

Rev. Rul. 74-587

Advice has been requested whether a nonprofit organization formed and operated in the manner described below is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization's charter provides that it is organized exclusively for charitable purposes and restricts its activities to those not proscribed by section 501(c)(3) or other related provisions of the Code. The declared objectives of the organization are 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 such objectives the organization devotes its resources to programs designed to stimulate economic development in high density urban areas inhabited mainly by low-income minority or other disadvantaged groups. Because of the lack of capital for development, the limited entrepreneurial skills of the owners, the social unrest and instability of the area, and the depressed market within which they operate, many of the businesses located in these high density urban areas have declined or fallen into disrepair, and others have ceased to operate.

The organization undertakes to combat such conditions by providing funds and working capital to corporations or individual proprietors who are not able to obtain funds from conventional commercial sources because of the poor financial risks involved in establishing and operating enterprises in these communities or because of their membership in minority or other disadvantaged groups. The program is designed to enable the recipient of funds or capital to start a new business or to acquire or improve an existing business. Depending upon the circumstances, the financial assistance may be in the form of low-cost or long-term loans or the purchase of equity interests in the various enterprises. The terms of any loan will be reasonably related to the needs of the particular business. Where the financial assistance takes the form of acquiring an equity interest, the organization disposes of such interest as soon as the success of the business is reasonably assured.

In selecting recipients for aid, the organization consults with other nonprofit and governmental organizations operating anti-poverty and anti-discrimination programs to identify particular undertakings that will fill a community need and offer the greatest potential community benefit. Preference is given to businesses that will provide training and employment opportunities for the unemployed or under-employed residents of the area. In selecting a recipient for financial assistance, the organization considers the applicant's motivation, education, experience, and prior participation in management and job training programs. It also considers recommendations from other organizations conducting rehabilitation and training programs.

The organization does not actively participate in the day-to-day operation of the businesses to which it provides financial assistance; however, it does review their progress periodically to

assure that the funds are used for the organization's purposes. In addition, when appropriate, the organization provides technical assistance and counseling.

The facts relating to the financial activities undertaken by the organization in carrying out this program established that these loans and purchases of equity interest are not undertaken for purpose of profit or gain but for the purpose of advancing the charitable goals of the organization and are not investments for profit .in any conventional business sense.

The organization is financed by grants from foundations and by public contributions.

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

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section. An organization that fails to meet either the organizational or the operational test is not exempt.

Section 1.501(c)(3)-1(d)(2) of the regulations defines the term "charitable" as including the promotion of social welfare by organizations designed to relieve the poor and distressed or the underprivileged, to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration.

The corporate charter declares the purposes of the organization to be exclusively charitable and contains appropriate restrictions against engaging in any activities proscribed under section 501(c)(3) or related provisions of the Code. To that extent, therefore, the organization meets the organizational requirements of the applicable regulations provisions.

To satisfy the "operational test" the organization's resources must be devoted to programs that qualify as exclusively charitable within the meaning of section 501(c)(3) of the Code and applicable regulations.

Through its program of financial assistance, the organization is devoting its resources to uses that benefit the community in a way that the law regards as charitable. Such conclusion follows from the fact that the organization's described program of aiding minority-owned businesses promotes the social welfare of the community, since it helps to lessen prejudice and discrimination against minority groups by demonstrating that the disadvantaged residents of an impoverished area can operate businesses successfully if given the opportunity and proper guidance. It also helps to relieve poverty, while at the same time lessening neighborhood tensions and dissatisfaction arising from the lack of employment opportunities by assisting local businesses that will provide a means of livelihood and expanded job opportunities for unemployed or underemployed area residents. Finally, it combats community deterioration by helping to establish businesses in the area and by rehabilitating existing businesses that have deteriorated.

Although 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.

Accordingly, the organization is exempt from Federal income tax under section 501(c)(3) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the regulations.