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

200147057

TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

Uniform Issue List
4942.03-07

Date:

AUG 28 2001

Contact Person:

Identification Number:

Telephone Number:

T:EO:B4

Employer Identification Number:

Legend:

M =
N =
O =
P =
Q =

x =

Dear Sir or Madam:

We have considered M's ruling request dated May 22, 2001. M requests a ruling that a proposed set-aside of funds, as described in detail below, will qualify as an appropriate 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 Taxes Regulations on the basis that the proposed set-aside satisfies the suitability test of section 53.4942(a)-3(b)(2).

M is a Trust that was formed in September, 1997. It is exempt from federal income tax 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 requests approval to set aside (1) an amount up to approximately $153x in its taxable year ending August 31, 2001, and (2) an amount up to the lesser of approximately $185x or its minimum distributable amount for its taxable year ending August 31, 2001, in the taxable year ending August 31, 2002, so that these amounts will be treated as qualifying distributions within the meaning of Code section 4942(g) for M's taxable years ending August 31, 2001, and August 31, 2002.

M has been making payments directly for its charitable purposes and may make grants to recipients, in each case solely for charitable purposes, in a rural, medically underserved region. Since its formation, M has undertaken a program, N, to provide health care services to residents

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located in the area. Through the N program, M has been involved in two separate projects: the P program ("Project 1") and the pediatric dental and child advocacy project ("Project 2").

In a ruling issued by this office on August 5, 1999, we approved a proposed set-aside of funds by M for its taxable years ending August 31, 1999, and August 31, 2000, with respect to Project 1. Pursuant thereto, M paid grants totally approximately $130x to an identified graduate school of medicine to fund its P program in O County. This program was developed to evaluate the cost and quality of at-home care provided to individuals with chronic lung disease or chest cancer. M's grants enabled the number of patients enrolled in this particular program to increase from 11 to 60 and helped the identified school to prove the viability of the program and its efficacy in reducing the incidence of hospitalization for enrolled patients.

M has now focused its activities on Project 2, which it is currently establishing in certain counties to address two areas of health care concern: the dental hygiene of children and the counseling and treatment of sexually, physically, and mentally abused children. Concerning the former area, M is working with Q, and local school districts in O County, to provide dental care services to children in O County at a new state of the art dental clinic. With respect to the latter area, M is working with Q to open a child advocacy center which will provide counseling and treatment services to sexually, physically, and mentally abused children in the O area.

M requests approval to set aside a maximum of approximately $338x. Specifically, M requests approval to set aside (1) an amount up to approximately $153x in the taxable year ending August 31, 2001, and (2) an amount up to the lesser of approximately $185x or its minimum distributable amount for the taxable year ending August 31, 2001, in the taxable year ending August 31, 2002, so that these amounts will be treated as qualifying distributions under section 4942(g)(2) of the Code in the taxable years ending August 31, 2001, and August 31, 2002. The set-asides will be used to fund the current phase of Project 2 in O County and the expansion of Project 2 to other identified counties in the region.

M plans to fund Project 2 by direct payment of expenses as they are incurred. These expenses will be incurred throughout the planning and implementation phases of Project 2. M is not sure that these expenses will be incurred prior to the end of the 2001 and 2002 taxable years. It needs to have the flexibility to set aside the amounts stated above inasmuch as M will need a lengthy period of time to plan and implement Project 2, as was the case with the successful Project 1.

Project 2 requires extensive coordination with community leaders and government officials, as well as significant long-term planning. M needs to solicit the support of local community leaders and government officials, hire staff, including medical personnel, identify suitable locations for the dental clinics and/or child advocacy centers, and order and install the appropriate equipment. Participants in Project 2, including local community leaders and government officials, dentists and other medical personnel, and various other local community organizations, require assurance that funding will be available to complete Project 2.

Over the past 18 months, M has been planning and implementing Project 2 in O County and recently assisted in opening a state of the art dental clinic to provide dental care services to

children enrolled in the O County school system. In order to implement Project 2 in O County, M first identified key local community leaders and government officials and then, over time, established working relationships with these leaders and officials to generate support for Project 2. Once this support was generated, M provided the necessary funds to Q to permit it to recruit and hire medical and administrative staff, identify a suitable location for the dental clinic, purchase equipment, furniture and supplies, and coordinate implementation of the program with the local school district. Inasmuch as this initial planning and implementation required a lengthy amount of time, M requests a set-aside because it anticipates that it will need a lengthy period of time to plan and implement Project 2 in its entirety.

Once Project 2 has been successfully established in O County, M plans on extending Project 2 to other counties. Initial planning meetings between the trustees of M and volunteers from Q, on the one hand, and local community leaders, on the other, have been held in two of the other counties to establish pediatric clinics. In addition, Q is compiling procedure manuals and business plan models to be use as a guide by the other counties in implementing Project 2.

You report that low-income persons rarely or ever visit a dentist. Therefore, M has undertaken Project 2 an effort to provide dental care services to children from low-income families in the identified counties.

In 1998, per capita income in O County was $15,155 and 6.9% of the work force was unemployed. Over 50% of the children living in O County rely on a program of health insurance provided by the particular State as their primary source of health insurance, but no dentist in O County will treat such patients. O County has been named a federal primary care shortage health personnel site.

Project 2 will involve an active partnership between M and the local school districts and government agencies in each participating county. Project 2 will require that each local school district make an investment, either financial or in-kind, in Project 2. For example, O County officials have provided the building space and utilities for the dental clinic free of charge. M will then fund the purchase of the necessary medical equipment, furniture and supplies for the dental clinics and will also provide the funds to transport the children from school to the clinics. In addition, Project 2 will involve the local school districts obtaining parental consent to allow the children to visit the dental clinic.

Participating children will be eligible to visit the dental clinic five times per year. Through these regular dental visits, these children will be provided with dental records and the experience of receiving on-going health care services. Pursuant to your stated assumption that 2,000 children participate in Project 2 in each county, for a total of 20,000 enrollees, the proposed budget for Project 2 is approximately $33x per dental clinic, resulting in an aggregate estimated budget of $330x. In each county, approximately $24x will be allocated to salary and benefits for personnel, including dentists, dental hygienists, and administrative staff, and approximately $7x will allocated to medical equipment, furniture and supplies. The remainder of the budget in each county (approximately $2x) will be allocated to miscellaneous expenses such as printing, promotional and educational items, and insurance.

In the future, Project 2 may involve the opening of child advocacy centers in each of the identified counties to provide counseling and treatment services to sexually, physically, and mentally abused children.

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 (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 regulation cites as one example of a suitable project a plan to erect a building to house the direct charitable, educational, or similar exempt activity of the 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.

The proposed set-aside for M's taxable year ending August 31, 2001, and August 31, 2002, is in furtherance of M's charitable purposes. As described above, the funds to be set aside will be used to promote the dental health of low-income children in rural, medically underserved counties in the region. Initially, Project 2 will focus on O County, and you have described the progress made to date in establishing a dental clinic, including the cooperation of local school and government authorities and community leaders. Once fully established in O County, M plans to extend Project 2 to the remaining identified counties. It is clear that the proposed set-aside will be used to accomplish a purpose described in section 170(c)(2)(B), as required by section 4942(g)(2). You have also established to our satisfaction that Project 2 can be better accomplished by such set-aside rather than by the immediate payment of funds. You have submitted a sworn statement from a trustee of M stating that the funds to be set aside on August 31, 2001, and August 31, 2002, 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 an amount up to $153x (approximately) on M's books and records for M's taxable year ending August 31, 2001, and the set-aside of an amount up to the lesser of approximately $185x or M's minimum distributable amount for the taxable year ending August 31, 2001, in the taxable year ending August 31, 2002, satisfies the requirements of Code section 4942(g)(2)(B)(i) and section 53.4942(a)-3(b)(2) of the regulations (the "suitability test"). Accordingly, these set-asides may be treated as qualifying distributions for M's taxable years ending August 31, 20001, and August 31, 2002.

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 Ohio 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, Cincinnati, OH 45201.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative.

We are also sending a copy of this ruling to the Ohio 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,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4