

IRC 4942(g)(2) Set-Asides

Reference Guide Sheet For Processing Set-Aside Requests

INSTRUCTIONS: This guide sheet and the accompanying “Law at a Glance” and sample private letter rulings are designed to assist in the processing of a request for advance approval of a set-aside under section 4942(g)(2). **Before starting your review, make sure that an IDRS check was undertaken to see if the organization is currently under examination.** Consult your manager for additional help, as needed.

1 Review the Issue(s) in the Request.

		YES	NO
a	Are there any issues in the request that EO Determinations cannot rule on (such as sections 4941 or 4945)? If "Yes," tell the requestor to submit a PLR request to EO Technical on those issues and continue processing this request. If "No," continue processing.		
b	Is the requestor seeking a contingent set-aside under Reg. 53.4942(a)-3(b)(9)? A contingent set-aside is a set-aside by a private foundation that is involved in litigation and may not distribute assets or income because of a court order. If "Yes," this is not a matter on which the precedent is clear, and then consult with your manager. If "No," continue.		
c	Is the requestor seeking approval of a set-aside or an extension of time under the suitability test of Reg. 53.4942(a)-3(b)(2) and (7)? If "Yes," go to Part 2. Note: Approval is only needed under the suitability test and not under the cash distribution test of Reg. 53.4942(a)-3(b)(3). If "No," consult with your manager.		

Exhibit 7.20.4-8 (Cont. 1) (09-01-2006)
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2 Suitability Test Approval

A "Yes" response to all of the questions in this part generally indicates that approval of the request is warranted. Any "No" response indicates that a requirement for approval has not been satisfied. If a favorable letter cannot be issued after development and coordination with EO Determinations Quality Assurance, consult with your manager to consider referring the request to EO Technical.

		YES	NO	NA
a	Was the request filed before the end of the organization's taxable year in which the amount is to be set-aside?			
b	Does the request identify a specific project for which the set-aside funds will be used?			
c	Does the request state the nature and purpose of the project?			
d	Does the request provide a detailed description of the specific project, including estimated costs, sources of future funds expected to be used for completion of the project, and location of any physical facilities to be acquired or constructed as part of the project?			
e	Does the request state the reasons why the project can be better accomplished by the set-aside rather than by an immediate payment of funds?			
f	Does the request state the amount to be set aside?			
g	If there are any planned additions to the set-aside after its initial establishment, is there a description of the amounts and approximate dates of the additions?			
h	Is there a statement by the appropriate foundation manager that the set-aside amount will be paid within a specified period of time that ends no more than 60 months after the date of the first set-aside? (Check Not Applicable (N/A) if the request is for a set-aside that will be paid more than 60 months after the date of the first set-aside or for an extension of time to pay the set-aside amount later than 60 months after the date of the first set-aside.)			
i	If this is a request for a set-aside that will be paid more than 60 months after the date of the first set-aside or for an extension of time to pay the the set-aside amount later than 60 months after the date of the first set-aside, is there a statement by an appropriate foundation manager showing good cause why the period for paying the amount set aside should be extended (including a showing that the proposed project could not be divided into two or more projects covering periods of no more than 60 months each) and setting forth the extension of time required? Note: evidence of the first set-aside (copy of original letter) needs to be in the file if the request is for an extension.			

Exhibit 7.20.4-8 (Cont. 2) (09-01-2006)

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		YES	NO
3	Did you review the "Law at a Glance" to make your determination?		
4	Did you follow the appropriate section 6110 procedures? If unsure of the section 6110 procedures, coordinate through your manager with EO Determinations Quality Assurance.		

Exhibit 7.20.4-8 (Cont. 3) (09-01-2006)

Processing Set-Aside Requests Under IRC 4942(g)(2)

IRC 4942(g)(2) Set-Asides: The Law at a Glance

1. Internal Revenue Code

- a. Section 4942(g)(2) – If the requirements of this section are met, 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 in the year of the set-aside rather than in the year in which it is actually paid.

2. Income Tax Regulations

- a. Section 53.4942(a)-3(b)(7) - Suitability Test – provides facts that organizations need to get an advance approval of a set-aside. The following facts are needed:
 - i. Nature and purposes of the project and the amount of the set-aside.
 - ii. Amount and approximate dates of any planned additions to the set-aside after its initial establishment.
 - iii. Why the project can be better accomplished by a set-aside rather than an immediate payment of funds.
 - iv. Description of the project including estimated costs, sources of any future funds expected to be used for completion of the project, and location of any physical facilities to be acquired or constructed as part of the project.
 - v. The amounts to be set aside will actually be paid within a specified period of time that ends not more than 60 months after the date of the first set-aside, or a statement showing good cause why the period for paying the amount set aside should be extended (including a showing that the proposed project could not be divided into two or more projects covering periods of no more than 60 months each) and setting forth the extension of time requirements.

3. Revenue Rulings

- a. **Revenue Ruling 75-511, 1975-2 CB 450** - A foundation, whose primary activity consisting of making renewable scholarships and fixed sum research grants, was unable to show that its grant-making program could be better accomplished by the use of set-asides than by the immediate payment of funds.

Exhibit 7.20.4-8 (Cont. 4) (09-01-2006)**Processing Set-Aside Requests Under IRC 4942(g)(2)**

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- b. **Revenue Ruling 77-7, 1977-1 CB 354** – The term “specific project” was held to include a building project to be undertaken by a public charity unrelated to the foundation making the set-aside.
- c. **Revenue Ruling 74-450, 1974-2 CB 388** - An operating foundation’s conversion of a portion of newly acquired land into an extension of an existing wildlife sanctuary and the remainder into a public park under a four year construction contract, under which payments were made mainly during the last two years, was held to constitute a specific project.

4. Other Resources

- a. IRM 7.27.16.6.8 - Set Asides
- b. 1984 CPE at page 282-Article P - “IRC 4942(g)(2) - Set Asides”

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Processing Set-Aside Requests Under IRC 4942(g)(2)

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

Date:

Contact Person:

UI LIST:

Identification Number:

UI No. 4942.03-07

Telephone Number:

Employer Identification Number:

Legend:a = 2001x = \$100,000M = Museum of American Culture

Dear Sir or Madam:

This is in reply to your written request for approval of a set-aside under section 4942(g)(2) of the Internal Revenue Code. You have been recognized as exempt under section 501(c)(3) of the Code and have been determined to be a private foundation under section 509(a) of the Code.

You intend to purchase and rehabilitate M, which is an historical museum. You request a set-aside amount of x in each calendar year 1996 through 1999 to be spent on a project involving the purchase and rehabilitation of the facility into a museum. You provided specific information that describes the project and estimated amounts required to complete the project. You also estimate that the project will be completed before the end of calendar year a. You have provided a representation that amounts set aside will actually be paid within 60 months after the date of the first set-aside. You also provided information that shows that you need to set aside amounts to accumulate sufficient funds to pay for the project since the immediate payment of funds will not be adequate to meet the anticipated costs.

Section 4942(g)(2)(A) of the Code states that 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 states 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 either clause (i) or (ii) are satisfied.

Section 4942(g)(2)(B)(i) of the Code is satisfied if, 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.

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Section 53.4942(a)-3(b)(1) of the Foundations and Similar Excise Taxes Regulations provides that a private foundation may establish that a project is one which can be better accomplished by a set-aside than by immediate payment of funds if the set-aside satisfies the suitability test described in subparagraph (2) of this paragraph.

Section 53.4942(a)-3(b)(2) of the regulations provides that 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 that require an expenditure of more than one year's income in order to assure the continuity of particular charitable projects.

In Rev. Rul. 74-450, 1974-2 C.B. 388, an operating foundation's conversion of a portion of newly acquired land into an extension of an existing wildlife sanctuary and the remainder into a public park under a four-year construction contract, under which payments are made mainly during the last two years, was held to constitute a "specific project" and the foundation's set-aside of all its excess earnings for four years was treated as a qualifying distribution under section 4942(g)(2) of the Code.

Based on the information furnished, your set-aside program is approved under section 4942(g)(2) of the Code. As required under section 4942(g)(2), the set aside amount must be paid within the 60 month period after the date of the first set-aside.

Your approved set-aside(s) shall be evidenced by the entry of the dollar amounts involved on your books and records as pledges or obligations to be paid by the date specified. The amounts set aside will be taken into account for purposes of determining your minimum investment return under section 4942(e)(1)(A) of the Code, and the income attributable to your set aside(s) will also be taken into account in computing your adjusted net income under section 4942(f) of the Code.

This letter will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this letter with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This 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 by others as precedent. If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert Choi
Acting Director, Exempt Organizations
Rulings and Agreements

Enclosure
Notice 437

Exhibit 7.20.4-8 (Cont. 7) (09-01-2006)

Processing Set-Aside Requests Under IRC 4942(g)(2)

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

Date:

Contact Person:

Identification Number:

UI LIST:

Telephone Number:

UI No. 4942.03-07

Employer Identification Number:

Legend:x = \$250,000

Dear Sir or Madam:

This is in response to your letter dated November 1, 1994, wherein you request a twenty-four month extension to pay out a set-aside approved on February 8, 1990.

Our ruling dated February 8, 1990 approved a set-aside in the amount of x dollars for the year ended December 31, 1989 for the purpose of acquiring and rehabilitating facilities which would provide housing for distressed persons in need of a mutual support community. You represented that the set-aside would be expended within 60 months from the date of the first set-aside. However, you state that due to unforeseen difficulties you are not likely to be in a position to expend such funds within the 60-month period.

You state that prior to the set-aside request, your director determined that in order for any property to be suited for your purposes it would need to meet the following requirements:

1. The property would need to be located in or near a low-income residential area from which the mutual support community's "residents" would be drawn;
2. the property itself would need to be suitable for housing the mutual support community's residents, as well as providing adequate space for training and rehabilitation facilities; and

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3. the area in question should provide recreational and social outreach facilities, such as parks and churches, that would be easily accessible to the community's residents.

You state that you began your search for a property meeting the above criteria prior to approval of the set-aside. After an extensive search you narrowed your focus to an abandoned school building in a low-income area. However, after discussing the purchasing terms with local school officials and the vast refurbishing necessary with engineers and builders, you determined that the acquisition was extremely impractical. Another abandoned building in the same area was considered. That building was razed prior to commencement of negotiations. Due to the high crime rate in the area you focused your search to another low-income area.

You then considered a proposal from another 501(c)(3) organization in the area which shares your goals for a joint project. After the conduct of a feasibility study by the other organization it was determined that the project was impractical.

Finally, while searching for an acceptable location, you were informed that a parcel of property consisting of one whole unimproved city block located in the downtown area might be available to you. The property was located directly adjacent to a public housing project and close to schools, parks, churches and recreational facilities. Although the property itself contained no buildings, the location made it possible to simply construct the mutual support community while allowing the adjacent housing project to serve as the residence for individuals being assisted.

The property was owned by the State's Department of Transportation, which purchased it with Federal Highway Administration (FHA) funds. Due to FHA's funding of the purchase, it still holds a lien on the property. Due to this lien you would need the approval of both the State authorities and FHA. A formal proposal was presented by the Mayor of the city to the Governor. A meeting was held between your representatives, city officials, the State Department of Transportation and FHA. Even though the outcome of the meeting was very positive, the negotiations stalled at this point. The cause of the delay was the possibility of an environmental contamination problem associated with the site. Your representatives have requested that you be allowed to conduct the necessary tests, but the state has been reluctant, given the complexity of the liability issues.

This situation has created an impasse in your negotiations to purchase the property with your set-aside funds. Nevertheless, plans are currently underway for carrying out examinations to determine if contamination exists with regard to the property's water or soil, which will permit you to estimate the potential liability. However, due to the extent of the testing necessary and the sensitive nature of the negotiations at the present time, it appears unlikely that your set-aside funds will be expended within the 60 month period.

You believe this property is ideal for your use and plans have already been drawn up for its development. Your representatives are optimistic that the current problems can be resolved, allowing negotiations to continue, and that you will expend the amounts set-aside within an additional 24 months.

Section 4942(g)(2)(B)(i) of the Code provides requirements for approval of a set-aside for a specific project that will be paid out in 5 years. A foundation must establish that the project is one which can better be accomplished by such set-aside than by immediate payment of funds.

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Moreover, a set-aside which satisfies the requirements of *section 4942(g)(2)(B)(i) of the Code* may have the period to pay the set-aside amount extended if good cause is shown.

Section 53.4942(a)-3(b)(7)(i)(e) of the Foundation and Similar Excise Taxes Regulations provides that a statement showing good cause why the period for paying the amount set aside should be extended and setting forth the extension of time required must be provided.

Based on the information submitted, we conclude that you have established good cause to extend the period of time in which to pay out the set-aside amount approved on February 8, 1990. Therefore, we approve your request for a twenty-four month extension of time to pay out the set-aside amount.

This letter will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This 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 by others 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,

Robert Choi
Acting Director,
Exempt Organizations
Rulings and Agreements

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