

Memorandum

Final Regulations Providing Additional Examples of Program-Related Investments

April 26, 2016

On April 25, 2016, the Department of the Treasury (“Treasury”) published final regulations (the “Final Regulations”) providing additional examples of Program-Related Investments (“PRIs”). The Final Regulations amend and finalize proposed regulations that were issued on April 19, 2012 (the “Proposed Regulations”).

The Final Regulations

Section 4944 of the Internal Revenue Code of 1986, as amended (the “Code”), imposes excise taxes on a private foundation and on foundation managers for making an investment that could jeopardize the foundation’s ability to carry out its charitable purposes (a “jeopardizing investment”). Code section 4944(c) excludes PRIs from the definition of a jeopardizing investment. A PRI is an investment that satisfies three requirements: (1) the primary purpose of the investment is to further one or more of the foundation’s charitable purposes; (2) no significant purpose of the investment is the production of income or the appreciation of property; and (3) no purpose of the investment is for lobbying or political campaign intervention activities.¹

The Proposed Regulations provided nine examples of investments that qualify as PRIs (the “Additional Examples”) to supplement the ten examples provided in the previously existing regulations.² A summary of the Additional Examples can be found at: <http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1404.pdf>.

¹ See Code sec. 4944(c) and Treas. Reg. sec. 53.4944-3(a)(1)(iii).

² See Treas. Reg. sec. 53.4944-3(b). The 10 examples in the existing regulations include nine examples of investments that qualify as PRIs and one example that does not.

While the Final Regulations adopt the Proposed Regulations in large part without modification, changes to the following three examples included in the Proposed Regulations are of particular interest:

- Example 11 – This example involves an investment by a private foundation in the subsidiary of a business enterprise that researches and develops new drugs for the purpose of developing a vaccine for a disease that predominantly affects poor individuals in developing countries. The investment agreement with the private foundation requires the subsidiary to distribute the vaccine to poor individuals in developing countries at a price that is affordable to the affected population. The Final Regulations clarify that the investment agreement does not need to preclude the subsidiary from also selling the vaccine at market rates to other individuals who can afford it. Treasury explains in the Summary of Comments and Explanation of Revisions to the Final Regulations (the “Summary and Explanation”) that because this example specifies that the private foundation’s primary purpose in making the investment is to fund scientific research in the public interest and no significant purpose of the private foundation’s investment involves the production of income or appreciation of property, permitting the subsidiary to also sell the vaccine at market rates to those who can afford it will not affect the treatment of the private foundation’s investment as a PRI.
- Example 13 – This example involves a private foundation that accepts common stock of a business enterprise in a developing country in exchange for making a below-market rate loan to the business enterprise for the purpose of combating environmental deterioration. In the Proposed Regulations, the example provided that the private foundation would liquidate the stock when the business enterprise became profitable or it was established that the business enterprise would never become profitable. The Final Regulations remove the sentence regarding the private foundation’s intention to liquidate the stock, thereby clarifying that a private foundation does not need to sell its stock in a business that becomes profitable for the investment to qualify as a PRI. Treasury and the IRS note, however, in the Summary and Explanation, that the establishment, at the outset of an investment, of an exit condition that is tied to the exempt purpose for which the investment is made, can be an important indication that accomplishment of such exempt purpose is in fact the primary purpose of the investment.
- Example 15 – This example involves a private foundation that makes below-market rate loans to poor individuals in a developing country to enable them to start small businesses. The fact pattern in the Proposed Regulations indicated that the loans were made to two specific individuals starting specific types of businesses after a natural disaster had caused significant damage to the country’s infrastructure. The Final Regulations amend the example to remove the reference to a natural disaster, thereby indicating that the occurrence of a natural disaster is not a prerequisite for the loans to qualify as PRIs. Rather, the making of the below-market rate loans to poor individuals in developing countries in itself is sufficient to meet the PRI requirements. The Final Regulations also amend the example to provide that the private foundation’s loans are made to enable poor individuals to start small businesses, rather than that the

loans are made to two specific poor individuals to enable such individuals to start specific types of businesses.

The Summary and Explanation also addresses several comments to the Proposed Regulations that were not incorporated into the Final Regulations. The following two points are of particular interest:

- Treasury declined to extend Example 16, which describes a loan to an LLC that qualifies as a PRI, to also describe an equity investment in an LLC that qualifies as a PRI. Treasury cited additional tax issues arising out of equity investments in entities treated as partnerships for federal income tax purposes, including attribution of activities and unrelated business taxable income, as adding more complexity than could be concisely summarized in an example. However, Treasury noted that it and the IRS are considering whether to address PRIs in the form of investments in partnership interests through the issuance of a revenue ruling.
- Treasury declined to provide an example involving an investment in a low-profit limited liability company (“L3C”) or a benefit corporation in the Final Regulations, concluding that a recipient’s status as an L3C or a benefit corporation is not determinative in the analysis of an investment’s treatment as a PRI. Treasury confirmed that the Additional Example involving a loan to an LLC applies equally to L3Cs, and examples involving PRIs to a corporation apply equally to benefit corporations.

The Final Regulations can be found at: <http://federalregister.gov/a/2016-09396>.

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