

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

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

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

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

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

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

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