

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

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## **LTR: IRS Approves Organization's Set-Aside Program.**

Citations: LTR 201321028

The IRS approved an organization's set-aside funding program for restoration of a historic building that will be dedicated entirely to the organization's exempt purposes when the work is finished, saying the project can better be accomplished using a set-aside than by making an immediate payment.

Contact Person - ID Number: \* \* \*

Contact Telephone Number: \* \* \*

UIL LIST: 4942.03-07

Release Date: 5/24/2013

Date: December 27, 2012

Employer Identification Number: \* \* \*

LEGEND:

Q = Name of Facility

R = City, State

u = \$ Cost of Project

v = \$ Amount of Set Aside

w = \$ Set-Aside Year 1

x = \$ Set-Aside Year 2

y = \$ Set-Aside Year 3

z = \$ Set-Aside Year 4

Dear \* \* \*

### **WHY YOU ARE RECEIVING THIS LETTER**

This is our response to your September 18, 2012, and your subsequent amendment thereto, requesting approval of a set-aside under Internal Revenue Code section 4942(g)(2). You've been recognized as tax-exempt under section 501(c)(3) of the Code and have been determined to be a private operating foundation under sections 509(a) and 4942(j)(3).

## OUR DETERMINATION

Based on the information furnished, your set-aside program is approved under Internal Revenue Code section 4942(g)(2). As required under section 4942(g)(2), the set aside amount must be paid within the 60-month period after the date of the first set-aside.

## DESCRIPTION OF SET-ASIDE REQUEST

You previously acquired a historic property, Q, located in R. You propose to restore Q at an estimated total cost of \$u. When you acquired Q, a portion of it was leased out to commercial tenants and the remaining part was vacant. After restoration the building Q, will be dedicated in its entirety to your exempt purposes.

The first floor will be used for orientation space, exhibition space, a gift shop and public space. The second floor will provide office space for various existing functions of your organization, and an exhibition space in the rear. The upper floor will contain exhibition spaces and spaces for organ recitals and receptions. A second exit from Q will also be built to meet a Fire Code requirement.

The project can better be accomplished using a set-aside than by making an immediate payment, because long-term expenditures must be made requiring more than one year's income to assure their continuity. You intend to restore Q using no outside financing. This is a major project demanding the accumulation of funds in earlier years for expenditure in later years. The predesign and design phases of the project will occupy the initial two years of the set-aside period. The final, construction phase of the project will be carried out in the third, fourth and fifth years of the set-aside period. You have requested an initial set-aside of \$w for the fiscal year ending March 31, 20\* \*, with additions of \$x, \$y, and \$z, for the fiscal years March 31, 20\* \*\*, March 31, 20\* \*\* and March 31, 20\* \*\*, respectively, the total set-aside requested being \$v. The set aside requested for each year is expected to be sufficient to ensure that you qualify that year as a private operating foundation under section 4942(j)(3).

You expect that the project will be completed by December 31, 20\* \*\*, and you have affirmed that all the amounts to be set aside will actually be paid within 60 months of the date of the first set-aside.

## BASIS FOR OUR DETERMINATION

Internal Revenue Code section 4942(g)(2)(A) states that an amount set aside for a specific project, which includes one or more purposes described in section 170(c)(2)(B), may be treated as a qualifying distribution if it meets the requirements of section 4942(g)(2)(B).

Section 4942(g)(2)(B) of the Code states that an amount set aside for a specific project will meet the requirements of this subparagraph if, at the time of the set-aside, the foundation establishes that the amount will be paid within five years and either clause (i) or (ii) are satisfied.

Section 4942(g)(2)(B)(i) of the Code is satisfied if, at the time of the set-aside, the private foundation establishes that the project can better be accomplished using the set-aside than by making an immediate payment.

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(b)(1) of the Foundations and Similar Excise Taxes Regulations provides that a

private foundation may establish a project as better accomplished by a set-aside than by immediate payment if the set-aside satisfies the suitability test described in section 53.4942(a)-3(b)(2).

Section 53.4942(a)-3(b)(2) of the Foundations and Similar Excise Taxes Regulations provides that specific projects better accomplished using a set-aside include, but are not limited to, projects where relatively long-term expenditures must be made requiring more than one year's income to assure their continuity.

In Revenue Ruling 74-450, 1974-2 C.B. 388, an operating foundation converted a portion of newly acquired land into a public park under a four-year construction contract. The construction contract payments were to be made mainly during the final two years. This constituted a "specific project." The foundation's set-aside of all its excess earnings for four years was treated as a qualifying distribution under Internal Revenue Code section 4942(g)(2).

#### WHAT YOU MUST DO

Your approved set-aside(s) will be documented on your records as pledges or obligations to be paid by the date specified. The amounts set aside will be taken into account to determine your minimum investment return under Internal Revenue Code section 4942(e)(1)(A), and the income attributable to your set aside(s) will also be taken into account in computing your adjusted net income under section 4942(f) of the Code.

#### ADDITIONAL INFORMATION

This determination is directed only to the organization that requested it. Internal Revenue Code section 6110(k)(3) provides that it may not be used or cited as a precedent.

Please keep a copy of this letter in your records.

If you have any questions, please contact the person listed in the heading of this letter.

Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements