DEPARTMENT OF THE TREASURY 200132041
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: MAY 16 2001

Uniform Issue List
4942.03-07

Contact Person:

Identification Number:

Telephone Number:

T:EO:B4

Employer Identification Number:.

Legend:

B =
M=
N=
o =
p =

x=

Dear Sir or Madam:

We have considered M's ruling request dated December 19.2000. M requests a ruling that a certain set-aside of funds will be treated as a qualifying distribution within the meaning of section 4942 of the Internal Revenue Code on the basis that the set-aside satisfies the suitability test of section 4942(g)(2)(B)(i) and the corresponding regulations.

M was incorporated in 1984. In 1988, the Service recognized M as exempt from federal income tax under section **501(c)(3)** of the Code and classified it as a private foundation under section 509(a).

M owns certain real property known as the N Property. This Property was acquired by M under the will of **B**, who died in 1986.

The Second Codicil to B's will specifically directed that the trustees of M shall not sell or otherwise dispose of the N Property but instead manage and operate it so as to ensure that "its lasting beauty and natural scenic wonders are available for generations of Americans to enjoy." They were also directed to maintain a game sanctuary and preserve located on the Property.

N is part of an area which Congress has designated as the N Wilderness Area. Although more than half of the N Property is not in N's watershed, the focal point for much of the environmental significance of the property is N. You describe N as "spectacularly beautiful" and as the only natural lake in the particular region.

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Approximately two-thirds of the N Property has not had any significant improvements. The improvements on the balance of the N Property consist of a hotel, cottages, related structures, nature trails, and scenic viewing spots. The hotel and cottages have significant historical and architectural value.

In a ruling letter issued in 1988. the Service held that M's ownership and proposed renovation, operation, and maintenance of the N property constituted a functionally related business of M and that the expenditure of funds to accomplish these activities would constitute a program-related investment for purposes specified in section 170(c)(2)(B) of the Code within the meaning of section 4944(c). The Service determined that M would operate the N Property, which included a hotel and a restaurant, in a non-commercial manner, i.e., not designed to produce income or to increase the value of the property. Instead, M planned to operate N as if it were a 'privately-owned state park" and so as "to preserve the environment and ecosystem of the property." In doing this, M would also "provide a facility for the education and benefit of the general public and preserve a significant area for scientific research."

In the above letter, the Service also ruled that M's ownership and proposed renovation, operation, and maintenance of N would not adversely affect its tax exempt status under section 501 (c)(3) of the Code and that the income derived form the use of the facilities by the general public would not constitute unrelated business taxable income within the meaning of sections 511-513.

In conformity with B's vision for the N Property, the Board of Directors of M has established the following as the mission for N: "The mission of N is to preserve this unique and pristine natural environment and scenic wonder as a tool for cleansing the spirit, finding purpose; and rewnnecting with basic values and principles for one's life. The natural setting, guest accommodations, programs and other resources will be developed and integrated to support these purposes."

The Board of Directors of M has developed an N Master Plan for certain improvements to the N Property designed to protect its environmental significance and increase its access to the public. You have attached a copy of this Master Plan. There are two guiding principles: First, the Plan must develop the N Property in a manner consistent with the mission, which demands respect for the natural environment and commitment to the preservation of the N Property as an educational and recreational facility open and accessible to the public. Second, the Plan must advance the N Property toward financial self-sufficiency to enable M to use its other assets for carrying out other charitable purposes.

Presently, M's Board of Directors has only approved the improvements and developments referred to in the N Master Plan as Phase I. The Board has not approved the further improvements and developments referred to in the N Master Plan as Phases II and Ill. At this point in time, the Board has not determined whether the N Master Plan will be implemented in full or whether only the approved Phase will be implemented.

The N Master Plan includes an Environmental Development Analysis and a Hospitality Development Analysis. The Environment Development Analysis seeks to preserve and protect the wilderness environment on the N property. In furtherance thereof, the N Master Plan establishes development zones and proposed uses for those development zones. The development zones (eleven altogether) and their potential uses include the following: nature study and research; observation points; hiking trails; mountain biking; swimming, fishing, and birding (lake area); wilderness recreation center; cabins and cottages; welcome center. and visitor parking.

As set forth in the N Master Plan, M has adopted a number of guidelines in planning the renovation and expansion at N to ensure that the charitable mission for the N Property is carried out. These guidelines include maintenance and improvement of the water quality of N. avoidance of encroachment upon the lake and the area immediately surrounding the lake, expansion of the trail system to more remote areas of the Property, and banning the use of chemical fertilizers, insecticides. and herbicides.

The Hospitality Development Analysis of the N Master Plan is designed to ensure that the public has access to the N Property and to make the N Property financially self-sustaining. This analysis requires an increase in the number of guest rooms by at least 50 rooms and additional recreational guest amenities. These 50 guest rooms will be placed in two developments, the 0 Cabins, and the P Lodges. Additional development may include expansion of the dining room and the addition of more meeting rooms. The N Master Plan also contemplates additional housing for staff and making the hotel wheel chair accessible. The old general store located on the N Property may be adapted for use as a registration center and an interpretive center.

M's Board of Directors has approved only the implementation of the projects that are described as Phase I in the N Master Plan. The improvements and developments that have been approved by the Board of Directors are scheduled to occur over the five-year period from 2001 to 2005. The estimated costs of implementing these improvements and developments are x dollars. M will make a set-aside in December, 2000, of this amount, which will be evidenced by an entry on M's books and records as a pledge or obligation to be paid at a future date, for the purpose of paying the costs associated with implementing these improvements and developments over the five-year period.

You have set forth the reasons why the implementation of Phase I of the N Master Plan cannot be better accomplished by an immediate payment of funds. The developments and improvements which M will undertake in the period from 2001 to 2005 are a series of projects in which relatively long-term expenditures must be made in order to assure the continuity of the N Property and the charitable mission associated with it. M plans to fund the projects with its existing assets by the direct payment of expenses as they are incurred. The projects to be undertaken by M are also of such a magnitude that they will require an accumulation of funds to finance the projects over the five-year period estimated for completion of these projects. The expenses to implement Phase I of the N Master Plan will be incurred over a five-year period, and the funds must be set aside to ensure their availability as expenses are incurred. The completion of certain projects will follow from the completion of other projects. Also, the construction work needs to be sequenced over time to ensure that the hotel can remain open each season throughout the construction. You further maintain that M will realize cost savings with a sequential plan for construction. Specifically, the location of the N Property makes it necessary for M to bring in a labor force. 'If the project is wntinual in nature, it is far more likely to attract quality workers and a qualified construction company at the most economical means." You believe that your plan will provide greater public accessibility to the N Property while at the same time protecting the environment.

You have furnished a chart showing specific expenditures, and the years in which made, over the five-year period. The two major expenditures are for the 0 Cabins in 2002. and for the P Lodges in 2004. You have allocated funds for a water storage tank (2004) and for ADA compliance (2005). Additional allocations are for recreational amenities (2005), staff housing (2002), and lake/boat access (2001). Finally, you have allocated funding for forest recovery, spread over the five-year period. Total expenditures are the requested set-aside of x dollars.

Section 4942(a) of the 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)(l) of the Code provides that the term "distributable amount" means, with respect to any foundatiin 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)(l) 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").

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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)(l) 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 x dollars set-aside for the projects in Phase I of the N Master Plan is being set aside for a specific project that accomplishes a charitable purpose under section 170(c)(2)(B) of the Code. The Service has previously determined that the operation and maintenance of the N Property and the N Hotel is a program-related investment of M. This involves preservation of the environment and the ecosystem on the N Property, the provision of a facility for the education and benefit of the general public, and the preservation of a significant area for scientific research. The specific projects encompassed in the N Master Plan for which the set-aside-is being made are all designed to further and enhance these charitable activities. Accordingly, the suitability test of section 53.4942(a)-3(b)(2) of the regulations is satisfied..

The developments and improvements described in Phase I of the N Master Plan can better be accomplished by a set-aside rather than by immediate payment of funds. This conclusion derives from the long-term nature and extent of the project, as well as the manner in which M intends to fund the project.

Based on the foregoing, we rule that the set-aside of x dollars on your books and records, specifically devoted to the planned developments and improvements of Phase I of the N Master Plan, 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, the set-aside may be treated as a qualifying distribution for your taxable year ending December 31.2000.

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)).

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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.

We are 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

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