

**Internal Revenue Service
Director, Exempt Organizations**

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**Department of the Treasury
P.O. Box 2508 - Room 4122
Cincinnati, Ohio 45201**

Employer Identification Number:

Person to Contact - ID#:

Contact Telephone Numbers:

Phone
Fax

UIL 4942.03-07

LEGEND

A= Name of Facility
B= Name of your Program
C= State
D= Date
E= Date
F= Date
G= Year
H= Year
I= Date
J= Year
K= Year
L= Date
a= \$
b= \$
c= \$
d= \$
e= Footage
f= \$
g= Footage
h= \$

Dear

You have requested advance approval of a set-aside under the suitability test of section 4942(g)(2) of the Internal Revenue Code. You are exempt from Federal income tax under section 501(c)(3) of the Code and are classified as an exempt operating foundation under sections 4942(j)(3) and 4940(d)(1) of the Code.

FACTS

By a letter dated D, we approved a set-aside in the amount of \$a for the taxable year ending E to expand and upgrade the existing facility of A in C. A is one of nine units of B, through which you provide individual and family support services that include assistance for children who have suffered a significant loss or lack a caring and nurturing environment. You are requesting approval of an additional set-aside in the amount of \$b for the tax year ended F, for the same project.

Recently you determined that the costs for the redevelopment project would significantly exceed the estimates upon which the first set-aside was based. The architect's preliminary site and redevelopment plan reflected estimated costs of \$c as a result of site-work issues specific to A. Value engineering efforts could only reduce costs to \$d. You then decided to redesign the project to create a facility that would meet future as well as current needs. The original project would have torn down all existing buildings but one and replaced them with a new structure of e square feet. Under the new plan, in addition to the construction of the new structure, four existing structures, previously slated to be torn down, will be repurposed for uses supporting the programs of A. These changes will increase the size of the facility to g square feet. Also increasing the cost of the project are the impact of a USDA Soils Survey, and decisions to replace overhead electrical and communications lines with underground conduits and to expand the water system to meet increased demand. The revised plan was approved by your Trustees during the second quarter of H. The total cost of the project will not exceed \$f. On I your Trustees approved a total set-aside amount of \$h, comprising the original approved set-aside of \$a and the additional set-aside of \$b. The obligation to pay the additional set-aside amount will be entered on your books and records for J on the earlier of the receipt of a favorable determination letter or F.

You anticipate that the final design development and construction documents can be completed by the architect in J, with construction commencing in K. The initial set-aside amount of \$a will be distributed for the project before L, the ending date of the original 60 month distribution period, and the additional set-aside amount of \$b will be distributed for the project before the end of the 60 month period commencing on the date of its recordation.

LAW

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code that are private operating foundations subject to the private operating foundation provisions of IRC 4942(j)(3).

Section 4942(g)(1) of the Code defines "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; (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 within one or more purposes of section 170(c)(2)(B) may be treated as a qualifying distribution if the amount meets the requirements of section 4942(g)(2)(B).

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 the amount set aside will be paid for the specific project within five years, and the specific project is one that can better be accomplished by the set-aside of income rather than by the immediate payment of funds (the "suitability test").

Section 4942(j)(3) of the Code requires that private operating foundations must spend at least 85% of its adjusted net income or its minimum investment return, whichever is less, directly for the active conduct of its exempt activities (the income test) in order to remain a private operating foundation.

Section 53.4942(a)-3(a)(2)(iii) defines as a qualifying distribution any amount set aside within the meaning of paragraph (b) of section 3.

Section 53.4942(a)-3(b)(1) of the Foundation and Similar Excise Tax 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) and paragraph (b) are satisfied. The requirements of paragraph (b) are satisfied if the foundation establishes to the satisfaction of the Commissioner the amount set aside will be paid for the specific project within 60 months after it is set aside, and (i) the set-aside otherwise meets the suitability test of section 53.4942(a)-3(b)(2) or (ii) the foundation satisfies the cash distribution test.

Section 53.4942(a)-3(b)(2) of the regulations provides that the suitability test for a set-aside is met if the foundation establishes 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 an example of a suitable project a plan to erect a building to house a direct charitable, educational, or similar exempt activity of the foundation.

Section 53.4942(a)-3(b)(7)(i) 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.

In 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.

ANALYSIS

You have sought timely approval of your set-aside of income in accordance with Section 53.4942(a)-3(b)(7)(i).

As required by Section 4942(g)(2)(A) of the Code and Section 53.4942(a)-3(b)(1) of the Regulations, your project will accomplish purposes described in section 170(c)(2)(B) of the Code, namely, the relief of orphan and other destitute children. See Rev. Rul. 67-151, 1967-1 C.B. 134, and Rev. Rul. 80-200, 1980-2 C.B. 173.

You have credibly represented that the amount set-aside for this specific project will be paid out within 60 months from the set-aside, as required by section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(1) of the regulations.

Your project is one that can better be accomplished by the set-aside of income rather than by the immediate payment of funds. The set-aside will ensure that funding is available to complete the project, which, because of redesign, may now be expected to take approximately 48 months to complete. As is customary and appropriate in the construction industry, payments will be made on an "as work is done" basis. The project is similar to the example from the Regulations cited above and to the project described in Revenue Ruling 74-450.

Your project therefore satisfies the suitability test as set forth in Section 4942(g)(2)(B)(i) of the Code and Section 53.4942(a)-3(b)(2) of the Regulations.

RULING

Based on the foregoing, the set-aside of \$b for the taxable year ending F, meets the requirements of Section 4942(g)(2)(B)(i) and accordingly constitutes a qualifying distribution under section 4942(g)(2).

Section 53.4942(a)-3(b)(8) of the regulations provides any set-aside approved by the Internal Revenue Service must be evidenced by the entry of a dollar amount in the books and records of a private foundation 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 the foundation's 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 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 Internal Revenue Service. This ruling does not address the applicability of any section of Code or regulations to the facts submitted other than with respect to the sections described.

This ruling does not address the effect of using debt proceeds to fulfill the obligations of the set-aside.

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.

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

Please keep a copy of this ruling letter in your permanent records.

If you have any questions about this ruling, please contact the persons whose name and telephone number are shown above in the heading of this letter.

Sincerely yours,

Rob Choi
Director, Exempt Organizations
Rulings and Agreements