

PRESENTED AT

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Austin, TX

**EXPLORING THE CONTOURS OF CHARITABILITY:
Economic Development, Community Revitalization,
Poverty Alleviation, Scientific Research, Education,
and the Environment
Key Concepts and Rulings**

Speakers:

Ann K. Batlle, *Morgan Lewis, Washington, DC*

Stephen M. Clarke, *Ernst & Young LLP, Washington, DC*

Erica Guyer, *The Rockefeller Foundation, New York, NY*

Joshua J. Mintz, *John D. and Catherine T. MacArthur Foundation, Chicago, IL*

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I. Economic Development

A. Code and Regs

1. “Economic development” is not explicitly stated as a charitable purpose in the Code or Regs.

B. Framework/Key Principles

1. Organizations that foster economic development should consider grounding their goals with other defined charitable purposes such as relieving poverty; lessening neighborhood tensions; lessening prejudice and discrimination; and promoting social welfare.²
2. Economic development corporations may be entitled to exemption under Section 501(c)(3) even though they provide services to for-profit companies where, in the words of the IRS, “the ultimate good received by the general public outweighs the private benefit accorded to the direct beneficiaries [the for-profit companies].”³
3. The IRS has listed the following factors as necessary to conclude that an organization formed to promote economic development is primarily accomplishing charitable purposes despite the presence of a private benefit:⁴
 - a) Assistance is targeted to aid an economically depressed or blighted area;
 - b) Assistance benefits a disadvantaged group, such as minorities, the unemployed or underemployed; and
 - c) Assistance is for businesses that have actually experienced difficulty in obtaining conventional financing because of the deteriorated nature of the area in which they were or would be located, or their minority composition.

C. Revenue Rulings

1. Rev. Rul. 74-587, 1974-2, C.B. 162 - IRS held that an organization formed to stimulate economic development in economically depressed areas for the purpose of providing jobs and greater economic opportunity for low-income, minority, or other disadvantaged groups served charitable purposes and therefore qualified for exemption under Section 501(c)(3).

¹ The speakers gratefully acknowledge the assistance of Amanda Brown at Morgan Lewis in preparing these reference materials.

² See Rev. Rul. 74-587, 1974-2 C.B. 162 and Rev. Rul. 76-419, 1976-2 C.B. 146

³ See, e.g., “Economic Development Corporations: Charity Through the Back Door,” by Robert Louthian and Marvin Friedlander, IRS Exempt Organizations Continuing Professional Education Technical Instruction Program for Fiscal Year 1992.

⁴ See, e.g., “Economic Development Corporations: Charity Through the Back Door,” by Robert Louthian and Marvin Friedlander, IRS Exempt Organizations Continuing Professional Education Technical Instruction Program for Fiscal Year 1992.

The organization made loans and purchased equity interests in businesses unable to obtain funds from conventional sources because of the financial risks associated with the location. The funds were intended to help create or grow businesses and preference was given to businesses that would provide jobs and job training opportunities in the community. The activities of this organization satisfied several charitable purposes, including lessening of prejudice, lessening neighborhood tensions through the creation of jobs, and combating community deterioration by helping to establish and rehabilitate businesses in the area. The ruling also noted that, “[a]lthough some of the individuals receiving financial assistance in their business endeavors under the organization’s program may not themselves qualify for charitable assistance as such, that fact does not detract from the charitable character of the organization’s program. The recipients of loans and working capital in such cases are merely the instruments by which the charitable purposes are sought to be accomplished.”

2. Rev. Rul. 76-419, 1976-2 C.B. 146 – The IRS granted exemption to an organization that purchased blighted land in an economically depressed community, converted the land into an industrial park, and induced businesses to locate new facilities in the park through favorable lease terms that required employment opportunities for unemployed and underemployed residents of the area. The organization gave priority to tenants that agreed to hire low skill workers and provide job training. The IRS found that by inducing enterprises to locate in an economically depressed area, the organization’s activities served to relieve poverty, lessen neighborhood tensions caused by the lack of job opportunities, and also combat community deterioration.
3. Rev. Rul. 77-111, 1977-1 C.B. 144 – The IRS found that an organization formed to promote economic development in deteriorated areas did not qualify for exemption under 5013(c)(3). The organization proposed to limit further decline in blighted areas by working with the city to construct a shopping center that would compete with retail centers located in suburbs. The shopping center space would be provided to tenants on favorable terms. The tenants would be required to hire a certain percentage of minorities. In this case, there was no showing that the businesses would not have located in the area but for the existence of the shopping center, and there was no requirement that they would provide jobs to disadvantaged residents of the area. As the ruling notes, “the organization does not limit its aid to businesses that are owned by members of a minority group or to businesses that would only locate within the area because of the existence of the center. The end result is that this organization’s activities are directed to benefit the businesses in the shopping center rather than exclusively to accomplish 501(c)(3) purposes.” Accordingly, the IRS concluded that the benefits provided to the businesses outweighed the public benefit and precluded exemption.

D. Additional Guidance

1. Private Letter Ruling 9134031⁵ - A private foundation’s loan to a minority owned bank that employed only racial minorities and made real estate and commercial loans mostly to minorities was held to be a charitable purpose under Regulation 1.501(c)(3)-1(d)(2). The bank was the only minority-owned bank in the area, but its capital had fallen below the minimum level required by the FDIC, so the loan was being made in an effort to prevent the bank from failing. The IRS concluded that the primary purpose of the loan was to encourage the economic development of a minority group. There was no requirement that the

⁵ Although private letter rulings are directed only to the organizations and individuals that request them and may not be used or cited as precedent (Section 6110(k)(3)), they provide useful insight into how the IRS is likely to treat a particular situation.

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