SIN:4944.00-00

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

199910066

Contact Person

Telephone Number

Reference to

Date DEC 15 1998

Legend:

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C=
E=
D=

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y=
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Ladies and Gentlemen:

This is reply to letter dated August 26, 1998, from your legal representative in which she requested rulings concerning the income tax consequences of certain investments.

B and C have been recognized as exempt from federal income tax under section 501(c)(3) of the Code and are private foundations within the meaning of section 509(a)

B and C are separate legal entities even though they share administrative operations and staff. Both have made significant grants to charitable organizations located in D; have a particular commitment to economic development and an interest in assisting in the revitalization of D, which is economically depressed; and have committed significant funds in the past to the activities of economic development organizations in D. The goal of the economic development endeavors is not only to fund exempt economic development organizations, but also to provide initiative in identifying and assisting in innovative economic development opportunities.

In furtherance of exempt purposes, B and C have entered into a limited partnership with E as the general partner. E is a limited liability company. The members of E will be local universities and potentially, other organizations exempt under section 501(c)(3) of the Code. Thus, organizations exempt under section 501(c)(3) will control the general partner and therefore the partnership. The purpose of the partnership is (1) to supplement and enhance the technology transfer and commercialization process of D's universities, (2) to assist in

the creation of new companies in D, and (3) to encourage, support, and supplement the new businesses by offering access to early seed capital and competent business advice and services. The partnership anticipates raising at least x to use as seed capital and first stage financing for start-up high technology ventures. The companies in which the partnership invests will have been unable to obtain conventional financing. The partnership will invest at least y and, in general, no more than z in any one venture, although there may be exceptions. Strong preference will be given to companies committed to locating in D.

The funds invested by B and C, as limited partners, may be used to invest in technology businesses that agree to place their operations in areas of D determined to be blighted or depressed by a governmental body. The companies must agree that the investment may be redeemed or repaid if they fail to maintain operations in D. These investments are intended to promote a dynamic cluster of growth companies located in the inner city and other blighted areas.

You have represented that this investment would not be made but for the relationship between the investment and charitable purposes; that no significant purpose of the investment is the production of income or the appreciation of property; and that no part of the investment will be used by the partnership to engage in attempts to influence legislation or to intervene in political campaigns. Neither B or C nor disqualified persons with respect to B or C will control the partnership.

Section 170(c)(2)(B) of the Code allows for the deductibility of charitable contributions for the use of organizations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations which are organized and operated exclusively for charitable purposes.

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. In the law of charity, combating community deterioration is considered to be a charitable purpose.

Revenue Ruling 74-587, 1974-2 C.B. 162, holds that a nonprofit organization formed to relieve poverty, eliminate prejudice, reduce neighborhood tensions, and combat community

deterioration through a program of financial assistance in the form of low-cost or long-term loans to, or the purchase of equity interests in, various business enterprises in economically depressed areas is exempt under section 501(c)(3) of the Code.

Section 4942 of the Code imposes a tax on the undistributed income of a private foundation. The undistributed income is defined, in part, as the amount by which qualified distributions are less than a "minimum investment return" of five percent of the "aggregate fair market value of all assets of the foundation", other than specifically excluded assets.

Section 4942 of the Code provides, generally, for the imposition of tax on the undistributed income of a private foundation for any taxable year. "Undistributed Income" means the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made before such time. The term "qualifying distribution" includes any amount paid to accomplish a charitable purpose, other than any contribution to (i) an organization controlled by the foundation or one or more disqualified persons with respect to the foundation, or (ii) a private foundation which is not an operating foundation.

Section 53.4942(a)-3(a)(2)(i) of the Foundation and Similar Excise Taxes Regulations provides that program-related investments, as defined in section 4944(c), and reasonable and necessary administrative expenses are included within the meaning of the term "qualifying distribution".

Section 4943 of the Code provides for the imposition of tax on the excess business holdings of any private foundation. Excess business holdings means, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

Section 53.4943-10(b) of the regulations provides that the term "business enterprise" does not include a functionally related business as defined in section 4942(j)(5) of the Code. In addition, business holdings do not include section 4944(c) program-related investments (such as investments in small businesses in central cities or in corporations that assist in neighborhood renovations).

Section 4944 of the Code provides for the imposition of tax on investments which jeopardize the carrying out of any of the exempt purposes of a private foundation. Section 4944(c),

however, provides for an exception from this tax in the case of program-related investments.

Section 53.4944-3 of the regulations discusses program-related investments. In general, such an investment must possess the following characteristics: (i) The primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B) of the Code; (ii) No significant purpose of the investment is the production of income or the appreciation of property; and (iii) No purpose of the investment is to accomplish the purpose of attempting to influence legislation or to attempt to participate in, or intervene in, any political campaign on behalf of any candidate for public office.

An investment shall be considered as made primarily to accomplish a purpose described in section 170(c)(2)(B) whether or not carried out by organizations described in section 170(c). In determining whether a significant purpose of an investment is the production of income or the appreciation of property, it shall be relevant whether investors solely engaged in the investment for profit would be likely to make the investment, the same terms as the private foundation. Section 53.4944-3(a)(2)(iii) emphasizes that the fact that an investment produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property. Example (3) describes a situation in which a private foundation purchases shares in a small business enterprise located in a deteriorated urban area. It was held that the investment significantly furthers the accomplishment of the foundation's exempt purposes and was a program-related investment even though the foundation may realize a profit if the corporation is successful and the common stock appreciates in value.

Section 53.4945-6(c)(1), of the regulations refers to grants made to noncharitable organizations. Since private foundations cannot make expenditures for a purpose other than a purpose described in section 170(c)(2)(B), a private foundation may not make a grant to an organization other than an organization described in section 501(c)(3) unless the making of the grant itself constitutes a direct charitable grant or the making of a program-related investment.

The purpose of the investment in E is to enhance the living conditions in a depressed community and help combat community deterioration by building a sound economic base. In the manner described, such a program promotes a charitable purpose within the meaning of sections 170(c)(2)(B) and 501(c)(3) of the Code. In addition, by imposing restrictions upon the use

of the invested funds, it has been established that the purpose of this investment is not the production of income or the appreciation of property. Furthermore, no purpose of the investment is to attempt to influence legislation or participate in or intervene in any political campaign on behalf of any candidate for public office. Accordingly, we are ruling that the described investment is a program-related investment within the meaning section 4944(c) of the Code.

Moreover, since the investment is a program-related investment, sections 4942, 4943 and 4945 of the Code would not be applicable and, because of such, favorable rulings are appropriate in respect to the requests under these Code sections.

Therefore, based on the particular facts and circumstances in your case, we make the following rulings:

1. The investments made by B and C in E will further charitable economic development purposes within the meaning of sections 170(c)(2)(B) and 501(c)(3) of the Code.

2. The investments made by B and C in the partnership will constitute a program-related investment under section 4944(c), and therefore, such investment will not be considered to be an investment that jeopardizes the carrying out of your exempt purposes under section 4944.

3. The investments made by B and C in the partnership will constitute a qualifying distribution for each of you for purposes of section 4942 in each year in which a payment is made with respect to the investment.

4. The investments made by B and C in the partnership will not constitute excess business holdings under section 4943.

5. The investments made by B and C in the partnership will not constitute a taxable expenditure under section 4945 provided you exercise expenditure responsibility with respect to the investment.

This ruling is based on the understanding that there will be no material changes in facts upon which it is based.

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 uses or cited by others a precedent.

We are informing your key District Director of this action. Please keep a copy of this ruling in your permanent records.

Sincerely yours,

Gerald V. Sack

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4