

P. IRC 4942(g)(2) - SET-ASIDES

1. Background

Prior to 1970, IRC 504 provided that an IRC 501(c)(3) organization (including an organization that would be classified as a private foundation under the post-1969 law) lost its exemption if its aggregated accumulated income was unreasonable in amount or duration. Thus, if a private foundation invested in assets that produced no current income, it did not need to make any distributions in furtherance of its exempt purposes. While the donor may have received substantial benefits from a contribution to the private foundation, "charity" might not have received any benefit.

In other cases, even though income was produced by the assets contributed to the foundation, no current distributions were required until the accumulations became unreasonable. Although a number of court cases had begun to set guidelines as to the circumstances under which an accumulation became unreasonable, in most cases the determination was subjective. In addition, the only available sanction (loss of exempt status) was either ineffective or unduly harsh.

The Tax Reform Act of 1969 dealt with this problem by enacting IRC 4942 which imposes an excise tax on private foundations for failure to distribute income for charitable purposes, effective for taxable years beginning after December 31, 1969. To avoid liability for this tax, a private foundation must make qualifying distributions (defined in IRC 4942(g)) each year at least equal to the foundation's distributable amount (defined in IRC 4942(d)).

An amount "set-aside" in one year for a specific project, but actually paid out in future years, may be treated as a qualifying distribution if the requirements of IRC 4942(g)(2) are satisfied.

Under IRC 4942(g)(2) and Reg. 53.4942(a)-3(b), as it existed prior to the change resulting from the Tax Reform Act of 1976, a set-aside was treated as a qualifying distribution only if it was approved in advance. To obtain such approval, IRC 4942(g)(2) required a private foundation to establish that the set-aside would be paid for the specific project within five years and to establish the "suitability" of the set-aside to achieve the goals of the specific project (suitability test).

While the above rules remain unchanged, IRC 4942(g)(2), as amended by the Tax Reform Act of 1976, effective for set-asides made in taxable years beginning after December 31, 1974, now provides an alternative means of treating a set-aside as a qualifying distribution under which a private foundation must distribute minimum amounts of cash during specific test years (cash distribution test.)

The legislative history of the Tax Reform Act of 1976 states that the cash-distribution test was intended to alleviate a situation which was unforeseen at the time of the 1969 Act, that is, the case of a new foundation or certain existing foundations whose assets are suddenly multiplied many times over, which finds it impossible as a result of Service inaction, to meet the payout requirements in its early years if it uses the suitability test set-aside, because each set-aside under the suitability test must be approved in advance. There are two major advantages to the cash distribution test. The first is that the set-aside need not be approved in advance by IRS. The second is that the private foundation need not establish that the project for which the amount is set-aside can be better accomplished by the set-aside than by the immediate payment of funds.

Proposed regulations relating to set-asides based on the changes made by the Tax Reform Act of 1976 were published in the Federal Register on 8-26-80. A public hearing was not held, but comments were received on several areas which resulted in changes to the proposed regulations. At the date of the writing of this topic, final regulations have been approved and are awaiting publication. This topic is based on the final regulations, a copy of which will either be contained in the text or distributed to you during the discussion of this topic.

2. Suitability Test

A. In General

The rules governing the suitability test under IRC 4942(g)(2)(B)(i) remain unchanged. A private foundation must establish to our satisfaction that the specific project for which an amount is set-aside is a project that can be better accomplished by the set-aside than by the immediate payment of funds and that the amount set-aside will be paid for the specific project within 60 months after it is set-aside. Specific projects that can be better accomplished by the use of a set-aside include, but are not limited to, projects in which relatively long-term grants or expenditures must be made in order to assure the continuity of particular charitable projects or program related investments (defined in IRC 4944(c)) or where grants

are made as part of a matching-grant program. Such projects include a plan to erect a building to house the exempt activity of the private foundation such as a museum or a plan to purchase a group of paintings offered for sale only as a unit that consequently requires a large expenditure.

In Revenue Ruling 75-511, 1975-2 C.B. 450, a foundation whose primary activity was the making of renewable scholarships and fixed sum research grants was unable to show that its grant-making program could be better accomplished by the use of set-asides than by the immediate payment of funds.

The ruling, quoting the applicable regulations, stated that specific projects of the kind that might qualify for a set-aside are those involving relatively long-term grants or expenditures that must be made in order to assure the continuity of particular charitable projects; for example, a plan to fund a specific research program which is of such magnitude as to require an accumulation of funds prior to commencement of the research. The ruling went on to state that the foundation's grant-making program is regularly carried on as part of its normal ongoing charitable activities. In most instances, the foundation had been able to fund these activities out of current income, and it had given no compelling reasons why it could not continue to fund its grant-making program in this manner. Under these circumstances, the ruling concluded that the foundation had not shown that its grant-making program could be better accomplished by the use of set-asides than by the immediate payment of funds. However, while this conclusion is still correct under the suitability test, this factual situation would now qualify under the cash distribution test, assuming the other parts of that test are satisfied, because the foundation need not show that its grant-making program could be better accomplished by the use of set-asides than by the immediate payment of funds.

In Revenue Ruling 77-7, 1977-1 C.B. 354, the term "specific project" was held to include a building project to be undertaken by a public charity unrelated to the foundation making the set aside.

In Revenue Ruling 74-450, 1974-2 C.B. 388, an operating foundation's conversion of a portion of newly acquired land into an extension of an existing wildlife sanctuary and the remainder into a public park under a four-year construction contract, under which payments were made mainly during the last two years, was held to constitute a "specific project".

The ruling stated that entering into the above contract would commit the organization to a major project costing substantially more than the foundation's

total available income on an annual basis, notwithstanding the fact that a major part of the required disbursement would not fall due until after the entire project was well along towards completion. Therefore, the project is one which can be better accomplished by a set-aside than by the immediate payment of funds.

B. Advance Approval

A private foundation must apply for approval of a set-aside under the suitability test before the end of the taxable year in which the amount is set-aside. The regulations provide that the request for advance approval of a set-aside under the suitability test must be sent to the National Office and include:

- 1) A statement describing the nature and purposes of the specific project and the amount of the set-aside for which approval is requested;
- 2) A statement describing the amounts and approximate dates of any planned additions to the set-aside after its initial establishment;
- 3) A statement of the reasons why the project can be better accomplished by a set-aside than by the immediate payment of funds;
- 4) A detailed description of the project including estimated costs, sources of any future funds expected to be used for completion of the project, and the location(s) (general or specific) of any physical facilities to be acquired or constructed as part of the project, and
- 5) A statement by an appropriate foundation manager (as defined in IRC 4946(b)) that the amounts to be set aside will actually be paid for the specific project within a specified period of time that ends not more than 60 months after the date of the first set-aside, or a statement showing good cause why the period for paying the amount set aside should be extended (including a showing that the proposed project could not be divided into two or more projects covering periods of no more than 60 months each) and setting forth the extension of time required.

3. Cash Distribution Test

A. In General

The cash distribution test is satisfied if:

- (1) The specific project for which the amount is set aside will not be completed before the end of the taxable year in which the set-aside is made;
- (2) The private foundation actually distributes in cash for an IRC 170(c)(1) or (2)(B) purpose (a charitable purpose) the "start-up period minimum amount" during the foundation's "start-up period" (both phrases are defined below); and
- (3) The private foundation actually distributes in cash for a charitable purpose, the "full-payment period minimum amount" in each taxable year of the foundation's "full-payment period" (both phrases are described below).

For purposes of these tests, an amount set-aside will be treated as distributed in the year in which actually paid and not in the year in which set aside.

B. Minimum Distribution Required During Start-Up Period

For private foundations created before 1-1-72, the "start-up period" is the four taxable years preceding the taxable year beginning in 1976. For foundations created after 12-31-71, or for organizations that first become foundations after that date, the "start-up period" is the four taxable years following the taxable year in which the foundation was created or became a foundation. For these purposes, a foundation will be considered created in the taxable year in which its distributable amount (IRC 4942(d)) first exceeds \$500.

The "start-up period minimum amount" is that amount that a foundation must distribute in its start-up period and cannot be less than the sum of:

- a) 20% of its distributable amount for the first taxable year of the start-up period;
- b) 40% of its distributable amount for the second taxable year of the start-up period;

- c) 60% of its distributable amount for the third taxable year of the start-up period, and
- d) 80% of its distributable amount for the fourth taxable year of the start-up period.

The above requirement means that the total amount (a, b, c, and d) must be distributed by the end the start-up period, and is not a requirement that any portion of this amount be distributed in any particular year of the start-up period.

The regulations provide the following examples to illustrate this principle:

Example (1). F, a private foundation created on January 1, 1975, uses the calendar year as its taxable year. The start-up period for F is January 1, 1976, through December 31, 1979. F has distributable amounts under section 4942(d) for taxable years 1976 through 1979 in the following amounts: 1976, \$100,000; 1977, \$120,000; 1978, \$150,000; 1979, \$200,000. F's start-up period minimum amount is the sum of the following amounts: 20% of \$100,000 (\$20,000); 40% of \$120,000 (\$48,000); 60% of \$150,000 (\$90,000); and 80% of \$200,000 (\$160,000); which equals \$318,000. Thus, F is required to actually distribute at least \$318,000 in cash or its equivalent during the start-up period.

Example (2). F, a private foundation created in 1969, uses the calendar year as its taxable year. F's start-up period is the calendar years 1972 through 1975. F makes two cash distributions in 1972. The first distribution is made on account of a set-aside made in 1969. Under section 4942(g), that distribution is treated as a qualifying distribution made in 1969. The second distribution is treated under section 4942(h) as made out of F's undistributed income for 1971. In addition, F makes a cash distribution in 1976 that is treated under section 4942(h) as made out of F's undistributed income for 1975. In determining whether F has distributed its start-up period minimum amount within the start-up period, the 1972 distributions are both taken into account because they were actually made during F's start-up period. The 1976 distribution is not taken into account, however, because that distribution was not actually made during F's start-up period.

Generally, only a distribution made during the start-up period is taken into account in determining whether a foundation has distributed the start-up period minimum amount. However, in the case of a foundation created after 12-31-71 (or which first became a foundation after that date), a distribution made during the

taxable year in which it was created (the year preceding the first taxable year of its start-up period) may be treated as a distribution made during the start-up period. In addition, a distribution actually made within 5 1/2 months after the end of the start-up period will be treated as a distribution made during the start-up period if:

- 1) The foundation was unable to determine its distributable amount for the fourth taxable year of the start-up period until after it ended, and
- 2) The foundation actually made distributions before the end of the start-up period based on a reasonable estimate of its distributable amount for the fourth taxable year of the start-up period.

C. Minimum Distribution Required During Full-Payment Period

A private foundation's full-payment period is defined as each taxable year that begins after the end of the start-up period. During this period, it must distribute in cash 100% of its distributable amount (IRC 4942(d)) with respect to the taxable year (without regard to IRC 4942(i)).

For taxable years beginning after 12-31-75, if a foundation distributes more than the full-payment period minimum amount for a taxable year, the excess can be carried forward to reduce the full-payment period minimum amount for up to 5 future taxable years (referred to as an "adjustment period"). An excess distribution made in one taxable year must be completely applied to future years before another excess distribution can be taken into account.

Generally, only a distribution made during a taxable year of the full-payment period may be taken into account in determining whether a foundation has distributed the full payment period minimum amount for a taxable year. The regulations provide the following examples to illustrate this principle:

Example (1). F, a private foundation created on January 1, 1973, uses the calendar year as its taxable year. F has a start-up period of January 1, 1974, through December 31, 1977, and a full-payment period that includes every taxable year beginning after December 31, 1977. F's distributable amount (as determined under section 4942(d)) for 1978 is \$500,000. Thus, F's full-payment period minimum amount for 1978 is \$500,000. During 1978 F distributes \$100,000 in cash to Charity X and \$400,000 in cash to Charity Y on account of a set-aside made in 1973. F has distributed its full-payment period minimum amount for 1978

because it has made actual cash distributions during that year which total \$500,000. However, F has made qualifying distributions (as determined under section 4942(g)) with respect to 1978 of only \$100,000. In order to avoid liability for the tax on undistributed income under section 4942(a), F must distribute or set-aside an additional \$400,000 before January 1, 1980.

Example (2). Assume the facts as stated in Example (1) except that in 1978 F makes cash distributions totaling \$600,000. Since the total cash distributions made in 1978 (\$600,00) exceed the full-payment period minimum amount for 1978 (\$500,000), there exists a \$100,000 excess which must be used by F to reduce its full-payment period minimum amounts for the years 1979-1983 (the taxable years in the adjustment period with respect to the 1978 excess). Therefore, if F's distributable amount (as determined under section 4942(d)) for 1979 is \$500,000, F's full-payment period minimum amount for 1979 is \$400,000 (\$500,000-\$100,000).

D. Failure to Distribute Minimum Amounts

If a foundation fails to distribute the start-up period minimum amount during the start-up period or the full-payment period minimum amount during the full-payment period, then any set-aside made during either period that was not approved in advance under the suitability test will not be treated as a qualifying distribution. In addition, any set-aside made after the taxable year in which the failure to distribute took place will not be treated as a qualifying distribution unless it is approved under the suitability test. Thus, in this situation a deficiency may be assessed under IRC 4942(a). In addition, IRC 6501(n)(3) provides a special rule with respect to the period within which a deficiency may be assessed.

However, the regulations provide that if the failure to distribute the full-payment period minimum amount was not willful and was due to reasonable cause, the foundation will be allowed to correct the failure to distribute. Correction by distribution of cash must occur during the correction period as defined in IRC 4942(e), determined with respect to the earliest taxable event (IRC 4962(e)(2)(A)) that would result if the failure to distribute were not corrected. This distribution to correct is treated as made during the taxable year in which the failure to distribute occurred. If the failure to distribute is due to the fact that the full-payment period minimum amount could only be determined after the end of the taxable year, no "willful failure to distribute" will occur if the foundation makes an additional distribution within 5 1/2 months after the end of the taxable year.

E. Cash Distribution Test - Approval and Information Requirements

Prior approval of a set-aside under the cash-distribution test is not required. Instead, the foundation must attach the following information to its annual information return for the taxable year in which the set aside is made:

- 1) A statement describing the nature and purposes of the specific project for which amounts are to be set aside;
- 2) A statement that the amount set aside will be paid for the specific project within a specified period not to exceed 60 months;
- 3) A statement that the project will not be completed before the end of the taxable year in which the set-aside is made;
- 4) A statement showing the distributable amounts determined under IRC 4942(d) for any past taxable years in the private foundation's start-up and full-payment periods; and
- 5) A statement showing the aggregate amount of actual payments made in cash for charitable purposes during each taxable year in the foundation's start-up and full-payment period. This statement should include a detailed description of any payments that are to be treated as distributed during a taxable year prior to the taxable year in which such payments were actually made and, in addition, should explain the circumstances that justify the application of those rules.

For the five taxable years following the year in which the amount is set-aside, this attachment must include the statements required in 4 and 5.

4. General Rules

A. Evidence of Set-Asides

A set-aside that is approved under the suitability test or which satisfies the cash distribution test need only be noted as a book-keeping entry on the foundation's books of account signifying a pledge or obligation to be paid at a future date(s). Revenue Ruling 78-148, 1978-1 380, held that a foundation may make a set-aside by means of a book-keeping entry, consisting of the amount by

which its minimum investment return for its immediately preceding taxable year exceeds its adjusted net income for that year. Any amount which is set aside will be taken into account for purposes of determining the foundation's minimum investment return under Reg. 53.4942(a)-2(c)(1), and any income attributable to the set-aside is taken into account in computing adjusted net income under Reg. 53.4942(a)-2(d).

If the suitability test or cash distribution test is otherwise satisfied, the 60 month period for paying the amount set-aside may, for good cause shown, be extended.

B. Contingent Set-Asides

In the event a foundation is involved in litigation and cannot distribute assets or income because of a court order, the foundation may seek and obtain a contingent set-aside. The amount of the set-aside would be limited to that portion of the foundation's distributable amount which is attributable to the assets or income that are held pursuant to court order and which, but for the court order precluding the distribution, would have been distributed. In the event that the litigation encompasses more than one taxable year, the foundation may seek additional contingent set-asides. These amounts must be distributed by the last day of the taxable year following the taxable year in which the litigation is terminated.

Appendix 1

Rev. Rul. 74-450, 1974-2 C.B. 388

26 CFR 53.4942(a)-3: Qualifying distributions defined.

Operating private foundation; qualifying distribution; set-aside; wildlife sanctuary enlarged. An operating private foundation's conversion of a portion of its newly acquired land into an extension of its existing wildlife sanctuary and the remainder into a public park under a four-year construction contract under which payments are mainly during the last two years constitutes a "specific project" and the foundation's set-aside of all its excess earnings for four years, for which it files a timely justifying application with the Service, will be treated as a qualifying distribution under section 4942(g)(2) of the Code, in applying the income test prescribed by section 4942(j)(3)(A), for each taxable year in which such earnings are set aside and remain unexpended.

Rev. Rul. 74-450

Advice has been requested concerning the extent to which income set aside in the manner described below may be treated as qualifying distributions in applying the income test for operating foundations that is prescribed by section 4942(j)(3)(A) of the Internal Revenue Code of 1954.

A private foundation, which is exempt under section 501(c)(3) of the Code, was organized to restore and perpetuate wildlife and game on the North American continent, and to foster such activities by others. The foundation has for many years maintained a wildlife sanctuary on its own land and distributed excess income from its investments to other exempt charitable organizations.

Shortly after the beginning of the current taxable year, the foundation received a bequest of a contiguous tract of land formerly used for farming purposes which doubled its total land holdings. The trustees in control of the foundation's affairs thereupon committed a portion of this farm land for conversion into an extension of its wildlife sanctuary and the balance for conversion into a public park. The combined conversion project will entail extensive tree planting, the building of a large earthen dam, and the construction of various fences, roads, and other public service facilities. It would currently be possible for the foundation to have all the work required to complete the entire farm land conversion project performed under a single four-year contract at an agreed total price of 120x dollars, no more than about 15x dollars of which would become payable in either of the first two years.

The foundation's productive investments are currently yielding a net income of 45x dollars per year. Its current annual operating expenses, which

include the cost of operating the present wildlife sanctuary and the excise taxes imposed under section 4940 of the Code, amount to 15x dollars.

In the belief that the charitable objectives of the foundation demand that it enter into a long-term conversion contract of the type outlined above, its trustees have directed that all its available excess earnings for a four-year period commencing with the current year be set aside and held as a separate fund with which to make whatever installment payments may fall due under the conversion contract from year to year. With a view to going forward on that basis, the foundation has also filed a timely application for Internal Revenue Service approval of such a set-aside under section 4942(g)(2) of the Code. For this purpose, it has supplied the Service with a detailed description of the complete conversion project outlined above. Its supporting material includes a statement generally locating all the physical facilities that are to be constructed and otherwise substantiating 120x dollars as a reasonable estimate of the overall cost.

The application for Service approval further shows that the total work required to convert the farm land to use as a wildlife sanctuary and public park will take approximately 4 years. It also includes a duly authorized representation by the chairman of its board of trustees that, in any event, all income earmarked and set aside pursuant to the proposed plan will be fully expended within a five-year period commencing with the date of the foundation's initial set aside to convert its newly acquired farm land in the manner described above.

Section 4942(j)(3)(A) of the Code prescribes one of the essential conditions that a private foundation must meet in order to qualify as an operating foundation. This condition is that the foundation make qualifying distributions whose combined aggregate amount is at least equal to substantially all of its adjusted net income.

Section 4942(g)(2) of the Code provides that an amount set aside for a specific project which comes within one or more of the purposes described in section 170(c)(2)(B) may be treated as a qualifying distribution, but only if, at the time of the set-aside, the private foundation establishes to the satisfaction of the Secretary or his delegate that the amount will be paid for the specific project within five years, and the project is one which can be better accomplished by such set-aside than by immediate payment of funds.

Under section 53.4942(a)-3(b) of the Foundation Excise Tax Regulations, specific projects of the kind that might qualify for a set-aside are those involving relatively long-term grants or expenditures that must be made in order to assure the continuity of particular charitable projects; for example, a plan to erect a building to house a direct charitable, educational, or other similar exempt activity of the foundation.

Section 53.4942(a)-3(b) of the regulations also provides that to obtain approval for a set-aside the foundation must furnish the Commissioner with a timely written statement setting out:

- (1) the nature and purpose of the specific project and the amount of the set-aside;
- (2) the amounts and approximate dates of any planned additions to the set-aside after its initial establishment;
- (3) the reasons why the project can be better accomplished by such set-aside than by the immediate payment of funds;
- (4) a detailed description of the project, including estimated costs and sources of future funds, and the location of any physical facilities to be acquired or constructed as part of the project; and
- (5) a statement by an appropriate foundation manager that the amounts to be set aside will actually be paid for the specific project within a specified period of time which ends not more than 60 months after the date of the first set-aside.

Section 53.4942(b)-1(b) of the regulations provides in part that any amount set aside by a foundation for a specific project, such as the acquisition and restoration, or construction, of additional buildings or facilities which are to be used by the foundation directly for the active conduct of the foundation's exempt activities, shall be deemed to be a qualifying distribution expended directly for the active conduct of the foundation's exempt activities if such amount has initially been shown to meet the set-aside requirements provided for in paragraph (b) of section 53.4942(a)-3.

Consummation of the foundation's plan to convert its newly acquired farm land into an extension of its existing wildlife sanctuary and a public park will serve its charitable and educational purposes all of which come within section 170(c)(2)(B) of the Code. Such plan thus constitutes a "specific project" of the class for which an amount may be set aside and treated as a qualifying distribution under section 4942(g)(2), if such amount is further shown to meet the additional requirements of that statutory provision.

As a matter of simple calculation the foundation's existing sources of income are sufficient to accomplish a complete funding of the estimated total cost in approximately 48 months, along with a continuing fulfillment of all other outstanding commitments; and that estimate likewise appears to be reasonably consistent with the detailed description of the contemplated construction and conversion work being undertaken. It is accordingly concluded that the full amount of such estimate will actually be paid for the specific project within the requisite period of 60 months.

Entering into the above-described contractual agreement would commit the organization to a major unitary project costing substantially more than the foundation's total available income on an annual basis, notwithstanding the fact that a major part of the required disbursement would not fall due until after the entire project was well along towards completion. Therefore, the proposed undertaking is one which can be better accomplished by a set-aside than by the immediate payment of funds and that all current income items specifically earmarked and set aside on the accounting records of the foundation for use in fulfilling the above-described conversion plan and program will thereupon become eligible for treatment as qualifying distributions under section 4942(g)(2) of the Code with respect to any taxable year within which they are so set aside and as of the end of which they remain unexpended.

Even though a private foundation considers itself within the scope of this Revenue Ruling, it must, in order to obtain approval of a set-aside, submit a request to the Commissioner of Internal Revenue, T:MS:EO, in accordance with the instructions provided in section 53.4942(a)-3(b)(3) of the regulations.

Appendix 2

Rev. Rul. 75-511, 1975-2 C.B. 450

26 CFR 53.4942(a)-3: Qualifying distributions defined.

Private foundation's set-asides for grantees; qualifying distributions.

A private foundation, whose primary activity is the making of renewable scholarships and fixed sum research grants that normally run for three years, for which payments have been made annually from current income, may not treat set-aside amounts representing the maximum for each grantee from which the annual payments will be made as qualifying distributions under section 4942(g)(2) of the Code.

Rev. Rul. 75-511

Advice has been requested whether, under the circumstances described below, amounts proposed to be set aside by a private foundation for certain specific projects will be approved by the Service under the provisions of section 4942(g)(2) of the Internal Revenue Code of 1954 and the regulations thereunder.

The foundation's primary activity is the making of scholarship and research grants to individuals for charitable purposes. In most cases, the foundation's research grants are fixed-sum grants that cover a period of three years and that are paid to the grantees in annual installments. Its scholarship grants are normally made on an annual basis to cover the grantee's college education and, if the student maintains a certain minimum academic average, the grants are renewable annually over a three year period. In most instances where the foundation has obligated itself to make grants to individuals for a certain number of years, the foundation has been able to fund the annual installment grant payments and the annual renewal grant payments out of its current income. In the few cases where the foundation has not been able to meet its obligations out of current income, it has made the grant payments out of corpus.

Instead of continuing to make its annual installment and renewal grant payments out of current income, the foundation proposes to set aside, for each grantee, an amount which represents the total amount of funds the foundation will need to make the installment or renewal grant payment for the duration of the recipient's grant period. Under this proposal, the foundation would make each annual installment or renewal grant payment out of the grantee's set-aside account until the applicable grant period has ended and the funds set aside for his use are depleted.

With a view toward going ahead on this basis, the foundation has timely sought approval by the Commissioner of Internal Revenue that such set-asides be

treated as qualifying distributions under the provisions of section 4942(g)(2) of the Code.

Section 4942(g)(2) of the Code provides that an amount set aside for a specific project which comes within one or more of the purposes described in section 170(c)(2)(B) may be treated as a qualifying distribution, but only if, at the time of the set-aside, the private foundation establishes to the satisfaction of the Secretary or his delegate that the amount will be paid for the specific project within five years, and the project is one which can be better accomplished by such set-aside than by immediate payment of funds.

Under section 53.4942(a)-3(b) of the Foundation Excise Tax Regulations, specific projects of the kind that might qualify for a set-aside are those involving relatively long-term grants or expenditures that must be made in order to assure the continuity of particular charitable projects; for example, a plan to fund a specific research program which is of such magnitude as to require an accumulation prior to commencement of the research.

In the instant case, the foundation's grant-making program is regularly carried on as part of its normal ongoing charitable activities. In most instances, the foundation has been able to pay the annual installment and renewal grant payments out of current income, and it has shown no compelling reasons why it cannot continue to fund its grant-making program in this manner. Under these circumstances, the foundation has not shown that its grant-making program can be better accomplished by the use of set-asides than by immediate payment of funds.

Accordingly, amounts proposed to be set aside by the foundation for the specific projects described above will not be approved by the Service as qualifying distributions under the provisions of section 4942(g)(2) of the Code.

Appendix 3

Rev. Rul. 77-7, 1977-1 C.B. 354

26 CFR 53.4942(a)-3: Qualifying distributions defined.

Rev. Rul. 77-7

In conjunction with a request for approval of a set-aside pursuant to section 4942(g)(2) of the Internal Revenue Code of 1954, a private foundation has asked whether the term "specific project" includes the accumulation of funds to endow a specific building project of an unrelated public charity.

Held, the term "specific project" as defined in section 53.4942(a)-3(b)(2) of the Foundation Excise Tax Regulations includes a project to be undertaken by a public charity unrelated to the private foundation making the set-aside.

Appendix 4

Rev. Rul. 78-148, 1978-1 C.B. 380

26 CFR 53.4942(a)-3: Qualifying distributions defined.

Private foundation; set-aside amount. A private foundation may set aside under section 4942(g)(2) of the Code, by means of a book-keeping entry, the amount by which its minimum investment return for its immediately preceding taxable year exceeds its adjusted net income for that year.

Rev. Rul. 78-148

Pursuant to section 4942(g)(2) of the Internal Revenue Code of 1954, a private foundation requested approval of a set-aside in the amount of x dollars, the amount by which its minimum investment return, as defined in section 4942(e), for its immediately preceding taxable year, exceeded its adjusted net income, as defined in section 4942(f) for that year. For the immediately preceding taxable year, the foundation made qualifying distributions in an amount equal to its adjusted net income.

Held, so long as the requirements of section 4942(g)(2) of the Code are otherwise met, the amount set aside may be that amount by which a private foundation's minimum investment return for its immediately preceding taxable year exceeds its adjusted net income for that year. The amount set aside need not reflect an accumulation of income, but may be a bookkeeping entry that will require funding out of corpus by the end of the set-aside period.