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

199929049

Date: APR 28 1999

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T:2

Legend

M=

Dear Sir or Madam:

This responds to your request for ruling dated March 3, 1998, and amended by your letters dated December 11, 1998 and December 15, 1998, concerning the effect of the Internal Revenue Code and Regulations on activities you intend to pursue.

M is a non-profit corporation which has been recognized by the Internal Revenue Service as an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986 (Code). M is also described in Section 509(a)(2) of the Code. M is the successor to a judicially operated program which has been engaged in the production of affordable housing for some twenty years. M has accomplished its goals by operating as the developer of affordable housing projects, and by operating as a lender to developers providing below-market and deferred payment junior financing to make housing affordable to eligible tenants and owners.

M now seeks to expand its activities beyond those described in its exemption application in two ways. First, M plans to provide credit enhancement service to developers of affordable housing. This service would consist of loan guarantees to lenders whose underwriting standards prohibit lending sufficient funds to enable affordable housing projects to proceed. The use of enhancements, rather that junior loans to developers, will enable M to minimize the amount of junior lending, and maximize the leverage of its capital so as to increase the assistance it is able to offer developers of affordable housing. This service M proposes is not available in the marketplace.

Secondly, M proposes to engage in pre-development and construction lending to projects which result in the production of affordable housing. M expects to provide these loans only when the developer is otherwise unable to obtain financing for land acquisition, pre-development and/or construction financing. M expects to serve as a "lender of last resort" to enable the development of affordable housing when federal, state or local government funding is not available, and when underwriting standards cause commercial lenders to decline such loans. M will offer these loans under terms more favorable than could be obtained in the market place, even if such loans were available. These loans will be at interest rates below the commercial market rate, and will be for terms substantially longer than offered by third party lenders. In addition, where necessary, M will allow borrowers to defer payment of principal and interest until the due date of the loans.

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In Re:

M intends to limit its lending, and its credit enhancement activities to housing organizations which are qualified for tax-exempt status on any basis described in Revenue Procedure 96-32, 1996-1 C.B., 717.

Section 501(a) of the Internal Revenue Code provides an exemption from federal income tax for organizations described in section 501(c)(3). Section 501(c)(3) describes organizations which are organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations (Regulations) provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term charitable is used in its generally accepted legal sense. The term includes, among other things, relief of the poor and distressed, and the promotion of social welfare by organizations designed to lessen neighborhood tensions and to combat community deterioration.

Revenue Procedure 96-32, 1996-1 C.B. 717 sets forth a "safe harbor" and facts and circumstances which distinguish organizations engaged in housing activities which are described in Section 501(c)(3) of the Code, from those not so described.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations exempt under Section 501(a) of the Code.

Section 512(a)(1) of the Code defines unrelated business taxable income as the gross income derived from any unrelated trade or business as defined in Section 513 of the that is regularly carried on, less allowable deductions.

Section 513(a) of the Code defines "unrelated trade or business" as any trade or business the conduct of which is not substantially related to the organization's exercise of performance of the purpose of functioning constituting the bases for its exemption under Section 501 of the Code.

M, and its predecessor organization have a long history of developing charitable housing, both directly and by service as a junior lender. The additional credit services described by M should increase its ability to enlarge the stock of charitable housing in the area of its operation. Further, the services as described are not available in the market place, and will be related to M's purposes because they will be available only to organizations operating within the safe harbor defined in Revenue Procedure 96-32, supra.

Based on the above facts and law, we therefore conclude M's conduct of lending activities in the manner described will not affect M's exempt status as an organization described in Section 501(c)(3) of the Code. Because M intends to limit its expanded activities so as to benefit only organizations operating within the safe harbor of Revenue Procedure 96-32, supra, we further conclude that fees M obtains from these lending activities will be related to the performance by M of its exempt function and will therefore not be subject to the tax imposed by Section 511 of the Code.

In Re:

Because this letter could help resolve any questions about your tax status, you should keep it with your permanent records.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be reported to your key District Director.

This ruling letter is directed only to the organization that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2