



## Joint Ventures Between CDCs and For-profits

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Joint ventures between a community development corporation (“CDC”) and a for-profit partner can present tremendous opportunities for CDCs to build its core skills and complete large scale projects. However, there are a host of business issues raised by the prospect of a CDC co-owning or working closely with a for-profit on a project. Many issues need to be carefully negotiated for the CDC to protect its financial integrity and credibility. Joint ventures also raise a number of legal issues, often bringing together corporate, partnership, tax, real estate and exempt organization law into a single realm. Therefore, careful thought must be brought to evaluating a CDC’s potential venture with a for-profit entity.

### *I. About Joint Ventures*

*What is a joint venture?*

There is some misconception about what the phrase “joint venture” means. More a term of art than a phrase with precise legal meaning, usually it does not describe only one form of ownership or relationship, as we’ll see. Rather, it is an association of two or more people engaged in a business venture, traditionally for profit (people can include more than what the law calls “natural persons,” i.e., corporations and other entities can be members of joint ventures). A joint venture often implies a partnership agreement, entered into for a single project, and for a finite period of time.

*What are the primary reasons a CDC and a for-profit might consider a joint venture?*

For the CDC:

**Inadequate experience:** It may be a CDC (1) has not done any physical development yet, (2) has not attempted a project of large scale before in a particular area such as housing, or (3) is trying to branch out, for example, from housing development into commercial or retail space development. The CDC can access the technical expertise of a for-profit business in a joint venture arrangement.

**Lack of staff.** The CDC may have a small staff or no staff at all, or its staff may be part-time or not have the available time required to carry out the development.

**Opportunity to achieve higher production scale.** Without the for-profit the nonprofit might not be able to do a particular project or might have to do a smaller project of less impact.

**Core skill building opportunity.** If structured correctly the arrangement can present a capacity building opportunity for the CDC with the for-profit in a mentoring role.

**Lack of financial strength.** It may be that a CDC has a long track record, solid staff with lots of experience and capacity, but that financially it is weak.

**Access to development financing through for-profit partner.** Often a for-profit partner will have access to conventional financing sources that a CDC will not. The developer may be in a strong financial condition or because of its track record and character, it is able to access a significant amount of capital that the CDC cannot attract on its own.

For the For-Profit:

**Access to the community.** The project may be in a community where a for-profit developer has not done business before. The CDC may have site control of a key property which is critical to a project's viability.

**Support among community residents.** The CDC may be able to garner support among neighborhood residents for a difficult project, get local elected officials on board in favor of the development, and help counter any nimbyism that could derail the project.

**Access to public funding sources.** This is often one of the strengths a CDC can bring to the relationship. Subsidies such as OCS grants, AHP grants, HOME funds, CDBG funds, state and local funds, either set-aside for nonprofits such as CDCs or made available to them because of local funding priorities, can be accessed by the for-profit through the joint venture with the CDC.

**Access to attractive debt sources.** The CDC may have access to low interest financing (LISC, for example) that the for-profit would not. Not only is this financing financially beneficial, but it often funds costs at an early risky stage of the project that a bank would not be willing to finance.

**Access to tax credit allocations.** This can occur via a CDC set-aside award or through the CDC's site or project control over a high scoring project. Without access through the CDC to the credits, the for-profit couldn't get the deal. However, in some states (California, for example) the awarding of tax credits is beginning to be slanted away from nonprofits in favor of for-profits.

**Pool of interested job applicants.** For an economic development joint venture, a CDC can be a pipeline for interested local residents to apply for the jobs to be created. Not only may this speed the filling of the jobs, but it can provide the for-profit co-venturer with some helpful initial screening of job applicants.

*What factor must be present for a joint venture to be considered by each party?*

**The whole must be greater than the parts.** It seems fairly obvious, but each party must be bringing something to the relationship that the other party needs, can't easily do or get without the other party, and which will make the resulting entity stronger than either party acting alone. If one or the other feels they can pull off the project alone, or if they have no goodwill or future favor to gain, the impetus for the joint venture may be eliminated.

## *II. Roles and Responsibilities*

*What can each party typically bring to the table?*

The CDC:

**The deal.** Often the CDC will bring a deal concept to the table along with predevelopment work that has been done, including possible title to the project property or at least site control. The more the CDC has developed the concept for the project and the more up-front work the CDC has done, the more attractive it can make the deal for a potential partner and the more leverage it will have over a prospective co-venturer during negotiations.

**Knowledge of the neighborhood.** A genuine CDC knows its target area(s) of operation and understands what the pressure points are and what the community needs, wants and will support. The CDC can shape a deal so it's consistent with a neighborhood revitalization plan, thereby ensuring the project's support and success and providing the joint venture partner with a marketing and acceptance comfort level not obtainable from a non-community-based business.

**Knowledge of the market.** Related to the above point is the CDC's knowledge of the market. Though the CDC may not have a definitive handle on all aspects of its market, it typically is in a much better position than a for-profit (particularly one not based in the neighborhood) to understand what the market is for housing, commercial space for growing businesses, business incubator space, day care center needs, local health care center potential, retail services.

**Political Support.** The CDC's contacts with local political and administrative officials can be a huge factor in making the project successful. Beyond the obvious overt support for the project, this can translate into public subsidies and other support such as zoning, building and environmental reviews in a more expedited manner (or in some cases a zoning change to make the project go).

**Attractive Public and Private Funding Sources.** Mentioned above, if the CDC can come to the table, even with preliminary commitments from such funding sources, it strengthens the attractiveness of the arrangement to the for-profit and gives the CDC added bargaining clout.

For the For-Profit:

**Technical Expertise.** The for-profit will bring its real estate development skills to the table. If the CDC is inexperienced, this is critical to successfully completing the project.

**Staff Size.** The for-profit will usually bring a full complement of full-time staff to the project.

**Financial Strength.** This can mean a conventional source lender is willing to lend to a deal where it would not be if the nonprofit alone was the sponsor. For example, in a recent deal in Indianapolis a limited liability company joint venture contracted with for-profit builders to build new homes on lots owned by the LLC; the builders funded the costs of construction through their own financing sources.

**Access to Conventional Funding.** Somewhat separate from the issue of financial strength, this goes more to the relationship the for-profit may have with banks or mortgage companies based on the for-profit's "character," i.e., its track record in completing deals skillfully, efficiently, on time and within budget. This may have resulted in long-standing relationships providing access to financing that may or may not correlate to the actual financial strength of the for-profit.

*What development roles often flow from what's brought to the table?*

For The CDC:

(1) Project conception and initial development, including obtaining of site control and initial project design; (2) community organizing in support of the project (e.g., rallying residents in favor of a large supermarket project new to the neighborhood); (3) financial application and packaging of public subsidy support; (4) marketing the units to be developed, etc.

For the For-Profit:

(1) Project budget development; (2) Hiring of contractor and construction manager; (3) application for and financial packaging for conventional financing sources; (4) general overall project development.

*III. Negotiating Pressure Points*

**Primary goal of the CDC.** Is the CDC looking primarily to create a valuable community asset that will benefit low income residents, stabilize the community and begin to revitalize the neighborhood? Is the CDC looking secondarily to share in the possible upside of an economic development project (but not if it impedes the primary goal)? Or is the primary goal of the CDC to make money from the project? Both of these cannot be the number one goal. A CDC needs to honestly assess its goals, because the negotiations need to reflect them.

**Relationship between the CDC and the For-Profit.** Beyond the experience and technical knowledge of the parties, this is an important "soft" issue that is most important to the success of the venture. Do the parties trust each other? Can they communicate effectively? Can they transcend their differing organizational missions and join forces to complete a charitable project that generates profit for the investor and compensates the CDC fairly while furthering its charitable mission.

**Responsibility for Fundamental Decisions Should be Clearly Spelled Out.**

This would usually be done in a separate development agreement entered into between the partnership and each individual partner, but could also be included in either the partnership or operating agreement. For example, if the CDC and the for-profit are co-general partners or are the members of a member-managed LLC, the for-profit may have the right to choose the contractor and the architect, but the CDC may retain the right to consent to the contracts hiring these parties, as well as to change order items above a certain dollar amount. On the other hand, the CDC may assume primary responsibility for marketing the units, either itself or by hiring a broker.

There is plenty of flexibility as to how to structure the parties' roles, but ultimately they should be in accord with the parties' strengths, should be reasonably commensurate with the fees or profits they will earn, and should be written clearly in a document both parties sign.

**Profit Sharing/Developer Fees.** The key issues are how much fees go to each party and when. The CDC must be sure that it is getting a fair deal and is not underestimating its contributions to the venture. Even though the for-profit may be carrying out the bulk of the project/development work, the CDC should recognize the value it brings. For example, perhaps the CDC has done the risky predevelopment work, obtained site control of the property needed for the development, brought subsidies and/or subsidized financing to the table, or garnered community support for the project. Without this the for-profit might be unable to consummate the deal.

*Developer fees should not be paid to the for-profit before they are earned.* The payment of fees should not take priority over achieving the charitable nature of the project. So, for example, if there are cost overruns during the construction period, there should be enough unpaid fees held back so that they can fund the cost overrun(s) above the construction contingency instead of the project being caught short. This hold back should be over and above the standard retainage that is required for construction disbursements.

**Maintaining CDC Involvement.** How does the CDC make sure it stays involved in the deal if it is not the managing general partner? One thing it should do is structure certain rights of intervention, such as if the project begins to fail to meet its charitable goals (such as local hiring) or the general partner is violating the terms of the partnership agreement. If the CDC is not in "control" of the development/operating entity, it must ensure that the for-profit does not have unfettered discretion to make business decisions. (The same is true for a LLC).

**Avoiding Excessive Private Benefit.** The CDC must, for example, resist issuing a reserve or guarantee of/against (1) operating losses or profits for the joint venture, (2) a return of capital or fees payable to the for-profit by the joint venture, or (3) indemnification for any losses incurred by the for-profit due to its participation in the joint venture (unless caused by the malfeasance of the nonprofit).

**Conflicts Resolution Mechanism.** There should be some form of arbitration or mediation built into the operational document in order to provide both parties with a mechanism for logically, fairly and expeditiously resolving disagreements that they cannot solve on their own.

**Handling Losses and Additional Capital Contributions.** This should not be slanted against the CDC, and will usually follow the parties' ownership interests and right to share profits. If the CDC has the right to share in 30% of the profits, it should be responsible for only 30% of the losses, not a higher amount.

Additionally, if additional capital must be contributed to make up those losses, it should be commensurate with the CDC's ownership percentage. The CDC should also consider placing limits on any responsibility it may have for losses and on any obligation it may have to contribute additional capital.

**How the Financing Comes into the Deal.** Financing for the project may be committed to the joint venture or LLC itself, or to the individual partners. If financing committed to a partner for the project is to be a debt obligation of the joint venture, it must be lent to the partnership by the partner. Otherwise, it will be deemed a capital contribution of the partner and in the case of bankruptcy or dissolution its return to the partner will be subordinate to repayment of the debts of the joint venture. The tax and LIHTC implications of how funds flow must also be considered.

**Critical Path.** Spelling out the order in which development milestones need to be achieved, and when, is an important ingredient to a successful joint venture.

**Exit Strategy.** How, when and for what price the CDC can be bought out by the for-profit, or vice versa, is a key point which should be included in the partnership agreement or the operating agreement.

#### IV. Structural and Management Options

*What are the basic ownership options for the joint venture?*

The basic options are **general partnerships**, **limited partnerships**, **limited liability companies** and **contractual relationships** (where the CDC or its affiliate is the owner of a property and the for-profit entity enters into a development agreement with the CDC to provide certain services).

*What is the basic character of a **general partnership**?*

Each partner is *jointly and severally* responsible for the obligations of the partnership arising from the wrongful acts or omissions (i.e., intentional acts or negligence) of another partner acting either in the partnership's ordinary course of business or with the authority of other partners, and for the breaches of trust by a partners acting within the scope of his or her apparent authority or by the partnership in the course of its business.

A partner is *jointly* liable for all other debts and obligations of the partnership. Partners have a general obligation to contribute toward the losses sustained by the partnership. They also have contribution obligations after the dissolution of the partnership. Each partner may take an active role in the operation of the business of the partnership.

*What is the basic character of a **limited partnership**?*

Limited partners are not jointly or severally liable for the obligations of the partnership, whether incurred through negligence, directly or contractually. They are liable for the obligations of the partnership only up to the amount of their capital contribution plus any amount of undistributed profit to which they are entitled. However, a limited partner may also not take an active role in the daily operation of the business of the partnership.

It may, however, under the Revised Uniform Limited Partnership Act (known as "RULPA," which has been adopted by most state legislatures), consult with and advise or render professional services to a general partner with respect to any matter, including the business of the partnership, as well as be a contractor for, or an agent or employee of, the limited partnership or of a general partner, or be an officer, director, or shareholder of a general partner that is a corporation. It may also approve of (1) amendments to the limited partnership agreement or certificate of limited partnership, (2) changes in the nature of the business, or (3) for removal of a partner. As an example, each NEF investment fund, as a limited partner of the project partnership in which it invests, has a right to remove the general partner for malfeasance or nonperformance.

*What is the basic character of a **limited liability company**?*

Members (as the owners are called, rather than partners or shareholders) of a limited liability company ("LLC") are afforded the limited liability they would possess as stockholders of a corporation.<sup>1</sup> In addition, the net income they receive as a member of the LLC is eligible for single level entity taxation treatment, identical to the treatment of the net income received by partners of a partnership. In other words, the taxes are paid by the members, not the LLC, so if a member is a tax-exempt entity, it keeps *all* income it earns except any which might be subject to UBIT (unrelated business income tax, discussed further below).

An LLC structure provides the following advantages:

- **A flexible management structure is permitted.** Management may rest in the hands of all members, may be centralized in the hands of one member, may be delegated to a manager who is not a member, or may be delegated to a Board of Managers. A not-for-profit corporation may assume the management role it desires and need not be confined to the role permitted a limited partner under state law.

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<sup>1</sup> Until recently an entity had to *lack* two of the following four characteristics of corporate status to be treated as a limited liability company for tax purposes: (1) continuity of life, (2) centralization of management, (3) free transferability of interests, or (4) limited liability. Maintaining (2) and (4) were essential, so structuring an arrangement where (1) and (3) were lacking was critical to maintaining LLC under tax rules. However, as of the issuance of final "check-the-box" tax regulations in January, 1997, it is no longer necessary for an entity to satisfy this test when choosing its entity classification for federal income tax purposes.

- **There is no need to have a general partner.** There is no need to form a corporate general partner and to capitalize such corporation in order to preserve the limited liability of the members, as is the case with a limited partnership (although an undercapitalized LLC may be subject to attack on a "piercing the corporate veil" theory as would a corporation).
- **Multiple classes of ownership are possible.** This is the same option provided a corporation, and there is flexibility on capital contributions.

*What are the percentage ownership options within any type of joint venture?*

Ownership can be split 50/50 or 99/1, as with the NEF limited partnerships. However, each partner/member must have and maintain a minimum net worth benchmarked on the expected financial obligations of the joint venture.

*What are the profit and loss sharing options within any type of joint venture?*

Profits and losses may generally be shared at percentages that differ from ownership interests, but the sharing of profits and losses deviating from ownership percentages must be based on substantial economic effect. This means that if a member has the right to share in profits in an amount greater than its ownership interest it must have a risk of loss with respect to an LLC obligation that justifies such higher profit rights (for example, a member could agree to assume a greater share of liability for a debt obligation of the LLC).

"Profits allocated to a tax-exempt nonprofit may be subject to unrelated business income tax, or UBIT. In order to be subject to UBIT, the activity of the joint venture must be "substantially unrelated" to the exempt purposes of the exempt organization, which means there must be a lack of "causal relationship" between the conduct of the business activity and the achievement of the tax-exempt purpose. This is sometimes a difficult line to draw. In addition, to be subject to UBIT, the business generating the profits must be "regularly carried on." The regularly carried on test focuses on the frequency and continuity of the activity producing the income. If a one-time activity produces income, such as a sale of real property or the sale of some kind of equipment or other materials, the business activity is not deemed to be regularly carried on. The IRS' concern here is that if an activity is regularly carried on and is commercial in nature, then the income produced should be on equal footing with the taxable earnings of a for-profit business.

UBIT is imposed on UBI at rates between 15% and 35% (the same as the basic federal corporate income tax rates), depending on the bracket as determined by the level of income. There are exceptions to UBI, however, if income is derived by an exemption organization in a "passive" manner, i.e., not obtained as the result of competitive activity. The most common UBI exceptions to UBIT liability are: (1) Annuities; (2) Dividends; (3) Interest; (4) Rents; and (5) Royalties.

Special rules apply to some of these exceptions. In addition, under Section 512(b)(4) of the Code, unrelated debt-financed income which flows from “unrelated debt-financed property” (UDFP), as determined by Section 514 of the Code, is not an exception to UBI. UDFP is property that is held to produce income and with respect to which there is “acquisition indebtedness.” One exception to UDFP is property where at least 85% of its use is substantially related – aside from the need of the organization for income or funds – to the exercise or performance of its tax-exempt purpose.

*What are the options for structuring the management of the joint venture?*

The options include single or co-general partners of a limited partnership, member management of a limited liability company, a general partnership, a managing member of a limited liability company, a non-member manager of a limited liability company, or a Board of Managers (akin to a Board of Directors) which is appointed by the members of the LLC.

*What are the advantages and disadvantages of having the for-profit be a contractual co-developer vs. an owner?*

As an alternative to having the for-profit assume an ownership position is entering into a simple contractual relationship, which can occur at various stages of the development.

Advantages:

The CDC has unfettered control over the project without having to cede control to the for-profit.

The CDC gets to share in the upside potential by itself (for example, a supermarket deal in which the CDC is the sole owner).

Disadvantages:

The for-profit does not have as much of an incentive to stay in the deal if it does not have capital at risk.

The CDC must bear the risk of loss by itself, i.e., its charitable assets are exposed to a greater extent than they would be.

The CDC cannot as easily learn from the for-profit if it is not a co-owner, i.e., the dynamics of the development relationship is different.

V. Legal Concerns

*Can a joint venture partnership be legally formed under the nonprofit law of a state?*

There is no such thing as a nonprofit partnership. There can, however, be a partnership or limited liability company which exclusively has nonprofit members, and therefore does not distribute profits to private parties due to the nature of the individual partners. In this regard you may need to remind a CDC having a strong philosophical bent against having any of its activities appear to be for-profit, that if it belongs to a joint venture, the entity will technically be classified as a for-profit entity. This is the case even if the CDC participates directly in the venture or LLC.

*Can a joint venture obtain tax-exempt status?*

As you might expect from the above answer, the answer is no.<sup>2</sup>

*What is the fundamental conflict between the purposes of, and restrictions on, a nonprofit and a for-profit?*

This has been discussed above, but again, the CDC must be organized and operated for substantially charitable purposes and therefore cannot be operated for private benefit. A for-profit, on the other hand, is organized precisely for the opposite reason – the prospect of a private benefit to investors is the motivating force behind putting their capital at risk in support of the business venture. That being said, however, a joint venture between the two is legally permissible, as long as several criteria are met, one being that the project is substantially in furtherance of the CDC's charitable purposes.

*Can a nonprofit be a general partner of a partnership?*

Until 1982 the IRS took the position that a tax-exempt organization's participation as a general partner in a limited partnership is *inherently incompatible* with its exclusive operation for charitable purposes.<sup>3</sup> Since 1982 the IRS has used a two prong analysis to determine whether participation by an otherwise exempt organization in a partnership as a general partner adversely affects Section 501(c)(3) qualification.

First, whether participation by an organization furthers its exempt purpose, and second whether the partnership arrangement allows the organization to act exclusively in furtherance of an exempt purpose. As for the second part of the test, a reserve or guarantee of/against operating losses, profits or fees; the return of capital; or indemnification by the exempt organization in favor of the for-profit

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<sup>2</sup> A recent piece written by a well-known attorney in the exempt organization field suggested that there is no reason why an LLC should not be able to obtain tax-exempt status due to its limitation of liability and avoidance of putting general capital at risk; however, that is not the current law.

<sup>3</sup> In 1982 a case called Plumstead Theatre Society v. Commissioner was handed down by the Tax Court regarding an organization operated to produce theatrical plays. The court concluded that the organization's serving as a general partner of a limited partnership was not inconsistent with exemption because the organization (i.e., the partnership) possessed the characteristics of a nonprofit theater rather than a for-profit theater. Among the important factors cited by the court was the fact that the general partner had no obligation to return the investor's capital from its own funds, and since the investor limited partners had no control over the operation of the exempt organization, the partnership did not operate for the private interests of the limited partners.

is evidence of the furthering of the private interests of the investor, and generally will cause concern with the IRS).

The acceptability of an exempt organization being the managing member of a limited liability company formed to support charitable economic development was confirmed in a ruling issued by the IRS in May of last year.

On March 4, 1998, Rev. Rul. 98-15 was released. The ruling focused on whole hospital joint ventures between exempt organizations and for-profit entities. However, the IRS has made clear that the principles of the ruling are intended to apply beyond the hospital context. Releasing joint venture guidance had been an item in Treasury's business plan for three years. Rev. Rul. 98-15 will be a source of significant advisement in the joint venture area for years to come. In spite of some views of protest in recent legal literature, the ruling clearly reaffirmed the holding of the Plumstead Theatre case. Prior to Rev. Rul. 98-15, the IRS had never issued a ruling of precedent affirming the basic finding of Plumstead Theatre that an exempt organization could be the general partner of a partnership under the right circumstances. Rev. Rul. 98-15 not only affirmed that, but it emphasized the importance of the exempt organization's maintaining sufficient control over the operations of the joint venture. The ruling contains two examples, one with a fact pattern obviously passing muster, the other with a fact pattern obviously failing the test.

In spite of being generally well received, Rev. Rul. 98-15 has created some confusion. For example: (1) can it provide useful guidance for the many joint venture structures that fall in-between the obvious positive and negative fact pattern examples contained in the ruling, (2) with respect to an organization that invests only a small portion of its assets in a joint venture structure (a so-called "ancillary joint venture") not passing muster, is loss of tax-exempt status the only permitted result, or will unrelated business income tax liability simply be triggered (this is particularly an issue in light of the fact that a small investment by an exempt organization via a non-controlling role, such as through a limited partner investment, might *only* cause unrelated business income tax liability without *any* jeopardy to the entity's exempt status), (3) how will the ruling's explicitly required elevation of an exempt organization's responsibility to further charitable purposes square with the general partner's fiduciary duty under state partnership law to act in the best interests of limited partners?

*Does the CDC or its affiliate have to be the general partner or managing member of the joint venture?*

No, the CDC could assume a limited partner/passive investor role in a joint project. Where the exempt organization is not in control of the entity, the IRS would not place the same level of scrutiny on the arrangement. Instead, the focus would be on whether the exempt organization receives adequate consideration in return for its investment (or has a reasonable expectation of a return for its investment). In a passive investor scenario, it would be important for the CDC to assess whether it continues to have as its primary focus the exempt purpose for which it was granted exemption from federal income tax. It could not participate in any way in a joint venture that conflicts with its exempt purpose. Further, a "passive investment" should be only a small part of the CDC's activities. If it is found to be primarily making investments rather than carrying out its exempt purpose, its exempt status could be jeopardized.

As mentioned, since 1982 the IRS has moved to the position that a nonprofit could be the general partner of a partnership if certain safeguards were present. However, say a proposed project was clearly charitable, but that the CDC failed the Plumstead "control" test in that it was not the general partner or managing member and therefore did not have general control of the business under partnership law (and consequently, could not cause the partnership to act exclusively in furtherance of charitable purposes).<sup>4</sup> It's possible this could be an acceptable structure.

*How do I know if the purpose of the joint venture is charitable?*

Housing Development:

The final "Safe Harbor" rule was issued on May 13, 1996. It provides a "safe harbor" to low income housing providers applying for an expedited exemption ruling. The primary focus of the Rev. Proc. is on the income level of households renting or buying affordable housing. The basic prongs of the rule which must be satisfied are the following:

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<sup>4</sup> LISC has needed to examine this issue in the context of a franchise economic development project in which the basic business ownership vehicle was an LLC, which early on had the local entrepreneur as the managing member of the LLC and the CDC as only a member. This was driven by the anticipated need of the franchiser to have the person who would be running the business and going through the training program be the person in control of the day-to-day operation of the franchise.

The issue of whether inserting rights of intervention for the CDC in the Operating Agreement could work as a solution to the problem was examined. A distinction was made between delegating to the managing member with and without constraint. Certain matters, such as the daily operation of the franchise business, would be delegated without constraint by the non-managing CDC to the entrepreneur managing member. Other items, such as the right to change the location of the business or the first source hiring provision of the Operating Agreement, could not be done without the consent of the CDC. In addition, the CDC would have the right to take corrective action, such as removing the managing member, if it proceeded without obtaining the CDC's prior written consent as to those items. In that way, the CDC could ensure the LLC didn't deviate from the Operating Agreement terms critical to maintaining the continuing charity of the activity. Presently, however, there is no clear precedent to cite with the IRS on this issue.

- For each project: (a) at least 75% of the units must be occupied by residents that are at or below 80% of median income for the area, and (b) either at least 20% of the units must be occupied by residents that are at or below 50% of median income for the area, or 40% of the units must be occupied by residents that are at or below 60% of the median income for the area. Up to 25 percent of the units may be provided to at market rates to persons having incomes in excess of the low-income limit.
- The project is actually occupied by the poor and distressed. One year transition period is considered by the IRS to be reasonable (generally for occupied structures being redeveloped).
- The housing is affordable to charitable beneficiaries (limitation of percentage of income to be paid in rental for rental projects or toward mortgage payments in for-sale projects).
- If a project consists of multiple buildings and each building doesn't separately meet the requirements of the above three sections, then the buildings must share common grounds.

The Safe Harbor also discusses the "Exempt Purposes Other Than Relieving the Poor and Distressed," states that "...organizations may qualify for exemption without having to satisfy the standards for relief of the poor and distressed by providing housing in a way that accomplishes *any* of the [following] purposes:" (1) combating community deterioration; (2) lessening the burdens of government; (3) eliminating discrimination and prejudice, (4) lessening neighborhood tensions; and (5) relief of the distress of the elderly or physically handicapped.

There are also examples in the safe harbor of projects that would qualify, and one example for homeownership indicates that the IRS will allow higher income limits for for-sale projects (the example that qualifies has 40% of units being sold to households at or below 70% of AMI, 25% of units being sold to households at or below 80% of AMI and 35% of units being sold to households at or below 115 % of AMI.

It is unclear how the safe harbor will be used. It is not Intended to supersede the previous rules on what qualifies as charitable in housing, but only to help expedite applications. It can also not be used to challenge the exemption of a nonprofit having a prior determination. However, it is safe to say that the rule will be looked to as a benchmark of charity, as it is as complete a treatment of the standards as has been (and will be) seen in a while.

#### Economic Development:

This is a rather convoluted and difficult to apply test, but an excerpt of it from GCM 39883 is as follows:

Based on the above revenue rulings and GCMs, a determination of whether a community development organization furthers charitable purposes requires an analysis of the following **three factors**: (1) whether assistance is being provided to help local businesses or to attract new local facilities of established outside businesses, (2) whether the type of assistance provided by the community development organization has non-commercial terms and the potential to revitalize the disadvantaged area, and (3) whether there is a nexus between the business entities assisted and relieving the problems of the disadvantaged area, or between the businesses and a disadvantaged group, like a minority, in the area...**with respect to the third factor**; the above revenue rulings and GCMs indicated that there are **three characteristics** that provide a nexus between the businesses assisted and relieving the problems of the disadvantaged area: (a) assistance recipients conducting their business in the economically disadvantaged area, (b) recipients not being otherwise able to obtain assistance from conventional sources because of the depressed nature of the area or affiliation of business participants with minority or other disadvantaged groups, and (c) assistance recipient selection is based on which recipients will offer the greatest potential community benefit by virtue of either their current operations or their promises to take certain actions benefiting the depressed area (emphasis supplied).

Note that I have written a article (published in May, 1997) about charitable economic development between nonprofits and for-profits, in which I challenge the validity of several aspects of the above guidelines. Please contact me if you would like to receive a copy of the article.

*What does the joint venture's organizational document (limited partnership agreement or operating agreement) need to say about the charitable nature of the project?*

From the for-profit's standpoint, and from state partnership law standpoint, absolutely nothing. Quite often the agreement will state simply that the purpose of the partnership is to acquire, develop and dispose of real property and do and perform any and all other activities as authorized under state law.

However, from the CDC's standpoint, and in light of Rev. Rul. 98-15 referred to above, it's important to include in the organizational document not only the charitable goals of the venture (e.g., relief of poverty, elimination of prejudice and discrimination, stemming of community deterioration), but also what activities are planned to achieve those goals (e.g., development of rental or for-sale housing affordable to low income households; creation of jobs to be filled by unemployed residents; providing of financing and technical assistance to minority entrepreneurs; establishment of new businesses in a deteriorated area). Normally the for-profit should not be concerned about adding this - even though it's unusual language - because these points should have been previously discussed or at the very least should be understood as the goals of the venture

(and, for example, under the LIHTC, will be required to comply with Section 42 of the Code).

*V. Conclusion*

Joint ventures with for-profits, whether they be through co-ownership or only contractually-based, are clearly the direction more mature CDCs, as well as some younger ones struggling with core skill levels, will want to follow in order to achieve greater impact in what they do. LISC strives to be open to and supportive of these relationships and arrangements. We must also be in a position to provide critical, practical suggestions to a CDC during negotiations. Otherwise, a CDC may find that the arrangement does not build its knowledge and skill base at all, does not maintain the primacy of its charitable goals, and/or that it is not adequately compensated for its contribution to the venture.