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

200411050

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Uniform Issue List
4942.03-05
4942.03-07

Date: DEC 17 2003

Contact Person:

Identification Number:

Telephone Number:

T:EO:B4

Employer Identification Number:

Legend:

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Dear Sir or Madam:

We have considered M's ruling request dated September 9, 2003, wherein M seeks approval of a proposed set-aside of funds in the amount of $1,500x, to be treated as qualifying distributions under section 4942(g)(2) of the Internal Revenue Code, for its taxable year ending December 31, 2003.

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

M has approved a $1,500x challenge grant ("Grant") to N, the largest private institution of higher education in the city of O, P. N serves over 20x students through a wide variety of educational programs and services at both the graduate and undergraduate levels. The matching funds in the set-aside request are a specific component of a larger multi-year grant, in excess of $2,500x, containing both the endowment challenge and program support.

M has a long history of developing challenge grants and strategic support initiatives for educational programs. Under its educational support, M has established a focus on entrepreneurship. Beginning in 1981, M established a series of entrepreneurship chairholders and professorships at five Q colleges and universities. The number of M funded education positions has grown to twelve. M has also provided single and multi-year program support grants on a national level to colleges, universities, and a national educators organization dedicated to developing and promoting entrepreneurship education. Program development has extended beyond campus: programs now also actively involve community business owners, positively impacting economic development within some of O's underserved communities.

M has been providing program, endowment, and specialized scholarship support to N for over 20 years to effect progressive growth, particularly in the entrepreneurship program. Initial grants focused on raising student awareness, which led to the establishment of an endowed Chair of Entrepreneurship in 1986 and the development and expansion of specialized curricula. Subsequent grants focused on specific projects, additional curriculum development, faculty and student conference support, as well as educational support programs for community small business owners. Other grants endowed need-based academic scholarships for Hispanic undergraduate students and provided capital support for the bookstore.

The Grant which is the subject of the set-aside request is the largest and most comprehensive grant made by M to N. These funds will establish R, an academic center devoted to entrepreneurship, in an identified college of N. M's objective is to launch R and to help raise an additional $1,500x for an endowment to sustain R's programs. R "represents a new phase in the entrepreneurship program of N by going beyond the academic program to offer mentoring, consultation and direct practice experience for students, alumni and community business owners."

The Grant is a five-year grant containing both program and matching support to create and launch the R programs and to establish an endowment that will enable R to be self-sustaining at the end of the grant period. The Grant provides funds in two parallel distributions that work in tandem to create the program and the endowment.

The operating portion, not a part of this set-aside request, provides working funds for launch and program delivery during the initial five years of R operations. During that period, M will provide annual operating funds. M views the two grant components as "strategically linked and has completed this agreement with N on that basis."

The set-aside request focuses on the endowment portion of the Grant which will seed the needed $3,000x endowment by providing a dollar-for-dollar challenge of up to $1,500x. These funds will be distributed as matched by other funds secured by R. The agreement requires that M distribute these matching funds only on the basis of actual new donations received and not as pledged support. This will assure that actual hard-dollar support is available.

The President of M states his intention to complete the Grant to N within the prescribed five-year set-aside period and to "hopefully encourage the completion in less time." M's trustees believe that a set-aside will boost N's promotional efforts and the challenge value of the Grant, help assure the availability of funds, and provide the flexibility to accelerate payouts during the program period.

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. Matching grant programs are specifically mentioned.

The proposed set-aside for M's taxable year ending December 31, 2003, is in furtherance of M's charitable purposes. It is a continuation of M's earlier funding of educational programs, but particularly in the field of entrepreneurship. The Grant described above is the largest one which M has furnished to N and will help establish R, an academic center devoted to the promotion of business entrepreneurship. It is characterized as an endowment. The challenge nature of the Grant should serve to enhance N's promotional efforts. The set-aside will also complement the furnishing by M of substantial operating funds to help get R off the ground. Finally, the President of M states his intention to hopefully complete the payout of set-aside funds in less than the prescribed five-year period.

Based on the foregoing, we rule that the set-aside of 1,500x dollars on M's books and records for its taxable year ending December 31, 2003, 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, 2003.

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)).

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 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,

We are sending a copy of this ruling to the 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,

Joseph Chasin

Joseph Chasin
Acting Manager, Exempt
Organizations Technical Group 4