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March 3, 2010

Hon. Douglas Shulman  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, DC 20224

Re: Comments Concerning Proposed Additional Examples on Program-Related Investments

Dear Commissioner Shulman:

Enclosed are comments concerning proposed additional examples on program-related investments. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stuart M. Lewis  
Chair, Section of Taxation

Enclosure

cc: Michael Mundaca, Acting Assistant Secretary (Tax Policy), Department of the Treasury  
William Wilkins, Chief Counsel, Internal Revenue Service  
Joshua Odintz, Acting Tax Legislative Counsel, Department of the Treasury  
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**ABA SECTION OF TAXATION**

**COMMENTS ON**

**PROPOSED ADDITIONAL EXAMPLES ON**

**PROGRAM-RELATED INVESTMENTS**

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by David S. Chernoff and Robert A. Wexler of the Committee on Exempt Organizations of the Section of Taxation. Substantive contributions were made by Victoria Bjorkland, Cassady V. Brewer, Paul Feinberg, Jennifer L. Franklin, Lisa Johnsen, David Levitt, Ken Monteiro, Drew Porter, and Richard L. Sevcik. The Comments were reviewed by Frederick J. Gerhart, Committee Chair. The Comments were further reviewed by Celia Roady of the Section’s Committee on Government Submissions and by Andrew Dubroff, Council Director for the Committee on Exempt Organizations.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

|           |                       |                        |
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Date: March 3, 2010

## EXECUTIVE SUMMARY

In 2002 comments were submitted to the Internal Revenue Service (the “Service”) and the Treasury Department (“Treasury”) regarding updated regulatory guidance on program-related investments by exempt organizations.<sup>1</sup> These comments included 19 proposed additional program-related investment examples to supplement the existing guidance in Regulation section 53.4944-3(b). The Office of Tax Policy and Internal Revenue Service 2009-2010 Priority Guidance Plan,<sup>2</sup> includes guidance on program-related investments. These Comments update the 2002 submission and include updated versions of the 2002 examples that remain most relevant and new examples that have become relevant.

These Comments include an updated set of 17 proposed examples and accompanying analysis that are intended to interpret existing law. The significant points addressed by the examples are the following:

1. If an activity is charitable when conducted in the U.S., it is likewise charitable if conducted in a foreign country;
2. Efforts to preserve and protect the natural environment and endangered species serve a charitable purpose;
3. Raising the living standards of needy families in underdeveloped or developing countries serves a charitable purpose;
4. The recipients of loans and working capital need not themselves qualify for charitable assistance because they are “merely the instruments” by which the charitable purposes are served;
5. The presence of a seemingly high projected rate of return should not, alone, prevent an investment from qualifying as a program-related investment because determination of the significant purposes for an investment requires a facts and circumstances analysis that takes into account all of the objective facts and circumstances of an investment, including evidence of the motive behind the investment, and the potential production of income or property appreciation is merely a factor in the analysis;
6. Program-related investments may be properly accomplished by or through loans to individuals, tax-exempt organizations, or for-profit domestic or foreign organizations, as well as by or through equity investments in for-profit domestic or foreign organizations, including limited liability companies;

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<sup>1</sup> See ABA Section of Taxation Comments, “Draft Examples of Program-Related Investments For Addition to Treasury Reg. Sec. 53.4944-3(b) and Analysis of Each,” available at [www.abanet.org/tax/pubpolicy/2002/020515pri.pdf](http://www.abanet.org/tax/pubpolicy/2002/020515pri.pdf).

<sup>2</sup> See Office of Tax Policy and Internal Revenue Service 2009-2010 Priority Guidance Plan (Nov. 24, 2009) (for “Exempt Organizations,” item 6 provides for “Guidance under Section 4944 on program-related investments”).

7. Providing credit enhancement, whether in the form of a guarantee, letter of credit, or otherwise, for a borrowing by a third party that accomplishes a charitable purpose may qualify as a program-related investment; and

8. The existence of an “equity kicker” as part of the overall return does not prevent an investment from qualifying as a program-related investment.

## Detailed Comments

### A. Introduction

These Comments first summarize the basic law on program-related investments (“PRIs”) and then propose 17 new examples to supplement the examples in the current Regulations.<sup>3</sup> Each proposed example is accompanied by an explanation of why it is relevant to current and future PRIs.

Section 4944<sup>4</sup> imposes an excise tax on private foundation investments that are deemed to jeopardize the carrying out of any exempt purposes. PRIs are a specific exception under section 4944 and are not considered to jeopardize exempt purposes.<sup>5</sup> To qualify, PRIs must satisfy three requirements:

- The primary purpose of the investment must further one or more exempt purposes of the foundation;
- The production of income or the appreciation of property may not be a significant purpose of the investment; and
- The PRI cannot be used to fund electioneering or lobbying activity.

The examples in the current Regulations address many of the critical issues for PRIs as they existed in 1972 when the Regulations were finalized. The existing examples remain relevant today, but private letter rulings and revenue rulings issued since 1972 have developed the PRI requirements. Many of these rulings, provide helpful, but not precedential guidance. These rulings require practitioners to search through voluminous authorities. In addition, over time, charitable activities have evolved, investment vehicles have changed, and the actual number and types of PRIs have increased.

### B. Summary of Basic Rules

As noted above, the section 4944 excise tax on private foundation investments does not apply to PRIs, and three requirements must be satisfied to qualify for this exception.

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<sup>3</sup> See Reg. § 53.4944-3(b).

<sup>4</sup> References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

<sup>5</sup> I.R.C. § 4944(c).

1. *Primary Exempt Purpose Test*

There are two parts to the *primary exempt purpose* test. First, the investment must *significantly further* the accomplishment of the foundation's exempt activities. Second, the investment must be such that it would not have been made *but for* its relationship to the foundation's exempt activities.<sup>6</sup>

The Service recognizes that a foundation's PRI may further the foundation's exempt purposes whether the investment is made directly to those in need of charitable assistance or via intermediaries because the intermediaries are "merely the instruments" by which the charitable purposes are served.<sup>7</sup>

2. *No Significant Investment Purpose Test*

The *no significant investment purpose* test requires an investment to have *no significant purpose* of producing income or appreciation of property. The current Regulations provide that the Service will consider whether investors solely concerned with profit would be likely to make the investment on the same terms. But the fact that an investment produces *significant* income or capital appreciation is not, alone, conclusive evidence that the income or appreciation is a significant purpose of the investment,<sup>8</sup> and the income or appreciation therefore does not preclude the investment from being a PRI.

The *no significant investment purpose* test is typically satisfied if an investment is made in the form of a loan at below-market interest rates that are, by definition, unattractive to commercial lenders. Even a loan at market rates may qualify if there is some reason (*e.g.*, high risk or inadequate security) that the loan would not be made conventionally. The Service has accepted annual interest rates for PRI loans ranging from zero percent to 15%, usually representing below-market, but occasionally at-market, rates. The Service has also accepted PRI loans that did not include any features designed to protect the investor or secure repayment (*e.g.*, PRI loans that the lender was willing to convert into grants) and, at the other end of the spectrum, PRI loans that included a full set of conventional mortgage terms or, in the case of a guarantee, a full set of conventional guarantee terms.<sup>9</sup>

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<sup>6</sup> Reg. § 53.4944-3(a)(2)(i).

<sup>7</sup> The wording in the text is derived from Rev. Rul. 74-587, 1974-2 C.B. 162, and will be clearer to non-tax specialists than the current language in Regulation section 53.4944-3(a)(2)(i), which states that "the term 'purposes described in section 170(c)(2)(B)' shall be treated as including purposes described in section 170(c)(2)(B) whether or not carried out by organizations described in section 170(c)."

<sup>8</sup> Reg. § 53.4944-3(a)(2)(iii).

<sup>9</sup> *See, e.g.*, PLR 8141025 (July 20, 1981) (approval of secured low-income housing loans at three percent interest, with 20-year terms); PLR 8030079 (Apr. 30, 1980) (approval of urban renewal loan at seven percent interest, with a ten-year term); PLR 8301110 (Oct. 8, 1982) (approval of secured loan for hotel construction in blighted area, at 15% annual interest over 25 years).

An investment in an entity having the dual purpose of both producing a return on investment and achieving a charitable purpose also may qualify as a PRI. In PLR 200136026,<sup>10</sup> a private foundation proposed to invest in a for-profit corporation formed to finance and promote the expansion of environmentally oriented businesses that would contribute to conservation and economic development in economically or environmentally sensitive areas. The corporation had dual goals of providing a rate of return for investors and demonstrating a clear environmental benefit through each investment. Only companies that satisfied certain environmental guidelines were eligible for the corporation's investment. The corporation also created an advisory committee, which included representatives of exempt public charities interested in preserving the environment, to scrutinize each investment. The foundation represented that the rate of return, alone, would not compensate for the speculative nature of investment in the corporation and the overall risk associated with the corporation's unique investment characteristics. The Service determined that, although the foundation expected a financial return, the investment was made directly to accomplish the foundation's charitable goals and thus qualified as a PRI.<sup>11</sup>

Interest rates on loans and projected rates of return on equity investments in many parts of the world (*e.g.*, Eastern Europe, Latin America, etc.) are considerably higher than in the U.S. Therefore, an investment that is at a *below-market-rate* in such countries will still appear to be producing a return considerably higher than the rate normally expected on portfolio investments in the U.S.

### 3. *No Political Purpose Test*

The *no political purpose* test requires the absence of a purpose to attempt to influence legislation, or to participate or intervene in campaigns of candidates for public office.<sup>12</sup> The most common method of assuring compliance with this requirement is to obtain a pledge from the investment recipient of compliance with the restriction on use of funds for political purposes. Typically, one would find this pledge in the PRI loan agreement or guarantee agreement. It may be more difficult to find this type of pledge in an equity investment, and the foundation will often require a side letter with the entity that is the investment vehicle.

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<sup>10</sup> June 11, 2001.

<sup>11</sup> See also PLR 8710076 (Dec. 10, 1986) (a \$10 million limited partnership was established with a taxable general partner, and limited partnership interests were offered to a small group of private foundations and private individuals, for the purpose of going beyond informational services to provide financial support to actual enterprises seeking to demonstrate that privatization of human services is a viable concept).

<sup>12</sup> Reg. § 53.4944-3(a)(1)(iii).

### C. Regulations – Proposed Additional Examples

The Regulations adopted in 1972 include nine examples describing loans and other investments that, under the facts and circumstances described, qualify as PRIs, and one example describing an investment that does not qualify as a PRI.<sup>13</sup> While the ten examples are useful and provide valuable guidance, they do not reflect the variety of PRIs that are made by private foundations in the current global grant-making environment. We suggest that the Service and Treasury supplement the ten existing examples to reflect current grant-making philosophy and practices, international social and economic realities, and forms of doing business that have emerged since 1972. Thus, the examples proposed in these Comments would supplement, rather than replace, the ten existing examples.

Neither the ten existing examples nor the examples proposed in these Comments address the interplay between section 4944 and section 4941, section 4942, section 4943, or section 4945. We assume for purposes of the proposed examples that the foundation will comply with the expenditure responsibility requirements of section 4945 whenever necessary and will not engage in self-dealing transactions described in section 4941. We also assume that no part of the proposed investment involves influencing legislation or elections and that, to the extent expenditure responsibility is required, the private foundation will take appropriate steps to comply with the expenditure responsibility requirements of section 4945.

We have not included any examples that focus on the legal status of the PRI borrower or investee being a limited liability company (“LLC”), as opposed to a corporation or partnership. LLCs have been more commonly used for PRIs in recent years. Low-profit LLCs, also known as L3Cs, have received significant recent attention but are merely a subset of regular LLCs. The various state statutes authorizing L3Cs all require the organization’s organizational documents to include suitable “charitable purposes” language. Exempt-organization tax practitioners typically also include these provisions in loan or investment documents for a regular LLC (even without any statutory mandate). We believe that, if a particular loan to, or investment in, an ordinary LLC would qualify as a PRI, then, *a fortiori*, a loan to, or investment in, an L3C should also so qualify. We also believe that LLCs do not warrant specific guidance.

The examples proposed in these Comments preserve the format of the existing ten examples by including some variation on the following type of language: “The loan has no significant purpose for P involving the production of income or the appreciation of property. The loan significantly furthers the accomplishment of P’s exempt activities and would not have been made but for its relationship to P’s exempt activities. Accordingly, the loan is a PRI.”

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<sup>13</sup> Reg. § 53.4944-3(b).

### **Example 1: Development and Marketing of New Drug**

C is a major, publicly traded pharmaceutical company with a substantial research and development budget. P is a private foundation whose exempt purposes include improving public health worldwide. P has consulted experts who have advised P that, with enough financial support, drug D might be developed within ten years to effectively treat a debilitating disease affecting millions of people in poor countries. C does not have a research program directed at developing drug D, and P has concluded that commercial drug companies like C are unlikely to devote the resources required because the potential market for drug D is not as certain or as immediately profitable as others C can pursue. If drug D is successfully developed and marketed, it may substantially improve public health in the affected countries as well as producing significant profits for C. Only a very small percentage of drug candidates successfully complete clinical trials and satisfy other regulatory tests. Over the course of five years, P proposes to engage in three separate investments with C.

First, P will make a loan to C at a below-market rate of interest, if C agrees to (i) devote the proceeds and a stated percentage of its own research and development funds to developing drug D over the next ten years and (ii) either manufacture and market or license drug D if developed in that time. C would not be willing to engage in such research activities absent P's loan. P's primary purpose in making the loan is to further its exempt activities, and the loan has no significant purpose for P involving the production of income or the appreciation of property. C is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The loan significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's loan is a program-related investment.

Second, P will invest in the equity of S, a corporate subsidiary that C has established to conduct the research and development activity. The agreement pursuant to which P invests in S will require that S work toward the development of drug D and remain focused on developing country needs that are distinct from C's other drug development activities. C has not been able to secure any venture capital investors because of the high risk involved in developing a new drug. P makes investments, but making an equity investment in S is not the type of investment that P would normally make under its investment policy. Although P's equity investment in S is likely to greatly increase in value if the development of drug D is successful, P's primary purpose in making the investment is to further its exempt activities, and the investment has no significant purpose for P involving the production of income or appreciation of property. S is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The investment significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's investment in shares of S is a program-related investment.

Third, five years later, C, through S, has successfully developed drug D and tested it. The drug is now ready to bring to market. Due to cash constraints, C is unwilling to

incur the substantial expenditures required to market, manufacture and distribute drug D, to train health-care providers in its use, or both unless P agrees to make an additional below-market rate loan to C. P makes the additional loan to C. P's primary purpose in making the additional loan is to further its exempt activities, and the loan has no significant purpose for P involving the production of income or the appreciation of property. C is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The loan significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's loan is a program-related investment.

***Analysis:** The first part of this proposed Example confirms that, if the potential for C to make a substantial profit on the sale of new drug D is secondary to furthering a clear charitable purpose, the profit potential is not problematic.<sup>14</sup> But for P's initial below-market rate loan, C would not undertake the research and development necessary to bring drug D to the market. P's purpose in making the loan is to facilitate the development and marketing of drug D, which will likely substantially improve the health of millions of people in poor countries. While it is clear that, if an activity is charitable when conducted in the U.S., it is likewise charitable if conducted in a foreign country, none of the examples in the current Regulations confirm this conclusion.*

*The second part of this proposed Example links an equity investment in a for-profit company, which is already a permitted form of PRI despite the possibility of a significant return, with accomplishing a charitable purpose in a foreign country, which is also permitted. None of the examples in the current Regulations address both features.*

*The third part of this proposed Example illustrates that bringing a developed product to market serves a charitable purpose if the product will provide a direct benefit to a charitable class. C is unwilling to invest capital to bring the drug to market, and P's below-market rate loan will provide the necessary funds for C to manufacture, market, and distribute drug D, and for C to train health-care providers in its use, thereby benefiting millions of people in poor countries. The potential for C to make a profit on the manufacture and sale of drug D is secondary to furthering a clear charitable purpose. The analysis and conclusions in this example should apply equally to other products, such as low-cost water pumps, water purification or filtering systems, and solar panels designed to help the poor.*

## **Example 2: Development of New Organic Farming Process**

C is a start-up corporation that has been actively seeking venture capital financing. C has obtained commitments from several venture capital investors, but has not obtained sufficient funding to move forward. C's "product" is a new process that would greatly reduce the losses of certain crops to pests without the use of pesticides, thereby making organic farming of such crops cheaper, more profitable and more

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<sup>14</sup> See *Plumstead Theatre Soc., Inc. v. Commissioner*, 74 T. C. 1324 (1980), *aff'd*, 675 F.2d 244 (9<sup>th</sup> Cir. 1982).

widespread. P is a private foundation whose exempt purposes include fostering and promoting a cleaner environment. P has concluded that, if C's process is widely adopted, the process will expand use of organic farming and reduce in the world's total pesticide burden. C believes that it is unable to attract other investors, and C approaches P to invest in C's equity. Although P makes occasional investments in start-up businesses, an investment in the shares of C is not the type of investment that P would normally make under its investment policy. As with all venture capital investments, the risk of loss is extremely high, but, if successful, the potential return on investment is also extremely high. P will invest in shares of C for the purpose of enabling C to successfully market its new process, and thereby reduce pesticide use and promote a cleaner environment. P invests in the shares of C.

Although P's equity investment in C is likely to greatly increase in value if the development of C's new process is successful, P's primary purpose in making the investment is to further its exempt activities, and the investment has no significant purpose for P involving the production of income or appreciation of property. C is a for-profit business, but C is merely the instrument by which P seeks to accomplish its exempt purposes. The investment significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's investment in shares of C is a program-related investment.

#### **Example 2A: Development of New Organic Farming Process**

The facts are the same as Example 2, except that, rather than turning to P after C has obtained some, but not enough, commitments from venture capital investors, C requests an equity investment from P as the first investor. C believes that P's investment will help bolster the credibility of the venture, and that P's investment is necessary to enable C to attract sufficient other investors.

Although P's equity investment in C is likely to greatly increase in value if the development of C's new process is successful, P's primary purpose in making the investment is to further its exempt activities, and the investment has no significant purpose for P involving the production of income or appreciation of property. C is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The investment significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's investment in shares of C is a program-related investment.

***Analysis:** When the potential for C, its other investors, or P to make a substantial profit if C's new "product" is successful is secondary to furthering a clear charitable purpose, the potential has not been problematic since Plumstead Theatre Society v. Commissioner.<sup>15</sup> But for P's equity investment, C would not undertake development of the new "product" because C does not otherwise have sufficient capital. P's investment in C enables the development of an organic farming process whose use will produce*

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<sup>15</sup> 74 T. C. 1324 (1980), *aff'd*, 675 F.2d 244 (9<sup>th</sup> Cir. 1982).

*significant environmental benefits, not financial returns. While there are authorities supporting efforts to preserve and protect the environment, none of the examples in the current Regulations address this important charitable endeavor. Proposed Examples 2 and 2A illustrate alternative investments that have no significant purpose of the production of income or the appreciation of property. Traditionally, P would invest on terms less favorable than those available to other investors. In proposed Example 2, P invests only after C is unable to attract other investors. In proposed Example 2A, C believes that P's investment is necessary to enable it to attract sufficient other investors.*

### **Example 3: Loan with Equity Kicker**

The facts are the same as in Example 2, except that P's investment in C takes the form of a loan with a below-market interest rate, and C also offers P pre-initial public offering shares in C as an inducement to make the loan. If C is unsuccessful, the shares will be worthless, but if C is successful and either engages in a public offering or is acquired by a larger company, the value of P's investment in the C shares might increase enough so that P would receive an extremely high rate of return on its investment. C made the same offer to a series of venture capital investors, but was unable to obtain sufficient financing on these terms.

Although P's loan and equity investment in C is likely to greatly increase in value if the development of C's new process is successful, P's primary purpose in making the loan and investment is to accomplish its exempt activities, and the loan and investment have no significant purpose for P involving the production of income or the appreciation of property. C is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The loan and investment significantly further the accomplishment of P's exempt activities and would not have been made but for their relationship to P's exempt activities. Accordingly, P's loan to, and investment in the shares of, C are program-related investments.

***Analysis:** We believe the addition of pre-IPO shares to P's potential return should not disqualify a loan or equity investment from being a PRI. The current Regulations provide generally that an investment's potential to produce significant income or capital appreciation is not, alone, conclusive evidence of a significant purpose involving the production of income or appreciation of property. This proposed Example explores "other factors" to be considered. The current Regulations further provide that it is "relevant" – but not determinative – whether a hypothetical investor solely engaged in investment for profit would be likely to make the investment on the same terms.*

### **Example 4: Terrorist Attack or Natural Disaster**

X, Y, and Z are small to mid-sized, for-profit business enterprises located in N, a domestic, urban area. A, B, and C are small to mid-sized farms located in R, a domestic, rural area. A terrorist attack occurs in N, and results in significant damage to the business district of N where the offices of X, Y, and Z are located. The business operations of X, Y, and Z are harmed because much of the infrastructure and many of the buildings in the

business district have been damaged, and customers have lost convenient access to the business district. X, Y, and Z are having difficulty meeting their respective financial obligations. Similarly, a natural disaster occurs in R. The farming operations of A, B, and C are harmed because of extensive damage to their crops, equipment, and buildings. Although they have not sought funding from conventional sources, A, B and C, as well as X, Y and Z, believe that conventional sources of funds would be unwilling or unable to provide funds on terms that they would consider economically feasible. P is a private foundation whose exempt purposes include alleviating poverty, providing relief to the poor and distressed, and combating community deterioration. P makes loans to A, B, C, X, Y, and Z bearing rates of interest somewhat reflecting the credit risk of the businesses and circumstances, but on terms that are financially acceptable to them.

P's primary purpose for making the loans is to assist those businesses located in the business district of N harmed by the terrorist attack, and in the rural area R harmed by the natural disaster. The loans made by P have no significant purpose involving the production of income or the appreciation of property. A, B, C, X, Y, and Z are for-profit businesses, but they are merely the instruments by which P seeks to accomplish its exempt purposes. The loans significantly further the accomplishment of P's exempt activities and would not have been made but for their relationship to P's exempt activities. Accordingly, the loans to A, B, C, X, Y, and Z are all program-related investments.

***Analysis:** This proposed Example updates the traditional charitable purpose of economic redevelopment of a physically "blighted" area. The fact that the blight and accompanying economic distress were caused by terrorism, rather than natural decay, does not diminish the traditional, charitable nature of its relief. While urban redevelopment is reflected in several examples in the current Regulations, a new example addressing terrorism would be helpful because P would need to act quickly, without taking time to seek a ruling. No further discussion is necessary with respect to whether (a) a below-market rate loan has the production of income as a significant purpose, or (b) the "instruments" through which the foundation seeks to accomplish its charitable purposes must themselves be tax-exempt entities.*

*None of the examples in the current Regulations addresses combating community deterioration and blight in rural areas. An Example addressing a natural disaster affecting such areas would be helpful because P would need to act quickly, without taking time to seek a ruling.*

### **Example 5: Environmental Investments in Poor Countries**

F is a foreign, for-profit financial intermediary formed for the purpose of financing and promoting the expansion of environmentally oriented businesses that will contribute to conservation and economic development in areas of poor countries that are environmentally sensitive. F will make direct investments in businesses in poor countries that foster and promote sustainable use of natural resources, the preservation of biological diversity, and organic agriculture with biodiversity linkages. P is a private foundation

whose exempt purposes include fostering and promoting biodiversity and environmental sustainability, as well as developing economically undeveloped or underdeveloped countries or regions. P makes equity investments, but an investment in the shares of F is not the type of investment that P would normally make under its investment policy. F has a target of generating an 18% to 22% rate of return for its investors. Although seemingly high for domestic investments, the projected rate of return is significantly less than the acceptable rate of return on international venture capital fund investments of comparable risk in poor countries. The targeted rate of return, taken as a factor by itself by P, in a normal investment strategy (and not in conjunction with a program-related investment), would not compensate P for the speculative nature of the investment and overall risk associated with F's unique investment characteristics. P invests in the shares of F.

Although P's equity investment in F is likely to generate a significant return if F is successful, P's primary purpose in making the investment is to further its exempt activities, and the investment has no significant purpose for P involving the production of income or the appreciation of property. F is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The investment significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's investment is a program-related investment.

*Analysis: This proposed Example is based on existing guidance<sup>16</sup> and addresses environmental purposes and economic development in poor countries, plus several important, but previously unaddressed, relationships. It is important in a world economy to be able to use foreign, for-profit financial intermediaries to accomplish philanthropic goals. The role of F is consistent with the use of the non-tax exempt entities described in existing guidance as "mere instruments" by which charitable purposes are accomplished. Although a projected rate of return might appear high, it actually may be below market for a high-risk, international venture capital fund investing in poor countries. Taking into account the fact that the rate is misleading is consistent with the approach in the current Regulations, which look beyond the mere fact that the investment "produces significant income or capital appreciation" to the "presence or absence of other factors." Even a projected return of 18% to 22% may be inadequate for a hypothetical investor solely engaged in investment for profit. If so, P may make the investment as a PRI.*

### **Example 6: Foreign Economic Development**

M is a poor country with a shortage of energy, natural resources, food and housing. Local bank loans to businesses in M, if available, are at rates that are not economically feasible. W and X are commercial banks, and Y is a struggling small business. W, X, and Y operate in M. Z is a financially secure business located outside M. Z is unwilling to locate any operations in M without some financial inducements. P

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<sup>16</sup> See PLR 200136026 (Jun. 11, 2001); Rev. Rul. 74-587, 1974-2 C.B. 162.

is a private foundation whose exempt purposes include alleviating poverty, providing relief to the poor and distressed, and combating community deterioration. P makes the following loans (collectively, the “Foreign Investments”): (a) a loan to the government of M at a below-market rate, the terms of which require that the money be re-loaned to W and X (who both join in the loan agreement) at a below-market rate, and that W and X re-loan those proceeds to local small businesses at below-market rates following standardized lending practices agreeable to P; (b) a below-market rate loan to Y (or otherwise on less favorable terms than customarily required by commercial lenders or investors for profit); and (c) a below-market rate loan to Z (or otherwise on less favorable terms than customarily required by commercial lenders or investors for profit) on the condition that Z locate operations in M.

P’s primary purpose in making each of the Foreign Investments is to further its exempt activities, and the Foreign Investments have no significant purpose involving the production of income or appreciation of property. W, X, Y and Z are for-profit businesses, but they are merely the instruments by which P seeks to accomplish its exempt purposes. The Foreign Investments significantly further the accomplishment of P’s exempt activities and would not have been made but for their relationship to P’s exempt activities. Accordingly, all of the Foreign Investments are program-related investments.

***Analysis:** This proposed Example is based on existing guidance.<sup>17</sup> The below-market rate loan to Y demonstrates how an investment in a foreign for-profit business may accomplish a charitable purpose. The below-market rate loan to M, the proceeds of which must be re-loaned to commercial banks in M, who must then re-loan those proceeds at below-market rates following standardized lending practices agreeable to P, demonstrates that the separation of P from the organization (the “instrument”) actually accomplishing the charitable purpose does not prevent the investment from qualifying as a PRI. The below-market rate loan to Z, to induce its location of operations in M, demonstrates that P is not limited to inducing companies to locate (and thereby provide jobs) in blighted, U.S. inner-city neighborhoods, as envisioned by the examples in the current Regulations. The loans to Y and Z demonstrate that an interest rate might be “below-market” despite appearing to be “at market,” due to one or more terms that increase the risk relative to loans by for-profit lenders or investors.*

### **Example 7: Rate of Return on Investment in Deteriorated Downtown**

X is a limited partnership that will construct and own a large hotel in the currently blighted and deteriorated downtown area of Y, a city in the United States. The land on which the hotel will be constructed is owned by the City of Y, which acquired it by eminent domain as part of a downtown redevelopment plan. Y will lease the land to X for 99 years. Long-term financing for the new hotel is provided by a group of local banks, corporations, and foundations. The foundation investors will receive interest on

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<sup>17</sup> See PLR 199943058 (Aug. 6, 1999); PLR 200036050 (Jun. 13, 2000); Rev. Rul. 74-587, 1974-2 C.B. 162.

their loans at a rate significantly exceeding the current “prime” rate and normal return on their portfolio investments, and the other lenders will receive the same rate plus a percentage of total room rentals over a set amount. P is a private foundation whose exempt purposes include alleviating poverty, providing relief to the poor and distressed, and combating community deterioration. P makes a loan to X to help finance the new hotel, whose financial success is far from certain.

Although if X is successful in developing the new hotel, P is likely to earn a return on the loan at a rate significantly exceeding the current “prime” rate and the normal return on conventional portfolio investments by foundations, this potential does not, alone, necessarily indicate a profit motive; all factors must be considered. P’s primary purpose in making the loan is to further its exempt activities, and the loan has no significant purpose involving the production of income or appreciation of property. X is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The loan significantly furthers the accomplishment of P’s exempt activities and would not have been made but for its relationship to P’s exempt activities. Accordingly, the loan is a program-related investment.

#### **Example 7A: Rate of Return on Investment in Deteriorated Downtown**

The facts are the same as in Example 7, except that the investment by P and the other foundations will take the form of an equity investment in exchange for limited partnership interests in X. Under the terms of the partnership agreement, P and the other foundations will receive guaranteed payments (within the meaning of section 707(c)) on their limited partner capital accounts at a rate significantly exceeding both the current “prime” rate and the normal return on their portfolio investments. Other than such guaranteed payments, P and the other foundations will not be entitled to any income or distributions from X. As in Example 7, the non-foundation participants (*i.e.*, the local banks and corporations) will receive a rate of return comparable to that received by P and the other foundations, but they also will receive a percentage of total room rentals over a set amount.

Although if X is successful in developing the new hotel, P is likely to earn a return on its investment at a rate significantly exceeding the current “prime” rate and the normal return on conventional portfolio investments by foundations, this potential does not, alone, necessarily indicate a profit motive; all factors must be considered. P’s primary purpose in making the investment is to further its exempt activities, and the investment has no significant purpose involving the production of income or appreciation of property. X is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The investment significantly furthers the accomplishment of P’s exempt activities and would not have been made but for its relationship to P’s exempt activities. Accordingly, the investment by P is a program-related investment.

***Analysis:** The two proposed Examples on limited partnership investments, which are based on existing guidance,<sup>18</sup> illustrate the traditional charitable endeavor of revitalizing a deteriorated downtown area in a U.S. city. Of particular interest is the interest rate (15.0 % in existing guidance, which considerably exceeded the then current “prime” rate and normal return on P’s portfolio investments). Even though the rate of return for a domestic investment may appear high, we believe “other factors” are relevant in determining whether a significant purpose of the investment is the production of income or appreciation of property. Proposed Example 7A varies the facts to illustrate that a section 707(c) guaranteed payment does not change the conclusion.*

### **Example 8: Credit Enhancement & Fees**

X, a tax-exempt science museum, owns land on which it wants to construct a larger, more modern museum building, but as a result if its credit rating X cannot obtain long-term financing at an affordable rate. The specific use for which the new museum will be constructed reduces its value as collateral. P is a private foundation whose purposes include charitable, scientific, and educational purposes. P makes one of the following investments: (a) P issues a letter of credit in favor of the bond trustee to guarantee payment of the first 20% of the principal amount of 20-year museum construction bonds to be issued by X and sold to investors, which bonds will be secured by the land and new museum building and bear a market interest rate; or (b) instead of issuing a letter of credit, P purchases from its bank (and guarantees to the bank) a letter of credit in favor of an insurance company to guarantee payment of the first 20% of the principal amount of a 20-year mortgage loan to be made to the museum by the insurance company, which loan will be secured by the land and new museum building and bear a market interest rate; or (c) instead of issuing or purchasing a letter of credit, P signs a guaranty of payment of the first 20% of the principal amount of a 20-year mortgage loan to be made to the museum by a commercial bank, which loan will be secured by the land and new museum building and bear a market interest rate. In each instance, P receives from X an initial fee in the amount of 1% of the amount of the total amount guaranteed, plus an additional annual fee of 1% of the amount guaranteed outstanding from time to time.

In all three instances, P’s primary purpose in providing the alternative credit enhancements to X is to further its exempt activities, and the credit enhancement has no significant purpose involving the production of income or appreciation of property. The alternative credit enhancements significantly further the accomplishment of P’s exempt activities and would not have been made but for their relationship to P’s exempt activities. Accordingly, the alternative credit enhancements are all program-related investments.

***Analysis:** All three scenarios in this proposed Example, which are based on existing guidance,<sup>19</sup> involve providing credit enhancement to enable a science museum*

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<sup>18</sup> See PLR 8301110 (Oct. 8, 1982).

<sup>19</sup> See PLR 9033063 (May 24, 1990) and PLR 200043050 (Jul. 25, 2000).

*with a sagging credit rating to construct a larger, more modern building. In each alternative, P charges both initial and annual fees, a common practice in commercial lending and credit transactions that has been approved in guidance. If P is ever required to fund its letter of credit or guaranty, or repay the bank if X draws on the letter of credit, P's payments will constitute qualifying distributions.*

### **Example 9: Equity Investment and Loans with Equity Kicker**

X is a small-business enterprise located in Z, a country that is economically depressed. Because X has generated little or no net income since its inception, conventional lenders are unwilling to provide funds to X at reasonable interest rates unless X increases the amount of its equity capital. P is a private foundation whose purposes include alleviating poverty, providing relief to the poor and distressed, and combating community deterioration. P and two for-profit investors purchase shares of two new classes of X's common stock. The two for-profit investors will be entitled to an annual dividend equal to five percent of X's net income, while P will be entitled to no such preferential annual dividend. P is compensated for the increased risk of holding an equity investment in X by being entitled to receive an "equity kicker" in the form of a special dividend (to be paid annually) in any year in which X's net income exceeds a stated dollar amount. The dividend will be ten percent of the excess amount of income. In addition, P will make a below-market loan, which will also entitle P to an additional "equity return" based on the same terms as its equity investment.

Although P's investments in X are likely to generate substantial returns if X is successful in its business ventures, including appreciation of X's common stock and X's payment of the special dividend in any year, P's primary purpose in making the investments is to further its exempt activities, and the investments have no significant purpose for P involving the production of income or the appreciation of property. X is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The investments significantly further the accomplishment of P's exempt activities and would not have been made but for their relationship to P's exempt activities. Accordingly, P's investments are program-related investments.

***Analysis:** While this proposed Example supports P's investment in a foreign country for traditional, charitable purposes, such as economic development and generating new jobs, its critical feature is the form of P's investment. Although P may earn more than an ordinary investor in an ordinary investment situation (i.e., the "equity kicker"), P is not acting in the same manner as a for-profit investor. The for-profit investors would not invest in X on the same terms; instead, the for-profit investors will receive the first five percent of X's annual profits, rather than ten percent over a stated threshold. P's investment may produce significant income or capital appreciation, but that fact, alone, is not conclusive evidence of a significant profit motive.*

### **Example 10: Lessening the Burdens of Government**

The downtown area of the City of M is old and deteriorated; further, it is located next to the area's most distressed low-income community. The City of M, together with its local community, civic and business leaders, wants to regenerate the downtown area into a center of commerce, housing, transportation, governmental services, cultural activities, and higher education opportunities. The redevelopment will also result in the creation of many new jobs. As a result of existing renewal projects, there is a significant shortage of parking in the downtown area. The existing developments have both eliminated prior open air parking lots and created an ever-increasing demand for parking. A study commissioned by the City of M determined that there is already a desperate need for substantially more parking in the downtown area, and the problem increases as redevelopment continues and more employees, persons using municipal services and the courthouse, shoppers, diners, and visitors come to the downtown area. Through its powers of eminent domain, the City of M acquired a large tract of land in the downtown area that is ideally suited for a parking garage. The City of M has agreed to lease the land to LLC X for development as a parking garage. LLC X is majority-owned and controlled by D, a for-profit real estate developer, who will operate and manage the new parking garage and receive a management fee. The other members of LLC X will include local businesses, community organizations, and civic-minded investors. LLC X will borrow some of the necessary construction funds from a group of local banks, at market interest rates, and mortgage the improvements as security for the loan. P is a private foundation whose exempt purposes include alleviating poverty, providing relief to the poor and distressed, combating community deterioration, and lessening the burdens of government. The provision of additional parking is essential to serve the needs of the stores, restaurants, municipal buildings, courthouse, and cultural and educational facilities being developed, as well as job creation. The City of M considers the provision of parking to be its burden and has requested, in writing, that LLC X assume some of this burden. Therefore, provision of parking serves to "lessen the burdens of government" within the meaning of Regulation section 1.501(c)(3)-(1)(d)(2). P will make a loan to LLC X for the remainder of the necessary funds at a below-market interest rate, without collateral (or otherwise on less favorable terms than customarily required by commercial lenders or investors for profit).

P's primary purpose in making the loan is to further its exempt activities, and the loan has no significant purpose involving the production of income or appreciation of property. LLC X is for-profit business, notwithstanding it having certain members that are community organizations and civic-minded investors, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The loan significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's loan is a program-related investment.

### **Example 10A: Lessening the Burdens of Government**

The facts are the same as in Example 10, except that the investment by P will take the form of an equity investment in exchange for a membership interest in LLC X. P's membership interest in LLC X will be subordinate to the other membership interests in LLC X such that the other investors will be entitled to a fixed, market-rate of return (the "hurdle rate") on their investment before P will be entitled to any return on its investment. Moreover, P's investment return will be capped at a fixed, below-market rate, and P's investment will be repaid only if and when the other investors have received distributions equal to their hurdle rate plus the return of all of their contributed capital. Otherwise, P will participate in distributions, including liquidating distributions, from LLC X on a pro rata basis along with the other investors in LLC X.

Although if LLC X is successful, P's investment in LLC X is likely to generate substantial returns, including appreciation of X's membership interests and X's payment of the investment return, P's primary purpose in making the investment is to further its exempt activities, and the investment has no significant purpose for P involving the production of income or the appreciation of property. LLC X is for-profit business, notwithstanding it having certain members that are community organizations and civic-minded investors, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The investment significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's investment is a program-related investment.

***Analysis:** Urban renewal and economic redevelopment of physically blighted and economically depressed neighborhoods are traditional charitable purposes already addressed by the examples in the current Regulations. None of the examples in the current Regulations address activities of "lessening the burdens of government," But analogous circumstances have been addressed in other guidance.<sup>20</sup> The proposed Example would confirm the propriety of this purpose. Also, although P's loan to LLC X may be at a "below-market" rate, some other term or terms make P's loan unattractive to commercial lenders or for-profit investors under the circumstances. We believe the alternative capital strategy in proposed Example 10A should not change any of the conclusions.*

### **Example 11: Solar Enterprises in Foreign Countries**

It is important to demonstrate a viable business model for the for-profit sector to provide an alternative source of power to un-electrified parts of the world because the nonprofit and governmental sectors lack the resources to bring power grids all of these regions. PC, a 501(c)(3) public charity formed to help bring solar power to un-electrified regions, plans to identify potential solar power companies and provide them with technical training and assistance in developing viable business plans. PC also plans to create and manage a solar development fund, in the form of a for-profit limited liability

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<sup>20</sup> See PLR 200124022 (Mar. 13, 2001).

company that will invest in equity of companies determined to be investment-ready. P is a private foundation whose purposes include promoting the security and well-being of people and the environment around the world. P is interested in bringing reliable power to poor populations in un-electrified parts of the world because the absence of electricity requires resorting to candles, batteries, kerosene, etc., which are expensive and hazardous to health and the environment, and electricity supports refrigeration for food and medical supplies, better medical equipment, machinery (such as sewing machines) for small businesses, and better communication (such as telephones and computers). P has determined that solar power is a viable source of electricity for communities that are close to the equator, and that the cost to residents will be competitive with alternative energy sources. Because few companies are capable of providing reliable solar power to these communities, there is a need to develop new businesses for this purpose. P hopes to demonstrate to the relevant audiences – consumers, companies, and investors – that solar power is an economically viable business in targeted areas. P makes investments, but making an equity investment in PC’s fund is not the type of investment that P would normally make under its investment policy due to PC’s lack of experience, the speculative nature of the venture, and the overall high risk of the venture. P has agreed to make an equity investment in PC’s solar development fund but only if PC prepares a report on the outcome of the project for dissemination within the international development community because P hopes that solar power companies will be encouraged to attract capital from traditional investors to bring power to un-electrified communities. Other investors will include international organizations and socially minded for-profit companies. If PC’s fund is successful, the projected return is in the 15% to 20% range, but this return is significantly below what P’s investment advisors consider to be a market rate considering the risks involved.

Although P’s investment in PC’s fund is likely to generate a substantial return if it is successful, P’s primary purposes in making the investment is to further its exempt activities, and the investment has no significant purpose for P involving the production of income or the appreciation of property. The investment significantly furthers the accomplishment of P’s exempt activities and would not have been made but for such relationship between the investment and P’s exempt activities. Accordingly, P’s investment is a program-related investment.

***Analysis:** The project in this proposed Example serves several charitable purposes, including promotion of public health and welfare, fostering economic self-sufficiency, and protection of the environment. In addition, as a demonstration project, it serves educational purposes. The benefit to the solar power businesses assisted by the project is incidental to the broader public benefits of the project. The facts are based on an actual project undertaken several years ago.*

**Example 12: Loans to Wholesaler to Purchase Organically Grown Cacao from Poor Farmers in Central and South America**

W is a for-profit commodities wholesaler that purchases organically grown cacao from poor farmers (directly or through farmer-owned cooperatives) in economically

undeveloped, environmentally sensitive, humid tropical forest regions of Central and South America, resulting in improved living conditions for those farmers and their families as well as both local and global environmental benefits. All eligible farmers must adhere to recognized, sustainable, organic agricultural techniques. Chocolate manufactured from organic cacao is better quality, tastes better, and brings higher prices than chemically grown cacao, requiring W to pay premium prices to the poverty-stricken farmers living in those tropical forests. P is a private foundation whose purposes include alleviating poverty, providing relief to the poor and distressed, and combating community deterioration. P will make a low-interest rate loan to W to allow W to engage in certain ancillary activities, such as research on sustainable agriculture employing organic methods and non-chemical pest control, organic certification assistance, and technical assistance and training to poor farmers. These activities will have a charitable effect. W's activities will also serve as a demonstration project that can be replicated elsewhere.

P's primary purpose in making the loan is to further its exempt activities, and the loan has no significant purpose involving the production of income or appreciation of property. W is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The loan significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's loan is a program-related investment.

***Analysis:** The loan in this proposed Example serves several charitable purposes, including relief to the poor and distressed or the underprivileged, and a beneficial effect on the environment and wildlife. In addition, as a demonstration project, W's activities serve an educational purpose for other geographic areas and for other forms of environmentally sensitive farming and harvesting.*

### **Example 13: Loans for Mortgage Assistance**

Individuals seeking a third-party loan must provide information about their current monthly income, if any, their assets and the circumstances around which they have lost employment. They must also demonstrate that they have not acted irresponsibly by, for example, accumulating large amounts of credit card debt for discretionary purchases or by purchasing a home that is obviously beyond their means. P is a private foundation whose exempt purposes include alleviating poverty, and providing relief to the poor and distressed. P will make loans to benefit individuals who have lost their jobs, through no fault of their own, and who are unable to pay their mortgages. P will evaluate each candidate separately. Some loans will be made directly to individuals, and some loans will be made through financial intermediaries. When P makes the mortgage payments directly to the applicant's lender, on behalf of the applicant, the applicant will sign a promissory note to P obligating the applicant to repay the amount of the loan with a below-market interest rate. The applicant's obligation to repay begins after the applicant finds meaningful employment or after the passage of Z years, whichever comes first. When P makes loans to for-profit and tax-exempt, not-for-profit community development financial institutions ("financial intermediaries"), the financial intermediaries will create and make available mortgage refinance products to

homeowners in low- and moderate-income communities who are burdened with adjustable rate mortgage loans made by predatory or sub-prime lenders to enable those homeowners to refinance their mortgages with affordable rescue loans and remain in their homes. P's loans to the financial intermediaries will be unsecured and will bear interest at a below-market interest rate. The mortgage refinance loans made by the intermediaries to the homeowners facing foreclosure will be at fixed, market rates. Reputable studies have shown that there is a ripple effect caused by abandoned or vacant homes, which is the usual outcome of foreclosures. The effects include physical deterioration and blight, lessening of the value of surrounding homes and neighborhoods, and increases in drug dealing and other crimes, demands for municipal services, and community tensions.

P's primary purpose in making loans to individuals and financial intermediaries is to further its exempt activities, to provide relief of the distressed, not all of whom are also poor, and the loans have no substantial purpose involving the production of income or appreciation of property. Although certain financial intermediaries are for-profit businesses, they are merely the instruments by which P seeks to accomplish its exempt purposes. The loans significantly further the accomplishment of P's exempt activities and would not have been made but for their relationship to P's exempt activities. Accordingly, P's loans are program-related investments. In addition, such loans, when made directly to individuals, do not require expenditure responsibility or the Service's approval under section 4945(g).

***Analysis:** The loans in this proposed Example serve charitable purposes by providing relief to distressed (even if not all poor) individuals, helping to prevent or lessen community distress, blight, tensions and other adverse consequences of foreclosures in residential communities, and combating community deterioration. They also lessen the burdens of government associated with the growing number of vacant and abandoned homes in residential communities.*

#### **Example 14: Global Health Technology Fund**

P is a private foundation that has developed S, an approach or strategy to encourage new low-cost diagnostic tools and drug delivery vehicles that will have particular application in poor countries because of specific challenges and conditions that are not widely shared with more developed countries, such as lack of consistent access to clean water, electricity, or refrigeration. Several start-up, for-profit companies possess technologies that have the potential to be developed or adapted for use in S. P will invest in the shares of these companies, directly or through a financial intermediary, to finance the development and regulatory approval of such technologies. As a condition of the investment, the companies must agree to make their technologies available on reasonable terms for use in S, but they are otherwise be free to use the technologies for their own commercial purposes. After a company has fully developed or adapted its technology, or it is established that the technology has failed to achieve its promise, P's share in the company would be liquidated or sold to a third party within a reasonable period of time consistent with the company's overall operations and access to capital.

P's primary purpose in making each of the investments is to further its exempt activities, and the investments have no significant purpose involving the production of income or the appreciation of property. Although the companies are for-profit businesses, they are merely the instruments by which P seeks to accomplish its exempt purposes, and P's ability to withdraw its funds once P's purpose for the investment has been completed ensures the funds will be dedicated to P's charitable purposes. The investments significantly further the accomplishment of P's exempt activities and would not have been made but for their relationship to P's exempt activities. Accordingly, P's investments are program-related investments.

*Analysis:* The investments in this proposed Example promote global health through scientific research and development for the purpose of identifying, treating, and curing diseases that have a disproportionate impact on the poor and underserved in developing countries. This represents an extension of activities approved in guidance,<sup>21</sup> and uses a similar "global access" approach to ensure that any technologies developed by private entities are made available at reasonable cost outside the developed world. It also illustrates how P may exit an equity PRI once the purpose of the PRI has ended.

#### **Example 14A: Global Health Technology Fund – Intellectual Property Rights**

The facts are the same as in Example 14, except that, in addition, each company will grant P a royalty-free license to intellectual property rights in the technologies so long as the technologies could be used for S, with the right to sublicense.

P's primary purpose in making each of the investments is to further its exempt activities, and the investments have no significant purpose involving the production of income or the appreciation of property. Although the companies are for-profit businesses, they are merely the instruments by which P seeks to accomplish its exempt purposes, and P's ability to withdraw its funds once P's purpose for each investment has been completed ensures the funds will be dedicated to P's charitable purposes. The investments significantly further the accomplishment of P's exempt activities and would not have been made but for their relationship to P's exempt activities. Accordingly, P's investments are program-related investments.

*Analysis:* This variant of proposed Example 14 highlights the way that intellectual property rights may be used by P to help safeguard the charitable purpose (i.e., ensuring "global access" to the technologies).

#### **Example 15: Loan to Support Health Insurance for Independent Workers**

N is an urban area with a large population of independent workers, including freelance workers, consultants, temporary employees, part-time employees, and self-employed individuals. These independent workers have difficulty obtaining health

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<sup>21</sup> See PLR 200603031 (Oct. 25, 2005).

insurance coverage at affordable premiums. A, a social welfare organization that is tax-exempt under section 501(c)(4), was formed to provide resources for its membership of independent workers and to engage in lobbying and political activities to assist independent workers. A is establishing S, a for-profit subsidiary that will provide health insurance coverage to A's existing and new members when the members cannot otherwise obtain insurance at affordable rates from other insurance providers. In addition, the health insurance coverage offered by S will be "portable" and will continue even when subscribers move from job to job. P is a private foundation whose exempt purposes include alleviating poverty and providing relief to the poor and distressed. P will make a loan to A to capitalize S. Because of P's loan, S will be able to offer health insurance coverage at affordable rates to independent workers and also to expand its insurance coverage to new categories of low-income independent workers, such as taxi drivers and restaurant workers. P's loan to A will bear an interest rate lower than the interest rates available from conventional sources of funds, but the interest rate on P's loan nevertheless reflects the credit risk of A and S. Under the terms of P's loan, S must enroll a certain percentage of low-income independent workers in its health insurance plan by certain target dates. P's primary purpose for making the loan is to promote the health of independent workers, alleviate poverty, and provide relief to the poor and distressed.

P's primary purpose in making the loan is to further its exempt activities, and the loan has no significant purpose involving the production of income or the appreciation of property. S is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The loan significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's loan to A to capitalize S is a program-related investment.

*Analysis: This proposed Example highlights the need for access to affordable health insurance coverage. A PRI may further the charitable purposes of relieving the poor and distressed and also promoting health. Guidance has previously permitted a subordinated, below-market rate loan to an insurance trust, which provided hard-to-get or less-expensive property and liability insurance for the trust's charitable members.<sup>22</sup>*

### **Example 16: Investment in Newspaper**

L is a well-respected daily newspaper – known for its premiere international affairs coverage and investigative journalism – in N, an urban area. L is published by M, a for-profit company, in hard copy form and is also available free-of-charge electronically through L's website. L, like many other newspapers, has faced financial difficulties due to competition from emerging digital media sources. L's readership and advertising revenue have declined precipitously in the past five years. P is a private foundation whose exempt purposes include advancing education. P makes a loan to M to fund L's foreign affairs coverage. P's loan to M will bear an interest rate lower than available from conventional sources of funds.

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<sup>22</sup> See PLR 8810026 (Dec 8, 1987).

P's primary purpose in making the loan is to further its exempt activities, by preserving L as a source of information on local, national, and international events, available to the general public of N, and the loan has no significant purpose involving the production of income or the appreciation of property. M is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The loan significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, P's loan to M to support L is a program-related investment.

***Analysis:** This proposed Example highlights the need to support for-profit newspapers struggling to exist in the age of digital media. It highlights the need for charitable dollars to support a newspaper's foreign affairs coverage, an educational resource for the general public.*

### **Example 17: Mixed-Income Housing**

C is a for-profit community development corporation organized to purchase, rehabilitate, and construct low and moderate income housing, including some single family homes, in a deteriorating part of an urban center. C has not been able to obtain sufficient funding on reasonable terms from commercial lenders. P is a private foundation whose exempt purposes include alleviating poverty, providing relief to the poor and distressed, and combating community deterioration. P and C believe that the community will be more stable, and more likely to prosper, if low income and moderate income housing co-exist in the same neighborhood. P will make a high-risk loan to C for purposes of developing housing.

P's primary purpose in making the loan is to further its exempt activities and the loan has no significant purpose involving the production of income or the appreciation of property. C is a for-profit business, but it is merely the instrument by which P seeks to accomplish its exempt purposes. The loan significantly furthers the accomplishment of P's exempt activities and would not have been made but for its relationship to P's exempt activities. Accordingly, the loan is a program-related investment.

***Analysis:** This proposed Example draws from Example 10 in the current Regulations, but reflects the modern strategy of combating community deterioration by combining low and moderate income housing in the same area.*