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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200318072

Date: FEB 4 2003

Contact Person:

Identification Number:

Uniform Issue List: 4942.03-07

Telephone Number:

T:EO:B2

LEGEND:
M =
N =
P =
Q =
x =
y =
z =
aa =
bb =
cc =

Dear Sir or Madam:

We have considered your letter dated December 2, 2002, requesting approval of a set-aside under section 4942(g)(2) of the Internal Revenue Code and section 53.4942(a)-3(b) of the Foundation and Similar Excise Tax Regulations, and a determination that the amount set aside may be treated as a qualifying distribution in the year in which it is set aside (but not in the year in which actually paid).

Facts:

M is recognized as an organization described in section 501(c)(3) of the Code, and is classified as a private foundation within the meaning of section 509(a).

M wishes to set aside a grant totaling $5.7564x to N. N is recognized as an organization described in section 501(c)(3) of the Code, and is treated as a publicly supported organization within the meaning of sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code during an advance ruling period that ends December 31, bb. No additions to the set-aside are planned.

The purpose of the grant is to complete the restoration and renovation of an historic site, known as P, which was built circa y. According to an Historic Structure Report prepared by Q (the "Q Report"), P requires extensive preservation, restoration, and rehabilitation to return its appearance to what it was during its period of historic significance, to stabilize the structure, and

to bring it to applicable code compliance. M made a grant to N in December, z, to allow N to accomplish certain portions of the restoration plan described in the Q Report. N now wishes to complete the renovation and restoration of P ("Phase 2 of the Restoration Project"). According to the Q Report, the cost of Phase 2 is estimated at $11.5128x.

M's grant is subject to an agreement between M and N (the "Agreement"). Under the Agreement, M will make a grant of $5.7564x to N to partially fund the costs of Phase 2 of the Restoration Project (the "Restoration Grant"). M will disburse the funds to N in a lump sum within 10 business days after the satisfaction of the conditions set forth in Paragraphs 2(a) and 2(b) of the Agreement. Upon receipt of the funds from M, N will deposit the funds in a separate interest bearing account (the "Project Account"). As the conditions set forth in Paragraphs 2(c) and 2(d) are satisfied, N may make disbursements from the Project Account solely to pay Reimbursable Costs of Phase 2 of the Restoration Project. According to the agreement, the term "Reimbursable Costs" means costs actually incurred by N for labor, materials, furnishings, fixtures, fees and permits for Phase 2.

M's obligation to make the Restoration Grant to N is subject to the following conditions precedent detailed in Paragraph 2 of the Agreement:

(a) On or before June 30, cc, N shall have received eligible matching contributions for Phase 2 of the Restoration Project in an amount not less than $5.7564x, and shall have provided M with evidence satisfactory to M in its sole discretion that such contributions have been received.

(b) Not later than September 30, cc, (i) N shall have submitted to M, and M shall have approved in writing, the concept, drawings, plans, specifications, scope and design of the work comprising Phase 2 of the Restoration Project (collectively, the "Plans"), and (ii) M shall be satisfied, in its sole discretion, that N has sufficient funding to complete Phase 2 of the Restoration Project as embodied in the Plans.

(c) Prior to the disbursement of any portion of the Restoration Grant from the Project Account for the purchase of any materials or the performance of any work for Phase 2 of the Restoration Project, N shall have submitted to M, and M shall have approved in writing, the contractor, vendor, or other supplier, and the finally awarded contract for the work or materials for which such disbursement is to be made.

(d) At the time the Restoration Grant is to be initially paid to N and at the time of disbursement of any portion of the Restoration Grant from the Project Account, N shall not be in default in the performance of any of its obligations under the Agreement and shall be an organization described in sections 501(c)(3) and 509(a)(1), (2), or (3) of the Code.

Should any of the conditions not be satisfied, and should M be unwilling to waive the same, then M's obligation to make the Restoration Grant may be terminated.

M states that the set-aside was made as of October 15, aa, and that the amounts set aside must and will actually be paid for Phase 2 of the Restoration Project within a period of

time that ends not more than 60 months after the date of the set-aside. The Agreement requires that the payments of the Restoration Grant be made on or before October 10, cc, which is less than 60 months from the date of the set-aside.

M believes that, due to the extent and cost of repairs and renovations needed for P, grants from the community at large must form an essential and significant part of the funding for Phase 2 of the Restoration Project. M states that the Restoration Grant, as part of a matching-grant program, is intended to stimulate grants to N from the community at large. By providing an eighteen-month period during which N may receive commitments from members of the community, M hopes to give N adequate time to publicize the renovation, as well as the financial needs of P, to generate the necessary community financial support. In addition, because of M's concern with the preservation of the historical and architectural features of P, M believes it is crucial that it retain a degree of control over the renovation process. By making the disbursement of the funds dependent upon approval of drawings, plans, and specifications of Phase 2 of the Restoration Project, M believes it can best meet the goal of preserving P.

Law:

Section 4942(a) of the Internal Revenue 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 taxable year following such taxable year, a tax equal to 15 percent of the amount of such income remaining undistributed at the beginning of such second taxable year.

Section 4942(c) of the Code provides that, for purposes of section 4942, the term "undistributed income" means, with respect to any private foundation for any taxable year as of any time, the amount by which (1) the distributable amount for each taxable year, exceeds (2) the qualifying distributions made before such time out of such distributable amount.

Section 4942(g)(1) of the Code defines the term "qualifying distribution," in general, as any amount paid to accomplish one or more purposes described in section 170(c)(2)(B), or 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 an amount of income that is set aside for a specific project which comes within one or more purposes described in 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).

Section 4942(g)(2)(B)(1) 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 private foundation establishes to the satisfaction of the Secretary both that the amount set aside will be paid for the specific project within five years and 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 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 (but not in the year in which actually paid), if the requirements of section 4942(g)(2)(B)(i) of the Code are met, 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 has been 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 the suitability test is satisfied if the private foundation establishes to the satisfaction of the Commissioner that the specific project for which the amount is set aside is one that can be better accomplished by a set-aside than by the immediate payment of funds. Specific projects that can be better accomplished by the use of a set-aside include, but are not limited to, projects 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 (as defined in section 4944(c)) or where grants are made as part of a matching-grant program. Such projects include, for example, a plan to erect a building to house the direct charitable, educational, or other similar exempt activity of the private foundation, even though the exact location and architectural plans have not been finalized.

Rev. Rul. 77-7, 1977-1 C.B. 354, holds that the term "specific project" includes a building project to be undertaken by a public charity unrelated to the foundation making the set aside.

Section 53.4942(a)-3(b)(7)(i) of the regulations provides that if an amount is set aside 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 private foundation must apply for the Commissioner's approval of the set-aside before the end of the taxable year in which the amount is set aside.

Discussion:

On the basis of the facts presented and applicable law, M's set-aside in aa of the Restoration Grant to N for renovation and restoration of P, pursuant to the terms of the Agreement, meets the requirements for a set-aside as described in section 4942(g)(2) of the Code and section 53.4942(a)-3(b) of the regulations.

M has timely sought approval of its set-aside of income in advance of the time when the amounts of income are to be set aside, as required by section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(7)(i) of the regulations.

M's set-aside of $5.7564x as a matching-grant will be for specific projects within the 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)(1) of the regulations. M represents that the amount set aside for Phase 2 of the Restoration Project will be paid out within 60 months from the time it 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. M's specific project, i.e., the Restoration Grant, is better accomplished by this set-aside of income, rather than by immediate payment, because it involves a grant made as part of a matching grant program as described in section 53.4942(a)-3(b)(2) of the regulations. Thus, M's Restoration Grant to N 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.

Conclusion:

Accordingly, we rule that up to $5.7564x of M's income to be set aside for the Restoration Grant to N will be treated as a qualifying distribution under section 4942(g) of the Code and section 53.4942(a)-3 of the regulations in the tax year when such amount is set aside.

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

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 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 must be taken into account in determining the private foundation's minimum investment return under 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 adjusted net income under section 53.4942(a)-2(d) of the regulations.

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

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

This ruling letter is directed only to M. 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,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2