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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200150037

Date: SEP 17 2001

Index Number: 4942.03-07

Contact Person:

Identification Number:

Contact Number:

T:EO:B4

Employer Identification Number:

Legend:
M =
N =
T =
U =
W =
X =

Dear Sir or Madam:

This is in response to M's letter dated December 13, 2000, as supplemented, in which M requested a set-aside ruling of T under section 4942(g)(2)(B)(i) of the Internal Revenue Code (the Code).

FACTS

M is a nonprofit corporation exempt from federal income tax under section 501(c)(3) of the Code. M files a Form 990-PF on a calendar year basis. Until the N calendar year, M was classified as a private operating foundation; however, in N, M failed to distribute two-thirds of its minimum investment return. M needs a favorable response to this ruling request to facilitate reclassification as a private operating foundation for the year U.

Since M was formed, it has owned and operated a residential facility for the aged and needy on approximately two acres in a residential area. In recent years, there have been changes in the surrounding neighborhood. To assure the continuity of service to, and safety for, the aged and needy (i.e. to continue the tax-exempt function of providing a residential facility for the aged and needy), M's Board decided that it must relocate the facility. It determined that approximately five acres of land would be needed on which to construct a new facility. Thus, M's Board will purchase the real estate at a cost not less than T before W. M's Board also authorized the hiring of a real estate consultant.

M's Board originally authorized the purchase of approximately five acres of land for T. M's real estate consultant recommended that T could pay for approximately two acres. The original

232

estimate of M's Board was based upon a judgment made as part of an initial consideration of the subject. M represents that the number of acres will depend upon proximity to shopping, availability of public transportation, factors relating to the safety of M's residents, and other market value factors. To date, no final decision has been made as to whether the building itself will be "built up" or extend horizontally. M believes that it would be premature to hire an architect until it has purchased the real estate. Although no architect has prepared any plans, M anticipates that the total cost of the project (land and building) will likely be in the X range or higher and alternative financial arrangements are being considered.

M has specifically requested that the Internal Revenue Service issue a ruling confirming that setting aside T to be expended to purchase land before W on which it will construct a new residential facility is a qualifying distribution for the year U and satisfies the suitability test of section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the Foundation and Similar Excise Taxes Regulations. Under the facts and circumstances, M believes that the acquisition of the land can better be accomplished by using a set-aside rather than the immediate payment of funds.

LAW & ANALYSIS

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 disqualifying persons, or (ii) a private foundation that 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 that comes within one or more purposes described within 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 that can be better accomplished by such set-aside rather than by immediate payment of funds (the "suitability test").

Section 4942(j)(3) of the Code defines the term "operating foundation" in general as a private foundation that engages directly in the active conduct of charitable, religious, educational, and similar activities, while other private foundations make grants for section 501(c)(3) purposes.

Section 53.4942(a)-3(b)(1) of the 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) 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 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, or (ii) 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 to assure the continuity of particular charitable projects or program-related investments. The regulation cites as an 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.

M states that its proposed set-aside will be used to purchase land on which to construct a residential facility for the aged and needy. Thus, it will be used to accomplish a purpose described in section 170(c)(2)(B) of the Code. Furthermore, the amount set aside will actually be paid for the project before W, which is within 60 months after it is set aside, as required by 53.4942(a)-3(b)(1) of the regulations. The set-aside satisfies the suitability test because the T minimum cost for vacant land on which M will construct a new residential facility cannot practically be made in the year U and because the facility will be used to assure continuity of M's charitable activity, as required by section 53.4942(a)-3(b)(2) of the regulations and the example cited therein, supra. M has established that the project is long-term in nature and is better accomplished by a future expenditure than by a current one.

RULING

Based on the foregoing, we rule that the set-aside of T specifically devoted to the purchase of land on which M will construct a new facility meets the requirements of section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations. Accordingly, M can treat the set-aside as a qualifying distribution expended directly for the active conduct of exempt activities for its taxable year ending December 31, U.

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.

We are informing the Ohio TE/GE office of this action. Please keep a copy of this ruling with your permanent records.

234

This ruling is directed only to M. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

235