Internal Revenue Service

Department of the Treasury

Washington, DC 20224

513.00-00

Contact Person:

199909056

Telephone Number:

In Reference to:

Date:

DEC 7 1998

DO:
EIN:

Dear Sir or Madam:

This is in reply to your letter of July 2, 1998, wherein you requested several rulings with respect to the Federal income tax consequences of establishing a proposed new investment vehicle to raise financial support for your activities.

You are exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code and are classified as a publicly supported organization within the meaning of section 509(a)(1) and 170(b)(1)(A)(vi) of the Code.

The information submitted indicates that you are a community development organization designed to strengthen the economy in a specific region. You have represented that the area within which you operate is generally considered to be one of the poorest and most economically distressed areas in the country. In order to accomplish your charitable program you provide financial support (either in the form of loans or occasionally purchase an equity interest in a company), technical and management expertise and marketing services to businesses in the area. You have represented that you place an emphasis on minority entrepreneurs and you primarily assist businesses which are unable to obtain financing from conventional sources.

In order to obtain a portion of the financing needed to carry on your charitable program you established a limited liability company (hereinafter referred to as an LLC). You have the right to appoint a majority of the members on the managing committee of the LLC. Accordingly, you were and will continue to be the managing member of the LLC. As initially established you only targeted banks and certain other financial institutions in the region as potential investors in the LLC. You have received a ruling from the Service recognizing that participating in this program would have no impact upon your status as an organization described in section 501(c)(3) of the Code. This ruling also recognized that any income you earned by reason of your participation in this program would be considered to be furthering your exempt purposes and would not be considered income from an unrelated trade or business within the meaning of section 513 of the Code.

Re:

As the managing member of the LLC you provide various services to the businesses you assist. These services include screening applicants for loans using the same standards as you do in your general program. Factors considered in determining which businesses will be assisted include ensuring that the applicant will provide at least 50 percent of the jobs it creates to residents of a county within the region you operate in; that the county's median family income is less than 80 percent of the national median; that at least 20 percent of the county's residents live at or below poverty level and that the county's rate of unemployment exceeds the national rate by 50 percent or more, or the rate of decline in county population for a set period of time was 10 percent or more.

You now propose to amend your LLC Agreement and create a new fund-raising vehicle which is to target a new class of investors. Targeted investors include individuals and institutional investors that have an interest in furthering the economic development of the region. Your new investment vehicle will pay investors a variable return based on the five year treasury note rate of return. The rights of this class of investor will differ marginally from the rights granted investors in the earlier vehicle you offered. One of the major differences being that these investors will not be afforded representation on the management committee of the LLC. You state that you will continue to be the controlling interest in the limited liability corporation. The criteria considered in making loans or Providing other support will remain unchanged under the proposed amended agreement. In addition, the income you receive as **your** allocable share of LLC income will continue to consist primarily of interest and loan fees.

Although redemptions are permitted under both the old agreement and the proposed amended agreement, the ability of a member of the LLC to request redemption is subject, at all times, to the availability of cash. The determination to permit redemption is made by your management committee. You further state that you do not intend to allow any redemptions that would preclude you from pursuing your lending and investment activities in a manner that furthers your charitable objectives.

You have requested the following rulings:

1. That your proposed amendment of the LLC agreement in the manner presented and your continued participation as a managing member of the limited liability corporation will not adversely affect your tax-exempt status under section 501(c)(3) of the Code; and

2. That the income derived by you from the LLC will not be considered unrelated business taxable income subject to United States federal income tax under section 511 of the Code.

Re:

Section 501(c)(3) of the Code provides in part for the exemption from federal income tax for organizations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the promotion of social welfare by organizations designed to relieve the poor and distressed, to lessen neighborhood tensions, or to combat community deterioration.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

Section 511(a) of the Code imposes a normal tax and a surtax on the unrelated business taxable income (defined in section 512) of organizations exempt from tax under section 501(c) of the Code.

Section 513(a) of the Code generally defines unrelated trade or business as any trade or business the conduct of which is not substantially related to the exercise or performance by an organization of the charitable, educational or other purpose constituting the basis for its exemption. In the case of an organization described in section 511(a)(2)(B), reference is made to the exercise or performance of any purpose or function described in section 501(c)(3).

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), Ct. D. 1650, C.B. 1945, 375, the Supreme Court of the United States held that the presence of a nonexempt purpose, if more than insubstantial, would destroy tax exempt status as a charitable organization.

Rev. Rul. 74-587, 1974-2 C.B. 162, describes an organization that was formed for the relief of poverty, the elimination of prejudice, the lessening of neighborhood tensions, and the combating of community deterioration in certain economically depressed areas through a program of financial assistance and other aid designed to improve economic conditions and economic opportunities in these areas. In furtherance of these objectives the organization devoted its resources to programs designed to stimulate economic development in high density urban areas

inhabited mainly by low-income minority or other disadvantaged groups. The organization made loans and purchased equity interests in businesses unable to obtain funds from conventional sources because of financial risks associated with their location and/or because of being owned by members of a minority or other disadvantaged group. The Service held that the organization qualified for exemption under section 501(c)(3) of the Code.

Rev. Rul. 76-419, 1976-2 C.B. 146, describes an organization that was formed for the relief of poverty, dependency, chronic unemployment, and underemployment, and the reduction of community tensions in an economically depressed community. In furtherance of these purposes the organization encouraged industrial enterprises to locate new facilities in the economically depressed area in order to provide more employment opportunities for low-income residents of this area. The organization purchased blighted land in the area and converted it into an industrial park. Lots in the park are leased to industrial enterprises on terms sufficiently favorable to attract tenants to this economically depressed area. Tenants were required by their leases with the organization to hire a significant number of presently unemployed persons in the area and to train them in needed skills. The organization, in selecting tenants for the industrial park, considered only those industrial enterprises whose hiring policies conform to current air employment legislation. The Service held that the organization furthered exclusively charitable purposes and qualified for exemption under section 501(c)(3) of the Code.

The information you have submitted indicates that you will be operating in an area which has been recognized as economically depressed. In addition, you will be assisting businesses in need and whose economic growth will have a positive impact on the general business environment in the community. Therefore, it appears that your activities are similar to those of the organizations described in Rev. Rul. 74-587, supra, and 76-419, supra. Furthermore, you control the managing committee of the LLC and have represented that you will ensure that, even though investors can redeem their interests in the LLC, you can refuse to redeem their interest if such a redemption could interfere with the accomplishment of your charitable mission. Although, you will receive your allocable share of income from the LLC, the LLC is furthering your charitable purposes and the income you receive is in furtherance of the purposes for which you have been recognized as exempt. See section 1.501(c)(3)-1(e) of the regulations.

Accordingly, we have concluded that amending your LLC Agreement in the manner presented and expanding the pool of potential investors will contribute to the accomplishment of the purposes for which you have been granted exemption under section 501(c)(3) of the Code. This ruling is based on the understanding

that there is no economic return for the investors other than the guaranteed return on their investment.

Therefore, based upon the information submitted we have concluded that:

1. Your proposed amendment of the LLC agreement in the manner presented and your continued participation as a managing member of the limited liability corporation will not adversely affect your tax-exempt status under section 501(c)(3) of the Code; and

2. the income derived by you from the activities of the LLC will not be considered unrelated business taxable income subject to United States federal income tax under section 511 of the Code.

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 by others as precedent.

A copy of this letter is being sent to your key District Director. Because this letter could help resolve any question about your exempt status, you should keep it in your permanent records.

If you have any question about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter. For other matters, including questions concerning reporting requirements, please contact your key District Director.

Sincerely yours,

(Signed) Garland A. Carter
Garland A Carter
Chief, Exempt Organizations
Technical Branch 2