Community welfare; financial assistance to economically depressed areas. A nonprofit small business investment company licensed under section 301(d) of the Small Business Investment Act of 1958, which was formed to relieve poverty, eliminate prejudice and discrimination, reduce neighborhood tensions, and combat community deterioration, and that provides low-cost or long-term loans to businesses not able to obtain funds from conventional commercial sources, with preference given to businesses that provide training and employment opportunities for the unemployed or under-employed residents of economically depressed areas, may qualify for exemption under section 501(c)(3) of the Code. Rev. Rul. 74-587 amplified.

ISSUE

Under the circumstances described below, does a nonprofit small business investment company licensed under section 301(d) of the Small Business Investment Act of 1958 qualify for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code?

FACTS

Corporation M, which otherwise qualifies for exemption under section 501(c)(3) of the Code, is organized and operated in essentially the same manner as the organization described in Rev. Rul. 74-587, 1974-2 C.B. 162. Rev. Rul. 74-587 describes a nonprofit organization, which qualifies for exemption under section 501(c)(3), formed to relieve poverty, eliminate prejudice and discrimination, reduce neighborhood tensions, and combat community deterioration through a program of financial assistance in the form of low-cost or long-term loans to various business enterprises located in economically depressed areas. The organization provides loans to businesses that are not able to obtain funds from conventional commercial sources, and gives preference to businesses that will provide training and employment opportunities for the unemployed or under-employed residents of the economically depressed areas.

Unlike the organization described in Rev. Rul. 74-587, M is licensed as a nonprofit small business investment company (SBIC) under section 301(d) of the Small Business Investment Act of 1958, as amended, 15 U.S.C. section 681(d) (1976). As a section 301(d) licensee, M is required to comply with certain regulations promulgated by the Small Business Administration (SBA). The SBA regulations permit a section 301(d) licensee to determine the terms of each loan made, including the rate of interest, according to the circumstances of each situation. Also, the SBA regulations do not require that a section 301(d) licensee operate at a profit. However, the SBA regulations do require that the interest rates charged by a section 301(d) licensee must be sufficient, in the aggregate, to recover the cost to the organization of acquiring
its loan funds. Further, the SBA regulations impose various considerations that will restrict the degree of financial support that may be offered to a prospective recipient. These considerations relate to the type of business to be aided by the loan, the extent to which the recipient can provide security, and the relationship between the section 301(d) licensee and the recipient. See 13 CFR Part 107 (1980).

LAW AND ANALYSIS

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 defines the term 'charitable' as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration.

In this case, the principal difference between M and the organization described in Rev. Rul. 74-587 is the presence of limitations imposed by the SBA regulations. As a section 301(d) licensee, M may be prevented by the SBA regulations from engaging in certain loan transactions which it might otherwise wish to engage in to further its exempt purposes. In contrast, the organization described in Rev. Rul. 74-587 is free to engage in transactions without regard to the limitations imposed by the SBA regulations. Nonetheless, the SBA regulations do not foreclose all opportunities for M to achieve charitable purposes, nor do they compel M to enter into transactions that do not further a charitable purpose. Although a narrower range of permissible transactions is available to M than to the organization described in Rev. Rul. 74-587, M may still provide loans to businesses that cannot secure financing through conventional commercial sources, the operation of which businesses will achieve charitable purposes in the manner described in Rev. Rul. 74-587.

HOLDING

Under the circumstances described above, M is organized and operated exclusively for charitable purposes and thus qualifies for exemption from federal income tax under section 501(c)(3) of the Code.

This revenue ruling is not intended to imply that all section 301(d) licensees qualify for exemption under section 501(c)(3) of the Code. The mere fact that an organization is incorporated or operated on a nonprofit basis does not qualify it for exemption under section 501(c)(3). Additionally, under section 301(d) of the Act and the regulations thereunder, an organization may be properly classified as a section 301(d) licensee even though it is not organized or operated exclusively for charitable purposes.
Whether a section 301(d) licensee qualifies for exemption under section 501(c)(3) depends upon the facts and circumstances of each case.

APPLICATION INSTRUCTION

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. See sections 1.501(a)-1 and 1.508-1(a) of the regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 74-587 is amplified.