



family who are not affiliated with Foundation. Foundation has made cash grants to several section 501(c)(3) organizations in support of the arts.

Family members of X acquired a collection of artwork, most of which is Style art from Geographic Region by deceased artists with other works of art displayed in museums and public institutions. Foundation represents that these artists have a well-established place in art history. The collection consists of fine art painting and sculpture. X's family members have donated several of these works of art to Foundation and are planning on donating additional works from their collection to Foundation. Foundation intends to hold this artwork not for sale or investment but for an educational lending program. Foundation will lend this artwork to qualifying section 501(c)(3) public museums, galleries, educational organizations such as schools or universities, and other similar institutions for public exhibition and to make available to the general public the cultural and artistic enjoyment of the art, to promote public interest in, and knowledge of, the visual arts, and to further research and study pertaining to historic art and artists. Foundation represents that all art it owns will be packaged, stored, protected, and preserved in a secure room with adequate climate controls and protection from natural light that is designed for such purposes, and will not be available for private use. The secure room in which the art will be stored will be either owned or leased by Foundation.

Foundation also has a collection of books and publications about art and art history that it lends to section 501(c)(3) organizations for educational purposes. In the coming years, Foundation intends to solicit donations to purchase additional artworks that are in line with its existing collection and that similarly will be used to lend to section 501(c)(3) organizations that support the arts and education. Foundation also holds quarterly meetings to discuss funding for grants and to strategize for the collection and lending of the artworks.

### **RULINGS REQUESTED**

- 1) The artwork owned by Foundation that is acquired through donations or purchases will constitute assets used directly in carrying out Foundation's exempt purposes and may be excluded from Foundation's minimum investment return under section 4942(e)(1)(A) and Treas. Reg. § 53.4942(a)-2(c)(3).
- 2) The amounts spent by Foundation to acquire additional art will constitute qualifying distributions within the meaning of section 4942(g)(1).

### **LAW AND ANALYSIS**

Section 4942(a) generally imposes an excise tax on the undistributed income of a private foundation.

Section 4942(c) provides that “undistributed income” is the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made out of such distributable amount.

Section 4942(d) defines “distributable amount” as an amount equal to the sum of the minimum investment return plus the amounts described in section 4942(f)(2)(C), reduced by the sum of the taxes imposed on the private foundation for the taxable year under subtitle A and section 4940.

Section 4942(e)(1) defines the term “minimum investment return” as five percent of the excess of (A) the aggregate of fair market value of all assets other than those which are used (or held for use) directly in carrying out the foundation’s exempt purposes, over (B) the acquisition indebtedness with respect to such assets.

Section 4942(g)(1) defines the term “qualifying distribution” for purposes of section 4942 generally as any amount paid to accomplish one or more purposes described in section 170(c)(2)(B) or any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B).

Treas. Reg. § 53.4942(a)-2(c)(2)(v) excludes from the assets taken into account in determining the minimum investment return any asset used (or held for use) directly in carrying out the foundation’s exempt purpose.

Treas. Reg. § 53.4942(a)-2(c)(3)(i) provides that an asset is used (or held for use) directly in carrying out the foundation’s exempt purpose only if the asset is actually used by the foundation in carrying out its exempt purpose or the foundation establishes that its immediate use for such exempt purpose is not practical and that definite plans exist to commence such use within a reasonable period of time. Assets held for the production of income or for investment are not used (or held for use) directly in carrying out the foundation’s exempt purpose.

Treas. Reg. § 53.4942(a)-2(c)(3)(ii)(c) provides that physical facilities used in charitable, educational, or other similar exempt activities, such as works of art owned by the foundation which are on public display, are examples of assets “used or held for use directly in carrying out the foundation’s exempt purpose.”

Treas. Reg. § 53.4942(a)-3(a)(2)(i) provides that the term “qualifying distribution” includes any amount paid to accomplish one or more purposes described in sections 170(c)(1) or 170(c)(2)(B). Treas. Reg. § 53.4942(a)-3(a)(2)(ii) provides that this term includes any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in sections 170(c)(1) or 170(c)(2)(B).

In Example (3) of Treas. Reg. § 53.4942(a)-3(a)(7), a private foundation that engaged in holding paintings and exhibiting them to the public purchased an additional building to

be used to exhibit the paintings. This expenditure constituted a qualifying distribution under Treas. Reg. § 53.4942(a)-3(a)(2).

Rev. Rul. 74-498, 1974-2 C.B. 387, holds that a collection of paintings owned by a foundation formed to further the arts, that is loaned under an active loan program for exhibition in museums, universities and similar institutions, is being used directly in carrying out the foundation's exempt purposes within the meaning of section 4942(e)(1)(A), and the value of the paintings is excluded in computing the foundation's minimum investment return.

Section 4942 generally imposes an excise tax on a private foundation's undistributed income, as determined for any taxable year by the calculation of the foundation's distributable amount, which includes its minimum investment return. Assets used, or held for use, in furtherance of a private foundation's exempt purposes are generally excluded from determining the minimum investment return. See section 4942(e)(1) and Treas. Reg. § 53.4942(a)-2(c)(2)(v). The regulations list works of art owned by a foundation that are on public display as an example of assets used or held for use directly in carrying out a foundation's exempt purpose. Treas. Reg. § 53.4942(a)-2(c)(3)(ii)(c).

Foundation has a history of furthering its exempt educational and charitable purposes by supporting museums and educational institutions that support the arts through grants of cash and by loaning its collection of books and publications about art and art history to these types of organizations. Foundation represents that upon receipt of additional artworks from X's family members, it will engage in an art loan program whereby Foundation's art collection will be loaned to section 501(c)(3) organizations that support the arts and education. The role Foundation will assume in making loans of artwork to section 501(c)(3) organizations, managing the art collection, providing for its exhibition and display, and holding it for exhibition, is similar to the active loan program managed by the foundation described in Rev. Rul. 74-498. Similar to the revenue ruling, the artworks owned by Foundation will constitute property used directly in carrying out its exempt purposes within the meaning of section 4942(e)(1)(A) and shall not be included for purposes of calculating its minimum investment return under section 4942(e)(1)(A) and Treas. Reg. § 53.4942(a)-2(c)(3). In addition, Foundation's expenditures to acquire additional artwork to add to its collection for exhibit and display by section 501(c)(3) organizations would be similar to the expenditures described in Example (3) in Treas. Reg. § 53.4942(a)-3(a)(7) that constituted qualifying distributions. Acquiring additional artwork for exhibition and display to the public, and not for private use, furthers Foundation's exempt purposes. Consequently, these expenditures will constitute "qualifying distributions" within the meaning of section 4942(g)(1).

## **RULINGS**

Based on the foregoing, and assuming the accuracy of the facts and representations set forth herein, we rule as follows:

- 1) The artwork owned by Foundation that is acquired through donations or purchases will constitute assets used directly in carrying out Foundation's exempt purposes and may be excluded from Foundation's minimum investment return under section 4942(e)(1)(A) and Treas. Reg. § 53.4942(a)-2(c)(3).
- 2) The amounts spent by Foundation to acquire additional art will constitute qualifying distributions within the meaning of section 4942(g)(1).

The rulings contained in this letter are based upon information and representations submitted by or on behalf of Foundation and accompanied by a penalty of perjury statement executed by an individual with authority to bind Foundation, and upon the understanding that there will be no material changes in the facts. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2023-1, section 11.05.

This 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 specifically described, and, except as expressly provided in this letter, no opinion is expressed or implied concerning the tax consequences of any aspects of any transaction or item of income discussed or referenced in this letter.

Because it could help resolve questions concerning federal tax status, this letter should be kept in Foundation's permanent records.

A copy of this letter must be attached to any tax return to which it is relevant. Alternatively, if Foundation files a return electronically, this requirement may be satisfied by attaching a statement to the return that provides the date and control number of this letter.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Foundation's authorized representative.

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

Sincerely,

Virginia Richardson  
Senior Technician Reviewer  
Office of the Chief Counsel  
(Employee Benefits, Exempt Organizations,  
and Employment Taxes)

cc: