



This document is scheduled to be published in the Federal Register on 04/19/2012 and available online at <http://federalregister.gov/a/2012-09468>, and on [FDsys.gov](http://FDsys.gov)

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 53

[REG-144267-11]

RIN 1545-BK76

Examples of Program-Related Investments

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance to private foundations on program-related investments. These proposed regulations provide a series of new examples illustrating investments that qualify as program-related investments. In addition to private foundations, these proposed regulations affect foundation managers who participate in the making of program-related investments.

DATES: Comments and requests for a public hearing must be received by

**[INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER].**

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-144267-11), room 5205, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-144267-11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW,

Washington, DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov/> (IRS REG-144267-11).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Courtney D. Jones at (202) 622-6070; concerning submissions of comments and requests for a public hearing, [Oluwafunmilayo Taylor](#), (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

**Background**

Section 4944(a) of the Internal Revenue Code (Code) imposes an excise tax on a private foundation that makes an investment that jeopardizes the carrying out of any of the private foundation's exempt purposes (a "jeopardizing investment"). Section 4944(a) also imposes an excise tax on foundation managers who knowingly participate in the making of a jeopardizing investment. Section 4944(b) imposes additional excise taxes on private foundations and foundation managers when investments are not timely removed from jeopardy.

Generally, under §53.4944-1(a)(2), a jeopardizing investment occurs when, based on the facts and circumstances at the time the investment is made, foundation managers fail to exercise ordinary business care and prudence in providing for the long- and short-term financial needs of the foundation. The determination of whether an investment is a jeopardizing investment is made on an investment-by-investment basis, taking into account the private foundation's entire portfolio. In exercising the requisite standard of care and prudence,

foundation managers may take into account the expected investment return, price volatility, and the need for portfolio diversification.

Section 4944(c) excepts program-related investments (“PRIs”) from treatment as jeopardizing investments. The regulations under section 4944(c) define a PRI as an investment: (1) the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B); (2) no significant purpose of which is the production of income or the appreciation of property; and (3) no purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(D) (attempting to influence legislation or participating in or intervening in any political campaign).

An investment is made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B) (referred to as “charitable purposes”) if it significantly furthers the accomplishment of the private foundation’s exempt activities and would not have been made but for the relationship between the investment and the accomplishment of those exempt activities. In determining whether a significant purpose of an investment is the production of income or the appreciation of property, §53.4944-3(a)(2)(iii) provides that it shall be relevant whether investors who are engaged in the investment solely for the production of income would be likely to make the investment on the same terms as the private foundation.

The regulations under other Code sections in Chapter 42 accord special tax treatment to PRIs. For example, §53.4942(a)-2(c)(3)(ii)(d) excludes PRIs from the assets a private foundation takes into account when determining how

much it must distribute under section 4942 as a “distributable amount” for the taxable year. In addition, §53.4942(a)-3(a)(2)(i) generally includes distributions that qualify as PRIs as “qualifying distributions” for purposes of meeting the distribution requirements under section 4942. Section 53.4943-10(b) excludes PRIs from being treated as business holdings for the purpose of calculating excess business holdings subject to excise tax under section 4943. Sections 53.4945-5(b)(4) and 53.4945-6(c)(1)(i) also make clear that PRIs will not constitute taxable expenditures under section 4945, provided the private foundation exercises “expenditure responsibility” in circumstances in which it is required to do so. Among other expenditure responsibility requirements, a private foundation must require a written commitment from the recipient of the PRI that the funds received will be used only for the purposes of the program-related investment. As noted, the primary purpose of a program-related investment must be the accomplishment of a charitable purpose.

Section 53.4944-3(b) contains nine examples illustrating investments that qualify as PRIs and one example of an investment that does not qualify as a PRI. The existing examples focus on domestic situations principally involving economically disadvantaged individuals and deteriorated urban areas.

The Treasury Department and the IRS are aware that the private foundation community would find it helpful if the regulations could include additional PRI examples that reflect current investment practices and illustrate certain principles, including that: (1) an activity conducted in a foreign country furthers a charitable purpose if the same activity would further a charitable

purpose if conducted in the United States; (2) the charitable purposes served by a PRI are not limited to situations involving economically disadvantaged individuals and deteriorated urban areas; (3) the recipients of PRIs need not be within a charitable class if they are the instruments for furthering a charitable purpose; (4) a potentially high rate of return does not automatically prevent an investment from qualifying as program-related; (5) PRIs can be achieved through a variety of investments, including loans to individuals, tax-exempt organizations and for-profit organizations, and equity investments in for-profit organizations; (6) a credit enhancement arrangement may qualify as a PRI; and (7) 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.

### **Explanation of Provisions**

The proposed regulations add nine new examples that illustrate that a wider range of investments qualify as PRIs than the range currently presented in §53.4944-3(b). The proposed regulations do not modify the existing regulations; rather, they provide additional examples that illustrate the application of the existing regulations. Generally, the charitable activities illustrated in the new examples are based on published guidance and on financial structures described in private letter rulings.

The new examples demonstrate that a PRI may accomplish a variety of charitable purposes, such as advancing science, combating environmental deterioration, and promoting the arts. Several examples also demonstrate that an investment that funds activities in one or more foreign countries, including

investments that alleviate the impact of a natural disaster or that fund educational programs for poor individuals, may further the accomplishment of charitable purposes and qualify as a PRI. One example illustrates that the existence of a high potential rate of return on an investment does not, by itself, prevent the investment from qualifying as a PRI. Another example illustrates that 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, and two examples illustrate that a private foundation's provision of credit enhancement can qualify as a PRI.

The last example demonstrates that a guarantee arrangement may qualify as a PRI. The proposed regulations address solely the impact of section 4944 on the facts described and do not address whether there is a qualifying distribution under section 4942. However, the Treasury Department and the IRS conclude that, based on the facts described in the last example, there would be no qualifying distribution under section 4942 at the time the foundation enters into the guarantee arrangement. Under certain circumstances, a private foundation may treat payments made under a guarantee arrangement as qualifying distributions.

Finally, the proposed regulations include examples illustrating that loans and capital may be provided to individuals or entities that are not within a charitable class themselves, if the recipients are the instruments through which the private foundation accomplishes its exempt activities.

### **Proposed Effective/Applicability Date**

Paragraph (b), Examples 11 through 19 of this section will be effective on the date of publication of the Treasury decision adopting these examples as final regulations in the **Federal Register**. Taxpayers may rely on paragraph (b), Examples 11 through 19 of this section before these proposed regulations are finalized.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on business.

### **Comments and Requests for Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “Addresses” heading. The IRS and the Treasury Department request comments on all aspects of the proposed rules. All comments will be available at [www.regulations.gov](http://www.regulations.gov) or upon request. A public

hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

### **Drafting Information**

The principal author of these proposed regulations is Courtney D. Jones, Office of the Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury Department and the IRS participated in their development.

### **List of Subjects in 26 CFR Part 53**

Excise Taxes, Foundations, Investments, Lobbying, Reporting and Recordkeeping Requirements, Trusts and trustees.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 53 is proposed to be amended as follows:  
Part 53--FOUNDATION AND SIMILAR EXCISE TAXES

Par. 1. The authority citation for part 53 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 53.4944-3 is amended by adding Examples 11, 12, 13, 14, 15, 16, 17, 18, and 19 to paragraph (b) and adding paragraph (c) to read as follows:

§53.4944-3. Exception for program-related investments.

\* \* \* \* \*

(b) \* \* \*



Example 11. X is a business enterprise that researches and develops new drugs. X's research demonstrates that a vaccine can be developed within ten years to prevent a disease that predominantly affects poor individuals in developing countries. However, neither X nor other commercial enterprises like X will devote their resources to develop the vaccine because the potential return on investment is significantly less than required by X or other commercial enterprises to undertake a project to develop new drugs. Y, a private foundation, enters into an investment agreement with X in order to induce X to develop the vaccine. Pursuant to the investment agreement, Y purchases shares of the common stock of S, a subsidiary corporation that X establishes to research and develop the vaccine. The agreement requires S to distribute the vaccine to poor individuals in developing countries at a price that is affordable to the affected population. The agreement also requires S to publish the research results, disclosing substantially all information about the results that would be useful to the interested public. S agrees that the publication of its research results will be made as promptly after the completion of the research as is reasonably possible without jeopardizing S's right to secure patents necessary to protect its ownership or control of the results of the research. The expected rate of return on Y's investment in S is less than the expected market rate of return for an investment of similar risk. Y's primary purpose in making the investment is to advance science. No significant purpose of the investment involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the investment and Y's exempt activities. Accordingly, the purchase of the common stock of S is a program-related investment.

Example 12. Q, a developing country, produces a substantial amount of recyclable solid waste materials that are currently disposed of in landfills and by incineration, contributing significantly to environmental deterioration in Q. X is a new business enterprise located in Q. X's only activity will be collecting recyclable solid waste materials in Q and delivering those materials to recycling centers that are inaccessible to a majority of the population. If successful, the recycling collection business would prevent pollution in Q caused by the usual disposition of solid waste materials. X has obtained funding from only a few commercial investors who are concerned about the environmental impact of solid waste disposal. Although X made substantial efforts to procure additional funding, X has not been able to obtain sufficient funding because the expected rate of return is significantly less than the acceptable rate of return on an investment of this type. Because X has been unable to attract additional investors on the same terms as the initial investors, Y, a private foundation, enters into an investment agreement with X to purchase shares of X's common stock on the same terms as X's initial investors. Although there is a high risk associated with the investment in X, there is also the potential for a high rate of return if X is successful in the recycling business in Q. Y's primary purpose in

making the investment is to combat environmental deterioration. No significant purpose of the investment involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the investment and Y's exempt activities. Accordingly, the purchase of the common stock is a program-related investment.

Example 13. Assume the facts as stated in Example 12, except that X offers Y shares of X's common stock in order to induce Y to make a below-market rate loan to X. X previously made the same offer to a number of commercial investors. These investors were unwilling to provide loans to X on such terms because the expected return on the combined package of stock and debt was below the expected market return for such an investment based on the level of risk involved, and they were also unwilling to provide loans on other terms X considers economically feasible. Y accepts the stock and makes the loan on the same terms that X offered to the commercial investors. Y plans to liquidate its stock in X as soon as the recycling collection business in Q is profitable or it is established that the business will never become profitable. Y's primary purpose in making the investment is to combat environmental deterioration. No significant purpose of the investment involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the investment and Y's exempt activities. Accordingly, the loan accompanied by the acceptance of common stock is a program-related investment.

Example 14. X is a business enterprise located in V, a rural area in State Z. X employs a large number of poor individuals in V. A natural disaster occurs in V, causing significant damage to the area. The business operations of X are harmed because of damage to X's equipment and buildings. X has insufficient funds to continue its business operations and conventional sources of funds are unwilling or unable to provide loans to X on terms it considers economically feasible. In order to enable X to continue its business operations, Y, a private foundation, makes a loan to X bearing interest below the market rate for commercial loans of comparable risk. Y's primary purpose in making the loan is to provide relief to the poor and distressed. No significant purpose of the loan involves the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment.

Example 15. A natural disaster occurs in W, a developing country, causing significant damage to W's infrastructure. Y, a private foundation, makes loans bearing interest below the market rate for commercial loans of comparable risk to H and K, poor individuals who live in W, to enable each of them to start a small business. H will open a roadside fruit stand. K will start a weaving

business. Conventional sources of funds were unwilling or unable to provide loans to H or K on terms they consider economically feasible. Y's primary purpose in making the loans is to provide relief to the poor and distressed. No significant purpose of the loans involves the production of income or the appreciation of property. The loans significantly further the accomplishment of Y's exempt activities and would not have been made but for such relationship between the loans and Y's exempt activities. Accordingly, the loans to H and K are program-related investments.

Example 16. X is a limited liability company treated as a partnership for federal income tax purposes. X purchases coffee from poor farmers residing in a developing country, either directly or through farmer-owned cooperatives. To fund the provision of efficient water management, crop cultivation, pest management, and farm management training to the poor farmers by X, Y, a private foundation, makes a loan to X bearing interest below the market rate for commercial loans of comparable risk. The loan agreement requires X to use the proceeds from the loan to provide the training to the poor farmers. X would not provide such training to the poor farmers absent the loan. Y's primary purpose in making the loan is to educate poor farmers about advanced agricultural methods. No significant purpose of the loan involves the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment.

Example 17. X is a social welfare organization that is recognized as an organization described in section 501(c)(4). X was formed to develop and encourage interest in painting, sculpture and other art forms by, among other things, conducting weekly community art exhibits. X needs to purchase a large exhibition space to accommodate the demand for exhibition space within the community. Conventional sources of funds are unwilling or unable to provide funds to X on terms it considers economically feasible. Y, a private foundation, makes a loan to X at an interest rate below the market rate for commercial loans of comparable risk to fund the purchase of the new space. Y's primary purpose in making the loan is to promote the arts. No significant purpose of the loan involves the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment.

Example 18. X is a non-profit corporation that provides child care services in a low-income neighborhood, enabling many residents of the neighborhood to be gainfully employed. X meets the requirements of section 501(k) and is recognized as an organization described in section 501(c)(3). X's current child care facility has reached capacity and has a long waiting list. X has determined that the demand for its services warrants the construction of a new child care

facility in the same neighborhood. X is unable to obtain a loan from conventional sources of funds including B, a commercial bank, because X lacks sufficient credit to support the financing of a new facility. Pursuant to a deposit agreement, Y, a private foundation, deposits \$h in B, and B lends an identical amount to X to construct the new child care facility. The deposit agreement requires Y to keep \$h on deposit with B during the term of X's loan and provides that if X defaults on the loan, B may deduct the amount of the default from the deposit. To facilitate B's access to the funds in the event of default, the agreement requires that the funds be invested in instruments that allow B to access them readily. The deposit agreement also provides that Y will earn interest at a rate of t% on the deposit. The t% rate is substantially less than Y could otherwise earn on this sum of money, if Y invested it elsewhere. The loan agreement between B and X requires X to use the proceeds from the loan to construct the new child care facility. Y's primary purpose in making the deposit is to further its educational purposes by enabling X to provide child care services within the meaning of section 501(k). No significant purpose of the deposit involves the production of income or the appreciation of property. The deposit significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the deposit and Y's exempt activities. Accordingly, the deposit is a program-related investment.

Example 19. Assume the same facts as stated in Example 18, except that instead of making a deposit of \$h into B, Y enters into a guarantee agreement with B. The guarantee agreement provides that if X defaults on the loan, Y will repay the balance due on the loan to B. B was unwilling to make the loan to X in the absence of Y's guarantee. X must use the proceeds from the loan to construct the new child care facility. At the same time, X and Y enter into a reimbursement agreement whereby X agrees to reimburse Y for any and all amounts paid to B under the guarantee agreement. The signed guarantee and reimbursement agreements together constitute a "guarantee and reimbursement arrangement." Y's primary purpose in entering into the guarantee and reimbursement arrangement is to further Y's educational purposes. No significant purpose of the guarantee and reimbursement arrangement involves the production of income or the appreciation of property. The guarantee and reimbursement arrangement significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the guarantee and reimbursement arrangement and Y's exempt activities. Accordingly, the guarantee and reimbursement arrangement is a program-related investment.

(c) Effective/applicability date. Paragraph (b), Examples 11 through 19 of this section will be effective on the date of publication of the Treasury decision adopting these examples as final regulations in the **Federal Register**. Taxpayers may rely on paragraph (b), Examples 11 through 19 of this section before these proposed regulations are finalized.

Steven T. Miller

Deputy Commissioner for Services and Enforcement.

[FR Doc. 2012-9468 Filed 04/18/2012 at 8:45 am; Publication Date: 04/19/2012]