UIL
4942.03-07
4942.03-05

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200026029

Date: MAR 30 2000

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T2

Employer Identification Number:

LEGEND: x =

Dear Sir or Madam:

This is in reply to your request that a set-aside of funds be recognized as satisfying the suitability test of section 4942(g)(2)(B)(I) of the Federal Income Tax Code and therefore a qualifying distribution for the purposes of section 4942(g)(I) of the Code.

You have been recognized as exempt from Federal income tax under section 501(c)(3) of the Code and are a private operating foundation within the meaning of section 4942(j)(3). As stated in your Articles of Incorporation, your purposes are to receive and administer funds for religious, charitable, scientific, and educational purposes.

In order to accomplish your charitable purposes you intend to build a facility to house and educate underprivileged or disadvantaged children of various ages. Although you have existed for several years, other than to purchase a site for your facility, you have made only minimal expenditures for charitable purposes. Rather, you have satisfied your mandatory distribution requirements by setting aside monies to be used at a later date to accomplish your charitable purposes.

As previously indicated, you recently purchased a site for your facility. However during your I999 fiscal year you were unable to make much progress in constructing your facility because you encountered several unexpected delays in getting the necessary zoning changes and regulatory approvals. Although these delays were burdensome and time consuming, they did not call for the expenditure of large amounts of money. Therefore, you have requested a ruling to set aside $x, the approximate difference between the amount you are statutorily required to distribute for charitable purposes on an annual basis and the amount actually expended for such purposes in I999. You have represented that the amount set aside will be expended within 60 months after the end of your I999 fiscal year.

You have finally obtained the necessary zoning and met other regulatory requirements. It is anticipated that your development plans wil be approved and you can begin construction of your facility. You have stated that you expect to begin construction of the facility in early 2000. However, in the event that additional set-asides are needed you have stated that you will seek rulings from the Service.

195

Re:

Section 501(c)(3) of the Code provides, in part, for exemption from federal income tax for a corporation organized and operated exclusively for charitable, scientific or educational purposes provided no part of the corporation's net earnings inure to the benefit of any private shareholder or individual.

Section 509(a) of the Code provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes of Chapter 42.

Section 4942(a) of the Code imposes a tax on the undistributed income of a private foundation.

Section 4942(c) of the Code defines undistributed income as the amount by which the distributable amount exceeds the qualifying distributions of the foundation.

Section 4942(g)(1) of the Code defines a "qualifying distribution" as (a) any amount paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled by the foundation or one or more disqualified persons or (ii) a private foundation which is not an operating foundation, or any amount paid to acquire an asset used directly in carrying out one or more purposes described in section 170(c)(2)(B).

Section 4942(g)(2)(A) of the Code provides that for all taxable years beginning on or after January 1, 1975, an amount set aside for a specific project which comes within one or more purposes described in section 170(c)(2)(B) may be treated as a qualifying distribution if it meet the requirements of subparagraph (B) of section 4942.

Section 4942(g)(2)(B)(i) of the Code provides that an amount set aside for a specific project may be treated as a qualifying distribution if, at the time of the set-aside, the foundation establishes to the satisfaction of the Secretary 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 rather than by immediate payment of funds (the "suitability test").

Section 53.4942(a)-3(b)(1) of the Foundation and Similar Excise Tax Regulations provides that an amount set aside for a specific project that is for one or more of the purposes described in section 170(c)(1) or (2)(B) of the Code may be treated as a qualifying distribution in the year in which set aside if the requirements of that section and section 4942(g)(2) are satisfied. The foundation must establish that the amounts set aside will be paid for the specific project within 60 months after it is set aside, and (i) the set-aside satisfies the suitability test, or (ii) the foundation satisfies the cash distribution test.

Section 53.4942(a)-3(b)(2) of the regulations provides that the suitability test is satisfied if the foundation establishes that the specific project is one 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. The regulation cites as an example of a suitable project a plan to erect a building or house the direct charitable, educational or similar exempt activity of the foundation (such as a museum building in which paintings are to be hung), even though the exact location and architectural plans have not been finalized.

Re:

Section 4942(j)(3) of the Code defines the term operating foundation, in general, as a private foundation which engages directly in the active conduct of charitable, religious, education and similar activities as contrasted to other private foundations which merely make grants for section 501(c)(3) purposes.

In Associated Industries of Cleveland, 7 T.C. 1449 (1961), the Court stated that a statute construing an exemption must be strictly construed and any doubt is to be resolved in favor of the taxing power.

Prior to the passage of the Tax Reform Act of 1969, there was little legal pressure on private foundations to distribute income to charity. This enabled individuals to take charitable deductions in one year and unduely delay the distribution of funds for charitable purposes. Section 4942 of the Code was enacted to eliminate this undesired delay in the benefit to charity. Now, pursuant to section 4942 private foundations are required to annually distribute, for charitable purposes, the foundation's minimum investment return. This minimum investment return is generally defined as an amount determined by multiplying the aggregate fair market value of the foundation's noncharitable assets by a set percentage. Failure to satisfy the mandatory distribution requirements will subject the foundation and its manager to an excise tax based on a percent of the income not distributed in accordance with the provisions of section 4942.

A "set-aside" is an exception to the general rule which requires private foundations to make annual distributions to charity. As an exception to a general rule it is to be narrowly construed. See Associated Industries of Cleveland, supra. The mere accumulation of funds is not an adequate reason for the Service to approve a set-aside request under section 4942(g)(2)(B)(I) of the Code.
Where a private foundation has established a history of not expending funds for charity it has not only subjected itself to the 4942(a) tax on a failure to distribute income to charity on an annual basis, it has also jeopardized its tax exempt status under section 501(c)(3) by its failure to engage in charitable activities.

The information you have submitted establishes that you expected to be able to begin constructing your facility in 2000. The construction of this facility to house, care for and educate underprivileged and disadvantaged youth is the purpose for which you were recognized as exempt under section 501(c)(3) of the Code. In addition, for reasons not under your control, during 1999 you were unable to fully work towards accomplishing this goal. In your letter of December 16, 1999, you indicated that once your zoning impediments were removed you would begin construction of the facility. On February 21, 2000, your zoning request was approved.

Therefore, based on the information you have submitted we have concluded that setting aside $x to be expended for your charitable purposes within 60 months from the last day of your 1999 fiscal year is a qualifying distribution for your 1999 fiscal year.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Re:

Because this letter could help resolve any question about your exempt status, you should keep it in your permanent records. If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Garland A. Carter

Garland A. Carter

Manager, Exempt Organizations

Technical Group 2