



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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Date: March 6, 2006

Contact Person:

Uniform Issue List:

Identification Number:

4942.03-07

Telephone Number:

Employer Identification Number:

Legend:

A =

B =

x =

Dear \_\_\_\_\_ :

We have considered A's request for a ruling regarding approval of a proposed set-aside of A's undistributed income for the year that ended on December 31, \_\_\_\_\_, under the suitability test of section 4942(g)(2)(B)(i) of the Internal Revenue Code, and Section 4942(a)-3(b)(2) of the Foundation and Similar Excise Taxes Regulations. The amount of the requested set-aside is x.

A is exempt under section 501(c)(3) of the Code and is a private foundation under section 509(a) of the Code. A's purpose is to build a senior facility. To accomplish this objective A was to utilize cash and land set aside for this purpose. The facility was not built because most of the property was sold to a client of A's former attorney. After years of litigation A succeeded in getting back the property.

A has begun preparations for building the facility. It has developed a master plan, but this is currently being challenged in court by some citizens of the municipality. A is also in the process of developing a subdivision in part of the property, so that additional cash

can be generated in order to accomplish its purpose. The sale of the subdivision requires B's approval.

A set aside of current distributable income will enable A to better achieve its exempt purpose by having cash available to fund this project.

A represents that all of the amounts to be set aside for this specific project will be paid out for this project within 60 months from the time when its first amount of income is set aside. A states the project can be better accomplished by a set-aside than by the immediate payment of funds because it will allow it to ensure construction progresses as planned.

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 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 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 provide matching grants.

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.

A has sought timely 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.

A's set-aside of X for a specific project is 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)(2) of the regulations.

A represented that its 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.

A'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 because this set-aside will allow it to retain control over the distribution of the funds to ensure construction progresses as planned and its exempt purposes can be carried on.

Accordingly, we rule that A's amounts of income of up to x dollars to be set aside for the purpose of providing funding for the construction of a building will be qualifying distributions under section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations in its tax year(s) when such amounts are 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 your adjusted net income (see section 53.4942(a)-2(d) of the regulations).

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

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

This ruling letter 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.

Please keep a copy of this ruling letter in 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.

Sincerely yours,

Andrew F. Megosh, Jr.  
Manager, Exempt Organizations  
Technical Group 2

Enclosure:  
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