Internal Revenue Service
Director, Exempt Organizations

Department of the Treasury
P.O. Box 2508 - Room 4122
Cincinnati, Ohio 45201

Release Number: **200946060**
Release Date: 11/13/09
Date: 8/19/2009

Employer Identification Number:

Person to Contact - ID#:

Contact Telephone Numbers:
Phone
Fax

UIL
4942.03.07

LEGEND
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Dear

By letter dated A, you requested a ruling that a set-aside in the amount of $s meets the requirements of Section 4942(g)(2)(B)(i) and accordingly constitutes a qualifying distribution under section 4942(g)for the taxable year ending December 31, 200 .

FACTS

Background: You are a corporation established under the laws of the State of B, exempt from federal income tax under section 501(c)(3) of the Code and classified as a private foundation under section 509(a).

You were created for the purpose of alleviating poverty and community deterioration by making investments in the form of equity, loans, guarantees and deposits in selected banks, microfinance institutions, cooperatives and social enterprise projects worldwide. You accomplish this primarily by providing various financial products, including loan guarantees, loans, equity investments, and deposit insurance, to financial institutions in developing countries, and by making deposits in them, on condition that they utilize their enhanced lending capacity to support self-help undertakings, such as micro enterprises and small businesses, among economically distressed populations. You currently direct assistance to countries in and , and parts of .

You received a favorable ruling on a similar set-aside in the recent past, a set-aside of $x for the taxable year ending December 31, 200 . While the current request was under consideration, you notified Service personnel that in the first quarter of 200 you decided not to proceed with the specific project for which you had made the earlier set-aside. You explained that the project was initially delayed by increasing political disorder in K beginning at the end of 200 and finally abandoned due to drastic deterioration if economic conditions in K, with rapid inflation making home mortgages unaffordable for the low-income segment that the project was targeting.

Requested set-aside: The project for which you have requested the set-aside is the establishment of D and E, two microfinance companies which will make loans to low income individuals in urban and rural areas of F and G, respectively, to enable them to expand micro-enterprises, generating income for their families and supporting jobs creation for the poor. D and E will design lending programs that will target the low-income, financially underserved populations of F and G, focusing on women borrowers on the individual level and on micro-enterprises with the potential for job creation at the enterprise level. The first type of loan will fall in the $t range, the second type in the $u range.

You will make a grant of $v to C, a non-governmental organization formed under the laws of H with extensive experience in establishing and operating microfinance programs throughout the world. C will use the grant to make an equity investment in D. You will also make a grant of $v to I, C's separately organized local affiliate in G, with which it will make an equity investment in E. You will make equity investments of $w in each of D and E. Simultaneously, J, like yourself a domestic exempt private foundation, will make grants and equity investments that mirror your own: that is, grants of $v to C and to I, to fund their investments in D and E, and equity investments of $w in D and in E. C will then be 51% owner of D; I will be 51% owner of E. You will have a 24.5% interest in each of D and E; similarly, J will have a 24.5% interest in each entity.

You will exercise expenditure responsibility as described in section 4945(h) and section 53.4945(5)(b) of the Regulations with regard to your grants to C and I and your program-related investments in them.

Before the end of the taxable year ending December 31, 200 , you were ready to proceed with your equity investments in C and I based on the terms and conditions that had been agreed upon among the investors. However, C had been unable to obtain confirmation from its local counsels in F and G about the precise licensing requirements for the new microfinance entities in those countries. Complying with all local regulatory and licensing requirements is one of your preconditions for making the grants to C and I, and the equity investments in D and E. Thus you were, through circumstances beyond your control, prevented from meeting your funding commitment to the project before the end of 200 . The final confirmation that the prerequisites of funding have been met is likely to come in early 200 . Your project can be better accomplished through a set-aside, which will permit you to postpone the payment of committed funding until all of your prudent funding requirements are satisfied. The funds will actually be disbursed before the end of 200 .

LAW

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code that are private foundations.

Section 4942(g)(1) of the Code defines "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; (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 within one or more purposes of section 170(c)(2)(B) may be treated as a qualifying distribution if the amount meets the requirements of section 4942(g)(2)(B).

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 the amount set aside will be paid for the specific project within five years, and the specific project is one that can better be accomplished by the set-aside of income rather than by the immediate payment of funds (the "suitability test").

Section 4945(d)(4) states that the term "taxable expenditure" includes any amount paid or incurred by a private foundation as a grant to an organization unless such organization is a certain type organization described in section 509(a)(1),(2) or (3), is an exempt operating foundation, or the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h).

Section 4945(h) defines the expenditure responsibility referred to in subsection (d)(4) as meaning that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and 3) to make full and detailed reports with respect to such expenditures to the Secretary.

Section 53.4942(a)-3(a)(2)(i) includes in the definition of "qualifying distribution" program-related investments, as defined in section 4944(c) paid to accomplish one or more purposes described in section 170(c)(1) or (2)(B).

Section 53.4942(a)-3(a)(2)(iii) defines as a qualifying distribution any amount set aside within the meaning of paragraph (b) of section 3.

Section 53.4942(a)-3(b)(1) of the Foundation and Similar Excise Tax 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) and paragraph (b) are satisfied. The requirements of paragraph (b) are satisfied if the foundation establishes to the satisfaction of the Commissioner the amount set aside will be paid for the specific project within 60 months after it is set aside, and (i) the set-aside otherwise meets the suitability test of section 53.4942(a)-3(b)(2) or (ii) the foundation satisfies the cash distribution test.

Section 53.4942(a)-3(b)(2) of the regulations provides that the suitability test for a set-aside is met if the foundation establishes 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 cites as an example of a suitable project a plan to fund a specific research program that is of such magnitude as to require an accumulation of funds before beginning the research, even though not all of the details of the program have been finalized.

Section 53.4942(a)-3(b)(7)(i) 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 4944(c) provides that investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes.

Section 53.4945-5(a)provides that under 4945(d)(4) the term ``taxable expenditure'' includes any amount paid or incurred by a private foundation as a grant to an organization (other than an organization described in section 509(a) (1), (2) or (3)),unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h).

Section 53.4945-5(b) sets forth the specific procedures which a private foundation must follow to be considered to be exercising ``expenditure responsibility'' under section 4945(h).

Rev. Rul. 68-117, 1968-1 C.B. 251, describes an organization formed to help poor rural inhabitants of developing countries by various means including arranging credit for farmers on reasonable terms with a realistic repayment schedule.

Rev. Rul. 74–587, 1974–2 C.B. 162, describes a nonprofit organization that qualified for exemption under IRC 501(c)(3) by providing low-cost loans to businesses in economically depressed areas. Because of lack of development capital, limited entrepreneurial skills of business owners, social unrest and instability in the area, and depressed economic conditions in the larger region, many businesses in the target areas had declined, fallen into disrepair, or failed. The organization combats these conditions by providing working capital, either through low-interest loans or purchases of equity interests, to businesses that cannot obtain commercial financing. The terms of financing were reasonably related to the needs of the particular businesses, and the organization disposed of any equity interest as soon as the particular business' success was reasonably assured.

ANALYSIS

You have sought timely approval of your set-asides of income in accordance with Section 53.4942(a)-3(b)(7)(i).

As required by Section 4942(g)(2)(A) of the Code and Section 53.4942(a)-3(b)(1) of the Regulations, your proposed set-aside will be used to accomplish purposes described in section 170(c)(2)(B) of the Code, namely, for the relief of the poor and distressed through economic development. See Rev. Rul. 68-117, 1968-1 C.B. 251, and Rev. Rul. 74–587, 1974–2 C.B. 162.

You have credibly represented that the amount set-aside for this specific project will be paid out within 60 months from the set-aside, as required by section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(1) of the regulations.

Your project is one that can better be accomplished by the set-aside of income rather than by the immediate payment of funds. Although you were prepared to disburse the funds before the end of 200 , you were prevented from doing so through circumstances beyond your control. Your own prudent funding procedures mandate that financial institutions must be in compliance with the laws of the countries in which they operate before you will release funds committed to them. In this instance, your local counsels in F and G were unable to provide confirmation that D and E met local regulatory and licensing requirements, making it impossible for you to make the planned disbursements before the end of 200 . You are like the organization in the above cited example from the Regulations, in that the project you have undertaken is of such magnitude that it has necessitated an accumulation of funds in advance, even though not all details of the program have been finalized.

We were considering the impact on your current request of the abandonment of the project in K for which a set-aside was approved for the year ending December 31, 200 . However, you have advised us that the 200 set aside amounts were distributed in early 200 , after the local counsels received confirmations from the Central Banks of F and G that the micro-financing companies were not required to obtain a license to proceed immediately with operations, allaying our concerns about the viability of the project.

Your project therefore satisfies the suitability test as set forth in Section 4942(g)(2)(B)(i)of the Code and Section 53.4942(a)-3(b)(2)of the Regulations.

RULING

Based on the foregoing, The set-aside of $s for the taxable year ending December 31, 2008, meets the requirements of Section 4942(g)(2)(B)(i) and accordingly constitutes a qualifying distribution under section 4942(g).

We direct your attention to Section 53.4942(a)-3(b)(8) of the regulations, entitled "Evidence of Set-Aside." This section provides that any set-aside approved by the Internal Revenue Service shall be evidenced by the entry of a dollar amount in the books and records of a private foundation 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 the foundation's 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 adjusted net income (see section 53.4942(a)-2(d) of the regulations).

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Internal Revenue Service. This ruling does not address the applicability of any section of Code or regulations to the facts submitted other than with respect to the sections described.

This ruling letter is directed only to the organizations that requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited as precedent.

Please keep a copy of this ruling letter in your permanent records.

A copy of this letter has been sent to your authorized representative.

If you have any questions about this ruling, please contact the persons whose name and telephone number are shown above in the heading of this letter.

Sincerely yours,

Robert Choi
Director, Exempt Organizations
Rulings and Agreements