Rev. Rul. 74-450, 1974-2 C.B. 388

Operating private foundation; qualifying distribution; set-aside; wildlife sanctuary enlarged. An operating private foundation's conversion of a portion of its newly acquired land into an extension of its existing wildlife sanctuary and the remainder into a public park under a four-year construction contract under which payments are mainly during the last two years constitutes a 'specific project' and the foundation's set-aside of all its excess earnings for four years, for which it files a timely justifying application with the Service, will be treated as a qualifying distribution under section 4942(g)(2) of the Code, in applying the income test prescribed by section 4942(j)(3)(A), for each taxable year in which such earnings are set aside and remain unexpended.

Advice has been requested concerning the extent to which income set aside in the manner described below may be treated as qualifying distributions in applying the income test for operating foundations that is prescribed by section 4942(j)(3)(A) of the Internal Revenue Code of 1954.

A private foundation, which is exempt under section 501(c)(3) of the Code, was organized to restore and perpetuate wildlife and game on the North American continent, and to foster such activities by others. The foundation has for many years maintained a wildlife sanctuary on its own land and distributed excess income from its investments to other exempt charitable organizations.

Shortly after the beginning of the current taxable year, the foundation received a bequest of a contiguous tract of land formerly used for farming purposes which doubled its total land holdings. The trustees in control of the foundation's affairs thereupon committed a portion of this farm land for conversion into an extension of its wildlife sanctuary and the balance for conversion into a public park. The combined conversion project will entail extensive tree planting, the building of a large earthen dam, and the construction of various fences, roads, and other public service facilities. It would currently be possible for the foundation to have all the work required to complete the entire farm land conversion project performed under a single four-year contract at an agreed total price of 120x dollars, no more than about 15x dollars of which would become payable in either of the first two years.

The foundation's productive investments are currently yielding a net income of 45x dollars per year. Its current annual operating expenses, which include the cost of operating the present wildlife sanctuary and the excise taxes imposed under section 4940 of the Code, amount to 15x dollars.

In the belief that the charitable objectives of the foundation demand that it enter into a long-term conversion contract of the type outlined above, its trustees have directed that all its available excess earnings for a four-year period commencing with the current year be set aside and held as a separate fund with which to make whatever installment payments may fall due under the conversion contract from year to year. With a view to going forward on the basis, the foundation has also filed a timely application for Internal Revenue Service approval of such a set-aside under section 4942(g)(2) of the Code. For this purposes, it has supplied the Service with a detailed description of the complete conversion project outlined above. Its supporting material includes a statement generally locating all the physical facilities that are to be constructed and otherwise substantiating 120x dollars as a reasonable estimate of the overall cost.

The application for Service approval further shows that the total work required to convert the farm land to use as a wildlife sanctuary and public park will take approximately 4 years. It also includes a duly authorized representation by the chairman of its board of trustees that, in any event, all income earmarked and set aside pursuant to the proposed plan will be fully expended within a five-year period commencing with the date of the foundation's initial set aside to convert its newly acquired farm land in the manner described above.

Section 4942(j)(3)(A) of the Code prescribes one of the essential conditions that a private foundation must meet in order to qualify as an operating foundation. This condition is that the foundation make qualifying distributions whose combined aggregate amount is at least equal to substantially all of its adjusted net income.

Section 4942(g)(2) of the Code provides that an amount set aside for a specific project which comes within one or more of the purposes described in section 170(c)(2)(B) may be treated as a qualifying distribution, but only if, at the time of the set-aside, the private foundation establishes to the satisfaction of the Secretary or his delegate 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 than by immediate payment of funds.

Under section 53.4942(a)-3(b) of the Foundation Excise Tax Regulations, specific projects of the kind that might qualify for a set-aside are those involving relatively long-term grants or expenditures that must be made in order to assure the continuity of particular charitable projects; for example, a plan to erect a building to house a direct charitable, educational, or other similar exempt activity of the foundation.

Section 53.4942(a)-3(b) of the regulations also provides that to obtain approval for a set-aside the foundation must furnish the Commissioner with a timely written statement setting out:

(1) the nature and purpose of the specific project and the

amount of the set-aside;

(2) the amounts and approximate dates of any planned additions to the set-aside after its initial establishment;

(3) the reasons why the project can be better accomplished by such set-aside than by the immediate payment of funds;

(4) a detailed description of the project, including estimated costs and sources of future funds, and the location of any physical facilities to be acquired or constructed as part of the project; and

(5) a statement by an appropriate foundation manager that the amounts to be set aside will actually be paid for the specific project within a specified period of time which ends not more than 60 months after the date of the first set-aside.

Section 53.4942(b)-1(b) of the regulations provides in part that any amount set aside by a foundation for a specific project, such as the acquisition and restoration, or construction, of additional buildings or facilities which are to be used by the foundation directly for the active conduct of the foundation's exempt activities, shall be deemed to be a qualifying distribution expended directly for the active conduct of the foundation's exempt activities if such amount has initially been shown to meet the set-aside requirements provided for in paragraph (b) of section 53.4942(a)-3.

Consummation of the foundation's plan to convert its newly acquired farm land into an extension of its existing wildlife sanctuary and a public park will serve its charitable and educational purposes all of which come within section 170(c)(2)(B) of the Code. Such plan thus constitutes a 'specific project' of the class for which an amount may be set aside and treated as a qualifying distribution under section 4942(g)(2), if such amount is further shown to meet the additional requirements of that statutory provision.

As a matter of simple calculation the foundation's existing sources of income are sufficient to accomplish a complete funding of the estimated total cost in approximately 48 months, along with a continuing fulfillment of all other outstanding commitments; and that estimate likewise appears to be reasonably consistent with the detailed description of the contemplated construction and conversion work being undertaken. It is accordingly concluded that the full amount of such estimate will actually be paid for the specific project within the requisite period of 60 months.

Entering into the above-described contractual agreement would commit the organization to a major unitary project costing substantially more than the foundation's total available income on an annual basis, notwithstanding the fact that a major part of the required disbursement would not fall due until after the entire project was well along towards completion. Therefore, the proposed undertaking is one which can be better accomplished by a set-aside than by the immediate payment of funds and that all current income items specifically earmarked and set aside on the accounting records of the foundation for use in fulfilling the above-described conversion plan and program will thereupon become eligible for treatment as qualifying distributions under section 4942(g)(2) of the Code with respect to any taxable year within which they are so set aside and as of the end of which they remain unexpended.

Even though a private foundation considers itself within the scope of this Revenue Ruling, it must, in order to obtain approval of a set-aside, submit a request to the Commissioner of Internal Revenue, T:MS:EO, in accordance with the instructions provided in section 53.4942(a)-3(b)(3) of the regulations.