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

200023050

Date: MAR 10 2000

Contact Person:

Significant Index Number: 4942.03-07

Contact Number:

OP:E:ED:T2

Legend:

F =
C =
x =

Dear Sir or Madam:

This is in reply to your ruling request of March 15, 1999, requesting that your proposed grant will be a qualifying distribution under section 4942(g)(1)(A) of the Internal Revenue Code.

F, your organization, is exempt from federal income tax under section 501(c)(3) of the Code, and is a private foundation under section 509(a) of the Code.

C is exempt from federal income tax under section 501(c)(3) of the Code, is not a private foundation under section 509(a)(1) of the Code, and is not controlled by F or any substantial contributor to F.

F will put "x" dollars of its funds into an escrow account with a bank as the escrow agent. Under the terms of the escrow agreement, the grant funds in the escrow will be released to the publicly supported charity C, specifically chosen by F, if, within two years, C raises a particular sum of money for itself through its own fundraising. If C does not raise this required challenge grant sum, F's grant funds in the escrow account will be paid to another public charity to be selected by F prior to expiration of the time period of the escrow for the challenge grant. The escrow agreement requires that all of its funds, and any income therefrom, will never revert back to F. The income from the escrow account will be payable to C. Such income can also be counted in C's fundraising goal for this challenge grant. The terms of the escrow agreement are reflected in a similar grant agreement between F and C. F specifies, and charity C agrees, that C must use the grant funds as an endowment for C, in which only the income on the funds, and not the principal, may be expended by C.

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F's grant also requires that any charity receiving any funds from the escrow account must meet the qualifying distribution requirements for the grantee under sections 4942(g)(1)(A)(i) and 4942(g)(1)(A)(ii) of the Code, in that the grantee must not be an organization controlled by F or any of F's disqualified persons under section 4946 of the Code, and the grantee must not be a private foundation under section 509(a) of the Code unless the grantee is also an operating foundation under section 4942(j)(3) of the Code.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for charitable and/or the other exempt purposes stated in that section.

Section 509(a) of the Code describes certain organizations exempt from federal income tax under section 501(c)(3) of the Code that are private foundations subject to the private foundation provisions of Chapter 42 of the Code. Sections 509(a)(1), 509(a)(2), and 509(a)(3) of the Code describe organizations exempt from federal income tax under section 501(c)(3) of the Code that are not private foundations.

Section 4942 of the Code imposes excise tax on any private foundation that does not make qualifying distributions of its annual distributable amount for exempt purposes.

Section 4942(g)(1)(A) of the Code provides that, in general, a qualifying distribution is any amount, including reasonable and necessary administrative expenses) paid to accomplish one or more of the purposes described in section 170(c)(2)(B) of the Code, which includes charitable purposes. That section further provides that a private foundation does not make any qualifying distribution under section 4942(g) of the Code where the distribution is a contribution to: (i) an organization controlled by the grantor foundation or by one or more of the grantor's disqualified persons, or (ii) any private foundation that is not also an operating foundation under section 4942(j)(3) of the Code.

Section 53.4942(a)-3(b)(2) of the Foundation and Similar Excise Taxes Regulations provides that a grant by a private foundation will be a qualifying distribution under section 4942(g) of the Code if the grant is its income set-aside by the grantor private foundation for no more than five years as part of the grantor's matching grant for a grantee public charity.

Section 4942(g)(2)(A) of the Code provides that an amount of income that is set aside for a specific project within one or more purposes of section 170(c)(2)(B) of the Code may be treated as a qualifying distribution if the amount meets the set-aside requirements of section 4942(g)(2)(B) of the Code.

Section 4942(g)(2)(B) of the Code provides, in pertinent part, 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 private foundation establishes to the satisfaction of the Secretary that the amount set aside will be paid for the specific project within five years and that the suitability test for a set-aside under section 4942(g)(2)(B)(i) of the Code is met.

Section 4942(g)(2)(B)(i) of the Code provides a suitability test in which the private foundation at the time of the set-aside must establish to the satisfaction of the Secretary that the specific project is one that can better be accomplished by the set-aside of income rather than by the immediate payment of funds.

Section 53.4942(a)-3(b)(1) of the regulations provides that the amounts of income set aside for a specific project for one or more of the purposes in section 170(c)(1) or 170(c)(2)(B) of the Code may be treated as qualifying distributions for the tax year(s) in which such amounts are set aside, but not in the tax year in which actually paid, if the requirements of section 4942(g)(2)(B)(i) of the Code are met, the 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 the set-aside otherwise meets the suitability test of section 53.4942(a)-3(b)(2) of the regulations.

Section 53.4942(a)-3(b)(2) of the regulations provides that its suitability test for a set-aside is met if the foundation establishes that the specific project is one in which relatively long-term grants or expenditures must be made. This regulation allows, as a suitable specific project, a set-aside of income by a foundation "where grants are made as part of a matching-grant program."

Section 53.4942(a)-3(b)(7)(i) of the regulations provides that a private foundation must obtain Internal Revenue Service approval of its set-aside of income under the suitability test by applying before the end of the tax year in which the amount is set aside.

Section 4945 of the Code imposes excise tax on any amount paid or incurred by a private foundation that constitutes a "taxable expenditure" under section 4945(d) of the Code.

Section 4945(d)(4) of the Code provides that a taxable expenditure means any amount paid or incurred by a private foundation as a grant to an organization unless such organization is described in section 509(a)(1) 509(a)(2) or 509(a)(3) or is an exempt operating foundation under 4940(d)(2) or (B) the grantor private foundation exercises expenditure responsibility with respect or such grant in accordance with section 4945(h) of the Code.

Section 4945(h) of the Code on expenditure responsibility requires that the grantor private foundation must obtain reports from the grantee as to the grantee's uses of the grant.

Section 53.4945-5(c)(1) of the regulations provides that, in the case of a grant described in section 4945(d)(4) of the Code, the granting private foundation must require reports on the use of the funds, compliance with the terms of the grant, and the progress made by the grantee toward achieving the purposes for which the grant was made. The grantee must make its reports as of the end of its annual accounting period within which the grant, or any portion thereof, is received and as of all such subsequent periods until the grant funds are expended in full or the grant is otherwise terminated. Such reports shall be furnished to the grantor within a reasonable period of time after the close of the annual accounting period of the grantee for which such reports are made. Within a reasonable period of time after the close of its annual accounting period during which the use of the grant funds is completed, the grantee must make a final report with respect to all expenditures made for such grant funds (including salaries, travel, and supplies) and indicating the progress made toward the goals of the grant. The grantor need not conduct any independent verification of such reports unless it has reason to doubt their accuracy or reliability.

You have timely sought approval of your set-aside of income in advance of the time when the amounts of income are to be set aside, as required by section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(7)(i) of the regulations.

Your set-aside for this challenge grant will be for a specific project within the charitable purposes of section 170(c)(2)(B) of the Code, as required by section 4942(g)(2)(A) of the Code and section 53.4942(a)-3(b)(2) of the regulations.

You represent that your amounts of income to be set aside for this specific challenge grant project will be paid out for this project within no more than 60 months from the time when the first amount is set aside, as required by section 4942(g)(2)(B) of the Code and section 53.4942(a)-3(b)(1) of the regulations.

Your project is better accomplished by this set-aside of income, rather than by immediate payment, under the suitability test of section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations because this challenge grant is a matching grant allowed as a suitable specific project for the set-aside of income.

Thus, your specific project of providing funds for this challenge grant meets the requirements for a set-aside of income under the suitability test of section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations.

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Your foundation, F, will pay the amount of "x" dollars to the bank escrow account which will be for no longer than a two year period. This payment by F is an amount set aside by F for a charitable purpose. F's payment constitutes a challenge or matching grant, which will later be actually paid to either the primary donee C or, if the matching funds are not raised by C, then to an alternative public charity, either of which will satisfy the requirements for a qualifying distribution grantee under section 4942(g)(1)(A) of the Code.

Accordingly, we rule that F's payment of "x" dollars into the bank escrow account will be a set aside for a grant to publicly supported exempt charity C, or another alternative publicly supported exempt charity, and will be a qualifying distribution by F under section 4942(g)(1)(A) of the Code in F's tax year in which F sets aside such grant amount into the bank escrow account.

Because F's grant is paid to the bank escrow account, F's payment to the bank is described in section 4945(d)(4) of the Code and, thus, F must exercise expenditure responsibility under section 4945(h) of the Code with respect to its grant.

Section 53.4942(a)-3(b)(8) of the regulations provides that any set-aside approved by the Internal Revenue Service must be evidenced by the entry of a dollar amount in your books and records as a pledge or obligation to be paid at a future date or dates. Further, the amount of the set-aside must be taken into account in determining your minimum investment return (see section 53.4942(a)-2(c)(1) of the regulations), and any income attributable to a set-aside must be taken into account in computing your adjusted net income (see section 53.4942(a)-2(d) of the regulations). Also, the income attributable to this set-aside will be a qualifying distribution in the tax year when it is paid from the escrow to the qualified charitable organization under section 4942(g)(1)(A) of the Code.

Because this letter could help to resolve any questions, please keep it in your permanent records and include a copy in your private foundation's annual return on Form 990-PF.

This ruling letter 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.

Sincerely,

(signed) Garland A. Carter

Garland A. Carter
Manager, Exempt Organizations
Technical Group 2

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