IRS Releases Long-Awaited Program-Related Investment Guidance

On April 18, 2012, the Internal Revenue Service (IRS) released new guidance on the program-related investments (PRIs) of private foundations. Although the proposed regulations – which provide nine new examples of investments that qualify as PRIs – do not break substantial new ground from a practice perspective, they do provide clear regulatory approval of certain principles and structures that have become well-established among PRI makers and practitioners in this area.

The proposed regulations also modernize the existing PRI examples and are more reflective of the types of charitable investments occurring today.

The new examples embody the following principles:

- A PRI may accomplish a variety of charitable purposes—such as advancing science, combating environmental deterioration, and promoting the arts.
- An investment that funds activities in a foreign country may further the accomplishment of charitable purposes and qualify as a PRI.
- The existence of a potentially high rate of return on an investment does not, by itself, prevent the investment from qualifying as a PRI.
- 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.
- Credit enhancements, including guarantees, can qualify as PRIs.
- PRIs may provide loans and capital to individuals or entities that are not themselves within a charitable class if the recipients are the instruments through which a private foundation accomplishes its exempt purposes.

The investments discussed in the examples include:

- an equity investment in a for-profit drug company made for the purpose of developing a vaccine to prevent a disease that predominantly affects poor individuals in developing countries;
- an investment in a new recycling business in a developing country that will recycle solid waste currently being disposed in a manner that contributes significantly to environmental deterioration; the investment, which has a potential for a high rate of return, is analyzed both as a common stock purchase and, in a separate example, as a loan accompanied by an offer of common stock;
- a loan to a business in a rural area that employs a large number of poor individuals, which business has been damaged by a natural disaster;
- loans to poor individuals living in a developing country where a natural disaster has occurred to enable them to start small businesses (a roadside fruit stand and a weaving business);

- a loan to a business that purchases coffee from poor farmers in a developing country, the proceeds of which are to be used to provide the farmers with training about advanced agricultural methods;
- a loan to a social welfare organization to fund the purchase of a large art exhibition space;
- a deposit by a private foundation in a bank to induce the bank to lend an identical amount to a charitable organization for the construction of a new child care facility in a low-income neighborhood; and
- a guarantee by a private foundation of a bank loan to a charitable organization for the construction of a child care facility; the charity is required to reimburse the private foundation for any amounts paid to the bank under the guarantee.

The IRS proposes to add the regulations as Examples 11 through 19 under Treasury Regulations Section 53.4944-3(b). Taxpayers may rely on the examples before the proposed regulations are finalized.

The IRS is accepting comments and requests for a public hearing on the proposed regulations, which must be received by July 18, 2012. The proposed regulations are available at http://www.gpo.gov/fdsys/pkg/FR-2012-04-19/pdf/2012-9468.pdf. ◆

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