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

200212034

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: DEC 28 2001

Contact Person:

Identification Number:

Telephone Number:

Uniform Issue List
4942.03-07
4942.03-05
T:ED:B4

Employer Identification Number:

Legend:

M =
N =
O =

x =

Dear Sir or Madam:

We have considered M's ruling request dated November 13, 2001, as supplemented by four (4) submissions which we received in December, 2001. M requests approval of a proposed set-aside of funds, to be treated as qualifying distributions under section 4942(g)(2) of the Internal Revenue Code, for its taxable year ending December 31, 2001.

M desires to reimburse organizations for expenses incurred in connection with the review and application process related to the approval of charter schools in the State of N.

The charter school bill was approved by the N legislature and recently became law. Under this legislation, local school boards, baccalaureate degree granting universities, and the Mayor of O are authorized to sponsor charter schools. These schools are independent, nonsectarian public schools operating under a performance contract known as a charter. The charter schools may serve any range of grades between kindergarten and 12th. They will be State funded and are required to maintain an admissions process open to all N residents.

M is exempt from federal income tax as an organization described in section 501(c)(3) of the Code. It has also been classified as a private foundation within the meaning of section 509(a).

M's goal is to set aside $100x in 2001 to fund grants to the sponsors of N charter schools as the qualified schools commence operations. M hopes to disburse at least $500x for this project over the next five years.

M requests the 60 month set-aside period in which to disburse the project funds because the N charter program is still in its initial phase; the approval process cannot begin until sometime in 2002. The first charter school probably cannot open until late in 2002 at the earliest. M believes that it is necessary to set aside $100x this year to allow for future funding of the charter school application process.

For each charter school that is approved, M will award a grant in the amount of $1x to $10x to the sponsoring or certifying entity. N does not reimburse any of the administrative expenses which such entity incurs in connection with the review process for approving charter school applicants.

Section 4942(a) of the Code imposes on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls within the taxable period), a tax equal to 15 percent of the amount of such income remaining undistributed at the beginning of such second (or succeeding) taxable year. Section 4942(c) defines the term "undistributed income" as the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made before such time out of such distributable amount.

Section 4942(d)(1) of the Code provides that the term "distributable amount" means, with respect to any foundation for any taxable year, an amount equal to (1) the sum of the minimum investment return plus the amounts described in subsection (f)(2)(c), reduced by (2) the sum of the taxes imposed on such private foundation for the taxable year under subtitle A and section 4940.

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) 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 amount set aside will be paid for the specific project within 60 months after it is set aside, and (1) the set-aside satisfies the suitability test, or (2) 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. Specific projects that can be better accomplished by use of a set-aside include projects where grants are made as part of a matching grant program.

The proposed set-aside for M's taxable year ending December 31, 2001, is in furtherance of M's charitable purposes. The funds to be set aside are designed to bolster a State of N project to encourage the creation of charter schools. M will use the funds set aside to reimburse the administrative expenses of State designated institutions which sponsor or certify nascent charter schools. It is clear that the proposed set-aside will be used to accomplish a purpose described in section 170(c)(2)(b) of the Code, as required by section 4942(g)(2). M has also established to our satisfaction that the project outlined above, which is analogous to a matching grant program, can be better accomplished by such set-aside rather than by the immediate payment of funds. M has assured us that the funds to be set aside on December 31, 2001, will actually be paid prior to the expiration of 60 months from the date of the set-aside.

Based on the foregoing, we rule that the set-aside of 100x dollars on M's books and records for its taxable year ending December 31, 2001, satisfies the requirements of section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations (the "suitability test"). Accordingly, the proposed set-aside may be treated as qualifying distributions for M's taxable year ending December 31, 2001.

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. Further, any amount which is set aside shall be taken into account for purposes of determining the foundation's minimum investment return (see section 53.4942(a)-2(c)(1)), and any income attributable to such set-aside shall be taken into account in computing adjusted net income (see section 53.4942(a)-2(d)).

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office, which deals with exempt organizations matters. The mailing address is: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

We are sending a copy of this ruling to the Ohio TE/GE Office. Because this letter could help resolve any questions about your tax status, you should keep it with 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.

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.

Thank you for your cooperation.

Sincerely,

(signed) Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4