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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: DEC 19 2002

Contact Person:

Identification Number:

UIL: 4942.00-00

Telephone Number:

T:EO:B4

Employer Identification Number:

Legend:
B=
C=
D=
v=
w=
y=

Dear Sir or Madam:

This is in reply to a letter dated June 24, 2002, which requested rulings on a contingent set-aside under section 53.4242(a)-3(b)(9) of the Foundation and Similar Excise Taxes Regulations.

For many years, B provided healthcare services and qualified for public charity status as a hospital under sections 170(b)(1)(A)(iii) and 509(a)(1) of the Internal Revenue Code. However, B sold all of its assets to C and ceased operating as a hospital on January 1, 1996. In a letter dated February 23, 1998, the Internal Revenue Service informed B that as of the date of its asset sale, it was reclassified to nonprivate foundation status under section 509(a)(2). The letter further indicated that B's classification under section 509(a)(2) would continue through the period ending June 30, 2001.

As an organization with nonprivate foundation status under section 509(a)(2), B has normally received more than one-third of its support from the general public and not more than one-third of its support from gross investment income. However, B will no longer satisfy the section 509(a)(2) support requirements for periods ending June 30, 2002 and beyond. B no longer generates gross receipts from the performance of health care services, and the proceeds from the sale of its assets are held in cash and various securities. The current value of B's

investments assets is v.

Although B sold all of its medical facility assets in January 1996, it continues to remain subject to certain significant, albeit contingent liabilities that arose prior to the asset sale through the conduct of its exempt activities. In a letter dated July 20, 2001, outside counsel for B estimates that B's exposure from pending litigation alone, including costs for defense, could be as high as w. In addition to existing claims, B is currently involved in worker's compensation litigation, and remains subject to the "18 plus one" rule under D law, whereby all infants born at the B facility prior to the January 1996 asset sale have until the age of maturity plus one year to file a medical malpractice claim against B. Accordingly, between the existing claims and potential future claims under the "18 plus one" rule, the total liability exposure to B may very well exceed the v total fair market value of its assets. B is under a court order that states while litigation is pending, it may not distribute amounts in excess of those required to satisfy its ordinary and necessary operating expenses.

Section 4942 (a) of the Code provides that there is hereby imposed 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 53.4942(a)-3(b)(9) of the Foundation and Similar Excise Taxes Regulations provides that in the event a private foundation is involved in litigation and may not distribute assets or income because of a court order, the private foundation may (except as provided in section 53.4942(a)-2(e)(1)(i) or (ii)) seek and obtain a set-aside for the purpose described in section 53.4942(a)-3(a)(2). The amount to be set-aside shall be equal to that portion of the private 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 of such assets or income, would have been distributed. In the event that the litigation encompasses more than one taxable year, the private foundation may seek additional contingent set-asides. Such amounts must actually be distributed by the last day of the taxable year following the taxable year in which the litigation is terminated. Amounts not distributed by the close of the appropriate taxable year shall be treated as described in section 53.4942(a)-2(d)(2)(iii)(c) for the succeeding taxable year.

B has provided representations and documentation that a contingent set-aside is appropriate due to a court order which prohibits it from making expenditures until pending litigation is resolved.

Based on the foregoing, we rule that B can make a contingent set-aside for the tax year ending June 30, 2002. The amount to be set-aside is equal to the entire portion of B's current year distributable amount, because no portion of B's assets, aside from operating expenses, may be distributed while litigation is pending. Based on B's preliminary calculations, the set-aside amount should be approximately y. The exact amount of the set-aside will be determined once B's final accounting for the taxable year has been completed.

We direct your attention to section 53.4942(a)-3(b)(4) 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.

This ruling is conditioned on the understanding that there will be no material changes in the facts upon which it is based.

We are informing the TE/GE office of this action. Please keep a copy of this ruling with your organization's 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