

B. ENVIRONMENTAL AND HISTORICAL PRESERVATION UNDER IRC 501(c)(3)

Introduction

Preservationist activity of recent years may be characterized as one of the most visible, and certainly vocal, efforts of the non-profit community. The increased activity is in response to the great commercial and residential pressures on our cultural and natural environments, new awareness of the effects of pollution, and shrinking energy supplies. There has also been a new awakening of appreciation in America's historical background, somewhat stimulated by the Bicentennial.

In any event, preservation organizations are no longer merely concerned with the maintenance of battlefield monuments, gardens, and nature trails but are now in the vanguard of attempts to change America's directions. The goals now include recycling, the rehabilitation of cities and towns, and the reclamation of areas of our natural environment blighted through overuse, lack of planning, or lack of care. Preservationists want green space in and around urban areas, wilderness areas and the preservation of the snail darter instead of the building of a \$100,000,000 dam. Preservationists want to revitalize downtowns suffering from years of urban neglect by encouraging the restoration of old and abandoned building facades and shells, otherwise left over memories of earlier eras.

The realization of the goals of today's preservationists come about through methods which are aggressive and innovative and may include land trusts, conservancies, revolving funds, lobbying activities, litigation, boycotting, confrontation tactics, and perhaps even intervention in political campaigns.

The purpose of this topic is to describe the tax laws, regulations, rulings, and new Service developments as they relate to the purposes and activities of preservationists, particularly in the IRC 501(c)(3) exemption context. Although not meant to be an all inclusive discussion in an area which has become very active, it will raise many issues of present concern.

The topic is divided into five subtopics. They are: 1) Environmental Preservation, 2) Historical Preservation, 3) Revolving Funds, 4) Unrelated Debt-Financed Income, and 5) Action, Advocacy and Confrontation Activities.

1. Environmental Preservation

a. Preservation of Lands for Public Use or Scenic Enjoyment

(1) The Law and Regulations

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

Regs. 1.501(c)(3)-1(d)(2) provides, in part, that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the advancement of education or science; erection or maintenance of public buildings, monuments, or works; or to combat community deterioration.

(2) Maintenance and Improvement of Community Recreational Facilities

Several published revenue rulings have recognized as charities organizations that devote their assets to the maintenance and improvement of community recreational facilities:

(a) Rev. Rul. 70-186, 1970-1 C.B. 128, holds that the organization formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features is exempt under IRC 501(c)(3).

(b) Rev. Rul. 68-14, 1968-1 C.B. 243, holds that an organization formed to promote and assist in city beautification projects and to educate the public in the advantages of street planting is exempt under IRC 501(c)(3).

(c) Rev. Rul. 78-85, 1978-1 C.B. 150, holds that an organization formed by residents of a city to cooperate with municipal authorities in preserving, beautifying and maintaining an urban public park is exempt under IRC 501(c)(3).

(3) Resource and Land Use, Beautification and Recycling Planning

Similarly, organizations engaged in resource planning and land use, beautification and recycling have also been held as charitable organizations in revenue rulings.

(a) Rev. Rul. 67-292, 1967-2 C.B. 184, holds that an organization formed for the purpose of purchasing and maintaining a sanctuary for wild birds and animals for the education of the public may qualify for exemption under IRC 501(c)(3).

The text of Rev. Rul. 67-292 is extracted below:

Rev. Rul. 67-292

An organization formed for the purpose of developing a sanctuary for wild birds and animals for the education of the public may be exempt from Federal income tax as an educational organization under section 501(c)(3) of the Internal Revenue Code of 1954. I.T. 2134, C.B. IV-1, 214 (1925), superseded. The purpose of this Revenue Ruling is to update and restate under the current statute and regulations the position set forth in I.T. 2134, C.B. IV-1, 214 (1925).

The organization was formed to purchase and maintain a large tract of forest land to be reserved as a sanctuary for wild birds and animals and to be open to the public for educational purposes. Its income is derived from contributions and is expended in furthering the purposes for which it was organized.

Section 501(c)(3) of the Internal Revenue Code of 1954 provides for the exemption from Federal income tax of organizations organized and operated exclusively for educational purposes.

Section 1.501(c)(3)-1(d)(3) of the Income Tax Regulations provides that the term "educational" for the purposes of section 501(c)(3) of the Code relates to the instruction of the public on subjects useful to the individual and beneficial to the community. An example in this section states that organizations such as museums, zoos, planetariums, symphony orchestras, and other similar organizations may be educational if they otherwise meet the requirements of the section.

A sanctuary for wild birds and animals to be used for public educational purposes is an organization similar to a museum or zoo. Therefore, the activities of this organization are educational in that they instruct the public on subjects useful to the individual and beneficial to the community.

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

An organization which considers itself within the scope of this Revenue Ruling must, in order to establish exemption under section 501(c)(3) of the Code, file an application on Form 1023, Exemption Application, with the District Director of Internal Revenue for the internal revenue 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.

This Revenue Ruling restates under current law the position set forth in I.T. 2134. Therefore, I.T. 2134 is superseded.

(b) Rev. Rul. 67-391, 1967-2 C.B. 190, holds that an organization formed to develop and disseminate an urban land use plan is exempt under IRC 501(c)(3).

(c) Rev. Rul. 66-179, 1966-1 C.B. 139, holds that a garden organization exclusively engaged in the development of plantings on public lands, making awards for civic achievements, and conducting similar activities for the community benefit is exempt under IRC 501(c)(3).

(d) Rev. Rul. 70-79, 1970-1 C.B. 127, holds that an organization formed to assist local governments of a metropolitan area by conducting research to develop solutions for such problems as water and air pollution, waste disposal, water supply, and transportation is exempt under IRC 501(c)(3).

(e) Rev. Rul. 72-560, 1972-2 C.B. 248, holds, in part, that combatting environmental deterioration through recycling of waste materials serves a charitable purpose in that it combats community deterioration. This revenue ruling is particularly distinctive in the environmental area and deserves reproduction here.

The text of Rev. Rul. 72-560 is extracted below:

An organization formed to educate the public regarding environmental deterioration due to solid waste pollution and operated with contributions and proceeds from sale of collected solid waste for recycling is exempt under section 501(c)(3) of the Code.

Rev. Rul. 72-560

Advice has been requested whether an organization that otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 is operated for charitable purposes where its only activities are those described below.

The organization was formed to educate the public regarding environmental deterioration due to solid waste pollution and to provide facilities for the collection of certain materials for recycling. It sponsors workshops, conferences, and exhibits to inform the public of the environmental problems caused by solid waste materials and the advantages of recycling such materials. It also has established centers staffed entirely by volunteers, where members of the public may bring solid waste materials such as old newspapers, glass containers,

and metal cans for disposal. The waste materials collected at the centers are sold to commercial companies for recycling. Any excess of income over expenses from the sale of waste materials is used by the organization in its other activities.

The organization's receipts are from contributions and the payments for the waste materials. Its disbursements are for the transportation of waste materials to the recycling companies, the construction of exhibits, sponsorship of workshops and conferences, and miscellaneous administrative expenses.

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

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations defines the term "charitable" as including the promotion of social welfare by organizations designed to combat community deterioration.

Section 1.501(c)(3)-1(d)(3)(i)(b) of the regulations defines the term "educational" as including the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities if the operation of such trade or business is in furtherance of the organization's exempt purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business.

By providing information to the public concerning environmental problems caused by solid waste materials and the advantages of recycling such materials, the organization is instructing the public on subjects useful to the individual and beneficial to the community.

The recycling of the waste materials is an essential element in the organization's efforts to combat environmental deterioration, since it prevents the pollution of the environment caused by the usual disposition of these materials. These activities are thus analogous to the tree planting and street cleaning operations that were held to serve a charitable purpose in Revenue Ruling 68-14, C.B. 1968-1, 243. Any income derived from the sale of the waste materials to the recycling companies is merely incidental to the accomplishment of the exempt purposes of the organization.

Accordingly, it is held that the organization's activities are charitable and educational and, since it otherwise qualifies for exemption, the organization is exempt under section 501(c)(3) of the Code.

b. Rev. Rul. 76-204 - Preservation of Ecologically Significant Land is a Charitable Purpose and Activity - An IRS Landmark

Rev. Rul. 76-204, 1976-2 C.B. 152 and its precursor, Rev. Rul. 75-207, 1975-1 C.B. 361, provides landmark authority in breaking from previous Service position in this area, for example, Rev. Rul. 67-292, *supra*. The prior position set forth in Rev. Rul. 67-292 was that an organization formed to develop a sanctuary for wild birds and animals for the education of the public is engaging in educational activities similar to those of a zoo or museum and thus qualifies for IRC 501(c)(3) exemption.

Rev. Rul. 76-204, provides, in effect, that preserving ecologically significant land is a charitable purpose and activity without the educational and open public access rationale stressed in Rev. Rul. 67-292. It recognizes that efforts to preserve and protect the natural environment for the benefit of the public serve as a charitable purpose in itself. This community benefit theory is stated in Rev. Rul. 76-204 as follows:

"The benefit to the public from environmental conservation derives not merely from the current educational, scientific, and recreational use that are made of our natural resources, but from their preservation as well."

Rev. Rul. 76-204, provides that limited public access on ecologically significant lands is necessary to realize the charitable purpose - preservation. To allow general public access would, in fact, be inconsistent with attainment of the charitable goals.

The Full Texts of Rev. Ruls. 76-204 and 75-207 are extracted below:

Environmental conservancy. A nonprofit organization formed for the purpose of preserving the natural environment by acquiring, by gift or purchase, ecologically significant undeveloped land, and either maintaining the land itself with limited public access or transferring the land to a government conservation agency by outright gift or being reimbursed by the agency for its cost, qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 76-204

Advice has been requested whether the nonprofit organization described below, which otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, is operated exclusively for charitable purposes.

The organization was formed by scientists, educators, conservationists, and representatives of the community-at-large for the purpose of preserving the natural environment. It accomplishes this purpose by acquiring and maintaining ecologically significant undeveloped land such as swamps, marshes, forests, wilderness tracts, and other natural areas. The organization acquires the land either as a recipient of a charitable gift or bequest, or as a purchaser. In order to be constantly aware of the availability of significant undeveloped areas, the organization works closely with Federal, state, and local government agencies, and private organizations concerned with environmental conservation.

Some of the land is maintained by the organization itself for the purpose of preserving it in its natural state. Generally, public access to such land is limited so that the delicate balance of the ecosystem remains undisturbed. In these situations the organization will allow educational and scientific research or study as long as such use will not disrupt the particular ecosystem.

Other tracts of land are merely held and preserved by the organization until arrangements can be made to transfer title to the land to a government conservation agency. This usually occurs when the agency is presently unable to acquire the land itself, but where the parcel is particularly suited for inclusion into a new or existing park, wilderness area, or wildlife preserve. Depending upon the circumstances surrounding the organization's initial acquisition of the land, and the restrictions on the particular government agency involved, the organization either makes an outright gift of the land to the agency, or is reimbursed by the agency for the cost of the land. Aside from this occasional reimbursement, the organization does not regularly receive any support from the government, but receives most of its funding from the general public.

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(d)(2) of the Income Tax Regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the advancement of education and science.

It is generally recognized that efforts to preserve and protect the natural environment for the benefit of the public serve a charitable purpose. *Restatement (Second) of Trusts* Section 375 (1959). In *Noice v. Schnell*, 137 A. 582 (N.J. 1927), the court held that a bequest, in trust, to preserve and protect from commercial development the Palisades along the Hudson River was a valid

charitable trust. In addition, in *President and Fellows of Middlebury College v. Central Power Corporation of Vermont*, 143 A. 384 (Vt. 1928), the court found that a devise of land to preserve a specimen of original Vermont forest was a charitable bequest. Similar charitable bequests have been upheld in other cases dealing with environmental preservation. *See, e.g., Richardson v. Essex Institute*, 94 N.E. 262 (Mass. 1911); *Cresson's Appeal*, 30 Pa. 437 (1858); and *Staines v. Burton*, 53 P. 1015 (Utah 1898).

Several published Revenue Rulings have also recognized the charitable and educational nature of organizations designed to preserve and promote the natural environment. For example, Rev. Rul. 70-186, 1970-1 C.B. 128, holds that an organization formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features qualifies for exemption under section 501(c)(3) of the Code. In addition, Rev. Rul. 67-292, 1967-2 C.B. 184, holds that an organization formed for the purpose of purchasing and maintaining a sanctuary for wild birds and animals for the benefit of the public may qualify as exempt from Federal income tax under section 501(c)(3).

Furthermore, the promotion of conservation and protection of natural resources has been recognized by Congress as serving a broad public benefit. For example, Congress declared in the National Environmental Policy Act of 1969, 42 U.S.C. Section 4321 (1969), that the prevention and elimination of damage to the environment stimulates the health and welfare of man and enriches the understanding of ecological systems and natural resources important to the nation.

The benefit to the public from environmental conservation derives not merely from the current educational, scientific, and recreational uses that are made of our natural resources, but from their preservation as well. Only through preservation will future generations be guaranteed the ability to enjoy the natural environment. A national policy of preserving unique aspects of the natural environment for future generations is clearly mandated in the Congressional declarations of purpose and policy in numerous Federal conservation laws. *See, e.g., Wilderness Act*, 16 U.S.C. Section 1131 (1964) (wilderness areas); *Estuarine Areas Act*, 16 U.S.C. Section 1221 (1968) (estuaries); *Wild and Scenic Rivers Act*, 16 U.S.C. Section 1271 (1968) (rivers); *Water Bank Act*, 16 U.S.C. Section 1301 (1970) (wetlands). While the public benefits from environmental conservation are clearly recognized and measurable, an equally important public purpose is served by preserving natural resources for future generations.

In this case, by acquiring and preserving (whether by self-maintenance or through transfer to a governmental agency) ecologically significant undeveloped land, the organization is enhancing the accomplishment of the express national policy of conserving the nation's unique natural resources. In this sense, the organization is advancing education and science and is benefiting the public in a manner that the law regards as charitable. The restrictions on current access to the

lands maintained by the organization are essential to the preservation of their natural state, and are therefore essential to the fulfillment of the organization's charitable purpose. A similar principle is set forth in Rev. Rul. 75-207, 1975-1 C.B. 361, which holds that the value of an island, owned by a private foundation dedicated to preserve the natural ecosystems on the island to which access is limited to invited public and private researchers, may be excluded from the foundation's minimum investment return under section 4942(e) of the Code.

Accordingly, the organization is operated exclusively for charitable purposes and qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

Private foundation's ownership and maintenance of island. The value of an island, owned by a private foundation dedicated to preserve the natural ecosystems and historical and archaeological remains on the island that has no residential use and to which present access is limited to invited public and private researchers, may be excluded from the foundation's minimum investment return under section 4942(e) of the Code.

Rev. Rul. 75-207

The Internal Revenue Service has been asked whether, in the situation discussed below, the value of an island owned and maintained by a private foundation may be excluded from the computation of the foundation's minimum investment return under section 4942(e) of the Internal Revenue Code of 1954.

The foundation, formed to further conservation, education, and the arts, owns and maintains an island located several miles off the coast of the United States. The island is uninhabited except for a small professional staff.

The island may be best characterized by the delicate and uniquely inviolate natural ecosystems and historical and archaeological remains present. Many common and rare varieties of flora and fauna coexist on the island in harmony with hard sand beaches, dunes, open meadows, forests, tidal flats, and wetlands. Further, the island is a historical repository of pre-colonial Indian, colonial Spanish and English, and American Revolutionary archaeological remains and artifacts. In consideration of the island's historical significance and pristine natural condition, the United States Department of Interior designated it is a National Historic Landmark.

The foundation is dedicated to the preservation of the island in its present state and to that end must restrict general public access at this time. There is no residential use made of the island. The foundation fully attempts to develop the educational value of the island through working relationships with public and private educational institutions, scientific and conservation organizations, and the

Federal government. Their researchers are invited to the island and their findings are published and disseminated to the general public.

Section 4942 of the Code generally provides for an excise tax on the failure of a private foundation to distribute income. The amount of income required to be distributed by a private foundation with respect to a particular taxable year is its "distributable amount." The term distributable amount is defined in the Code as an amount equal to (1) the minimum investment return or the adjusted net income (whichever is higher), reduced by (2) the sum of the taxes imposed on such private foundation for the taxable year under subtitle A and section 4940.

Section 4942(e)(1)(A) of the Code excludes from the computation of the "minimum investment return" assets that are "being used (or held for use) directly in carrying out the foundation's exempt purpose."

Section 53.4942(a)-2(c)(3)(i) of the Foundation Excise Tax Regulations provides, in part, that an asset is "used (or held for use) directly in carrying out a foundation's exempt purpose" only if the asset is actually used by the foundation in carrying out its exempt purposes.

Section 53.4942(a)-2(c)(3)(ii) of the regulations illustrates this principle by including as examples real estate used by the foundation directly in its charitable, educational, or other similar exempt activities, and research facilities which under the facts and circumstances serve a useful purpose in the conduct of such activities.

The limited access to the island is uniquely essential to the fulfillment of the foundation's educational and charitable purposes under the facts and circumstances described. Thus, the island is being used directly to carry out the foundation's exempt purposes in the manner indicated in the regulations examples cited above.

c. Openspace or "Greenspace" Preservation - Non Ecologically Significant Land

The Service has been recently considering exemption cases involving organizations created for the preservation of open space or "greenspace."

In Rev. Rul. 78-384, 1978-43 I.R.B. 8, an organization acquires real estate for the dual purpose of holding land for preservation of open space and farming. Unlike the situation presented in Rev. Rul. 76-204, the land contains no ecologically significant attributes. However, the farming is restricted so that it is compatible with the ecology of the area. The ruling found that although there was

some ecological preservation involved, the organization was not preserving land of any distinctive ecological significance within the meaning of Rev. Rul. 76-204.

Rev. Rul. 78-384 thus stands for the principle that the preservation of the environment (absent any significant environmental attributes) does not constitute a charitable purpose and/or activity per se.

The text of Rev. Rul. 78-384 is extracted below:

Section 501.--Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Preserving ecologically significant land. A nonprofit organization that owns farmland and restricts its use to farming or other uses the organization deems ecologically suitable, but is not operated for the purpose of preserving ecologically significant land and does not otherwise establish that it serves a charitable purpose, does not qualify for exemption under section 501(c)(3) of the Code; Rev. Rul. 76-204 distinguished.

Rev. Rul. 78-384

Advice has been requested whether the nonprofit organization described below is operated exclusively for charitable purposes, and thus qualifies for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization is a nonprofit corporation that owns farm land. It restricts the use of its farm land to farming or such other uses as the organization deems ecologically suitable for the land. The organization states that it benefits the public by restricting its land to uses compatible with the ecology of the area.

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(d)(3) of the Income Tax Regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

Rev. Rul. 76-204, 1976-1 C.B. 152, holds that an organization preserving ecologically significant land for the benefit of the public is operated exclusively for charitable purposes under section 501(c)(3) of the Code.

Although the organization described above restricts its land to uses that do not change the environment, it is not preserving land that has any distinctive ecological significance within the meaning of Rev. Rul. 76-204. In addition, any benefit to the public from this organization's self-imposed restriction on its own land is too indirect and insignificant to establish that the organization serves a charitable purpose within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations.

Accordingly, because the organization does not preserve ecologically significant land and has not otherwise established that it serves a charitable purpose, it is not operated exclusively for charitable purposes, and thus does not qualify for exemption from federal income tax under section 501(c)(3) of the Code.

d. Inurement Issues

Particular care should be taken to insure that no private benefit results from the preservationist organization's activities. For example, Rev. Rul. 75-286, 1975-2 C.B. 210, holds, in part, that an organization with membership limited to the resident property owners and business operators within a city block and formed to preserve and beautify the public areas on the block does not qualify for exemption under IRC section 501(c)(3), but does qualify under section 501(c)(4). Whenever an organization is serving the private interests of its members within the meaning of Regs. 1.501(c)(3)-1(d)(1)(ii), the fact is irrelevant that the organization has charitable purposes and activities, such as involving preservation, for purposes of IRC 501(c)(3) exemption.

e. General Exemption Criteria for Environmental Organizations

The following factors are perhaps useful criteria for determining whether a particular environmental type organization qualifies for exemption. They are suggestive only, are not all inclusive, and are of course subject to individual cases and their particular facts and circumstances:

- (1) whether the organization's properties or proposed holdings are "ecologically significant" so that the public can be said to benefit from their conservation. Property designated as "wilderness areas" or "wild and scenic rivers," etc. by Federal, state or local conservation agencies is one indication;

- (2) whether the organization's governing body and membership are composed of scientists, educators, conservationists, and representatives of the community-at-large and whether the organization has close working relationships with appropriate private and governmental conservation organizations;
- (3) whether public access to the land maintained by the organization is limited commensurate with the condition of the ecosystem. However, even with the most delicate ecosystem, the organization should attempt to show some development of the educational and scientific value of the lands. For example, the organization may invite researchers from public and private educational institutions and government agencies for the purpose of performing a study of the ecosystem and reporting the results of the study to the public. Of course, if the environment is not endangered, there should be public access comparable to traditional educational and recreational uses.

2. Historical Preservation

a. Background Information

In 1966, Congress enacted The National Historic Preservation Act (80 Stat. 915, 16 U.S.C. 470 et seq.) which declared it a national policy to preserve for public use, historic sites, buildings, and objects of national significance for the inspiration and benefit of the people of the United States.

Under the Act the Secretary of the Interior, through the National Park Service, was empowered to (a) "contract and make cooperative agreements with States, municipal subdivisions, corporations, associations or individuals, with proper bond where deemed advisable, to protect, preserve, maintain or operate any historical or archaeological building, site, object, or property used in connection therewith for public use, regardless as to whether the title thereof is in the United States"; and (b) "restore, reconstruct, rehabilitate, preserve and maintain historic or prehistoric sites, buildings, objects, and properties of national historical or archaeological significance and where deemed desirable establish and maintain museums therewith."

The Act also established a charitable, educational and nonprofit corporation known as the National Trust for Historic Preservation in the United States "(National Trust)". The purposes of the National Trust shall be to receive donations of sites, buildings and objects significant in American history and culture, to preserve and administer gifts of money, securities, or other property of whatsoever character for the purpose of carrying out the preservation program.

Subsection 470(a) of the Act provides that the Secretary of the Interior is authorized to expand and maintain a national register of districts, sites, buildings, structures, and objects significant in American history, architecture, archeology, and culture, hereinafter referred to as the National Register and to grant funds to States for the purpose of preparing comprehensive statewide historic surveys and plans in accordance with criteria established for the preservation, acquisition and development of such programs. The term "historic preservation" is defined as including the protection, rehabilitation, restoration and reconstruction of districts, sites, buildings, structures, and objects significant in American history, architecture, archeology or culture. The criteria established for properties to be included in the National Register is the quality of significance in American history, architecture, archeology, and culture which is present in districts, sites, buildings, structures, and objects that possess integrity of location, design, setting, materials, workmanship, feeling and association, and that:

- (1) (1) are associated with events that have made a significant contribution to the broad patterns of our history; or
- (2) are associated with the lives of persons significant in our past; or
- (3) embody the distinctive characteristics of a type, period, or method of construction or that possess high artistic values, or that represent a significant and distinguishable entity whose components may lack individual distinction; or
- (4) have yielded, or may be likely to yield, information important in prehistory or history.*

It is apparent that the national policy inherent in the National Historic Preservation Act provides persuasive authority to find historical preservation a charitable endeavor under Federal tax laws.

b. Historical Preservation Revenue Rulings

The Service has published a number of revenue rulings concerned with historical preservation activities. None has gone as far as the environmental Rev. Rul. 76-204, supra, discussed in part 1 of this topic.

In Rev. Rul. 76-204, it was held, in effect, that preservation of ecologically significant land was charitable per se. Public benefit was found notwithstanding the limited public access to the land. There was no dependence on a strictly educational rationale. This is not the case in the historical preservation revenue rulings discussed below, as in, for example, Rev. Rul. 75-470, 1975-2 C.B. 207.

In Rev. Rul. 75-470, an organization was held to be charitable when it preserves or restores historically significant buildings but only if the buildings are available for public viewing. There is, however, the mixed environmental/historical preservation Rev. Rul. 75-207, discussed in Part 1, concerned with a private foundation whose island asset is excluded from the IRC 4942(e) minimum investment return. The island asset in the revenue ruling, in addition to being a pristine wilderness, is also classified as a National Historic Landmark by the Department of Interior because of it being a historical repository of pre-colonial, Indian, colonial, Spanish, English, and American Revolutionary archaeological remains and artifacts. Public access to the island is restricted to ensure that the island's characteristics are preserved.

Notwithstanding the limited access to the general public, Rev. Rul. 75-207 held that the asset was being used by the foundation in carrying out its charitable

* There are approximately 15,000 properties listed on the National Register at this time. For a discussion on the National Register, see "The National Register of Historic Places," by William J. Murtugh and Sally G. Oldham; American Preservation, February/March 1979, page 26.

purposes and thus its value was not includible in its IRC 4942(e) minimum investment return.

(1) Rev. Rul. 67-6, 1967-1 C.B. 135 and Rev. Rul. 76-147, 1976-1 C.B. 151
-- The Combatting Community Deterioration Rationale

Rev. Rul. 67-6 held that an organization whose activities are primarily devoted to preserving the traditions, architecture, and scenic appearance of an historic community by means of individual and group action before the local legislature and administrative agencies with respect to zoning, traffic, and parking regulations may be exempt under IRC 501(c)(4), but not under IRC 501(c)(3).

Rev. Rul. 67-6 noted that combatting community deterioration through remedial action leading to the elimination of the physical, economic and social causes of such deterioration is "charitable." More importantly, 67-6 noted that "preserving and maintaining an historic area for the benefit and education of the general public also is 'charitable'."

Rev. Rul. 67-6 came to an adverse holding under IRC 501(c)(3) because of the organization's substantial lobbying activities, making the organization an "action" organization. Another reason for the adverse ruling was because of a finding that preserving the traditions, architecture, and appearance of a community for the sole benefit of the residents of the community (as distinguished from the general public both within and without the community) was not "charitable."

The latter rationale in Rev. Rul. 67-6 for denial under IRC 501(c)(3) was abandoned in Rev. Rul. 76-147, 1976-1 C.B. 151.

Rev. Rul. 76-147 holds that an organization formed to improve conditions in an area of a city where the income level is higher and housing is better than in other areas of the city and whose activities include providing general information on methods of counteracting housing deterioration and ways of improving homes may qualify under IRC 501(c)(3).

Rev. Rul. 76-147 provides, in effect, that an organization with a purpose and activity of preserving the traditions, architecture, and appearance of a community, as described in Rev. Rul. 67-6, provides community benefit since such preservation combats community deterioration.

Rev. Rul. 76-147 states that:

"Rev. Rul. 67-6, is modified to remove any implication that preserving or improving a community does not benefit a sufficiently broad segment of the public to be charitable. So long as the community interests served by such activities are truly public interests of a class of persons not themselves comprising a charitable class, then such activities may be deemed to confer a public benefit that the law regards as charitable. However, the conclusion that the organization described in that revenue ruling is an 'action' organization within the meaning of section 1.501(c)(3)-1(d)(3)(ii) remains in effect."

The text of Rev. Rul. 76-147 is extracted below:

Community improvement organizations. An organization formed to improve conditions in an area of a city where the income level is higher and housing better than in other areas of the city and whose activities include providing general information on methods of counter-acting housing deterioration and ways of improving homes may qualify for exemption under section 501(c)(3) of the Code; Rev. Rul. 67-6 modified.

Rev. Rul. 76-147

Advice has been requested whether the nonprofit organization described below, which otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, is operated exclusively for charitable purposes.

The organization was formed to improve conditions in a community by identifying community problems and by encouraging their resolution by community members. Membership in the organization is available to anyone living in the community. The community involved consists of an area of a city where the median income level is generally higher and where housing is generally better than in many other areas of the city.

Activities of the organization include urging community residents to clean and repair private property, encouraging realtors to use nondiscriminatory sales practices in the buying and selling of homes, providing general information on methods of counteracting housing deterioration and ways of improving homes, sponsoring alley clean-up campaigns, taking surveys to determine the adequacy of schools and recreational facilities in the area, and supporting programs directed at achieving reasonable population density standards in relation to community resources.

The organization implements its activities by distributing pamphlets and brochures to members of the community, holding open meetings, and conducting letter-writing campaigns. It does not engage as a substantial part of its total operations in legislative activities and does not support or endorse candidates for public office.

Funds of the organization are derived from voluntary contributions from its membership and from the general public, and are used to meet operating expenses.

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(d)(2) of the Income Tax Regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the promotion of social welfare by organizations designed to combat community deterioration.

By engaging in the community improvement activities described above, the organization is combatting community deterioration within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations. Such activities benefit a community in a charitable manner whether or not the community is presently in a state of decline. The community, and derivatively all those who live there, are benefitted. See Rev. Rul. 68-655, 1968-2 C.B. 213, which states that an organization engaged in activities designed to stabilize a neighborhood is combatting "potential" community deterioration and qualifies for exemption under section 501(c)(3) of the Code.

Accordingly, the organization is operated exclusively for charitable purposes and qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

Rev. Rul. 67-6, 1967-1 C.B. 135, which concerns an organization whose purpose is to preserve the traditions, architecture, and appearance of a community for the benefit solely of residents of the community, is modified to remove any implication that preserving or improving a community does not benefit a sufficiently broad segment of the public to be charitable. So long as the community interests served by such activities are truly public in scope and not merely the private interests of a class of persons not themselves comprising a charitable class, then such activities may be deemed to confer a public community benefit that the law regards as charitable. However, the conclusion that the organization described in that Revenue Ruling is an "action" organization within the meaning of section 1.501(c)(3)-1(d)(3)(ii) of the regulations remains in effect.

(2) Rev. Rul. 75-470 - The "Educational" Rationale

Rev. Rul. 75-470, 1975-2 C.B. 207, holds that an organization formed to promote an appreciation of history through the acquisition, restoration, and preservation of homes, churches, and public buildings having special historical or architectural significance and to open the structures for viewing by the general public is exempt under IRC 501(c)(3). The organization acquires historical and architectural structures, together with the surrounding land, and hires craftsmen to effect the restoration of these structures in the most authentic manner possible. After a building is restored the organization opens it to the general public. Its operations are financed from admission fees to the restored buildings and from contributions by the public. The ruling held that the restoring of buildings and making them available to the general public is carrying on activities similar to a museum and is educational and charitable within the meaning of IRC 501(c)(3).

The ruling brought out three factors to be considered in ruling on preservation of historical sites:

- (a) The property is historically and/or architecturally significant;
- (b) The property is open to the general public; and
- (c) The property is restored and maintained by the exempt organization.

The full text of Rev. Rul. 75-470 is extracted below:

Preservation of buildings having historical or architectural significance. A nonprofit organization formed to promote an appreciation of history through the acquisition, restoration, and preservation of homes, churches, and public buildings having special historical or architectural significance and to open the structures for viewing by the general public qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 75-470

Advice has been requested whether the nonprofit organization described below, which otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, is operated exclusively for charitable and educational purposes.

The organization was formed for the purpose of promoting an appreciation of history through the acquisition, restoration, and preservation of homes, churches, and public buildings having special historical and/or architectural significance. In furtherance of this purpose the organization acquires historically and architecturally significant structures, together with the surrounding land, located in the United States and foreign countries, and hires craftsmen to effect the restoration of these structures in the most authentic manner possible.

The organization consults with governmental agencies and local historical societies to locate those structures which are deserving of restoration and preservation. After a building is restored, the organization opens it to the general public. Its operations are financed from admission fees to the restored buildings, and from contributions from the public.

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 or educational purposes.

Example (4) of section 1.501(c)(3)-1(d)(3)(ii) of the Income Tax Regulations describes museums and similar organizations as "educational" within the meaning of section 501(c)(3) of the Code.

The subject organization's activities consist of acquiring, restoring, and preserving historically and/or architecturally significant buildings and making such restored buildings available for public viewing. In this manner, the organization is carrying on activities similar to those of a museum and is educational and charitable within the meaning of section 501(c)(3) of the Code.

Accordingly, the organization is operated exclusively for charitable and educational purposes and thus qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

This ruling, to a great extent, describes many of the well known American historical museum complexes, some of which have acquired, restored, and preserved or recreated, whole colonial or 19th century towns.

(3) Rev. Rul. 77-367 - Replicated 19th Century Village - Benefits Retained

Rev. Rul. 77-367, 1977-2 C.B. 193 provides that a nonprofit organization formed to create and operate a replica of an early American village is engaging in educational activities similar to those of a museum and qualifies for IRC 501(c)(3) exemption. This is true even though the corporation which donated the land and a substantial percentage of the organization's support is benefitted by having the

village named after it and by having its name associated with the village through both the corporation's and the organization's advertising.

The ruling found that the private benefits were incidental to the benefits flowing to the general public from access to the village and its historic structures. Rev. Rul. 66-358, 1966-2 C.B. 218 was cited.

The text of Rev. Rul. 77-367 is extracted below:

Qualification; benefits inuring to donor; corporate name. A nonprofit organization formed to create and operate a replica of an early American village is engaging in educational activities similar to those of a museum and qualifies for exemption even though the corporation which donated the land and a substantial percentage of the organization's support benefits by having the village named after it and by having its name associated with the village through both the corporation's and the organization's advertising.

Rev. Rul. 77-367

Advice has been requested whether the nonprofit organization described below, which otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, is operated exclusively for charitable and educational purposes.

The organization was formed for the purpose of creating and operating a replica of an early 19th century American village. The village consists of 25 authentically restored and furnished houses and commercial structures. These structures were acquired from the area in which the organization is located. They have been grouped to create a replica of a village typical of those existing in the area during the early 19th century. The organization employs qualified architects and craftsmen to effect the restoration of the structures in the most authentic manner possible. The organization provides trained persons to act as guides in demonstrating to the public how people lived and worked in the area in the early 19th century.

The village is located in a rural area on land donated to the organization by a corporation that provides a substantial percentage of the organization's support. The village is named after the corporation. The organization's operations are financed from admission fees, contributions from the general public, grants from other organizations, and funds donated by the corporation. The corporation encourages the public to visit the village by publicizing the facility in connection with its own advertising program. The corporation financially assists the organization in publishing informational and publicity pamphlets and in publishing the results of historical research carried on by the staff of the

organization. In each publication so financed, the corporation is given credit for its financial support.

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

Example (4) of section 1.501(c)(3)-1(d)(3)(ii) of the Income Tax Regulations describes museums and similar organizations as "educational" within the meaning of section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes described in section 501(c)(3) of the Code unless it serves a public rather than a private interest.

Rev. Rul. 75-470, 1975-2 C.B. 207, describes a nonprofit organization formed to promote an appreciation of history through the acquisition, restoration, and preservation of homes, churches, and public buildings having special historical or architectural significance and to open the structures for viewing by the general public, and concludes that it qualifies for exemption under section 501(c)(3) of the Code.

The subject organization, by carrying on its program of creating and operating a replica of an early 19th century village, and making the village open to the public for viewing, is engaging in activities similar to those of a museum and to those of the organization described in Rev. Rul. 75-470. Such activities further educational and charitable purposes within the meaning of section 501(c)(3) of the Code.

Although the corporation benefits by having the village named after it, by having its name associated with the village in conjunction with its own advertising program, and by having its name mentioned in each publication of the organization that it finances, such benefits are merely incidental to the benefits flowing to the general public from access to the village and its historic structures. See Rev. Rul. 66-358, 1966-2 C.B. 218.

Accordingly, the organization is operated exclusively for charitable and educational purposes and, thus, qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

3. Revolving Funds

a. General

The Service is now considering the recognition of IRC 501(c)(3) exemption to organizations which restore and preserve historically significant properties by means of a "revolving fund" (purchasing the property, encumbering it with appropriate restrictive covenants and easements, and selling it at fair market value to private homeowners and businesses and using the sale proceeds to repeat the process with other property).

Cases involving revolving trusts demonstrate a crucial factual distinction from the facts of published revenue ruling in the historical preservation area. In the published rulings, such as in Rev. Rul. 75-470, discussed in Part 2, public access to the historical properties is generally available compared to the facts in representative revolving fund cases.

It should be noted in the discussions that follow that although we are dealing with facts describing historical preservation organizations, environmental trusts, such as the conservancy described in Rev. Rul. 76-204, *supra*, in part 1, may also utilize revolving funds for the acquisition of lands for ultimate sale for example, to governmental authorities.

b. The Characteristics of "Revolving Fund" Organizations

These organizations may be formed for the purpose of preserving the historic character of their communities through the acquisition and preservation of historically significant properties, and educating the public on the importance of historic preservation. By protecting historic structures from demolition or alteration, it will be argued, the organization is helping its community through retaining links to its heritage. The acquired structures, which may include private residences as well as commercial structures, may be generally visible from the public right of way, and where they are not so visible, the organization may provide for a minimal amount of public viewing of the exteriors. In the case of buildings acquired with Federal funds, appropriate federal regulations provide for some public viewing. In many situations, however, no public viewing of the interiors of the acquired properties is provided.

Typically, the organization may locate a specific historic property, encumber it with historic preservation covenants, as discussed in c below and sell it at fair market value to an interested buyer (who in many cases will be a private individual). The funds expended on one structure are thus "revolved" and used over and over to continue to acquire, encumber and sell suitable properties. The organization will usually undertake some restoration of structures where necessary.

However, in some cases, the organization will expect the purchaser to make needed repairs. The historic preservation covenants require restoration, bar any exterior alterations without the consent of the selling organization, and give the organization the right of first refusal in the event the purchaser should later desire to sell. Since covenants sometimes decrease the value of property, the organization may expect to lose money in resale operations.

The selection criteria for the structures to be purchased are designed to insure that only historically significant properties are acquired. The organization usually confines its acquisitions to properties listed on the National Register of Historic Places or in a state or city register of historic places, properties which have been determined by an official state historical review organization as being eligible for listing in the National Register, and properties located in Historic Districts (designated by the Department of Interior).

Before considering the merits of IRC 501(c)(3) exemption of the "revolving fund" entity, it would be appropriate to provide a short discussion on preservation covenants and easements.

c. Revolving Fund Preservation Covenants and Easements

Preservation covenants and easements are means by which preservation organizations may ensure that properties are preserved in perpetuity.

Easements for preservation have a variety of purposes. They may be "scenic" easements in the classical sense of providing a control on the visual amenities of a natural or historic site. They may be "facade" easements controlling the physical aspects, for example, of the outside of a building or buildings. They may control interior features of buildings having historical significance. More often, they may combine several different purposes and in a single instrument include protection of a building or landscape and its surroundings.

The control over the appearances, by covenant, is similar in nature to the retention of a "scenic easement" by the organization. By covenant, the organization is given the right to control the physical appearance of the building or natural landscape in such a way as to maintain the historical, or architectural significance of the building or the environmental purity of the land. It may be argued that the placing of covenants and easements on historical and environmental properties would tend to indicate that the encumbering organization is concerned with the public benefit, and not merely engaged in the commercial selling of real estate.

d. The Merits of Revolving Fund Exemption Under IRC 501(c)(3)

The following discussion may provide a persuasive rationale for recognizing exemption to the revolving fund preservation organization.

(1) Law, Regulations and National Policy

To be described in IRC 501(c)(3), an organization must serve a public rather than a private interest. Regs. 1.501(c)(3)-1(d)(1) provides that even if an organization serves a public interest, if it also serves a private interest it is not entitled to exemption under IRC 501(c)(3).

Regs. 1.501(c)(3)-1(d)(2) define "charitable" as follows:

The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

"Educational" is defined, in part, in Regs. 1.501(c)(3)-1(d)(3) as "The instruction of the public on subjects useful to the individual and beneficial to the community."

In determining whether a particular organization is "charitable" within the meaning of IRC 501(c)(3), it may be argued that there are two basic issues which arise. The first, of course, is whether its purpose is in fact charitable. If it is not, then the manner by which it accomplishes its purpose is irrelevant. In our

revolving fund cases, for example, if it is determined that the organizations' purpose is not "charitable," then no further inquiry need be made; the organizations would not be entitled to exemption under IRC 501(c)(3).

If an organization's purpose is charitable, the second issue arises: Whether its methods of accomplishing this purpose in some way prevent recognition of exemption under IRC 501(c)(3). Questions of varying difficulty arise in resolving this issue. For example, if the organization participates in political campaigns, or its activities result in inurement to an individual, both of which are specifically prohibited by the Code, then it is clear that the organization cannot be recognized as exempt, no matter its purpose. A more difficult problem which can occur in resolving this issue arises when there is a possibility that the organization serves a private interest along with serving a public interest; in some cases, serving the public interest will also result in incidental benefits to private interests. See, e.g., Rev. Rul. 76-147, 1976-1 C.B. 151 (discussed in Part 2) and Rev. Rul. 70-186, 1970-1 C.B. 128 (noted in Part 2).

The purpose of the revolving fund organization is to educate and otherwise benefit the public by restoring and preserving historically significant properties. It would be argued that this purpose is charitable. This position is supported by the law of charitable trusts. For example, the Restatement of Trusts states that "a trust to beautify a city, or to preserve the beauties of nature, or otherwise to add to the aesthetic enjoyment of the community, is charitable." Restatement (Second) of Trusts, section 374 (comment F). Professor Scott states that

A trust is charitable where the purpose is to contribute to the aesthetic enjoyment of the community. Thus the courts have upheld a trust for... promoting the permanent preservation of lands of beauty or historical interest
[IV A. Scott on Trusts, section 374.10 (3d ed. 1967).]

Bogert notes that the courts have upheld the validity of charitable trusts "to preserve natural scenery, or to beautify public property or private grounds by encouraging the keeping of fine yards and gardens or by planting trees, shrubs, or flowers." G. Bogert, Trusts and Trustees, section 378 at 179, 180 (2d ed. 1959).

The Service has published rulings indicating that the restoration and preservation of historically significant properties can benefit the public in ways which are charitable. For example, in Rev. Rul. 75-470, 1975-2 C.B. 207 (discussed in Part 2), the organization acquired and restored historically or

architecturally significant properties. After restoration, the properties were opened to the general public. The ruling concluded that the organization was similar to a museum and was therefore entitled to exemption as being educational and charitable. Although the revolving fund organization described in (b) above may not require the properties it is concerned with to be open to the public for more than minimal periods, it is argued that an educational benefit exists in the acquisition, restoration and preservation of the exteriors of the properties without public access.

The public benefit position is similar, if not identical, to the theory of public benefit of preservation as expressed in environmental Rev. Rul. 76-204, discussed in Part 1. Aside from the educational benefits to the public from the restoration and preservation of historically significant properties, there is also community benefit to the extent that such restoration and preservation combats community deterioration. In Rev. Rul. 76-147, 1976-1 C.B. 151 (discussed in Part 2), an organization combating community deterioration was held exempt.

Congress has also made it clear in recent years that the restoration and preservation of historically significant properties is to be encouraged whenever possible. Although the policy expressed by Congress does not, obviously, mean that an organization performing such a function is necessarily entitled to exempt status, it does indicate that Congress believes the activity to be beneficial to the public. Thus, 16 U.S.C. section 461 provides:

"It is declared that it is a national policy to preserve for public use historic sites, buildings, and objects of national significance for the inspiration and benefit of the people of the United States."

The Historic Preservation Act of 1966 (16 U.S.C. section 470) provides, in part:

"[T]he historical and cultural foundations of the Nation should be preserved as a living part of our community life and development in order to give a sense of orientation to the American people"

To similar effect, see: IRC sections 167(n), 167(O) and 170(f)(3)(B).

A similar National Policy discussion, of course, may be found in Rev. Rul. 76-204 in regard to environmental preservation.

The continued notion of "public benefit" by preservation of the historic character of a community is inherent in Congressional modification of depreciation allowances by the Tax Reform Act of 1978. See IRC 191 (as amended by section 2124(a)(1) of the Tax Reform Act of 1976; P.L. 94-455; Vol. 1, 1976-3 C.B. 392 and; section 701(c)(2)(f) of the Revenue Act of 1978, P.L. 95-600, 1978-3 Vol. 1, C.B. 134). Therein, Congress specifically precluded the application of accelerated depreciation and demolition costs involving the destruction of "certified historic structures." These are structures that are listed in the National Register, or located in a registered historic district, as defined in IRC 191(d)(1)(A)(2), and certified by the Secretary of the Interior as being of historic significance in the historic district.

Continued evidence of Congressional endorsement of historic preservation is seen in the Tax Reform Act of 1976 amendment to IRC 170(f)(3). Section 2124(e), P.L. 94-455, 1976-3 (Vol. 1) 395; amended by section 309, P.L. 95-30, 1977-1 C.B. 468. IRC 170(f)(3)(B) provides that a charitable deduction is allowed for certain partial interests in property, until June 13, 1981, for contributions to a charitable organization described in IRC 170(b)(1)(A) for property used exclusively for "conservation purposes." Conservation purposes are defined to mean the preservation of land areas for public recreation, education, or scenic enjoyment, the preservation of historically important land areas or structures, or the preservation of natural environmental systems. (Underscoring supplied.)

The partial interests in property are a lease on, option to purchase, or easement with respect to real property granted in perpetuity and a remainder interest in real property.

The Supreme Court has also endorsed preservationist methods, at least in the hands of municipalities, in the recent landmark Grand Central Station case.

The U.S. Supreme Court held in the case of Penn Central Transportation Co. v. New York, 438 U.S. 104 (1978), that New York City's landmark preservation law is constitutional and that the city can prohibit construction of a 53 story office tower on top of Grand Central Station, a certified National Historic Landmark.

The Court noted that the New York city law is typical of many urban landmark laws in that its primary method of achieving its goals is not by acquisitions of historic properties, but rather by involving public entities in land

use decisions affecting these properties and providing services, standards, controls, and incentives that will encourage preservation by private owners and users.

Of significant importance is the Court's holding that property was not taken without compensation, when government restricted the use of a landmark site the owner had wanted to redevelop.

The decision by the court, in effect, puts preservation on equal footing with zoning and land use as a tool a city may use to maintain and improve the quality of life.

(2) Analysis

From the foregoing analysis, it may be evident charitable purposes are served by the restoration and preservation of historically significant properties. The issue thus becomes whether the revolving fund organization method of achieving the restoration and preservation of the properties in some way prevents recognition of IRC 501(c)(3) exempt status.

It may be argued that the "revolving fund" method appears, at least in the facts described, to violate none of the express proscriptions of IRC 501(c)(3). Although there may be circumstances in which preservationist organizations may violate the proscriptions on influencing legislation and participating in political campaigns or on inurement, those circumstances are not applicable to the hypothetical organization described above.*

There is also distinct possibilities of inurement occurring if a revolving fund organization, as part of its revolving fund organization, undertakes to finance in some way the purchase of the properties from it. Inurement could occur, for example, if the organization sold a property at a favorable interest rate to one of its members, or, for that matter, any individual. There also may be UBIT issues, as discussed in Part 4. In any event, inurement is not an issue with the hypothetical organization described.

* Preservationist organizations, by their very nature, may be action oriented organizations as shall be discussed in Part 5.

The revolving fund organization, as described, also would not appear to serve private, rather than public interests, other than incidentally. The sellers of the properties do not benefit in any way because of the nature of the organization making the purchase, except to the extent that they would prefer that the properties be preserved. Presumably, they are primarily interested in obtaining what they considered to be a fair price for their property; the fact that one of the subject organizations purchases the property, rather than a real estate developer, makes no difference to them.

Likewise, the purchaser of a property from one of these organizations would not appear to benefit in any unique way from the organization selling to him. Presumably, the purchaser could have bought the property himself and restored and preserved it on his own, without being subject to the covenants imposed by the organization. In fact, rather than benefitting the purchaser, the organization's actions may work to his disadvantage economically. The covenants generally have the effect of requiring considerable expenditures to restore and preserve a property for a use which may well not be its highest economic use. Further, those properties for which Federal funds are used must be open to the public for at least a minimal number of days each year, which presumably would cause some inconvenience in the case of private dwellings.

(3) Resolution

It is arguable that the revolving fund organization as described is entitled to exemption under IRC 501(c)(3). Its purpose is charitable; the restoration and preservation of historically significant properties serves to educate the public; it operates to prevent community deterioration and in general serves to benefit the public to an extent clearly outweighing any possible detriment to the public arising from the organizations' activities. The organization's method of accomplishing its purpose is reasonably calculated to do so and, in fact, appears to be the most effective way, from the standpoint of cost to the various governments and the public, of accomplishing its purpose. Further, there is no evidence in the description that the organization's activities violates any of the express proscriptions of IRC 501(c)(3) or that it serves private interests other than incidentally.

It is noted that the above discussion is merely a rationale for recognizing the exemption of the revolving fund entity under IRC 501(c)(3).

The Service is presently considering publishing in this area and favorable private letter rulings have been issued.

e. General Exemption Considerations

In determining whether revolving funds qualify for exemption, consideration may be given to the factors that follow:

(1) The organization's method of selecting properties for acquisition should be reasonably designed to ensure that the properties are in fact of an historical, architectural, or ecologically significant nature so that the public can be said to benefit from their restoration and preservation. Confining acquisitions to properties listed on governmental historic registers or historic districts, or comparably classified as ecologically significant land is one method of accomplishing this.

(2) The terms of the covenants should be reasonably designed to ensure that the properties are in fact restored and preserved. Although it cannot be stated specifically what the duration of the covenants should be, durations should be substantial, and as a rule, the longer they are in force the better. This may be analogized to IRC 170(f)(3)(B), discussed above, which allows deductions for easements on property used exclusively for conservation purposes, but only if the easement is granted in perpetuity. It should also be clear that the organization is able to enforce its rights as holder of the easements and/or covenants and protect the preservation purposes which the easements are intended to advance. See the Conference Report in regards to IRC 170(f)(3)(B), associated with the Tax Reduction and Simplification Act of 1977 (P.L. 95-30), Conference Report No. 95-263, 1977-1 C.B. 523.

(3) There is a distinct possibility of inurement occurring if an organization, as part of its revolving fund operation, undertakes to finance in some way the purchase of the properties from it. Inurement could occur, for example, if the organization sold a property at a favorable interest rate to one of its members, or, for that matter, an individual. So long as the sale of a restored

property is at fair market value, there would generally be no private benefit to the purchaser.

(4) The sale to the public of a restored property at fair market value should be viewed as a "substantially" or "functionally" related trade or business. (See, however, discussion of rental of debt-financed property in Part 4 below.) Relatedness is likely in view of the fact that the restoration organization retains control, through covenants or easements, over the physical appearance of the property.

(5) In the case of properties acquired with Federal funding, occasional public viewing should be evident consistent with Federal regulation.

See also factors that are appropriate on page 57.

4. Unrelated Debt - Financed Income -- Leases of Historically or Architecturally Significant Buildings

a. Rev. Rul. 77-47

The unrelated trade or business provisions amended by the Tax Reform Act of 1969, includes unrelated "debt-financed" income" from investment property. The investment income included is proportionate to the debt on the property. Various types of passive income are subject to this tax but only if the income arises from property acquired or improved with borrowed funds and the production of income is unrelated to the purpose constituting the basis of the organization's tax exemption.

If substantially all (85 percent or more) of any property is used for an organization's exempt purposes, such property is not treated as "debt-financed" property.

Rev. Rul. 77-47, 1977-1 C.B. 156, provides that buildings, acquired through assumption of outstanding mortgages by an exempt organization that restores, preserves and exhibits buildings of historical and/or architectural significance, constitute debt-financed property when they are leased at fair rental value for uses that neither bear any relationship to the buildings' historical or architectural significance nor accommodate viewing by the general public.

The text of Rev. Rul. 77-47 is extracted below:

Unrelated debt-financed income; leases of historically or architecturally significant buildings. Buildings, acquired through assumption of outstanding mortgages by an exempt organization that restores, preserves, and exhibits buildings of historical and/or architectural significance, constitute debt-financed property within the meaning of section 514(b)(1) of the Code when they are leased at fair rental value for uses that neither bear any relationship to the buildings' historical or architectural significance nor accommodate viewing by the general public.

Rev. Rul. 77-47

Advice has been requested whether property acquired and used in the manner described below constitutes debt-financed property within the meaning of section 514(b)(1) of the Internal Revenue Code of 1954.

An organization that is exempt from Federal income tax under section 501(c)(3) of the Code was formed to promote the appreciation of history and architecture by acquiring, restoring, and preserving buildings of historical and/or architectural significance. In most instances, the organization opens the restored buildings to the general public for a nominal admission fee. By carrying on its activities in this manner, the organization is operating for educational purposes essentially in the same manner as a museum.

Occasionally, the organization acquires an historically or architecturally significant building by assuming an outstanding mortgage on the property as a part of the purchase price. Some of the buildings that are acquired in this manner are leased for uses that neither bear any relationship to the building's historical or architectural significance nor accommodate viewing by the general public.

Rent charged by the organization for these buildings generally conforms with the fair market value of the particular building and is sufficient to recover the cost of purchase, restoration, and maintenance, and generate net income for use in the organization's exempt functions. All leases by the organization are made subject to restrictive covenants to insure that the historical architecture of the buildings is maintained by the lessee.

Section 514(b)(1) of the Code defines the term "debt-financed property" which is held to produce income and with respect to which there is an acquisition indebtedness as defined in section 514(c).

Section 514(c)(2)(A) of the Code provides that the term "acquisition indebtedness" includes property acquired subject to a mortgage or other similar lien.

Section 514(b)(1)(A)(i) of the Code excludes from the definition of debt-financed property any property substantially all the use of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of the purpose or function constituting the basis for its exemption.

Section 1.514(b)-1(b)(1) of the Income Tax Regulations provides that, in determining whether the exclusion set forth in section 514(b)(1)(A)(i) of the Code is applicable, the principles in section 1.513-1 should be applied in determining whether there is a substantial relationship between the property and the exempt purpose of the organization.

Section 1.513-1(d)(2) of the regulations generally provides that trade or business is "related" to exempt purposes only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related" only if the causal relationship is a substantial one. Thus, for the conduct of trade or business to be substantially related to the purposes for which exemption is granted, the production of goods or the performance of the services involved must contribute importantly to the accomplishment of these purposes.

The buildings that the organization acquired through the assumption of outstanding mortgages and leased after restoration may constitute "debt-financed property" within the meaning of section 514(b)(1) of the Code since such property is held to produce income and is subject to acquisition indebtedness. Thus, it is necessary to determine whether substantially all of the use of the buildings is substantially related to the organization's exempt purpose, and therefore excluded from the definition of debt-financed property under the provisions of section 514(b)(1)(A)(i).

The organization's educational purpose is carried on by acquiring, restoring, and preserving historically and architecturally significant buildings and making such buildings available for public viewing in a manner similar to a museum. The leasing of buildings under the circumstances presented bears no relationship to the historic or architectural significance of the buildings and neither accommodates nor encourages viewing by the general public. This leasing does not contribute importantly to the accomplishment of the organization's educational purpose and has no causal relationship to the achievement of that purpose (aside from the need of the organization for income). Thus, substantially all the use of the buildings is not substantially related to the organization's exempt purposes. Accordingly, the leased buildings constitute "debt-financed property" within the meaning of section 514(b)(1) of the Code.

As described in Rev. Rul. 77-47, notwithstanding the threshold charitable activity concerned, i.e., preserving and restoring historically significant buildings,

the commercial reuse of the buildings so taints the "educational" value that the causal relationship to exempt purposes is lost.

There is some current feeling, however, that Rev. Rul. 77-47 reevaluation in light of the Service's favorable position on revolving funds. It is argued that the substantial relatedness requirement is satisfied through the acquisition and restoration of historic buildings, notwithstanding the outstanding mortgages or subsequent commercial rental arrangements. Also, a recent private letter ruling, concluded that a private foundation which rented out debt financed historic buildings in a manner similar to that in Rev. Rul 77-47 could exclude the value of the buildings from its IRC 4942(e) minimum investment return since the rental activity constituted a "functionally related business."

In any event, Rev. Rul. 77-47 is published authority and should be applied in appropriate situations.

b. Neighborhood Land Rule

IRC 514(b)(3)(A) provides that if an organization that acquires realty and intends to use it for exempt purposes within 10 years, it will not be treated as debt-financed property if it is in the neighborhood of other property used by the organization for exempt purposes and the intent to use the property for exempt purposes within ten years is not abandoned.

Regs. 1.514(b)-1(d)(1)(ii) provides that property is considered in the "neighborhood" of property owned and used by an organization for its exempt purposes if the acquired property is contiguous with the exempt purpose property. If the acquired property is not contiguous with the exempt purpose property, it may still be in the "neighborhood" of such property if it is within one mile of such property and the facts and circumstances of the particular situation make the acquisition of contiguous property unreasonable.

Regs. 1.514(b)-1(d)(1)(iii) provides that the neighborhood land rule does not apply to property ten years after it is purchased. In addition, the rule applies after the first five years only if the organization satisfies the Service that future use of the land for exempt purposes, before the expiration of the ten year period, is reasonably certain. The organization need not show binding contracts in satisfying this requirement but must have a definite plan detailing a specific improvement and completion date, and show some affirmative action toward the fulfillment of such plan.

Regs. 1.514(b)-1(d)(1)(iii) provides that if the neighborhood land rule is inapplicable because the acquired land is not in the neighborhood of other land used for exempt purposes or because the organization fails to establish after the first five years that the property will be used for exempt purposes, but the land is eventually used for exempt purposes within the ten year period, such property is not treated as debt-financed property for any period prior to such conversion.

IRC 514(b)(3)(D) and Regs. 1.514(b)-1(d)(4) provide that where the neighborhood land rule is initially inapplicable but the land is eventually used for exempt purposes, a refund of taxes shall be allowed.

The neighborhood land rule may be particularly applicable in the historic preservation area. For example, the organization described in Rev. Rul. 77-47, supra, could probably fall into the neighborhood land rule exception from debt-financed income with a showing that the commercial use of its historically or architecturally significant buildings was merely temporary.

5. Action, Advocacy, and Confrontation Activities of IRC 501(c) Preservation Organizations

a. General

Preservation organizations are active organizations. The goals of these organizations are such that realizations may only be attained through the most aggressive methods including lobbying, intervention in political campaigns, litigation, or activities such as boycotts, picketing, demonstrations and even confrontations in international waters.

The discussion in this subtopic will be concerned with these activities.

b. Political Intervention

By definition under IRC 501(c)(3), a charitable organization may not engage in any political campaign activity. A discussion on the effect political campaign activity has on the exemption of IRC 501(c) organizations, to include IRC 501(c)(3) organizations, is found in this EOATRI textbook.

c. Legislative Activity

(1) General

IRC 501(c)(3) organizations, such as preservation organizations are permitted to engage in an insubstantial amount of legislative activity except as provided by IRC 501(h).

IRC 501(h) provides for certain public charities to make an election (through Form 5768) and have their legislative activities governed by expenditures tests which may allow many charities to spend as much as 20 percent of their budgets on lobbying activities. Most preservation organizations are generally publicly supported charities defined in IRC 170(b)(1)(A)(vi) or 509(a)(2). They are eligible to make the election and it would be assumed that many have made it. If the election has been made, part VII of Form 990, Schedule A, should be completed.

A more complete discussion of the public charity lobbying provisions may be found in the 1978 EOATRI textbook.

The discussions below complement the lobbying discussion in the cited sources above and are tailored to preservationist organizations.

(2) Excepted Lobbying Activities

The following activities are regarded as permissible "legislative" activities under the Code and regulations and, therefore, would not be a factor in applying the "substantial part" test, under IRC 4945 regarding private foundation lobbying, and under IRC 4911 regarding public charities making the IRC 501(h) lobbying election.

(a) Invited Appearances

Representatives of organizations such as preservation groups are allowed to testify, on written invitation by committees or subcommittees of a legislative body, at public hearings with respect to legislative matters of direct interest to the organization or its members. Rev. Rul. 70-449, 1970-2 C.B. 112. A similar exception is also found in IRC 4945(e) and Regs. 53-4945-2(d)(2) in respect to private foundation lobbying. IRC 4911(d)(2)(B) provides a similar exception from lobbying for public charities electing under IRC 501(h).

(b) Nonpartisan Analysis Study and Research

Making available the results of nonpartisan analysis, study or research to legislatures will not fall within the prescribed attempts to influence legislation. See, for example, Rev. Rul. 64-195, 1964-2 C.B. 138, which holds that the exempt status of a nonprofit educational organization under IRC 501(c)(3) is not affected by its nonpartisan study, research and assembly of materials in connection with court reform and the dissemination of such materials to the public. This exception from lobbying of making available the results of nonpartisan analysis, study, or research was incorporated as an exception from lobbying under IRC 4945(e) for private foundations. Regs. 53.4945-2(d). See also IRC 4911(d)(2)(A) which provides the nonpartisan analysis exception in regard to public charities making the IRC 501(h) election.

(c) "Self-defense"

IRC 501(c)(3) organizations may engage in legislative activity with respect to legislative proposals that might affect the existence of the organization, its legal powers and duties, its tax exempt status, or the deductibility of contributions to such an organization. Similarly, the organization may make expenditures in order to initiate legislation if such legislation concerns only matters which might affect the existence of the organization, its powers and duties, its tax-exempt status, or the deductibility of contributions to such organization. See IRC 4911(d)(2)(c) for public charity lobbying (after the IRC 501(h) election), and Regs.53-4945-2(d)(3) in respect to private foundation lobbying.

(d) Communications with Members

Under IRC 4911(d)(2)(D), for preservationist organizations electing under IRC 501(h), communication to a preservation organization's members on "information" about legislation, without encouraging members to lobby, does not constitute legislative activity. However, if information regarding pending legislation or status is accompanied by suggestions that members urge their legislative representatives to take particular action, the communication should be regarded as lobbying.

(3) Private Ruling Letter 7819051 - IRC 501 and 4911 - Lobbying; Presentation of Structural Preservation Interests Before City Advisory Body

The Service has issued a ruling in this area concerning an exception from lobbying for preservation organizations engaged in presentation of structural

preservation interests before a city advisory body. This ruling held that expenditures made while presenting preservation interests before an administrative body are not expenditures incurred for the purpose of influencing legislation within the meaning of IRC 4911 of the Code.

The text of Private Letter Ruling 7819051 is extracted below:

LTR 7819051, February 10, 1978

[Code Secs. 501 and 4911]

Exempt organizations; Lobbying; Excise tax on; Presentation of structural preservation interests before city advisory body.--CCH.

This is in reply to the letter, dated August 15, 1977, which was submitted on your behalf by ***** your legal representative, inquiring whether the described activity is considered "lobbying" for the purposes of section 501(h) and 4911 of the Internal Revenue Code of 1954.

The information you have submitted indicates that a major part of your activities is presenting the preservation interests before the Board of Architectural Review and the City Council of ***** pursuant to 53 Pennsylvania Statutes sec. 8001 et. seq. and local ordinance Article 1351 of the Codified Ordinances of the City of *****. These laws require that a request to alter or demolish a structure within an established historic district must be reviewed by the board of Historical Architectural Review and then by the City Council, The ultimate decision whether to grant a certificate of appropriateness for building changes is made by the City Council by resolution.

Section 501(h) of the Code provides that certain organizations recognized as exempt from Federal income tax under section 501(c)(3) of the Code may make an election to take advantage of a ceiling on the amount of expenses they may incur in "lobbying" and "grass roots lobbying".

Section 4911 of the Code sets the dollar limitations on expenses that may be incurred on permissible "lobbying" and on "grass roots lobbying" activities and provides definitions for the terms used in that section of the Code.

Section 4911(d)(1) defines lobbying expenses as including any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of legislation.

Section 4911(e)(2) of the Code defines the terms legislation as including actions with respect to Acts, bills, resolutions, or similar items by the Congress, any State legislation, any local council or similar governing body.

The Architectural Review Board is merely an advisory body, the activities it carries on are of an administrative nature. Accordingly, expenditures that you make while presenting preservation interests before that body are not expenditures incurred for the purpose of influencing legislation within the meaning of section 4911 of the Code.

Your activities before the City Council concern the execution or administration of a law already in existence. Accordingly, an action by the City Council upon such a measure is a nonlegislative act. Therefore, the expenses you incur while presenting the preservation interests before the City Council of ***** are not expenditures to influence legislation for the purposes of section 4911 of the Code. The mere fact that the ultimate decision regarding this matter is made by the City Council in form of a resolution is not dispositive.

(4) Measurable Lobbying Activities

The following activities would be regarded as legislative activities for purposes of the "substantial part" test, IRC 4911, or IRC 4945.

(a) Direct Lobbying

Direct lobbying by a preservation group is an example of a measurable legislative activity. Direct lobbying includes meetings, correspondence, telephone discussions with, testimony before, or the submission of "position papers" to members of legislatures, legislative staffs or officials of executive branches engaged in the legislative process.

(b) Grassroots Lobbying

Legislative activity also includes efforts by IRC 501(c)(3) organizations to mold the opinion of the general public or any portion of it with respect to pending legislation or to encourage the public or some portion of the public to communicate with congressional or legislative representatives regarding legislation. Such activities are known as "grassroots" lobbying.

Again, for further discussion in this area, see discussion on "Legislative Activities of IRC 501(c) Organizations" in the 1978 EO textbook and the Addendum in this EOATRI textbook.

d. Preservation Litigation

The Service has, for many years, recognized as charities certain types of organizations that engage in litigation. Favorable IRC 501(c)(3) rulings have been issued to three basic types of organizations that litigate: 1) legal aid societies; 2) civil liberties organizations; and 3) public interest law firms. In all three categories, charitable classification is based upon the fact that the organization provides legal representation where such representation is not available from traditional sources.

However, the Service (in private rulings) has only recently extended IRC 501(c)(3) exemption to "public interest" type organizations that institute and maintain environmental litigation as party plaintiffs under state and federal environmental legislation. Typical of the activities of such organizations may be initiation of a suit against a local manufacturer and the state environmental protection agency to seek enjoinder of the manufacturer from polluting activities. This type of organization does not have its own staff of attorneys and does not provide legal representation to others. Instead, the organization employs private attorneys to represent it in bringing and maintaining environmental litigation.

As previously discussed in this topic in Parts 1, 2, and 3, it is now generally recognized that efforts to preserve and protect the natural environment (and historic environment) for the benefit of the public serve a charitable purpose.

Further, Congress has provided for private litigation to enforce federal laws in numerous environmental statutes. See, e.g., the authorization for private suits to enforce the Clean Air Act, 42 U.S.C. subsection 1857h-2; the citizen suit provision of the Federal Water Pollution Control Act Amendment of 1972, 33 U.S.C. subsection 1365. Many state environmental statutes contain similar provisions.

At least in private rulings as of this time, the Service's position is that the previously described organizations' program of litigation as a party plaintiff under state and federal environmental statutes is an appropriate means of enforcing environmental (or historical) preservation statutes. By seeking to enforce state and federal environmental statutes, the organization is furthering the purpose for which it was organized, which is to protect and restore environmental quality. This purpose is a charitable purpose within the meaning of Regs. 1.501(c)(3)-1(d)(2).

Publication is also being considered in this area.

e. Coercion, Intimidation and Confrontation Activities -- How Far May Activities Go To Promote Purposes Under IRC 501(c)(3)?

Often IRC 501(c)(3) preservation organizations engage in activities designed to force an unrelated party to act or refrain from acting in a way that the organizations believe will assist in the accomplishment of purposes. Typically, the emphasis of such activities is on protecting environmental and historical resources--saving land for food production, maintaining clean waterways, conserving energy, protecting endangered animal species from extinction or cruelty, or saving a historic building in the way of an urban "renewal" project.

Issues are raised recurringly as to whether, under what (if any) circumstances such methods as strikes, economic boycotts, picketing and mass demonstrations are permissible methods of furthering educational and charitable purposes under IRC 501(c)(3).

Although this is an area of controversy, there is growing support for the position that, under IRC 501(c)(3), the regulations thereunder, and charitable case law, the correct approach in a case involving an organization using the methods described above is that such methods or activities are proper so long as the three following conditions are satisfied:

- (1) the organization's purpose is charitable;
- (2) the organization's activities are neither illegal, contrary to public policy, nor in conflict with express statutory restrictions or limitations; and
- (3) the activities of the organization are in furtherance of its exempt purpose and reasonably related to the accomplishment of such purpose.

The following comments apply these conditions in turn, to the boycott, confrontation, picketing, etc. type of activity.

- (1) As we have discussed, organizations dedicated to environmental and historical preservation are promoting purposes within the scope of IRC 501(c)(3).

(2) The question of whether coercion, intimidation and confrontation activities are illegal is a matter of fact. It may be of interest here to study Rev. Rul. 75-384 which holds that exempt status is precluded under 501(c)(3) and (c)(4) because of illegal activities.

The text of Rev. Rul. 75-384 is extracted below

Antiwar protest organization. A nonprofit organization formed to promote world peace and disarmament by nonviolent direct action and whose primary activity is the sponsoring of antiwar protest demonstrations in which demonstrators are urged to commit violations of local ordinances and breaches of public order does not qualify for exemption under section 501(c)(3) or (4) of the Code.

Rev. Rul. 75-384

Advice has been requested whether a nonprofit organization formed to promote world peace and disarmament by nonviolent direct action including acts of civil disobedience qualifies for exemption from Federal income tax under section 501(c)(3) or 501(c)(4) of the Internal Revenue Code of 1954.

The purposes of the organization are to educate and inform the public on the principles of pacifism and nonviolent action including civil disobedience. Its primary activity is the sponsoring of protest demonstrations and nonviolent action projects in opposition to war and preparations for war.

Protest demonstrations are conducted at military establishments, Federal agencies, and industrial companies involved with military and defense operations. Other activities consist of peace marches and protests against the use of tax monies for war purposes. The protest demonstrations constitute the primary activity of the organization. They are designed to draw public attention to the views of the organization and to exert pressure on governmental authorities. To derive the maximum publicity of an event, demonstrators are urged to commit acts of civil disobedience. Participants deliberately block vehicular or pedestrian traffic, disrupt the work of government, and prevent the movement of supplies. These activities are violations of local ordinances and breaches of public order. Incidental to demonstrations, leaflets are dispersed presenting the views of the organization.

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(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. The regulation further states that the term "charity" includes lessening the burdens of government and the promotion of social welfare by organizations designed (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

As a matter of trust law, one of the main sources of the general law of charity, no trust can be created for a purpose which is illegal. The purpose is illegal if the trust property is to be used for an object which is in violation of the criminal law, or if the trust tends to induce the commission of crime, or if the accomplishment of the purpose is otherwise against public policy. IV Scott on Trusts Sec. 377 (3d. ed. 1967). Thus, all charitable trusts (and by implication all charitable organizations, regardless of their form) are subject to the requirement that their purposes may not be illegal or contrary to public policy. See Rev. Rul. 71-447, 1971-2 C.B. 230; Restatement (Second), Trusts (1959) Sec. 377, Comment (c).

In this case the organization induces or encourages the commission of criminal acts by planning and sponsoring such events. The intentional nature of this encouragement precludes the possibility that the organization might unfairly fail to qualify for exemption due to an isolated or inadvertent violation of a regulatory statute. Its activities demonstrate an illegal purpose which is inconsistent with charitable ends. Moreover, the generation of criminal acts increases the burdens of government, thus frustrating a well recognized charitable goal, i.e., relief of the burdens of government. Accordingly, the organization is not operated exclusively for charitable purposes and does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code.

Section 501(c)(4) of the Code describes civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

Illegal activities, which violate the minimum standards of acceptable conduct necessary to the preservation of an orderly society, are contrary to the common good and the general welfare of the people in a community and thus are not permissible means of promoting the social welfare for purposes of section 501(c)(4) of the Code. Accordingly, the organization in this case is not operated exclusively for the promotion of social welfare and does not qualify for exemption from Federal income tax under section 501(c)(4).

Rev. Rul. 71-447, 1971-2 C.B. 230, explains that all charitable trusts, educational or otherwise, are subject to the requirement that the purpose of the trust may not be illegal or contrary to public policy. In support of this statement, Rev. Rul. 71-447 cites Restatement (Second) of Trusts, section 377, Comment c., which states: "A trust for a purpose the accomplishment of which is contrary to public policy, although not forbidden by law, is invalid."

The Service through Rev. Rul. 71-447 has applied this "public policy" requirement to preclude the exemption of private educational institutions that operate on a discriminatory basis. There has been apparently no other use of the public policy rationale in cases involving IRC 501(c)(3) status.

In any event, the burden should be on the organization to demonstrate that a particular activity is not contrary to public policy.

Finally, it should be clear that the organization is not engaged in any activity that would be in conflict with express IRC 501(c)(3) statutory restrictions such as intervention in political campaigns or substantial lobbying activities.

- (3) Whether methods such as economic boycotting further exempt purposes and are reasonably related to exempt purpose accomplishment is also a matter of fact.

Consider the hypothetical campaign of a preservationist organization, whose goal is to save a rare wild cat from extinction. Through advertisements in the newspaper and broadcast media, the organization urges that general public to boycott the products of foreign country X until country X stops its commercial hunters from killing the threatened wild cat.

This type of activity, which may also be accompanied by fund raising solicitations, may also be partly a lobbying effort. (See Example 2 in 1978 EOATRI textbook at page 88.)

In any event, the boycotting campaign, as described, may raise the consciousness level of the general public to, in fact, boycott products, or at least provide the organization contributions to further its goals.

Under these circumstances, it would be difficult to deny that such a campaign was not furthering a preservation purpose or not reasonably related to accomplishing that purpose.

Perhaps of interest is a recent National Office private letter ruling concerning the exempt status under IRC 501(c)(3) of an organization, engaging in environmental preservation activities, education of the public regarding environmental problems, and conducting research regarding same.

The organization, otherwise qualified for exemption under IRC 501(c)(3), engages in "confrontation" activities through use of small water craft expeditions on the high seas. Members representing the organization "bear witness" on international waters to protect the harvesting of certain species of rare large marine animals by focusing attention on them. According to the facts, the expeditions are not carried on in a dangerous or reckless manner.

According to the presentations of the organization, none of its activities disrupt the harvesting of the animals by the commercial hunters. The organization's members who "bear witness" are instructed not to do any act that would place either them or any hunters in physical danger. Information available indicates that no international or maritime laws are violated by any of the actions of the organization on the high seas.

The ruling recognized exemption of the organization under IRC 501(c)(3), concluding that the confrontation activity described serves the preservation and educational interests of the organization.