4942.03-00

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

Date: JUN 12 2001

Contact Person:
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ID Number:
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Telephone Number:
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T:EO:B4

Employer Identification Number: **********

Legend:

The Foundation = **********
A= **********
X= **********
Y=**********

Dear Applicant:

This is in response to a letter of September 13, 2000, requesting three rulings on behalf of the Foundation with respect to the use of certain assets.

The Foundation received a determination letter, dated December 14, 1982, that it was a tax-exempt private foundation as described in sections 501(c)(3) and 509(a) of the Internal Revenue Code. Its stated purpose was to reduce educational deficiencies and lessen social and cultural tensions. Prior to the death of A, its founder, in 1998, it made grants to public charities assisting public school education.

Subsequent to the death of A, in 1998, the Foundation acquired two pieces of property, X and Y. It also acquired additional assets in the form of artwork, furnishings, and manuscripts as a result of a series of distributions from A's estate. Several paintings were distributed to the Foundation on January 12, 2000. The Foundation took possession of all the assets by May 2000. At that time it decided that instead of selling them, it would use them for charitable

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programs operated either by the Foundation or by other charitable organizations. To this end the Foundation expanded its board of trustees, purchased insurance coverage for the assets, determined short-term charitable programs for its new assets and commenced planning activities. It also hired consultants with experience in construction projects for facilities of not-for-profit organizations to make recommendations as to repairs; improvements and maintenance which would be required in order to make X, a property which includes residential buildings, recreational facilities and gardens, suitable for public uses. These included upgrading heating and air conditioning, renovation of parts of the structures, obtaining a zoning variance, and devising a plan for the use of X, such as conference center, a public park or open space, an archive, or environmental center.

To date, the Foundation has hosted conferences, meetings and other events at X with several public charities, and governmental entities. It has also entered into a lease with a public charity that permits the public charity to lease one of the recreational facilities free of charge for seven to eight months of the year.

With regard to the art collection, the Foundation has determined that it is not practical to open X to the general public for the purposes of viewing the art. It has loaned several of its most valuable paintings to three art museums, and signed an agreement with another museum to exhibit some of its paintings for a year, beginning July 25, 2000. The Foundation has also assembled a team of conservators and students to implement a conservation plan for the art collection. A database has been developed to catalog the tangible personal property. The archives, which contain letters from historically important individuals, require cataloging, conservation, and repair.

The Foundation is working with a consultant to determine the long-range disposition of Y while putting it to immediate charitable use in the interim. Y contains buildings of historic significance and land of environmental significance. The Foundation is negotiating with two public charities in the hope that Y will ultimately be a center for environmental and cultural conservation. The Foundation has hosted more than thirty visitors from public charities, universities, private foundations and government agencies that have undertaken study and research at Y.

The Foundation has asked the Service to rule that:

1. Upon receiving title to the assets described above, the Foundation has used them or held them directly in carrying out its exempt purpose; and therefore these assets may be excluded in determining the Foundation's minimum investment return pursuant to section 4942(e)(1) of the Code.

2. The expenses and costs incurred in maintaining and preparing the assets described above for their ultimate charitable use constitutes "qualifying distributions" within the meaning of section 4942(g) of the Code.

3. The assets described above are in use (or held for use) directly in carrying out the Foundation's exempt purposes within the meaning of section 4942(e) of the Code by the implementation of the activities described above.

Section 4942(a) of the Code imposes on private foundations (other than "operating foundations" as defined in section (j)(3)) an excise tax of fifteen percent on a foundation's undistributed income.

Section 4942(c) of the Code defines the term "undistributed income" as the amount by which the distributable amount exceeds its "qualifying distributions." The amount of income required to be distributed by a private foundation with respect to a particular taxable year is its "distributable amount."

Section 4942 (d) of the Code defines the term "distributable amount" as an amount equal to (1) the sum of the "minimum investment return" increased by certain qualifying distributions recouped by an organization and reduced by (2) the sum of taxes imposed on the private foundation under subtitle A and section 4940.

Section 4942(e)(1) of the Code defines the term "minimum investment return" as five percent of the excess of (A) the aggregate of fair market value of all assets other than those which are used (or held for use) directly in carrying out the foundation's exempt purposes, over (B) the acquisition indebtedness (determined under section 514(c)(1) without regard to the taxable year in which the indebtedness occurred. Thus, an organization may exclude from its calculation of "minimum investment return" the value of assets which are used (or held for use) directly in carrying out the organization's exempt purpose.

Section 4942(g)(1)(A) of the Code provides that for the purposes of this section, the term "qualifying distribution" generally means any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B) or any paid to acquire an asset used to (or held for uses) directly in carrying out one or more purposes described in section 170(c)(2)(B). The purposes described in section 170(c)(2)(B) are, in part, religious, charitable, scientific, literary, or educational.

Section 53.4942(a)-2(c)(2)(v) of the Foundation and Similar Excise Taxes Regulations excludes from the assets taken into account in determining the "minimum investment return" any asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B). The purposes described in section 170(c)(2)(B) are, in part, religious, charitable, scientific, literary or educational.

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Section 53.4942(a)-2(c)(3)(I) of the regulations provides that an asset is "used (or held for use) directly in carrying out the foundation's exempt purpose "only if the asset is actually used by the foundation in the carrying out of the charitable educational, or other similar purpose which gives rise to the exempt status of the foundation, or the foundation owns the asset and establishes to the Commissioner's satisfaction that its immediate use for such exempt purpose is not practical (based on the facts and circumstances of the particular case) and that definite plans exist to commence such use within a reasonable period of time.

Section 53.4942(a)-2(c)(3)(ii) of the regulations provides examples of assets which are used (or held for use) directly in carrying out a foundation's exempt purpose. These may include real estate used by the foundation directly in its charitable, educational, or other similar exempt activities, any physical facilities used in such activities, such as paintings or other works of art owned by the foundation which are on public display, and property leased by a foundation in carrying out its charitable, educational, or other similar exempt purpose at no cost or at a nominal rent to the lessee or for a program–related purpose (within the meaning of section 4944(c)). In general, whether a particular asset is being held for the production of income or investment rather than used or held for use directly by the foundation is a question of fact.

Rev. Rul. 75-470, 1975-2 C.B. 207 holds that an organization formed for the purpose of promoting an appreciation of history through the acquisition, restoration and preservation of homes, churches and other buildings of architectural or historical significance, and to open these building for viewing by the general public qualifies for exemption under section 501(c)(3).

Rev. Rul. 86-49, 1986-1 C.B. 243 holds that an organization formed for the purpose of preserving the historic or architectural character of a community though acquisition and subsequent disposition of the property subject to restrictive covenants qualifies as a charitable organization under section 501(c)(3) of the Code.

Rev. Rul. 74-498, 1974-2 C.B. 387 holds that a collection of paintings owned by a foundation formed to further the arts that is loaned under an active loan program for exhibition in museums, universities and similar institutions, is being used directly in carrying out the foundation's exempt purposes within the meaning of section 4942(v)(1)(A) of the Code, and the value of the paintings is excluded in computing the foundation's minimum investment return.

Rev. Rul. 68-572, 1969-2 C.B. 119 provides, in relevant part that a lease between two parties, both of whom are exempt under section 501(c)(3) will be considered as substantially related to the charitable purpose of the lessor where

the lease is substantially below market value and there is a close relation between the purposes and functions of the parties.

Rev. Rul. 75-207, 1975-1 C.B. 361 determined that a private foundation which preserved an island of ecological significance in its natural state, limited public access to researchers, and had working relations with public and private educational systems was being used directly to carry out the Foundation's exempt purposes under section 4942(e)(1)(A) of the Code.

The collection of paintings are exhibited in several museums under an active loan program in a manner such as the one described in Rev. Rul. 74-498, 1974-2 C.B. 387, and are thus being used directly in carrying out the Foundation's exempt purposes.

The leasing of one of X's recreational facilities to a public charity free of charge for seven to eight months of the year is a below-market value lease to an exempt organization, as described in Rev. Rul. 68-572 and is substantially related to the foundation's charitable purpose,

Y is of ecological significance in its natural state; and although it is not open to the general public, it is currently in use for educational and conservation purposes, as described by Rev. Rul. 75-207.

Foundation assets that are not currently in use for their ultimate charitable purposes are being prepared for their ultimate charitable use. Preparation in this case includes repairs, renovations and restorations that are necessary before the assets can be put into public uses. In light of the size and type of assets involved the Foundation's timetable seems reasonable.

Based on the application of the above principles to the facts presented in the ruling request, we rule as follows:

1. That ever since the Foundation received title to the assets described above it has used them or held them directly in carrying out its exempt purpose. Therefore they may be excluded in determining the Foundation's minimum investment return.

2. That the expenses and costs incurred in maintaining and preparing these assets for their ultimate charitable use constitutes "qualifying distributions" within the meaning of section 4942(g).

3. That the Foundation's implementation of charitable activities and proposed plans and timetable regarding the ultimate charitable use of the assets will not affect the characterization of the assets as being used (or held for use) directly in carrying out the Foundation's exempt purposes.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based. Any changes that may have bearing on your tax status should be reported to the Service.

We are sending a copy of this ruling to the Ohio TE/GE office. Because this letter could help resolve any questions about your exempt status, you should keep it with your permanent records.

If you have any questions, 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(j)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

Sincerely yours,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4