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

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Contact Person:

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Legend:
A =
B =
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Dear Sir or Madam:

This letter is in response to A's request for a ruling on the tax consequences of a proposed fiscal year 1999 set-aside under section 4942 of the Internal Revenue Code. A has requested a ruling that the proposed set-aside be deemed to be a qualifying distribution under section 4942(g)(2) of the Code for A's taxable year ending December 31, 1999, because it satisfies the "suitability test" of section 53.4942(a)-3(b)(2) of the Foundation and Similar Excise Taxes Regulations.

A has been recognized as exempt under section 501(c)(3) of the Code and classified as a private foundation under section 509(a).

A proposes to assist B, an educational institution recognized as exempt under section 501(c)(3) of the Code. B plans to construct a pool to promote physical education and a building that will provide shower facilities, office space and storage areas. Pool construction began the first week of January 2000. A set aside x in order to build the pool facility. A attests that this set-aside will actually be paid for the construction of the pool facility within 60 months of the date of the set-aside.

Pursuant to the construction contract, A will release funds periodically as contract installments become due. This periodic disbursement of funds will be made pursuant to the set-aside. The set-aside will assure A that its funds will be used for their intended purpose, the construction of the pool facility. The immediate payment of funds will not provide A with such assurance.

Section 501(c)(3) of the Code provides for the exemption of organizations that are organized and operated exclusively for religious, charitable, or educational purposes, no part of the net earnings of which inures to the benefit of any shareholder or individuals.

Section 4942(g)(1) of the Code provides that, for purposes of this section, the term "qualifying distribution" means--

(A) any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3)), except as provided in paragraph (3), or
(B) any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B).

Section 4942(g)(2)(A) of the Code provides, in general, that for all taxable years beginning on or after January 1, 1975, subject to such terms and conditions as may be prescribed by the Secretary, 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).

Section 4942(g)(2)(B) of the Code provides, in part, that an amount set aside for a specific project shall meet the requirements of this subparagraph 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 5 years, and, at the time of the set-aside, the private foundation establishes to the satisfaction of the Secretary that the project is one which can better be accomplished by such set-aside than by immediate payment of funds.

Section 53.4942(a)-3(b)(1) of the regulations describes certain set-asides and provides that--

(1) In general. 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) 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) and this paragraph (b) are satisfied. The requirements of this paragraph (b) are satisfied if the private 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

    (i) The set-aside satisfies the suitability test described in subparagraph (2) of this paragraph, or

    (ii) With respect to a set-aside made in a taxable year beginning after December 31, 1974, the private foundation satisfies the cash distribution test described in subparagraph (3) of this paragraph.

If the suitability test or cash distribution test is otherwise satisfied, the 60 month period for paying the amount set aside may, for good cause shown, be extended by the Commissioner.

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 the 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 (such as a museum building in which paintings are to be hung), even though the exact location and

architectural plans have not been finalized; a plan to purchase an additional group of paintings offered for sale only as a unit that requires an expenditure of more than one year's income; or a plan to fund a specific research program that is of such magnitude as to require an accumulation of funds before beginning the research, even though not all of the details of the program have been finalized.

During fiscal year 1999, A set aside x for a pool facility construction project. This facility will promote physical education. In addition, A indicates that this set-aside will be paid for the construction of the pool facility within 60 months of the date of the set-aside. Furthermore, the set-aside will assure A that its funds will be used for their intended purpose, the construction of the pool facility. The immediate payment of funds will not provide A with such assurance. Therefore, the project can be better accomplished by a set-aside than by the immediate payment of funds.

Accordingly, based on the information presented, we rule that A's proposed set-aside constitutes a qualifying distribution under section 4942(g)(2) of the Code because it meets the requirements described in section 53.4942(a)-3(b)(1) and satisfies the "suitability test" described in section 53.4942(a)-3(b)(2).

Our approval of your set-aside for 1999 is based upon our understanding that the set-aside has, in fact, been pledged for the specific project indicated and in the amount indicated, and that the pledged funds will be expended within the 60 month period. This ruling applies only to income set aside for tax year 1999, since you have not requested set-asides for any other year.

Under section 53.4942(a)-3(b)(8) of the regulations, a set-aside that is approved by the Commissioner or which satisfies the cash distribution test 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. Any amount which is set aside shall be taken into account for purposes of determining the private foundation's minimum investment return under 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 under section 53.4942(a)-2(d).

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.

Because this letter could help resolve any future questions about A's exempt status and qualifying distributions, please keep a copy of this ruling in the organization's permanent records.

Sincerely,

Robert C. Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

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