



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

Identification Number:

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Employer Identification Number:

UIL:
4942.03-05
4944.03-00

Legend:

Foundation =

A =

B =

C =

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X =

Dear _____ :

This is in response to the June 13, 2005 ruling request submitted by your representative.

FACTS

The facts submitted indicate that Foundation is recognized as exempt from income tax pursuant to section 501(c)(3) of the Internal Revenue Code and is a private foundation under section 509(a) of the Code. Since 1979, the Foundation has been involved in designing, funding, and implementing charitable projects of its own and active grantmaking. The Foundation's charitable programs focus on helping individuals attain economic independence by advancing educational achievement and entrepreneurial success, with the ultimate goal of promoting a society of economically independent individuals and engaged citizens who

contribute to the improvement of their communities. The Foundation develops and implements programming focused on promoting education and entrepreneurship and is particularly committed to programs that advance both goals, as is the case with the current proposal.

The Foundation proposes to acquire a membership interest in the A (the "Fund"), which will be organized for the purpose of investing in businesses in low-income communities owned or controlled by members of a minority or other disadvantaged group that have not been able to obtain conventional financing on reasonable terms, and that will provide community benefits. In addition to the Foundation, the other Members of the Fund will be current or former professional athletes on, or owners, coaches or managers of a professional sports team located in the greater B metropolitan area, or athletes, owners, coaches or managers from other professional sports teams who currently reside in the greater B metropolitan area. Members may invest in their individual capacities, through a permitted assignee, or through an entity they control. It is also possible that, with the Foundation's consent, other organizations that are exempt under Code Section 501(c)(3) may be permitted to invest in the Fund. The proposal requires that the Members who are individuals (or, in the case of a Member that is an entity, other than one exempt under Code Section 501(c)(3)), an individual who controls the entity participate in an educational program regarding angel investing and entrepreneurship that will be developed and provided by the Foundation to the Individual Members.

The Foundation's proposed investment in the Fund combines several of the Foundation's charitable and educational approaches. First, the Foundation's Capital Contributions to the Fund will be used along with other Member Capital Contributions to provide financial support to businesses that operate in low-income communities and are owned by minorities or members of other disadvantaged groups. These businesses often do not have access to financing and thus cannot compete on a level playing field with businesses that do have such access. The Foundation's proposed contribution to the Fund will increase the Fund's ability to help these businesses compete on a level playing field, thus enhancing the economic well-being of the low-income communities in which these businesses operate.

In addition to these charitable components, the initiative also includes an educational component that is directly related to the Foundation's focus on entrepreneurship and education. It is intended that the individual members of the Fund will learn about angel investing and acquire entrepreneurial skills by being active participants in the Fund and making decisions regarding appropriate Fund investments. Further, the Foundation will play a direct role in this educational aspect of the Fund's activities by developing a program to train the individual members of the Fund regarding angel investing and entrepreneurship. If the program is successful in meeting these charitable and educational goals in this initial phase, the Foundation intends to replicate this program in other C cities with low-income communities.

A (the "Fund"), a private investment fund, is to be organized as a D limited liability company. The purposes of the Fund, as set forth in the Fund's draft Operating Agreement, are to enhance social welfare, support community improvement, eliminate prejudice and discrimination, and

promote economic self-sufficiency by serving, or providing investment capital for, low-income communities or low-income persons through making investments in specific types of businesses described more fully below, known as "Portfolio Companies," including providing technical assistance and training to the Portfolio Companies. A further purpose of the Fund is educational – to educate the individual members, each of whom must be affiliated with professional sports teams which are located in the greater B metropolitan area, or current or former professional athletes, or current or former owners, coaches or managers of other professional sports teams who currently reside in the greater B metropolitan area, regarding angel investing and entrepreneurship.

The Fund will accept Capital Contributions from its Members, including the Foundation. The Foundation will make Capital Contributions to the Fund in the form of matching contributions, up to \$x. The Fund will make qualified investments in Portfolio Companies that will further the aforementioned charitable purposes. As an angel investing fund, the Fund typically will provide financial support for new and growing businesses, bridging a gap between individual and institutional venture capital rounds of financing, or serving as the only source of external financing.

The Fund will have a maximum of twenty Members, excluding Foundation. Each Member who is an individual must be either: (a) a current or former professional athlete on, or a current or former owner, coach or manager of, a professional sports team located in the greater B metropolitan area or affiliated with, or formerly affiliated with, a B professional sports team or (b) a current or former professional athlete on, or a current or former owner, coach or manager of, a professional sports team located outside the greater B metropolitan area, so long as such individual currently resides in the greater B metropolitan area. Each Member that is an entity must be either (a) controlled by an individual meeting the criteria for individual membership, described above, who must participate in the entrepreneurship education activities and provide assistance to Portfolio Companies or (b) an entity that is exempt from tax under Code Section 501(c)(3) and whose purposes are charitable under Code Section 170(c)(2)(B).

The Foundation's mission is to advance educational achievement and entrepreneurial success, and its proposed acquisition of a Membership Interest in the Fund furthers both aims. The Foundation proposes to contribute up to \$x to the Fund on a dollar-for-dollar matching basis with the Capital Contributions of the Fund's other Members. The Fund, in turn, must use at least 85% of Member Capital Contributions to invest in Portfolio Companies. For purposes of meeting this 85% requirement, any amounts expended by the Fund in providing technical assistance and training to a Portfolio Company relating to the organization or operation of a trade or business, shall be considered an investment in the Portfolio Company. The Fund also may use a limited amount of Member Capital Contributions to pay for the reasonable and ordinary business or operating expenses of the Fund ("Expenses") and to invest in companies that do not satisfy the investment criteria set forth in the Operating Agreement. By virtue of the requirement that at least 85% of Member Capital Contributions must be used for qualifying investments, such Expenses and non-qualifying investments will not account for more than 15% of Member Capital Contributions. Moreover, pursuant to the terms of an Educational

Consulting Agreement, the Foundation will provide an educational program for the Individual Members of the Fund concerning angel investing and entrepreneurship at no cost to the Fund.

One of the Foundation's charitable purposes in proposing to become a Member of the Fund is to provide capital to minority-owned businesses located in low-income communities, in order to help those communities and contribute to reducing poverty. With the exception of certain short-term investments the Fund is permitted to make between the receipt of funds and the investment, reinvestment or distribution of these funds, at least 85% of the Capital Contributions from the Members must be used by the Fund to invest in, or provide technical assistance to Portfolio Companies.

"Portfolio Company" is defined as a business located in a low-income community in the greater B, D metropolitan area, but also possibly in other low-income communities in other C regions. In addition, at least sixty-seven percent (67%) of the individuals (excluding the Fund and its Members) that own and/or control such business must be members of a group or groups that, because of their race, gender or economic status, traditionally have been denied access to equity funding and credit, and the business, because of its minority or low-income composition or its location in a low-income community, actually must have been denied access to traditional sources of equity financing and credit. Moreover, preference will be given to a Portfolio Company that would create or retain jobs for minority or low-income individuals in low-income communities within the greater B, D metropolitan area or other C region, provides services to residents of such disadvantaged areas, or otherwise contributes to the economic revitalization of such disadvantaged areas.

Before investing in a particular company, the Fund will verify that the company is located in a census tract in the greater B, C metropolitan area with a poverty rate of at least 20% or a tract for which median household income does not exceed 80% of the statewide median household income. (The same requirement will apply for any contemplated investments in other communities.) If the company does not satisfy this criteria, the Fund may consider other factors tending to show that the company is in a depressed community, such as unemployment and public assistance rates, level of educational attainment of the residents of the tract, the presence of rampant physical blight, a large stock of abandoned structures and structures needing repair, a crumbling infrastructure, and a lack of a range of basic and/or affordable retail services. Thus, if one or more of these other factors reflects heightened poverty for the tract, the Fund may invest in the company.

A further purpose of the Foundation's proposal is to educate the Fund's Individual Members concerning angel investing and entrepreneurship. As a condition to investing in the Fund, Individual Members must agree to participate in an educational program designed by the Foundation for this purpose. Further, the Foundation will enter into an Educational Consulting Agreement with the Fund that will set forth the educational activities that will be provided by the Foundation. These educational activities will be provided by the Foundation to the Fund and its Individual Members at no cost.

The Foundation expects that its Capital Contribution to the Fund and this entrepreneurship initiative, more generally, will spur additional investors to provide capital to the target Portfolio Companies on reasonable terms, and that ultimately, there will not be a need for initiatives of this sort.

The Fund's Operating Agreement requires Members to provide assistance to Portfolio Companies in which the Fund has made an investment, as reasonably requested by the Fund. A Member's failure to do so may result in the Member being placed on probation or the redemption of the Member's Membership Interest in the Fund. Furthermore, Members may assist Portfolio Companies in which the Fund currently holds an investment by appearing in an individual capacity in advertisements or other promotional materials of a Portfolio Company, provided that if the Member is to receive compensation for such services, the compensation must be reasonable and the Member must obtain the prior consent of the other Members. These are concrete ways in which the athletes and other Members can assist the target businesses and give back. Furthermore, the Members are likely to be attracted to the fact that they will be working together with others involved in professional sports and going through a significant educational program as a team.

The Fund expects to be structured as an angel investment fund and thus primarily will provide financial support for new and growing businesses. Unlike traditional angel funds, however, the Fund's investment criteria require the Fund to invest in businesses in low-income communities that have been unable to obtain conventional financing at reasonable rates. Thus, while it is hoped that the Fund's investments (which the Members will select) will both help needy communities and fledgling businesses and be successful, the return on the Members' investment is expected to be substantially lower than for typical angel investments. The Fund expects to achieve a substantially lower rate of return. The Operating Agreement provides that in the event a Portfolio Company investment reaches a certain level of economic success such that it would no longer qualify as a program-related investment as defined in Code Section 4944(c) and the regulations promulgated thereunder, the Foundation may cause the Fund to terminate the Foundation's participation in that particular investment (while still remaining a Member of the Fund). The Foundation believes that were it not for the Foundation's design and implementation of this program and commitment to become a significant investor in the Fund, the athletes would not invest in these communities.

The Operating Agreement and other documents contain terms to ensure that the Members' Capital Contributions to the Fund, and the Foundation's Capital Contributions, in particular, are used for investments that qualify as program-related investments, as defined in Code Section 4944(c) and the regulations promulgated thereunder. The Fund may not:

- carry on propaganda or otherwise attempt to influence legislation (within the meaning of Section 4945(d)(1) of the Code);

- participate in or intervene in (including the publishing or distributing of any statements) any political campaign on behalf of (or in opposition to) any candidate for public office;
- influence the outcome of any specific public election, or carry on, directly or indirectly, any voter registration drive (within the meaning of Section 4945(d)(2) of the Code);
- act in a manner that would result in a “taxable expenditure” within the meaning of Section 4945(d) of the Code were the Fund a private foundation described in Section 509(a) of the Code;
- make any grant to any other organization or entity which, if such grant were made by a private foundation, would not comply with the requirements of Section 4945(d)(3) or 4945(d)(4) of the Code;
- further, directly or indirectly, any purpose other than one specified in Section 170(c)(2)(B) of the Code, which purposes include the payment of expenses of the Fund; or
- discontinue or materially alter the business activities in which it is currently engaged.

The Fund will be managed by its Members, who will exercise all corporate powers, including the power to decide the specific investments the Fund will make, subject to a number of checks by the Foundation. As set forth in the Fund’s Operating Agreement, the Members may not, without the Foundation’s consent, take any action that would affect the Fund’s or the Foundation’s tax status or charitable purposes.

Furthermore, the Foundation has authority to require the liquidation of certain Fund investments and may withdraw, under certain circumstances, from its participation in a particular investment or from the Fund entirely. In particular, if the Foundation determines that an investment in a Portfolio Company no longer is consistent with the Fund’s purposes, the Fund must take any and all actions within its power to liquidate such investment. Furthermore, the Foundation may withdraw from the Fund or decline to make any Capital Contribution if it determines that the Fund has used Member Capital Contributions other than for Fund purposes or if the Fund fails to observe or perform any agreement, covenant, term or condition contained in the Operating Agreement, which failure would affect the Foundation’s charitable status or the status of its investment in the Fund. (The Fund may avoid this result by curing certain breaches within fifteen days, although a failure to use Capital Contributions for Fund purposes, among other breaches, is non-curable.) Finally, the Foundation may require the Fund to terminate the Foundation’s participation in a particular investment if the Foundation determines that the investment has reached a certain level of significant economic success such that the Foundation’s investment no longer would qualify as a program-related investment. Alternatively, although this is not currently reflected in the Operating Agreement, the Foundation

may agree to accept a cap on its investment return in that particular Portfolio Company investment, rather than require the Fund to liquidate its investment. This would require the Members to amend the Operating Agreement.

The Operating Agreement contains additional means by which the Foundation may ensure that the Fund's investments constitute program-related investments. The Fund must provide written reports to its Members both before and after it invests in a Portfolio Company describing the nature of the proposed investment, how it furthers the Fund's purposes, the progress of the Fund toward achieving its purposes generally, and any other information relating to the Fund's operations, activities and financial condition as requested by the Members. The Foundation will reimburse the Fund for reasonable costs associated with providing certain information to the Members, including any information the Foundation may request to discharge its "expenditure responsibility" requirements with respect to its Capital Contributions to the Fund.

As a further check to ensure the Fund's compliance with key provisions of the Operating Agreement, the Foundation's approval is required to make fundamental changes to the Fund's operations and structure. The provisions which may not be amended without the Foundation's approval include the section defining the Fund's purposes and permissible types of investment, the requirement that at least 85% of Member Capital Contributions be used to invest in Portfolio Companies, the definition of "Portfolio Company," and the provisions requiring liquidation of investments that are no longer consistent with the Fund's purposes, among others.

The Foundation's participation in this entire program not only involves its acquiring a Membership Interest in the Fund, but other direct charitable activities including planning for and preparing organizing documents for the Fund, including a Private Placement Memorandum. As the program unfolds, the Foundation may incur legal expenses in connection with ensuring that the Fund complies with all applicable laws (such as rules regarding expenditure responsibility) and serves the Foundation's charitable purposes. Furthermore, the Foundation will be involved in attracting investors to the Fund and publicizing the availability of funding from the Fund. The Foundation also will provide the ongoing educational programming to Individual Members concerning entrepreneurship and angel investing. Finally, the Foundation plans to undertake parallel initiatives that will support or complement its goals in establishing the Fund. These initiatives include the Urban Entrepreneur Partnership discussed above and a program to encourage commercial banks to provide reasonable, market-rate loans to businesses owned by historically disadvantaged groups and businesses that serve economically underserved communities in the B metropolitan area and C region. It is hoped that these loans would support the types of businesses to be supported by the Fund and ultimately make the Foundation's "investment" unnecessary. All of these initiatives will further the Foundation's charitable and educational purposes.

The following rulings are requested:

1. The Foundation's Capital Contributions to the Fund, as described herein, qualify as a program-related investment, as defined in Code Section 4944(c) and the regulations promulgated thereunder.

2. The expenses incurred and to be incurred by the Foundation in connection with this proposal, including the cost of establishing and maintaining the Fund, providing educational programming to the Individual Members, and ensuring that the Fund complies with all applicable laws and serves the Foundation's charitable purposes are qualifying distributions for purposes of Code Section 4942 and the regulations promulgated thereunder.

LAW:

Sections 501(a) and 501(c)(3) of the Internal Revenue Code provide for the exemption from federal income tax of those organizations that are organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in Code Section 501(c)(3) in its generally accepted legal sense and includes the relief of the poor and distressed or of the underprivileged and the promotion of social welfare by organizations designed to lessen neighborhood tensions, eliminate prejudice and discrimination or combat community deterioration.

Section 1.501(c)(3)-1(c)(3)(i)(a) of the regulations provides that the term "educational," as used in Code Section 501(c)(3), is defined to include "[t]he instruction or training of the individual for the purpose of improving or developing his capabilities."

Section 53.4944-1(a)(2) of the Miscellaneous and Special Excise Tax Regulations provides that a jeopardizing investment is one in which the foundation manager fails to exercise ordinary business care and prudence in making such investment.

Section 53.4944-3(a)(1) of the regulations provides that for purposes of Code section 4944 and sections 53.4944-1 through 53.4944-6 of the regulations, a "program-related investment" shall not be classified as an investment which jeopardizes the carrying out of the exempt purposes of a private foundation. A "program-related investment" is an investment which possesses the following three characteristics: (i) the primary purpose of the investment is to accomplish a purpose described in Code section 170(c)(2)(B); (ii) no significant purpose of the investment is the production of income or the appreciation of property; and, (iii) no purpose of the investment is to accomplish one or more of the purposes of Code section 170(c)(2)(D).

The permissible purposes described in section 170(c)(2)(B) of the Code are "religious,

charitable, scientific, literary, or educational . . . or to foster national or international amateur sports competition . . . , or for the prevention of cruelty to children or animals.”

The prohibited purposes described in section 170(c)(2)(D) of the Code are “attempting to influence legislation” and “participat[ing] in, or interven[ing] in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”

Section 53.4944-3(a)(2)(i) of the regulations provides that an investment shall be considered to be made primarily to accomplish a purpose described in Code section 170(c)(2)(B) if it significantly furthers the accomplishment of the private foundation's exempt activities and if the investment would not have been made but for such relationship between the investment and the accomplishment of the foundation's exempt activities. Moreover, for purposes of Code Section 4944 and sections 53.4944-1 through 53.4944-6 of the regulations, the term "purposes described in section 170(c)(2)(B)" shall be treated as including purposes described in section 170(c)(2)(B) whether or not carried out by an organization described in section 170(c).

Section 53.4944-3(b) of the regulations includes the following example of a program-related investment:

Example (3). X is a small business enterprise located in a deteriorated urban area and owned by members of an economically disadvantaged minority group. Conventional sources of funds are unwilling to provide funds to X at reasonable interest rates unless it increases the amount of its equity capital. Consequently, Y, a private foundation, purchases shares of X's common stock. Y's primary purpose in purchasing the stock is to encourage the economic development of such minority group, and no significant purpose involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the investment and Y's exempt activities. Accordingly, the purchase of the common stock is a program-related investment, even though Y may realize a profit if X is successful and the common stock appreciates in value.

Rev. Rul. 74-587, 1974-2 C.B. 162 held that a community development organization that proposed to purchase equity interests in or provide low-cost loans to minority-owned businesses in depressed communities was organized and operated for charitable purposes. The organization targeted minority-owned businesses in economically disadvantaged or depressed areas, and assisted those that were unable to obtain funds from conventional sources because of the financial risks or discrimination. The organization gave preference to businesses that

would provide training and employment opportunities to the unemployed. Furthermore, the organization disposed of its equity stake in companies when the businesses achieved a certain level of success. The Ruling stated that the direct recipients of the aid need not be a charitable class as long as they act as the charitable instruments to accomplish the charitable purposes and as long as the investments only incidentally benefit businesses or others who are not a charitable class.

Rev. Rul. 77-111, 1977-1 C.B. 144, laid out factors by which the Service will determine whether a community development organization furthers charitable purposes. The Service indicated that the relevant factors include whether financial assistance will be limited to businesses owned by minority groups that are unable to obtain conventional financing and that are located in a deteriorated area. Furthermore, the Service considered whether there is a nexus between the business entities assisted and relieving the problems of a disadvantaged area or a disadvantaged group.

Section 4942(g)(1)(A) of the Code provides that the term “qualifying distribution” means “any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3)), except as provided in paragraph (3).”

Section 53.4942(a)-3(a)(2)(i) of the regulations states that the term “qualifying distribution” means “[a]ny amount (including program-related investments, as defined in section 4944(c), and reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(1) or (2)(B)” other than contributions to non-operating foundations and to organizations controlled by the foundation or its insiders.

The Foundation's proposed Capital Contributions to the Fund possess the requisite three characteristics of a program-related investment under Code Section 4944(c) and section 53.4944-3(a) of the regulations.

ANALYSIS:

The first requirement of a program-related investment is that its primary purpose is to accomplish a purpose described in Code section 170(c)(2)(B). The Foundation's proposal to acquire a Membership Interest in the Fund meets this requirement in that its primary purpose is charitable and educational. The primary purpose of the Foundation's proposed Capital Contributions is to enhance social welfare, support community improvement, eliminate prejudice and discrimination, and promote economic self-sufficiency by serving, or providing investment capital for, low-income communities, or low-income persons by making investments in, or providing technical assistance to, Portfolio Companies. Furthermore, another purpose of the

program, as evidenced by the Member requirements regarding participation in the Fund's educational activities, is to educate the Individual Members concerning angel investing and entrepreneurship.

With the exception of certain short-term investments the Fund is permitted to make between the receipt of funds and the investment, reinvestment or distribution of those funds, the Fund must use at least 85% of Member Capital Contributions for purposes consistent with Rev. Rul. 74-587. Specifically, the Fund must use at least 85% of Member Capital Contributions to invest in companies that (1) are located primarily in low-income communities in the greater B, D metropolitan area, but also may be located, to a lesser extent, in other low-income communities in other C regions, (2) are owned or controlled by members of a group that, because of their race, gender or economic status, traditionally have been denied access to equity funding and credit, and (3) because of their minority or low-income composition or location in a low-income community, have been denied access to traditional sources of equity financing and credit. For purposes of meeting this 85% requirement, amounts expended in providing direct technical assistance and training to a Portfolio Company shall be considered an investment in the Portfolio Company. In addition, preference will be given to companies that would create or retain jobs for minority or low-income individuals in low-income communities within the greater, B, D metropolitan area or other C regions, provide services to residents of such disadvantaged areas, or otherwise contribute to the economic revitalization of such disadvantaged areas.

Thus, there will be a nexus between the business entities to be assisted by the Fund and relieving the problems of a disadvantaged area and/or a disadvantaged group because (1) the companies to be assisted conduct their businesses in economically disadvantaged areas, (2) the target companies are not able to obtain funds from conventional sources because of the owners' membership in a disadvantaged group or the location of the business, and (3) the recipients are selected based on who will fill a community need and offer the greatest potential community benefit. This is the type of nexus alluded to in Revenue Rulings 77-111 and 74-587. Furthermore, the Foundation's acquisition of a Membership Interest in the Fund will significantly further the Foundation's exempt purposes to promote economic independence by advancing educational achievement and entrepreneurial success.

The educational component of the proposed initiative furnishes additional evidence that the primary purpose of the investment is to accomplish a purpose described in Code section 170(c)(2)(B). Individual Members of the Fund must participate in the educational activities provided by the Foundation, which will include training and instruction about how to evaluate business opportunities and follow investments, the principles of entrepreneurship, functioning as an angel investor, collaborating in a business climate, and doing so in the spirit of giving back to the community. Furthermore, the very act of selecting companies in which to invest and making and monitoring those investments will give Members practical experience that is an intrinsic part of the educational activities.

These activities are consistent with the definition of "educational" under the regulations, which

includes instructing and training individuals to improve or develop their capabilities. Section 1.501(c)(3)-1(d)(3)(i)(a) of the regulations; see, e.g., Rev. Rul. 68-504, 1968-2 C.B. 211 (finding exempt an organization with membership open to all bank employees in a particular urban area operated to conduct an educational program and publish a professional magazine). The Foundation's proposal is educational because it encourages the Members' personal development and skills and does not primarily benefit private interests, but rather serves broad public interests.

The second requirement of a program-related investment is that no significant purpose of the investment is the production of income or the appreciation of property. The regulations state that a relevant consideration in determining whether this requirement is satisfied is "whether investors solely engaged in the investment for profit would be likely to make the investment on the same terms as the private foundation." Section 53.4944-3(a)(2)(iii) of the regulations. Here, although the Foundation is investing on the same terms as the other Members of the Fund, none of the Members is investing solely for profit. The Fund is expected to yield a return that is substantially lower than a typical angel investment. The lower expected return is due to the risky nature of the Fund's investment criteria, which requires that investments be made in businesses in low-income communities that have been unable to obtain conventional financing at reasonable rates. All of the Members are willing to accept the risks and expected lower returns because they have charitable agendas, including a commitment to improve economically depressed communities, promote minority entrepreneurship, and eliminate prejudice and discrimination. Moreover, the Foundation believes that were it not for its participation in the Fund, the athletes would not invest in these communities.

Moreover, the Foundation has numerous control mechanisms to ensure that the Fund's investments satisfy the program related investment criteria. If the Foundation determines that an investment no longer satisfies the Fund's purposes, the Fund must take any and all actions to liquidate such investment. Furthermore, the Foundation may withdraw from the Fund altogether or decline to make any Capital Contribution if it determines that the Fund has used Member Capital Contributions other than for Fund purposes or if the Fund fails to observe or perform any agreement, covenant, term or condition contained in the Operating Agreement, which failure would affect the Foundation's charitable status or the status of its investment in the Fund. In addition, Members of the Fund may not, without the consent of the Foundation, take any action that would affect the tax status or charitable purposes of the Fund or the Foundation in effect as of the date of the Operating Agreement. Moreover, the Fund may not deviate from the investment guidelines set forth in the Operating Agreement without obtaining the prior written consent of the Foundation.

The Fund may not change its investment objectives without the Foundation's consent and the Foundation may exit from the Fund or from a particular investment under certain circumstances. Among the possible circumstances under which the Foundation might require the Fund to redeem its participation in an investment is if the Portfolio Company reaches a certain level of economic success such that the Foundation's interest would not qualify as a program-related investment. Alternatively, although this is not currently reflected in the Operating Agreement,

the Foundation may agree to accept a cap on its investment return in that particular Portfolio Company investment, rather than require the Fund to redeem its participation in the investment.

The regulations do not require the Foundation to exit from an investment because of economic success, however, but rather provide that “the fact that an investment produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.” Section 53.4944-3(a)(2)(iii) of the regulations. Nevertheless, the Service has found economic development organizations that follow this practice to be charitable, and has determined that proposed investments with this feature, among others, constitute program related investments. For example, in Rev. Rul. 74-587, the Service found charitable an economic development organization that proposed to purchase equity interests in minority-owned businesses in depressed areas, but that would dispose of such interests when the businesses achieved a certain level of success.

Thus, the totality of the circumstances demonstrates that no significant purpose of the Foundation’s proposed acquisition of a Membership Interest in the Fund is the production of income or the appreciation of property.

The third and final requirement of a program-related investment is that no purpose of the investment is to carry on propaganda or otherwise attempt to influence legislation or to participate in, or intervene in, any political campaign on behalf of any candidate for public office. The terms of the Operating Agreement specifically ensure that this be the case. The Foundation has the right to withdraw from the Fund or decline to make any Capital Contribution if the Fund were to violate these prohibitions.

Furthermore, the expenses incurred and to be incurred by the Foundation in connection with this proposal, including but not limited to the fees to establish and ensure that the Fund complies with all legal requirements (such as expenditure responsibility), amounts paid to attract Fund investors, the cost to provide educational programming to the Individual Members, and the expenses to research and implement the possible replication of the Fund in other communities, are qualifying distributions.

The Foundation not only proposes to become a Member of the Fund, but is undertaking other direct charitable activities to support and complement the Fund’s activities. These activities include planning for and preparing organizational documents for the Fund. Furthermore, the Foundation may incur legal and other expenses in connection with ensuring that the Fund complies with all applicable laws and serves the Foundation’s charitable purposes, including payment of the Fund’s expenses in complying with its expenditure responsibility reporting requirements. These are reasonable and necessary expenses because were it not for the Foundation’s efforts, the Fund – the investment vehicle through which the Members may invest in Portfolio Companies – would not have been established. Furthermore, the Foundation will be

involved in attracting investors to the Fund and maintaining continuity until these investors are in place. These also are reasonable and necessary expenses to ensure that there is indeed a Fund with duly constituted Members to whom the Foundation can make Capital Contributions.

In addition, once the Fund is operational, the Foundation will provide the ongoing educational programming to the Individual Members of the Fund as well as provide technical assistance to the Portfolio Companies. Once again, these are reasonable and necessary expenses to ensure that the Foundation's charitable and educational purposes are fulfilled. Moreover, the Foundation's expenses in supporting complementary initiatives, including encouraging commercial banks to provide market-rate loans to minority businesses in B, likewise are reasonable and necessary to accomplish the Foundation's charitable purposes of increasing minority entrepreneurship, thereby reducing poverty and improving communities.

Thus, the expenses incurred and to be incurred by the Foundation as described above are reasonable and necessary within the meaning of Code Section 4942(g) and should be included as qualifying distributions in the years of payment. Providing it is successful, the Foundation hopes to replicate this program in other cities and expects that the expenses associated with these subsequent efforts will be lower as the Foundation will be able to use documents drafted for this initiative as models and will benefit from the experience of developing and implementing this program.

CONCLUSION:

Based on the foregoing, we rule as follows:

1. The Foundation's Capital Contributions to the Fund, as described herein, qualify as a program-related investment, as defined in Code Section 4944(c) and the regulations promulgated thereunder.

2. The expenses incurred and to be incurred by the Foundation in connection with this proposal, including the cost of establishing and maintaining the Fund, providing educational programming to the Individual Members, and ensuring that the Fund complies with all applicable laws and serves the Foundation's charitable purposes are qualifying distributions for purposes of Code Section 4942 and the regulations promulgated thereunder.

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

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

Because this letter could help to resolve future questions about your federal tax responsibility, please keep a copy of this ruling in your permanent records. If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Mary Jo Salins
Acting Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437