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Tax Exemption for Organizations

Investing in Black Businesses

The issue of tax exemption for charitable organizations has been a source of discussion and disagreement for years. This debate has become more intense recently as charitable organizations have sought new structures for performing established charitable objectives and a broader classification of objectives to be considered charitable. In this note the permissible scope of the charitable tax exemption is merged with an issue of greater urgency: the exclusion of poverty groups and certain minority groups from the economic mainstream of life in the United States.

The question is whether the charitable exemption provided in § 501(c)(3) of the Internal Revenue Code of 1954 should be granted to organizations which make investments in businesses that are owned and operated by members of minority and poverty groups, that employ members of minority and poverty groups, and that are unable to obtain investment capital from conventional lenders at reasonable interest rates. The legal issues will be dealt with here as they would apply to an organization making such investments as its exclusive activity. However, if organizations which invest exclusively are tax exempt, then organizations making these investments in combination with other activities would also be exempt if their other activities are charitable.

1. The following organizations are exempt from federal income taxation under Int. Rev. Code of 1954, § 501(c)(3): "Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carried on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."

2. The term "organization" as used herein means any corporation, community chest, fund, or foundation which is not organized or operated for profit, but is operated solely for the purpose of making investments designed to alleviate unemployment and broaden the economic base of poverty and minority groups, and thus to facilitate the economic integration of these groups into our society.

3. The term "investment" as used herein means the making of loans (either "soft" or of a more traditional type) or guarantees, or the provision of equity capital through the purchase of stock or other interests.

4. The term "business" as used herein means a co-operative, corporation (including a community development corporation), partnership, or proprietorship.

5. The term "minority and poverty group" refers to those racial, ethnic, or economic groups which are poor or have traditionally been denied equal access to job opportunities and to the investment capital necessary to become competitive entrepreneurs.

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A typical organization making investments exclusively of investment capital from individuals or groups seeking to initiate new businesses to expand existing businesses. If the proposed new business, by its potential both for economic success and for providing jobs to the unemployed, qualifies for assistance, the organization would first attempt to arrange financing at a reasonable rate from a commercial institution. Where this attempt is successful, the organization would not invest in the applicant's business unless supplemental assistance is needed. Where conventional financing cannot be arranged, however, the organization could invest its own funds in the business.

The Internal Revenue Service has issued several private determination letters to organizations planning to invest in minority and poverty group businesses and carry on other activities. (Hereafter, "minority

6. One such organization is the Cooperative Assistance Fund, which has already been formed by pooling some "social investment" resources which several tax-exempt organizations wished to contribute. N.Y. Times, September 29, 1968, at 1. Col. 6. Rev. Ruling 67-149, 1967-1 Cum. Bull. 133 recognizes the right of one charitable organization to fund or give financial assistance to another charitable organization. The advantages of such pooling arrangement over individual efforts by separate organizations are: (1) one "bad" investment is not likely to destroy the entire investment portfolio, (2) diversification of risk is easier, and (3) larger organizations are more capable of hiring the experts needed to evaluate the comparative potential of the businesses. Address of John Simon, President of the Taconic Foundation, Meeting of the Counsel on Foundations, May 16, 1968. See also J. Simon, A Summary of the Discussions Among Foundations Interested in Establishing a Fund Dedicated to Expanding Economic and Housing Opportunity, May 1, 1963 (an unpublished report in the Yale Law Library).

7. When conventional lending institutions are unwilling to invest under any conditions this criteria presents no problem. However, when an institution is willing to make funds available only at high rates the determination of "reasonableness" would be based on an assessment of the likelihood that the high rates would make it impossible for the business to operate profitably. "Reasonableness" then, is not to be determined by applying strict business criteria. For example, the conventional lender might be exercising reasonable business judgment in raising the interest rate or taking "points" because the applicant has no credit history or has never owned a business. This extra one or two percent, however, might spell the difference between success and failure for the business. Thus, it is a factor which must be discounted or totally disregarded if black people are to be afforded an equal chance to succeed in business.

8. The Boston Urban Foundation, a trust, was created to provide loans and grants to individuals to start their own businesses or acquire existing ones in economically depressed areas of Boston. This organization was granted tax exemption under Int. Rev. Code of 1954, § 501(c)(3). Determination of tax exemption of Boston Urban Foundation, June 24, 1968 (on file at Yale Law Journal).

Charitable exemption was also granted to the Coalition Venture Corporation, created to provide loans, grants and guarantees to individuals, corporations, or co-operatives to enable them to establish new businesses or purchase existing ones, in order to benefit economically depressed areas of New York. Determination of tax exemption of Coalition Venture Corporation, Jan. 2, 1969 (on file at Yale Law Journal).

One of the proposed activities of the Cooperative Assistance Fund is the making of loans or equity financial assistance available to businesses or individuals seeking to start their own businesses or acquire existing ones in economically depressed communities. See note 6 supra. The organization's other proposed activities include the management or support of job-training projects, educational programs to prepare minority members for
and poverty group" will be used interchangeably with "black" since a large majority of minority and poverty group members are black.)

The IRS has not, however, published a revenue ruling or any public guidelines concerning the permissible scope of the activities of these organizations. Nor has the IRS, in its private determination letters, stated the legal basis for its conclusions. The absence of a clear, publicly stated IRS policy has fostered uncertainty which could inhibit the making of such investments by existing organizations and the formation of new nonprofit organizations to pursue similar programs.

The inability of minority and poverty-group members to obtain investment capital, whether because of discrimination or the high risk generally associated with their business ventures, has long been recognized as one of the reasons for the failure of these groups to make major steps toward achieving economic equality through entrepreneurship. Obviously, minority business ownership is not a cure-all for economic inequality. Only when the limitations of black entrepreneurship are recognized can we intelligently assess its value. First, the number of new jobs created by each new or expanded business is likely to be small because the businesses themselves will often be small, and unable to employ a substantial number of the unemployed at a profitable level of operation. Second, the earnings of the owner and the wages of his employees will contribute directly to the economic development of the minority or poverty community only to the extent that this money is spent or reinvested within the community. Third, absent some incentive to train unskilled employees, the profit motive will impel entrepreneurs (black or white) to hire proven, stable employees who require no training and who are in all likelihood already em-

managerial positions or entrepreneurship, and promotion of nondiscriminatory and improved housing. This organization was also granted charitable tax exemption. Determination of tax exemption of Cooperative Assistance Fund, Jan. 2, 1969 (on file at Yale Law Journal).

9. Like all determination letters these merely summarize the proposed activities of the organization seeking exemption and state a conclusion as to whether the organization is tax exempt as long as its activities are confined to those summarized.

10. A type of vicious circle operates to keep blacks out of the business system. A Negro construction company that has built only garages may want to bid on a government contract or handle a major renovation project in the ghetto. But it lacks the necessary capital, it cannot secure adequate bonding, and it cannot convince the customer that it has the capacity to perform the job. McKersie, Vitalize Black Enterprise, 46 Harv. Bus. Rev. 88, 90 (1968).

11. This is based on the theory that the poverty community is a "nation" within a nation which, consequently, must have a favorable "balance of payments" in order to develop economically. This rationale provides the theoretical foundation for the proposed Community Self Determination Act (also referred to as the "CORE Proposal"), S. 3875, 90th Cong., 2d Sess. (1968).
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ployed. Fourth, ownership of small businesses alone will not assure these groups the institutional power and economic parity necessary for the social stability of their communities.

These limitations must be balanced against the probable benefits of black entrepreneurship, which include the value of the limited number of jobs created by new businesses and expansions; the increased economic activity in the community and the resulting multiplier effect; the psychological value of ownership or of having members of one's own race own the business in his community; and the training provided individuals who may contribute to the further development of the community. Despite its limitations, black entrepreneurship will contribute substantially to the development of minority and poverty communities by alleviating unemployment and broadening the economic base of these communities.

There are two related problems in granting charitable tax exemption to organizations which invest in minority and poverty-group businesses: whether the investment activity is an "unrelated trade or business," and whether the alleviation of unemployment and broadening of the economic base of poverty communities is a charitable purpose.

The first of these problems arises because the investment activity of these organizations appears, at least superficially, to resemble the business of commercial lending institutions.

12. The marginal product of each new employee must be balanced against the marginal profit he will produce if the business is to yield a profit.

Garrity, Red Ink for Ghetto Industries? 46 HARV. BUS. REV. 4 (May-June, 1968) presents an economic model which suggests that it might be impossible for a ghetto business to hire only hardcore unemployed and make a profit. The experience recounted in Watts Manufacturing Co., A Case Study of a New Plant in a Ghetto Area 12-13 (June, 1968), also indicates a high absentee rate and turnover among the employees. Several methods are being used, with some success, to instill a sense of responsibility among the employees. These methods include individual and group incentive programs and constant reminders that they are part of a team effort which the entire nation is watching. One other method of meeting training cost and thus minimizing the effect of turnover on the business, is described in note 55 infra.


14. The psychological value of ownership or of having members of one's own race own the businesses in his community cannot be measured accurately. It seems reasonable, however, that since the neighborhood businessman (especially the corner store owner) is one of the first people with whom children come into contact, these encounters might have significant importance in the formation of self-identification. The failure of ghetto youths to have positive figures of their own race with which they can identify is believed to be one of the reasons that these children have low regard for themselves and one of the reasons for juvenile delinquency. See note 65 and accompanying text infra.

15. Whether these organizations are businesses might seem an academic point because the only income resulting from their investments is dividend and interest income which is not taxable to charitable organizations as unrelated business income anyway. I.R.T. REV. CODE OF 1954, § 512(b)(1). In this case, however, since the organization's exclusive activity is the operation of the investment business (assuming that the making of investments is
An organization may meet the requirements of section 501(c)(3) 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 purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business . . . . 16

A business is "related" to the organization's exempt purpose if there is a substantial causal relationship between the operation of the business and the achievement of its exempt purposes, other than the organization's need for the profits realized from the business. 17 For example, the manufacture and sale of ceramics would not be an "unrelated trade or business" where the purpose of the organization is the promotion of the art of ceramics. 18 However, the manufacture and sale of macaroni would be "unrelated" where the only relationship between the business and the achievement of the exempt purpose is that the profits from the business are used to support the organization's activities. 19

The purposes of the organizations considered here are to alleviate unemployment and to broaden the economic base of minority and poverty groups. The investments of these organizations bear a "substantial causal relationship" to the achievement of these purposes because the inability of members of minority and poverty groups to obtain investment funds is a major obstacle to the economic development of their communities. 20

The conclusion that the investment activity is not an unrelated trade or business leads to the second issue,
whether the making of this contribution to the economic development of poverty areas is a tax exempt purpose under the Code.

Charitable v. Social Welfare Organizations

Section 501(c)(3) of the Code exempts from taxation any organization operated exclusively for "charitable" purposes if no part of its net earnings inures to a private individual or shareholder,\(^2\) and if influencing legislation or supporting political campaigns or candidates is not a substantial part of its activities.\(^2\) Section 501(c)(4) of the Code provides tax exempt status for nonprofit organizations formed and operated exclusively for the promotion of "social welfare."\(^2\) Although both charitable and social welfare organizations are exempt from taxation on their own income, there is an important difference in their treatment for tax purposes: contributions to charitable organizations are deductible to the donor in computing his taxable income, while contributions to social welfare organizations are not deductible.\(^2\)

The current regulations\(^2\) indicate that a social welfare organization can be a charitable organization if it falls within the definition of "charitable" and is not an "action" organization.\(^2\) Reg. § 1.501(c)(3)-1(d)(2) expressly states that the term "charitable" includes the promotion of social welfare by organizations designed to accomplish any of the charitable purposes enumerated in that regulation.\(^2\) These purposes include the elimination of prejudice and discrimination, the defense of human and civil rights, and the prevention of community deterioration and juvenile delinquency. Social welfare organizations are also typically "dedicated to one or more forms of civic betterment or social improvement such as the elimination of prejudice and

\(21\) The words "private individual or shareholder" refer to "persons having a personal and private interest in the activities of the organization" and not to persons who might be affiliated with the businesses in which the organization invests. Treas. Reg. § 1.501(a)-1(c) (1960).

\(22\) See note 1 supra.


\(24\) In re Rev. Code of 1954, § 170(a)(1) provides for a personal tax deduction for contributions to "charitable" organizations. There is no corresponding provision regarding contributions to "social welfare" organizations.


\(26\) The term "action" organization is defined in Treas. Reg. § 1.501(c)(3)-1(c)(3) (1957).

\(27\) See p. 1219 infra.

\(28\) The term "charitable" as defined in Treas. Reg. § 1.501(c)(3)-1(d)(2) (1967) includes: Relief of the poor and distressed, or of the underprivileged; 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.
discrimination, the defense of human and civil rights, or the prevention of community deterioration and juvenile delinquency."  

Revenue Ruling 67-294 held that organizations created to make loans to business entities as an inducement to locate in economically depressed areas in order to alleviate unemployment are social welfare organizations under § 501(c)(4). Both the purpose and the economic effects of organizations which invest in black businesses are the same as those of the organizations granted tax exemption in Rev. Ruling 67-294. In terms of purpose, both organizations seek to alleviate unemployment in economically depressed areas. As stated in Rev. Ruling 67-294: "Financial assistance is offered only if it will provide more than temporary alleviation of unemployment." Since the employment of community unemployed whenever feasible is one of the conditions on which investments would be made in minority and poverty-group businesses, a major purpose of these investments would also be the alleviation of unemployment. 

Similarly, the economic effects of investments in minority and poverty group businesses are the same as the effects of loans to induce businesses to locate in poverty areas. Both the loans and the investments stimulate new businesses and expansions of existing businesses. The entrepreneurs in each case are required to make the new jobs created available to the unemployed of the community. In either case, the effect is a stimulation of economic activity in the community and a decrease in unemployment. 

Because the purposes and economic effects of these two types of organizations are the same, it follows that the proposed investment organizations are within the scope of Rev. Ruling 67-294 and qualify for "social welfare" exemption under § 501(c)(4). 

The pertinent regulations indicate that, aside from the fact that a
social welfare organization can be an action organization while a charitable organization cannot, there is no significant distinction between the two types of organizations. Thus, so long as an organization making investments in black businesses is not an action organization, it qualifies for the tax exemption provided by § 501(c)(3).

The determination must still be made whether an organization is an action organization, but this determination is easier to make than the determination of whether an organization is "charitable," because the Code criteria are clearer and less elaborate.

Organizations making investments in minority and poverty group businesses are not action organizations within the purview of the pertinent regulations. The Regulations define an action organization as one which, as a substantial part of its activities, attempts to "influence legislation," or participates, "directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office." If the investment activities of these organizations involve neither of these pursuits, it seems clear that they would qualify for charitable exemption under § 501(c)(3).

The Nature of Charities

Since donations to charitable organizations are deductible by the donor while donations to social welfare organizations are not, the qualification of an organization for exemption under § 501(c)(3) rather than § 501(c)(4) could have a significant effect on the amount of capital made available to organizations discussed here. The main criterion for exemption under § 501(c)(3) is that the organization must be operated exclusively for a charitable purpose. In the analysis above, it was argued that investments of the type described serve the "social welfare" of the society, and that this brought the organizations in question within the aegis of § 501(c)(3) by virtue of Revenue Ruling

33. For a more complete summary of the "social welfare"-"charitable" distinction, see Chester, supra note 32. He concludes at 305:

34. An organization is regarded as attempting to "influence legislation" if it (a) contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting or opposing legislation; or (b) advocates the adoption or rejection of legislation. Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii) (1967).


36. See note 24 and accompanying text supra.
Quite apart from this chain of precedent and administrative interpretation, however, an independent examination of the term "charitable" as used in § 501(c)(3) establishes that these organizations qualify thereunder.

The layman's definition of "charity" is confined to gifts to the needy. Using this restrictive definition, one might question the charitable character of loans to black entrepreneurs, who—despite the difficulty they may encounter in borrowing from conventional lenders—are not necessarily poverty-stricken themselves and who, in any event, will be entitled to the profits of their enterprises. Reg. § 1.501(c)(3)-1(d)(2), however, provides:

The term "charitable" is used in § 501(c)(3) in its generally accepted legal sense and is . . . not . . . limited by the separate enumeration . . . of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions.

The legal definition of "charity" is "broad and comprehensive, and has been so for centuries." This definition is supported by numerous British and American court decisions. As stated in Special Commissioners v. Pemsel, the accepted British definition of "charity" was extremely broad, including both "trusts for the relief of poverty" and "trusts for other purposes beneficial to the community." The court pointed out that trusts of the latter type were considered charitable despite the fact that "incidentally they benefit the rich as well as the poor, as indeed every charity that deserves the name must do, either directly or indirectly." A similarly broad definition of "charity" is accepted in this country, as articulated in Jackson v. Phillips. There a charity was said to include any gift that aided an indefinite number

37. See notes 25-33 and accompanying text supra.
38. WEBSTER'S NEW WORLD DICTIONARY 246 (College ed. 1960) defines "charitable" as: "kind and generous in giving money or other help to those in need."
40. Reiling, What is a Charitable Organization?, 44 A.B.A.J. 525, 26 (1958). According to the House Ways and Means Committee, tax exemption for charitable organizations is "based upon the theory that the government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds and by the benefits resulting from the promotion of the general welfare." H.R. REP. No. 1960, 75th Cong., 3d Sess. 19, 20 (1938).
41. These decisions extend back to 1601 when the Statute of Elizabeth respecting charitable uses was adopted. Reiling, supra note 40, at 526.
42. 3 Tax Cases [Eng. 1890-98] 55 (H.L. 1891).
43. The court also included in the definition of "charity" trusts for the advancement of education and trusts for the advancement of religion. Id. at 96.
44. Id.
45. 14 Allen 539 (Mass. 1867).
of persons either by providing education or religion, by relieving them of disease or suffering, by assisting them “to establish themselves in life,” by erecting public buildings, or by “otherwise lessening the burdens of government.”

The courts have not required that all recipients of aid from charitable institutions be poverty-stricken. Estate of Carolyn Gray held that the provision of free nursing care to practicing nurses without regard to their ability to pay was a charitable activity. The court observed that no clear line was available for determining if a given beneficiary’s financial status was sufficiently needy to justify calling the gift charitable, and indeed, that “‘need’ is a wholly relative term, the conception of which must, within reasonable limits, vary . . . .” The court concluded that the trust had an exclusively charitable purpose, despite the fact that its benefits accrued to some persons who were not poor.

Moreover, exemptions under the rubric “charitable” have traditionally been given to many organizations which serve the poor no more, and perhaps less, than they serve other groups. For example, colleges and universities have long been tax exempt; yet in most cases they offer education to students (rich and poor alike) at less than the cost of operating the institution. The narrow definition of “charitable” is also inadequate since it precludes exemption for “works such as public monuments, libraries, public swimming pools . . . and other purposes and activities which are charitable in the legal sense of the word but not devoted to relief of the poor and the suffering.”

The broad judicial definition of the term “charitable” is consistent with that stated in the tax regulations. Reg. § 1.501(c)(3)-1(d)(2), defines “charitable” to include “relief of the poor and distressed or of the underprivileged; . . . lessening of the burden of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or . . . to combat community deterioration and juvenile delinquency.” On each of these criteria,
contributing to the economic development of minority and poverty groups by investing in businesses owned by and employing members of those groups should be considered a charitable purpose.

First, investments in black businesses will have the effect of "relieving the poor." In numerical terms, each new business or business expansion will lead to an increase in the number of jobs available.\textsuperscript{5}\textsuperscript{3} Since one condition of the loan or investment would be the hiring of community unemployed whenever feasible,\textsuperscript{5}\textsuperscript{4} there would be some assurance that the business would hire the people who need jobs most.\textsuperscript{5}\textsuperscript{5}

A Department of Labor survey shows that in some slum areas unemployment and underemployment . . . runs as high as 30 per cent. Thus, . . . it is hard to disagree with the Kerner Commission and others who maintain that the greatest single immediate need is to provide the ghetto dwellers with worthwhile job opportunities.\textsuperscript{5}\textsuperscript{6}

One factor that should greatly assist the employment of those previously thought to be unemployable is that the businesses in which investments are made will be owned and operated by persons who, because of their backgrounds and experiences, are likely to be more understanding and tolerant of initial ignorance of business and productive processes on the part of new employees.\textsuperscript{5}\textsuperscript{7}

\textsuperscript{5}\textsuperscript{3} Approximately 3,500 blacks have been hired by companies whose operations have expanded because of the activity of Operation Breadbasket in Chicago. McKersie, \textit{Vitalize Black Enterprise}, 46 \textit{Harv. Bus. Rev.} 88, 92 (Sept.-Oct., 1968).

\textsuperscript{5}\textsuperscript{4} See note 31 and accompanying text, supra.

\textsuperscript{5}\textsuperscript{5} One method of meeting the costs of training and high turnover rate which generally results when hardcore unemployed are hired is the JOBS Programs. Financial assistance up to $3,590 per year for each employee ($2,640 for on-the-job training and $850 for supportive services) can be obtained to provide both occupational skill training and individual supportive services to facilitate the retention of these individuals on the job. U.S. Dept. of Labor, Manpower Admin., Jobs-National Alliance of Businessmen Section III, Description of Option B, 1968.

\textsuperscript{5}\textsuperscript{6} Garrity, \textit{Red Ink for Ghetto Industries?}, 46 \textit{Harv. Bus. Rev.} 4, 6 (1968). In January, 1967, a special survey showed that the unemployment rate in urban ghetto areas was approximately three times the national rate of 3.7%. U.S. Dept. of Labor, A Sharper Look At Unemployment in U.S. Cities and Slums, March 15, 1967. For other statistics which also suggest the magnitude of the problem of unemployment in the ghetto see Dunlop, \textit{New Forces in the Economy}, 46 \textit{Harv. Bus. Rev.} 121, 127 (1968).

\textsuperscript{5}\textsuperscript{7} Some employee problems with which the ghetto entrepreneur might be faced are lack of work experience, prison records, lack of knowledge of complex work forms such as application blanks and time cards, and failure to dress "properly" for interviews. Standards for employment might have to be adjusted to meet the needs of the community, rather than have the community meet pre-set industry standards. See Watts Manufacturing Co., \textit{Case Study of a New Plant in a Ghetto Area} 10 (June, 1968).

Although there is certainly no statistical data available which proves that black entrepreneurs are, or will be more understanding of these problems, it is becoming more apparent that black people are more sensitive to the needs and aspirations of other black people (e.g., the growing identification of blacks with the struggle for equality). The inability of white society to assure equal economic participation to black America certainly indicates that black entrepreneurs could do little worse. It also seems reasonable that
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Second, contributing to the economic development of minority and poverty groups will lessen the "burdens of government." The Small Business Act of 1953\(^58\) and the Economic Opportunity Act of 1964\(^59\) unequivocally declare that it is the policy of the federal government to bear the "burden" of assisting small businesses and abolishing the "paradox of poverty" due to lack of opportunity for education and employment. These functions are primary goals and effects of investing in businesses controlled by the poor.

The assimilation of members of minority and poverty groups into the economic mainstream of life in the United States is also a burden of government for another reason which has become obvious to most only in recent years. The government has the burden of maintaining an orderly society, free from civil disorder. There is no assurance that economic aid to minority and poverty groups will prevent violence, but there is an increasing awareness that without economic and political justice and equality, order is impossible.\(^60\) These investments should be interpreted neither as an attempt to "buy off" hostilities which have resulted from prior injustices nor to compensate for old members of other economically oppressed groups would be more tolerant of initial employment problems.

58. The Small Business Act of 1953 states: "It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect insofar as is possible the interest of small-business concerns ...." Chapter 282, § 202, 67 Stat. 230.

59. Section 2 of the Economic Opportunity Act of 1964 states: "It is ... the policy of the United States to eliminate the paradox of poverty in the midst of plenty in this Nation by opening to everyone the opportunity for education and training, the opportunity to work, and the opportunity to live in decency and dignity." 42 U.S.C. § 2701 (1964).

60. In some cities during the riots there seemed to have been some relation between whether a business was owned by a minority-group member and whether it was a victim of the riots. The extent of this relationship, was indeterminable after the fact since in some cases law enforcement officers were engaged in attacks on businesses. For example, in Newark, N. J., "during the course of three nights, according to dozens of eye witness reports, law enforcement officers shot into and smashed windows of businesses that contained signs indicating they were Negro owned." REPORT OF THE NATIONAL ADVISORY COMMISSION ON CIVIL DISORDERS 68 (Bantam ed., 1968).

Other evidence indicates that there might be some connection between one's economic status and his propensity to participate in violence. In cities in which the 1967 racial disorders occurred over 20 per cent of the participants were unemployed; and many who were employed worked in intermittent, low status or unskilled jobs. Blacks who lived in those cities were three times as likely as whites to hold unskilled jobs. Id. at 414.

That economic development and pride of ownership might affect the level of unrest has also been demonstrated in Mexico where the Mexican Ejido, a land reform system, has been started. Land is given to the community residents to be distributed to members of the community as the residents determine. Although the community residents do not "legally" own the land they have the legal right to use the land for life and devise it to their heirs. "A ... lesson from the history of the ejido is that THIS PARTICULAR COMMUNITY CONTROL VENTURE VISIBLY SATISFIED MANY WIDELY FELT POPULAR NEEDS: IN TURN DIMINISHING SOME FORMS OF UNREST." M. Edel, The Mexican Ejido: A Lesson for Community Control in the United States, January, 1969 (an unpublished report in the Yale Law Library). See also Herbers, New Stakes for Blacks May Cool Things Off, N.Y. Times, Apr. 27, 1969, sec. 4, at 8, Col. 4.
prejudices. Rather, their effect may be to establish new perspectives more consistent with the principles of an orderly society where equality of opportunity is the *professed* ideal.  

Third, contributing to the economic development of minority and poverty groups by investing in their business will help to alleviate "community deterioration and juvenile delinquency." Because most of the businesses will be located within poverty communities and investments will be made only in businesses which agree to hire unemployed of poverty communities, it is probable that money generated through business ownership and employment will be re-spent in these communities. This will lead, in turn, to a multiplier effect within the poverty community stimulating further economic activity, thereby attacking the root causes of community deterioration and some of the causes of juvenile delinquency. The probability of delinquency is substantially increased when the child grows up in a community in which unemployment and the absence of occupational identity are the dominant mode of life for men.

**Guidelines**

The conclusion of the foregoing discussion is that an exemption under § 501(c)(3) should be granted to organizations which invest in businesses which are owned and operated by members of minority and

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61. The relative merits of direct government subsidies and indirect (tax) subsidies, such as charitable tax exemption, need not be argued here since the phrase "lessening of the burdens of Government" does not mean that there must be a greater benefit from the charity which is given a tax subsidy than there would be if a direct government subsidy were given to fulfill the same purpose. The task of measuring the relative values of the forms of subsidies would be considerable, although there are many areas in which private organizations and the government provide parallel services, e.g., education.

63. The exempt organization should be legally required to insist that an entrepreneur initiating a new business or expanding an existing one, outside the poverty area, bear an extra burden of demonstrating that his business will alleviate unemployment in the poverty community.

64. Keeping the money earned by ghetto residents in the ghetto community (and bringing in more from outside) is one of the most critical problems facing these communities. See note 11 *supra.*

While Negro personal income is growing faster than that of the nation as a whole, white and not Negro financial institutions are siphoning off this income growth . . . . Even though Negro purchasing power increased by almost $4 billion between 1963 and 1966, there was a decrease of 6,000 among Negro self-employed. A. Schuchter, *White Power/Black Freedom: Planning the Future of Urban America* 152 (1968). Schuchter also points out that white insurance companies are collecting far more in premiums in the black community than they are reinvesting. *Id.*

poverty groups, which employ members of minority and poverty
groups, and which are incapable of obtaining investment capital from
conventional lenders at reasonable rates.\textsuperscript{66} Since the terms of the
investments and the types of businesses in which they are made are
critical to the fulfillment of the organization’s charitable purposes,
guidelines should be developed to determine whether particular in-
vestments are sufficiently calculated to achieve the charitable purposes
as to qualify the investing organization for tax exemption. The re-
mainder of this Note will suggest some of the problems which might
arise in assuring the charitable nature of the investment activity.

One requirement of the investments of exempt organizations is that
they should be limited to businesses owned and operated by members
of minority and poverty groups.\textsuperscript{67} While guidelines to determine who
is a member of one of these groups would probably be rather simple to
apply, a safeguard might be necessary to ensure that a black entre-
preneur does not sell his business to someone not a member of a
minority or poverty group, thereby jeopardizing the exempt status of
the organization. A preventive mechanism could be a provision in the
investment agreement allowing the organization to accelerate any
loan or withdraw any equity interest if the business is sold to anyone
who would not qualify for a loan directly from the exempt organiza-
tion.

A second requirement is that the interest rate charged on debt in-
vestments must be “reasonable,” a requirement implicit in the stated
condition that investments be made only in businesses incapable of
obtaining investment capital from conventional sources at reasonable
rates.\textsuperscript{68} Without this requirement, the exempt organization would be
performing no beneficial function not already performed by con-
ventional lending institutions willing to loan money at high rates.

Another limitation designed to ensure fulfillment of the charitable
purposes is that investments be made only in businesses which agree

\textsuperscript{66} See p. 1212 \textit{supra}.
\textsuperscript{67} Investments in businesses owned or operated by a director of or contributor to the
exempt organization, or by members of their families would be subject to the restrictions
imposed by § 503(c) of the Code. This section prohibits a charitable organization from
lending its income or corpus, without receiving reasonable interest rates and adequate
security or engaging in any other transaction resulting in a substantial diversion of its
income or corpus to: “the creator of such organization (if a trust); a person who has
made a substantial contribution to such organization; a member of the family ... of an
individual who is a creator of such trust or who has made a substantial contribution to
such organization; or a corporation controlled by such creator or person through the
ownership, directly or indirectly, of 50 per cent or more of the total combined voting
power of all classes of stock of the corporation.”

\textsuperscript{68} See note 7 and accompanying text, \textit{supra}.
to hire community unemployed whenever feasible.\textsuperscript{69} In addition, the organization should be required to make its investment decisions solely on the basis of the investment's potential for fulfilling the charitable purposes for which the exemption is granted. In this connection, a business located outside a minority or poverty community should be expected to carry a heavier burden of proof that its activity will alleviate unemployment and stimulate economic activity in these communities.\textsuperscript{70}

All of the foregoing requirements should be essential to an organization's receipt and maintenance of an exemption under §501(c)(3). Where the investment is one of equity rather than debt capital, two other guidelines would be desirable, although they need not be conditions precedent to the granting of tax exempt status.

In order to limit the degree of control exercisable by the investing organization over the affairs of the business, a separate class of stock without voting rights could be requested by the exempt organization. Non-voting stock is desirable because control by “outside” decision-makers has long outlived its usefulness to minority and poverty communities. The individual pride and responsibility so essential to the economic and political development of black communities can be fostered only by black control of community institutions. Efforts should, however, be made by the investing organization to provide advisory or consultative aid.

Second, where equity investments are made, a mechanism could be created for allowing gradual conversion of the organization's non-voting stock into voting stock owned by residents of the community. The ownership of stock by residents would begin to broaden the economic base of the community and to provide more of the poor and black with an opportunity to participate in shaping the economic destiny of their communities.

Few people would deny the necessity of assuring members of minority and poverty groups an equal chance to succeed in the eco-

\textsuperscript{69} The criteria “whenever feasible” might be considered objectionable on grounds of vagueness. There is, however, some value in flexibility here as with most new methods of combating social ills. For example, the Housing and Urban Development Act of 1968, Pub. L. No. 90-448, § 3 (Aug. 1, 1968), directs the Secretary of HUD to “require, in consultation with the Administrator of the Small Business Administration, that to the greatest extent feasible contracts for work to be performed pursuant to such programs shall, where appropriate, be awarded to business concerns, including but not limited to individuals or firms doing business in the fields of design, architecture, building construction, rehabilitation, maintenance, or repair, located in or owned in substantial part by persons residing in the area of such housing” (emphasis added).

\textsuperscript{70} See p. 1224 supra.
nomic system. The use of investments to help provide this assurance puts emphasis on the quality and profitability of the businesses in which the investments are made, and on the provision of employment opportunities for minority and poverty-group members. Because these investments would carry an obligation of repayment with interest or the possibility of returns on equity investments, they would also avoid the stigma generally associated with grants or welfare-type payments. The assurance of charitable status would encourage organizations to make these investments and—while not resolving all the problems which minority and poverty groups face in this country—would add another weapon to the arsenal needed to combat poverty in the United States.

Recently, several organizations have indicated their intention of investing in minority and poverty group businesses either as a small part of their total operations or as a major or exclusive activity.71 Other organizations may be awaiting a public ruling or guidelines from the Internal Revenue Service. A ruling affirming tax exemption for such organizations under § 501(c)(3), consistent with the guidelines and legal theory advanced here, could have significant implications for the future economic development of minority and poverty groups.

71. N. Y. Times, Sept. 29, 1968, at 1, Col. 6.