

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

Number: **200614030**
Release Date: 4/7/06
229564/SE:T:EO:RA:T:PE

Date: January 13, 2006
No Third Party Contact:
SIN #: 501.03-08
509.02-02
170.00-00

Contact Person:

ID Number:

Telephone Number:

Employer Identification Number:

Legend:

B =

Dear _____ :

This is in response to your ruling request as to the tax consequences associated with pre-seed capital funding activities.

You are a tax-exempt under section 501(c)(3) of the Internal Revenue Code and is classified as a supporting organization under section 509(a)(3) of the Code. You support B, which is tax-exempt under section 501(c)(3) and classified as a non-private foundation under sections 509(a)(1) and 170(b)(1)(A)(ii). B operates a community college.

B faces serious problems because of a lack of learning and teaching opportunities in its geographic area for college graduates. B is located in a county with an unemployment rate well above the rest of the state and an economy dependent upon heavy industrial and manufacturing businesses which have been downsizing their workforces. The geographic area has been determined to be economically depressed. This has caused B great difficulty in maintaining and expanding its educational programs, and providing few opportunities for highly qualified college graduates. As a result of the high unemployment rate, many graduates have difficulty finding opportunities within B's geographic area.

To combat the serious economic problems that are affecting your geographic area and consequently B's ability to accomplish its tax-exempt purposes, you propose to establish a state-of-the-art high technology innovation center and resource hub. B, in

participation with the county chamber of commerce (a section 501(c)(6) organization) and the county government, will operate the program which will be designed to support all facets of the start-up, development and growth of enterprises. The program's objective is to grow jobs and spearhead economic growth in your geographic area which will be a crucial component of B's ongoing mission to provide its faculty, students and the community with the cutting-edge knowledge, experience and skills needed to succeed in an increasingly high-technology, innovation driven economy. It is anticipated that the program will provide B's students with contemporary entrepreneurial experiences and opportunities. B believes it must provide its students with real-world experiences and opportunities to establish a clear path from the classroom to personal and career fulfillment by enabling faculty to show and students to learn how to translate ideas into useful products and services that support economic growth, expanding businesses and new jobs.

You have stated that to help solve both the educational and economic problems caused by the shortage of opportunities for exposure to real-world businesses around its campus and in its geographic area, the program is designed to provide training, resources and experiences to B's students and faculty from theoretical learning to practical business application. The program will consist of a comprehensive innovation center and resource hub which will include a research and business incubator, fellowships and internships, advanced computer and communication systems and a pre-seed capital fund.

The research and business incubator will provide state-of-the-art computer and information systems, office space, administrative services and training in business and marketing. These facilities will be located on the main campus of B and in a nearby industrial park owned by B. The goals of the incubator are to increase real-world innovation and technology based experiences that advance the education of the college's students, to perfect the innovation and technology-based business acumen of its faculty, and to attract, develop and retain high-technology and innovation based industries in your county so that students, faculty and staff have opportunities to continue their learning and skills in your geographic area.

You have stated that strong connections will be made between B's faculty and the incubator. As a comprehensive regional innovation center and resource hub, your program will be committed to give anyone, including faculty, who has an idea, technology, or business a free first-level assessment. College faculty will also be involved as advisors in assessing and in providing resources and services to the incubator's assisted and associated businesses. The faculty will transfer ideas from the classroom into laboratories, computer simulations, and production facilities, as well from such laboratories, simulations, and facilities to the classroom.

The program will also expand B's available offerings to undergraduate students. The program will be offered to students in order to provide real-life learning experiences. B's students will be eligible for co-op as well as part-time employment opportunities with incubator companies and resource providers.

Those involved in the program hope to attract entrepreneurs and businesses from across the spectrum of the emerging innovation-based businesses. An insufficient number of companies in such industries have established operations in your geographic area, thus limiting the number and depth of learning, research and career opportunities for the students of B. A component of the program is the development of advanced computer and communications systems to connect B with the community, the incubator, and the individuals and businesses that participate in the program's activities. The communication system will connect the incubator sites and the main campus of B with telephone, video-conferencing, distance learning and other communication facilities.

The final component of the program is a pre-seed capital fund that will be allocated to enterprises associated with the incubator for early-stage product development, marketing and business planning efforts. You desire to establish a separate fund under your control for monies donated for the purpose of eventual contribution toward this pre-seed fund. With the fund, pre-seed monies will be invested in qualifying businesses, especially in the early stages of proving technical feasibility, assessing the potential of inventions, and underwriting the cost of new product development, marketing and business planning. By furnishing pre-seed capital, successful entrepreneurs will be attracted to the incubator. As a result, you hope they will settle where the prerequisites for research, education and business development prevail. With regard to the pre-seed capital fund, greater than average risk may be incurred to foster worthwhile start-ups developed at an early stage. The start-ups will offer research, educational, and career opportunities to B's students, faculty and graduates. You state that the pre-seed fund will not be motivated by profit, yet will maintain a risk/reward balance.

The fund will raise capital on a philanthropic basis. The fund will then be distributed to qualifying entrepreneurs on a matching basis for a small equity interest in the venture. You have stated that the purpose of the equity exchange is not profit, but as a mechanism to self-perpetuate the fund. The fund will match dollar-for-dollar capital raised by the entrepreneur. The primary purpose of the fund is to ensure that additional pre-seed capital is available to encourage innovation and entrepreneurial behavior in your geographic area. You believe this supports both B and your geographic area as it promotes future economic growth.

You have requested the following rulings:

1. Funding of the pre-seed capital fund from contributions will not jeopardize your exempt status under section 501(c)(3) of the Code.
2. Contributing to the funding of the pre-seed capital fund will not jeopardize you status as a non-private foundation under section 509(a)(3) of the Code.
3. Contributions made to you are deductible charitable contributions under section 170 of the Code.

Section 170 of the Code allows as a deduction any charitable contribution, as defined in subsection (c), made within the tax year. Section 170(c)(2) defines charitable contribution to include a contribution or gift to or for the use of a corporation or foundation: (a) created or organized in the United States or under the law of any state; (b) organized and operated exclusively for charitable or educational purposes; (c) no part of which inures to the benefit of any private shareholder or individual; and (d) is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation and does not participate in or intervene in any political campaign of any candidate for public office.

Section 170(b)(1)(A)(ii) defines a school as an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where the educational activities are regularly carried on.

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3), including organizations that are organized and operated exclusively for charitable, educational or scientific purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. Such term includes relief of the poor and distressed or of the underprivileged, advancement of education, and promotion of social welfare by organizations designed to accomplish any of the above purposes, or to combat community deterioration and juvenile delinquency.

Section 1.501(c)(3)-1(d)(3) of the regulations defines the term "educational" to include the instruction or training of individuals for the purpose of improving or developing their capabilities or the instruction of the public on subject useful to individuals and beneficial to the community.

Section 509(a)(3) of the Code states that a private foundation includes a section 501(c)(3) organization other than an organization which is organized and at all times thereafter operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) and is operated, supervised or controlled by or in connection with one or more organizations described in section 509(a)(1) and is not controlled directly or indirectly by one or more disqualified persons.

Rev. Rul. 70-584, 1970-2 C.B. 114 provides that a nonprofit organization that recruits college students for internship programs providing work experience in various phases of government related to their studies while enabling them to contribute to the community qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 74-587, 1974-2 C.B. 162 provides that a nonprofit organization formed, in

part, to combat community deterioration through a program of financial assistance in the form of low cost or long term loans to, or the purchase of equity interests in various business enterprises in economically depressed areas is exempt under section 501(c)(3) of the Code. The loans and purchases of equity interests were not undertaken for the purpose of profit but for the purpose of advancing the charitable goals of the organization and were not considered to be investments in a conventional business sense.

Rev. Rul. 75-284, 1975-2 C.B. 202, provide that a nonprofit organization that was formed to provide high school graduates and college students with work experience, for which they receive no compensation, in selected trades or professions, and that is financed by tuition and contributions from the general public, is an organization operated exclusively for charitable and educational purposes and qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 76-419, 1976-2 C.B. 146, provides that a nonprofit organization that purchases blighted land in an economically depressed community, converts the land into an industrial park in order to provide employment opportunities for low income residents of the area in exempt under section 501(c)(3) of the Code.

Rev. Rul. 79-323, 1979-2 C.B. 106, provides that an industrial commission, established by a state legislature to study the problems of industrial life in a particular geographic area, is composed of representatives appointed by elected officials from each participating municipality and is authorized to provide for the housing of industries, acquire land, borrow money, sell property, issue bonds, and establish a per capita assessment. Its activities are subject to review by the state and member municipalities. Amount to be contributed to the commission are deductible charitable contributions under section 170(c)(1) of the Code.

Rev. Rul. 81-284 1981-2 C.B. 130, provides that a nonprofit small business investment company licensed under section 301(d) of the Small Business Investment Act of 1958, which was formed to relieve poverty, eliminate prejudice and discrimination, reduce neighborhood tensions, and combat community deterioration, and that provide low –cost or long-term loans to businesses not able to obtain funds from conventional commercial sources, with preference given to businesses that provide training and employment opportunities for the unemployed or under-employed residents of economically depressed areas, may qualify for exemption under section 501(c)(3) of the Code.

The facts indicate that the program is operated to further the educational and charitable purposes of B. The educational opportunities created directly through pre-seed capital businesses located at the research and business incubator and associated with your program will contribute importantly to B's teaching program. Your program will enhance the environment in which to instruct students and support the faculty for the purpose of improving and developing their capabilities. See section 1.501(c)(3)-1(d)(3) of the regulations, and revenue rulings 70-584 and 75-284, supra. You have stated that you will invest your pre-seed capital funds primarily in companies and ideas that further the

educational mission of exposing students and faculty to cutting-edge, innovative business endeavors. You believe that any benefit to the companies in which you invest will be incidental to the purpose of advancing the educational purposes of B. Your investments in these companies are viewed as a step along a continuum of activities from classroom studies through practical commercial application, necessary to fulfill B's educational mission. The pre-seed capital fund contributes importantly and directly to carrying out your educational purposes.

The pre-seed capital fund is expected to assist in the promotion of professional specialty occupations, including high-technology and new-economy careers in B's geographic area. These careers will enhance the geographic area to attract new industry and provide useful products and services that support economic growth, new jobs, and expanding businesses which will foster the development of an innovation-oriented economy. See section 1.501(c)(3)-1(d)(2) of the regulations. Thus the educational program will improve the overall economic area and further social welfare purposes. See Revenue Rulings 74-587, 76-419 and 81-284, supra.

Thus, this activity will not jeopardize your exempt status under section 501(c)(3) of the Code nor your non-private foundation status under section 509(a)(3). In addition, any gift to you for the purposes discussed herein will qualify as a charitable contribution under section 170. See also Rev. Rul. 79-323, supra.

Accordingly, based on all the facts and circumstances described above, we rule:

1. Funding of the pre-seed capital fund described herein will not jeopardize your tax-exempt status under section 501(c)(3) of the Code.
2. Funding of the pre-seed program described herein will not jeopardize your nonprivate foundation status under section 509(a)(3) of the Code.
3. Contributions made to you are deductible as charitable contributions under section 170 of the Code.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based.

These rulings are directed only to the organization that requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited by others as precedent.

These rulings do not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we

intend to make available for inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Please keep a copy of this ruling in your permanent records.

Sincerely,

/s/

Lawrence M. Brauer
Acting Manager,
Exempt Organizations
Technical Group 1

Enclosure:
Notice 437