200347021

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Uniform Issue List
4942.03-00
4942.03-07

Date:

AUG 27 2003

Contact Person:

Identification Number:

Telephone Number:

T:EO:BR4

Employer Identification Number:

Legend:

B =
M =
N =
O =
P =
Q =
R =
S =

x =

Dear Sir or Madam:

We have considered M's ruling request dated June 19, 2003, wherein 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 June 30, 2003.

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 requests approval of a set-aside in the amount of $500x for its taxable year ending June 30, 2003. Amounts to be set aside will be paid to N, a section 501(c)(3) organization whose primary purpose is to support the goals and objectives of O, a State history museum and a division of P. The latter entity, as stated in a determination letter from the Internal Revenue Service, is a wholly owned State agency of a political subdivision of a State, and thus is automatically exempt from federal income tax under section 115(a) of the Code. The set-aside will be used specifically to provide funding for Q, an exhibit gallery which will be located in R. P is developing R within the S State capitol complex and N is supporting P's development and construction of R. M will pay the set-aside to N over a period of four years upon satisfaction of the criteria contained in the proposed Grant Agreement included with your submission.

Q is an 8,000 square foot exhibit gallery within R. It is estimated that Q will be complete by June, 2005, at a cost of approximately $2,000x. The use of a set-aside is necessary to provide P with a funding commitment, while permitting M to retain control over the distribution of its funds to ensure that (1) construction progresses as planned; (2) funding from a planned issuance of S bonds are used for the specified purpose; and (3) contributions from M are used for the specified purpose.

The Grant Agreement provides that funding by M will be conditioned upon completion of progress reports by P. The building housing Q is scheduled to be completed in December, 2004. However, the exhibits in Q will not be completed until June, 2005. P must provide M with a progress report every six months containing information regarding the progress of development and construction of Q, until P spends all grant funds. Each advance from M is contingent upon completion of Q and the use of grant funds for Q exhibits, not the building.

The Grant Agreement has recently been revised to provide that, in the event that Q and R are complete and open to the public prior to June 1, 2007, then M will pay N the balance of the amount that remains payable as soon as practicable following M's determination that the requirements in the Grant Agreement have been satisfied.

M's commitment represents a portion (about one-fourth) of the total funds required for Q. It is important to M that its support for the construction of Q be used for that purpose. M does not want its contribution spent on other parts of R or for the general operating budget of P. M believes that a set-aside is the only mechanism that ensures that the proper use of M's funds, especially in this case where the facility will be owned and operated by a State agency. Concerning the latter point, S's fiscal crisis has put completion of R in jeopardy. Because of the budget crisis, there have been severe cuts to practically every State agency. M is concerned that if funding for R is inadequate, an unrestricted contribution by M could be reallocated or applied in ways that are not intended. Inasmuch as the S Legislature failed to appropriate additional funding for R, the Legislature authorized the issuance of additional bonds to finance the project in May, 2003. However, a recent decision by the highest court in S declared that the State commission that was authorized to issue bonds is unconstitutional. Although the commission has been reorganized, "this event has caused great uncertainty regarding the ability of the State to issue bonds in a timely manner, which adds an element of substantial risk to the project."

R is a $59,000x project that involves the construction of a 200,000 square foot museum and research facility located in the S capitol complex. Q, which contains approximately 8,000 square feet in R, will incorporate nine broad subject areas from S history that have affected both the internal and external images, culture, and history of S. Construction of Q has not yet commenced. The current projection is that Q will be complete and open to the public by June, 2005.

The Grant Agreement requires that N shall include the full name of your founder, B (now deceased) and/or M at the entrance of the gallery. Also, N is required to use the M name, trademarks, service marks, logos, commercial symbols or other identification to identify M as a sponsor, donor, or contributor.

The $500x that will be set aside for purposes of Q will actually be paid within the four year payment period specified in the Grant Agreement. This payment period will end no later than 60 months after the date of the first set-aside.

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.

The proposed set-aside for M's taxable year ending June 30, 2003, is in furtherance of M's charitable purposes. The funds to be set aside will be used to help fund a gallery, Q, which will include various subject areas from the history of S. Q is housed in a museum, O, which is part of the State capitol complex. The funds will clearly be used to advance an educational purpose within the meaning of section 501(c)(3) of the Code. Thus, the set-aside will be used to accomplish a purpose described in section 170(c)(2)(b), as required by section 4942(g)(2). M has also established to our satisfaction that the project outlined above 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 in its taxable year ending June 30, 2003, 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 500x dollars on M's books and records for its taxable year ending June 30, 2003, 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 June 30, 2003.

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 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,

We are sending a copy of this ruling to the 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,

Debra J. Kawecki

Debra J. Kawecki
Acting Manager, Exempt
Organizations Technical Group 4