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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Uniform Issue List

4942.03-07

4942.03-05

Date: AUG - 6 2004

Contact Person:

Identification Number:

Telephone Number:

T:EO:BR4

Employer Identification Number:

Legend:

M =

N =

O =

P =

Q =

R =

x =

Dear :

This is in response to M's ruling request dated December 30, 2003, wherein M seeks approval of a proposed set-aside of funds in the amount of \$, to be treated as qualifying distributions under section 4942(g)(2) of the Internal Revenue Code, for its taxable year ending

FACTS:

M is exempt from federal income tax as an organization described in section 501(c)(3) of the Code and is also classified as a private foundation within the meaning of section 509(a).

M was originally founded to produce computer databases and other tools for basic research in the humanities, and to foster a wider interest in the history, literature, and music of the past. Since its inception, M has employed professional classical scholars who work with a network of partners at leading universities to produce electronic databases (currently on CD Rom) that contain historical texts and related scholarly editorial materials.

M's Bylaws were amended to broaden its charitable and educational purposes and to expand its permissible charitable activities. The amended Bylaws provide that M's primary purposes are: (a) to support the conservation and scholarly study of materials of historic and cultural significance; (b) to foster a wider public interest in the history and culture (including

literature, music, art, and cinema) of the past; (c) to support education (especially of young people, in reading, history, cultural and scientific literacy); (d) to support and encourage charitable and educational activities in countries making the transition from communist and other nondemocratic regimes to open democratic societies; and (e) to support research and dissemination of information on individual intellectual, economic, and political freedom around the world.

M is involved in the design and construction of N, a center in O, P, to be used by Q, an agency of the federal government, to preserve and house its motion picture, audio-visual, and recorded sound collections. At the request of Q, an identified private foundation purchased the property for N, consisting of approximately acres with improvements, from a Federal Reserve Bank. In , the private foundation transferred ownership of the N property and all related obligations under the Q grant to M. Since that time, M has been working with Q and R, an office of the federal government, on the plans for this project. Funds for design and construction are intended to be provided by M, subject to reimbursement of a portion of the cost, as described below. The total expenditures by M with respect to the N project are now expected to exceed \$

Once completed, M will transfer title to the property to the United States. Congress has authorized R to transfer an amount not to exceed \$: to the donor entity within 90 days of the U.S.' acquisition of the property.

N will be Q's main archival storage and conservation facility for its moving image and recorded sound collections and will incorporate conservation laboratories for audio-visual media, archival facilities for the storage of all of Q's moving image and sound media, including nitrate film, and separate processing staffs for moving image and recorded sound materials. The expectation is that it will be the largest facility of its kind, a state of the art conservation and preservation facility dedicated to preserving America's audio-visual heritage and making it accessible to future generations.

In M purchased approximately acres of additional real property adjacent to the original property to allow more flexibility for the design of N. In Q and the R accepted the design concept for N. Pursuant thereto, the project consists of five design elements, as follows:

Design Element A – Site Development: Site Development includes extensive rock excavation and related earthworks, all new site utilities, new roads, parking, and landscape.

Design Element B – Renovation of Collections: The existing building on the property will be renovated and will become the primary audio-visual collections storage facility. The renovation of the existing building includes abatement of all hazardous materials and complete interior demolition of all building systems down to the concrete shell, followed by the installation of all new mechanical, electrical, plumbing, and fire protection systems and all new architectural finishes throughout.

Design Element C – Construction of Central Plant Building: The new Central Plant Building will be the mechanical plant for the entire N. It will be constructed partially below grade behind the S Building, and will house central chillers, boilers, electrical, and related equipment for the entire development together with air handling units serving the S Building. It will also house engineers' offices, workshop, and parts storage. The total floor area will be approximately square feet, including a separate structure housing emergency generators.

Design Element D – Construction of Conservation Building: The new conservation building to be constructed is comprised of public spaces, offices, audio-visual and electronic labs, photographic wet labs, and shipping/receiving facilities. The total floor space will be approximately square feet.

Design Element E – Construction of Storage Vaults: Two connected buildings will be constructed, each containing a total of about vaults together with associated mechanical equipment building and equipment spaces. The total floor area will be approximately square feet.

Based on the current design and the master plan, the project will be broken down into two phases, Phase I and Phase II. In addition, each phase will be broken down into Part A and Part B. Phase I-A will consist of site development (Design Element A). Phase I-B will consist of the renovation of the existing building that will store the primary audio-visual collection (Design Element B), and the construction of the Central Plant Building (Design Element C). Phase II covers the construction of the new Conservation Building (Design Element D) and the new vaults (Design Element E). Phase II-A will consist of the "foundations and structural" portion of the work. Phase II-B will consist of the remaining design and construction work.

You represent that the N can better be accomplished by setting aside project funding now rather than by paying it currently. Accordingly, M proposes to set aside \$ to be used for Phase I of the N project. You expect Phase I to be completed by May, at a total cost of about \$. A portion of this amount has already been paid. The balance of funds to be set aside will be paid out as work is completed and invoices are submitted, reviewed, and approved. Based on the project schedules at the time of submission of the ruling request, the set-aside funds should be completely expended within a short time after the May, target completion date for Phase I. However, in light of the complexity and scale of the construction project, it is possible that the May, completion date could be delayed significantly. Regardless, the set-aside amount will be completely paid out no later than December, or months after the December, set-aside date.

RULING REQUESTED:

M requests a ruling approving the set-aside of \$ in its taxable year or the completion of Phase I of the N project. Specifically, M requests a ruling that the set-aside satisfies the suitability test of section 4942(g)(2)(B)(i) of the Code and Section 53.4942(a)-3(b)(2) of the regulations. Therefore, it will be treated as a qualifying distribution in M's taxable year

LAW:

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)(1) of the Code provides that the term "distributable amount" means, with respect to any foundation 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)(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 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").

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)(1) 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 sets forth specific examples of projects

appropriate for asset-aside, which include "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."

ANALYSIS:

The planning and execution of a project of the magnitude of N is an extensive and time consuming process, and it is made more complicated by the fact that R and Q are involved with planning and design development relating to renovation and construction to prepare the property and improvements for transfer to the United States. M is providing plans, specifications, and drawings to R and Q for review and comment. It is difficult to predict when designs will be completed and approved, permits issued, construction contracts signed, materials and equipment on hand, workers ready, and weather cooperative. In addition, plans may require modification if new problems surface once construction is underway.

M plans to pay funds out of the set-aside amount as work is completed and invoices are submitted, reviewed, and approved. The size of the N project, both in dollar amounts and labor, indicates that it is the type of project in which long term expenditures must be made in order to assure the continuity of the project. It would be unwise, as well as out of line with normal construction practice, for M to pay up front for all of the work before it is substantially completed. If it did so, M would lose the leverage and negotiating power necessary to ensure that the work is done according to specifications.

The regulations provide that a project for which a set-aside is appropriate includes a plan to erect a building to house the direct charitable, educational, or other similar exempt activity of the private foundation, even if architectural plans have not been finalized. See section 53.4942(a)-3(b)(2) of the regulations. Here, M is designing and constructing several buildings that will constitute a large conservation and archive storage complex. Thus, the N project fits squarely within the example of the cited regulation. You have stated your anticipation that the set-aside amount of \$ x will be paid out by May, , but in no event later than December, , which is within the required month time frame.

RULING:

Based on the foregoing, we rule that the set-aside of \$ x on M's books and records for its taxable year ending December 31, , satisfies the requirements of section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations (the "suitability test"). Accordingly, the proposed set-aside may be treated as qualifying distributions for M's taxable year ending December 31,

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

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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)).

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,

(S)

Debra Kaweck
Manager, Exempt Organizations
Technical Group 4