TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200225036

Date: March 25, 2002

Contact Person:

Identification Number:

U.I.L. No.
4942.03.07

Telephone Number:

T:EO:B2

Employer Identification Number:

Legend

X =
Y =
x =

Dear Applicant:

This is in reply to X's ruling request dated December 18, 2001, for approval of a set-aside of funds under the suitability test of section 4942(g)(2)(B)(i) of the Internal Revenue Code and section 53.4942(a)-3(b)(2) of the Foundation and Similar Excise Taxes Regulations, for its tax year ending December 31, 2001.

X is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation under section 509(a) of the Code. X does not ordinarily commit funds in advance but instead distributes funds each year to qualified charities. On December 22, 2001, X set-aside x dollars which are to be used towards the construction of an intensive care unit for a non-profit hospital, owned and operated overseas by Y. Y, a religious institution, is supervised and controlled by a church which qualifies as an exempt organization under section 501(c)(3).

X has set-aside x dollars for the construction of an intensive care unit. The project is in the preliminary stage of construction as part of the construction of the entire hospital. Y hopes to raise sufficient funds to construct the entire hospital. The amount set-aside exceeds the estimated cost of construction of the intensive care unit. Any remaining funds are to be used for general construction of the hospital.

The set-aside is intended only to meet the distribution requirement of the December 31, 2001, tax year. The set-aside is not needed for compliance with the distribution requirements of any prior year. The amount set aside is significantly less than X's annual distributable amount. X represents that all of the amounts set aside for this specific project will be paid out by December 22, 2006.

202

X believes that the project can be better served through set-aside rather than an immediate direct contribution to the hospital because the set-aside will encourage closure of the project by all parties. X further believes that the set-aside will encourage other participants to make final commitments to the hospital to ensure that the project will go forward and be completed in a timely manner. Although X's pledge is not contingent on a matching grant by others, both X and Y believe that the existence of the set-aside, once publicized to others, will encourage contributions to the overall project. There is no written agreement between X and Y regarding the set-aside.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for charitable and/or the other exempt purposes stated in that section.

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code that are private foundations subject to the private foundation provisions of Chapter 42 of the Code.

Section 4942 of the Code generally imposes excise tax on any private foundation that does not expend qualifying distributions for exempt purposes at least equal to its distributable amount for its tax year.

Section 4942(g)(1) of the Code provides that, in general, a qualifying distribution is any amount, including reasonable and necessary administrative expenses, paid to accomplish, or to acquire an asset used directly in carrying on, one or more of the purposes described in section 170(c)(2)(B) of the Code, which includes charitable purposes.

Section 4942(g)(2)(A) of the Code provides that an amount of income that is set aside for a specific project within one or more purposes of section 170(c)(2)(B) of the Code may be treated as a qualifying distribution if the amount meets the set-aside requirements of section 4942(g)(2)(B) of the Code.

Section 4942(g)(2)(B) of the Code provides, in pertinent part, 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 private foundation establishes to the satisfaction of the Secretary that the amount set aside will be paid for the specific project within five years and that the suitability test for a set-aside under section 4942(g)(2)(B)(i) of the Code is met.

Section 4942(g)(2)(B)(i) of the Code provides a suitability test in which the private foundation at the time of the set-aside must establish to the satisfaction of the Secretary that the specific project is one that can better be accomplished by the set-aside of income rather than by the immediate payment of funds.

Section 53.4942(a)-3(b)(1) of the Foundation and Similar Excise Taxes Regulations provides that the amounts of income set aside for a specific project for one or more of the purposes in section 170(c)(1) or 170(c)(2)(B) of the Code may be treated as qualifying distributions for the tax year(s) in which such amounts are set aside, but not in the tax year in which actually paid, if the requirements of section 4942(g)(2)(B)(i) of the Code are met. The requirements are met if the 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 the set-aside otherwise meets

the suitability test of section 53.4942(a)-3(b)(2) of the regulations.

Section 53.4942(a)-3(b)(2) of the regulations provides that its suitability test for a set-aside is met if the foundation establishes that the specific project is one in which relatively long-term grants or expenditures must be made. The regulation cites, as an example of a suitable project, a plan to erect a building to house the direct charitable, educational or similar exempt activities of the foundation, such as a museum building, even if the exact location and architectural plans have not been finalized.

Section 53.4942(a)-3(b)(7)(i) of the regulations provides that a private foundation must obtain Internal Revenue Service approval of its set-aside of income under the suitability test by applying before the end of the tax year in which the amount is set aside.

Rev. Rul. 77-7, 1977-1 C.B. 354 held that the term "specific project" as defined in section 53.4942(a)-3(b)(2) of the Foundation and Similar Excise Taxes Regulations includes a project to be undertaken by a public charity unrelated to the private foundation making the set-aside.

X's set-aside for this project will be for a specific project within the educational and charitable purposes of section 170(c)(2)(B) of the Code, as required by section 4942(g)(2)(A) of the Code and section 53.4942(a)-3(b)(2) of the regulations.

X represents that its amounts of income to be set aside for this specific project will be paid out for this project within 60 months from the time when the first amount is set aside, as required by section 4942(g)(2)(B) of the Code and section 53.4942(a)-3(b)(1) of the regulations.

X's project is better accomplished by this set-aside of income, rather than by immediate payment, under the suitability test of section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations. The set-aside will encourage the timely completion of the project and the existence of the set-aside will encourage contributions to the overall hospital construction project.

Therefore, X's specific project of building an intensive care unit for a non-profit hospital meets the requirements for a set-aside of income under the suitability test of section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations.

Accordingly, we rule that X's set-aside of "x" dollars of its income for the construction of the intensive care unit, with any excess funds being used for the general construction of the hospital, was a qualifying distribution under section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations for its tax year ending on December 31 of 2001, when the amount of income was set aside.

Section 53.4942(a)-3(b)(8) of the regulations provides that any set-aside approved by the Internal Revenue Service must be evidenced by the entry of a dollar amount in your books and records as a pledge or obligation to be paid at a future date or dates. Further, the amount of the set-aside must be taken into account in determining your minimum investment return (see section 53.4942(a)-2(c)(1) of the regulations), and any income attributable to a set-aside must be taken into account in computing X's adjusted net income (see section 53.4942(a)-2(d) of the regulations).

Except as we have ruled above, we express no opinion as to the tax consequences of the

transaction under the cited provisions of the Code or under any other provisions of the Code.

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

Because this ruling letter could help to resolve any questions, please keep it in your permanent records and include a copy with your annual return, Form 990-PF.

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,

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2

205