1946).

⁶⁸ In re Gold Star Parents Association, *supra*; In re Boy Explorers of America, 67 N. Y. S. 2d 108 (1946); In re Victory Committee of Greenpoint, 59 N. Y. S. 2d 546 (1945); In re Certificate of Incorporation of Humanity Club, 155 N. Y. S. 2d 210 (1956).

office is to be located.⁶⁹ So, too, approval of educational organizations is vested in the Superintendent of Public Instruction.⁷⁰ And so on. Thus, by avoiding incorporation of our typical "personal and perpetual holding company," avoidance of *any* supervision by the public authorities is attempted. If this device is sustained, anybody may avoid all statutory supervision of "public welfare" activities simply by not incorporating. Obviously, if such a "purpose clause" were submitted, *in advance*, to a court experienced with non-profit organizations and to the several state agencies concerned with specific approvals and supervision, it would receive short shrift.

Non-profit organizations for the benefit of employees of a certain company or companies only (besides being not tax exempt) must obtain special approval of the proper state supervisory authority (e.g., Board of Standards and Appeals in New York).⁷¹

Actual purpose (motive), rather than the purpose stated is the real test of legality of purpose.⁷² And the state may challenge any corporation or foundation for grasping more powers than it is authorized to use.⁷³

Thus on many separate counts the usually all-embracing "purpose clause" of the "business foundation" is improper and void. Were such a clause to be sustained it would in practical effect authorize the trustees to do very nearly anything they please with the funds. For example, as has been shown above, a friend or relative might be granted aid at will under the "alleviation of poverty and destitution" purpose. A grant to the trustee himself conceivably might be authorized, at the will of the trustees, as a charitable purpose which "in the discretion of the trustees may seem desirable." Without laboring the point, it is clear that what we would have is not a charitable "purpose clause," but in fact a *carte blanche* to the trustees (who may be the settlor and his family) to do with the trust funds whatever they wish. So broad and vague a purpose is not only illegal, but it verges on the immoral.

Courts Must Stop Abuse of the "Charitable Foundation" Whether or Not Attorneys-General Act

Statutes in practically every state give to the state's attorney-general the power, and *duty*, to challenge misuse of corporate or other organization authority. *Quo warranto* proceedings may and

⁶⁹ Pa. Stat., Secs. 2851-205, 2851-207.

⁷⁰ Id., Sec. 2851-211.

⁷¹ *Wilson v. Picard*, 173 Misc. 788, 20 N. Y. S. 2d 119 (1940).

⁷² *Vanderbilt v. Commissioner*, 93 F. 2d 360 (1st Cir. 1937); *Cummins-Collins Foundation*, 15 T. C. 613, 622 (1950); *Trinity Operating Co. v. Corsi*, 269 A. D. 716, 53 N. Y. S. 2d 744 (1945); *Kubik v. American Composers Alliance, Inc.*, 54 N. Y. S. 2d 764 (1945).

⁷³ *Syracuse Savings Bank v. Yorkshire Insurance Co.*, 301 N. Y. 403; 94 N. E. 2d 73 (1950); Note, *Distinction Between Powers and Objects in Articles of Incorporation*, 46 Harv. L. Rev. 1337 (1933).

should be brought by the attorney-general to vacate, revoke or annul the charter of a corporation or other organization guilty of improper conduct, or neglect or failure to use its powers, or use of unauthorized powers. Such action may be based on the attorney-general's own information and volition, or on the complaint of a private person.⁷⁴ Thus the New York Civil Practice Act⁷⁵ says: "The attorney-general may maintain an action upon his own information or upon the complaint of a private person."

State administrative officers or agencies, other than the attorney-general, also may initiate proceedings based on improper conduct or abuse of the real functions of public-welfare type organizations.⁷⁶

Courts themselves, of their own motions (*sua sponte*) may act summarily when perversion or willful disregard of corporate propriety occurs.⁷⁷

In the typical device, not one but several corporations may be violating the principles and provisions of corporation and other statutes, while the "foundation" makes complete mockery of them. Yet the attorney-general usually does nothing. Instead, simply assuming this to be merely a question of trust law, he

⁷⁴ Pa. St. Secs. 2852-1112, 1107; D. C. Publ. L. 389, c. 269 Sec. 7 (1954); Md. Code Ann. (1951) art. 23, Sec. 120; Ore. L. 1953, c. 549 Sec. 6; Wis. St. (1953) Sec. 180.06; Ohio Rev. Code (1954) Sec. 1701.11(D); Calif. Ann. Civ. Code Secs. 345, 404b; A. B. A. Model Bus. Corp. Act Secs. 6, 51; Del. Corp. L. Sec. 68; N. Y. Gen. Corp. L. Secs. 90 et seq.; N. Y. Civ. Prac. Act Sec. 1217; etc. See, Oleck, Non-Profit Corporations and Assns. Sec. 229 (1956), citing many cases and statutes; and see, Com. ex rel. Truscott v. Yiddisher Kultur Farband, 382 Pa. 553, 116 A. 2d 555 (1955); Southerland ex rel. Snider v. Decimo Club, Inc., 16 Del. Ch. 183, 142 A. 786 (1928); People v. Stilwell, 157 A. D. 839, 142 N. Y. S. 881 (1913), affg. 78 Misc. 96, 138 N. Y. S. 693 (misuse of powers); Nicolai v. Maryland Agric. & Mech. Assn., 96 Md. 323, 53 A. 965 (1903) (misuse of powers); State v. Dyer, 200 S. W. 2d 813 (Tex. 1947) (misuse of powers); Bennett v. American-Canadian Ambulance Corps., 179 Misc. 21, 37 N. Y. S. 2d 470 (1942) (misuse for profit); Ames v. Kansas, 111 U. S. 449, 4 S. Ct. 437, 28 L. Ed. 482 (1884); State ex rel. Johnson v. Conservative Savings & Loan Assn., 143 Nebr. 805, 11 N. W. 2d 89, 92 (1943); Aitken v. Stewart, 129 Calif. App. 38, 18 P. 2d 988 (1933); Syracuse Savings Bank v. Yorkshire Ins. Co., 301 N. Y. 403, 94 N. E. 2d 73 (1950); Red Ball Motor Freight Co., Inc. v. Southern Pacific Trans. Co., 231 S. W. 2d 462 (Tex. 1950); 35 Words and Phrases, Quo Warranto (1960 Cum. Supp. ed.).

⁷⁵ Sec. 1217. See also statutes requiring reports from trustees of charities, such as N. H. Rev. St. Ann. §§ 7:19-32 (1955); Ohio Rev. Code §§ 109.23-99 (1953); Mass. Gen. L. ch. 12 §§ 8A-I (1958); Calif. St. 1959, ch. 1258 § 1 adopting permanently 9C Unif. L. Ann. 208-15 (1957).

⁷⁶ Pa. St. Secs. 2851-1005, 1307; N. Y. Gen. Corp. L. Sec. 130; Walker Memorial Baptist Church v. Saunders, 173 Misc. 455, 17 N. Y. S. 2d 842, affd. without op. 259 A. D. 1010, 21 N. Y. S. 2d 512, revd. on other gds. 285 N. Y. 462, 35 N. E. 2d 42, rehear. den. 286 N. Y. 607, 35 N. E. 2d 944 (1941).

⁷⁷ People v. Volunteer Rescue Army, Inc., 262 A. D. 237, 28 N. Y. S. 2d 994, affd. without op. 39 N. Y. S. 2d 1022 (1943); Com. ex rel. Truscott v. Yiddisher Kultur Farband, 382 Pa. 553, 116 A. 2d 555 (1955); Morrison v. Philadelphia College of Law, Inc., 56 Dauph. 265; Kardo Co. v. Adams, 231 F. 950 (C. C. A. 6, 1916); 19 C. J. S., Corporations, Sec. 1651.

may even *assume* it to be valid, with hardly a glance at the grave questions underlying the "trust."

The attorney-general generally fails to recognize that the real issue in such a case is the propriety of the establishment of this "trust," not the propriety of its administration.

This, of course, is breathtakingly wrong. But the reason for such egregious error is plain. The attorney-general usually devotes his attention (if any is given at all) to the *trust law* applicable to a *valid* charitable trust. He generally ignores the real problems of *corporation law*, *tax law*, *administrative law*, *accounting practice*, and the root problem—cynical use of the charitable trust device to evade taxes, to violate corporation law, to evade required state agency supervision, and to control a holding-company complex of corporations in perpetuity from the grave. The attorney-general often merely *assumes* (as above remarked) that under general principles of construction the "trust deed" should be sustained as a charitable gift. Rarely does an attorney-general indicate awareness of the vital question of a founder's *ultimate purpose* in setting up the "foundation," even with himself and his relatives as "trustees."

Sometimes an attorney-general will say that if the trust was invalid and void ab initio, the irrevocability clause falls with the rest of the trust and the trustees held the assets on a constructive trust for the settlor. This is even more than the boldest user of a foundation as a personal holding company would dare to hope for. It means that if what he does is declared illegal, his purpose still will be accomplished by a *constructive* trust—with himself again the trustee, constructively. As Alice in Wonderland said: "Curioser and curioser."

But the most obnoxious error of all is the argument (referred to above) that "no member of the public or relative of the settlor of a valid charitable trust has standing to question the administration of the trust."⁷⁸ Here, too, there is the gratuitous *assumption* that use of a foundation as a business device is ipso facto a valid charitable trust. Then it is argued that abuses of discretion in the administration of charitable trusts are correctable only at the instance of the Attorney General.

The real issue is not the propriety of *administration*, but the propriety of *establishment*. Moreover, the law is that any interested person, or the Court itself, may question the legality of use or abuse of corporate powers, as has been shown above. For that matter, a Court of Equity has *inherent power* to correct improper results of the use of rules of law.⁷⁹

Taking the kindest possible view, the attitude of some assistant attorneys-general may be attributed to sheer bewilderment and lack of thorough understanding of what really is being done.

⁷⁸ See the citations, *supra* note 17.

⁷⁹ Oleck, Historical Nature of Equity Jurisprudence, 20 Fordham L. Rev. 23-44 (1951).

After all, the problem of misuse of the concept of charitable foundations is one of the most complicated and intricate of all fields of law, finance and business. It involves corporation law, law of charities, trust law, tax law state and federal, administrative law, accounting procedures, practice and procedure law, high finance and more. The use of foundations as business devices has been carefully developed by some of the most astute corporation and tax lawyers in the nation over a period of years. Misuse has been grounded on creation of such elaborate devices as to confuse and baffle all but the most thoroughly experienced and learned legal minds.

Viewing the attitude of so many attorneys-general from another aspect, a practical factor that must influence that attitude becomes apparent. After all, if the attorney-general's office is sensitively aware of its duties respecting misuse of corporations and foundations, it will investigate such abuses itself. But we all know that attorneys-general generally have avoided involvement with these complex problems. For one thing, their offices almost all lack adequate personnel or budgets for this additional burden. For another, they usually scrutinize the operation of the foundation rather than its establishment. There are few cases in which any attorney-general directly attacked the validity of a foundation as a business device. This, despite the clear mandate and duty to prevent abuses, referred to in the statutes of so many states. The interested founders, the trustees, *trust companies*, and the attorneys for all of these, usually are powerful and able—not given to unquestioning submission to control. Pressure and influence have been known to have been used by a few of them. Nobody likes to be told what he may or may not do with his own property, and also many attorneys-general are politicians, or they never become attorneys-general.

With all compassion for the dilemma of attorneys-general offices, we nevertheless cannot submit to further abuse of the law by amoral devices simply out of sympathy for the bewilderment of attorneys-general (in fact actually *assistant* attorneys-general, usually) who are out of their depth or beyond their facility capacities in these legal maelstroms. The tax-free, corporation-law-flouting "business foundation" is a legal abomination, requiring extermination by the courts, if attorneys-general are unable to handle the problem. The courts have the inherent power and duty to summarily stop perversion or willful disregard of corporate and other propriety, whether or not the attorney-general acts.⁸⁰

As early as 1907 courts recognized the true facts when a partnership used a corporation as a mere instrumentality, and

⁸⁰ *People v. Volunteer Rescue Army, Inc.*, 262 A. D. 237, 28 N. Y. S. 2d 994, affd. without op. 39 N. Y. S. 2d 1022 (1943); and see, *Com. ex rel. Truscott v. Yiddisher Kultur Farband*, 382 Pa. 553, 116 A. 2d 555 (1955); *Morrison v. Philadelphia College of Law, Inc.*, 56 Dauph. 265; *Kardo Co. v. Adams*, 231 F. 950 (C. C. A. 6, 1916); 19 C. J. S. Corporations, Sec. 1651.

the courts disregarded the seeming form and attached the consequences of the "corporate" acts to the partnership.⁸¹ "Where several corporations became in effect a single enterprise and merged their operations (i.e., as in so many foundations), their several entities were disregarded. . . .⁸² The cycle is completed by reference to classic cases in which the fiction of corporate organization has been disregarded, but without recreating or recognizing any other entity . . . In fact, the courts have repeatedly examined the underlying enterprise to find what its real purport was . . . The nature of the enterprise determines the result, negating the corporate personality or any other form of organization of that enterprise . . ." ⁸³

In other words, the courts and their agencies (such as attorneys-general) now *can* treat enterprises as what they *are*, not as what they *say* they are. It is most disheartening, in this day and age, that any attorney-general should revert to the blindly formalistic doctrines of the past century—stubbornly saying, in effect, that the label or form adopted by an enterprise is the final determinant of what that enterprise really is. Today, "in effect the courts look through the paper delineation to the actual enterprise; and then determine whether it is criminal, illegal, contrary to public policy, or otherwise bad (as the circumstances may be) for individuals to conduct that enterprise by any kind of organization." ⁸⁴

The Need For a New System of Regulation

In 1955, while writing *Non-Profit Corporations and Associations*,⁸⁵ I became convinced that the existing systems of governmental regulation of "charities" and "merely non-profit" organizations are quite inadequate. Others besides myself had and have come to the same conclusion.⁸⁶ With this in mind, I drafted a *Proposed Uniform Non-Profit Organizations Act*, which

⁸¹ *In re Rieger*, 157 F. 609 (S. D. Ohio, 1907).

⁸² *Sampsell v. Imperial Paper Co.*, 313 U. S. 215 (1941).

⁸³ *Berle, Enterprise—Entity Theory*, 47 Columbia L. R. 343 (1947), citing among many cases, *United States v. Lehigh Valley Ry.*, 220 U. S. 257 (1911); *Chicago etc. Ry. v. Minneapolis Civic Assn.*, 247 U. S. 490 (1918); *United States v. Reading Co.*, 253 U. S. 26 (1919); *Brundred v. Rice*, 49 Ohio St. 640, 32 N. E. 169 (1892); *Northern Securities Co. v. U. S.*, 193 U. S. 197 (1904).

⁸⁴ *Berle, supra*, note 83.

⁸⁵ Prentice-Hall, 1956; second printing 1959.

⁸⁶ D'Amours, *The Necessity for the Control of Public and Charitable Trusts*, in the 1946 Proceedings of the Natl. Assn. of Attys.-Gen. Conference (1947); Nathan Report (on the English proposals) *Charitable Trusts Committee Report*, CMD. No. 8710 (1952); Taylor, *Public Accountability of Foundations and Charitable Trusts* (1953); Bogert, *Proposed Legislation Regarding State Supervision of Charities*, 52 Mich. L. R. 633 (1954); Lees, *Governmental Supervision of Charitable Trusts*, in the 1955-6 U. of Mich. Law School Legal Research Center report on Current Trends in State Legislation 609 (1957); Bolton & Weithorn, *Conduct Endangering Exempt Status*, in the

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is set forth in the above-mentioned book.⁸⁷ Without pretending to be definitive, that proposed act included the governing device of a separate licensing and regulating agency—which I termed the “Licensing Commission for Non-Profit Organizations.” It would license and supervise both incorporated and unincorporated organizations, putting foundations in the same general category as other charities or merely non-profit organizations as the case might be. Or it would leave “business foundations” to the governance of the business organization law.

The proposals elicited a thunderous silence from all quarters. The American Bar Association’s Committee on Corporate Law and the drafters of the proposed *Model Non-Profit Corporations Act* exhibited something less than ecstatic enthusiasm for my suggested Uniform Act. My remark that the Model Act smacked of business corporation statute habits⁸⁸ undoubtedly had something to do with this cool reception; nor was my boldness cured by the diffidence of my explanation that my proposed Act was merely a *suggestion*.

A very recent (January, 1960) study of the inadequacies of present regulation of foundations and other charities has been made by Prof. Kenneth L. Karst of Ohio State University College of Law.⁸⁹ I shall not repeat here the facts and conclusions of that excellent study, except to point out that Prof. Karst again has emphasized the need for a regulatory agency similar to the one I had suggested.⁹⁰

Prof. Karst’s fine work, however, is unhappily reminiscent in one particular respect—he is concerned almost solely with the *administration* of non-profit organizations *after* they have been established.⁹¹ He pays small attention to the far more fundamental problem—the key to the whole matter—the *nature of the establishing process itself*. Yet, if the organization process (foundation or incorporation) is sound and healthy, the probability of healthy operation becomes much greater. As Prof. Karst points out, supervision by attorneys-general has been almost non-existent. But viewing all foundations as usually *ipso facto* valid trusts is perpetuation of a fundamental misconception.

The need for a sound system of regulation now is very serious. Meanwhile, however, the courts *can* prevent some of the abuses—if they will. The typical system (in Ohio) of one as—

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Proceedings of 3rd Biennial N. Y. U. Conf. on Charitable Foundations, 193, 206 (1957); Report of N. H. Atty.-Gen., Supervision of Charitable Trusts, 1 (1958); Karst, The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility, 73 Harv. L. R. 433 (1960).

⁸⁷ *Supra*, n. 85, at pp. 417-433.

⁸⁸ Oleck, Non-Profit Corporations and Assns., 418 (1956).

⁸⁹ Karst, The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility, 73 Harv. L. R. 433-483 (1960).

⁹⁰ *Supra*, n. 85, at pp. 417-433.

⁹¹ *Supra*, n. 89.

sistant attorney-general to supervise 1130 registered trusts and Heaven knows how many unregistered ones, not to mention other types of organizations of this kind, is almost nonsensical. If this sounds like a call for more government regulation—so be it; it is exactly that.

Conclusion

The problem of abuse of the foundation device in fact contains a socio-legal issue more important than the mere question of whether a particular instrument is valid or invalid. It poses a question that may well affect the future history of this nation. In effect the issue is this:

Does this nation, or does it not, desire or permit an *hereditary aristocracy of wealth* based on amoral manipulation of forms and legal rituals, while the government turns a blind eye to it?

I submit that the whole course of law and history since World War I, in this country, evidences a national policy that wealth shall *not* be passed on perpetually by inheritance—that sharp limits shall be put on the power of any person to control wealth or power in perpetuity—that persons in each generation shall *earn* (not *inherit*) wealth and power. Our almost confiscatory inheritance and gift tax laws, for example, proclaim that policy.

Evasion of that policy, whether by the use of stock options, or “foundations,” or whatever device, is a symptom that must be met by repressive decisions and statutes. Our immediate problem here is the epidemic of misuse of the “charitable foundation” as a device to perpetuate ownership and control by an “hereditary aristocracy of wealth.” That is a symptom of serious moral disease. Not only repressive, but also curative measures are needed.

The courts already have too long delayed the correction of this “clever” abuse of policy. It is no exaggeration to say that toleration of this kind of amoral conduct plays directly into the hands of the enemies of our free (under law) system of capitalism. When the people see that wealth regularly can hire skillful lawyers to evade and mock the law-policy declared by Congress and Legislatures, ultimately the people will lose faith in their laws and government.

More immediately, court toleration of hypocritical misuse of charitable privilege already is having a bad effect on honest founders and foundations. Admirably motivated foundations and founders already find themselves viewed with suspicion. Hypocrites have clothed themselves in the fleece of charity, and it is hard to tell the sheep from the goats.

The courts must declare that use of “charitable foundations” for improper purposes no longer will be tolerated. That already is the law. Application of that law can be effected only by courts that study each particular set of case facts with penetrating understanding of their real, rather than seeming, nature.