UIL: 4942.03-07

200118055

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

Date: FEB 5 2001

Contact Person:

Identification Number:

Telephone Number:

*****

T:EO:B:4

Employer Identification Number:

Legend:
B:
C:
E:
K:
L:

Dear Taxpayer:

We have considered B's ruling request dated September 1, 2000, concerning whether a proposed set-aside of E will satisfy the suitability test of Section 4942(g)(2)(B)(i) of the Internal Revenue Code and constitute a qualifying distribution under Section 4942(g)(1)(A) of the Code.

Facts

B is a non-profit corporation, exempt from federal income tax under section 501(c)(3) of the Code and is classified as a private foundation under section 509(a). B conducts programs and makes grants to organizations and individuals worldwide to advance four goals: to strengthen democratic values; to reduce poverty and injustice; to promote international cooperation; and to advance human achievement. B works through its United States headquarters and through a network of L overseas offices ("field offices").

For the past several years, B has made a large number of grants per year, with a relatively small grant size. A substantial number of these are grants to organizations in other countries, where the cost of living is considerably lower than in the U.S. These grants have an effective purchasing power that exceeds their U.S. dollar value. B consistently meets or exceeds the annual distribution requirement under section 4942 of the Code and, since the enactment of section 4940(e), consistently has qualified for the reduced 1% excise tax rate under section 4940.

B has developed a large scale initiative, tentatively entitled C, that B believes has the potential to make a significant impact toward the advancement of one or more of B's goals. C is much larger than anything that B has typically undertaken and is, in fact, the largest and most complex grant that has been approved by B in decades. C involves the establishment of a very large international fellowship program that would be available to disadvantaged non-U.S. students from the regions in which B works overseas. C would support fellowships for up to three years of post-baccalaureate study for a cadre of talented individuals from groups within these regions that lack systematic access to higher education. C is structured in such a way that it will benefit fellowship recipients in their individual capacities, and will increase their capacity

244

for leadership and participation in national development in their own countries, as well as their commitment to greater intellectual and cultural vitality, and economic and social justice worldwide.

C requires substantial planning and start-up with B providing C with interim funding during the start-up period, withholding full funding until the project is established and operational. In order to provide funding for C, B is requesting approval to set aside of E, as an entry on its books and records during its fiscal year ending K. This set aside request includes two components: the fellowship component, and the "pipeline" component that will be managed and disbursed through the C's field offices with the objective of preparing disadvantaged students at an earlier stage in their education for subsequent consideration in the fellowship competition or other further education. As described below, a substantial portion of the fellowship component will be granted to one or more U.S. public charities and the earnings on the grant amount will also be used to support C.

B expects that the funding set aside for the "pipeline" component of C will be administered through the field offices. Funds will be disbursed over a five-year period to other organizations for activities aimed at preparing future possible participants in C (or other programs) for graduate study. The programs will vary from field office to field office depending on local conditions and needs, but may include activities such as educational enrichment opportunities, scholarship opportunities at the collegiate or pre-collegiate level, summer programs, or the like.

B believes that the amount it proposes to set aside will be necessary to enable C to have the intended impact. B's prior experience with international fellowship programs, including those supported through its field offices, has demonstrated that such programs can be successful not only in encouraging academic progress but also in developing leadership potential. This experience leads B to expect that C, while complex in scale, scope and design, will be able, with proper preparation, to accomplish the intended objectives. B's views have been reinforced during its extensive planning process for C, which has included contacts and consultations with more than 50 external organizations and individuals with experience in international fellowship and exchange programs and activities. Coordination among multiple organizations allows B to ensure that C is established and operational before B provides full grant funding.

B itself will not administer C. It intends to make a grant of a substantial portion of the fellowship component to one or more U.S. public charities, which will act as coordinator(s) of C. The U.S. coordinator(s) will be responsible for overall administration of C. This will include, for example, providing technical advice and assistance to the local intermediaries; assisting with university placements for fellows; coordinating networking and additional educational opportunities for fellows; creating post-fellowship convening opportunities for the fellows; resolving language, visa, tax, and other similar issues in connection with the fellowships; monitoring, reporting on, and evaluating the progress of C; and overseeing the use of grant funds in accordance with the terms of C. B has not yet identified the U.S. coordinator(s). It will make the selection based on factors such as the capacity to administer a large, multi-national, multi-organizational project; experience in international fellowship programs; ability to provide administrative and technical assistance to grantees and fellowship recipients; etc.

B will disburse the remainder of the fellowship component to the local or regional intermediary organizations which operate in the countries and regions from which the fellows will be selected. The local intermediaries -- and not B or the U.S. coordinator(s) -- will be responsible for the recruitment and selection of the fellows. Although the local intermediaries have not yet been chosen, there could be as many as L organizations -- one from each of the countries in which B has offices. The local intermediaries will be selected based on their ability to carry out the purposes of C at the local and regional level. In addition, C may involve the participation of several other organizations which will carry out particular aspects of the program design, such as evaluation and communications.

The fellowship component of C will involve five discrete but interrelated stages: (1) recruitment, selection, and placement of the fellowship recipients; (2) the pre-fellowship period; (3) the fellowship period; (4) the post-fellowship period; and (5) ongoing monitoring and evaluation.

In the first stage, the local intermediaries will be principally responsible for the recruitment and selection of the fellows from among the designated class of groups that lack systematic opportunities for higher

education. The recruitment and selection functions to be performed by the local intermediaries will involve identification of the groups that will comprise the eligible class of fellowship recipients; recruitment of potential candidates from within these groups; and establishment of selection committees with the expertise to choose fellows based on C's criteria. Although the recruitment and selection process will vary from area to area, there may be some opportunities for collaboration in which several intermediaries join together on a broader regional basis.

While admission decisions will, of course, be made by the universities themselves, the intermediaries will assist the fellowship recipients as necessary in considering where to apply, in the preparation of applications for admission, and in making arrangements for enrollment. To ensure that reliable information is available about a broad array of options, the U.S. coordinator(s) will create and maintain an international database of high quality graduate-level programs in universities around the world, and will disseminate this information to fellowship recipients. The U.S. coordinator(s) will also be available to provide other assistance to fellowship recipients, particularly those who choose to study in the U.S., with respect to travel, visa, tax, and other matters.

The second, third, and fourth stages of C involve important elements in addition to the fellows' graduate study. A central aspect of C involves providing opportunities for fellows to engage in individual and group activities that will enhance the likelihood of their academic success, increase their leadership skills, strengthen their connections to other fellows, and facilitate their subsequent transition into positions and institutions where they can apply their newly-acquired knowledge and leadership skills in or on behalf of their home countries. The U.S. coordinator(s) and the local intermediaries will work jointly to develop and conduct these activities, which will include individual pre-fellowship training in language, computer and research skills; academic, logistic and administrative support for fellows as needed during the term of the fellowship; and regional and international seminars and workshops for all or sub-groups of fellowship recipients which will contribute to leadership training and provide opportunities for fellows to share experiences and form long-lasting academic and professional networks. C will also provide modest follow-up funds to enable former fellows to continue their research and to participate in international events where their attendance would further serve the objectives of C.

C will also include a long-term monitoring and tracking component, which will help to measure its success as well as to ensure that the grant funds are used for the intended charitable purposes. B will monitor the progress of C on a continual basis through reports from the U.S. coordinator(s) and the local intermediaries on activities and expenditures. It will also consult regularly with these grantees, make field visits, provide technical advice and assistance as needed, and develop tracking procedures to follow the accomplishments of the fellows after the completion of their participation in C. B's field offices will be integrally involved in the monitoring and tracking process.

C is expected to span a ten year period, although B's grant funds will be fully disbursed within five years of B's fiscal year ending K. The first year of C will involve organizational planning, selection of at least some of the U.S. coordinator(s) and the intermediary organizations, development of program guidelines and materials, and selection of the first cohort of fellows from three or four initial sites. The first year will also involve advance planning for up to four additional sites and, if possible, selection of fellows from those sites. During the second year, the first cohort of fellows will begin their studies, work will continue on the selection of intermediaries, and selection will begin for the second cohort of fellows. B's field offices in the field sites will also undertake the "pipeline" component to prepare potential fellowship candidates during the early years of C. If all goes well, C will be fully operational by the third or fourth year, and, in any event, by no later than the fifth year. B expects that the final cohort of fellows will be selected in the eighth year of C, and will complete their studies by the eleventh year.

B has stated that it has not yet finalized the plans for C or selected the intermediaries that B will use to carry C out. However, B has represented that C is not a normal part of B's annual grant-making and is, instead, a one-time, long-term investment in building human capital in countries where B has field offices and/or makes grants. B believes that its ability to ensure the success of C, given its extraordinary size, multi-national scope, multi-organizational scope, long-term nature, and overall complexity, hinges on its set-aside of the entire grant amount at the outset, with disbursal of the funding over the succeeding five years as the planning process is completed and C becomes fully operational.

Ruling Request

B requests a ruling that:

> B's set-aside of E in its fiscal year ending K, for C will satisfy the suitability test of Section 4942(g)(2)(B)(i) of the Internal Revenue Code, and therefore will constitute a qualifying distribution under Section 4942(g)(1)(A) of the Code.

Law

Section 4942 of the Code imposes an excise tax on private foundations that fail to make certain minimum annual "qualifying distributions."

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, except as otherwise provided; or (B) 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 meets the requirements of subparagraph (B) of section 4942(g)(2).

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 Taxes 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) may be treated as a qualifying distribution in the year in which set-aside (but not in the year in which actually paid), if the requirements of section 4942(g)(2) and this paragraph are satisfied. The requirements of this paragraph (b) are satisfied if the private foundation establishes to the satisfaction of the Commissioner that the amount 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 fund a specific research program that is of such magnitude as to require an accumulation of funds before beginning the research, even though not all of the details of the program have been finalized.

In Rev. Rul. 74-450, 1972-2 C.B. 388, involved a set-aside granted to a private operating foundation, under the suitability test, for a project involving the 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 which required most of the payments during the last two years.

Rev. Rul. 75-511, 1975-2 C.B. 450, involved a foundation's proposed set-aside for annual scholarship payments which was denied. The foundation's principal activity was the making of scholarship grants. The foundation selected new scholarship recipients each year; the scholarships typically covered a three year period and were paid annually. In the past, the foundation simply paid each year's scholarship installments out of its current income. Instead of continuing that practice, however, the foundation sought approval to

set aside, for each grantee, an amount sufficient to cover that grantee's scholarship payments for the three year scholarship term. Under this proposal, the foundation would then pay scholarship installments out of each grantee's set-aside account until those funds were depleted. The foundation did not show that making scholarship grants in this case was an activity that could be better accomplished by a set-aside than by immediate payment of funds.

Analysis

C is a complex, long-term project which will take place over a ten year period although B has stated that all amounts it will set aside to fund C will be disbursed in five years. B needs to coordinate among multiple organizations in order to allow B to ensure that C is established and operational before B provides full grant funding. C requires substantial planning and start-up with B providing C with interim funding during the start-up period, withholding full funding until the project is established and operational. C's primary focus is activities in foreign countries which may involve delays and set-backs not normally experienced in B's usual grant activities. C is much larger than B's typical program, and is, in fact, B's largest, most complex grant in decades. C appears to be unique and extraordinary to B in terms of size, multi-national scope, multi-organizational scope, long-term nature, and overall complexity. Startup of C will take many months and should not be fully operational for three to five years.

Unlike the scholarship program described in Rev. Rul. 75-511, C is not a regular part of B's on-going grant-making program. B does not have a regular, annual fellowship program that serves the same purposes as C. Under the particular representations made herein, B's set aside of E is a project that would be better accomplished in such a manner than by the immediate payment of funds.

Ruling

Based upon the information you have submitted, under the facts described above, B's set-aside of funds for C will satisfy the suitability test of Section 4942(g)(2)(B)(i) of the Code, and therefore will constitute a qualifying distribution for the Foundation's fiscal year ending K.

We direct your attention to section 53.4942(a)-3(b)(8) of the regulations, entitled "Evidence of set-aside". This section provides that a set-aside approved by the Internal Revenue Service shall be evidenced by the entry of a dollar amount on the books and records of a private foundation as a pledge or obligation to be paid at a future date or dates.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transaction described above under any other provision of the Internal Revenue Code.

Because this ruling could help resolve future questions about your federal income tax status, you should keep it in your permanent records.

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.

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,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

248