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ALLEVIATING PROBLEMS UNDER THE TAX REFORM ACT OF 1969 THROUGH TREASURY REGULATIONS

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Although there may be differing opinions as to the merits of the many provisions in the Tax Reform Act of 1969, there is general agreement in both Congress and the Administration that the Act is one of the most complicated and innovative tax statutes ever passed.

When one stops to consider that the Tax Reform Act, signed into law by President Nixon on December 30, 1969, represents a compromise or meshing of the provisions as passed by the House and the Senate and that each of those versions represented the views and interactions of many Congressmen and Senators and, when one stops to consider that this is the first major tax legislation in recent years where the Administration was controlled by one party and Congress was controlled by the other party, it is easy to understand why such a law would have many ambiguities and uncertainties not to mention some outright inconsistencies which must be resolved if the Act is to be fairly administered.

Treasury regulations have provided the time honored route to the solution of problems of interpretation of tax statutes. In discussing my subject, I would first like to give you some backkground into the authority or weight to be accorded Treasury regulations, then describe the new program in Treasury and the Internal Revenue Service for issuing regulations under the Tax Reform Act. After that, we will go into a number of the problem areas which the new regulations will have to deal with.

Authority to Issue Tax Regulations

Since 1886, the Secretary of Treasury has had delegated to him broad ruling making powers to carry out the functions of his office. Even absent such delegation, it seems clear under the Constitution, which requires the Executive Department to enforce and administer laws passed by Congress, that the Secretary had not only the power but the duty to promulgate regulations under the income tax laws.

In addition to the broad delegation of powers which I have just mentioned, there is specific authority in the Internal Revenue Code authorizing and requiring tax regulations. Section 7805(a) of the Code provides that:

> ". . . the Secretary or his delegate shall prescribe all needful rules and regulations for the enforcement of this title."

We do not have to stop with section 7805(a). There are many places in the Tax Reform Act where the "Secretary or his delegate" is directed or authorized to prescribe regulations. During the drafting of regulations under the 1954 Code, Laurens Williams, who was then Assistant to the Secretary of Treasury and Head of the Legal Advisory Staff, stated that there were 1,338 places in the 1954 Code where the Secretary or his delegate was directed or authorized to issue regulations. This amounted to a delegation in almost two out of every three sections or subsections in the 1954 Code. While I have not counted the specific delegations in the Tax Reform Act, I would guess that the ratio of delegations to sections and subsections is at least as high as it was for the 1954 Code.

Shifting now from the authority to issue Treasury regulations to the weight to be given them, we find that while Courts have the power to review Treasury regulations and to disregard them if the Court determines they are unreasonable, unwarranted, or arbitrary, the Courts generally follow the rule that Treasury regulations are entitled to great weight. The force and effect or weight will vary according to the type of regulations. In the tax area, regulations can be divided into three categories:

1. Substantive or legislative regulations. An example of this is in section 385, added to the Code by the Tax Reform Act. That section authorizes the "Secretary or his delegate" to "prescribe such regulations as may be necessary or appropriate to determine whether an interest in a corporation is to be treated for purposes of this title as stock or indebtedness." We will come back to this section later on.

2. Interpretative regulations. These regulations state the position of the Government and control the position of the Internal Revenue Service on every issue they resolve until they are changed or modified by Court action or by subsequent amendments to the regulations.

3. Procedural regulations—which deal with the administration of the tax laws.

Of the three types of regulations, most controversies between taxpayers and the government are likely to develop in the interpretative regulations. This is particularly true with the regulations program under a law as complicated and as far reaching as the Tax Reform Act.

The Treasury and the Internal Revenue recognized, even before the Reform Act became law, the massive program that would be required to issue regulations in an orderly fashion.

They have moved quickly to muster the personnel and develop a program and procedures for what surely is the most difficult regulations project ever faced by the Treasury and the Internal Revenue Service.

As you know, the usual procedure for issuing regulations involves publication of proposed regulations in the Federal Register in the form of a notice of proposed rule making.

The Administrative Procedure Act passed in 1946 and since codified in Title 5 of the United States Code is applicable to the Treasury Department. It requires, among other things, that notice of proposed rule making be published in the Federal Register and that the issuing agency give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. The Administrative Procedure Act exempts from the notice requirement interpretative rules and circumstances where the agency finds that notice and public procedure thereon are impractical, unnecessary, or contrary to the public interest.

Although it appears that interpretative regulations could be issued without notice and opportunity for the public to be heard, I know of no instance where interpretative income tax regulations which affect the rights of taxpayers have been issued without notice and opportunity to submit views. I am not counting temporary regulations which have been issued from time to time without prior notice where time did not permit notice. For example, temporary regulations were issued on January 16, 1970, providing for an election permitted under section 83, which I will discuss later. That election had to be made by certain taxpayers by January 29, 1970. Obviously, there was not sufficient time between the time the 1969 Act became law on December 30, 1969, and the last day for making the election, January 29, 1970 to go through the usual notice procedure.

I might point out here that it has always been my experience both in and out of the Treasury and the Internal Revenue Service that those agencies want and encourage constructive suggestions and comments on proposed regulations or, for that matter, even on regulations after they have become final. This is especially true at the present time. I heard Commissioner Thrower emphasize this when he addressed a meeting of tax people last March in Washington and several other officials working on the Regulations program have repeated it.

As part of the regulations program under the 1969 Act, a Policy Committee composed of the Assistant Secretary of Treasury (Mr. Cohen), the Commissioner (Mr. Thrower), the Chief Counsel (Mr. Worthy) and the Assistant Commissioner (Technical) (Mr. Swartz) was formed last January.

The Policy Committee meets regularly to consider and determine questions of policy raised during the drafting of proposed regulations. The idea is to give the drafting level technician guidance during all stages of the drafting process. In this way the draftsman will not have to waste time in redrafting a regulation after a policy decision used by him is later reversed.

In addition to its other responsibilities, the Policy Committee established a priority classification for the various regulations projects and set target dates for each project. There are 178 separate regulation projects under the 1969 Act. Neither the priority classification nor the target dates have been made public. The Committee also decided that the regulations program would not attempt to solve all conceivable problems.

As I mentioned before, the Administrative Procedure Act requires that notice of proposed rule making be accompanied with an opportunity for interested persons to submit their views, with or without oral presentation. Generally, whenever regulations of an extensive nature are proposed, a public hearing is held. In the past, anyone who requested an opportunity to speak was allowed to do so. Many presentations consisted of speakers reading long, highly technical, and I might add, boring comments on the regulations.

On October 23, 1970, the Internal Revenue Service had published in the Federal Register an amendment to its procedural rules which added ground rules for the conduct of the public hearings on notices of proposed rule making.

The new hearing rules are much like those under which the House Ways and Means Committee and Senate Finance Committee have been operating for the past few years. Those persons desiring to testify at the public hearing will be required to submit a written statement at a specified time in advance of the date of the hearing. Such persons will also have to submit a written digest, outline or list of issues. Instead of reading written statements at the time of the hearing, witnesses are asked to limit their discussion to matters contained in the written statement and to be prepared to answer questions from the Treasury and Internal Revenue Service people at the hearing.

The first public hearing under the new rules was held on October 26, 1970. Several others have been held since and more are scheduled in the near future.

Another change over past practices with respect to the public hearings is that some or all of the members of the Policy Committee have been present at the hearings and have taken an active part in the discussion of issues and problems.

Section 1348—The fifty percent maximum rate on earned income

A key provision of the 1969 Act is the maximum tax rate on earned income of sixty percent in 1971 and fifty percent for 1972 and thereafter. The statute—section 1348—has a definition of "earned income" which specifically excludes "any deferred compensation within the meaning of section 404." The statute also excludes lump sum distributions from a qualified pension or profit sharing plan which receive capital gain treatment.

If the regulations under this provision are to provide full guidance, they must interpret what is meant by "deferred compensation within the meaning of section 404" in many areas where the statute is silent. For example, since the statute specifically excludes from "earned income" lump sum distributions which receive capital gain treatment, what should happen to ordinary income distributions from a qualified pension or profit sharing plan? There is also the question as to whether payments under unfunded deferred compensation plans should be characterized as deferred compensation or as "earned income" for purposes of section 1348. Mr. John S. Nolan, Deputy Assistant Secretary of the Treasury for Tax Policy, in a speech delivered in October, 1970, indicated that the Treasury Department had reached a tentative decision to treat ordinary income distributions from qualified pension or profit sharing plans as "earned income." He also indicated that unfunded deferred compensation plans probably would not qualify as "earned income."

It is interesting to note that the Tax Section of the New York State Bar Association, in a very comprehensive report on employee benefits under the 1969 Act, has recommended that periodic distributions from qualified pension, profit-sharing and annuity plans and payments under section 403(b) annuities from charitable organizations not be considered as "earned income" except to the extent that payment is made in the year in which the right to such payment was vested and in the following year.

The legislative history of section 1348 is not particularly helpful in providing answers for the regulations. The House version of the 1969 Act simply excluded "any deferred compensation payment" without further explanation. The phrase "within the meaning of section 404" was added by the Conference Committee on the bill, presumably in response to some criticisms filed on the House version which pointed out the lack of specific language on the meaning of "any deferred compensation." The addition of the words "within the meaning of section 404" unfortunately still leaves some unanswered questions. Section 404 does not contain a definition of the term "deferred compensation" and it contains no references to employee stock options, either statutory or nonstatutory.

The consensus from those who have been willing to state a position on income from the disposition of stock acquired under a nonstatutory stock option is that such income should qualify as earned income. Mr. Nolan pointed out that while it was arguable that the bargain element in a nonqualified stock option was earned at a prior time, the rule in section 1.421-6 of the Regulations, that the income is not ordinarily deemed to arise until the option is exercised, appears to be controlling and would remove such options from classification as deferred compensation. The New York Bar Association takes the same view on nonqualified or nonstatutory options and even goes beyond Mr. Nolan's statements by asserting that income from the disposition of stock acquired under a statutory stock option should also not be considered "deferred compensation within the meaning of section 404."

With respect to the treatment of income from nonstatutory options, if, as it appears, the regulations will characterize that income as "earned income," such options may become a popular device to reward key employees since the employer gets an ordinary deduction from such an option. As you know, there is no deduction to the employer in the case of qualified options unless the recipient makes a disqualifying disposition and becomes subject to ordinary income tax. It is the amounts taxed as ordinary income on certain dispositions of stock acquired under a qualified or statutory plan which may be treated as "earned income" instead of "deferred compensation" in the regulations.

The earned income rate limitation has another problem area for the regulations. The amount of earned income subject to the limitation must be reduced if the tax preference items exceed $30,000. The reduction is based on the greater of the current year's preferences or the average preferences for the current and four preceding years. It is obvious that if the reduction is applied to 1971, the first year when the rate limitation is applicable, the four preceding years would include some years prior to the enactment of the Tax Reform Act.

Since there were no tax preference items in years before the Tax Reform Act, it seems strange that section 1348 would require tax preference items to be determined for years when there were no such items. This anomaly is an example of what can happen when tax statutes are drafted hurriedly and not subjected to public comment. That particular language in section 1348 was not in either the House or the Senate version of the Reform Act. It was inserted in conference.

Mr. Nolan has suggested that the regulations will provide averaging back only to 1970. In other words, in 1971 the tax preference items for 1970 and 1971 will be averaged. In 1972, 1970, 1971 and 1972 would be averaged—and so on until the full five-year period is reached.

Section 83—Restricted Property Rules

Section 83 of the Code is new. It was added by the 1969 Act to alter the tax treatment of deferred compensation arrangements known as restricted stock plans. Under Treasury Regulations in effect at the time of the 1969 Act, no tax was imposed at the time the employee received the restricted stock. Tax was deferred until the time the restrictions lapsed and then only the value of the stock when it was transferred to the employee was treated as compensation, provided the stock had increased in value. If the stock had decreased in value between the time it was transferred and the time when the restrictions lapsed, only the lower value was treated as compensation.

Section 83 eliminates the "heads I win—tails you lose" concept in the Regulations and provides that the fair market value of the property in excess of any amount paid for it by the recipient is included in the employee's income at the first time the recipient's rights in the property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier. The statute also permits an employee to make an election to take restricted property into income in the year received even though he receives it subject to a substantial risk of forfeiture and his interest is not transferable.

Section 83 was made applicable, generally, to property transferred after June 30, 1969, and the election had to be made in accordance with rules prescribed by Treasury within 30 days after the transfer or after enactment of the Tax Reform Act, whichever was later.

It was the election provisions of section 83 which produced the first regulations under the 1969 Act. On January 16, 1970, slightly more than two weeks after the 1969 Act became law, temporary regulations were issued to provide for the election under section 83. The temporary regulations will eventually be superseded by final regulations but, as of now, they are still in full force and effect.

The final regulations under section 83 will also have to deal with the question of what is meant by the statutory term "performance of substantial services."

Section 83 specifically provides that the rights of an employee will be considered as subject to a substantial risk of forfeiture (and hence, eligible for tax deferral) if the employee's rights to full enjoyment of the property are conditioned upon the future *performance of substantial services.*

There is no hint in either the statute or the Committee Reports as to what is to be considered *performance of substantial services.* Whether the test should be based on the amount of time or the value of services, or both, are tough questions. A covenant not to compete would usually not constitute a substantial risk of forfeiture since it is wholly within the employee's control. However, in special cases, such a covenant could constitute a substantial risk if it were applicable to a person well below retirement age.

Section 83 introduces another question which the Regulations must answer. Will income taxed under this section qualify for the earned income rate limitation in section 1348? It would seem so and Mr. Nolan indicates that the Regulation will so provide.

Section 385—Treatment of Certain Interests in Corporations As Stock or Indebtedness

Section 385 is a good example of how Congress, from time to time, dumps a tough problem or a controversial tax area into the laps of the tax administrators.

This section authorizes the Secretary or his delegate "to prescribe such regulations as may be necessary or appropriate to determine whether an interest in a corporation is to be treated***as stock or indebtedness."

The section then goes on to state that the regulations shall set forth factors which are to be taken into account in determinig whether a debtor-creditor relationship exists or a corporation-shareholder relationship exists and lists five factors which may be taken into account.

The legislative history of section 385 provides little other help. The section first appeared in the Senate version of the 69 Act. The Senate Finance Committee report discusses section 385 and section 279, relating to the disallowance of corporate interest on certain acquisition indebtedness, under one heading. It has this to say about section 385:

> "In view of the uncertainties and difficulties which the distinction between debt and equity has produced in numerous situations, the committee further believes that it would be desirable to provide rules for distinguishing debt from equity in the variety of contexts in which this problem can arise. The differing circumstances which characterize these situations, however, would make it difficult for the committee to provide comprehensive and specific statutory rules of universal and equal applicability. In view of this, the committee believes it is appropriate to specifically authorize the Secretary of Treasury to prescribe the appropriate rules for distinguishing debt from equity in these different situations."

Several interesting problems are presented by the buck-passing in section 385. For one thing, although section 385 is new, it involves the problem of distinguishing between debt and equity—a problem which has been with us about as long as the income tax law itself. Will the regulations under section 385 be entitled to weight as legislative regulations in the nature of law? What will their effective date be? What happens if the Treasury takes a long time to issue these regulations?

Those of us outside the Government do not know what priority has been assigned to the regulations under section 385. I would assume, however, that they have a very low priority, since there does not appear to be an easy solution to a problem that has been around such a long time.

One factor specified in the statute which will undoubtedly be difficult to weigh is the factor of convertibility into stock of the corporation. I am sure the Service would welcome some good ideas about handling that factor.

Section 279—Interest on Indebtedness Incurred by Corporation to Acquire Stock or Assets of Another Corporation

This is a new section which was proposed in the House version of the 1969 Act, modified somewhat in the Senate version and modified further by the Conference Committee. There are fairly extensive committee reports to help chart the way through the statutory language.

Section 279 limits the deduction by a corporation of interest on certain bonds and debentures which are issued as consideration for acquisitions of stock or other assets of another corporation. The section is designed to deter the conglomerate merger, which in the past had been engineered largely by convertible debt obligations.

Several new terms are introduced in this section. For example, "corporate acquisition indebtedness" triggers the interest limitation provisions of section 279. The statute contains a detailed definition of what constitutes "corporate acquisition indebtedness," including a convertibility test and a ratio of debt-to-equity or earnings test. The drafting of regulations for these provisions does not appear to be any more difficult than other areas except for one aspect. Certain of the tests in section 279 must be applied to affiliated groups on a consolidated basis *even* if separate returns are filed. The Secretary or his delegate is authorized in section 279(g) to prescribe regulations which will determine how these tests are to be computed on a consolidated basis. I do not envy those assigned to draft these regulations.

Section 305—Distributions of Stock and Stock Rights

The 1969 Act made some significant changes or amendments to section 305, dealing with distributions of stock and stock rights.

Formerly that section provided that a shareholder was not taxed on a dividend paid in stock or rights to acquire such stock unless:

1. The stock dividends were paid in discharge of certain dividends on preferred stock, or
2. A shareholder could elect to receive his dividend in cash instead of stock.

That rule was enacted as part of the 1954 Code and replaced what had developed as a court made "proportionate interest test." Those decisions had held that a stock dividend was taxable if it increased the shareholder's proportionate interest in the corporation. This was a difficult test to apply and was dropped at the time of the 1954 Code for the test in section 305.

However, under that test, corporations were able to develop methods or plans which, in effect, gave stockholders an indirect choice between receiving cash or increasing their proportionate interests in the corporation, often without any actual distribution of stock to the stockholders who got the increase in proportionate interests.

As amended by the 1969 Act, section 305 includes a "proportionate interest test" in subsection (b) and in subsection (c). The amendments are drafted in rather general terms no doubt to cover the various ingenious ways corporations have attempted to achieve the effect of a cash dividend to some shareholders and a corresponding increase in the proportionate interest of other shareholders.

On May 1, 1970, a Temporary Regulation under section 305 was issued to clarify the tax status of a dividend issued entirely in stock except that cash was to be distributed in lieu of fractional shares in order to save the issuing corporation the expense and inconvenience of issuing fractional shares. The Temporary Regulation held that the stock dividend paid under those circumstances was not taxable. Temporary Regulations were used in this instance, I believe, because time was a factor and because hardly any taxpayer except maybe a public interest organization would object to or be hurt by the regulation.

Another rule in new section 305 provides that a distribution of stock or rights will be taxable if it is one of a series of distributions which has the result of the receipt of cash by some shareholders and an increase in the proportionate interests of the other shareholders in the corporation. It will be difficult in the regulations to describe what will and what will not be deemed a series of distributions. One of the problems with specificity in the regulations in an area such as this is that it provides a road map or blue print for just how far a corporation can go in avoiding the impact of the new law.

A further new provision in section 305 taxes a shareholder receiving a distribution from a corporation of convertible preferred stock on his common stock on the value of the stock received, unless he proves to the Internal Revenue Service that the distribution will not result in a disproportionate distribution. The regulations under this provision will no doubt establish some general guides which can be used to satisfy this requirement. Martin Worthy, Chief Counsel of the Internal Revenue Service, indicated in a talk before the Tax Executives Institute in September that:

> "The major consideration which would seem to influence this determination is whether there is a basis for predicting at what

time and to what extent the stock will in fact be converted. The factors which we will probably require be taken into account include the period of time in which the conversion right must be exercised, the conversion price, the dividend rate, the redemption provisions, and the marketability of the convertible stock. If, after considering these factors, it is reasonable to anticipate that some shareholders will exercise their conversion rights and some will not, then the distribution will be subject to tax as a dividend. If, however, the conversion right is exercisable over a period of time, such as ten years, and the dividend rate is consistent with market conditions, there is then no basis for predicting at what time and to what extent the stock will be converted, and under this principle the distribution would not run afoul of the new provision."

There will be some cases under section 305 where a change in the conversion ratio will result in an increase in the proportionate interest of some shareholders and consequently a tax even though no actual distribution of stock has been made. This will involve a problem of valuation which the regulations may or may not attempt to solve.

In summary, section 305 under the 1969 Act is a good example of a complex provision designed to discourage the ever present efforts of tax planners to come up with plans which afford tax savings. The statutory language is in rather general terms, leaving the details and the interpretations to be covered in regulations.

Private Foundations

In a normal legislative year, the statutory provisions in the Tax Reform Act dealing with exempt organizations by themselves would have given the tax administrators plenty to work on. 1969 definitely was not a normal tax legislative year. The private foundation provisions were just a part, although a very large part, of the problems and headaches left to the administrators to solve.

Under the Act, the term "private foundation" was introduced to provide a touchstone for a number of new restrictions and excise taxes on those exempt organizations which fell within the definition of "private foundation."

The permissible activities of "private foundations" are tightened to prevent self dealing between the foundations and their substantial contributors, to require the distribution of income for charitable purposes, to limit their holdings of private business, to give assurance that their activities are properly restricted as provided by the exemption provisions of the tax laws, and to provide certainty that investments of these organizations are not jeopardized by financial speculation.

The income tax provisions applicable to private foundations were added to the Code as Part II of Subchapter F. Subchapter F covers exempt organizations. Part II is headed "Private Foundations" and contains three new sections, including section 509 which defines the term "private foundation". John Nolan pointed to some language in section 509 which illustrates some of the difficulty of implementing the 1969 Act.

One part of section 509(a) provides:

> "For purposes of paragraph (3), an organization described in paragraph (2) shall be deemed to include an organization described in section 501(c)(4)(5), or (6) which would be described in paragraph (2) if it were an organization described in section 501(c)(3)."

A little over a month after Mr. Nolan pointed out that statutory language, proposed regulations were published covering that language along with the other provisions in section 509. The proposed regulations do make sense out of the statutory language, at least I felt they did when I read them. I am not sure you would feel that way on hearing the proposed regulations, but I would like to find out. Here is what the proposed regulations say:

> "For purposes of section 509 (a)(3), an organization which is operated in conjunction with an organization described in section 501(c)(4) (5), or (6) (such as a social welfare organization, labor or agricultural organization, business league, or real estate board) shall, if it otherwise meets the requirements of section 509(a)(3), be considered an organization described in section 509(a)(3) if such section 501(c)(4)(5), or (6) organization would be described in section 509(a)(2) if it were an organization described in section 501(c)(3). The section 501(c)(4)(5), or (6) organization, which the section 509(a)(3) organization is operating in conjunction with, must therefore meet the tests of a publicly supported organization set forth in section 509(a)(2). For example, X medical association, described in section 501(c)(6), is supported almost entirely by membership dues of $100 per member. X organized and operated an endowment fund for the sole purpose of furthering medical education. The fund is an organization described in section 501(c)(3). Since the medical association is supported almost entirely by membership dues of $100 per member, it would be a publicly supported organization described in section 509(a)(2) if it were described in section 501(c)(3) rather than section 501(c)(6). Accordingly, if the fund otherwise meets the requirements of section 509(a)(3), it will be considered an organization described in section 509(a)(3)."

All told, the proposed regulations under section 509 take up 13½ pages of fine print in the Federal Register of November 20, 1970. Interested persons have 30 days from that date to submit comments and suggestions in writing. A public hearing will undoubtedly be held at a later date.

The proposed regulations contain many helpful examples and much detail that resolve problems with the statutory language. I would say, however, that there will still be difficulty in distinguishing between "grants", on the one hand, and contract payments or payments for services on the other hand. This distinction is vital in applying the one-third support test in section 509(a)(2).

Paragraph (g) of the proposed regulations is entitled "Grants distinguished from gross receipts". Subparagraph (1) of paragraph (g) points out that grants are often made to a foundation subject to terms and conditions imposed by the grantor to insure that the grantee's programs or activities are conducted in a manner compatible with the grantor's own programs and policies and beneficial to the public. The grantee may also perform a service or produce a work product which incidently benefits the grantor. This makes it difficult to distinguish amounts received as "grants" *for* the carrying on of exempt activities (which is the good or desirable category) from amounts received as gross receipts *from* the carrying on of exempt activities.

Subparagraph (2) of the proposed regulations under section 509 then sets out some distinguishing factors, but the language seems to make the distinction hinge on the primary purpose of the grant or payment. If it is primarily to confer a direct benefit upon the general public, it will be deemed a grant. If it is primarily to serve the needs of the payor, it will be deemed "gross receipts from".

Here again, I am sure the Internal Revenue Service would like to hear from anyone who can draw a more specific yet acceptable line.

The excise taxes imposed on private foundations are in a new Chapter 42 added to the Internal Revenue Code. These include a tax on investment income, self-dealing, a failure to distribute income, excess business holdings and others.

Regulations have not yet been issued under Chapter 42. One of the problem areas will be providing clear rules to distinguish an "operating foundation", which gets special status, from a private foundation which does not qualify as "operating".

The Code provides generally that a foundation is in the "operating" category if its income and assets are devoted "directly" to the "active conduct" of its charitable or educational activities.

Obviously there are degrees of activity and the regulations may well have to simply spell out the extremes on either end and leave the actual line between the two rather hazy.