

which such judicial proceeding is terminated during which the governing instrument or any other instrument does not permit compliance with such provisions. Thus, the exception described in subparagraph (1)(ii) of this paragraph applies after 1971 only for taxable years during which such judicial proceeding is pending. Accordingly, beginning with the first taxable year following the taxable year in which such judicial proceeding is terminated, such foundation will be required to meet the requirements of section 4942 and the regulations thereunder (and be subject to the taxes provided upon failure to do so) except to the extent such foundation is required to accumulate income as described in subparagraph (1)(i) of this paragraph, even if the governing instrument continues to prohibit invasion of capital or corpus. In any case where a foundation's governing instrument or any other instrument requires accumulation of income as described in subparagraph (1)(i) of this paragraph beginning with the first taxable year following the taxable year in which such judicial proceeding is terminated, the distributable amount (as defined in paragraph (b) of this section) for such foundation shall be reduced by the amount of the income required to be accumulated. Therefore, if the foundation's adjusted net income for any taxable year equals or exceeds its minimum investment return for such year, the accumulation provisions will be given full effect. However, if the minimum investment return exceeds the adjusted net income for any taxable year, the foundation will be required to distribute such excess for such year. For purposes of this paragraph, a judicial proceeding will be treated as pending only if the foundation is diligently pursuing its judicial remedies and there is no unreasonable delay in such proceeding for which the private foundation is responsible.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). X, a private foundation organized in 1930, is required by the mandatory terms of its governing instrument to accumulate 25 percent of its adjusted net income and to add such accumulations to corpus. The instrument also prohibits distribu-

tion of corpus for any purpose. On July 13, 1971, X instituted an action in the appropriate State court to reform the instrument by deleting the accumulation and corpus provisions described above. If the court's final order reforms the accumulation provisions to allow distributions of income sufficient to avoid the imposition of a tax under section 4942, then section 4942 applies to X, regardless of the court's action with respect to the corpus provisions. However, if the court rules that the accumulation provision may not be reformed, section 4942 applies to X only to the extent provided for in subparagraph (3) of this paragraph, regardless of the court's action with respect to the corpus provision.

Example (2). Private foundation Y was created by the will of A who died in 1940. Y's governing instrument requires that 40 percent of Y's adjusted net income be added to corpus each year. In an action commenced prior to December 31, 1971, a court of competent jurisdiction rules that this accumulation provisions must be complied with. In Y's succeeding taxable year its adjusted net income is \$120,000, and its minimum investment return is \$140,000. Thus, Y is required to accumulate \$48,000 (40 percent of \$120,000) and shall be allowed to do so. Therefore, Y's distributable amount for such taxable year shall be the greater of its adjusted net income (\$120,000) or its minimum investment return (\$140,000), reduced by the amount of the income required to be accumulated (\$48,000) and the taxes imposed by Subtitle A of the Code and section 4940 and increased by any trust distributions described in paragraph (b)(2) of this section. Accordingly, Y's distributable amount for such taxable year is \$92,000 (\$140,000 reduced by \$48,000), before other adjustments. If Y's minimum investment return had been \$120,000 instead of \$140,000, its distributable amount for such taxable year would have been \$72,000 (\$120,000 reduced by \$48,000), before other adjustments. Similarly, if Y's minimum investment return had been \$100,000 instead of \$140,000, its distributable amount for such taxable year would also have been \$72,000, before other adjustments.

[T.D. 7256, 38 FR 3317, Feb. 5, 1973; 38 FR 4577, Feb. 16, 1973, as amended by T.D. 7486, 42 FR 24265, May 13, 1977; TD 7594, 44 FR 7138, Feb. 6, 1979; T.D. 7610, 44 FR 21644, Apr. 11, 1979; T.D. 7715, 45 FR 56803, Aug. 26, 1980; T.D. 7849, 47 FR 50857, Nov. 10, 1982; T.D. 7878, 48 FR 11943, Mar. 22, 1983]

§ 53.4942(a)-3 Qualifying distributions defined.

(a) *In general*—(1) *Distributions generally.* For purposes of section 4942 and the regulations thereunder, the amount of a qualifying distribution of

property (as defined in subparagraph (2) of this paragraph) is the fair market value of such property as of the date such qualifying distribution is made. The amount of an organization's qualifying distributions will be determined solely on the cash receipts and disbursements method of accounting described in section 446(c)(1).

(2) *Definition.* The term *qualifying distribution* means:

(i) Any amount (including program-related investments, as defined in section 4944(c), and reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c) (1) or (2)(B), other than any contribution to:

(a) A private foundation which is not an operating foundation (as defined in section 4942(j)(3)), except as provided in paragraph (c) of this section, or

(b) An organization controlled (directly or indirectly) by the contributing private foundation or one or more disqualified persons with respect to such foundation, except as provided in paragraph (c) of this section;

(ii) Any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c) (1) or (2)(B). See paragraph (c)(3) of § 53.4942(a)-2 for the definition of *used (or held for use)*; or

(iii) Any amount set aside within the meaning of paragraph (b) of this section.

(3) *Control.* For purposes of subparagraph (2)(i)(b) of this paragraph, an organization is "controlled" by a foundation or one or more disqualified persons with respect to the foundation if any of such persons may, by aggregating their votes or positions of authority, require the donee organization to make an expenditure, or prevent the donee organization from making an expenditure, regardless of the method by which the control is exercised or exercisable. "Control" of a donee organization is determined without regard to any conditions imposed upon the donee as part of the distribution or any other restrictions accompanying the distribution as to the manner in which the distribution is to be used, unless such conditions or restrictions are described in paragraph (a)(8) of § 1.507-2 of

this chapter (Income Tax Regulations). In general, it is the donee, not the distributor, which must be "controlled" by the distributing private foundation for the provisions of subparagraph (2)(i)(b) of this paragraph to apply. Thus, the furnishing of support to an organization and the consequent imposition of budgetary procedures upon that organization with respect to such support shall not in itself be treated as subjecting that organization to the distributing foundation's control within the meaning of this subparagraph. Such "budgetary procedures" include expenditure responsibility requirements under section 4945(d)(4). The "controlled" organization need not be a private foundation; it may be any type of exempt or nonexempt organization including a school, hospital, operating foundation, or social welfare organization.

(4) *Borrowed funds*—(i) *In general.* For purposes of this paragraph, if a private foundation borrows money in a particular taxable year to make expenditures for a specific charitable educational, or other similar purpose, a qualifying distribution out of such borrowed funds will, except as otherwise provided in subdivision (ii) of this subparagraph, be deemed to have been made only at the time that such borrowed funds are actually distributed for such exempt purpose.

(ii) *Funds borrowed before 1970.* (a) If a private foundation has borrowed money in a taxable year beginning before January 1, 1970, or subsequently borrows money pursuant to a written commitment which was binding as of the last day of such taxable year, to make expenditures for a specific charitable, educational, or other similar exempt purpose, if such borrowed funds are in fact expended for such purpose in any taxable year, and if such loan is thereafter repaid, in whole or in part, in a taxable year beginning after December 31, 1969, then, at the election of the foundation as provided in subdivision (ii)(b) of this subparagraph, a qualifying distribution will be deemed to have been made at such time or times that such loan principal is so repaid rather than at the earlier time that the borrowed funds were actually distributed for such exempt purpose.

(b) The election described in subdivision (ii) (a) of this subparagraph is to be made by attaching a statement to the form the private foundation is required to file under section 6033 for the first taxable year beginning after December 31, 1969, in which a repayment of loan principal is made. Such statement shall be made a part of such form and shall be attached to such form in each succeeding taxable year in which any repayment of loan principal is made. The statement shall set forth the name and address of the lender, the amount borrowed, the specific use made of such borrowed funds, and the private foundation's election to treat repayments of loan principal as qualifying distributions.

(iii) *Interest.* Any payment of interest with respect to a loan described in subdivision (i) or (ii) of this subparagraph shall be treated as a deduction under paragraph (d)(1)(ii) of § 53.4942(a)-2 in the taxable year in which it is made.

(5) *Changes in use of an asset.* If an asset not used (or held for use) directly in carrying out one or more purposes described in section 170(c) (1) or (2)(B) is subsequently converted to such a use, the foundation may treat such conversion as a qualifying distribution. The amount of such qualifying distribution shall be the fair market value of the converted asset as of the date of its conversion. For purposes of the preceding sentence, fair market value shall be determined by making a valuation of the converted asset as of the date of its conversion in accordance with the rules set forth in paragraph (c)(4) of § 53.4942(a)-2.

(6) *Certain foreign organizations—(i) In general.* Distributions for purposes described in section 170(c)(2)(B) to a foreign organization, which has not received a ruling or determination letter that it is an organization described in section 509(a) (1), (2), or (3) or 4942(j)(3), will be treated as a distribution made to an organization described in section 509(a) (1), (2), or (3) or 4942(j)(3) if the distributing foundation has made a good faith determination that the donee organization is an organization described in section 509(a) (1), (2), or (3) or 4942(j)(3). Such a "good faith determination" ordinarily will be considered as made where the determination

is based on an affidavit of the donee organization or an opinion of counsel (of the distributing foundation or the donee organization) that the donee is an organization described in section 509(a) (1), (2), or (3) or 4942(j)(3). Such an affidavit or opinion must set forth sufficient facts concerning the operations and support of the donee organization for the Internal Revenue Service to determine that the donee organization would be likely to qualify as an organization described in section 509(a) (1), (2), or (3) or 4942(j)(3).

(ii) *Definition.* For purposes of this subparagraph, the term *foreign organization* means any organization which is not described in section 170(c)(2)(A).

(7) *Payment of tax.* The payment of any tax imposed under chapter 42 of the Code shall not be treated as a qualifying distribution.

(8) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). M, a private foundation which uses the calendar year as the taxable year, makes the following payments in 1970: (i) a payment of \$44,000 to five employees for conducting a foundation program of educational grants for research and study; (ii) \$20,000 for various items of overhead, 10 percent of which is attributable to the activities of the employees mentioned in payment (i) of this example and the other 90 percent of which is attributable to administrative expenses which were not paid to accomplish any section 170(c) (1) or (2)(B) purpose; and (iii) a \$100,000 general purpose grant paid to an educational institution described in section 170(b)(1)(A)(ii) which is not controlled by M or any disqualified persons with respect to M. Payments (i) and (ii) of this example are qualifying distributions to the extent of \$46,000 (\$44,000 of salaries and 10 percent of the overhead, both of which are reasonable administrative expenses paid to accomplish section 170(c) (1) or (2)(B) purposes). Payment (iii) of this example is also a qualifying distribution, since it is a contribution for section 170(c)(2)(B) purposes to an organization which is not described in subparagraph (2)(i) (a) or (b) of this paragraph. The other 90 percent of payment (ii) of this example may constitute items of deduction under paragraph (d)(1)(ii) of § 53.4942(a)-2 if such items otherwise qualify under such paragraph.

Example (2). On February 21, 1972, N, a private foundation which uses the calendar year as the taxable year, pays \$500,000 for real property on which it plans to build hospital facilities to be used for medical care and

education. The real property produces no income and the hospital facilities will not be constructed until 1974 according to the set-aside plan submitted to and approved by the Commissioner pursuant to paragraph (b) of this section. The purchase of the land is a qualifying distribution under subparagraph (2)(ii) of this paragraph. If, however, the property used were to produce rental income for more than a reasonable period of time before construction of the hospital is begun, then as of the time such rental use becomes unreasonable (i) such purchase would no longer constitute a qualifying distribution under subparagraph (2)(ii) of this paragraph, and (ii) the amount of the qualifying distribution would be included in N's gross income. See paragraphs (c)(3)(i) and (d)(2)(iii) (b) of § 53.4942(a)-2.

Example (3). In 1971, X, a private foundation engaged in holding paintings and exhibiting them to the public, purchases an additional building to be used to exhibit the paintings. Such expenditure is a qualifying distribution under subparagraph (2)(ii) of this paragraph. In 1975, X sells the building. Under paragraph (d)(2)(iii) (b) of § 53.4942(a)-2, all of the proceeds of the sale (less direct costs of the sale) are included in X's adjusted net income for 1975.

Example (4). In January 1969, M, a private foundation which uses the calendar year as the taxable year, borrows \$10 million to give to N, a private college, for the construction of a science center. M borrowed the money from X, a commercial bank. M is to repay X at the rate of \$1.1 million per year (\$1 million principal and \$0.1 million interest) for 10 years, beginning in January, 1973. M distributed \$5 million of the borrowed funds to N in February 1969 and the other \$5 million in March 1970. M files a statement with the form it is required to file under section 6033 for 1973 which contains the information required by subparagraph (4)(ii) (b) of this paragraph. Pursuant to M's election, each repayment of loan principal constitutes a qualifying distribution in the year of repayment. Accordingly, the distribution of \$5 million to N in March 1970 will not be treated as a qualifying distribution. Each payment of interest (\$0.1 million annually) with respect to M's loan from X is treated as a deduction under paragraph (d)(1)(ii) of § 53.4942(a)-2 in the taxable year in which it is made.

Example (5). Private foundation Y engages in providing care for the aged. Y makes a distribution of cash to H, a hospital described in section 170(b)(1)(A)(iii) which is not controlled by Y or any disqualified person with respect to Y. The distribution is made subject to the conditions that H will invest the money as a separate fund which will bear a name commemorating the creator of Y and will use the income from such fund only for H's exempt hospital purposes which relate to care for the aged. Under

these circumstances, the distribution from Y to H is a qualifying distribution pursuant to subparagraph (2)(i) of this paragraph.

(b) *Certain set-asides—(1) In general.* 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) may be treated as a qualifying distribution in the year in which set aside (but not in the year in which actually paid), if the requirements of section 4942(g)(2) and this paragraph (b) are satisfied. The requirements of this paragraph (b) are satisfied if the private 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

(i) The set-aside satisfies the suitability test described in subparagraph (2) of this paragraph, or

(ii) With respect to a set-aside made in a taxable year beginning after December 31, 1974, the private foundation satisfies the cash distribution test described in subparagraph (3) of this paragraph.

If the suitability test or cash distribution test is otherwise satisfied, the 60 month period for paying the amount set aside may, for good cause shown, be extended by the Commissioner.

(2) *Suitability test.* The suitability test is satisfied if the private foundation establishes to the satisfaction of the Commissioner that the specific project for which the amount is set aside is one that can be better accomplished by the set-aside than by the immediate payment of funds. Specific projects that can be better accomplished by the use of a set-aside include, but are not limited to, projects 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 (as defined in section 4944(c)) or where grants are made as part of a matching-grant program. Such projects include, for example, a plan to erect a building to house the direct charitable, educational, or other similar exempt activity of the private foundation (such as a museum building in which paintings are to be hung), even though the exact location and architectural plans

have not been finalized; a plan to purchase an additional group of paintings offered for sale only as a unit that requires an expenditure of more than one year's income; or 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.

(3) *Cash distribution test; in general.* The cash distribution test is satisfied if:

(i) The specific project for which the amount is set aside will not be completed before the end of the taxable year in which the set-aside is made,

(ii) The private foundation actually distributes, in cash or its equivalent and for one or more of the purposes described in section 170(c) (1) or (2)(B), the "start-up period minimum amount" described in subparagraph (4) of this paragraph during the private foundation's start-up period, and

(iii) The private foundation actually distributes, in cash or its equivalent and for one or more of the purposes described in section 170(c) (1) or (2)(B), the "full-payment period minimum amount" described in subparagraph (5) of this paragraph in each taxable year of the private foundation's full-payment period.

For purposes of the cash distribution test, an amount set aside will be treated as distributed in the year in which actually paid and not in the year in which set aside.

(4) *Minimum distribution required during start-up period—(i) Start-up period.* For private foundations created before January 1, 1972, the start-up period is the four taxable years immediately preceding the taxable year beginning in calendar year 1976. For private foundations created after December 31, 1971 (or for organizations that first become private foundations after that date), the start-up period is the four taxable years following the taxable year in which the private foundation was created (or otherwise became a private foundation). For purposes of this subparagraph (4), a private foundation will be considered "created" in the taxable year in which the private foundation's

distributable amount (as determined under section 4942(d)) first exceeds \$500.

(ii) *Start-up period minimum amount.* The amount that a private foundation must actually distribute in cash or its equivalent during the private foundation's start-up period is not less than the sum of:

(a) Twenty percent of the private foundation's distributable amount (as determined under section 4942(d)) for the first taxable year of the start-up period,

(b) Forty percent of the private foundation's distributable amount for the second taxable year of the start-up period,

(c) Sixty percent of the private foundation's distributable amount for the third taxable year of the start-up period, and

(d) Eighty percent of the private foundation's distributable amount for the fourth taxable year of the start-up period.

(iii) *Timing of distributions.* The requirement that a private foundation distribute the start-up period minimum amount during the start-up period is a requirement that such amount be distributed before the end of the start-up period, and is not a requirement that any portion of such amount be distributed in any one taxable year of the start-up period.

(iv) *Distribution actually made during start-up period.* In general, only a distribution actually made during the start-up period is taken into account in determining whether a private foundation has distributed the start-up period minimum amount. However, in the case of a private foundation created after December 31, 1971 (or an organization that first became a private foundation after that date), a distribution actually made during the taxable year in which the foundation was created (the year immediately preceding the first taxable year of the private foundation's start-up period) may be treated as a distribution actually made during the start-up period. In addition, a distribution actually made by a private foundation within 5½ months after the end of the start-up period will be treated as a distribution actually made during the start-up period if:

(a) The private foundation was unable to determine the distributable amount for the fourth taxable year of the start-up period until after the end of such period, and

(b) The private foundation actually made distributions prior to the end of the start-up period based upon a reasonable estimate of the private foundation's distributable amount for the fourth taxable year of the start-up period.

(v) *Examples.* The provisions of this subparagraph (4) may be illustrated by the following examples:

Example (1). F, a private foundation created on January 1, 1975, uses the calendar year as its taxable year. The start-up period for F is January 1, 1976 through December 31, 1979. F has distributable amounts under section 4942(d) for taxable years 1976 through 1979 in the following amounts: 1976, \$100,000; 1977, \$120,000; 1978, \$150,000; 1979, \$200,000. F's start-up period minimum amount is the sum of the following amounts: 20% of \$100,000 (\$20,000); 40% of \$120,000 (\$48,000); 60% of \$150,000 (\$90,000); and 80% of \$200,000 (\$160,000); which equals \$318,000. Thus F is required to actually distribute at least \$318,000 in cash or its equivalent during the start-up period.

Example (2). F, a private foundation created in 1969, uses the calendar year as its taxable year. F's start-up period is the calendar years 1972 through 1975. F makes two cash distributions in 1972. The first distribution is made on account of a set-aside made in 1969. Under section 4942(g), that distribution is treated as a qualifying distribution made in 1969. The second distribution is treated under section 4942(h) as made out of F's undistributed income for 1971. In addition, F makes a cash distribution in 1976 that is treated under section 4942(h) as made out of F's undistributed income for 1975. In determining whether F has distributed its start-up period minimum amount within the start-up period, the 1972 distributions are both taken into account because they were actually made during F's start-up period. The 1976 distribution is not taken into account, however, because that distribution was not actually made during F's start-up period.

(5) *Minimum distribution required during full-payment period—(i) Full-payment period.* A private foundation's full-payment period includes each taxable year that begins after the end of the private foundation's start-up period.

(ii) *Full-payment period minimum amount.* The amount that a private foundation must actually distribute in cash or its equivalent in a taxable year

of the private foundation's full-payment period is not less than 100 percent of the private foundation's distributable amount determined under section 4942(d) (without regard to section 4942(i)) with respect to the taxable year.

(iii) *Carryover of distributions in excess of full-payment period minimum amount.* If, in a taxable year beginning after December 31, 1975, a private foundation distributes an amount in excess of the full-payment period minimum amount for the taxable year, the excess shall be used to reduce the full-payment period minimum amount in the taxable years in the adjustment period. The amount of the excess distribution used to reduce the full-payment period minimum amount in each successive taxable year of the adjustment period shall be equal to the amount of such excess less the sum of the full-payment period minimum amounts for all prior taxable years in the adjustment period to which the excess was previously applied. The taxable years in the adjustment period are the five taxable years immediately following the taxable year in which the excess distribution is made. Any distribution in excess of the full-payment period minimum amount made during a taxable year of the adjustment period shall not be taken into account under this subparagraph (iii) until any earlier excess has been completely applied against full-payment period minimum amounts during its adjustment period.

(iv) *Distributions actually made during a taxable year.* Except as described in subdivision (ii) of subparagraph (6), only a distribution actually made during a taxable year of the full-payment period is taken into account in determining whether a private foundation has distributed the full-payment period minimum amount for such year.

(v) *Examples.* The provisions of this subparagraph (5) may be illustrated by the following examples:

Example (1). F, a private foundation created on January 1, 1973, uses the calendar year as its taxable year. F has a start-up period of January 1, 1974, through December 31, 1977, and a full-payment period that includes every taxable year beginning after December 31, 1977. F's distributable amount (as determined under section 4942(d)) for 1978 is

\$500,000. Thus, F's full-payment period minimum amount for 1978 is \$500,000. During 1978 F distributes \$100,000 in cash to Charity X and \$400,000 in cash to Charity Y on account of a set-aside made in 1973. F has distributed its full-payment period minimum amount for 1978 because it has made actual cash distributions during that year which total \$500,000. However, F has made qualifying distributions (as determined under section 4942(g)) with respect to 1978 of only \$100,000. In order to avoid liability for the tax on undistributed income under section 4942(a), F must distribute or set aside an additional \$400,000 before January 1, 1980.

Example (2). Assume the facts as stated in Example (1) except that in 1978 F makes cash distributions totaling \$600,000. Since the total cash distributions made in 1978 (\$600,000) exceed the full-payment period minimum amount for 1978 (\$500,000), there exists a \$100,000 excess which must be used by F to reduce its full-payment period minimum amounts for the years 1979-1983 (the taxable years in the adjustment period with respect to the 1978 excess). Therefore, if F's distributable amount (as determined under section 4942(d)) for 1979 is \$500,000, F's full-payment period minimum amount for 1979 is \$400,000 (\$500,000-\$100,000).

(6) *Failure to distribute minimum amounts*—(i) *In general.* If a private foundation fails to actually distribute the start-up period minimum amount during the start-up period or, except as described in subdivision (ii) of this subparagraph (6), if a private foundation fails to actually distribute the full-payment period minimum amount during a taxable year of the full-payment period, then any set-aside made by the private foundation during the start-up period (if the failure relates to the start-up period) or during the taxable year (if the failure relates to the full-payment period) that was not approved by the Commissioner under the suitability test described in subparagraph (2) of this paragraph will not be treated as a qualifying distribution. Further, any set-aside made after the year of such a failure to so distribute a minimum amount will be treated as a qualifying distribution only if the Commissioner approves the set-aside under the suitability test. In any case in which a set-aside ceases to be treated as a qualifying distribution as a result of a failure to distribute the full-payment period minimum amount, a private foundation may be assessed a deficiency under section 4942(a) within

the period described in section 6501(n)(3).

(ii) *Correction of certain failures to distribute.* If a private foundation's failure to distribute the full-payment period minimum amount during a taxable year of the full-payment period was not willful and was due to reasonable cause, the private foundation may correct the failure to so distribute. Correction will be achieved if the private foundation distributes within the correction period cash or its equivalent in an amount not less than the difference between the full-payment period minimum amount for the taxable year and the amount actually distributed during the taxable year. The correction period is the correction period as defined in section 4962(e), determined with respect to the earliest occurring taxable event (as defined in section 4962(e)(2)(A)) that would result if the failure to distribute a full-payment period minimum amount were not corrected. The additional distribution will be treated for purposes of subparagraph (5) of this paragraph as made during the taxable year with respect to which the failure occurred. If a private foundation fails to distribute the full-payment period minimum amount during a taxable year of the full-payment period because such amount can be determined only after the end of the taxable year, no "willful failure to distribute" the full-payment period minimum amount will occur if the private foundation makes an additional distribution within 5½ months after the end of the taxable year.

(7) *Approval and information requirements*—(i) *Suitability test.* If an amount is set aside under the suitability test of section 4942(g)(2)(B)(i) and subparagraph (2) of this paragraph, the private foundation must apply for the Commissioner's approval of the set-aside before the end of the taxable year in which the amount is set aside. The Commissioner will either approve or disapprove the set-aside in writing. An otherwise proper set-aside will not be treated as a qualifying distribution under this paragraph (b) with respect to a taxable year if the Commissioner's approval is not sought before the end of the taxable year in which the amount is actually set aside. To obtain approval by the

Commissioner for a set-aside under the suitability test, the private foundation must write to Commissioner of Internal Revenue, Attention: OP:E:EO:T, 1111 Constitution Avenue, NW., Washington, DC 20224, and include:

(a) A statement describing the nature and purposes of the specific project and the amount of the set-aside for which approval is requested;

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

(c) A statement of the reasons why the project can be better accomplished by a set-aside than by the immediate payment of funds;

(d) A detailed description of the project, including estimated costs, sources of any future funds expected to be used for completion of the project, and the location or locations (general or specific) of any physical facilities to be acquired or constructed as part of the project; and

(e) A statement by an appropriate foundation manager (as defined in section 4946(b)) that the amounts to be set aside will actually be paid for the specific project within a specified period of time that ends not more than 60 months after the date of the first set-aside, or a statement showing good cause why the period for paying the amount set aside should be extended (including a showing that the proposed project could not be divided into two or more projects covering periods of no more than 60 months each) and setting forth the extension of time required.

(ii) *Cash distribution test.* If an amount is set aside under the cash distribution test of section 4942(g)(2)(B)(ii) and subparagraphs (3), (4), and (5) of this paragraph, then for taxable years ending after April 2, 1984, the private foundation must submit an attachment with the return required by section 6033 for the taxable year in which the amount is set aside and for certain subsequent taxable years. For the taxable year in which the amount is set aside the attachment must include:

(a) A statement describing the nature and purposes of the specific project for which amounts are to be set aside;

(b) A statement that the amounts set aside for the specific project will actu-

ally be paid for the specific project within a specified period of time that ends not more than 60 months after the date of the set-aside;

(c) A statement that the project will not be completed before the end of the taxable year of the private foundation in which the set-aside is made;

(d) A statement showing the distributable amounts determined under section 4942(d) for any past taxable years in the private foundation's start-up and full-payment periods; and

(e) A statement showing the aggregate amount of actual payments made in cash or its equivalent, for purposes described in section 170(c)(1) or (2)(B), during each taxable year in the private foundation's start-up and full-payment periods. This statement should include a detailed description of any payments that are to be treated, pursuant to the rules of subparagraphs (4)(iv) and (6)(ii) of this paragraph (b), as distributed during a taxable year prior to the taxable year in which such payments were actually made and, in addition, should explain the circumstances that justify the application of those rules.

For the five taxable years following the taxable year in which the amount is set aside (or, if longer, for each taxable year in the extended period for paying the amount set aside), the attachment must include the statements required by (d) and (e) of this subdivision (ii). The submission of the statement required by (b) of this subdivision (ii) will satisfy the requirement of section 4942(g)(2)(B) and subparagraph (1) of this paragraph (b) that the private foundation establish 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.

(8) *Evidence of set-aside.* A set-aside that is approved by the Commissioner or which satisfies the cash distribution test 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. Any amount which is set aside shall be taken into account for purposes of determining the private foundation's minimum investment return under § 53.4942(a)-2 (c)(1), and any income attributable to such set-aside

shall be taken into account in computing adjusted net income under § 53.4942(a)-2(d).

(9) *Contingent set-aside.* In the event a private foundation is involved in litigation and may not distribute assets or income because of a court order, the private foundation may (except as provided in § 53.4942(a)-2 (e)(1)(i) or (ii)) seek and obtain a set-aside for a purpose described in § 53.4942(a)-3 (a)(2). The amount to be set aside shall be equal to that portion of the private foundation's distributable amount which is attributable to the assets or income that are held pursuant to court order and which, but for the court order precluding the distribution of such assets or income, would have been distributed. In the event that the litigation encompasses more than one taxable year, the private foundation may seek additional contingent set-asides. Such amounts must actually be distributed by the last day of the taxable year following the taxable year in which the litigation is terminated. Amounts not distributed by the close of the appropriate taxable year shall be treated as described in § 53.4942(a)-2 (d)(2)(iii)(c) for the succeeding taxable year.

(c) *Certain contributions to section 501(c)(3) organizations—(1) In general.* For purposes of this section, the term "qualifying distribution" includes (in the year in which it is paid) a contribution to an exempt organization described in section 501(c)(3) and described in paragraph (a)(2)(i) (a) or (b) of this section if:

(i) Not later than the close of the first taxable year after the donee organization's taxable year in which such contribution is received, such donee organization makes a distribution equal to the full amount of such contribution and such distribution is a qualifying distribution (within the meaning of paragraph (a) of this section, without regard to this paragraph) which is treated under paragraph (d) of this section as a distribution out of corpus (or would be so treated if such section 501(c)(3) organization were a private foundation which is not an operating foundation); and

(ii) The private foundation making the contribution obtains adequate

records or other sufficient evidence from such donee organization (such as a statement by an appropriate officer, director, or trustee of such donee organization) showing (except as otherwise provided in this subparagraph) (a) that the qualifying distribution described in subdivision (i) of this subparagraph has been made by such organization, (b) the names and addresses of the recipients of such distribution and the amount received by each, and (c) that the distribution is treated as a distribution out of corpus under paragraph (d) of this section (or would be so treated if the donee organization were a private foundation which is not an operating foundation). Where a distribution is for an administrative expense which is part of a section 170(c) (1) or (2)(B) expenditure or is part of another section 170(c) (1) or (2)(B) expenditure that cannot reasonably be separately accounted for, the provisions of subdivision (ii) of this subparagraph may be satisfied by the submission by the donee organization of a statement setting forth the general purpose for which such expenditure was made and that the amount was distributed as a qualifying distribution described in subdivision (i)(c) of this subparagraph.

(2) *Distribution requirements.* (i) In order for a donee organization to meet the distribution requirements of subparagraph (1)(i) of this paragraph, it must, not later than the close of the first taxable year after its taxable year in which any contributions are received, distribute (within the meaning of this subparagraph) an amount equal in value to the contributions received in such prior taxable year and have no remaining undistributed income for such prior taxable year. In the event that a donee organization redistributes less than an amount equal to the total contributions from donor organizations which are required to be redistributed by such donee organization by the close of the first taxable year following the taxable year in which such contributions were received, amounts treated as redistributions of such contributions shall be deemed to have been made pro rata out of all such contributions regardless of any earmarking or identification made by such donee organization with respect to the source

of such distributions. See paragraph (d)(2)(ix) of § 53.4942(a)-2 for the treatment of amounts deemed not to have been so redistributed. For purposes of this paragraph, the term *contributions* means all contributions, whether of cash or property, and the fair market value of contributed property determined as of the date of the contribution must be used in determining whether an amount equal in value to the contributions received has been redistributed.

(ii) For purposes of this paragraph, the characterization of qualifying distributions made during the taxable year (*i.e.*, whether out of the prior year's undistributed income, the current year's undistributed income, or corpus) is to be made as of the close of the taxable year in question, except to the extent that a different characterization is effected by means of the election provided for by paragraph (d)(2) of this section or by subdivision (iv) of this subparagraph. Once it is determined that a qualifying distribution is attributable to corpus, such distribution will first be charged to distributions which are required to be redistributed under this paragraph.

(iii) All amounts contributed to a specific exempt organization described in section 501(c)(3) and in paragraph (a)(2)(i) (*a*) or (*b*) of this section within any one taxable year of such organization shall be treated (with respect to the contributing private foundation) as one "contribution". If subparagraph (1) (i) or (ii) of this paragraph is not completely satisfied with respect to such contribution within the meaning of such subparagraph, only that portion of such contribution which was redistributed (within the meaning of subparagraph (1) (i) and (ii) of this paragraph) shall be treated as a qualifying distribution.

(iv) In order to satisfy distribution requirements under section 170(b)(1)(E)(ii) or this paragraph, a donee organization may elect to treat as a current distribution out of corpus any amount distributed in a prior taxable year which was treated as a distribution out of corpus under paragraph (d)(1)(iii) of this section provided that (*a*) such amount has not been availed of for any other purpose, such as a carry-

over under paragraph (e) of this section or a redistribution under this paragraph for a prior year, (*b*) such corpus distribution occurred within the preceding 5 years, and (*c*) such amount is not later availed of for any other purpose. Such election must be made by attaching a statement to the return the foundation is required to file under section 6033 with respect to the taxable year for which such election is to apply. Such statement must contain a declaration by an appropriate foundation manager (within the meaning of section 4946(b)(1)) that the foundation is making an election under this paragraph and it must specify that the distribution was treated under paragraph (d)(1)(iii) of this section as a distribution out of corpus in a designated prior taxable year (or years).

(3) *Examples.* The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples. It is assumed in these examples that all private foundations described use the calendar as the taxable year.

Example (1). In 1972 M, a private foundation, makes a contribution out of 1971 income to X, another private foundation which is not an operating foundation. The contribution is the only one received by X in 1972. In 1973 X makes a qualifying distribution to an art museum maintained by an operating foundation in an amount equal to the amount of the contribution received from M. X also distributes all of its undistributed income for 1972 and 1973 for other purposes described in section 170(c)(2)(B). Under the provisions of paragraph (d) of this section, such distribution to the museum is treated as a distribution out of corpus. Thus, M's contribution to X is a qualifying distribution out of M's 1971 income provided M obtains adequate records or other sufficient evidence from X showing the nature and amount of the distribution made by X, the identity of the recipient, and the fact that the distribution is treated as made out of corpus. If X's qualifying distributions during 1973 had been equal only to M's contribution to X and X's undistributed income for 1972, X could have made an election under paragraph (d)(2) of this section to treat the amount distributed in excess of its 1972 undistributed income as a distribution out of corpus and in that manner satisfied the requirements of this paragraph.

Example (2). Assume the facts stated in example (1), except that X is a private college described in section 170(b)(1)(A)(ii) which is

controlled by disqualified persons with respect to M and that the records which X furnishes to M show that the distribution would have been treated as made out of corpus if X were a private nonoperating foundation. Under these circumstances, result is the same as in example (1).

Example (3). Assume the facts stated in example (1), except that X makes a distribution to the museum equal only to one-half of the contribution from M, that the remainder of such contribution is added to X's funds and used to pay charitable administrative expenses, and that the records obtained by M from X are not sufficient to show the amounts distributed or the identities of the recipients of the distributions. The contribution by M to X will be a qualifying distribution only to the extent that M can obtain (i) other sufficient evidence (such as statements from officers or employees of X or from the museum) showing the facts required by subparagraph (1)(ii) (a), (b), and (c) of this paragraph and (ii) a statement from X setting forth that the remainder of the contribution was used for charitable administrative expenses which constituted qualifying distributions described in paragraph (a)(2)(i) of this section.

Example (4). X and Y are private nonoperating foundations. A is an exempt organization which is not described in section 501(c)(3) but which supervises and conducts a program described in section 170(c)(2)(B). Y, but not X, controls A within the meaning of paragraph (a)(3) of this section. In 1972, X and Y each makes a grant to A of \$100, specifically designated for use in the operation of A's section 170(c)(2)(B) program. X has made a qualifying distribution to A because the distribution is one described in paragraph (a)(2)(i) of this section. However, because A is controlled by Y, Y's grant of \$100 to A does not constitute a qualifying distribution within the meaning of such paragraph (a)(2)(i). Furthermore, because A is not an exempt organization described in section 501(c)(3), Y's grant to A does not constitute a qualifying distribution by operation of the provisions of this paragraph.

Example (5). N, a private nonoperating foundation, had distributable amounts of \$100 in 1970 and \$125 in 1971. In 1970 N received total contributions of \$540: \$150 from Y, a public charity; \$70 from Z, a private foundation; \$140 from Q, a private foundation, subject to the requirement that N earmark the amount and distribute it before distributing Z's contribution; and, \$180 from R, also a private foundation. However, R specifically instructed N that such contribution did not have to be redistributed because R already had made enough qualifying distributions to avoid all section 4942 taxes. N is not controlled by Y, Z, Q, or R, and N made no qualifying distributions in 1970. By the close of 1971, N had made qualifying distributions of

\$420, earmarking \$140 as having been a distribution of Q's contribution, but had made no election under paragraph (d)(2) of this section to have any amount distributed which was in excess of N's 1970 undistributed income treated as distributed out of corpus. Therefore, the first \$225 of qualifying distributions made in 1971 (the sum of \$100 and \$125, N's distributable amounts for 1970 and 1971, respectively) are treated as amounts described in paragraph (d)(1) (i) and (ii) of this section. Since Y's contribution is a contribution from a public charity and does not have to be "redistributed" and since R specifically instructed N that its contribution need not be "redistributed", the remaining \$195 of qualifying distributions will be treated as distributed pro rata from Z's and Q's contributions, regardless of N's earmarking. Accordingly, of Z's original qualifying distribution of \$70 only \$65 (\$195 multiplied by \$70, Z's contribution, over \$210, the total (\$70 plus \$140) of Z's and Q's contributions) will be treated as redistributed by N. Similarly, of Q's original qualifying distribution of \$140 only \$130 (\$195 multiplied by \$140 over \$210) will be treated as redistributed by N. Thus, Z's gross income for 1972 will be increased by \$5 (\$70 less the \$65 actually redistributed), and Q's gross income for 1972 will be increased by \$10 (\$140 less the \$130 actually redistributed).

(4) *Limitation.* A contribution by a private foundation to a donee organization which the donee uses to make payments to another organization (the secondary donee) shall not be regarded as a contribution by the private foundation to the secondary donee if the distributing foundation does not earmark the use of the contribution for any named secondary donee and does not retain power to cause the selection of the secondary donee by the organization to which such foundation has made the contribution. For purposes of this subparagraph, a contribution described herein shall not be regarded as a contribution by the foundation to the secondary donee even though such foundation has reason to believe that certain organizations would derive benefits from such contribution so long as the original donee organization exercises control, in fact, over the selection process and actually makes the selection completely independently of such foundation.

(5) *Transitional rule.* (i) For purposes of this paragraph, a contribution to a private foundation which is not an operating foundation and which is not

controlled (directly or indirectly) by the distributing foundation or one or more disqualified persons with respect to the distributing foundation will be treated as a contribution to an operating foundation if:

(a) Such contribution is made pursuant to a written commitment which was binding on May 26, 1969, and at all times thereafter.

(b) Such contribution is made for one or more of the purposes described in section 170(c) (1) or (2)(B), and

(c) Such contribution is to be paid out to the donee private foundation on or before December 31, 1974.

(ii) For purposes of this subparagraph, a written commitment will be considered to have been binding prior to May 27, 1969, only if the amount and nature of the contribution and the name of the donee foundation were entered in the records of the distributing foundation, or were otherwise adequately evidenced, prior to May 27, 1969, or notice of the contribution was communicated in writing to such donee prior to May 27, 1969.

(d) *Treatment of qualifying distributions*—(1) *In general.* Except as provided in subparagraph (2) of this paragraph, any qualifying distribution made during a taxable year shall be treated as made:

(i) First out of the undistributed income (as defined in paragraph (a) of § 53.4942(a)-2) of the immediately preceding taxable year (if the private foundation was subject to the initial excise tax imposed by section 4942(a) for such preceding taxable year) to the extent thereof;

(ii) Second out of the undistributed income for the taxable year to the extent thereof; and

(iii) Then out of corpus.

(2) *Election.* In the case of any qualifying distribution which (under subparagraph (1) of this paragraph) is not treated as made out of the undistributed income of the immediately preceding taxable year, the foundation may elect to treat any portion of such distribution as made out of the undistributed income of a designated prior taxable year or out of corpus. Such election must be made by filing a statement with the Commissioner during the taxable year in which such

qualifying distribution is made or by attaching a statement to the return the foundation is required to file under section 6033 with respect to the taxable year in which such qualifying distribution was made. Such statement must contain a declaration by an appropriate foundation manager (within the meaning of section 4946(b)(1)) that the foundation is making an election under this subparagraph, and it must specify whether the distribution is made out of the undistributed income of a designated prior taxable year (or years) or is made out of corpus. In any case where the election described in this subparagraph is made during the taxable year in which the qualifying distribution is made, such election may be revoked in whole or in part by filing a statement with the Commissioner during such taxable year revoking such election in whole or in part or by attaching a statement to the return the foundation is required to file under section 6033 with respect to the taxable year in which the qualifying distribution was made revoking such election in whole or in part. Such statement must contain a declaration by an appropriate foundation manager (within the meaning of section 4946(b)(1)) that the foundation is revoking an election under this subparagraph in whole or in part, and it must specify the election or part thereof being revoked.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). M, a private foundation which was created in 1968 and which uses the calendar year as the taxable year, has distributable amounts and qualifying distributions for 1970 through 1976 as follows:

	1970	1971	1972	1973
Distributable amount	\$100	\$100	\$100	\$100
Qualifying distribution	0	100	250	100
	1974	1975	1976
Distributable amount	\$100	\$100	\$100
Qualifying distribution	100	100	100

In 1971 the qualifying distribution of \$100 is treated under subparagraph (1)(i) of this paragraph as made out of the \$100 of undistributed income for 1970. The qualifying distribution of \$250 in 1972 is treated as made: (i) \$100 out of the undistributed income for

1971 under subparagraph (1)(i) of this paragraph; (ii) \$100 out of the undistributed income for 1972 under subparagraph (1)(ii) of this paragraph; and (iii) \$50 out of corpus in 1972 under subparagraph (1)(iii) of this paragraph. The qualifying distribution of \$100 in each of the years 1973 through 1976 is treated as made out of the undistributed income for each of those respective years under subparagraph (1)(ii) of this paragraph. See paragraph (e) of this section for rules relating to the carryover of qualifying distributions out of corpus.

Example (2). *M*, a private foundation which uses the calendar year as the taxable year, has undistributed income of \$300 for 1981, \$200 for 1982, and \$400 for 1983. On January 14, 1983, *M* makes its first qualifying distribution in 1983 when it sets aside (within the meaning of paragraph (b) of this section) \$700 for construction of a hospital. On February 24, 1983 a notice of deficiency with respect to the excise taxes imposed by section 4942 (a) and (b) in regard to *M*'s undistributed income for 1981 is mailed to *M* under section 6212(a). *M* notifies the Commissioner in writing on March 24, 1983, that it is making an election under subparagraph (2) of this paragraph to have its distribution of January 14th applied first against its undistributed income for 1982, next against its undistributed income for 1981, and last against its undistributed income for 1983. Thus, \$200 of the \$700 qualifying distribution is treated as made out of the undistributed income for 1982; \$300, out of undistributed income for 1981; and \$200 (\$700 less the sum of \$200 and \$300), out of the undistributed income for 1983. Thus, an initial excise tax of \$45 (15 percent of \$300) is imposed under section 4942(a). Since *M* made the election described above, the \$300 (treated as distributed out of undistributed income for 1981) corrects (within the meaning of section 4963(d)(2)) the taxable act because the undistributed income for 1981 is reduced to zero. Furthermore, correction is effected within the correction period (as defined in section 4963(e)(1) and § 53.4963-1(e)). Therefore, under the provisions of section 4961(a), the additional tax imposed by section 4942(b) will not be assessed.

(e) *Carryover of excess qualifying distributions*—(1) *In general.* If in any taxable year for which an organization is subject to the initial excise tax imposed by section 4942(a) there is created an excess of qualifying distributions (as determined under subparagraph (2) of this paragraph), such excess may be used to reduce distributable amounts in any taxable year of the adjustment period (as defined subparagraph (3) of this paragraph). For purposes of section 4942, including paragraph (d) of

this section, the distributable amount for a taxable year in the adjustment period shall be reduced to the extent of the lesser of (i) the excess of qualifying distributions made in prior taxable years to which such adjustment period applies or (ii) the remaining undistributed income at the close of such taxable year after applying any qualifying distributions made in such taxable year to the distributable amount for such taxable year (determined without regard to this paragraph). If during any taxable year of the adjustment period there is created another excess of qualifying distributions, such excess shall not be taken into account until any earlier excess of qualifying distributions has been completely applied against distributable amounts during its adjustment period.

(2) *Excess qualifying distributions.* An excess of qualifying distributions is created for any taxable year beginning after December 31, 1969, if:

(i) The total qualifying distributions treated (under paragraph (d) of this section) as made out of the undistributed income for such taxable year or as made out of corpus with respect to such taxable year (other than amounts distributed by an organization in satisfaction of section 170(b)(1)(E)(ii) or paragraph (c) of this section, or applied to a prior taxable year by operation of the elections contained in paragraphs (c)(2)(iv) and (d)(2) of this section), exceeds

(ii) The distributable amount for such taxable year (determined without regard to this paragraph).

(3) *Adjustment period.* For purposes of this paragraph, the taxable years in the adjustment period are the 5 taxable years immediately following the taxable year in which the excess of qualifying distributions is created. Thus, an excess (within the meaning of subparagraph (2) of this paragraph) for any 1 taxable year cannot be carried over beyond the succeeding 5 taxable years. However, if during any taxable year in the adjustment period an organization ceases to be subject to the initial excise tax imposed by section 4942(a), any portion of the excess of qualifying distributions, which prior to such taxable year has not been applied against distributable amounts, may not be carried

over to such taxable year or subsequent taxable years in the adjustment period, even if during any of such taxable years the organization again becomes subject to the initial excise tax imposed by section 4942(a).

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). (i) F, a private foundation which was created in 1967 and which uses the calendar year as the taxable year, has distributable amounts and qualifying distributions for 1970 through 1976 as follows:

Year	1970	1971	1972	1973
Distributable amount	\$100	\$100	\$100	\$100
Qualifying distribution	0	\$250	\$70	\$140

Year	1974	1975	1976	
Distributable amount	\$100	\$100	\$100
Qualifying distribution	\$60	\$75	\$105

(ii) The qualifying distributions made in 1971 will be treated under paragraph (d) of this section as \$100 made out of the undistributed income for 1970, then as \$100 made out of the undistributed income for 1971, and finally as \$50 out of corpus in 1971. Since the total qualifying distributions for 1971 (\$150) exceed the distributable amount for 1971 (\$100), there exists a \$50 excess of qualifying distributions which F may use to reduce its distributable amounts for the years 1972 through 1976 (the taxable years in the adjustment period with respect to the 1971 excess). Therefore, the \$100 distributable amount for 1972 is reduced by \$30 (the lesser of the 1971 excess (\$50) and the remaining undistributed income at the close of 1972 (\$30), after the qualifying distributions of \$70 for 1972 were applied to the original distributable amount for 1972 of \$100). Since the distributable amount for 1972 was reduced to \$70, there is no remaining undistributed income for 1972. Accordingly, the qualifying distributions made in 1973 will be treated as \$100 made out of the undistributed income for 1973 and as \$40 out of corpus in 1973. Since this amount (\$140) exceeds the distributable amount for 1973 (\$100), there exists a \$40 excess which F may use to reduce its distributable amounts for the years 1974 through 1978 (the taxable years in the adjustment period with respect to the 1973 excess). However, in accordance with subparagraph (1) of this paragraph such excess may not be used to reduce F's distributable amounts for the years 1974 through 1976 until the excess created in 1971 has been completely applied against distributable amounts during such years. The distributable amount for 1974 is reduced by \$40 (the lesser of the unused portion of the 1971 excess (\$20) plus the 1973 excess (\$40) and the re-

maining undistributed income at the close of 1974 (\$40), after the qualifying distributions of \$60 for 1974 were applied to the original distributable amount for 1974 of \$100). The distributable amount for 1975 is reduced by \$20 (the lesser of the unused portion of the 1973 excess of qualifying distributions (\$20) and the remaining undistributed income at the close of 1975 (\$25), after the qualifying distributions of \$75 for 1975 were applied to the original distributable amount for 1975 of \$100). Consequently, qualifying distributions made in 1976 will be treated as made first out of the \$5 of remaining undistributed income for 1975 and then as \$100 made out of the undistributed income for 1976.

Example (2). Assume the facts as stated in example (1), except that in 1974 F receives a contribution of \$300 from G, a private foundation which controls F (within the meaning of paragraph (a)(3) of this section), and F distributes such contribution in 1975 in satisfaction of paragraph (c) of this section. Under these circumstances, there would be no excess of qualifying distributions for 1975 with respect to such distribution, since such distribution is excluded from the computation of an excess of qualifying distributions by operation of subparagraph (2)(i) of this paragraph.

Example (3). Assume the facts as stated in example (1), except that in 1972 F is treated as an operating foundation (as such term is defined in section 4942(j)(3)). In accordance with subparagraph (3) of this paragraph since F is not subject to the initial excise tax imposed by section 4942(a) for 1972, the 1971 excess cannot be carried forward to 1972 or any subsequent year in the adjustment period with respect to the 1971 excess, even if F is subsequently treated as a private nonoperating foundation for any year during the period 1973 through 1976.

[T.D. 7256, 38 FR 3323, Feb. 5, 1973, as amended by T.D. 7486, 42 FR 24265, May 13, 1977; T.D. 7849, 47 FR 50857, Nov. 10, 1982; T.D. 7938, 49 FR 3848, Jan. 31, 1984; T.D. 8084, 51 FR 16302, May 2, 1986]

§ 53.4942(b)-1 Operating foundations.

(a) *Operating foundation defined—(1) In general.* For purposes of section 4942 and the regulations thereunder, the term "operating foundation" means any private foundation which, in addition to satisfying the assets test, the endowment test or the support test set forth in § 53.4942(b)-2 (a), (b) and (c), makes qualifying distributions (within the meaning of § 53.4942(a)-3(a)(2)) directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose equal in value to: