The Profitable Nonprofit Corporation: Business Activity and Tax Exemption under Section 501(c)(3) of I.R.C.

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THE PROFITABLE NONPROFIT CORPORATION:
BUSINESS ACTIVITY AND TAX EXEMPTION
UNDER SECTION 501(c)(3) OF I.R.C.

ROBERT J. DESIDERIO†

I
INTRODUCTION

Since the enactment of the first revenue act, one question has arisen persistently: Is an organization, otherwise qualified, which engages in substantial commercial and business activities intending to make a profit entitled to be classified as a tax exempt organization under what is presently section 501(c)(3) of the Internal Revenue Code? The question is not rhetorical; over the years it has demanded and received extensive discussion. But after numerous cases, various regulations, scores of revenue rulings and an abundance of articles, the question still pervades the area of tax exempt organizations. Apt are those too-oft quoted words of the wise old Indian Chief introduced to us by Dean Prosser:

Lighthouse, him no good for fog. Lighthouse, him whistle, him blow, him ring bell, him flash light, him raise hell; but fog come in just the same.1

The fog came in years ago, and after many scientific attempts, it has yet to be lifted. Confusion abounds!

The purpose of this article is to argue for (and if an “argument” is not necessary since no one contests the conclusion, then to explain the reasons for) a positive answer to the question posed. In answering this question, the discourse will, at the same time, furnish a negative answer to a second question which under the tax law necessarily follows a positive answer to the first. That question is: Under sections 511-513 of the Code, will the organization, even though it is tax exempt, be taxed on the income it earns from its business activities as “unrelated business taxable income”? My thesis is that certain organizations which engage in business activities for profit are entitled to a tax exemption because the trades or businesses which comprise such activities are “related” trades or businesses. Thus, the income therefrom cannot be “unrelated business taxable income.”2

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2. As a result of the Tax Reform Act of 1969, another group of questions must be asked if the first question is answered positively. First, is the organization a “private foundation”? Under section 509 of the Code, all section 501(c)(3) organizations are private foundations.
What will differ this article from others is the approach taken and some of the conclusions reached. Instead of expounding upon the tax law and theory of exempt organizations in the abstract, the discussion will focus upon the application of the law to one organization, the Community Development Corporation (CDC), with the intention of analyzing the law by demonstrating that the CDC is entitled to a tax exempt status under present Federal tax law. In addition, the article will question the policy behind granting tax exempt status to CDC type organizations and suggest a revision to the Internal Revenue Code. It is intended that the analysis is broad enough to be applied to other organizations confronted with the same problem.

Hopefully, the fog will at least be lessened and not transformed into smog!

Two terms, essential to the discussion, must be defined: A “non-profit corporation” and a “community development corporation.” A nonprofit corporation means a corporation no part of the income or profit of which is distributable to its members, directors or officers.” A nonprofit corporation is not the antithesis of a corporation which operates with or for a net profit. As the Model Act definition indicates, the characteristic which distinguishes it from a “for profit” corporation is that net income cannot be distributed to interested persons. It should also be noted that a “nonprofit corporation” is not the same as a “tax exempt” corporation. Indeed, all “tax exempt” corporations are “nonprofit corporations,” but since the prerequisites for tax exemption are greater than those for incorporation, the reverse is not true. This distinction between a “non-profit” and a “for profit” corporation is important to the following discussion and will be drawn upon extensively.
A "Community Development Corporation" (CDC) is more of a concept than a specific organization. It "covers a wide variety of community services and self-help purposes and organizations differing in structure and operations." It is not my purpose to develop and explain the many purposes and structures that are included within the CDC concept. This has been done elsewhere. What I intend to do is to propose a CDC model which generates the profitability issue taken up by this article.

The model is not suggested as the structure to be followed by all depressed communities, although it does have a factual basis. The HELP organization which Dr. Ferran presented in the previous article is the prototype after which it was structured. One additional word: The discussion will be based on the assumption that the model CDC is only one corporation. You will recall that HELP is two corporations: Del Sol Products, Inc., is the wholly-owned subsidiary of HELP. Even though these two organizations are legally separate, in reality they are one organization. It is ridiculous to require the incorporation of two entities to satisfy the niceties of tax law when the two entities are in fact one organization, and that organization is entitled to a tax exempt status.

Although the model CDC is incorporated as a nonprofit corporation, it has characteristics of both the traditional nonprofit and for-profit corporation.

Structurally, the CDC is a two-tiered corporation. At its base it is a nonprofit corporation furnishing educational programs, health services, social and recreational activities and all other community services which are presently nonexistent or inadequate in rural and urban poverty areas. At its second level, it functions as a business corporation, engaging in commercial and productive activity, which brings employment opportunities to the community and stimulates an effective exchange of dollars and ideas. The net revenues derived from these business activities are used to generate additional business activity and to underwrite the cost of community services.

Thus, the model CDC is a community organization, having both a social and economic development objective. To accomplish these objectives it will engage in both social and business activities. The busi-

8. Desiderio and Sanchez, supra note 6, at 218-19.
ness tier of the CDC includes the operation of trades or businesses in almost the same manner as an ordinary business enterprise conducts its activities. The plan is schematic: The residents of the community, who are also members of the CDC,\(^9\) receive education, health services and, more importantly, vocational training through the social divisions of the CDC. The vocational training enables these residents to be placed in employment positions with the business enterprises conducted by the CDC, where their vocational training will be supplemented by on-the-job training. At the same time, the business enterprises will increase the economic base of the community by introducing and retaining dollars in the community. The goal is ownership; there will be a time when the residents, pursuant to a plan of divestiture, will own and operate these profit-making enterprises directly. Community capitalism! It is an attainable ideal.\(^10\)

II

THE PROBLEM OF COMMERCIAL ACTIVITY

A. Congressional Policy

Provision granting tax exemption to qualified organizations has been a part of the tax law from its inception. Sections 501(a) and 501(c)(3), the basic law granting tax exemption, had their beginnings with the Excise Act of 1909,\(^11\) and have not changed in substance since. Under section 501(a), "an organization described in subsection (c) . . . shall be exempt from taxation . . ." And according to subsection (c)(3):

> Corporations . . . organized and operated exclusively for . . . charitable, . . . or educational purposes, . . . 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 carrying 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.

\(^9\) A non-profit corporation usually has members and not shareholders.

\(^10\) For a legislative plan to accomplish the same result, see Community Self Determination Act of 1968, S. 3875, H.R. 18709, 90th Cong. 2d Sess. (1968).

\(^11\) Payne-Aldrich Tariff Act § 38, 36 Stat. 112 (1909): That every corporation . . . organized for profit and . . . engaged in business . . . shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation . . .; Provided, however, That nothing in this section contained shall apply to . . . any corporation or association organized and operated exclusively for religious, charitable, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.

Brief note must also be made of section 170 of the Code, the "charitable contribution" section. Section 170 allows a person who contributes money or property to qualified organizations to deduct the amount of the contribution (with certain limitations) in determining his taxable income. Corporations exempt under section 501(c)(3) are qualified organizations.

Congress' plan has been simple. The overall policy is that private philanthropy is a social good which should be fostered. What better way for society to influence private charity than by tax incentive? Thus, charitable organizations and their contributors have been extended preferential treatment by ridding the organization of the obligation to pay income taxes and by granting the contributor a tax deduction equal in amount to his contribution.

This policy explains the statutory conditions to exemption as found in section 501(c)(3): (1) The organization must have a charitable or educational purpose; (2) no individual can be distributed any part of the net income—what would be tax revenues cannot be distributed to interested parties (recall the definition of a nonprofit corporation); and (3) the organization, since it is operating with public funds, cannot become connected with special interest legislation and partisan politics. As a result of both Congressional policy and statutory language, it would seem that all "nonprofit corporations" which have a charitable or educational purpose and which do not become involved in political activity, should be exempt from Federal income taxes. Profitable ventures, so long as they, or the income therefrom, further the organization's purpose, should not prevent exemption. To be exempt from Federal income taxation, assumes, at least, the possibility of income which could have been taxed. Whether or not this is the current view is uncertain. As will

13. Actually, § 501(c)(3) includes organizations whose purposes are "religious, charitable, scientific, testing for the public safety, literary or education . . . , or for the prevention of cruelty to children and animals.
14. The words of Senator Bacon, in debate over the Corporate Excise Tax Act of 1909 are explicit in recognition of not only the possibility, but the fact, that exempt organizations could engage in income producing activities:

Mr. President, there are several aspects as to which consideration may be had in regard to the matter of taxing benevolent and religious institutions. There is a wide difference of opinion among people as to whether such organizations should be taxed at all or whether they should be taxed on profits. I do not propose to go into that question at all. It is not necessary to go into it, because this is not a general tax act. This is a provision by which a certain class of property is singled out for taxation, and it is one, as we are making a distinction, where we can very properly make a distinction in favor of religious, benevolent, and charitable institutions, without going into the general question whether they should be subject to taxation or not.
be developed below, it is my general belief that today profitable activities do have an adverse effect upon organizations, otherwise qualified, seeking exempt status. Until the '50's, however, this was not the case.

Prior to 1950, organizations which were otherwise exempt were entitled to tax exemption status notwithstanding the source or extent of the income, so long as the income was destined for exempt purposes. In other words, a tax exempt corporation could conduct an extremely profitable trade or business and retain its exempt status if the commercial activity was itself in furtherance of the charitable purpose or the earnings therefrom were used to support the activities conducted in furtherance of its exempt purpose. This latter condition became known as the "destination of income" test.²

It occurred to me that in this partial levy of tax, where we are seeking to reach a certain class of wealth, we very properly except those institutions and those enterprises which have no element of personal gain in them whatever, and which are devoted exclusively to the relief of suffering, to the alleviation of our people, and to all things which commend themselves to every charitable and just impulse.

In regard to the particular corporation of which the honorable Senator from Wyoming (Mr. Clark) has made mention, I want to say that if it be true that there are features in the business of that corporation which are not strictly religious, educational, or benevolent, they would not be screened by this amendment; and if they are all of them religious, benevolent, and educational, the fact of their magnitude would not, in my opinion, be any reason why we should exclude them from the beneficial provisions of this amendment.

I will say to the Senator from Wyoming and to the Senate—and I hope I may have the attention of the Senator from Wyoming now particularly—that the corporation which I had particularly in mind as an illustration at the time I drew this amendment is the Methodist Book Concern, which has its headquarters in Nashville, which is a very large printing establishment, and in which there must necessarily be profit made, and there is a profit made exclusively for religious, benevolent, charitable, and educational purposes, in which no man receives a scintilla of individual profit. Of course if that were the only one, it might not be a matter that you would say we would be justified in changing these provisions of law to meet a particular case, but there are in greater or less degree such institutions scattered all over this country. If Senators will mark the words, the amendment is very carefully guarded, so as not to include any institution where there is any individual profit, and further than that, where any of the funds are devoted to any purpose other than those which are religious, benevolent, charitable, and educational. So, it seems to me it is doubly guarded. It is guarded so as not to include in the exemption any corporation which has joint stock or in which any individual can receive a dividend for his personal use, and it is further guarded so as not to include any corporation which assesses any part of its revenue for any purpose other than those which are mentioned—religious, benevolent, charitable and educational.

15. See e.g., C. F. Mueller Co. v. Commissioner, 190 F.2d 120 (3d Cir. 1951); Roche's Beach, Inc. v. Commissioner, 96 F.2d 776 (2d Cir. 1938).
16. The most famous case illustrating this point is C. F. Mueller Co. v. Commissioner, 190 F.2d 120 (3d Cir. 1951), in which it was brought out that New York University Law School owned the Mueller Macaroni Company.
17. The term was first used and the test has been derived from, Trinidad v. Sagrada
This "destination of income" rule caused an uproar. The point was rather poignantly made that exempt organizations, because of the tax laws, were enjoying a competitive advantage over tax-paying organizations involved in similar business activity. The exempt corporation's dollar was worth more than the business corporation's dollar.

...The tax-exempt status of ellemosynary institutions had enabled them to use their profits tax-free to expand operations, while their competitors could expand only with the profits remaining after taxes. Also, in a number of instances, some of these organizations used their tax exemptions to purchase a business. ...Moreover, by reason of the fact that their earnings were not subject to tax, tax exempt organizations were enabled to outbid taxable corporations in the purchase of other businesses.18

Congress was faced with a conflict of policies. On the one hand, it had the traditional policy granting preferential treatment to philanthropic organizations; on the other, it was presented with the economic policy abhorring unfair competition.

A solution was reached; at first blush it was an adequate answer, but upon close examination, it will be found to be nothing but a weak conceptual compromise. In 1950, Congress enacted the Revenue Act of that year which, while leaving untouched the provisions granting tax exemptions to charitable organizations, taxed their "unrelated taxable income."19 Unrelated taxable income is income from "any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable... purpose or function constituting the basis for its exemption...."20 (Emphasis added.) At first look, it appears that the

Orden de Predicadores, 263 U.S. 578 (1924). No attempt has been made to develop the evolution of the "destination of income" test. For an excellent discussion of it see Eliasberg, supra note 11, at 60-74.


19. Revenue Act of 1950, Ch. 994, 64 Stat. 909. The act included the predecessors of §§ 502, 503, 504, 511, 512, 513 and 514 of the Code. Section 502 deals with the "feeder" problem; § 503 which was amended by the Tax Reform Act of 1969, dealt with prohibited transactions; §504, which was repealed by the Tax Reform Act of 1969 dealt with the problem of accumulation of earnings and business investments which jeopardized the organization's exempt activities; and §514 which was also amended by the Tax Reform Act of 1969, deals with unrelated debt financed income. This article will be concerned only with unrelated business income as provided for in §§511-513, and more specifically only with the definition of "unrelated taxable income" as defined in § 513(a).

For the relationship between §§ 502 and 511-513, see Eliasberg, supra note 11, at 77-101.

scales were balanced; the competitive advantage was (hopefully) eliminated; and the policy of favoring private philanthropic organizations was preserved. But close study indicates that (1) organizations earning income from activities not themselves in furtherance of their exempt purposes are taxed on such income irrespective of its destination, but would, at the same time, retain their tax exempt status and (2) organizations earning income from activities which furthered their exempt purposes are not taxed, no matter what the competitive effect. In other words, the test turns on the relatedness of the activities not the competitiveness of the business. In no case has the tax exemption of the corporation been jeopardized. The intent is clear:

In neither the House bill nor your committee’s bill does this provision deny the exemption where the organizations are carrying on unrelated active business enterprises, nor require that they dispose of such business... [These provisions merely impose the same tax on income derived from an unrelated trade or business as is borne by their competitors. In fact it is not intended that the tax imposed on unrelated business income will have any effect on the tax-exempt status of an organization.21] (Emphasis added.)

Herein lies the compromise and the source of the present troubles. The problem was deemed to be one of competitive advantage caused by elimination of the tax cost from income earned by exempt organizations. But instead of doing away with the tax exemption for organizations seeking profits—which would have done away with the problem—Congress provided only that the “unrelated income” would be taxable. Of course, “unrelated income” of organizations would be put on par with similar income of like businesses,\textsuperscript{22} but “related income” would still be worth more than income of like businesses.

Most people thought the Revenue Act of 1950 the cure to the problem; however, that has not been the case. The problem of profitability and tax exemption had laid relatively dormant for the past twenty years. The reasons for such dormancy have been: (1) Regulations promulgated by the Treasury which make tax exemption for organizations operating unrelated trades or businesses of any magnitude a near impossibility, and (2) a general feeling by the Treasury, the courts and writers that, practically speaking, exempt organizations could not operate “related” trades or businesses that were more than the normal fund-raising devices. The first reason has been adequately rebutted by Kenneth E. Eliasberg in an article in the Tax

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22. Section 511 imposes upon the unrelated business taxable income of an exempt organization the corporate normal tax and surtax of § 11.
This article will take on the second reason, but first a survey of the law and regulations providing for tax exemption.

**B. The Statutory Scheme and the Regulations**

Section 501(c)(3) lists three conditions to tax exemption: (1) The organization must be "organized and operated exclusively" for charitable or educational purposes; (2) no part of its net earnings can inure to any person and (3) it cannot engage in certain political activity. It is the first of these requirements with which this paper is concerned. Is a CDC type organization organized and operated exclusively for charitable or educational purposes? The conclusion reached is that a CDC, as described in the introductory statement, is organized and operated for a charitable purpose as set out in section 501(c)(3).

The regulations to section 501(c)(3) tell us that the term "charitable" "is used . . . in its generally accepted legal sense" and includes:

- Relief of the poor and distressed or of the underprivileged;
- . . . 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; . . . or (iv) to combat community deterioration and juvenile delinquency.

It serves no purpose at this time to argue that a CDC is a "charitable" organization or to elaborate on why it has as a purpose the "relief of the poor and distressed or of the underprivileged," "the lessening of the burdens of Government," the lessening of "neighborhood tensions," or the combating of "community deterioration." Simply stated, the CDC has as its objective the economic and social development of a community, which objective falls within the ordinary definition of "charitable" and includes all the standards listed in the regulations.

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24. The argument is premised on the belief that a CDC is a "charitable" organization. This does not mean that a CDC cannot meet the definition of an "educational" organization or be organized for both "charitable" or "educational" purposes. Treas. Reg. § 1.501(c)(3)-1(d)(3) provides that the term "educational" . . . relates to "(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; . . ." But since the "charitable" purpose route is of wider application and since the argument which follows applies equally to both classifications, the discussion has been limited to the CDC as a charitable organization.


26. Definitions of "charitable" include:

"Charitable" may be used in either a broad or a narrow sense. In its narrow sense, charity means whatever is bestowed gratuitously on the needy or suffering for their relief. In its wide sense, charity denotes all the good affections which men should bear to each other, and in that sense embraces what is generally understood as benevolence, philanthropy, and good will.
The real problem emerges when the CDC engages in business and commercial activities in order to accomplish its objectives. There is no doubt that a CDC will operate its trades or businesses very much (but not exactly) like a "for profit" corporation, and that it will be aiming for profits—albeit less than maximum. Do these factors make the CDC any less "charitable"? To put it in terms of section 501(c)(3), has the CDC been organized and operated exclusively for "charitable" purposes? This question includes a second question which must be looked at first: How is a CDC’s purpose to be determined?

Two criteria deserve observation: The statements of the organization, indicating what purposes are intended (subjective) and the activities of the organization over a given period, indicating what in fact the purposes are (objective). Both factors are essentially the same; they differ only in time of application. The subjective factor looks at the organization’s words, while the objective factor focuses upon the organization’s acts. From both, the purpose, or purposes, are determined. The tax law, as interpreted by the regulations, terms the subjective factor, the “operational test.” Only an organization which is both organized and operated exclusively for a charitable purpose is entitled to a tax exemption.

1. Organizational Test

Under the regulations, a CDC will meet the “organizational test” if the purposes of the organization, as defined in its articles, are “charitable” in nature and its articles “do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.”

A definition of charity used by counsel in the case of Vidal v. Girard, 2 How. 126 (1844), and subsequently quoted with approval in many courts, including the Supreme Court (Ould v. Washington Hospital, 95 U.S. 303), is as follows:

Whatever is given for the love of God, or the love of your neighbor, in the catholic and universal sense, given from these motives and to these ends, free from the stain or taint of every consideration that is personal, private or selfish.

In the last cited case it is said:

A charitable use, where neither law nor public policy forbids, may be applied to almost anything that tends to promote the well-doing and well-being of social man.


no problem; all that the articles must state is that the organization is created for a charitable purpose, as defined in the Code. The second part does present questions of interpretation and application. (Notice that an organization which is empowered to engage in an "insubstantial" amount of "non-exempt-purpose" activities can still pass the test.) For example, assume that the purpose and powers clauses of a CDC's articles of incorporation provide:

(1) The corporation is organized and operated exclusively for charitable purposes as defined in section 501(c)(3) of the Internal Revenue Code of 1954, including, but not limited to, the social and economic development of the community known as The Neighborhood.

(2) The corporation is empowered to engage in any activities, not prohibited by law, which are in furtherance of the above purposes, including, but not limited to, manufacturing activities, commercial activities, the operation of day care centers, and community centers, and the providing of educational, social and recreational programs.

Do these clauses meet the organizational test: Is the CDC empowered to engage in any activities not in furtherance of its exempt purpose? If so, are they substantial or insubstantial? Can these questions be answered merely from an analysis of the articles?

The regulations attempt an answer. By way of illustration, they state than "an organization that is empowered by its articles 'to engage in a manufacturing business,' . . . does not meet the organizational test regardless of the fact that its articles may state that such an organization is created 'for charitable purposes within the meaning of section 501(c)(3) of the Code.'" The issue then is whether the phrase empowering the CDC to engage in manufacturing activities precludes the CDC from being tax exempt. The answer should be that the phrase does not prevent the CDC from attaining tax exempt status.

The illustration in the regulations must be read with an implied condition: "an organization that is empowered by its articles to engage in a manufacturing business which is not in furtherance of its exempt purpose does not meet the organizational test . . . ." Without it, the power to engage in manufacturing or commercial activity per se would prevent a CDC from being tax exempt. It is submitted that such a conclusion would invalidate the illustration because nowhere in the statute and legislative history is business activity prohibited

In fact, the Senate Report, quoted earlier, indicates just the opposite. The interpretation of the illustration adding the implied condition is not without authority. In *Lewis v. United States*, the exempt status of a testamentary trust was questioned. In addition to stating what were charitable or educational purposes, the will contained the following powers:

To carry out the express purposes of this trust and in aid of its execution and the proper administration, management and disposition of the trust estate, the trustees are vested with the following additional powers:

1. To hold, maintain, operate or continue, at the risk of the trust estate, so long as they deem it advisable, any and all property or business which it may receive hereunder;

The commissioner contended that the trust did not meet the organizational test, relying on the regulatory illustration. The court, in rejecting the commissioner's argument and holding that the trust was entitled to an exception under section 501(c)(3), stated:

... this regulation does not foreclose the tax exempt status of the Foundation because the authority of the trustees to carry on a business is delimited by the language prefacing the grant of that power as quoted above. The trustees have the power to conduct a business only if that operation will aid them in carrying out "the express purposes of this Trust..." This authority is decidedly and strictly limited to further tax exempt purposes of the Foundation and it clearly meets the organizational test. (Emphasis added.)

According to this interpretation of the regulations, any CDC which has stated a purpose in accord with the definition of "charitable" and which has not been expressly empowered to engage in activities alien to that purpose, has met the organizational test. To illustrate this point, assume that the CDC articles provide the following purpose and powers clauses:

1. The corporation is organized and operated for charitable and educational purposes under section 501(c)(3) of the Internal Revenue Code of 1954, including the social and economic development of the community known as The Neighborhood.

31. *Id.* at 952.
32. *Id.* at 952-53.
33. *Id.* at 953.
34. Any act not incidental to the corporate purpose or expressly empowered is ultra vires. It cannot be assumed that the CDC will engage in ultra vires activities.
(2) The corporation is empowered to engage in any trade or business.

This would not meet the organizational test. The reason is not because it has been empowered to engage in substantial "non-exempt-purpose" activities, but because it has two purposes: the first being charitable and the second being business related. The future of the CDC is leading in two directions; it does not have an exclusive purpose. Had the second clause been limited by the words "which are in furtherance of the above purpose," then the organizational test would have been met. The CDC is led in only one direction; the empowered activities are limited to those which guide the CDC in fulfillment of that purpose.

2. Operational Test

Although the CDC may have been "organized" exclusively for a charitable purpose, it may not be operating with such purpose in mind. Under the regulations a CDC will lose its qualification as an exempt organization if it fails to operate as a charitable organization; that is, if its conduct is not for the exclusive purpose of alleviating community depression.35

The "operational test" is different from the organizational test. Under section 1.501(c)(3)-1(c), "An organization will be regarded as 'operated exclusively' for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."36 (Emphasis added.) And section 1.501(c)(3)-1(e), when talking about commercial activity of exempt organizations, adds:

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, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. . . .

(Emphasis added.)

The regulations are prescribing two rules: (1) All activities, if sub-

36. Treas. Reg. § 1.501(c)(3)-1(c).
stantial in amount, whether or not commercial, must be in furtherance of the exempt purpose; if not it is not engaging primarily in activities which accomplish its exempt purpose; and (2) the CDC must not be organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513.

As was indicated above, the concept of an unrelated trade or business was added in 1950 (sections 511-513) to rid exempt organizations of any unfair competitive advantages. Recall, the Congress was explicit: Unrelated business taxable income of an exempt organization was to be taxed as if it were taxable income earned by a for-profit corporation, but the organization was not to lose its exempt status because it earned such income. "Unrelated business taxable income" means the net income "derived by any organization from any unrelated trade or business . . . ." Thus, the crucial issue for an exempt organization was whether it was operating an unrelated trade or business. This was the solution worked out to implement different social policies: the fostering of private charities and the elimination of unfair competitive activities. However, because of section 1.501(c)(3)-1(e) of the regulations, the meaning of an "unrelated trade or business" is important for a second reason: It is essential not only in determining whether an exempt organization is subject to the unrelated business income tax of section 511, but also in determining whether it will, in the first place, be tax exempt under section 501(c)(3).

Section 513 defines an unrelated trade or business as any trade or business which is not substantially related to the purposes for which the organization received its tax exemption. In determining whether the trade or business is related, the fact that income is destined for an exempt purpose cannot be considered. This was Congress' means of eliminating the unfair competitive position that exempt organizations were enjoying. A charitable organization, as with any business, needs funds to operate. When it engages in business activities to generate those funds, it will be taxed on the income from such activities so that it will not have a competitive advantage over like businesses. But since its purpose is charitable (and the business was a means to attain this end) the organization should still be considered a tax-exempt organization.

To be an unrelated trade or business, certain conditions must be met: (1) The activity must amount to a trade or business. Since,

39. What is a trade or business is determined by section 162 of the Code. Treas. Reg. § 1.513-1(b). The Tax Reform Act of 1969 added a statutory explanation [§ 513(c)] of
by definition, a CDC will operate a trade or business, we must conclude that this condition is satisfied. (2) The trade or business must be regularly carried on. Again, there is no question that the business of the CDC will be regularly carried on; thus this condition will be considered met. (3) The trade or business must not be substantially related to the exempt purpose of the exempt organization. If the trade or business is substantially related to the exempt organization. If the trade or business is substantially related to the exempt purpose of the organization (other than through the use of the income) then the trade or business is not an unrelated trade or business.

According to the regulations, a trade or business is related to the exempt purpose if the "conduct of the business activities has causal relationship to the achievement of exempt purposes."\textsuperscript{40} It is "substantially related ... only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes."\textsuperscript{41} (Emphasis added.) Obviously, in determining whether a trade or business "contributes importantly" to the exempt purpose, the regulations intend that each case be decided individually, according to its facts and circumstances.\textsuperscript{42} The regulations themselves provide very little concrete support.\textsuperscript{43} Worse the term "trade or business" which had been included in the regulations since 1967 [§1.513-2]. The major purpose of this section is to give Congressional sanction to the taxing of advertising income earned by exempt organizations which publish periodicals.

For purposes of this section (§ 513), the term "trade or business" includes activity which is carried on for the production of income... or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for the profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

Tax Reform Act of 1969, §121(c).
41. Id.
42. Id.
43. Treas. Reg. § 1.513-1(d)(3) provides:

\textbf{SIZE AND EXTENT OF ACTIVITIES.} In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are
yet, few cases have been decided under the regulations. A number of revenue rulings have been issued, but they have not been helpful; they provide little or no basis on which to formulate a working hypothesis. Moreover, the rulings tend to be inconsistent with the court decisions that have been handed down.44

One conclusion can be stated, however. If a trade or business is an "unrelated trade or business," then the business activity is not in furtherance of an exempt purpose as required by sections 1.501(c)(3)-1(c) and 1.501(c)(3)-1(e) of the regulations. Although the language used in section 513 and 1.513-1(d)(2)—"substantially related" or "causal relation" or "contributes importantly,"—is different from the language of section 1.501(c)(3)-1(c), (e)—"activities must be in furtherance of the exempt purpose,"—both tests are the same. The difference is one of semantics. If the trade or business is not "substantially related," then by any ordinary meaning of the words, the activities of that trade or business cannot be in furtherance of the exempt purpose. (The wise old Indian Chief must have read the tax code before he informed us that a lighthouse does not prevent fog.) The history of the unrelated business income sections substantiates this conclusion. Congress intended to tax those commercial activities which, in themselves, did not further the exempt purpose.45

Thus, when the definition of "unrelated trade or business" of section 513, as interpreted by the regulations, is read along with requirements of sections 1.501(c)(3)-1(c) and 1.501(c)(3)-1(e), the result is that there is really only one requirement: A CDC which conducts a trade or business is exempt if the trade or business (without considering the destination of any income) is in furtherance of the CDC's charitable purposes. This conclusion can be demonstrated by casting the regulations into the three questions which they in fact ask and then by the process of elimination conclude with the one relevant question.

44. For a compilation of the cases and revenue rulings, see 1 S. Weithorn, Tax Techniques for Foundations and Other Exempt Organizations, § 41.03 (1970).
1. Is the CDC organized or operated for the primary purpose of carrying on a trade or business?

2. Is the CDC operating the trade or business only to generate funds to support its charitable activities?

3. Is the operation of a trade or business by a CDC *per se* in furtherance of its exempt purpose?

If the answers to the first two questions are in the positive, then the CDC has been organized for the primary purpose of operating an unrelated trade or business which under section 1.501(c)(3)-1(e) means that the CDC is not exempt. But if the answer to question three is in the positive, then the answer to question two must be in the negative. They are mutually exclusive; the operation of the trade or business cannot be only to support charitable activities if it is itself in furtherance of such activities. And if the answer to question three is positive, the answer to question one is irrelevant. If the operation of a trade or business is in furtherance of the charitable purpose, then it matters not whether the CDC was organized for the primary purpose of operating a trade or business. Thus, the only question which must be answered is whether the trade or business which the CDC is operating is in furtherance of its charitable purpose.\footnote{Besides the conclusion that the business activities of the CDC are themselves in furtherance of its charitable purpose, a second argument favoring exempt status is available. Assume, if you will, that the CDC's trade or business is an unrelated trade or business. Thus, the business activities themselves are not in furtherance of the charitable purpose. But assume further that the business activities do further the charitable purpose because the income therefrom is used to support charitable activities; that is, the income is "destined" to a charitable end. If the CDC is not organized for the primary purpose of operating the unrelated trade or business, it can still be tax exempt. Rev. Rul. 64-182, 1964-1 Cum. Bull. 186. However, if the CDC was organized for the primary purpose of operating the unrelated trade or business, it is not under section 1.501(c)(3)-1(e) of the regulations outlined to an exempt status, even if all its income will be used for a charitable purpose. I submit that this conclusion is wrong and that the regulations are involved to the extent that they so provide. Indeed, § 513 does provide that an unrelated trade or business is not made related by directing income to charitable activities. Congress wanted this income to be taxed. However, this is not the question! The question is whether the CDC should be granted a tax exemption; not whether it should be taxed on certain income. This point has been developed excellently in Eliasberg, *supra* note 11, an article worth reading. I do not intend to delve any further here.}

If it is, then two conclusions must follow: (1) It is tax exempt under section 501(c)(3) and (2) it is not subject to the unrelated business income tax of section 511.

III

**THE CDC AS A TAX EXEMPT ORGANIZATION**

To furnish more than a "yes" or "no" answer to the above question requires first that a misconception be corrected. This misconception...
tion is related to, if not caused by, the ambivalent position Congress adopted when it enacted the Revenue Act of 1950.47

Cases48 and writers49 have stated, or at least implied, that an otherwise qualified corporation which is organized and operated with the intention of running a profitable business as its only major activity is not entitled to be tax exempt. The reason: There are two purposes, one charitable and the other profit making. Thus, the corporation is not organized and operated exclusively for an exempt purpose. The premise on which this conclusion is based is that business or commercial activity, by itself, assumes a business or profit making purpose. That is, it is both means and end. This contention has usually arisen with cases concerning religious and educational publishing companies, the best example of which is Fides Publishers Ass'n v. United States.50

The Fides Publishers Association was a nonprofit corporation organized under the Indiana not-for-profit corporation statute. Its purpose as stated in its articles was:

Printing, publishing, distributing, wholesale and retail, books and pamphlets and other publications to promote Christian culture and doing all things necessary thereto to the extent that an individual would be able to do, also to promote without profit arts, crafts and trades.51

Pursuant thereto, Fides' only activities were the publishing and selling of religious books "(1) to provide literature on Catholic Action; (2) to provide literature liable to equip the apostle to achieve a deepening of his life once he is engaged in the work of the Church; (3) to bring out of the apostle a written testimony of his experiences in his apostolic pioneering."52 As the court indicated, these goals were educational and religious in nature. However, the court found Fides' activities were not solely in furtherance of these goals and that Fides had a second purpose.53 Fides was "an independent, profit-

further, except to say that I agree with Mr. Eliasberg's position that an organization is entitled to a tax exemption even if it operates an unrelated trade or business so long as the income therefrom is destined for charitable purposes. Of course, this income should be taxed.

47. See § II.3.
50. 263 F. Supp. 924 (N.D. Ind. 1967).
51. Id. at 926.
52. Id. at 928.
53. Id. at 932-36.
making publisher of specialized literature . . . operated for a business purpose . . ."  

The theory went as follows:

... The publishing activities further the exempt purpose of educating the lay apostolate. Certainly there is no better way to capture the attention of a widely dispersed public. The publication of literature is concededly the "common method in carrying out the religious and educational purpose of any exempt organization." . . . It cannot be logically argued otherwise.

The exemption can only be denied, then, if the taxpayer is being operated for some non-exempt purpose which is substantial in nature. Such a purpose does exist. It may be described as the publication and sale of religious literature at a profit. In effect, the sale activity of Fides defines at least one purpose for which it is operated. It could not be otherwise. If it were, every publishing house would be entitled to an exemption on the ground that it furthers the education of the public.  

As with similar cases, the decision is based on three factors: (1) Fides was in fact profitable; it it were not, the decision might have been different;  

(2) Fides’ sole activity was the carrying on of the publishing business; the court emphasized this;  

and (3) Fides’ publishing activities were no different from those of a for-profit publishing house. The ghostly presence of the “anti-competitive bugaboo” is again apparent.

No doubt, profitable activity can be an end in itself. But from this, it cannot be concluded that profitable activity, when there is no other activity, is always an end in itself. It can be the means by which another end—a purpose, an objective—is accomplished: the education of the lay apostolate or the development of a depressed community. What difference does it make whether the results of the trade or business are profitable or unprofitable if it has been determined that the trade or business is being operated to accomplish charitable, educational or religious purpose as defined in the regulations? If the fear is the accumulation of income, then that is what should be attacked. In fact, section 504 of the Code had been added by the Revenue Act of 1950 to provide that an organization could lose its exemption should it accumulate income unreasonably. Of course, the courts had been extremely reluctant to use this sec-

54. Id. at 936.
55. Id. at 935.
The point is, however, that Congress had recognized that failure to expend income in accordance with the exempt purpose is an evil separate from the earning of the income. Section 504 was repealed by the Tax Reform Act of 1969.5 9

As to the second Fides criteria, all that can be said is that it makes no difference whatsoever whether the organization engages in one type or many types of activities. What is decisive is whether the activities which are conducted are in furtherance of the exempt purpose.

The final criterion on which the Fides court relied—that Fides’ activities were no different from a normal publishing company’s activities—misses the point completely. There is an essential difference between Fides and an ordinary publishing company. Fides was organized as a “nonprofit corporation”; a publishing company is not. The difference is that in a Fides-type corporation, individuals will not benefit financially from the profits earned. In a normal business corporation, they will. In fact, that is their reason for not becoming associated with the corporation. Thus, while both corporations might be employing the same type of activities, their objectives are different. In the nonprofit business, activities are the means to an end; in the for-profit they are the end.

Now, let us focus upon the question raised at the end of the prior section. To review: A CDC is a nonprofit corporation, having one objective—community development—but utilizing two programs: (1) a social program providing nonbusiness type training and services and (2) an economic program involving the operation of self-help trade, or businesses. Both programs are intended to relieve “the poor and distressed,” or to lessen “the burdens of Government,” or to lessen “neighborhood tension,” or to combat “community deterioration.” Thus, it can be easily concluded that a CDC is tax exempt because all its activities are in furtherance of a charitable purpose and because it is not organized and operated for the primary purpose of conducting an unrelated trade or business.

The social activities develop the person, and thus the community, by providing him with educational, vocational, health and other services. The business activities provide the people with jobs and possibly with products and services needed by the community. (For example, the trade or business could be a shopping center.) Thus,


each person is benefited. The multiplier effect of intra-community spending causes the community’s economic base to increase. Thus the poor and distressed are relieved; community deterioration is combated; and the burdens of government are lessened—not only because governmental programs and aid are reduced or eliminated but also because the community, since the tax base would be enlarged, would be contributing a larger share of total tax revenues. This should also mean that the community would receive greater qualitative and quantitative allocation of normal governmental services—refuse collection, police protection and street and public grounds care. In other words, the CDC would be operating a trade or business (in the ordinary sense of the term) which is related to its exempt purpose, and under the *Fides* criteria, the CDC should be exempt because at least two of the criteria would be met. The CDC has two types of activities, social and commercial. Its sole activity is not the operation of a trade or business. Next, it probably would not earn a profit since wages and other business related expenditures will absorb all the revenue. But even if there might be a profit, it will not be accumulated; it will be ploughed back into the nonbusiness programs. The third factor—similarity to usual businesses—might not be met. Although an argument can be made that the CDC is operating its business differently because decisions are not made solely on profit (dollar) motive but on the benefit to the community, it cannot be concluded that the businesses themselves are any different. However, in none of the cases has this factor, by itself, been the reason for denying exemption. One of the other factors was also involved.60

Instead of ending here, let us carry our analysis one step further. Assume that the CDC has only one activity, the operation of a trade or business. To give the hypothetical some substance, assume further that the business involves the operation of a large, self-service supermarket. Is this organization entitled to a tax exemption under section 501(c)(3)? My answer is “yes.”

It is important not to forget that the CDC is incorporated as a nonprofit corporation. It is also important to remember that the CDC’s primary objective is still the development of a depressed community. The operation of the supermarket is a means of achieving this objective. The supermarket helps in three ways: (1) it provides employment for community residents; (2) it provides needed quality grocery and household items at reasonable prices; and (3) it intro-

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roduces the profit motive with its resulting benefits (and its evils) to the community. In other words, "capitalism" is being injected as the medicine to cure the depressed community.

Well, you say, the CDC is doing and effecting what any business large or small does. Why should a CDC receive preferential treatment? To some extent, all supermarkets cause these three effects in any community in which they are located. While not denying the truth of this comparison, the conclusion is still that the CDC is entitled to be tax exempt under present law. The CDC, although operating a business, has as its objective community development. The three effects are the intended result; the business is the means of attaining them. The ordinary business has as its end "profits." The three effects are secondary, unintentional results. Added to this of course is the important difference that no individual connected with the CDC can receive any of the net profits, while with the ordinary business, individual profit is the sine qua non. In other words, the CDC differs from the normal business corporation in that (1) the CDC is organized and operated exclusively for a charitable purpose as defined in the regulations; (2) no part of its net income will inure to any individual; and (3) assumingly, it will not become active in political matters. These are the three conditions to tax exemption under section 501(c)(3).

In summary, a CDC, along with similar organizations, can be operating sizeable trades or businesses, as its sole activity or in conjunction with other activities, and still be entitled to an exempt status under present law. The trades or businesses are related to, and thus in furtherance of, its charitable purpose.

61. A recent case, Monterey Public Parking Corp. v. United States, 321 F. Supp. 972 (N.D. Calif. 1970), may be some authority for this position. In that case, a group of businessmen formed a nonprofit corporation to construct and operate public off-street parking in downtown Monterey. The reason for this action was that Monterey was faced with the impending decay of center-city neighborhoods rendered crowded and uncomfortable by narrow streets, increasing vehicular traffic, and a lack of off-street parking facilities. Monterey's municipal government, in the opinion of many, could not expeditiously finance and construct needed parking facilities, and as a result several private business and professional persons organized plaintiff corporation. Id. at 974.

The issue was whether Monterey Parking Corp. was entitled to a tax exemption under either § 501(c)(3) or 501(c)(4) or both. The court held that it was entitled to an exempt status under both sections, treating the requirements of the sections indistinguishable for the purposes of this case. The following language of the court is extremely interesting:

This Court cannot say that plaintiff corporation, organizationally or operationally, subserves, in any substantial way, private interests. There is no question that all but one of plaintiff's organizers were businessmen whose establishments would tend to suffer if the traffic problems of downtown Monterey were not soon resolved. Customers, finding themselves unable to find convenient parking, would avoid the center city in favor of suburban shopping
IV

SHOULD THE CDC BE EXEMPT?

A. Reasons for Tax Exemption

Why does a CDC—or any other organization for that matter—want to be exempt under section 501(c)(3)? Of course, by definition a tax exempt organization is relieved from the obligation of paying taxes on its income.\(^6\)\(^2\) (As was seen above, this is not completely accurate. An organization can be exempt and still be taxed on "unrelated business income.") The freedom from paying tax is an important benefit for most exempt organizations. Theoretically, this "subsidy" centers. But this was a threat not only to plaintiffs, but to all the City of Monterey, and the deliberations of the City Council so state. . . .

The City of Monterey, therefore, was the primary beneficiary when plaintiff succeeded in constructing public parking facilities without any significant outlay of public funds. . . . The provision of public parking can clearly be regarded as a burden of local government, and when this is accomplished by private individuals, this burden is lessened within the meaning of Regulation § 1.501(c)(3)-1. . . .

Plaintiff’s organizers were also undeniably benefitted. But this benefit is indistinguishable from that which inhered to the community as a whole. Their profits may have been enhanced or maintained as customers continued to shop in the downtown area, but this observation applies equally to the profits of all downtown businessmen, to the property values of all property owners there, and to the value of the tax base of the entire City of Monterey. The validation stamp system is available to all persons and businesses, not just to the organizers. No profits, direct or indirect, and no advertising advantages have accrued to plaintiff’s organizers which have not also accrued to non-organizers.

The Court therefore finds that the benefits to plaintiff’s organizers do not constitute a substantial non-exempt purpose under either of the subsections of § 501 invoked herein.

Nor under either subsection is the simple conduct of a business fatal to exemption. What is crucial is the manner of such conduct. If dividends are paid to the members or shareholders of the organization, the Courts will ignore protestations of charitable intent. . . . Or if there is substantial possibility that upon dissolution, accumulated assets will find their way into private hands, exemption is barred. . . . Likewise unqualified for exemption under either subsection are corporations which carry on commercial enterprises which are unrelated to their charitable purposes; the fact that profits therefrom are later fed into an exempt organization is not relevant. . . .

In short, the preponderance of the evidence is that not only are plaintiff’s tangible assets and profits devoted to exempt purposes, but also that the business itself “obviously bears a close and intimate relationship” to those purposes. . . . Plaintiff has none of the indicia by which Courts have exposed bad faith attempts to take advantage of § 501: no dividends for private persons, no under the table distributions of assets, no advertising advantages or special prices for a privileged few. The business activity itself is similar to that which others engage in for private profit, but it is not carried on in the same manner; it is carried on only because it is necessary for the attainment of an undeniably public end. . . . [Emphasis added.]

Id. at 976-77.

should be beneficial to a CDC also. The CDC would have the "tax dollar" to use in its social and economic activities.

Practically speaking, however, CDC's are not helped by being relieved of their tax obligation. They are not generating enough income on which to incur a tax liability. And when they do reach a break-even point, wages, salaries and other community-related deductible expenses can be increased so that the break-even point is never seriously exceeded. This reduction of taxable income is not something "bad" or to be frowned upon. Funds are being passed onto the people who need them most. This would seem to justify the activity itself. But in addition, these monies, since they will most likely be spent and not saved, will, in the long run, generate further income, income which will be taxed. Thus, although tax revenues over the short run might be reduced, over the long run, they might be increased. If and when a CDC reaches that fortunate stage of its business life at which it is earning a profit, it should be taxed! At that point, its members—the community residents—should be gainfully employed and other activities should be adequately financed from the recurring profits. Society should no longer "subsidize" it. The CDC might at that point begin to enjoy a real competitive advantage as a result of a tax exemption, an advantage which would not outweigh any benefits derived from the tax subsidy.

A second reason for the section 501(c)(3) tax exemption is that a person who contributes money or property to such an organization receives a tax deduction, under section 170 of the Code, for the amount of the contribution. An incentive for private giving is the intended result. It has been a basic tenet of our system that the individual as opposed to the government should decide which philanthropic organizations should receive his support. The tax deduction provides the incentive and works as the allocator of federal revenue to charitable organizations according to each individual's desires prior to collection, while still allowing the individual to decide what organizations should receive support through his tax dollars. Again, for most organizations this is a prime reason for wanting a tax exemption.

Presently, CDC's are not deriving funds from individual "charitable" giving. Whether it is because to many people CDC's are not "charities" in the same sense as the United Fund type organizations or whether it is because the extremely large amount of funds needed make a public request unrewarding, CDC's are not soliciting financial

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63. The assumption is that wages are reasonable so that net income is not indirectly being distributed to interested persons contrary to § 501(c)(3).
64. See Stone, supra note 12.
aid from the general public. The one exception might be the contributions by large business corporations. But although they are contributing management assistance and are providing markets, corporations are not donating substantial financial aid. A serious question would arise concerning the propriety of such an act should directors decide to contribute large amounts of funds to a CDC for altruistic motives.\(^6\) Again, the conclusion intended is that although a tax exemption might theoretically help a CDC because of the tax deduction a contributor would be allowed when he contributes funds to it, practically, the benefit is not so great as to cause a prolonged discussion or to base a fight for tax exempt status on it.

This leads to the third reason for the tax exemption. To me, it is the most important. Federal tax exempt status has taken on a second purpose: It is used as a condition precedent for a grant.

Of the many hurdles that a CDC must straddle, the highest is funding. Many financing schemes are being formulated, but at this time, funding generally comes from an agency of the federal government or grant from a private foundation. Some of the federal programs\(^6\)\(^7\) and all the large foundations\(^6\)\(^7\) require that the CDC be tax exempt, usually under section 501(c)(3). The reasons seem to be twofold: First, a private foundation which itself is tax exempt under section 501(c)(3), could lose its tax exemption if grants were made for purposes contrary to the basis of its tax exemption. Thus the large foundations require the CDC to be organized and operated for the exempt purposes that are the same as its own. Secondly, the federal agencies and private foundations know that the CDC's are being regulated to some degree by the Internal Revenue Service. Thus, their own status and funds are protected.\(^6\)\(^8\)

The point is that it appears that a tax exempt status is important for a reason other than, or at least in addition to, relief from payment of federal taxes.\(^6\)\(^9\) If this be the case and since CDC's are in dire need of funds, I propose that CDC's be given direct aid from the federal government so that reliance on outside resources and artificial rules is not required. Presently, I would like to see this done by

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67. This statement is based on letters received from the Ford and Rockefeller Foundations. Letter from Thomas H. Wright, Jr., Assistant to the Secretary, The Ford Foundation, to Robert J. Desiderio, April 22, 1970; letter from Esther S. Staram, Assistant Secretary, The Rockefeller Foundation, to Robert J. Desiderio, April 10, 1970.
68. Ford Foundation letter, supra note 67.
69. CDC's are not the only organizations which need a tax exempt status as a condition precedent for funding. Examples of other organizations are public service law firms and environmental organizations. Consider the words of John H. Adams, Executive Director of
creation of Community Banks.\textsuperscript{70} If this is not politically feasible, I would opt for direct government subsidy, granted and regulated by one agency such as the Office of Minority Business Enterprise of the Department of Commerce or the Office of Economic Opportunity. But if direct subsidy is not a political or economic alternative then the game of attaining tax exempt status must be played.

\section*{B. The CDC Should Be Taxed}

The prior section has raised four points. First, the CDC will be operating trades or businesses for a profit. Second, a CDC is presently entitled to a tax exemption under section 501(c)(3). Third, the CDC is not subject to the unrelated business income tax of section 511. Fourth, the CDC seeks tax exempt status as a necessary step in the process of acquiring outside funding. Tax exemption for a CDC is indispensable only because it is a prerequisite to funding. The bulk of the article has been a brief, arguing that under present tax law a CDC is entitled to an exempt status. But as indicated in the prior section, I am of the opinion that funding outlets or direct funding should be provided. Should such funding be provided, organizations like CDC's should not be granted tax exempt status.

My primary reason is a belief that the present tax structure is inequitable and too complex and that a tax and financial structure based upon the "comprehensive tax base" and "direct funding" should be adopted. This means that, in theory at least, tax exemption as a whole should be eliminated. Assuming, however, that a new tax theory of taxation is not established, I propose that the present statute be revised so that a CDC and like organizations are not entitled to a tax exempt status. Again, I must emphasize, that funding \textit{must} come from other sources. The revision, to section 501(c)(3), would provide:

\begin{quote}
Corporations \ldots organized and operated exclusively for charitable \ldots purposes, which does not intend to operate or is not operating a trade or business regularly, no part of the net earnings of
\end{quote}

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\begin{flushleft}
the National Resources Defense Council, \textquoteright"a New York-based group organized to take legal action to protect the environment,\textquoteright in reference to the effect a postponement of its application for an exempt status had on National:
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The I.R.S. almost drove us out of business before we even started.\ldots It was impossible to get any contributions without an exempt ruling.

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Wall Street J., Mar. 31, 1971, at 20, col. 3.
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70. \textquoteright"The Nixon Administration probably will propose soon a Community Development Bank to assist states and localities in the financing of community development programs.\textquoteright Wall Street J., Feb. 3, 1971, at 4, col. 2. For an illustration of legislation setting up a Community Development Bank system, see Community Self-Determination Act of 1968, S. 3875, S. 3876, H.R. 18709, 90th Cong. 2d Sess. (1968).
\end{flushleft}
which inures to the benefit of any private stockholder or individual... taxation under this subtitle unless such exemption is denied under section 502 or 503 and unless such organization intends to operate or is operating a trade or business regularly.

Since present thought is directed only at 501(c)(3) organizations, the revision was limited to such and not to all exempt organizations. This revision is presented merely as a suggestion concerning how the Code should read. No attempt has been made at this time to refine it or to make it consistent with other provisions and rules, specifically sections 511-513. However, except for certain specific problems, the abuses sections 511-513 are attempting to cure will be precluded by this revision.

The revision is nothing more than a definition of a tax exempt organization as a nonprofit corporation which does not have as a purpose the making of a profit and which does not become involved in political activities. At the same time, it was recognized that all exempt organizations do run fund drives or conduct fund raising activities (e.g., dances, raffles, etc.) Even if this particular type of activity is treated as a trade or business, the proviso that it must be carried on "regularly" would protect such organizations from being tax exempt.

The reasons for this revision are two fold. The first reason, though not a determinate one, is that such a result will eliminate the confusion, once and for all. Line drawing, as to what is the CDC's purpose, will not have to be practiced. At least some certainty will be a result, which by itself is sufficient. Recall the discussion about the Revenue Act of 1950 and its purpose.71 This type of revision should have been enacted in 1950. If it had, any competitive advantages would have been eliminated, and the current problems would have been prevented. Secondly, and more important, is the fact that the trade or business being operated is simply that, a trade or business. It should be taxed like any other business. The argument that no person will benefit personally was presented as the interpretation of section 501(c)(3) the drafters intended, not as an interpretation that had more than legal meaning. Of course, you can say that a CDC could be tax exempt but taxed on its income from its trade or business (similar to present rules dealing with unrelated business income). This is not denied. I suggest however that the reason for doing so is not tax exemption but some other purpose, probably fund raising. That is a poor method of constructing tax laws. If the real problem is funding, then it is that problem which ought to be faced.

71. See § II.a.