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REPLY TO:  
DES MOINES

August 24, 2006

Mr. Mark Edelman  
Director  
Community Vitality Center  
Iowa State University  
478 Heady Hall  
Ames, IA 50011

RE: Community Foundations – Support of Entrepreneurial Programs

Dear Mr. Edelman:

This letter is in response to your request that we research the ability of community foundations exempt under IRC § 501(c)(3) to support certain entrepreneurial programs. As part of your request, you described as possible activities grants to entrepreneurs, grants to other nonprofit organizations involved with entrepreneurial activities, and grants to governmental entities or agencies. As discussed below, similar activities have been approved by the Internal Revenue Service ("IRS") as charitable under the categories of the promotion of social welfare and the lessening on the burdens of government.

Promotion of Social Welfare. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" includes the promotion of social welfare by organizations designed to relieve the poor and distressed, to lessen neighborhood tensions, or to combat community deterioration. In Rev. Rul. 74-587, 1974-2 C.B. 162, the IRS has ruled that an organization that maintained a program of providing financial assistance and other aid to businesses in economically depressed areas was promoting social welfare. In the ruling, the organization devoted its resources to programs designed to stimulate economic development in urban areas inhabited mainly by low-income minority or other disadvantaged groups. Specifically, the organization provided funds

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and working capital to corporations or individual proprietors who were not able to obtain funds from conventional sources because of the poor financial risk involved due to their location, or because of their membership in minority or other disadvantaged groups. The financial assistance was in the form of low-cost or long-term loans, or the purchase of equity interests which would be disposed of as soon as the success of the business was reasonably assured. The organization also provided technical assistance and counseling when appropriate.

In Rev. Rul. 74-587, the IRS stated that the organization promoted the social welfare of the community since it helped to lessen prejudice and discrimination against minority groups by demonstrating that they could operate businesses successfully if given the opportunity and proper guidance. The IRS also stated that the organization helped to relieve poverty and lessen neighborhood tensions by assisting local businesses that would provide a means of livelihood and expanded job opportunities for unemployed and underemployed area residents. Finally, the IRS stated that the organization was also combating community deterioration by helping to establish businesses in the area and rehabilitating existing businesses.

Consistent with Rev. Rul. 74-587, the IRS has issued private letter rulings to similar organizations. In these rulings the IRS not only approved the organization's activities in providing financial and other support to businesses, but also approved the arrangements the organizations proposed to implement to obtain the funding necessary to support their programs. For example, Letter Ruling 199909056 involved a community development organization designed to strengthen the economy in an economically distressed area of the country. The organization provided financial support (either in the form of loans or by a purchase of an equity interest), technical and management expertise, and marketing services to businesses in the area. The organization placed an emphasis on minority entrepreneurs and primarily assisted businesses that were unable to obtain financing from conventional sources. To fund its program, the organization established a limited liability company ("LLC") with area banks and financial institutions. The IRS had previously ruled that the organization's participation in the LLC would not adversely affect the organization's status under Section 501(c)(3). In the current ruling the IRS approved the admission of individual and institutional investors in the LLC provided the organization continued to be the controlling member.

Likewise, in Letter Ruling 200351033 the IRS addressed an organization that was established to create affordable housing income in a certain area. The organization proposed to expand its purposes to promote community development by making grants and loans to low-income persons and others who lacked adequate access to capital and credit. To implement this program the organization proposed to organize an LLC with commercial lenders in the area. The organization represented that the businesses to which the LLC would lend would have been denied loans from commercial lending sources and most would be owned by members of minority groups, women or low-income individuals. In other cases, the underwriting process would ensure that the businesses to which the loans were made: (1) were located in a distressed area; (2) would use the funds to employ individuals who fall into a targeted population or live within a distressed area; or (3) would use the funds to provide necessary services or products that are otherwise unavailable to residents of distressed areas. In addition to the loans, the organization also proposed to provide technical assistance to the borrowers. The IRS ruled that

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the organization's expanded activities and participation in the LLC would not adversely affect its Section 501(c)(3) status.

Based on the above rulings, a community foundation can properly make grants to entrepreneurs or to support entrepreneurship programs provided the following requirements are satisfied: (i) the grants are provided to aid an economically depressed or blighted area; (ii) the grants benefit a disadvantaged group, such as minorities; and (iii) the grants aid businesses that have experienced difficulty in obtaining conventional financing due to their location or the minority composition of the business.

Lessening the Burdens of Government. Reg. § 1.501(c)(3)-1(d)(2) provides another category of charitable purposes is that of lessening the burdens of government. An organization will be viewed as lessening the burdens of a government when the organization's activities are activities that a government unit considers to be its burdens, and such activities actually lessen that burden. Rev. Rul. 85-2, 1985-1 C.B. 178.

Organizations which provide grants directly to a governmental unit have been held to be exempt as lessening the burdens of government. For example, an organization that provided funds to a county's law enforcement agencies to police illegal narcotic traffic was held to lessen the burdens of government and therefore qualified for Section 501(c)(3) status. Rev. Rul. 85-1, 1985-1 C.B. 177. Likewise, an organization that made funds available to a police department to assist the department in offering rewards for information leading to the apprehension and conviction of criminals was held to be exempt. Rev. Rul. 74-246, 1974-1 C.B. 130. Furthermore, in Rev. Rul. 71-29, 1971-1 C.B. 150, the IRS ruled that a grant by an organization to a city transit authority for the purpose of maintaining a mass transportation system qualified as a charitable expenditure. Finally, in Rev. Rul. 62-78, 1962-1 C.B. 86, the IRS ruled that a 501(c)(3) organization could make distributions to a state or municipality, or to an activity which was an integral part thereof, without jeopardizing its exempt status provided the funds were used to carry out purposes which constituted the basis for the donor organization's exemption.

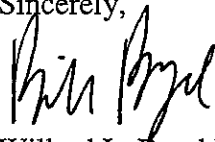
Based on the above rulings, a community foundation can properly make grants to governmental entities for use in entrepreneurial programs and activities conducted by such entities.

Grants to Other Organizations. Finally, a Section 501(c)(3) organization may make grants to other organizations under certain circumstances. In Rev. Rul. 64-182, 1964-1 C.B. 186, the organization was formed to aid other charitable organizations through contributions and grants to such organizations for charitable purposes. The IRS ruled that the organization was entitled to Section 501(c)(3) exemption. Furthermore, in Rev. Rul. 68-489, 1968-2 C.B. 210, a Section 501(c)(3) organization proposed to make distributions to non-501(c)(3) organizations to support projects that were in furtherance of its own exempt purposes. The IRS ruled the organization would not jeopardize its exemption in making such distributions so long as it retained control and discretion as to the use of the funds and maintained records establishing that the funds were so used. Accordingly, a community foundation can make grants to other organizations with these parameters.

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I trust the above analysis is responsive to your inquiry. Please let me know if you have any questions or would like to discuss this matter further.

Sincerely,

A handwritten signature in black ink, appearing to read "Willard L. Boyd III". The signature is written in a cursive style with a large initial "W".

Willard L. Boyd III

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