

## tax-exempt organizations lawflash

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### Proposed Regulations Offer New Examples of Program-Related Investments

*New examples describe additional charitable purposes and investment structures for PRIs.*

The Internal Revenue Service (IRS) and the Treasury Department have issued long-awaited proposed Treasury Regulations providing nine additional examples of investments that qualify as program-related investments (PRIs). The existing regulations were issued in 1972 and do not reflect the types of PRIs that private foundations commonly employ today. The new guidance is welcome because it confirms that the IRS approves of many additional PRI activities. For example, the new examples show how PRIs can fund a wide range of charitable programs, including by supporting commercial businesses that serve as intermediaries to reach the intended charitable beneficiaries. The examples also demonstrate a variety of PRI investment structures, including equity investments, loans, loans with equity components, and guarantee arrangements.

While the rules that govern PRIs apply to private foundations, these new examples may also be useful for public charities that conduct PRI-like social and community investment activities.

The following is a summary of the key principles of the proposed regulations, together with our observations about the new guidance. The full text of the proposed regulations is available online at <http://www.morganlewis.com/pubs/PRIProposedRegulations.pdf>.

#### PRI Requirements

Internal Revenue Code Section 4944 prohibits investments deemed to jeopardize the carrying out of a private foundation's exempt purposes. An investment meeting the PRI requirements is not a jeopardizing investment.

In general, an investment must satisfy three requirements to qualify as a PRI: (1) the primary purpose of the investment must further one or more exempt purposes of the foundation, (2) the production of income or the appreciation of property may not be a significant purpose of the investment, and (3) the PRI cannot be used to fund electioneering or lobbying activity.

#### Additional Charitable Purposes Illustrated

The nine new PRI examples in the proposed regulations (numbered sequentially after the existing 10 examples) show that how different charitable purposes may be advanced by PRIs where the funding is used to support certain activities:

- Advancing science by funding published research and the development of drugs to treat diseases that predominantly affect the poor (Ex. 11)
- Combating environmental deterioration by funding a recycling business (Ex. 12 and 13)
- Providing relief to the poor by (i) funding a failing business that employs a large number of poor individuals (Ex. 14) or (ii) funding small businesses started by the poor (Ex. 15)
- Educating poor farmers about advanced agricultural methods by funding a commercial enterprise to provide training to the farmers (Ex. 16)

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- Promoting the arts by funding the purchase of space to be used for art exhibitions (Ex. 17)
- Advancing education by providing funding to a Section 501(k) childcare organization (Ex. 18 and 19)

## New Examples of Investment Structures

The proposed regulations also illustrate the following PRI investment structures:

- An equity investment in a subsidiary of a commercial enterprise where the subsidiary was established to carry on the activities that further charitable purposes (Ex. 11)
- An equity investment (or loan with an equity component) in a commercial business whose only activity will be the activity that supports the charitable purposes (Ex. 12 and 13)
- A loan to a distressed business enterprise that will enable it to continue its business operations (Ex. 14)
- A loan to poor individuals that will enable them to start a small business (Ex. 15)
- A loan to a business where the loan proceeds are required to be used for training the poor suppliers of the borrower (Ex. 16)
- A credit support which may be collateralized (Ex. 18) or subject to a reimbursement agreement (Ex. 19)

## General Guiding Principles

The additional examples also illustrate the following general principles:

- An investment that funds activities in foreign countries may further the accomplishment of charitable purposes and qualify as a PRI (Ex. 12, 13, 15, and 16).
- The existence of a high potential rate of return on an investment does not, by itself, prevent the investment from qualifying as a PRI (Ex. 12).
- A private foundation's acceptance of an equity position in conjunction with making a loan does not necessarily prevent the investment from qualifying as a PRI (Ex. 13).
- A private foundation's provision of a guarantee or other credit support can qualify as a PRI (Ex. 18 and 19).

We note that the proposed regulations are subject to further refinement, and the IRS has asked for comments from the field to assist them as they finalize the regulations. Please let us know if you would like assistance in preparing and submitting comments to the IRS.

## Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

### Washington, D.C.

Celia Roady	202.739.5279	<a href="mailto:croady@morganlewis.com">croady@morganlewis.com</a>
Matthew R. Elkin	202.739.5285	<a href="mailto:melkin@morganlewis.com">melkin@morganlewis.com</a>
Alexander L. Reid	202.739.5941	<a href="mailto:areid@morganlewis.com">areid@morganlewis.com</a>
Kimberly M. Eney	202.739.5825	<a href="mailto:kenev@morganlewis.com">kenev@morganlewis.com</a>
Edward T. Chaney	202.739.5831	<a href="mailto:echaney@morganlewis.com">echaney@morganlewis.com</a>

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