

# **The Program-Related Investment Promotion Act of 2008**

## **A Proposal for Encouraging Charitable Investments**

### **BACKGROUND**

Congress has long recognized the value of private foundations investing their assets to support charitable projects and activities. This principle was codified nearly forty years ago in section 4944 of the Internal Revenue Code, which penalizes private foundations for engaging in high-risk investments, unless those investments accomplish charitable purposes.

- Charitable investments permitted under section 4944 are known as **program-related investments** (PRIs).
- PRIs are typically structured as interest-free or below-market loans, loan participations or guarantees, letters of credit, and equity investments. They have been used to support community revitalization, low-income housing, microfinance, historic preservation, social services, education, and many other charitable causes.
- PRIs receive essentially the same tax treatment as grants and may be made purely to further a charitable purpose, without regard to any return on investment.
  - However, in contrast to grants, PRIs may be repaid. Thus, the foundation can recover its charitable investment—and perhaps a return on its investment—and then re-deploy those funds in support of other charitable activities.
  - Moreover, as reflected in the examples in Treas. Reg. § 52.4944-3, PRIs can be used to leverage philanthropic dollars from other sources. Thus, PRIs have the potential to significantly increase the total funds working to advance charitable purposes.

### **THE DIFFICULTY WITH PRIS**

PRIs' tax treatment and potential return should make them attractive to private foundations, both as a grant-alternative and a vehicle for marshaling additional funds to accomplish charitable goals. However, this is not the case.

- Available data suggest that foundations make comparatively few PRIs and a considerable number of those made are simply loans to charities.
- Many foundations view PRIs as difficult to design, implement, and monitor—and they decline to make PRIs because of the perceived complexity and transaction costs.
  - There is no uniform process in place to confirm that a foundation's proposed investment complies, both initially and over time, with the PRI regulations.
  - Nor are there uniform standards for forming economic entities that would be appropriate recipients of PRIs.
  - Requesting an opinion of counsel or a private letter ruling from the IRS can be costly and time-consuming, especially for complex PRIs.

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- In the end, foundations' reluctance to make PRIs presents a significant missed opportunity to increase the number of dollars working toward charitable goals.

### **THE PRI PROMOTION ACT OF 2008**

The recent decline in the financial markets has severely impacted foundation endowments and charitable giving. While the full effect is not yet known, one thing is certain: fewer charitable dollars will be available when the need for such funds is greatest.

We are seeking legislation that will help to facilitate PRIs and, accordingly, the flow of capital from foundations to organizations providing charitable services to those in need. To accomplish this, the **PRI Promotion Act of 2008** includes the following:

- **Determination Process.** The PRI Promotion Act proposes a process whereby an entity seeking to receive PRIs can receive an IRS determination that below-market foundation investments in the entity will qualify as PRIs. Foundations may rely on the determination—and continue to make PRIs in the entity—unless and until the determination is revoked. The process is voluntary: an entity is not required to seek a determination in order to receive a PRI.
- **Rebuttable Presumption for L<sup>3</sup>Cs.** For purposes of the determination process, entities organized under state or tribal law as **low-profit limited liability companies** (L<sup>3</sup>Cs) would be entitled to a rebuttable presumption that below-market foundation investments qualify as PRIs.
  - An L<sup>3</sup>C is a type of LLC that is formed specifically to further a charitable mission. While the L<sup>3</sup>C is a for-profit entity, its primary purpose is to achieve its charitable objective, with profit a secondary goal.
  - Pursuant to statute, an L<sup>3</sup>C must be organized and operated at all times to satisfy the IRS requirements for PRIs. Thus, the L<sup>3</sup>C is designed to qualify as a recipient of PRIs.
  - As a type of LLC, the L<sup>3</sup>C's flexible structure allows members to make different types of investments that have varying levels of risk. The highest-risk investments come from PRIs. By absorbing excess risk, PRIs provide a financial backbone for an L<sup>3</sup>C and position it to attract non-charitable investors that may earn market returns at acceptable levels of risk. Thus, the L<sup>3</sup>C can bring new pools of funds to bear on social problems traditionally addressed by non-profit dollars alone.
  - The L<sup>3</sup>C structure evolved from a desire to relieve economic distress caused by high unemployment—as is occurring in newspaper publishing, automobile manufacturing, furniture, and textiles. However, L<sup>3</sup>Cs can be organized to advance any charitable goal. Proposed L<sup>3</sup>Cs include food banks, health clinics, affordable housing, and museums.
  - On April 30, 2008, Vermont amended its Limited Liability Company Act to include the L<sup>3</sup>C. Similar legislation is being considered by other jurisdictions, including Montana, North Carolina, Georgia, Michigan, Minnesota, and the Crow Nation.

- **Reporting Requirement for Non-Exempt PRI Recipients.** The PRI Promotion Act requires any for-profit organization with a PRI determination to file an information return with the IRS.
  - In the return, the for-profit organization must account for its use of PRI funds consistent with the foundations' charitable purposes and it must provide a narrative description of the charitable accomplishments that resulted from the organization's use of PRI assets.
  - Information returns would be required for years in which the for-profit entity received or held one or more PRI, and would be made available by the IRS for public inspection.

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## **An Act**

*Be it enacted by the Senate and the House of Representatives of the United States of America in Congress assembled,*

### **SEC. 1. SHORT TITLE AND TABLE OF CONTENTS.**

(a) SHORT TITLE.-This Act may be cited as the "Program-Related Investment Promotion Act of 2008."

(b) TABLE OF CONTENTS.-The table of contents for this Act is as follows:

Sec. 1. Short title and table of contents.

Sec. 2. Promotion of program-related investments.

Sec. 3. Declaratory judgment remedy

Sec. 4. Information returns

Sec. 5. Publicity of information

Sec. 6. Conforming amendments.

Sec. 7. Effective date.

### **SEC. 2. PROMOTION OF PROGRAM-RELATED INVESTMENTS.**

Section 4944(c) is amended to read as follows:

“(c) PROGRAM-RELATED INVESTMENTS.-

“(1) TREATMENT OF PROGRAM-RELATED INVESTMENTS.-For purposes of this subchapter, program-related investments:

“(A) are not investments which jeopardize the carrying out of exempt purposes;

“(B) are qualifying distributions under section 4942; and

“(C) are not business holdings under section 4943.

“(2) DEFINITION OF PROGRAM-RELATED INVESTMENT.—For purposes of this subchapter and of chapter 61, an investment made by a private foundation constitutes a program-related investment if:

“(A) the primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B), and

“(B) no significant purpose of the investment is the production of income or the appreciation of property.

Determinations of whether an investment qualifies as a program-related investment shall be based on consideration of all relevant facts and circumstances.

“(3) SAFE HARBOR DETERMINATIONS.—The Secretary shall establish a procedure under which an entity seeking to receive program-related investments may petition the Secretary for a determination that below market rate investments by private foundations in such entity will be program-related investments meeting the requirements of paragraph (2). Under this procedure, the Secretary shall rule on all requests within 90 days of submission. Entities organized under state law, or the law of any federally-recognized tribe, as low-profit limited liability companies shall be entitled to a rebuttable presumption that below market rate investments by private foundations in such entities are program-related investments.

“(4) EFFECT OF DETERMINATION.—Once a determination has been made that below market rate investments in an entity qualify as program-related investments, organizations making such investments shall be entitled to rely on the determination, unless and until the Secretary publishes notice of revocation of the determination.

“(5) VOLUNTARY NATURE OF THE PROCESS.—Entities seeking program-related investments are not required to seek a determination under paragraph (3) and the absence of such a determination shall not affect the ability of a private foundation to make a program-related investment based on its own determination that the investment qualifies as a program-related investment.

“(6) ORGANIZATIONS TREATED AS PRIVATE FOUNDATIONS.—For purposes of this subsection and section 6104A, all references to private foundations include organizations that are treated as private foundations under any of the provisions of sections 4940 through 4948, inclusive, whether created under state law or the law of any federally-recognized tribe.

“(7) BELOW MARKET RATE INVESTMENT.—For purposes of this subsection, a below market rate investment is an investment that would be unlikely to be made on the same terms by an investor engaged in the investment solely for profit.”.

### **SEC. 3. DECLARATORY JUDGMENT REMEDY.**

Section 7428(a)(1) is amended by striking “or” at the end of subparagraph (D) and by adding after subparagraph (D) the following new subparagraph:

"(E) with respect to whether investments in an entity are program-related investments (as described in section 4944(c)(2)), or"

#### **SEC. 4. INFORMATION RETURNS.**

Part III of subchapter A of chapter 61 of the Internal Revenue Code shall be amended by inserting after section 6033 the following new section:

##### **“SEC. 6033A. INFORMATION REPORTING BY FOR-PROFIT ORGANIZATIONS RECEIVING PROGRAM-RELATED INVESTMENTS.**

“(a) ORGANIZATIONS REQUIRED TO FILE.—Any for-profit organization investments in which have been determined to be program-related investments through a determination of the Internal Revenue Service pursuant to section 4944(c)(3), or by a determination of a court pursuant to section 7428(a), shall, in addition to any other applicable filing obligations, file an annual return providing the information specified in subsection (b) for any taxable year in which it receives or retains one or more program-related investments, as defined in section 4944(c)(2).

“(b) REQUIRED REPORTING.—The return described in subsection (a) shall provide, in such manner and at such time as the Secretary may by forms or regulations prescribe, the following information-

- “(1) the organization's gross income for the year;
- “(2) its expenses attributable to such income incurred within the year;
- “(3) its disbursements within the year for the exempt purposes of the organizations holding program-related investments in the organization, together with a narrative statement describing the results obtained from the use of those assets for charitable purposes;
- “(4) a balance sheet showing its assets, liabilities, and net worth as of the beginning of such year;
- “(5) a statement of the portion of its liabilities and net worth that represent capitalization obtained by means of program-related investments as of the beginning of such year;
- “(6) a statement of any interest, dividends, or other distributions paid with respect to any program-related investments during the year;
- “(7) such other information as the Secretary may by forms or regulations prescribe.”.

#### **SEC. 5. PUBLICITY OF INFORMATION.**

Subchapter B of chapter 61 of the Internal Revenue Code is amended by inserting after section 6104 the following new section:

## **“SEC. 6104A. PUBLICITY OF INFORMATION REGARDING ORGANIZATIONS RECEIVING PROGRAM-RELATED INVESTMENTS.**

“(a) INSPECTION OF PETITIONS FOR DETERMINATION OF PROGRAM-RELATED INVESTMENT STATUS.—If an organization seeks a determination pursuant to section 4944(c)(3) that investments by private foundations in such organization will be program-related investments, the petition seeking such a determination, together with any documents submitted in support of such petition, and any determination or other document issued by the Internal Revenue Service with respect to such petition shall be open to public inspection at the national office of the Internal Revenue Service.

“(b) INSPECTION OF ANNUAL INFORMATION RETURNS.—The information required to be furnished by section 6033A shall be made available to the public at such times and in such places as the Secretary may prescribe.

“(c) PUBLIC INSPECTION OF PETITIONS AND ANNUAL RETURNS.—Any organization that receives a determination from the Internal Revenue Service that private foundation investments shall be program-related investments pursuant to section 4944(c)(3) shall make copies available at the organization's principal office, during regular business hours, of the petition for such determination (together with supporting materials provided with the petition and documents issued by the Internal Revenue Service with respect to such petition), as well as the annual returns required by section 6033A filed by such organization. Upon request of an individual made at such principal office, copies of such petition materials and annual reports shall be provided to such individual without charge other than a reasonable fee for any reproduction and mailing costs. The inspection and duplication rights granted in this subsection shall apply to an annual return only during the three-year period beginning on the last day prescribed for filing such return (determined with regard to any extension of time for filing).”.

## **SEC. 6. CONFORMING AMENDMENTS.**

(a) Paragraph (4)(A) of section 501(n) is amended by inserting “paragraph (2) of” before “section 4944(c).”

(b) Paragraph (1) of section 514(b) is amended by redesignating subparagraphs (D) and (E) as subparagraphs (F) and (G) and by inserting after subparagraph (C) the following new subparagraph:

“(D) any property owned or treated as owned by a private foundation by virtue of its having made a below market rate investment (within the meaning of section 4944(c)(7)) in an entity that has received a determination from the Internal Revenue Service pursuant to section 4944(c)(3), or by a court pursuant to section 7428(a), that below market rate investments in such entity qualify as program-related investments;”

(c) Paragraph (1) of section 4942(g) is amended by striking “or” at the end of subparagraph (A), by redesignating subparagraph (B) as subparagraph (C) and by inserting after subparagraph (A) the following new subparagraph:

“(B) any program-related investment, as defined in paragraph (2) of section 4944(c), or”

(d) Paragraph (3) of section 4943(d) is amended by striking “or” at the end of subparagraph (A), by redesignating subparagraph (B) as subparagraph (C) and by inserting after subparagraph (A) the following new subparagraph:

“(B) any program-related investment, as defined in paragraph (2) of section 4944(c), or”

#### **SEC. 7. EFFECTIVE DATE.**

The amendments made by this Act shall be effective as to investments made and returns filed for tax years beginning after December 31, 2008.

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**is a project of the**

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*We leverage our resources to support and expand the breadth, reach, and self sufficiency of the socially beneficial sector and the resources available to achieve socially beneficial results.*