



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

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Contact Person:

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4942.04-00

4943.03-00

Dear \_\_\_\_\_ :

We are responding to a ruling request made on your behalf by your authorized representative.

You are an organization that has been recognized as described in section 501(c)(3) of the Internal Revenue Code. You are classified as a private foundation defined in section 509(a) of the Code.

You are requesting a ruling as to the proper tax treatment under section 4943 of the Code of certain investment-related activities to be carried on by a proposed wholly-owned subsidiary (the "Subsidiary").

You were formed to make grants to support organizations that help low-income individuals create wealth and take control of their lives. These organizations work to advance home ownership, support enterprise development, provide quality child care and/or increase access to capital in rural and urban communities across the United States. In addition, you are a leading provider of program-related investments ("PRIs") and investments in entities that produce not only an investment return but also serve community development purposes to enhance communities and populations that are underserved. These investments are known as "double bottom line investments."

You propose creating the Subsidiary to undertake various activities that further your mission. The proposed Subsidiary's activities will include one or more of the following:

1. Provide advice and consulting services relating to PRIs and other double bottom line investments to other private foundations, exempt organizations and socially motivated investors for a fee. Such advice could include assistance in selecting possible investment opportunities, due diligence such as financial analysis, business plan analysis and credit analysis with respect to the investee, monitoring performance of such

investments, and provision of general support in connection with overseeing such investments.

2. Act as a fundraiser or “placement agent” to locate investors for community development venture capital funds or Rural Business Investment Companies where there are federal or other matching funds available to support investments in targeted underserved fields, industries or geographic locations.
3. Provide certain asset management services such as setting up and administering a positive screen for investments in publicly-traded companies whose activities and business practices support your mission.
4. Establish and manage a public mutual fund for the purpose described at item 3, above.

You acknowledge that any income of the Subsidiary will be fully subject to Federal income tax under the Code. See e.g., Revenue Ruling 69-528, 1969-2 C.B. 127, ruling that an organization that was formed to provide investment services on a fee basis exclusively to organizations exempt from Federal income tax under section 501(c)(3) of the Code was not exempt from tax under section 501(a) of the Code because it was regularly carrying on the business of providing investment services that would be an unrelated trade or business if carried on by any of the tax-exempt organizations on whose behalf it operated. However, you want to ensure that the Subsidiary will be considered a “functionally related business” as defined in section 4942(j)(4) of the Code, which is exempted from the definition of “business enterprise” under section 4943(d)(3) of the Code so as to avoid “excess business holdings” which could subject you to adverse tax consequences and divestiture requirements under section 4943 of the Code.

Accordingly, you are requesting the following rulings:

1. The proposed Subsidiary is a “functionally related business” with regard to you within the meaning of section 4942(j)(4) of the Code because it furthers your exempt purpose.
2. Your ownership of the proposed Subsidiary will not cause you to be subject to the divestiture requirements, or to be liable for the tax imposed on “excess business holdings” of a private foundation engaged in a “business enterprise” under section 4943 of the Code.

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.

Section 4942(j)(4) of the Code provides the term “functionally related business” means

- (a) A trade or business which is not an unrelated trade or business (as defined in section 513), or
- (b) An activity which is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which is related (aside from the need of the organization for income or funds or the use it makes of the profit derived) to the exempt purposes of the organization.

Section 4943 of the Code provides for the imposition of tax on the excess business holdings of any private foundation. The term “excess business holdings” means, with respect to the holdings of any 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 Foundation and Similar Excise Taxes Regulations provides that the term “business enterprise” does not include a functionally related business as defined in section 4942(j)(4) 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 an exception from this tax in the case of program-related investments.

Section 4944(c) of the Code provides that for purposes of section 4944, program-related investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes.

Section 53.4944-3(a) of the regulations states (1) for purposes of section 4944 and sections 53.4944-1 through 53.4944-6, a “program-related investment” shall not be classified as an investment which jeopardizes the carrying out of the exempt purposes of a private foundation. A “program-related investment” is an investment which possesses the following characteristics:

- (1) 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;

- (2) No significant purpose of the investment is the production of income or the appreciation of property; and,
- (3) 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.

Section 53.4944-3(a)(2)(i) of the regulations provides that an investment shall be considered as made primarily to accomplish a purpose described in section 170(c)(2)(B), if it significantly furthers the accomplishment of the private foundation's exempt activities, and if the investment would not have been made but for such relationship between the investment and the accomplishment of the foundation's exempt activities. The term "purposes described in section 170(c)(2)(B)" shall be treated as including purposes 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 on 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) at section 53.4944-3(b) of the regulations 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 53.4944-3(a)(2)(ii) of the regulations provides that an investment in an activity described in section 4942(j)(4)(B) and the regulations thereunder shall be considered, for purposes of this paragraph, as made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B).

You were formed to make grants to support organizations that help low-income individuals create wealth and take control of their lives. In furtherance of your exempt purposes, you are a provider of PRIs and investments in entities that produce an investment return and serve community development purposes to enhance communities and populations that are underserved.

The Subsidiary will encourage other private foundations to invest in the development of minority and underserved communities by providing advice and consulting services to other private foundations, exempt organizations, and socially motivated investors; act as a fundraiser or "placement agent" as described above; provide asset management services as described above; and, establish and maintain a public mutual fund in furtherance of your exempt purposes. Accordingly, the activities of the proposed Subsidiary will be carried on within a larger complex of other endeavors which are related to your exempt purpose.

The proposed Subsidiary's programs will promote a charitable purpose within the meaning of section 170(c)(2)(B) of the Code, helping low-income individuals create wealth and take control of their lives. The proposed investment will not be made for the production of income or the appreciation of property. No purpose of the proposed investment is to attempt to influence legislation or to attempt to participate in, or intervene in, any political campaign on behalf of any candidate for public office.

Accordingly, based on the information furnished, we rule as follows:

1. The proposed Subsidiary will be a "functionally related business" with regard to you within the meaning of section 4942(j)(4) of the Code because it furthers your exempt purpose.
2. Your ownership of the proposed Subsidiary will not cause you to be subject to the divestiture requirements, or to be liable for the tax imposed on "excess business holdings" of a private foundation engaged in a "business enterprise" under section 4943.

This ruling is based on the understanding that there will be no material change in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

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

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert C. Harper, Jr.  
Manager, Exempt Organizations  
Technical Group 3

Enclosure:  
Notice 437