Internal Revenue Service

UIL -4942.03-05

Department of the Treasury

Washington, DC 20224

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Contact Person:

Telephone Number:

In Reference to:

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Date:

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Key District Office:

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Dear Sir or Madam:

This is in response to your letter dated September 22, 1998, from your authorized representative, requesting a ruling relating to a set aside under section 4942(g)(2)(B)(i) of the Internal Revenue Code (hereafter, "Code").

A was organized as a not-for-profit corporation under the laws of the State Y on October 8, 1993. In 1995, the Internal Revenue Service recognized A's status as an exempt organization under section 501(c)(3) of the Code and its classification as an operating foundation within the meaning of section 4942(j)(3) of the Code. A's purposes, as stated in its Articles of Incorporation, are to receive and administer funds for religious, charitable, scientific, and educational purposes. In order to carry out these purposes, A has embarked on a specific program to assist abandoned or under privileged children. A has two specific programs related to this purpose.

First, as to a facility in Central America, A will acquire and/or begin to construct and operate a facility designed to house, educate, and care for children, taking into account the specific needs of each child. It is contemplated that some will need full time care because they have been orphaned or abandoned, while others may need lesser amounts of assistance. The site will be located in either one of two countries. The construction

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and/or operation of such facility will occur no later than September 23, 1999.

A's initial steps of a working plan for this facility include (a) the employment of an experienced Childcare Specialist/Administrator to provide guidance in the selection of a site and the development of the specifications for the facility; (b) the location and acquisition of a site that is suitable for the construction of the facility that includes suitable existing structures in the target locations; (c) the construction or remodeling of a suitable facility on the acquired site; (d) employment of a full time director; (e) the development of appropriate educational, social, spiritual, cultural, and recreational programming to be offered by the facility; (f) the development of a plan to provide basic health services (either directly or through a third party); (g) obtain necessary certifications; and (h) development of appropriate guidelines for the selection of the children to be served at this facility.

In addition to it planned facility in Central America, A intends to pursue its charitable endeavors in the United States through the development of a 10 acre tract of land in the city of X that it purchased in 1997. A is in the planning stages to renovate the existing structures on this tract of land and possibly construct additional buildings. The X facility will educate and provide recreation to underprivileged and disadvantaged children in a day camp setting.

The primary focus of the X facility will be arts enrichment in a rural, natural environment. The day camp and its attendant staff will holistically address each child's individual physical, educational, spiritual, psychological, cultural, and social needs. The day camp will emphasize the building of self-esteem in underprivileged and disadvantaged children through personalized attention in art enrichment activities and exposure to a nature rich environment.

In order to acquire and/or construct the facility in Central America, as well as to renovate and construct X facility, A will be required to make an expenditure of funds well in excess of its annual income. In prior years the Service had issued private letter rulings recognizing that a set-aside of funds in certain amounts met the suitability test of section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the Foundations and similar excise tax regulations (the regulations).

A's adjusted net income for its fiscal year ending September 30, 1998 will be approximately t. A's Board of Directors anticipate that an expenditure in excess of that amount, in

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addition to the amounts set aside in earlier years will be necessary to acquire the facility in Central America plus X facility. Thus, the funding of these projects can best be accomplished through the current accumulations of A's earnings.

A's Directors have authorized an additional set aside of u on A's books and records for its fiscal year ending September 30, 1998. These funds have been placed in a separate account in a financial institution so that these funds will be available when needed. The funds set aside will be expended within 60 months for purposes of both of the facilities described in the preceding material. A's request for this ruling was timely filed.

Based on the forgoing, A has requested the following ruling:

> The set aside of u on A's books and records for the purposes of acquiring and construction the facility in Central America and/or renovating X 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 and can therefore be treated as a qualifying distribution for A's fiscal year ending September 30, 1998.

Section 4942(g)(1) of the Code defines the term "qualifying distribution", in part, as (A) any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than (certain excluded contributions) . . . or (B) 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).

Section 4942(g)(2)(A) 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).

Section 4942(g)(2)(B)(i) 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 established to the satisfaction of the Secretary that the amount will be paid for the specific project within 5 years, and -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 Regulations provides, in part, 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 . . . if the requirements of section 4942(g) and this paragraph (b) 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 described in subparagraph (2) of this paragraph.

Section 53.4942(a)-3(b)(2) provides, in part, that the suitability test is satisfied if the private foundation establishes to the satisfaction of the Commissioner that the specific project for which the amount is set aside is one that can be better accomplished by the set aside than by the immediate payment of funds. 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 in order to assure the continuity of particular charitable projects. . . Such projects include, for example, a plan to erect a building to house the direct charitable, educational, or other similar exempt activity of the private 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. . .

Section 53.4942(a)-3(b)(7) provides, in part, that if an amount is to be set aside under the suitability test of section 4942(g)(2)(B)(i) and subparagraph (2) of this paragraph, the private foundation must apply for the Commissioner's approval of the set-aside before the end of the taxable year in which the amount is set aside.

Rev. Rul. 74-450, 1974-2 C.B. 388 describes a situation in which the Service approved the set aside of the income of an operating foundation as meeting the requirements for qualifying distribution and set-aside under the provisions of the Code and Regulations. The conversion of the foundation's newly acquired land into an extension of its existing wildlife sanctuary and the remainder into a public park under a four year construction contract where payments are primarily due in the last two years meets the requirements for a qualifying distribution.

A in this case has met the requirements of the Code and Regulations with respect to both of it exempt purpose facilities, the facility in Central America and the X facility. With respect to the facility in Central America, it is true that A has not picked a specific site for the facility. Nevertheless, it has

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concrete plans for the facility and has in mind a certain type of site for the facility. As noted in section 53.4942(a)-3(b)(2) it is not necessary, in meeting the requirements of the suitability test, for the foundation to have identified a specific location or have finalized architectural plans. The site for X facility is identified and the land was purchased. Both facilities carry out the exempt purposes of A and are quite similar to the example provided in the Regulations cited in the preceding sentence as well as the facts of Rev. Rul. 74-450. The amount set aside will be paid for the specific project within 60 months after it is set aside. The application for approval by the Commissioner was timely filed.

Accordingly, we rule as follows:

The set aside of u on A's books and records for the purposes of acquiring and/or constructing the facility in Central America and/or X 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 and can therefore be treated as a qualifying distribution for A's fiscal year ending September 30, 1998.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transfers and transactions described above under any other provision of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to A's authorized representative. You should keep a copy of this letter in your permanent records.

If you have any questions, please contact the person whose name and telephone appear at the heading of this letter. This ruling is directed only to the organization that requested it. Internal Revenue Code section 6110(j)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

Kenneth J. Earnest

Kenneth J. Earnest
Acting Chief,
Exempt Organizations
Technical Branch 3