SCHOOL OF LAW
CASE WESTERN RESERVE UNIVERSITY

Case Western Reserve Law Review

Volume 20 | Issue 4

1969

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Recommended Citation

William S. Paddock, *Tax and Other Legal Aspects of Business Involvement in Ghetto Development Programs*, 20 Case W. Res. L. Rev. 825 (1969)
Available at: https://scholarlycommons.law.case.edu/caselrev/vol20/iss4/7

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NOTE

Tax and Other Legal Aspects of Business Involvement in Ghetto Development Programs

I. INTRODUCTION

THE WAR ON POVERTY has failed to provide a solution to the Nation's urban crisis. The discontent and turmoil which continue to emanate from the core areas of our cities bear witness to this failure. Conventional welfare programs based on the handout are a mere palliative for the underlying economic and social causes of chronic poverty. The dole is demeaning; it tends to promote economic dependence rather than afford the disadvantaged an opportunity for becoming productive citizens. Big government, operating through traditional channels, has been unable to offer particularized programs to accommodate what are essentially local needs. With characteristic inefficiency, the faceless bureaucracy has hindered effective implementation of existing programs, while legislative laggardness has inhibited the development of new and innovative approaches to the urban poverty problem. It is in this perspective of general governmental failure that critics have called for increased involvement of private industry in the effort to eradicate poverty and blight from the cities.[1]

To date, the greatest response from the private sector has been in the form of increased employment opportunities for the "hard core" unemployed. Under the Manpower Training Act of 1962,[2] the federal government has been providing direct subsidies to private companies in order to absorb the increased rehabilitation and training costs associated with hiring from disadvantaged minority

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[1] The findings of the Community Self-Determination Act of 1968, S.3876, 90th Cong., 2d Sess. (introduced July 24, 1968), embody a general indictment of existing government programs:

> Programs and policies which tax some to support others offer no hope and no opportunity to those who have the capacity to become productive, contributing citizens. Handouts are demeaning; they do violence to a man, strip him of dignity, and breed in him a resentment toward the total system. The Nation must find ways, instead, to help presently nonproductive citizens achieve the independence, self-respect, and well-being enjoyed by their more fortunate fellows . . . . *Id.* § 2(b).

The bipartisan bill calls for a broad partnership between private industry and government to place a solid economic floor under the ghettoes of the Nation's cities. For a comprehensive discussion of the bill, see notes 107-29 *infra* & accompanying text.

[2] 42 U.S.C. §§ 2571-2620 (Supp. 1969). The specific programs implemented under this legislation are discussed in note 11 *infra*.

groups. Many corporations have participated in the effort.[3] Beyond question, the creation of productive jobs for inner city residents is an essential first step toward ending the cycle of poverty which has precipitated today's urban crisis. Jobs alone, however, will not be sufficient to effect complete economic integration of ghetto areas which must be the ultimate goal of any meaningful urban development program. To break the cycle of economic dependence, efforts must be made to evolve programs which augment the ghetto's social capital (housing and social service facilities), increase the concentration of productive resources in or near disadvantaged areas, and, most importantly, provide the means whereby inner city residents can ultimately acquire ownership and control of these new institutions. Only through such a total development effort, which will provide the disadvantaged with a vested proprietary interest in local institutions, can the dissidence and destruction now plaguing the cities be ended.

Some have suggested that the profit motive is inconsistent with involvement in broad-based development programs, that private corporations should limit their activities to hiring and training the hard core for employment in existing institutions, and that the creation of new social capital must be left exclusively to government.[4] It is submitted that this view is ill-conceived, for it overestimates the ability of government to get the job done, and fails to recognize that private industry has a substantial dollars and cents interest in preserving the vitality of the cities. The exigencies of the times, combined with the government's failure to provide a solution, call for a reassessment of the traditional roles of the public and private sectors in the area of social welfare. More than any other interest group, the corporate establishment has a vested interest in the prosperity and civil tranquility of the urban environment.[5] Most of the Nation's wealth has become concentrated in large corporations, which also control most of the highly skilled managerial talent. These considerations combine to place a social responsibility on private industry. Moreover, aside from an abundance of capital and problem-solving expertise, industry has other unique assets which make it particularly well suited to undertake urban development

[3] The various companies participating in job training programs under the Manpower Act are listed in Kalb, *How Businessmen and the Ghetto Can Get Together*, IRON AGE, May 30, 1968, at 47.

[4] Henry Ford II has remarked that investments in education, housing, and other social capital must be "done by people other than business." *Id.*

[5] The extent of private industry's vested interest is analyzed in notes 69, 148-49 *infra* & accompanying text.

projects. Private industry has the necessary experience in working with major capital investment enterprises and a tradition of solving problems through innovation of new techniques. Local corporations would be highly sensitive to the particular needs of the community and thus better able to tailor a development effort. Once committed, industry could assume primary responsibility for such development programs as constructing low-income housing and creating new businesses in ghetto areas, while the federal government would support these private efforts through direct subsidies and tax incentives.

In an effort to assess the attitude of industry with respect to its role in ghetto development programs, over 30 major corporations in the greater Cleveland, Ohio, area were surveyed during the summer of 1968. Each corporation was sent a comprehensive questionnaire asking it to respond to specific questions relating to community development programs which it had already initiated or contemplated initiating, and what, if any, legal problems it anticipated might arise out of such activity.[6] In addition to serving as a means of compiling

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[6] The survey was conducted by members of the *Law Review* Staff, and made possible by a grant from the School of Law. The following is a sample questionnaire:

I. Does your corporation have any "set" policy regarding corporate aid to partially alleviate Cleveland's community problems?
- a. Has your corporation completed any community projects in the past?
- b. Is your corporation presently engaged in administering any community programs?
- c. Does your corporation have any plans for future projects?
- d. What reasons would your corporation list for not acting at all?

II. If your corporation were to begin a project to partially alleviate some existing social problem — would you fear any legal reprecussions in any of the following areas?
- a. General corporate law constraints?
  1. Charge of ultra vires acts?
  2. Of wasting of assets?
  3. Of bad business judgment?
  4. Others?
- b. Anti-trust problems?
- c. Tax or securities problems?
- d. Problems with union contracts?
- e. Others?

III. What economic drawbacks or pressures are present or would be likely to present themselves if your corporation decided to enter the field of community improvement?
- a. Loss of profits?
- b. Loss of shareholders?
- c. Union strikes?
- d. Others?

IV. Has your corporation engaged in discovering sources of aid available to a profit-making institution interested in administering a program to fulfill some community needs?

V. What programs do you believe a corporation of your size and financial

basic information, the questionnaire was used as an introduction for interviewers who pursued the issues further in personal discussions with executives from each of the corporations surveyed. Although each company specifically requested that its answers to the various questions remain confidential, some generalizations are possible: (1) A few companies had no interest in anything but their own profit-making. (2) Most felt that they had a definite social responsibility, and many were exploring ways of becoming more deeply involved in community development. Although only one company had become unilaterally involved with rehabilitating ghetto housing and financing an independent inner city business, several companies had contributed to a revolving fund for housing rehabilitation and most had made donations to *Cleveland: Now!*, a comprehensive inner city development program initiated by Cleveland's

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standing could most beneficially provide to help solve the urban problem and what legal difficulties would you foresee in each?

a. Training hard core unemployed?
b. Rehabilitating slum and fringe area housing?
c. Aid to education?
d. Transfer or lease of assets used in a part of your production process to a community corporation in return for senior securities in that coroation. The members of the community would have equity ownership and control, and your corporation would in turn become a customer?
e. Health programs?
f. Youth programs in fringe and slum areas?
   1. Dances or canteens?
   2. Summer vacations at employees' homes?
   3. Baseball leagues or recreation areas?
g. Self help programs for homeowners in ghettoes and fringe areas? (For example, joining a revolving loan guarantee fund for homeowners, or providing supplies for rehabilitation at cost)

VI. What incentives do you believe should be offered by federal and/or state government to a corporation about to enter the field of community improvement?

a. Tax credits?
b. Relaxing anti-trust laws?
c. Enabling legislation to protect directors from shareholders and complaining unions?
d. Others?

VII. Do you feel that you would breach the fiduciary obligation you owe to your shareholders by investing their money in projects of this nature?

a. Have you ever considered the possibility of a shareholder suit against the corporation for its *inaction* in community affairs?
b. Do you feel that the actions taken by some corporations in alleviating urban problems have placed an additional burden upon directors to become involved with community problems?

VIII. What problems concern you relative to corporate entry into community affairs which have not been mentioned in the foregoing?

IX. Please list in order of importance the five major roadblocks which would confront your corporation if it were about to embark upon a community project.

Mayor, Carl B. Stokes.[7] (3) Most directors and executives did not perceive any significant legal constraints on corporate social involvement. Shareholder actions to restrain the corporation from acting were scoffed at, while tax and securities problems were considered surmountable. Although several corporations were apprehensive about labor opposition to social programs directed at minority groups, the vast majority of corporations viewed limited capital resources as the only major constraint. (4) Since most of the companies viewed themselves as being in intensely competitive industries, they felt that private corporations could not underwrite major development efforts alone without some government assistance either in the form of grants or tax incentives. The staff of interviewers was left with a general feeling that without some form of government subsidy, any social development program would be completely contingent upon continued economic prosperity, and that even a mild business recession would cause a severe cut-back in socially-oriented activities. However, despite the fact that most of the corporations responding welcomed tax incentives in the form of deductions for expenditures on community projects or even tax credits, there was unanimous opposition to involvement in any government backed programs which would restrict private development efforts to tight regulations and entangle them in a welter of bureaucratic red tape.

Using the results of the survey as a frame of reference, this Note will endeavor to expose the myriad of legal and economic factors that a private corporation should consider before initiating an urban development project. Examining the alternatives from the viewpoint of a hypothetical corporation, called X Corporation, the discussion explores the ways in which a private corporation could best employ its capital and managerial talent toward the end of providing inner city residents with ownership and control of productive facilities located in the community. Specifically, Part II investigates the organizational vehicles which X Corporation could use to (1) establish a subsidiary in the ghetto, nurture its independence, and ultimately divest itself of ownership and control; and (2) mobilize the resources of the business community to encourage minority entrepreneurship by providing seed capital and essential counseling services to independently owned ghetto businesses employing local residents. In evaluating the various organizational vehicles which

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[7] *Cleveland: Now!* is discussed in notes 92-94 *infra* & accompanying text.

might be employed to achieve these objectives, special attention is given to: (a) the availability of funds under existing federal programs; (b) possible income tax advantages in the form of deductions for expenditures; and (c) the overall effectiveness of various programs in eliciting broad community support and participation. Attention then focuses on the comprehensive Community Self-Determination Act of 1968,[8] which if adopted would afford private industry broad tax incentives for establishing productive facilities in ghetto areas, and provide a mechanism whereby ownership and control of these facilities would ultimately pass to local residents. Lastly, Part III explores the possibility of shareholder suits to restrain corporate social involvement, and the more novel question of whether shareholders can take any meaningful steps to require management to participate in inner city development programs.

II. CREATING AND ASSISTING INNER CITY BUSINESSES

A. Formation of a Ghetto Subsidiary

Assuming that X Corporation is a relatively large industrial concern, the most direct action which it could take to create new employment opportunities and establish the groundwork for eventual community proprietorship would be through formation of a wholly-owned subsidiary in the ghetto area pursuant to a plan whereby ownership and control would ultimately be vested in area residents.[9]

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[8] S. 3876, 90th Cong., 2d Sess. (1968).

[9] The creation of a wholly-owned subsidiary in the inner city is not without precedent. Perhaps the most well known project is Watts Manufacturing Company, established by Aeroject General Manufacturing Company in the Watts district of Los Angeles. Formed after the Watts riots of 1965, Watts Manufacturing employs over 200 area residents who were selected without regard to education or past criminal records. *See* U.S. CHAMBER OF COMMERCE, URBAN ACTION CLEARINGHOUSE, CASE STUDY NO. 6, 1 (1968). Other large corporations have or will initiate similar projects:

> —Westinghouse Electric Corp. plans a new factory in Pittsburgh's Homewood-Brushton Negro area that will turn out motorized personnel carriers for use in industrial plants.
>
> —Lockheed Aircraft Corp. is erecting a plant to make aircraft ground support equipment in San Antonio's Mexican-American district. General Dynamics Corp. already has a new metal and woodworking operation there, with products ranging from shipping pallets to aircraft structures.
>
> —Avco Corp. is building a plant to handle the company's printing needs in Boston's Roxbury Negro area. EG&G Inc., . . . is putting a metal fabrication operation in the same neighborhood.
>
> —International Business Machines Corp. will make computer cables in a plant in Brooklyn's Bedford-Stuyvesant Negro ghetto.
>
> —Brown Shoe Co. is planning to build a shoe plant in St. Louis' Jeff-Vander-Lou slum area. Wall St. J., Oct. 9, 1968, at 32, col. 1 (Midwest ed.).

Most of these projects have been developed through cooperation with local community

Such a subsidiary could be formed in the conventional way by creating a new corporation, "G Corporation," followed by a transfer of assets and cash in exchange for stock and securities in the new corporation. Since X Corporation would control G Corporation immediately after the transfer, the exchange would not be a taxable event.[10] G Corporation would be eligible for assistance under the Manpower Development and Training Act to help overcome initial costs of hiring and training employees drawn from the inner city area.[11]

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organizations and are receiving government money under various training programs. Many parent corporations plan to divest ownership and control of the ghetto facilities to community residents. For example, EG&G plans to reduce its holdings in its Boston ghetto plant to 50 percent in 20 years through distribution of stock for management options, an employee stock purchase plan and a public offering to Roxbury residents. *Id.*

[10] INT. REV. CODE OF 1954 § 351 [hereinafter cited as CODE]. Section 351 provides that no gain shall be recognized upon a transfer of appreciated assets to a corporation solely in exchange for stock or securities in the transferee corporation, provided that immediately after the transfer, the transferor is in "control" of the transferee corporation. Control is defined as possession of at least 80 percent of the combined voting power of all classes of voting stock and at least 80 percent of the total value of all other shares. CODE § 368(c). Of course, if X Corporation should transfer only cash to the ghetto subsidiary, there would be no potential gain, and thus no compelling reason to meet the control requirements of section 351. Without the control strictures of section 351, X Corporation might have more leeway to develop a plan for ultimate divestiture of its G Corporation stock to community residents. However, where land or other appreciated property is transferred to the ghetto subsidiary, section 351 treatment will be desirable. In any event, the control requirements of section 351 will not present an insurmountable obstacle to an effective divestiture plan. *See* notes 20-23 *infra.*

[11] For a comprehensive analysis of the abnormally high labor costs involved with operating a plant in a ghetto area, see Garrity, *Red Ink for Ghetto Industries?*, HARV. BUS. REV., May-June, 1968, at 4. To compensate for the extra cost of training unskilled workers drawn from ghetto areas, private corporations are eligible for federal grants under the Manpower Training and Development Act of 1962, 42 U.S.C. §§ 2571-2610 (Supp. 1969). Two programs have been implemented under this legislation. The older On-the-Job Training Program (OJT), 42 U.S.C. § 2584 (Supp. 1969), makes up to $850 per trainee available to cover the cost of supportive services such as remedial education and extra job counseling which are necessary to make the hard core fully productive. *See* Kalb, *supra* note 3, at 53. Contracts under the OJT program are made with the Department of Labor, and must combine work with a "program of occupational training" under which each trainee receives classroom instruction pertaining to the particular occupation for which he is being trained. *See* 29 C.F.R. § 20.20 (1969).

The newer and more comprehensive job development program is Job Opportunities in the Business Sector (JOBS), sponsored by the National Alliance of Businessmen headed by Henry Ford II. The key feature of the JOBS program is the fact that trainees become employees of the participating employer upon entrance into the program, and thus are assured of permanent employment at the completion of the training phase. Since all trainees become employees at the beginning of the training program, they receive salaries and other employee benefits. The security of a permanent job from the start of the training program has had a positive effect upon trainee motivation. *See* DEP'T OF LABOR, MANPOWER REPORT OF THE PRESIDENT 93 (1969). The mechanics whereby a private corporation like X Corporation or its subsidiary can secure a government contract under the JOBS program are outlined in JOBS, NATIONAL ALLIANCE OF BUSINESSMEN, REQUEST FOR PROPOSAL MA-4 (Labor Dept. print.). All private companies, regardless of size, located in 50 designated cities

Aside from providing immediate employment opportunities, G Corporation would function as an industrial laboratory where, under

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are eligible to participate in the JOBS program. For the listing of the specific cities, which generally includes the 50 largest cities in the United States, see *id.* at 47. Following the prescribed format, an employer desiring to participate in the program submits to the regional manpower administrator a proposal contract wherein the employer estimates the increased costs it will experience upon hiring disadvantaged individuals. Such increased expenses would include the cost of:

a) Orientation
   (1) medical and dental examination and services
   (2) initial counseling
   (3) basic job related orientation
b) Job Related Basic Education
   (1) special counseling and testing
   (2) Pre-vocational education
   (3) basic skill preparation
c) On-the-Job Training
   (1) Skill training
   (2) special counseling and coaching
   (3) wastage, equipment breakage
   (4) productivity differential (additional costs resulting from less than "normal" trainee productivity)
d) Administrative Cost and Overhead
   (1) transportation
   (2) Supervisory and co-worker orientation
   (3) general administration and overhead *Id.* at 3.

All of these services, except on-the-job skill training, may be subcontracted to qualified public or private agencies. Individuals who are "poor persons who do not have suitable employment and who are either (1) school dropouts, (2) under 22 years of age, (3) 45 years of age or over, (4) handicapped, or (5) subject to obstacles to employment" are eligible to become employee-trainees upon certification by the Concentrated Employment Program. *Id.* at 51.

Once the cost estimates have been approved by the Labor Department, they are converted into a fixed per trainee cost schedule which is incorporated into the contract. The employer then files monthly invoices certifying the number of trainees participating in each cost classification over the relevant monthly period, and is reimbursed by the government. Under JOBS program "Option B." a less complicated contract procedure is available for smaller employers. *See id.* at 23-35. For an extensive discussion of various successful training programs, see Kalb, *supra* note 3; 2 GREENLEIGH ASSOCIATES, INC., OPENING THE DOORS: JOB TRAINING PROGRAMS 13 (1968); U.S. CHAMBER OF COMMERCE, URBAN ACTION CLEARINGHOUSE, PHILADELPHIA UTILITY OFFERS JOBS TO MINORITIES (1968); *Id.*, BOSTON FIRM MARKING TEN YEARS OF SUCCESS IN HIRING HARD CORE; *Id.*, BUFFALO EMPLOYS THE HARD CORE WITH OPPORTUNITIES DEVELOPMENT CORPORATION; Borek, *A New Business for Business: Reclaiming Human Resources*, 77 FORTUNE, Jan. 1968, at 159.

Although federal manpower grants will compensate for high labor turnover rates and the costs of training, such grants will not compensate for other direct and indirect costs which tend to be higher in inner city areas. When the high costs of land, insurance, and taxes in the inner city are considered, formation of a ghetto subsidiary, even with government training subsidies, does not present an extremely attractive investment from a strictly dollars-and-cents point of view. Moreover, the abnormally high direct costs associated with the operation of a ghetto plant do not account for the indirect opportunity costs involved with the loaning of executive talent to the inner city operation. Although the ghetto subsidiary may be of considerable public relations value to the parent, and will pay a social dividend in the form of increased inner city affluence and the preservation of civil tranquility, the parent cannot expect to receive an immediate cash return on the ghetto investment which is competitive with alternative investment opportunities. In order to compensate for increased costs of operating a ghetto

the direction of experienced X Corporation personnel, employee skills could constantly be elevated.

Initially, the ghetto subsidiary would be heavily dependent upon X Corporation as a source of capital and managerial talent. Whether it will also be dependent upon X Corporation as a major buyer of its products will in most cases be determined by the nature of X Corporation's business. For example, if X Corporation manufactures highly sophisticated electronic equipment, given the nature of the ghetto subsidiary's workforce, it is unlikely that it can become a major supplier. Even where X Corporation's production process is such that the subsidiary could become a major supplier of an essential item, X Corporation might be reluctant to rely on it as a source of supply owing to the risks involved in such an operation. However, where there are alternative suppliers for an essential item to whom X Corporation could resort if the ghetto subsidiary were unable to meet its needs, the risks of a buyer-seller relationship would be reduced.

Whether or not X Corporation enters into a buyer-seller relationship with its ghetto subsidiary, it is clear that the subsidiary must be guaranteed a market for its output. If, as proposed, the subsidiary is destined to become independent and self-sufficient, it should produce an item with general marketability and growth potential. Moreover, the subsidiary's production process should be labor intensive in order to maximize employment opportunities. Initially, X Corporation might be the subsidiary's sole customer. After the fledgling corporation becomes established, additional sales outlets could be pursued. In this respect it should be noted that the federal government gives special preference on government procurement contracts to facilities located in areas of concentrated underemployment or unemployment.[12]

Following its original intention, when the ghetto subsidiary approaches self-sufficiency, X Corporation will seek an appropriate mechanism by which to divest itself of control.[13] A likely vehicle

facility, and possibly to assuage shareholder opposition to ghetto involvement, the parent corporation may seek additional income tax benefits upon disposition of the inner city operation. *See* notes 20-24 *infra* & accompanying text.

[12] 29 C.F.R. sections 8.1-.9 (1969), require the Secretary of Labor to classify as an area of "concentrated unemployment or underemployment" any city or labor area having a population of 250,000 or more and a rate of unemployment of 6 percent or more. Firms located in or near an area so classified, and which agree to hire from that area, can apply for a certificate of eligibility entitling them to preference on government procurement contracts. *Id.* § 8.8 Watts Manufacturing, discussed *supra* note 9, has received extensive contracts to make tents and other equipment for the military.

[13] It should be noted that an early disposition of the parent's equity interest in the

for divestiture would be through stock distributions to the subsidiary's employees. A simple device would be for the ghetto subsidiary to issue new shares and distribute them either directly to its employees as compensation,[14] or to a qualified profit sharing trust.[15] The subsidiary might also make a public offering to inner city residents and combine its offering with a simultaneous redemption of shares from X Corporation. A gradual redemption of shares from X Corporation would lead to adverse tax consequences since, to the extent of the subsidiary's earnings and profits, X Corporation would have to pay tax on any gain at ordinary income rates.[16] However, X Corporation could receive capital gains treatment if the subsidiary were to redeem X Corporation's entire interest in exchange for the subsidiary's long term notes.[17] The subsidiary could retire the shares redeemed or hold them as treasury stock and resell the shares to the public or distribute them to employees.[18] X

subsidiary by sale or gift will not jeopardize nonrecognition under the initial incorporation pursuant to *Code* section 351. This is so because the parent was in control of the subsidiary "immediately after the transfer" of assets in exchange for stock and there was no preexisting legal obligation to divest control. *See* Wilgard Realty Co. v. Commissioner, 127 F.2d 514 (2d Cir. 1942); W. M. Smith Electric Co., ¶ 54,199 P-H T.C. Memo (1954).

[14] In Rev. Rul. 69-75, 1969-8 IRB 9, the Revenue Service held that a corporate employer could deduct the fair market value of authorized but unissued shares distributed by the corporation to its employees as compensation. The value of the stock distributed to the employees would be taxable to them as compensation income under *Code* section 61, see Treas. Regs. § 1.61-2(d)(4) (1969). Employees drawn from the inner city, however, may not have sufficient cash to pay the tax. Therefore, the tax should be avoided by restricting the transferability of the shares or otherwise rendering the value of the shares uncertain. *See* Treas. Regs. §§ 1.61-2(d)(5), 1.421(6) (1969). The value of the shares would then be taxable as compensation income to the employee when the restriction lapses. *See* Rev. Rul. 68-86, 1968-1 CUM. BULL. 184.

[15] A profit-sharing trust qualifying under *Code* section 401(a) is exempt from taxation under section 501(a). Although employer contributions of its own stock to the profit sharing trust will not give employees legal title to the company's shares, it will provide them with a beneficial interest in the profitability of the company and thereby achieve the social benefits of community proprietorship. The subsidiary would be entitled to deduct the value of its stock contributions to the trust as compensation expenses under *Code* section 162(a), not in excess of 15 percent of the aggregate regular compensation paid to qualified employees, and the contributions would not be taxable to the employees. CODE § 404(a)(3). Since the trust is tax exempt, it could sell the subsidiary's shares to local community residents without capital gains tax and loan the proceeds from such sales to the subsidiary for working capital or expansion. Caution should be exercised when the trust makes loans to the employer in order to insure that the transaction is one at "arms length," with adequate security and interest provisions.

[16] *See* CODE §§ 317(b), 302(d), 301(c), 316(a).

[17] CODE § 302(b)(3). If X Corporation receives less than 30 percent of the fair market value of the subsidiary's shares (exclusive of evidences of the subsidiary's indebtedness) in the year of sale, any gain could be reported on the installment method. *See* CODE § 453.

[18] In Rev. Rul. 62-217, 1962-2 CUM. BULL. 59, the IRS held deductible as compensation expenses the fair market value of treasury shares distributed to employees.

Corporation could also secure capital gains treatment for any appreciation in the value of its G Corporation stock by making a secondary distribution directly to ghetto residents.[19]

Most of the corporations interviewed in the Cleveland area indicated that they did not want to tie up corporate capital in urban improvement projects for extended periods. Although any number of conventional devices could be employed by a parent corporation to divest itself of a ghetto subsidiary and thereby provide the inner city residents with a proprietory interest in the productive resources of the community, the traditional divestiture mechanisms would not allow the parent to effect a complete withdrawal of invested capital at an early date. It is unlikely that the ghetto subsidiary could generate enough profits to redeem all of its shares from the parent in the first few years of operation. Even where the shares are redeemed for the subsidiary's notes, the parent's capital would still be locked into debt instruments which in all probability would not be marketable. Likewise, because of the ghetto community's general lack of funds and the expected reluctance of community residents to buy capital shares with what little money they have, it is doubtful that the parent could dispose of its entire holding of the subsidiary's stock through a public offering to inner city residents without a sustained selling effort extending over a number of years.

Given that the traditional divestiture mechanisms are inadequate to effect an early withdrawal of capital, the parent corpora-

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[19] Unless a specific exemption is available, distribution of a controlling block of shares to ghetto residents would probably require registration with the Securities Exchange Commission pursuant to sections 5 and 2(11) of the Securities Act of 1933, 15 U.S.C. §§ 77(e), 11(b)(77), (1964). If the value of the offering is less than $300,000, short form registration under Regulation A, 17 C.F.R. §§ 230.251-.263 (1968), would allow distribution through use of an offering circular rather than a full fledged prospectus.

Since the inner city residents will be buying or subscribing for the shares of the ghetto company, they are entitled to benefit from the full disclosure requirements of the federal securities laws. However, public distribution of shares in a wholly-owned subsidiary as part of a comprehensive local urban development program presents a unique situation. First, the distributing parent corporation is not motivated by the expectation of profits on the offering, and will most likely suffer a pecuniary loss. Second, the development program is inherently localized; the productive facility is situated in the community, and all prospective offerees of the securities are local residents. These factors combine to make available a complete exemption from registration under section 3(a)(11) of the Securities Act of 1933, 15 U.S.C. § 77(c)(11) (1964), which exempts from registration securities "sold only to persons resident within a single State or Territory, where the issuer of such security . . . is . . . incorporated by and doing business within, such State or Territory." For a detailed discussion of the "intrastate" exemption, see 1 L. LOSS, SECURITIES REGULATION 591-605 (1961). Local state statutes should be consulted with respect to Blue Sky registration requirements.

tion might attempt to divest the subsidiary by gift if it could secure a compensating tax benefit.[20] A recent revenue ruling indicates that the parent might donate its subsidiary stock to a charitable organization and take a charitable deduction equal to the fair market value of the stock.[21] The crucial question here would be whether a corporation or foundation organized to receive stock in a ghetto corporation, distribute the stock to disadvantaged minority and poverty groups, and reinvest the proceeds in similar ghetto businesses, would be organized exclusively for "charitable" purposes within the meaning of section 501(c)(3) of the *Internal Revenue Code of 1954*.[22] The regulations define the word charitable broadly to include organizations formed "to lessen neighborhood tensions" and "to combat community deterioration."[23] In Revenue Ruling 68-655,[24] the Revenue Service held that a nonprofit organization formed to promote racial integration in housing, to lessen neighborhood tensions, and to prevent neighborhood deterioration which, among other activities, purchased homes to resell at no profit on an open occupancy basis, was exempt under section 501 (c)(3). The ruling states that by purchasing homes in the neighborhood and reselling at no profit to selected needy individuals, the organization accomplished the charitable purposes of reducing community tensions, stabilizing the neighborhood and combatting community deterioration.

The thrust of Revenue Ruling 68-655 is that the commercial activity of selling homes to disadvantaged individuals in order to preserve community stability and prevent deterioration is in furtherance of the organization's exempt purpose and hence not an "unrelated trade or business."[25] The ruling recognized that home

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20 Under the Community Self-Determination Act of 1968, X Corporation would receive substantial tax benefits upon the sale of a ghetto facility to a community-sponsored development corporation. *See* notes 105-27 *infra* & accompanying text.

21 *See* Rev. Rul. 68-655, 1968-52 IRB 16, discussed in detail in note 24 *infra* & accompanying text.

22 Under section 501(c) (3), organizations formed exclusively for charitable purposes are exempt from taxation.

23 Treas. Regs. § 1.501(c) (3)-1(d) (2) (1968).

24 1968-52 IRB 16.

25 Treas. Regs. section 1.501(c)(3)-1(e)(1) (1968), provides that an organization may meet the requirements of section 501(c)(3) even though it carries on a trade or business as a substantial part of its activities, if the trade or business is "in furtherance of the organization's exempt purpose or purposes and the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business. . . ." Under *Code* section 513(a), unrelated trade or business is defined as any business "not substantially related . . . to the exercise or performance" of the organization's exempt purposes. To the extent that the receipt of shares in a ghetto corporation for the

ownership will give disadvantaged minorities a vested proprietory interest in the well being of the community and that an organization promoting home ownership through the purchase and sale of homes to selected buyers would operate to reduce tensions, preserve stability, and prevent deterioration. Ownership and control of the productive resources of the community would have the same positive effect on community stability. Stock ownership, like home ownership, would provide ghetto residents with a stake in the economic prosperity of the community and thereby promote stability and tend to prevent deterioration. Control over the productive facilities of the community would break the ties of paternalistic dependency and provide disadvantaged minorities with a new hope for self-determination.

The most desirable exempt organization to effect divestiture would be a charitable development corporation which would hold the shares in the ghetto subsidiary and embark on a program to educate inner city residents concerning the desirability of share ownership. Such an educational effort would be necessary to dispel community ignorance and skepticism concerning corporate investment. To overcome community reluctance to exchange money for share certificates and intangible voting rights, the charitable corporation might have to provide added security by guaranteeing repurchase of the shares at the issuance price. The revenue derived from the sale of shares could be combined with funds received through cash contributions and used to loan money or make equity investments in other independently owned ghetto businesses.[26] Since such invest-

purpose of sale to disadvantaged inner city residents will operate to reduce community tensions by stablizing the neighborhood and combatting community deterioration, such sales would be in furtherance of an exempt purpose and therefore would not constitute an unrelated trade or business. Because no part of the net earnings of an organization qualifying for exemption under section 501(c)(3) may "inure to the benefit of any private shareholder *or individual*" (emphasis added), the charitable corporation distributing shares of local corporations must recoup the fair value of the stock upon sale to the ghetto residents.

[26] The Inner City Business Improvement Forum, a nonprofit local development corporation organized with the help of major Detroit corporations to aid businesses in disadvantaged inner city areas, is exempt from taxation under section 501(c)(3) and would provide an ideal vehicle for divestiture of a gretto subsidiary. For a more detailed discussion of the activities of the Detroit development corporation and similar efforts by private businesses in other cities, see notes 83-90 *infra* & accompanying text.

Perhaps the most far-reaching effort toward community ownership of productive resources is Action Industries, Inc., a "ghetto conglomerate" located in the Venice area of Los Angeles. Action Industries owns two service stations, a real estate development company, a maintenance company, and is now planning to raise additional capital of $1 million through a private offering of 20,000 shares of convertible preferred at $25 per share to corporations, institutions, and individuals. The firm of Kleiner, Bell and Com-

ment activity would be in furtherance of the organization's exempt purpose of promoting community stability, it would not constitute an unrelated trade or business.[27] Also, to the extent that investments in other community businesses provide new employment opportunities for disadvantaged ghetto residents and induce the influx of new capital into the ghetto, the exempt organization would accomplish the additional charitable objectives of "[r]elief of the poor and distressed or of the underprivileged, lessening the burdens of government, [and] promotion of social welfare."[28]

Before the parent makes the contribution of the subsidiary's stock to the nonprofit community development organization, the latter should apply to the Revenue Service for a ruling that it is exempt from taxation as a charitable organization under section 501(c)(3).[29] Exemption would insure a charitable deduction for the parent corporation equal to the fair market value of the stock contributed.[30] Should the value of the subsidiary's stock contributed exceed 5 percent of the parent corporation's taxable income for the year, the parent would be entitled to a 5-year carryover.[31] Practically speaking, since the rate of corporate taxation is presently about 52.8 percent for a corporation earning over $25,000, the charitable deduction allows the parent corporation to recoup only 52.8 percent of its total investment in the ghetto subsidiary. Nevertheless, because the charitable deduction is equal to the full fair market value of the stock contributed, the parent corporation will save the capital gains tax which it would have been required to pay had it sold the stock outright. This tax savings, equal to the capital gains tax on the amount by which the present value of the subsidiary's

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pany is underwriting the issue without fee and has estimated that the entire offering is assured of placement. *See* THE URBAN DEVELOPER, Vol. 1, No. 2, at 2 (pub. by Hyde Park Bank & Trust Co., Feb. 1969). Action Industries will raise another $500,000 through a public offering of 250,000 shares of Class A common at $2 per share to local residents. In order to insure community control, 500,000 shares of Class B common will be issued to Project Action, a nonprofit community organization which will vote the Class B shares to elect the board of directors. *Id.* A nonprofit community ownership organization similar to Project Action that would qualify as a section 501(c)(3) organization would provide a convenient vehicle through which X Corporation could divest its ghetto subsidiary.

[27] The investment activities of the charitable development corporation would closely parallel the activities of the Detroit organization which has been held exempt under *Code* section 501(c)(3). *See* notes 86-87 *infra* & accompanying text.

[28] Treas. Regs. § 1.501(c)(3)-1(d)(2) (1968).

[29] For the proper application procedure, see Treas. Regs. § 1.501(a)-1 (1968).

[30] CODE § 170(b)(2).

[31] *Id.* The parent corporation could spread the contribution of the subdidiary's stock over several years if necessary to secure a maximum deduction.

stock exceeds the parent's cost basis,[32] must be considered when determining the true value of the charitable deduction. If the parent had transferred low basis, appreciated property to the subsidiary pursuant to the initial incorporation under section 351,[33] there would be a considerable tax savings thereby making the charitable deduction more attractive.[34]

B. *Unilateral Aid to Independent Ghetto Businesses*

Rather than forming a wholly owned subsidiary in the ghetto and transferring ownership through divestiture, X Corporation could accomplish the objectives of encouraging ghetto entrepreneurship and promoting community ownership by aiding independent ghetto businesses. Two methods of involvement would be the revitalization of existing businesses with government and corporate money, and the creation of new independent ghetto corporations with capital derived from government loans.

Several ways are available by which capital can be secured for existing ghetto businesses. Because of their small size and independent ownership, these companies will be eligible for federal loan assistance from the Small Business Administration (SBA). Working in conjunction with the SBA, X Corporation would be able to aid more than just one or two small businesses in the ghetto area. The availability of SBA loans and loan guarantees would reduce the demands on X Corporation's capital, and thus permit it to supply counseling services to a larger number of businesses. Moreover, by asserting its influence in the business community, X Corporation could procure supply contracts from other corporations as well as secure greater participation by banks and other financial institutions, thereby maximizing SBA participation.[35] Hopefully, X Corporation's activities would act as a catalyst for the involvement

[32] Pursuant to the initial incorporation under *Code* section 351, the parent would have a cost basis in the subsidiary stock equal to its adjusted basis in the property originally transferred. *See* CODE § 358.

[33] *See* note 10 *supra* & accompanying text.

[34] Since *Code* sections 1245 & 1250 apply only to sales of tangible depreciable personal property and depreciable realty respectively, there would be no "recapture" of depreciation upon the gift of the subsidiary's shares to a charity via reduction in the amount of the charitable deduction called for under *Code* section 170(e) for gifts of *tangible* depreciable property.

[35] Securing the commitment of commercial banks will be vital to the success of any development effort. SBA funds for direct loans are limited, and the real infusion of capital into the inner city economy must come from traditional banking sources. Unfortunately, banks as a whole have been noticeably reluctant to loan money to high risk small businesses in ghetto areas, even where SBA loan guarantees are available. *See* McKersie, *Vitalize Black Enterprise*, HARV. BUS. REV., Sept.-Oct. 1968 at 88. However, where established companies have taken the initiative to support inner city busi-

of a broad cross section of the business community in the development effort.

With its power to make and guaranty substantial loans, the Small Business Administration constitutes a major source of capital. The SBA is authorized to loan up to $350,000 to small business concerns for the financing of plant construction or rehabilitation, for the purchase of equipment, and for working capital purposes where conventional financing is not available.[36] Traditionally, the SBA has been extremely conservative in selecting loan recipients. To overcome this conservatism and to open the door for increased federal aid to businesses located in areas of substantial unemployment, Congress enacted legislation in 1967 calling on the SBA to give special consideration to small business concerns located in urban or rural areas with high proportions of unemployed or low-income individuals, and particularly to small business concerns owned by low-income individuals.[37] This legislation also authorizes Economic Opportunity Loans (EOL's).[38] As with regular SBA loans, EOL's are made on a direct loan, guarantee, or participation basis, and are available only when funds cannot be obtained on reasonable terms from traditional sources.[39] Although the credit requirements for an

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nesses by guaranteeing them a market for their products and agreeing to supply expert business guidance, the credit risks associated with ghetto businesses are reduced considerably, and the banks have been more responsive to inner city needs. In Rochester, New York, major corporations have formed a development company to assist ghetto businesses, and have been highly successful in securing the participation of commercial banks. *See* notes 75-82 *infra.*

Acting in response to increased support for ghetto entrepreneurs from major Chicago businesses, the Hyde Park National Bank and Trust Company formed an Urban Development Division last spring. The special division is designed to make loans to inner city small businessmen and provide mortgage financing for home acquisition and rehabilitation. The development division is complete with an applicant screening department and a business counselling and guidance department to aid ghetto businesses once credit has been extended. The extra costs of administering the program are assumed by major corporations who have agreed to take smaller interest payments on their own time deposits held by the bank. As of February, 1969, the development division had loaned $754,050 to 25 ghetto businesses in the west and south sides of Chicago. *See* THE URBAN DEVELOPER, Vol. 1, No. 2, at 1 (pub. by Hyde Park Nat'l Bank, Feb. 1969).

[36] 15 U.S.C.A. § 636 (1964). *See* 13 C.F.R. §§ 122.1-16 for the administrative regulations. The SBA will provide direct loans where other financing is not available on reasonable terms, and these loans may be obtained by qualified small businesses without the participation of banks. *Id.* at §§ 120.2, 122.8. The borrower, however, must be a "small business concern." *Id.* at §§ 121.3-.3-14 (1969). Further credit requirements are that the borrower be of good character, have ability to operate the business successfully, and have enough capital so that the business has a reasonable chance for success so as to insure that the loan will be repaid. *Id.* at § 122.16.

[37] 42 U.S.C.A. §§ 2901-05 (Supp. 1969).

[38] 42 U.S.C.A. § 2902 (Supp. 1969); 13 C.F.R. § 119.1-.81 (1969).

[39] *Id.*

EOL are less stringent,[40] the amount of the loan is limited to a maximum of $25,000.[41] There are no specific collateral requirements for an EOL, but the applicant may be required to pledge whatever worthwhile collateral is available.[42] Furthermore, in order to receive an EOL, at least 50 percent of the business must be owned by low-income groups;[43] and to insure the success of the business, SBA may require the borrower to participate in an approved management training program.[44] The maximum interest rate permitted on an EOL is 5 1/2 percent, and it can be as low as 4 5/8 percent for businesses located in redevelopment areas.[45] The SBA will also guarantee a lease of commercial and industrial property made by a small business concern otherwise unable to obtain a lease, because of its poor credit standing.[46] Thus, by operating in conjunction with SBA, X Corporation can undertake a number of meaningful programs to revitalize dormant or struggling inner city businesses.

On the other hand, X Corporation could engage in the creation of new ghetto corporations. Once X has located an aspiring entrepreneur from the inner city,[47] it can employ its legal talent to create

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[40] To be eligible for an EOL, the borrower must be of good character, have shown ability to operate the business successfully, and have enough capital that with the EOL there is a reasonable chance that the business will succeed and that the loan will be repaid. 13 C.F.R. § 51 (1969).

[41] 42 U.S.C.A. 2902 (Supp. 1969). The EOL program is divided into two parts. "EOL I" and "EOL II." EOL I is designed to aid people already in business where business income provides the owner with only a marginal existence. EOL II is designed to aid existing businesses which, although profitable, have been unable to secure adequate financing for expansion. *See* The Chance to Do . . . , Economic Opportunity Loan Programs EOL 1, *EOL 2*, (SBA print. 1967).

[42] 13 C.F.R. § 119.31(d) (1969).

[43] *Id.* § 119.21(b) (1969).

[44] 42 U.S.C.A. § 2902 (Supp. 1969). It should be noted, however, that SBA will finance management training courses given by public or private organizations. *Id.* § 2906(b); 13 C.F.R. § 119.81 (1969).

[45] These areas are so designated under the Public Works and Economic Development Act of 1965, 42 U.S.C.A. § 3121 (Supp. 1969); 13 C.F.R. §§ 301.1-.63 (1969).

[46] 15 U.S.C.A. § 692 (Supp. 1969). The SBA guarantee insures payment of rent directly or in participation with private insurance companies. The guarantee extends for a minimum of 5 years to a maximum of 20 years on a participating basis, and 15 to 20 years on a direct basis. *See generally* 13 C.F.R. §§ 106.1-.7 (1969).

[47] Locating a ghetto entrepreneur may present a difficult problem for white businessmen. SBA has recently instituted a program known as "Project Own" under which teams of SBA personnel are actively seeking out qualified businessmen from inner city areas. Private companies seeking involvement in a ghetto project might consult SBA as a first step in locating a qualified inner city businessman. For a more detailed discussion of SBA Project Own, see notes 54-56 *infra.*

To facilitate the location of qualified individuals in ghetto areas, Detroit businessmen have worked through various community organizations which act as a liaison between the white corporate establishment and the ghetto community. *See* notes 89-90 *infra* & accompanying text.

the fledgling corporation while it trains the future businessman in a managerial program.[48] A large part of the initial financing could come from SBA loans, although X Corporation might also lend money, guarantee the SBA loan, or take an equity position in the new corporation.[49] X might also assist in creating lines of credit to the ghetto business from prospective suppliers of materials and services as well as guaranteeing the new business a market by agreeing to buy its products, while at the same time exerting its influence in the business community to secure other buyers.[50]

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[48] In 1967, Eastman Kodak Company of Rochester, New York, conducted a series of studies to determine how it might aid in the creation of independently owned businesses in Rochester's inner city area. The results of these investigations are contained in a booklet entitled *A Plan for Establishing Independently Owned and Operated Businesses in Inner City Areas*, published by Eastman in 1967. The booklet recommended the creation of a community investment company to be sponsored by a number of area corporations. The Eastman study came to fruition in January, 1968, with formation of the Rochester Business Opportunities Corporation (RBOC) which will be analyzed in greater detail in the latter part of this Note. *See* notes 75-82 *infra* & accompanying text. The Kodak study recommends that a new ghetto business should have the following characteristics:

> 1. The first product need not require a high level of technical skill to manufacture, but the type of skill required initially should lead to the acquisition of higher levels of skill.
> 2. The product should be marketable to a range of customers. An exclusive dependence on just one customer is undesirable. Such dependence limits the growth possibilities of business while increasing its risks.
> 3. The initial capital investment should be relatively small. A product or service with a high labor content in its manufacture tends to generate more jobs . . . .
> 4. The extent to which employees of existing businesses — particularly local ones — would be hurt by new competition must be considered. To create a new enterprise which would only replace existing jobs in successful and established business would not be desirable. This would negate one of the major goals: that is, the creation of new job opportunities and new wealth.
> 5. A single enterprise might ultimately have several product lines. This would spread the business risk and enhance the opportunities. Thus, it is conceivable that there might be one section devoted to sub-assembly work on electronic components, another to repair and service, and another to the fabrication of a finished product.

[49] The Kodak study, *supra* note 48, suggests that about 45 percent of initial capital could be provided by SBA loans, and that the remaining 55 percent of the total should be equity capitalization. Ten percent of the total equity capitalization should be raised by the ghetto entrepreneurs, and X Corporation would supply the balance of the equity capital. With a total capitalization of $100,000, $45,000 would come from the SBA, $10,000 from the ghetto entrepreneurs, and $45,000 from X Corporation. It is further recommended that the shares issued to X Corporation be redeemable by the ghetto business thereby allowing it to become totally independent at a future time.

[50] It is vitally important that the new ghetto company be guaranteed a market for its products in the critical early years of operation. Supply contracts from major corporations will shelter the fledgling company during its infancy until it can become fully competitive. However, as pointed out by the Eastman Kodak study, *supra* note 48, before inner city businesses receive substantial preferential treatment from other large corporations, the impact on existing competition must be considered. For example, were X Corporation to enter into a long term requirements contract with a ghetto com-

Once the ghetto corporation was assured of a market for its products, it might be sufficiently secure to receive bank credit. The

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pany, independent producers would be foreclosed from selling to X Corporation for an extended period. Likewise, where several large buyers of a given product discriminate in favor of ghetto businesses in the selection of suppliers, and also extend counseling services and preferential credit terms to inner city businesses, the competitive position of independent producers of that product may be injured. It is also suggested that X corporation exert its influence in the business community to secure purchase contracts for the ghetto concern from other large companies. *Cf.* Davis, *The Role of Private Industry in Aiding the Poor*, 19 VA. L. WEEK. 104, 108 (1968), where it is noted that in January, 1968, the president of Neiman-Marcus Co., a large Dallas retailer, sent a letter to the company's 9000 suppliers saying that "We shall in our purchasing activities look with favor upon those companies taking positive steps toward employing and training people of minority groups." The question arises whether the application of this kind of economic leverage, combined with other preferential treatment accorded inner city businesses, may run afoul of the antitrust laws; for although securing the economic independence of disadvantaged minorities is a noble goal, the adverse impact on competition may be very real.

The fact that X Corporation and its own competitors combine to aid ghetto businesses should not be construed as a combination in restraint of trade in violation of section 1 of the Sherman Act, 15 U.S.C. § 1 (1964). "Unlike the typical object of antitrust attack, these are actions contrary to the pecuniary interests of the parties concerned and thus do not pose the dangers normally associated with collaboration among competitors." Turner, *The Scope of Antitrust and Other Economic Regulatory Policies*, 82 HARV. L. REV. 1207, 1210 (1969). Although Professor Turner (former Chief Counsel of the Justice Department Antitrust Division) directed this observation to the potentially anti-competitive relationship between competitors who engage in a joint venture to aid urban development, the same absence of pecuniary reward to X Corporation pervades the entire plan to aid inner city businesses, and this fact. combined with the social benefits produced, should be given great weight when subjecting the plan to scrutiny under the antitrust laws. Thus, although a long term contract whereby X Corporation agrees to buy all its requirements of a given product from a ghetto company might foreclose other sellers from selling to X Corporation, there would be no violation of section 3 of the Clayton Act, 15 U.S.C. 14 (1964), because of the public purpose which the contract serves. *See* Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320 (1961). Similarly, although the use of economic leverage by X Corporation to induce its other suppliers to buy from the ghetto concern has overtones of "reciprocity," there would be no violation of the Clayton Act since X Corporation receives no pecuniary benefit as a result of the reciprocal agreement or understanding. In any event, it is clear from the *Tampa* case and the express wording of the statute that there can be no violation of section 3 of the Clayton Act unless the plan to aid a ghetto business results in a "substantial" lessening of competition. Given the small size of the ghetto operations, it would appear that the potentially anticompetitive effects would not be sufficiently substantial to support a Clayton Act violation.

Nevertheless, even if the foreclosure effects of the exclusive dealing requirements contract or the application of economic leverage to induce X Corporation's other suppliers to buy from the ghetto company are not likely to substantially injure competition, these activities might constitute an "unfair trade practice" under Federal Trade Commission Act § 5, 15 U.S.C. § 45 (1964). In such case, X Corporation should be advised to seek an advisory opinion from the Federal Trade Commission. *See* discussion of FTC Act § 5 *infra*. Even though an agreement among X Corporation and its competitors to buy from and give preferential treatment to selected ghetto businesses has overtones of price fixing and market allocation, there would be no violation of the Sherman Act because the parties to the agreement or understanding receive no pecuniary benefit.

Section 2 of the Clayton Act, 15 U.S.C. § 13 (1964), prohibits price discrimination, and section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1964), prevents unfair trade practices and methods of competition. Conceivably, the plan to aid ghetto business might infringe the letter of these prohibitions, if X Corporation plans to sell

new corporation would also have preference on government contracts,[51] and in this respect recent legislation orders the SBA to sesure government contracts and subcontracts for small businesses receiving SBA loan funds. Aside from securing start-up capital and guaranteeing the new corporation a market for its production, X Corporation's real contribution would be in the form of specialized counseling advice on proper business techniques. Without expert guidance in such essential matters as marketing, accounting, and cost control, the new ghetto corporation would not be successful. Although the government can supply seed capital and provide an outlet for production, it does not have the necessary business expertise to give continuous advice and counsel on proper business methods.[52] It is in this essential area that private corporations can

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products to the ghetto operation on favorable terms. Recently, however, the Federal Trade Commission, which has broad powers under both statutes, has indicated that it will not attack plans to discriminate in favor of ghetto businesses. In an Advisory Opinion issued on May 25, 1968, Advisory Opinion Digest No. 253, 3 CCH TRADE REG. REP. ¶ 18,358, at 20,728 (1968), the FTC held that an apparel manufacturer's plan to give extended preferential credit terms to ghetto businesses owned by local residents would not infringe Clayton Act section 2, and would not constitute an unfair trade practice under FTC Act section 5. Implicit in the opinion is the recognition by the FTC that some anticompetitive effects may be a necessary quid pro quo for economic and social progress. *Cf.* Bank Merger Act of 1966, 12 U.S.C. § 1828(c) (Supp. 1969), which provides that a merger between banks having significant anticompetitive effects will not be held unlawful under Clayton Act § 7, 15 U.S.C. § 18 (1964), where the anticompetitive effects of the merger are "clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." *Id.* § 1828(c)(5)(B). However, the Commission's advisory opinion is predicated upon a finding that ghetto retailers did not compete with other clothing stores. Also, the FTC required that the manufacturer submit a report to the Commission one year after the date the plan to give discriminatory credit terms was initiated, indicating that it intends to keep such plans under scrutiny. Given the limited scope of the Advisory Opinion 253 and the FTC's retention of jurisdiction, X Corporation should be advised to seek FTC approval before embarking on a plan to sell to ghetto businesses on favorable terms which it does not offer to other customers.

[51] 42 U.S.C.A. § 2906(c)(A) (Supp. 1969); 15 U.S.C.A. § 637 (1964).

[52] Many of the corporations surveyed in the Cleveland area were supplying the services of executive personnel to a number of ghetto businesses, and several corporations had assigned executives to devote substantial amounts of company time to work on various urban development projects. One frequently asked question was whether the salaries paid to corporate personnel devoting such time to urban programs should be treated as business expenses for tax purposes or whether some other treatment is called for under the tax law.

Under *Code* section 162(a), every employer is entitled to an ordinary and necessary expense deduction for compensation paid to employees. The deduction is subject to two basic limitations: it must be reasonable in amount in light of the nature and extent of the services rendered, and the services must actually have been rendered *to the employer.* Treas. Regs. § 1.162-7 (1968). Assuming that the amount of compensation paid to executives who are loaned to ghetto businesses is reasonable, it must be determined whether the services are rendered "to the employer." Where the ghetto business is intended to become a supplier of goods or services, the loaning corporation has a genuine business interest in the success of the ghetto operation and the quality of its

make the greatest contribution toward vitalizing the inner city economy.[53]

Additionally, it should be noted that SBA has recently begun to actively seek the participation of individual private corporations in ghetto development efforts. The 1967 legislation authorizing the SBA to make EOL's provided the impetus for Project Own. Initiated in the summer of 1968, Project Own is an agency-wide program designed to encourage minority entrepreneurship in economically depressed areas.[54] The key feature of the program is the fact that SBA is actively seeking assistance from the private sector — from banks to provide financial assistance, and from industry to provide management and technical assistance to newly created ghetto businesses. To locate potential entrepreneurs in the ghetto,

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product or service. Thus, where the loaning corporation expects to enter into a business relationship with the ghetto company, executive counseling services rendered to the ghetto firm would result in a direct benefit to the loaning corporation and hence the services should be considered as rendered "to the employer." Where, however, there is no expectation that the loaning corporation will enter into a business relationship with the inner city business, the pecuniary benefit to the employer flowing from the donation of services becomes remote. It might be argued, however, that salaries paid to loaned executives in such a situation are in respect of past or future services and deductible on that basis. *Cf.* Ware Knitters v. United States, 168 F. Supp. 208 (Ct. Cl. 1968). To the extent that the loaning corporation's efforts to help ghetto entrepreneurs increase its public image, salaries paid to loaned executives might be treated as public relations expenses. Moreover, where the loaning corporation is situated close to the ghetto area such that it will benefit directly from the quieting effect that ghetto entrepreneurship will have on the potential for civil unrest, the salaries paid might be deductible as expenses for the protection of business operations.

As a practical matter, however, it is unlikely that the Revenue Service will attack the deduction where executives spend a few hours of company time per week assisting a ghetto entrepreneur. Where company personnel are spending substantial amounts of time aiding inner city businesses, it is probably necessary for the employer to show some expectation of financial benefit to stay within the theoretical limits of the compensation expense deduction. In view of the great social benefit to be derived from such assistance, it seems highly unlikely that the IRS will attack the deduction in either case. For a discussion of the deductibility of salaries paid to employees while they are working for a charitable development organization see note 93 *infra.*

[53] Negro businessmen are particularly in need of expert advice on business techniques. For many reasons, largely a result of the fact that the blacks have been excluded from the business world, they lack managerial skills and attitudes. For an analysis of these difficulties and some suggestions as to how they may be overcome, see McKersie, *supra* note 35, at 88.

In recent years, large corporations have experienced difficulty in recruiting top students from the prestigious colleges and universities. Increasingly, these socially conscious students have turned to more rewarding jobs in government or have gone into teaching. Therefore, one ancillary benefit of corporate involvement in urban development might be to change the image of a corporate career and make it more attractive to to better students.

[54] Much of the information concerning Project Own has been taken from an address by Bernard Kulik, SBA director for the City of Detroit, given before the Institute of Continuing Legal Education Conference on Inner City Businesses, Detroit, Michigan, March 21, 1969.

SBA has created "ME" (minority entrepreneurship) teams in 28 locations, primarily in large cities. These teams work closely with community organizations to find potential or existing small businessmen in ghetto areas. Once these are located, SBA acts as a catalyst for the participation of private institutions in getting a new business going or revitalizing an existing business. Since SBA funds for direct loans are limited, the agency uses its guarantee powers to secure loans from banks. Private equity investment in individual ghetto businesses can be as little as 1 percent, and this "equity" can be in the form of a loan if it is subordinated to the SBA financing. In addition to providing financing, the SBA has been recruiting private corporations to supply necessary management and technical advice to the ghetto businesses. Although Project Own is still in its infancy, it has met with some success. For the 6-month period ending in February, 1969, Project Own secured $1,755,446 in financial assistance for minority-owned businesses in Cleveland, Ohio.[55] By providing the organization to seek out and screen potential businessmen in ghetto areas, Project Own affords private industry a unique opportunity for meaningful involvement in community development programs.[56]

C. *Multilateral Aid to Independent Ghetto Businesses*

In large metropolitan areas, unilateral projects involving direct transfers of assets and counseling services to ghetto businesses by individual corporations acting independently may not be practical.[57] The magnitude and complexity of today's urban problems probably require a cooperative effort by a broad cross-section of industry. By pooling their capital resources and diversity of specialized talents, several corporations working together through a nonprofit intermediary investment or development corporation can mount a broad-based attack on urban problems. Such a cooperative program would allow the full participation of corporations too small to initiate independent development projects.

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[55] Cleveland Plain Dealer, March 30, 1969, § A, at 25, col. 1. The Cleveland effort has made use of SCORE (Service Corps of Retired Executives), an SBA sponsored program which draws upon the talents of retired businessmen to provide free (except for direct expenses) business advice to inner city companies.

[56] One largely undeveloped area for ghetto enterpreneurship is the establishment of franchised retail outlets and eating places in the inner city. National franchising companies operate with controlled buying procedures and have well-developed training and supervisory programs and thus are well suited to guide inexperienced minority group businessmen.

[57] The consensus among the corporations surveyed in the Cleveland area was that unilateral programs by single corporations would not be effective.

(i) Formation of a Section 502 Development Company.— An extremely effective vehicle for assisting ghetto businesses would be a nonprofit development corporation chartered under section 502 of the Small Business Investment Act of 1958.[58] Such a development company is an enterprise incorporated under state law, formed for the purpose of furthering the economic development of the community, having the authority to promote and assist the growth and development of small businesses in the area.[59] Although a development company may be organized either as a profit or a nonprofit enterprise,[60] private corporations contemplating the development corporation as a vehicle to channel capital into the ghetto would ordinarily prefer the nonprofit variety in order to secure additional tax benefits.[61]

To form such a development corporation, X and other area corporations would contribute cash to the development company which in turn would make loans, loan guarantees, and equity investments in ghetto businesses. Under section 502 of the 1958 Investment Company Act,[62] the development corporation would be eligible for SBA loans up to $350,000 to finance plant construction, conversion, or expansion, including the acquisition of land, for each specific "identifiable" ghetto businesses receiving assistance.[63] Although SBA money is not available for working capital under the section 502 program, the necessary operating funds could be provided from the development company's own resources or from local banks. In depressed areas, the development corporation could secure SBA financing for up to 90 percent of the amount required to finance each identifiable small business.[64]

The development corporation would act as a clearinghouse for essential technical assistance and advisory services, secure the participation of banks and other financial institutions, and help to arrange purchase contracts between participating corporations and the assisted ghetto businesses. The involvement of established businesses in the cooperative development effort would also stimulate the creation of new business opportunities for the inner city companies. Ultimately, the development corporation might divest its

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[58] 15 U.S.C.A. §§ 695-96 (1964).

[59] 13 C.F.R. § 108.2(d) (1969).

[60] *Id.*

[61] *See* notes 66-74 *supra* & accompanying text.

[62] 15 U.S.C.A. § 696 (1964).

[63] *Id.*; 13 C.F.R. § 108.502 (1969).

[64] 13 C.F.R. § 108.502-1(e) (1969).

equity holdings in various ghetto corporations in much the same manner as X Corporation proposed to spin-off its wholly-owned ghetto subsidiary through a charitable entity,[65] and thereby broaden community participation.

Organized exclusively for the purpose of promoting the economic and social stability of the community by encouraging minority and poverty group entrepreneurship, reducing unemployment, and facilitating community ownership of productive resources, the nonprofit development corporation would qualify for tax exemption under section 501(c)(4) of the *Internal Revenue Code*,[66] as a social welfare organization,[67] or under section 501(c)(6) as a business league or chamber of commerce.[68] Business contributions to the nonprofit development corporation exempt under either provision would be fully deductible as ordinary and necessary business expenses under section 162(a) of the *Internal Revenue Code*.[69]

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[65] *See* notes 21-34 *supra* & accompanying text.

[66] CODE § 501(c)(4). Section 501(c)(4) exempts from taxation organizations not organized for profit and operated exclusively for the promotion of social welfare. A social welfare organization is one "operated primarily for the purpose of bringing about civic betterments and social improvements." Treas. Regs. § 1.501(c)(4)-1(a)(2)(i) (1968).

[67] Rev. Rul. 67-294, 1967-2 CUM. BULL. 193; Rev. Rul. 64-187, 1964-1 CUM. BULL. 187; I.T. 3706, 1945-2 CUM. BULL. 87.

[68] CODE § 501(c)(6) exempts from taxation "business leagues and chambers of commerce, not organized for profit and no part of the net earnings of which inures to the benefit of private shareholders." The Rochester Business Opportunities Corporation (RBOC), a section 502 development company organized to assist inner city businesses in the Rochester, New York, area, is exempt under *Code* section 501(c)(6). Letter from Leonard S. Zartman, Legal Dep't, Eastman Kodak Co., to *Case Western Reserve Law Review*, Jan. 24, 1969. For a more detailed discussion of the RBOC, see notes 75-82 *infra* & accompanying text.

[69] Private industry has a vested business interest in the economic prosperity and civil tranquility of the community in which it is located. The presence of a vast slum in the inner city, characterized by substandard and dilapidated housing, high rates of crime, unemployment, and underemployment creates a volatile environment which is not conducive to efficient business operations. Thus, area corporations have a genuine business and interest in eliminating the underlying causes of poverty and the potential for civil unrest, and expenditures made in that direction are in the nature of business costs. A series of revenue rulings provides ample authority for the proposition that business contributions to a nonprofit investment corporation organized to eliminate unemployment and promote industrial development are deductible as ordinary and necessary business expenses.

In 1945, the Revenue Service ruled that business contributions to a post-war development fund, organized primarily to "'promote the economic, industrial, and agricultural welfare of M County so that opportunities for employment will be provided for returning men and women'" were fully deductible as ordinary and necessary business expenses. I.T. 3706, 1945-2 CUM. BULL. 87. After announcing the general rule that contributions to development organizations are deductible expenses where "the contribution is made for a bona fide business purpose and is reasonably calculated to further the business of the contributor," the Service stated: "It is the desire of the Bureau that its policy with respect to the treatment of such contributions be as liberal

Given the broad definition of charitable organization under the income tax law,[70] the nonprofit development corporation exempt under section 501(c)(4) might also qualify for exemption under section 501(c)(3) as a charitable corporation, in which case corporate contributions would be deductible under section 170(b)(2) as charitable contributions.[71] Under the latter section, annual corporate charitable contributions are limited to 5 percent of taxable income, but there is a 5-year carryover of unused deductions.[72] Ex-

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as possible, consistent with the statute." *Id.* Implicit in this broad statement of policy is the IRS's recognition that business expenditures which promote social welfare as well as selfish, profit-oriented interests are properly within the purview of "ordinary and necessary."

In 1964, the Service ruled that a nonprofit corporation formed to aid and promote the purposes of the Area Redevelopment Act, 42 U.S.C.A. § 2501 (1964), qualified for federal tax exemption under *Code* section 501(c)(4), and that business contributions to it were fully deductible as ordinary and necessary business expenses. Rev. Rul. 64-187, 1964-1 CUM. BULL. 187. The purpose of the Area Redevelopment Act is to "overcome unemployment and accompanying hardship and wasting of vital human resources" by facilitating the "financing of projects for the purchase and development of land, or facilities for industrial and commercial usage in areas that have substantial and persistent unemployment or underemployment and which have been designated as 'redevelopment areas' by the Secretary of Commerce." *Id.*

In Revenue Ruling 67-294, 1967-2 CUM. BULL. 193, a nonprofit organization created to make loans to business entities as an inducement to locate in an economically depressed area in order to alleviate unemployment was held exempt as a "social welfare" organization under *Code* section 501(c)(4). The ruling stated that "[b]y encouraging industry to settle in an economically depressed area, the organization is helping to alleviate unemployment and is being operated to bring about civic betterment and social improvement." *Id.* Although the Service did not address itself to the question of whether business contributions to the organization would be deductible business expenses, Revenue Ruling 67-294 specifically cites and follows Revenue Ruling 64-187, *supra*, where contributions to a similar organization were held deductible under *Code* section 162(a). It is clear from these authorities that business contributions to the proposed section 502 development company would be fully deductible.

[70] Treas. Regs. § 1.501(c)(3)-1(d)(2) defines charitable purpose to include "[r]elief of the poor and distressed or of the underprivileged; . . . lessening of the burdens of Government; and promotion of social welfare by organizations designed . . . to lessen neighborhood tensions . . . or . . . to combat community deterioration . . . ." Directly or indirectly, the proposed development corporation, by promoting community stability through investments in ghetto businesses, would accomplish all of the above charitable objectives outlined in the regulations. *See* notes 23-25 *supra* & accompanying text.

[71] A "social welfare" organization exempt under section 501(c)(4) will qualify for exemption as a charitable organization "if it falls within the definition of 'charitable' set forth in paragraph (d)(2) of § 1.501(c)(3)-1 and is not an 'action' organization as set forth in paragraph (c)(3) of § 1.501(c)(3)-1." Treas. Regs. § 1.501(c)(4)-1(a)(2) (1968). The development corporation would not be involved in politics or in attempts to influence legislation, and therefore would not be an "action" organization as defined in Treas. Regs. § 1.501(c)(3)-1(c)(3) (1968). Hence, it would qualify for charitable status under *Code* section 501(c)(3). *See* note 25 *supra.*

Since the commercial activities of loaning money to ghetto business and/or buying stock in such companies would be in furtherance of the development corporation's exempt purposes, such activity would not constitute an "unrelated trade or business." *See* Treas. Regs. § 1.501(c)(3)-1(e)(1) (1968).

[72] CODE § 170(b)(2).

emption under section 501(c)(3) would thus allow nonbusiness contributors a charitable deduction under section 170 and would also render the development corporation eligible to receive grants from large charitable foundations.[73] Of course, contributing corporations would be entitled to only one deduction for amounts contributed during the taxable year, and if the development corporation qualifies as a charitable organization, contributing companies would be forced to take a charitable deduction and could not take a business expense deduction.[74]

Under the leadership of Eastman Kodak Company, a section 502 development corporation known as the Rochester Business Opportunities Corporation (RBOC) has been formed by major businesses in Rochester, New York, for the purpose of assisting new and existing businesses owned and operated by minority group persons in the city's ghetto area.[75] The RBOC is organized as a nonprofit membership corporation with no stock issued, and is exempt from taxation under section 501(c)(6) as a business league.[76] Contributions to the RBOC have been held tax deductible as ordinary

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[73] For a discussion of recent contributions by the Ford Foundation to urban development projects in various cities, see note 79 *infra*. *See also* N.Y. Times, Sept. 29, 1968, at 1, col. 7.

[74] CODE § 162(b) provides that no deduction may be taken under section 162(a) for any contribution or gift which would be allowable as a deduction under section 170 (charitable deduction) were it not for the percentage limitations provided in section 170. In view of the percentage limitations placed on charitable contributions, it would appear that a non-charitable development corporation organized as a social welfare organization or a business league would provide a more expedient tax vehicle for channeling private business capital into the ghetto. The Rochester development program combines a tax exempt business league with a charitable foundation, and thereby maximizes tax benefits by taking advantage of both charitable and business expense deductions. *See* notes 76-82 *infra* & accompanying text.

[75] The RBOC, organized on January 26, 1968, represents the culmination of a long period of tension between the inner city community and big businesses in Rochester. The initial impetus for the creation of the RBOC came in the summer of 1964 when a riot focused the attention of the business sector on the ghetto conditions in the inner city. However, no immediate action was taken and tensions continued unabated until 1966 when Eastman Kodak Co. was forced into a confrontation with a militant group called FIGHT (Freedom, Integration, God, Honor, Today) over the company's job training and employment opportunities for minority groups. In the dialogue that developed, the militant group suggested that Kodak establish a plant in the inner city to be owned and operated by ghetto residents, patterned after Watts Manufacturing Company established in Los Angeles by Aerojet-General Company. *See* note 9 *supra*. Feeling that a broader base effort was necessary, Kodak formed its own community development corporation for the purpose of assisting independent businesses in the inner city area. Soon thereafter, the RBOC was established by Kodak in a cooperative effort with the Chamber of Commerce and various Rochester businesses. So far, 60 participating Rochester businesses have contributed $250,000 to the effort. U.S. CHAMBER OF COMMERCE, URBAN ACTION CLEARINGHOUSE, Case Study No. 6, 1 (1968).

[76] Zartman letter, *supra* note 68.

and necessary business expenses, apparently by a private ruling.[77] An affiliated organization known as the Rochester Opportunities Foundation, Inc. (ROF) is exempt from taxation under section 501 (c)(3) as a charitable corporation.[78] Since the ROF is organized exclusively for charitable purposes, contributions to it by private individuals are deductible as charitable contributions under section 170, and the ROF is eligible to receive grants from other large charitable foundations.[79] On the basis of a recent ruling,[80] the ROF may distribute its funds to the RBOC even though the latter is not a charitable organization so long as the ROF retains control over the funds contributed to insure that they are employed only for objectives consistent with its own exempt charitable purposes.[81] By combining a nonprofit development corporation with a charitable

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[77] U.S. CHAMBER OF COMMERCE, URBAN ACTION CLEARINGHOUSE, Case Study No. 6, 1 (1968).

[78] Zartman letter, *supra* note 68.

[79] Under Rev. Rule. 67-149, 1967-1 CUM. BULL. 133, charitable organizations exempt under *Code* section 501(c)(3) may make distributions to like organizations.

In recent months, large foundations have begun to contribute substantial amounts to urban development efforts. On March 26, 1969, Ford Foundation announced grants totaling $883,325 for bonding programs to enable minority building contractors to bid on construction jobs in Cleveland, New York, Boston, and Oakland, California. On the same day, Ford announced grants totaling $221,000 to support the business activities of two Philadelphia community groups headed by former gang leaders and a $100,000 credit guaranty for the use of Ebony Development Corporation of Baltimore. *See Ford Foundation News Release*, March 26, 1969, at 1, 6. The grant to Ebony Development Corporation will enable the corporation to borrow funds needed for purchase by black employees of 10 inner city supermarkets in Baltimore. With the help of the SBA and a large wholesale grocer, Ebony plans to combine the 10 supermarkets into a chain operation. *Id.* at 6.

In addition to the increased grants to development programs, major foundations have been reevaluating their investment portfolios in anticipation of making direct investments in ghetto companies. Ten major foundations, including Ford, Carnegie Corporation of New York, Rockefeller Brothers Fund, and the Taconic Foundation, are considering a joint investment effort. *See* N.Y. Times, Sept. 29, 1968, at 1, col. 7.

[80] Rev. Rul. 68-489, 1968-36 IRB at 15, represents a major step in the development of an effective tax vehicle for corporate involvement. It holds that a charitable organization exempt under *Code* section 501(c) (3) can make distributions to organizations which are not themselves exempt under that provision so long as the distributions are limited to specific projects that are in furtherance of the charitable organization's own exempt purposes, provided it retains control and discretion as to the use of the funds distributed and maintains records establishing that the funds are used for section 501 (c) (3) purposes.

[81] The crucial issue here is whether the activities of the development corporation — creating and assisting ghetto businesses — fall within the statutory meaning of "charitable." The activities of the RBOC with respect to the assistance rendered to inner city business are similar to the activities of a Detroit section 502 development corporation which has been held exempt under section 501(c)(3). *See* note 89 *infra* & accompanying text. Thus, there is no question that the activities of the RBOC fall within the definition of charitable provided in the regulations, and that contributions by the ROF to the RBOC for investment in inner city businesses are within the scope of ROF's charitable exemption.

foundation, the organizational structure of the Rochester corporate involvement program provides an effective tax vehicle utilizing both business and charitable deductions to shelter needed capital into the ghetto. Working closely with the SBA, the RBOC has made substantial progress toward vitalizing the inner city economy.[82]

(*ii*) *Charitable Investment Corporation.*— The racial disturbances that rocked the City of Detroit, Michigan, during the summer of 1967[83] prompted an intense reevaluation of the city's development program which theretofore had been considered one of the most progressive and racially attuned in the nation. Business and civic leaders combined to form the New Detroit Committee (NDC)[84] for the purpose of reassessing past programs and atti-

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[82] The organization of the RBOC is fully explicated in U.S. CHAMBER OF COMMERCE, URBAN ACTION CLEARINGHOUSE, Case Study No. 6, 1 (1968); *see also* Davis, *supra* note 50 at 104; McKersie, *supra* note 35, at 97-99. The efforts of the Rochester Business community have been praised in Congress. *See* Address by Rep. Horton, 113 CONG. REC. 34,156 (daily ed. Nov. 29, 1967).

Although the RBOC has assisted numerous small businesses in Rochester, the Fighton Project represents the first cooperative attempt by government and private industry to initiate a wholly Negro owned and operated large scale business enterprise. Fighton Manufacturing Corporation has been organized as a joint venture by Xerox Corporation and the militant Negro organization, FIGHT. The new corporation will manufacture electrical transformers and metal stampings, employ over 100 people, and is expected to have gross sales of $1 million annually. Xerox has agreed to provide technical advice including a full-time manufacturing expert and a financial analyst, and has also agreed to purchase $500,000 worth of products during each of Fighton's first 2 years. The project is supported by a $445,677 training grant from the Department of Labor. The RBOC will spend about $200,000 to buy and renovate a plant for lease to the new corporation and will encourage its other members to buy Fighton products. *See* N.Y. Times, June 21, 1968, at 24, col. 5. The Fighton project was announced by Rev. Franklin D.R. Florence, FIGHT leader, and the New York Times account of the announcement provides a glimpse into the type of involvement between diverse elements of society that is possible under such programs: "As Mr. Florence read his statement, a half dozen Xerox officials and other white businessmen in gray suits stood behind him in the sparsely furnished office, which is decorated with pictures of Stokely Carmichael, H. Rap Brown, Muhammed Ali and Che Guevara." *Id.*

The key to the RBOC's early success in securing the cooperation and participation of the black community has been the deep personal involvement of top-level community leaders in a genuine effort to help the disadvantaged help themselves. Such personal contact is essential to break the barriers of resentment and mutual distrust between the "establishment" and the black community so that meaningful progress (social as well as economic) can be made. By placing more gray suited corporate executives in more sparsely furnished offices, private industry can make a great contribution toward solving the urban crisis.

[83] *See generally* REPORT OF THE NAT'L ADVISORY COMM'N ON CIVIL DISORDERS 47-60 (1968).

[84] *See id.* at 84-85, for an account of the NDC's formation and early difficulties in securing the fiscal committment of state authorities. Initiated by the joint effort of the Mayor of Detroit and the Governor of Michigan, the NDC was envisioned as a central planning body for Detroit's revitalization after the 1967 riots. Although original membership ranged from key industrialists to leading black militants, the militant element resigned over a dispute concerning conditions attached to a $100,000 grant to a black organization. *Id.* at 84. Another set-back occurred in the fall of 1967 when the state leg-

tudes, toward the end of developing an effective new approach to the problems of race and poverty in the inner city. The Committee concluded that direct action in the form of intensified economic development was essential, and that to maximize community involvement, development programs should incorporate local planning organizations operated by inner city residents.

To implement the Committee's mandate for direct action, Detroit businessmen formed the Economic Development Corporation of Greater Detroit (EDC) in July, 1968.[85] Initial funding for the EDC was provided by a $1,450,000 grant from New Detroit, Inc., a charitable planning organization formed by major Detroit corporations.[86] Organized as a Michigan nonprofit membership corporation, the broad policy objective of the EDC is to channel the resources of the white business community (capital, business expertise, and buying power) to black, community-based planning groups which in turn will invest these resources in the ghetto community to effect the maximum reduction in unemployment, neighborhood tensions, and community deterioration. In October, 1968, the EDC was held exempt from taxation under section 501(c)(3) of the *Internal Revenue Code* as a charitable organization,[87] and in January 1969, the scope of the EDC's charitable activities was extended to include the making of loans at below market interest rates and without conventional collateral requirements to independent ghetto businesses that are "owned or controlled by residents of those areas who are members of minority or poverty groups."[88]

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islature refused to pass the NDC's open housing proposal and turned down a request for increased state aid to Detroit schools. *Id.*

Confronted with these disaffections, private industry has assumed increasing responsibility for the overall development effort. In 1968, area businessmen organized and contributed $12 million to New Detroit, Inc., a nonprofit charitable corporation designed to resume the broad planning activities initiated by the NDC. Operating through specialized development organizations, New Detroit, Inc. has allocated approximately $6 million to housing construction and rehabilitation and $1,450,000 to aid ghetto businesses.

[85] Much of the information concerning the organization and operation of the EDC is taken from an address by Mr. Michael C. Weston, EDC Secretary and Treasurer, given before the Institute of Continuing Legal Education conference on Inner City Businesses, Detroit, Michigan, March 21, 1969.

[86] *See* note 84 *supra.* New Detroit, Inc. has been held exempt from federal income taxation as a charitable corporation under *Code* section 501(c)(3). Corporate contributions are deductible under *Code* section 170(b)(1)(2).

[87] The IRS determination letter was issued to the EDC on Oct. 10, 1968.

[88] By the terms of the expanded determination of exempt status issued on January 29, 1969, the EDC may make loans, called "soft" loans, to "corporate or other businesses which are indigenous to the disadvantaged areas of the greater Detroit community in the sense that they are owned or controlled by residents of those areas who are members of minority or poverty groups." These loans or loan guarantees are made where funds

The organizational structure of the EDC evidences the deep involvement of the Detroit business community. The Board of Directors is composed of 51 of the city's business leaders and the organization operates through a 17-man executive committee employing a four-man full-time staff. Within this organizational framework, requests for assistance are processed so as to effect a maximum degree of interaction between business leaders, ghetto planning groups, and ultimately individual inner city businessmen. The EDC's most distinctive operating feature is that potential recipients are located not by white intrusion into the ghetto, but through various community operated planning groups. Requests for assistance from individual ghetto businessmen are referred to a black planning group, such as the Inner City Business Improvement Forum (ICBIF), a local development corporation chartered under section 502 of the Small Business Investment Act of 1958.[89] The planning group proceeds to evaluate the prospective recipient to determine the amount of financial assistance needed and the nature of business counseling services which will be necessary to insure the success of the business venture. Financial assistance, which can take the form of a grant, low interest loan, loan guaranty, or equity investment, does not come directly from the EDC, but rather from the local planning group operating as a nonprofit loan or investment company which is partially funded by the EDC.[90] Once the planning group has secured the requisite financing, it requests the EDC to provide specific technical advice on business matters directly to the ghetto businessman. The EDC then contacts member firms for personnel who will provide the requested assistance. Moreover, as part of the comprehensive effort to finance and counsel independently owned ghetto businesses, the EDC has requested member corpora-

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are not obtainable from conventional financial sources, and are available at below market interest rates and without normal security or collateral requirements. The purpose of such soft loans is to encourage the establishment of viable businesses in the inner city area, thereby accomplishing the charitable purposes of reducing unemployment, lessening neighborhood tensions, and preventing community deterioration. *See* notes 23-28 *supra* & accompanying text. Although there are no limits on the interest rates which may be charged on soft loans or on the income levels of the businesses receiving assistance, the EDC is required by the IRS to keep adequate records to substantiate that any disbursements made have been to corporations owned or controlled by inner city residents.

[89] The ICBIF is itself exempt from taxation under *Code* section 501(c)(3). Telephone conversation with Mr. Lawrence P. Doss, ICBIF President, April 28, 1969.

[90] Since a planning group, such as the ICBIF, is chartered as a section 502 local development corporation, it is eligible for substantial financial assistance from SBA. *See* notes 62-64 *supra* & accompanying text. The availability of SBA financing for the planning group allows the EDC to extract maximum leverage from its own funds.

tions to review their purchasing policies to determine whether present requirements can be supplied by inner city businesses.

The Detroit corporate involvement program provides a dramatic illustration of the effectiveness of the charitable corporation as a vehicle to channel corporate money, expertise, and buying power into the inner city economy. Operating through various community sponsored organizations, the charitable investment corporation can, while securing maximum SBA participation, cause meaningful interaction between the white and black business communities without the undesirable overtones of white paternalism.

In Cleveland, local corporations have pledged a total of $11 million to *Cleveland: Now*!, a comprehensive inner city development effort initiated by Cleveland Mayor Carl B. Stokes.[91] A total of $500,000 of *Cleveland: Now!* funds has been allocated to the Greater Cleveland Growth Corporation for the development of inner city businesses. The Growth Corporation works closely with SBA, and especially with SBA Project Own, in making loans to ghetto entrepreneurs. As of February, 1969, *Cleveland: Now!* had actually collected $4,042,304, only $57,450 of which has been spent on small business opportunities.[92] Of the $4 million plus of *Cleveland: Now!* funds already collected, $300,000 represents the value of professional services and assistance given by business and industry.[93] Although the Cleveland organization to aid independent ghetto businesses has some structural weaknesses which may in

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[91] *Cleveland: Now*! is exempt from federal taxation under section 501(c)(3), and contributions are deductible under section 170 of the *Internal Revenue Code.*

[92] Cleveland Plain Dealer, Feb. 26, 1969, at 1, col. 3.

[93] *Id.* An interesting tax question concerns the deductibility of the $300,000 in professional services provided *Cleveland: Now!* by local business and industry. Under the regulations, no charitable deduction may be taken for the value of services donated to a charitable organization. *See* Treas. Regs. § 1.170-2(a) (2) (1968). The statutory basis for the treasury's position is that *Code* section 170(a)(1) requires an actual "payment" to a charity, and the IRS takes the position that services do not constitute a "payment." *See* B. BITTKER, FEDERAL INCOME ESTATE AND GIFT TAXATION 174 (1964). Logically, the next question is whether the corporations donating the services of their top executives to a charity can continue to deduct, as compensation expenses under *Code* section 162(a), all salaries paid to employees who spend company time working on charitable development projects. Although there appears to be no authority on this question, there would seem to be no reason for denying the compensation deduction. To the extent that the employer retains control over the employee's activities, the services rendered to the charity are performed "for the employer." In its business discretion, the employer may decide that the corporation will gain a substantial public relations benefit from involving its employees in charitable activity. Where the charitable activity is community development that will ultimately improve the inner city business climate, the corporation will receive a direct benefit from the charitable activities of its employees. The cumulative effect of these corporate benefits flowing from the charitable activities of its employees should be sufficient to justify the compensation expense deduction.

part account for the fact that only a fraction of its resources have been put to use,[94] the program serves as another illustration of how a charitable entity can be established to involve the resources of private corporations in a concerted effort to rejuvenate the inner city economy.

(iii) Small Business Investment Company.— There is yet another vehicle which could be formed for the purpose of channeling private corporate capital into ghetto businesses: a Small Business Investment Company (SBIC) under the Small Business Investment Act of 1958.[95] An SBIC is a private corporation chartered under state law and licensed by the SBA for the express purpose of supplying venture capital and long term financing to small business concerns.[96] Initial minimum private investment required for formation of an SBIC can be as little as $150,000, and the SBIC would be eligible for loans from the SBA aggregating $300,000.[97] Na-

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[94] The pledge of $11 million, as well as the services of key personnel donated to *Cleveland: Now!* by area corporations evidences local industry's concern for the inner city. Unfortunately, however, the Cleveland Growth Corporation which actually disperses funds to ghetto businesses lacks the comprehensive structure of the Detroit development effort whereby private industry has been involved in the process by which money is allocated to community sponsored planning groups acting as a liaison between the white corporate establishment and the black ghetto community. Without the black planning group to act as an intermediary, greater difficulties will occur in the sensitive areas of screening potential recipients and policing loans once they are made. These added problems may cause the dispensing organization to be overly conservative in its screening process.

Unlike the Detroit Economic Development Corporation the Cleveland Growth Corporation has not brought major Cleveland corporations together in a common development effort to aid inner city businesses, and thus has not fully utilized private industry as a source of managerial expertise and economic buying power. Another drawback is the fact that the growth corporation has confined itself to loaning money, and has not become a source of much-needed equity capital. In this respect it should be noted that profits earned by a charitable corporation on equity investments in ghetto corporations would not jeopardize the organization's exempt status where such profits are reinvested in furtherance of its exempt purposes. *See* notes 26-27 *supra* & accompanying text. The charitable corporation could also sell the shares which it acquires to local residents since such activity would further the charitable purposes of reducing neighborhood tensions and preventing community deterioration by promoting local ownership and control of the community's productive resources. *See* notes 25-26 *supra* & accompanying text. For a discussion of the relative superiority of risk capital investments in ghetto businesses, see text accompanying note 106 *infra.*

[95] 15 U.S.C.A. §§ 681-87 (1964). Relevant SBA regulations are contained in 13 C.F.R. §§ 107.1-.1411 (1969).

[96] 15 U.S.C.A. §§ 681, 685 (1964). A "small business concern" is generally defined as a business "which is independently owned and operated and which is not dominant in its field of operation." *Id.* § 632; 13 C.F.R. § 121.3(a) (1969).

[97] Under 15 U.S.C.A. § 683 (1964), an SBIC is required to have a *total* initial paid-in capital and surplus of $300,000. However, section 682 authorizes the SBA to purchase the SBIC's subordinated debentures in an amount equal to the paid-in capital and surplus from private sources; and this amount is included in the SBIC's total paid-in capital and surplus. Thus, with $150,000 in capital from private sources and

tional banks, federal reserve member banks, and state banks insured by the Federal Deposit and Insurance Corporation are authorized to purchase SBIC shares in an amount equal to 5 percent of the bank's capital and surplus.[98] The SBIC itself is authorized not only to make long term loans to selected small business concerns in the ghetto area,[99] but also to purchase stock[100] or debt securities[101] issued by those concerns. In addition to supplying capital to inner city businesses, the SBIC could provide essential consulting and advisory services.[102]

As part of a comprehensive plan to facilitate the flow of capital to small businesses, Congress has provided several income tax incentives for investing in SBIC's. For example, dividends paid to an SBIC by small businesses are subject to 100 percent dividends received deduction.[103] In order to partially compensate for the greater risk that may be involved with investments in an SBIC, Congress has also provided that any loss on the sale of SBIC stock shall be treated as an ordinary loss, fully deductible from taxable income, while any gain on the sale of SBIC stock is treated as capital gain, taxable at a maximum rate of 25 percent.[104] The SBIC itself gets similar tax treatment with respect to any losses sustained on convertible debentures issued by small business concerns.[105]

The SBIC can play a vital role in development of the inner city

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$150,000 in SBA subordinated debentures, the SBIC would have the statutory $300,000 total paid-in capital and surplus. Once formed, the SBIC may borrow money from the SBA for *operating* purposes in an amount equal to 50 percent of its *total* paid-in capital and surplus. 15 U.S.C.A. § 683(b) (1964).

With $150,000 in private capital and $150,000 in SBA subordinated debentures, the SBIC may borrow another $150,000 for operating purposes. With greater amounts of private capital contribution, an SBIC can receive more SBA funds up to a maximum of $7,500,000. *Id.*

[98] 15 U.S.C.A. § 682(b) (Supp. 1969).

[99] 13 C.F.R. § 107.301 (1969). An SBIC may not make loans for a period of less than 5 years' duration, *id.* § 107.301(a), or for a period longer than 20 years, except that loans may be renewed for an additional 10 years. *Id.* § 107.602(d). An SBIC may make short term loans of less than 5 years' duration only where necessary to protect previous investments. *Id.* § 107.301(d).

[100] *Id.* § 107.301(b)(1). Without SBA approval, an SBIC may not obtain voting control of the small businesses in which it invests. *Id.* § 107.901(b), except where necessary to protect its investments. *Id.*

[101] *Id.* § 107.302, which defines equity security to include convertible debt securities. The SBIC is intended to function as a source of equity venture capital, and not as a banking institution. Thus, the relevant SBA regulations foster equity investments.

[102] *Id.* § 107.601. An SBIC is authorized to form a subsidiary corporation for management consulting services. *Id.* § 107.602.

[103] CODE § 243(a)(2).

[104] CODE §§ 1242, 172; Treas. Regs. § 1.1242-1 (1968).

[105] CODE § 1243.

economy. With emphasis on equity participation, the success of the SBIC as a profit-making venture is intimately tied to the success of the ghetto corporations in which it invests, giving the SBIC a vested interest in the profits and growth of the inner city companies. Since the SBIC is oriented toward profits and growth rather than security of principal, it should enjoy a more amicable relationship with the ghetto companies than would exist in the normal debtor-creditor situation. This mutuality of interest between the SBIC and the ghetto companies would facilitate a freer flow of ideas on a business-like basis without the stigma of the handout. Without the constant burden of interest payments, the ghetto companies would have more freedom of action in the crucial early years of operation. Finally, an SBIC can also function as that much needed vehicle through which to promote stock ownership among inner city residents. Two recently-formed SBIC's, Accord in Detroit and Business's Development Corporation in Philadelphia, have sold stock to inner city residents at low prices and are reinvesting the proceeds in newly created ghetto companies.[106]

There are numerous organizational vehicles available for private corporations to engage in assistance to ghetto businesses. The most attractive approach would be a cooperative effort between several corporations utilizing one of the above-mentioned programs. Through either the establishment of an SBIC, a charitable investment corporation, a section 502 development company, or a combination of these devices, corporate capital can be effectively channeled into the inner city for the promotion and development of independently owned and operated ghetto businesses.

D. *Proposed Federal Legislation Offering Special Tax Incentives for Private Investment in Ghetto Businesses — The Community Self Determination Act of 1968*

Under all of the corporate involvement programs proposed thus far, the only tax advantage available to companies participating in programs designed to aid inner city businesses is in the form of a tax deduction for amounts contributed.[107] As previously noted, however, the availability of a tax deduction for corporate expenditures on ghetto projects, although helpful, is probably not sufficiently at-

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[106] *See* McKersie, *supra* note 35, at 95.

[107] The deduction may take the form of a business expense deduction, or a charitable deduction, depending upon the nature of the donee organization. *See* notes 66-73, 87-88 *supra* & accompanying text.

tractive to induce the large-scale commitment necessary to make real progress toward solutions to the urban crisis.[108] Since a corporation's income is presently taxed at a maximum rate of about 52 percent, the deduction means that the government supplies only 52 cents of each corporate dollar spent in the ghetto — the other 48 cents comes out of corporate earnings that would otherwise be available for distribution to shareholders or for other internal corporate purposes. Although the 48 cents coming out of the corporate treasury will eventually return to the corporation and its shareholders in the form of a social dividend, cash flow is reduced by 48 percent of the expenditure with no expectation of an immediate monetary return.

In view of the relatively limited attractiveness of the tax deduction from a financial point of view, proponents of corporate involvement have called for the institution of tax credits and other more direct tax incentives that will enable corporate investments in ghetto businesses to generate an immediate financial return. It is generally assumed that the prospect of an immediate dollar return which is competitive with alternative investment opportunities will provide a more powerful inducement to profit oriented private industry than appeals to the corporate conscience.[109] Although the idea of involving private corporations in the high risk, high cost area of ghetto enterprise through a system of indirect government subsidies is not without its skeptics,[110] the movement has continued

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108 *See* note 34 *supra* & accompanying text for a discussion of the potential value of the charitable deduction incident to the contribution of low basis property to a ghetto project.

109 During the presidential campaign of 1968, both candidates endorsed using the tax law to encourage businesses to locate plants in poverty areas. As a candidate, President Nixon stated that "[t]ax incentives — whether direct credits, accelerated depreciation or a combination of the two — should be provided to those businesses that locate branch offices or new plants in poverty areas . . . ." He also approved "tax incentives to corporations which hire and train the unskilled and upgrade the skills of those at the bottom of the employment ladder." RESEARCH INST. OF AM., TAX COORDINATOR BI-WEEKLY ALERT at 1 (Sept. 26, 1968). *See also* REP. OF THE JOINT ECONOMIC COMM. EMPLOYMENT AND MANPOWER PROBLEMS IN THE CITIES: IMPLICATIONS OF THE REP. ON THE NAT'L ADVISORY COMMISSION ON CIVIL DISORDERS, S. Rep. No. 1568 90th Cong., 2d Sess. 8-9 (1968), where the role of tax incentives is discussed.

110 Michael Harrington has warned that the "economics of free enterprise make it unlikely that the entrepreneurs — even with tax incentives and subsidies — are really going to involve themselves in the high risk problems of the poor." Harrington, The Urgent Case for Social Investment, *Saturday Rev.* Nov. 23, 1968, at 32. *See also* Harrington, The Social Industrial Complex, *Harper's Magazine*, Nov. 1967, at 55. Former Assistant Treasury Secretary Stanley S. Surrey has repeatedly argued against special tax credits and incentives for non-revenue purposes, reasoning that their cost, in terms of foregone federal revenues, greatly exceeds the cost of direct federal expenditures. Address by Secretary Surrey, Fifth Annual Development Forum Urban America, Inc.,

to gain momentum.[111]

Inspired by Xerox Corporation's Fighton project in Rochester,

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Oct. 28, 1968. *See* Wall St. J., Oct. 29, 1968, at 7, col. 3. Senator Long, chairman of the Senate Finance Committee has also spoken against the use of tax incentives to involve the business community in urban redevelopment. *See* RESEARCH INST. OF AM., TAX COORDINATOR BI-WEEKLY ALERT, *supra* note 109. Indeed, some businessmen have recently exhibited a certain ambivalence toward the desirability of tax incentives. *See* Demaree, *What Business Wants from President Nixon*, FORTUNE, Feb. 1969, at 84.

111 Once the policy decision has been made to involve private industry in the war on poverty, the crucial issue becomes whether the inducement for action will take the form of direct government subsidies, or indirect subsidies through tax incentives. In principle, the Treasury Department has consistently opposed the tax inducements. The Treasury's basic arguments are: (1) the cumulative effect of a system of special credits and deductions to achieve specific social goals would lead to an erosion of the tax base because when such programs exist the rate of taxation becomes dependent upon the source of income, and corporations with equal incomes will be taxed at unequal rates; (2) the effectiveness of a tax incentive program in achieving the desired social goal is difficult to evaluate since there is no effective way to measure the cost of such programs in terms of foregone tax revenues; (3) tax incentive programs are impossible to control since the tax benefits remain in effect long after the social objective has been accomplished. *See* Note, *Government Programs to Encourage Private Investment in Low-Income Housing*, 81 HARV. L. REV. 1295, 1310 (1968). The Treasury Department's specific objections to tax incentives are contained in *Hearings on S. 2100 Before the Senate Comm. on Finance*, 90th Cong., 1st Sess. 148, cited in Note, *supra*. However logical the treasury's arguments, they ignore the fact that the present tax structure is full of special social goals. As pointed out by the late Senator Robert Kennedy:

> The concept of government incentives to induce desired investments by private industy is neither new nor radical.
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> . . . .
>
> We have used the tax laws as a means of persuading private citizens and enterprises to invest in desired ways at desired times, and in desired locations. To encourage long-term investment, we tax capital gains at a ceiling of twenty-five percent. To encourage charitable contributions, we allow them to be deducted from current income. To encourage oil and mineral production, we offer depletion allowances. To encourage the building of grain storage facilities and defense plants, we have offered faster-than-normal depreciation rates. To encourage investment in capital goods, as opposed to inventory or consumption, we have allowed tax credits for such investment; suspended that credit when we wished to slow investment down; and reinstated it in order to speed investment up again. R. KENNEDY, TO SEEK A NEWER WORLD 42-43 (1967).

It is evident that the tax law is, and has always been, a positive instrument of social policy and not merely a revenue device. *See* Symposium, *Federal Taxation as an Instrument of Social and Economic Policy*, 20 U. FLA. L. REV. 431 (1968). The concept of using tax incentives in the form of tax credits and rapid depreciation allowances to induce companies to establish plants in ghetto areas resembles most closely the use of similar tax devices to encourage investment in underdeveloped countries. *See* Hellawell, *United States Income Taxation and Less Developed Countries: A Critical Appraisal*, 66 COLUM. L. REV. 1393 (1966). The economic development of Puerto Rico through "Operation Bootstrap," has been facilitated by a system of tax exemptions "carefully protected by our own Internal Revenue Code." R. KENNEDY, *supra*. Surely, if tax incentives are appropriate to encourage the economic development of foreign countries, they are just as appropriate to encourage investment in underdeveloped urban areas within this country.

Notwithstanding the treasury's opposition, the 90th Congress did pass Title IX of the Housing and Urban Development Act of 1968, P. L. 90-448, 82 Stat. 476 (1968), creating a tax oriented mechanism designed to increase the return to private capital in-

New York,[112] by successful self-help programs in Crawfordville, Georgia and the Bedford-Stuyvesant section of New York City,[113] and by the growing disinchantment with conventional poverty programs, legislation was introduced in Congress in July of 1968 containing sweeping tax incentives for private industry to invest in ghetto businesses as part of a radically new approach to solving the crisis in the cities as well as the poverty problems in rural areas. The new bill, known as the Community Self-Determination Act of 1968,[114] would create a comprehensive program designed to involve private industry in a partnership with government for the purpose of helping the poor "achieve gainful employment and the ownership and control of the resources of their community, including businesses, housing, and financial institutions."[115] The proposed incentives for corporate involvement are embodied in six major amendment to the *Internal Revenue Code* which, through a system of tax credits and exemptions, rapid amortization, and nonrecognition provisions, would overcome the high costs of operating a plant in a poverty area and

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vested in low income housing. *See* Gabinet & Coffey, *Housing Partnerships: Shelters from Taxes and Shelters for People*, 20 CASE W. RES. L. REV. 723 (1969) (this issue). Bipartisan legislation now in Congress would amend the *Internal Revenue Code* in six major respects offering a broad spectrum of tax benefits to industrial corporations which become involved with the creation and operation of new businesses in ghetto areas. *See* notes 119-127 *infra* & accompanying text.

[112] *See* note 82 *supra.*

[113] Crawford Enterprises is a community-owned, cooperatively operated factory in Crawfordville, Georgia. Formed by a rural economist with the aid of the Southern Christian Leadership Conference, the factory has been sufficiently profitable to enable it to take steps toward the acquisition of local housing facilities and commercial establishments. *See* A. TOBIER, COOPERATIVE COMMUNITIES NORTH AND SOUTH: A RESPONSE TO POVERTY, reprinted in 114 CONG. REC. 9271 (daily ed. July 24, 1968) (introduction to S. 3876, 90th Cong. 2d Sess. 1968). A somewhat less successful effort toward community ownership was begun by the late Senator Kennedy in the Bedford-Stuyvesant section of New York. *Id.*

[114] S. 3876, 90th Cong., 2d Sess. (1968) [hereinafter cited as S. 3876]. S. 3876 is the Republican version of the bill introduced by Senator Percy on July 24, 1968. An identical bill, S. 3875, backed by the Democratic Party was introduced by Senator Nelson on the same day. *See also* H.R. 18715, 90th Cong., 2d Sess. (1968). The bill is presently undergoing refinement by its major co-sponsors pending reintroduction in the 91st. Congress. Letter from Senator Percy to CASE W. RES. L. REV., April 17, 1969.

[115] S. 3876, at § 2(c). Concluding that "[h]andouts are demeaning," and that past programs and policies which "tax some to support others offer no hope and no opportunity to those who have the capacity to become productive, contributing citizens," the bill finds that:

> [T]he private enterprise system and the independent sector should be offered new incentives to join with the people of a community in a partnership for individual and community improvement, especially in providing technical and managerial expertise, offering training for job with a future, providing investment capital, and building productive plants and facilities for sale to members of the community. *Id.* §§ 2(b), (e).

provide a positive dollar return to the participating corporation. Ultimately, the facilities established by private corporations would be sold to community-owned and operated development corporations which would use the profits from these operations to provide essential social services to the community, thereby "reducing the burden of taxation on the rest of society."[116] In order to fully understand the operation of the various tax devices, a brief description of the bill's major nontax features is necessary.

The first step in implementing the proposed program would be formation of a National Community Development Corporation Certification Board, an independent federal agency, which would oversee the formation of local Community Development Corporations (CDC's) in various poverty areas both in the inner city and in depressed rural areas. To obtain its charter, a CDC would have to organize in the community by securing the approval of at least 10 percent of the residents who agree to buy at least one share of $5 par value stock in the CDC. A minimum of 500 community residents 16 years of age or older would be required to pledge a total of at least $5,000 before the CDC can receive a provisional charter from Washington. The permissible size of the community could vary from 3000 to 300,000 residents. To be eligible to form a CDC, the community must have a "development index" of less than 90, which in general means that the community must have a level of affluence, measured in terms of area unemployment or median family income, no greater than nine-tenths the national level.[117] Ultimately, a majority of the community residents would have to approve formation of the CDC before the corporation could receive a permanent charter. Once chartered, the CDC would then be eligible to receive loans and other assistance from a local community development bank which in turn would be eligible for assistance from a National Development Bank funded by the issuance of debentures guaranteed by the federal government. Residents of the community would elect a board of directors and the directors appoint a Business Management Board which would have primary operational control over the CDC's investment and community service activities. Thus, the CDC becomes the instrument through

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[116] *Id.* § 2(e).

[117] *Id.* § 138. The development index is a key feature of the bill. The tax incentives to private corporations are geared to the index — as the index rises with the increase in community affluence, the tax benefits become less attractive. *See* note 120 *infra* & accompanying text.

which local residents will ultimately acquire ownership and control of the resources of the community.[118]

Private industry enters the picture by entering into "turnkey" contracts with a CDC whereby a private corporation would agree to construct a productive facility in the poverty area, operate it for several years, and then sell it to the CDC when the facility becomes economically self-sustaining. During the period in which the turnkey facility is operated by a private corporation, the corporation would receive substantial tax benefits.

(1) Amortization.— Assume that X Corporation enters into a turnkey contract with a local CDC to construct a manufacturing plant in the ghetto, operate it for 5 years or until the plant shows a net after-tax profit of *Y* dollars for 2 consecutive years, whichever occurs first. Assume further that X Corporation constructs a new facility at a total cost of $1 million. Under section 304 of the new bill, X Corporation could elect to amortize its entire investment in the facility, including the cost of land, over a relatively short period.[119] The time period over which X Corporation may amortize its turnkey investment is determined by the development index of the local community.[120] In a community with a development index

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118 The rather elaborate procedure for the formation and operation of a CDC is set out more fully in the introductory remarks by Senators Nelson and Percy, 114 CONG. REC. 9270 (daily ed. July 24, 1968) introduction to S.3876, 90th Cong., 2d Sess. *See also* Note, *Community Development Corporation: a New Approach to the Poverty Problem*, 82 HARV. L. REV. 644 (1969). The bill has been severely criticized on the ground that CDC's would perpetuate the economic isolation of the ghetto. *See* Sturdivant, *The Limits of Black Capitalism*, HARV. BUS. REV., Jan.-Feb. 1969, at 122. Andrew J. Biemiller, AFL-CIO legislative director and a former Congressman, has also spoken out against the bill. Cleveland Plain Dealer, Feb. 23, 1968, at 20, col. 1.

119 S. 3876 § 304. The amortization deduction is in lieu of the normal depreciation deduction allowable under present *Code* section 167. However, a taxpayer having elected amortization could at anytime thereafter elect to discontinue amortization and pick up regular section 167 depreciation, but cannot use any method of accelerated depreciation. *Id.* at § 304(c).

120 S. 3876, at § 304. As defined in section 138, the development index is equal to the ratio of the national percentage rate of unemployment to the rate of unemployment in the poverty area *or* the ratio of the median family income in the poverty area to the national family median income, whichever ratio, expressed as a whole number, is lower. As the development index rises from less than 80 toward the national norm of 100, the period over which X Corporation could amortize its investment *increases* from 36 to 60 months. The higher the level of community affluence, the longer it would take to recover the investment. Once the development index attains 100, or the national average, amortization would no longer be allowed, and a major incentive for investing in turnkey facilities would disappear. Thus, by gearing rapid recovery of total investment to the level of community affluence, the bill incorporates a mechanism whereby the tax benefits to private industry are automatically phased out as the need for corporate involvement disappears. This feature of the bill should dispel the fears of opponents who argue that tax benefits, once adopted, will remain available long after the social objective has been accomplished. *See* note 110 *supra*. The bill has other

of less than 80, X Corporation could recover its entire investment in 3 years.

(2) Human Investment Credit.— Section 306 of the bill amends the *Internal Revenue Code* by adding section 41 providing for a tax credit equal to 10 percent of the wages and salaries paid to employees of the turnkey facility who are drawn from the poverty area and who are also CDC shareholders. The 10 percent human investment credit is in addition to the 7 percent credit presently available on investments in machinery.[121]

When X Corporation sells the turnkey facility to the CDC, it would receive the following tax benefits:

(1) No Recapture of Investment Credits.— Normally when a taxpayer sells property on which it has taken an investment credit, there will be some recapture of the previous credit.[122] Under section 305 of the new bill, however, there would be no recapture of the credit upon a sale to a CDC.

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built-in safeguards and self-effectuating controls which tend to eliminate the arguments against tax incentives raised by the Treasury. *See Id.* Section 306 would give the Secretary of the Treasury review power over every turnkey contract, and no such contract can become effective for tax purposes without his approval. Section 311 gives the IRS the power to require information returns from turnkey contractors. Such information will enable the Treasury to assess the cost of turnkey contracts in terms of foregone tax revenues, thereby providing a basis upon which to evaluate the effectiveness of the program.

[121] S. 3876, at § 306. The 10 percent human investment credit is analogous to the 7 percent tax credit for investment in machinery presently allowed under section 38 of the *Internal Revenue Code.* The higher rate of the credit for human investment is "due to the impermanence of the investment in human skills." 114 CONG. REC. 9283 (daily ed. July 24, 1968) (remarks by Senator Percy). The amount of the human investment credit cannot exceed "(A) so much of the liability for tax for the taxable year as does not exceed $25,000, plus (B) 50 percent of so much of the liability for tax for the taxable year as exceeds $25,000." *Id.* Thus, X Corporation would have to pay tax on at least $25,000 of income before it could receive a credit for wages paid, and the credit could not exceed half of the tax on X's income over $25,000. There would be, however, a 3-year carryback and a 7-year carryover for unused human investment credits. *Id.*

The idea of an income tax credit based on wages paid to employees drawn from poverty areas originated with the Urban Employment Opportunities Development Act of 1967, S. 2088, 90th Cong., 1st Sess. (1967), introduced by the late Senator Kennedy on July 12, 1967. The Kennedy bill provided for a tax credit equal to 25 percent of the wages paid to low income individuals. Other tax incentives contained in the bill included: (1) a 10 percent investment credit on machinery instead of the usual 7 percent; (2) a 7 percent credit on costs of construction or leasing of facilities; (3) a 3-year carryback and 10-year carryover of unused credits; (4) a useful life, for purposes of depreciation, equal to two-thirds of the normal useful life applicable to real and personal property; and (5) a net operating loss carryover of 10 years. *See* R. KENNEDY, *supra* note 111, at 44. The impact of the Kennedy bill is analyzed in Garrity, *Red Ink for Ghetto Industries?*, HARV. BUS. REV. May-June, 1968, at 16.

[122] *See* CODE § 47(a). Under S. 3876, there would be no recapture of investment credit provided the CDC did not dispose of the facility within 1 year after the sale.

(2) Nonrecognition of Gain.— Section 307 provides that upon the sale of a turnkey facility to a CDC, gain shall be recognized only to the extent that the gain exceeds the taxpayer's holdings of Class B stock issued by a Community Development Bank (CDB).[123] Thus, by reinvesting the proceeds from the sale of a turnkey facility in a new facility or in CDB stock, X Corporation could postpone recognition of its capital gains.

(3) No Recapture of Amortization.— If X Corporation were to sell the turnkey facility to someone other than a CDC, it could expect to experience recapture of the tax benefits derived from rapid amortization of depreciable property.[124] Under section 308 of the new bill, however, there would be no recapture of prior amortization if X reinvested the proceeds from the sale in another turnkey facility or in CDB stock.[125]

(4) Sustained Profitability Credit.— The tax benefits from investing in a turnkey project would not end upon the sale of the facility to a CDC. Section 309 provides that X Corporation would continue to receive a tax credit equal to 15 percent of the profits generated by the turnkey facility for 5 years after sale to a CDC.[126] By gearing this substantial tax benefit to the profitability of the turnkey facility, the bill creates a powerful inducement for X Corporation to employ its business expertise to make the turnkey project efficient and profitable when it is turned over to the CDC. By extending the credit over a period of 5 years, the bill encourages X Corporation to retain close ties with the turnkey operation after

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[123] Unrecognized gain is applied against the basis of the new facility or holdings of CDB stock. S. 3876, at § 307. *Cf.* CODE § 1034, providing for nonrecognition of gain upon the sale of a residence where a new residence is acquired within 1 year. By reducing the basis of the new facility in an amount equal to the unrecognized gain from previous sales of turnkey facilities, the taxpayer would have a significantly lower amortizable basis in the new facility. Assuming that the investment in the old facility had been completely written off through amortization deductions at the time of sale, the entire amount realized upon the sale of the facility would be gain. Reinvestment in a new facility of comparable size would give the tax payer a zero basis in the new facility and thus preclude amortization deductions on the new facility. Thus, it is evident that the tax benefits available under S. 3876 decrease significantly on subsequent investments where no capital gains tax has been paid on previous dispositions.

[124] *See* CODE §§ 1245 & 1250.

[125] S. 3876 § 308. If X Corp. should elect to recognize gain as provided under section 308, there would be recapture of amortization only to the extent of the gain recognized. *Id.*

[126] *Id.* § 309. The amount of the credit could not exceed X Corporation's tax liability computed without regard to any foreign tax credits, partially exempt interest, or investment credits. There is a 3-year carryback and a 5-year carryover of unused sustained profitability credits. *Id.*

its sale, providing assistance and supply contracts to insure the facility's continued profitability.[127]

The Community Self Determination Bill presents a marked departure from previous poverty programs. Unlike present programs of the welfare type which often have a tendency to perpetuate the economic dependency of the disadvantaged, the Self-Determination Bill would provide the poor with the essential tools to shape a prosperous existence for themselves. The key to the bill's success is economic development, and the key to such development is the broad participation of private industry. Through a system of powerful tax incentives, the bill would bypass the federal government as the middleman in the effort to eradicate poverty[128] and involve private corporations directly with local communities in a broad based self-betterment program. The availability of a positive dollar return on ghetto projects made possible by tax inducements would involve increased numbers of large corporations[129] in the effort to find a solution to the country's greatest domestic problem.

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[127] Without the inducement of the sustained profitability credit, the investing corporation might be tempted to take advantage of early tax benefits in the form of rapid amortization and credits for wages paid, without making a concerted effort to develop a truly profitable operation. It has been suggested that the sustained profitability credit would not itself be sufficient to insure that the investing corporation would not milk the turnkey facility for early tax benefits without concern for its future profitability; and that the CDC should insist that the turnkey contract sales price be based on a multiple of earnings formula to provide an added incentive for the turnkey contractor to create a profitable operation. *See* Note, *supra* note 118 at 663.

[128] Rather than siphoning tax dollars from local industry to Washington and then channeling those same dollars back into the urban ghettos and rural poverty areas under federally implemented poverty programs, the tax incentive approach would leave a certain amount of potential tax revenues in local industry and direct those funds toward socially desirable ends through a system of appropriate controls. The significant by-products of such a direct approach would be elimination of some bureaucratic inefficiencies, and more importantly, the opportunity for the poor to better themselves in productive employment. As to whether the tax incentive approach to involving private industry is superior to direct government subsidies, see note 111 *supra* & accompanying text. Although there is some evidence that businessmen favor the tax credit approach over direct subsidies (see JOINT ECONOMIC COMM. REP. *supra* note 109 at 9) many of the corporate executives surveyed in the Cleveland area indicated that they feared the red tape which would accompany any program of subsidization by the federal government, and some disfavored government assistance in any form other than tax deductibility for expenditures made on private development efforts. In this respect it should be noted that the comprehensive tax incentive provisions of the Community Self-Determination Bill would be virtually self-effectuating thereby, eliminating much governmental red tape. *See* note 120 *supra* & accompanying text.

[129] The tax incentive provisions of S. 3876 are directed toward large industrial corporations; most small companies would not have the capital or manpower necessary to find a turnkey project. However, small companies would continue to benefit from federal grants under the various manpower programs and could participate in the cooperative development programs outlined in notes 57-106 *supra* & accompanying text.

III. The Scope of Corporate Authority to Engage in Ghetto Development Projects

It is evident from the preceeding materials that there are many viable programs which private corporations might initiate to enhance the development of the inner city economy. One basic question remains — whether the application of corporate assets and expertise to aid ghetto businesses is beyond the scope of corporate authority.[130]

A private corporation has only such powers as are expressly or impliedly granted in its charter or are derived from powers expressly granted to all corporations by statute.[131] Where the power to divert corporate assets for the benefit of the public welfare is not expressly reserved in the corporate charter or conferred by statute, the requisite authority must be inferred from the general purposes for which the corporation was created. Since the common law viewed the corporation as existing exclusively to generate profits for its shareholders, the early cases held that a corporation had no implied power to make contributions to the general public welfare,[132] and that contributions for specific projects could be justified only where there was a demonstrable "corporate benefit" flowing to the corporation as a result of the expenditure.[133] Although a strong argument can be made that expenditures on ghetto development projects result in a significant corporate benefit sufficient to sustain funds expended under the common law rule,[134] this will be unnecessary in the majority of states which have enacted broad statutes expressly empowering corporations to divert funds to charity

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130 Several of the corporations surveyed in the Cleveland area expressed some concern that extensive urban development programs might be ultra vires, giving rise to shareholder suits and the potential for personal liability of the directors for misuse of corporate assets.

131 *See generally* 18 C.J.S. *Corporations* §§ 23-34 (1939); H. Henn, Corporations §§ 183-86 (1961); Annot., *Power of a Business Corporation to Donate to a Charitable or Similar Institution*, 39 A.L.R.2d 1192 (1955).

132 The leading early case is Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919), holding that a corporation could not accumulate earnings from a general public purpose without paying any dividends to its shareholders. The court did not, however, rule out the possibility that some earnings could be applied to a public purpose.

133 *See, e.g.*, Brinson Ry. Co. v. Exchange Bank, 16 Ga. App. 425, 85 S.E. 634 (1915); Richelieu Hotel Co. v. International Military Encampment Co. 140 Ill. 248, 29 N.E. 1044 (1892); Note, 39 Cornell L. Q. 122 (1953); Annot., *supra* note 131 at 1194 n.2.

134 The arguments respecting the private corporation's vested business interest in the general prosperity and civil tranquility of the local community are set out in note 148 *infra* & accompanying text.

and for the general social and economic betterment of the community.[135] Once a proposed ghetto development project has been brought within the authority derived from the statute, the directors are limited only by that standard of reasonableness and prudence which attaches to the exercise of all corporate powers.[136]

Characteristic of the breadth of the statutes empowering private corporations to act for the public welfare is the New York statute authorizing corporations "[t]o make donations, irrespective of corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic or similar purposes . . . ."[137] In Ohio, corporations are empowered "to make donations for the public welfare or for charitable, scientific, or educational purposes."[138] The leading case in this area is *A. P. Smith Manufacturing Co. v. Barlow*,[139] where the New Jersey Supreme Court upheld against shareholder objection the corporation's gift of $1500 to Princeton University. The Court held that not only was the donation lawful under the statute authorizing charitable gifts, but it was also within the corporation's implied and incidental powers under common law principles since a contribution to a local university would benefit the corporation by strengthening the community.[140]

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[135] *See* discussion of specific statutory provisions in notes 137-39 *infra.*

[136] Even in states which have not enacted statutes eliminating the requirement of a corporate benefit to justify expenditures for the public welfare, the modern definition of "corporate benefit" has been expanded to include the benefits, in public relations value, which flow from corporate involvement in social programs. Thus, in Union Pacific Railroad Co. v. Trustees, Inc., 8 Utah 2d 101, 329 P.2d 398 (1958), the Utah Supreme Court refused to give retroactive application to a recently enacted statute authorizing gifts to charity and the public welfare, but nonetheless sustained a contribution to a nonprofit organization on the ground that corporate power for such activity was implicit in the corporation's charter:

> The new concept of corporate responsibility seems to have become fait accompli.
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> . . . .
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> We believe that if it [the contribution] were made with the studied and not unreasonable conviction that it would benefit the corporation, it should be the type of thing that should rest in the sound discretion of management and within the ambit of a legitimate exercise of implied authority in the ordinary course of the company's business. 8 Utah 2d at 107-09, 329 P.2d at 401-02.

[137] N.Y. BUS. CORP. LAW § 202(12) (McKinney 1962).

[138] OHIO REV. CODE § 1701.13 (Page 1964). Other state statutes are similarly worded. *See e.g.*, CAL. CORP. CODE § 802(g) (West 1955) ("to make donations for the public welfare or for charitable, scientific, or educational purposes"); ILL. STAT. ANN. tit. 32, § 157.5(m) (Smith-Hurd 1964) (same); MICH. COMP. LAWS § 450.10(K) (West 1967) (same); PA. STAT. ANN. tit. 15, § 1302(16) (1967) (same). National Banks are also authorized to make contributions for the public welfare. 12 U.S.C. § 24 (1964).

[139] 13 N.J. 145, 98 A.2d 581 (1953).

[140] *Id.* at 154, 98 A.2d at 586.

Finding that under modern economic conditions much of the Nation's wealth has become concentrated under corporate control, the court declared that these conditions "require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities within which they operate" and that:

> [I]ndividual stockholders, whose private interests rest entirely upon the well-being of the plaintiff corporation, ought not be permitted to close their eyes to present-day realities and thwart the long-visioned corporate action in recognizing and voluntarily discharging its high obligations as a constituent of our modern social structure.[141]

Although it might be argued that the contribution of a modest sum to a university or other established charitable institution is distinguishable from the application of sizable amounts of corporate assets to form a ghetto business, it is clear that the present-day realities in the Nation's cities pose a much more immediate threat to private corporations and to the public in general than the potential demise of a local university. The establishment of large corporate foundations to fund numerous community betterment projects is indicative of the growing sense of corporate social responsibility.[142] Indeed, the state enabling statutes speak not in terms of traditional charitable giving alone, but authorize corporate expenditures for "the public welfare . . . or similar purposes"[143] which would seem to include use of corporate funds for any project reasonably calculated to further the common good.[144] Moreover, since the federal government has actively solicited private corporations to become involved in urban development by offering direct subsidies for job training and tax inducements for aid to inner city businesses, it is extremely unlikely that a state court would refuse to find that such activities fall within the scope of the state statute authorizing private corporations to act for the public welfare.

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141 *Id.*

142 For a discussion of the recent activity of the Ford Foundation funding ghetto businesses and housing projects, see note 79 *supra.*

143 *See* note 138 *supra.*

144 In James McCord Co. v. Citizens' Hotel Co., 287 S.W. 906 (Tex. Civ. App. 1926), a number of local corporations had pooled their funds to construct a hotel for the betterment of the city. When sued for their subscriptions, the corporations defended on the grounds that operation of a hotel was ultra vires for them since they were not authorized by their respective charters to engage in the hotel business. The court denied the defense and held that the hotel was a civic enterprise within the statute authorizing such endeavors by private corporations. The subscriptions were not considered as being for the purpose of engaging in the hotel business, but were merely seen as a vehicle for a joint effort to construct a hotel as a community enterprise for the welfare of the city. *See also* A. J. Anderson Co. v. Citizens Hotel Co., 8 S.W.2d 702 (Tex. Civ. App. 1928).

Once a ghetto project is rendered intra vires by virtue of powers implied in the corporate charter or by the express authority derived from the enabling statute, the directors must exercise due care and prudence with respect to the ghetto project. If the directors come to the independent conclusion that involvement in urban development is in the best interest of the corporation and are not motivated by personal gain, the corporate activity will come within the protection of the "business judgment" rule which will effectively insulate the directors from liability to the corporation or its shareholders for misuse of corporate funds.[145] Since many established corporations have already undertaken substantial programs to develop the inner city economy by assisting ghetto businesses,[146] there will be considerable precedent for any given project, thereby providing a standard upon which to judge the reasonableness of the amounts expended.

In view of the expanding sense of corporate social responsibility, the real question may no longer be whether shareholders can restrain corporate social activity, but rather whether a group of concerned shareholders can induce a lethargic management to act. As previously noted,[147] corporate profitability is a partial function of the general economic prosperity of the local community. The existence of a large mass of economically deprived people inhibits the growth of the local economy and thereby retards corporate growth. Where a corporation is situated close to a ghetto area such that the possibility of civil disorder poses a direct threat to efficient business operations, expenditures to eliminate the fundamental causes of riots may be necessary to protect the business.[148] To the extent that

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[145] Professor Henn gives the following functional definition of the business judgment rule:

> If in the course of management, directors arrive at a decision, within the corporation's powers (*intra vires*) and their authority, for which there is a reasonable basis, and they act in good faith, as a result of their independent discretion and judgment, and uninfluenced by any considerations other than what they honestly believe to be the best interests of the corporation, a court will not interfere with internal management and substitute its judgment for that of the directors .... H. HENN, *supra* note 131 at 365.

[146] *See* notes 9, 75, 81, 85-88 *supra* & accompanying text.

[147] *See* note 69 *supra.*

[148] An inner city plant located near a ghetto area is exposed to the danger that its property may be burned and looted, causing a sharp rise in insurance rates. The potential for civil disorder may expose employees to the threat of physical harm, and an actual riot may necessitate a suspension of operations with a resultant loss of business revenues. Thus, many urban businesses may be faced with the alternative of either moving their operation away from the danger or taking meaningful steps to eliminate its source. *Cf.* Jefferson Mills, Inc. v. United States, 259 F. Supp. 305 (N.D. Ga. 1965), *aff'd per curiam*, 367 F.2d 392 (5th Cir. 1966).

festering slum conditions cause existing businesses to relocate elsewhere and discourage the location of new businesses in the area, corporations situated on or near the fringes of the core area lose the advantages of external economies normally associated with the concentration of many businesses in one geographic area. Also, when a corporation physically removed from the imminent threat of violence fails to participate in efforts initiated by inner city corporations designed to eradicate slum conditions, the non-participant company may be regarded as uninterested in the city's welfare producing a detrimental effect on its public image. By the same token, active participation in programs to enhance the well-being of the urban community can be of considerable public relations value.[149]

Given the threat of physical harm to business operations, the ghetto's economic drain on the vitality of the business climate, and the exhortations for action from the government and the general public, it may very well be that the failure of the Board of Directors to institute or participate in an urban development program would constitute a breach of the fiduciary duty of due care which the directors owe to the corporation.[150] Since in this context the failure of the directors to act would constitute negligence to the corporation, the directors could not invoke the business judgment rule to absolve themselves from liability.[151] True, difficulties of measuring damages and establishing causation might very well preclude a shareholder derivative action seeking to hold the directors personally liable for their failure to protect the corporation from physical harm and loss of the company's public image stemming from its failure to join other companies in an urban improvement program. At the very least, however, the question of the corporation's role in community development would seem a proper subject for a shareholder resolution proposing an amendment to the by-laws or the corporate charter to the effect that the company is cognizant of deteriorating social and economic conditions in the community and the concomitant threat to the company's prosperity, and that the directors should investigate various ways in which company assets and

[149] The development efforts initiated by major corporations have received extensive and repeated coverage in national news media. *See* note 9 *supra.*

[150] Although the guidelines vary slightly among the states, the standard of prudence and due care owed the corporation by the directors is "that diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in their personal business affairs." PA. STAT. ANN. tit. 15, § 1408 (Purdon 1967).

[151] By definition, the business judgment rule presupposes the exercise of due care. *See* note 145 *supra.*

personnel might be employed to alleviate the danger to the corporation.[152] The amendment could also state that after thorough investigation of alternative measures, the directors should implement a comprehensive program directed toward eliminating the fundamental causes of community poverty and discontent. Although delineating a specific program is probably beyond the scope of legitimate shareholder control over management, bringing the basic policy decision before the shareholders at the annual meeting would be within the ambit of proper shareholder concerns.[153] In this respect it should be noted that if the corporation is registered with the Securities and Exchange Commission pursuant to section 12 of the Securities Exchange Act of 1934,[154] the shareholders might also be entitled to inclusion of a 100-word statement concerning the proposed resolution in management's proxy solicitation materials.[155]

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[152] *See* Auer v. Dressel, 306 N.Y. 427, 118 N.E.2d 590 (1955), holding that even though the shareholders of a corporation lack the authority to designate corporate officers, they may properly suggest to the directors their collective preference as to which men should be chosen. Thus, where shareholders lack the power to compel the directors to involve the corporation in urban development, they may still express their view on the matter in a shareholder resolution at the annual meeting.

[153] *See generally Proper Subject: A Symposium*, 34 U. DET. L.J. 520 (1957). *See also* note 152 *supra.*

[154] 15 U.S.C. § 781 (1964).

[155] Under Commission Rule 14a-8, 17 C.F.R. § 240.14a-8 (1969), any security holder entitled to vote may submit a proposal for inclusion on management's proxy solicitation statement. If management opposes the proposal, the shareholder is entitled to inclusion of his name and address and a 100-word statement in support of the proposal. However, management is not required to print the 100-word statement if the proposal is "*primarily* for the purpose of promoting general economic, political, racial, religious, social or similar causes," Rule 14a-8(c)(2), 17 C.F.R. § 240.142-8(c)(2) (1969) (emphasis added), or relates to "the ordinary business operations of the issuer." *Id.* Rule 14a-8(c)(5).

In 1951 the S.E.C. rejected a shareholder request under Rule 14a-8(a) for inclusion of a 100-word statement concerning a shareholder proposal for abolition of segregated seating on Greyhound buses operating in the South. Peck v. Greyhound Corp., 97 F. Supp. 679 (S.D.N.Y. 1951). However, it does not appear that the shareholder alleged that segregated seating constituted an imminent threat to Greyhound's business. Although a shareholder proposal concerning the corporation's involvement in urban development would involve promotion of a "general economic cause," it would appear that in view of the imminent threat to the corporation's business posed by a volatile environment, such a proposal would not be "primarily" for general economic considerations, and thus would not be within management's exemption from the 100-word requirement. Also since the company has not regularly given aid to ghetto business or undertaken other worthwhile development projects, it cannot be said that a shareholder proposal concerning such activities would relate to the "ordinary business operations" of the company.

Recently, shareholders of Dow Chemical Company attempted to get a proposal on management's proxy statement to amend the corporation's charter to preclude the company from selling napalm "to any buyer unless that buyer gives reasonable assurance that the substance will not be used on or against human beings." Health Rights News, May 1968, at 3, col. 3. Management opposed the proposal, and was not required to include it in its proxy statement because the Dow shareholders had not submitted the proposal within time to allow its inclusion as required by Rule 14a-8(a). *Id.* In its letter

IV. Conclusion

It is becoming increasingly evident that conventional government programs of the welfare type have been unable to solve the economic and social problems which have precipitated today's urban crisis. Although certainly not a panacea for these ills, the concentration of private industry in large cities constitutes a vast and largely untapped resource of capital and problem-solving expertise which, through imaginative programs, can be effectively utilized to reduce unemployment and lay the groundwork for the assimilation of disadvantaged minorities into the mainstream of American prosperity. Given the inducements provided by the tax law and the absence of any significant legal constraints on the scope of corporate activity, private industry is limited only by the extent of its dedication and the resourcefulness of its imagination.

William S. Paddock

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to Dow management, the shareholder group listed among their reasons for the proposal the fact that Dow had been unable to recruit well-qualified college graduates as a result of bad publicity concerning the sale of napalm, and that Dow had also lost foreign customers for the same reason. It remains to be seen whether these or similar economic considerations relating to the prosperity of the corporation will be sufficiently specific to allow mandatory inclusion of the 100-word statement on management's proxy solicitation.