

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
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Date:  
February 14, 2018

### Legend

Foundation =

Dear :

This letter responds to a letter from your authorized representative dated August 16, 2017, and subsequent correspondence, requesting rulings under Internal Revenue Code (“IRC”) §§ 4942 and 4944.

### Facts

Foundation is recognized by the Internal Revenue Service as an organization described in IRC § 501(c)(3) and a private operating foundation under IRC § 509(a). Foundation’s mission is to operate and support educational programs and projects assisting underserved and impoverished children and families.

Foundation represents that it accomplishes its mission by operating a program that achieves lasting positive outcomes for the children and families it serves. Foundation states it builds the capacity of providers and community based organizations to enhance their financial sustainability, operational effectiveness, management knowledge and ability, physical and organizational infrastructure, and policy environment. In addition, Foundation represents it provides technical assistance to policy makers to enhance the regulation and support of early learning providers, offers technical assistance and financing to service providers to enhance the adoption and use of best practices in childhood development, and conducts research and evaluation to identify lessons learned from these efforts.

Foundation proposes to operate a Loan Program. The primary purpose of the Loan Program is to further Foundation’s educational and charitable purposes by making loans to service providers that provide educational programs and other support to impoverished children and families. The Loan Program includes making direct loans to

service providers who lack the stable revenue needed to qualify for commercial loans, and to more financially-secure organizations to fund charitable and educational projects that are financially risky and may not have been undertaken without the financial support offered by Foundation. Additionally, Foundation will make loans to intermediaries that have unique expertise in lending money to and assisting educational and community-based organizations, of which intermediaries will identify qualified service providers and make loans of the Foundation's funds to these service providers. Utilizing intermediaries in this way helps Foundation effectively use its loans to further its charitable and educational purposes.

The borrowers under the Loan Program include providers of education, health, housing or other social services serving Foundation's exempt activities. In addition to lending money to non-profit organizations, Foundation may also loan money to for-profit organizations.

Foundation represents all loans must be used to advance the charitable and educational purposes of the Foundation. Foundation represents that production of income or appreciation of property is not a significant purpose of the Loan Program. Foundation states that the Loan Program typically involves high-risk loans and repayment terms are designed to be favorable to the service provider.

Foundation states that specific repayment terms are determined by the nature of the individual loan and the financial status of the borrower. Foundation represents these loans may have a longer repayment period, below market rate interest rates, charge no interest, require only a portion of the loan to be repaid, or provide that the loan may be forgiven altogether. Foundation states a large portion of its work focuses on capacity building of higher-risk service providers and therefore expects that a sizable portion of the loans will consist of forgivable loans.

In addition, Foundation represents that all loans made under the Loan Program prohibit the recipients from using the loan to fund prohibited activities such as influencing legislation, participating in a political campaign, and undertaking any activity for any purpose other than one specified in IRC §170(c)(2)(B). Foundation states none of the loans will be made to disqualified persons as defined in IRC § 4946.

Foundation represents it conducts the Loan Program through a staff of full-time, salaried experts in education and related areas, as well as expert consultants that specialize in key areas to supplement the work of its staff. Foundation represents it will provide technical assistance and oversight to enhance the quality of the services that all providers and community based organizations provide to Foundation's target population.

Foundation represents it will establish guidelines for the operation of loans provided through an intermediary, advise on how loans to service providers are to be structured,

and provide qualifications required for service providers seeking a loan. Foundation states that this includes, but is not limited to, standards for curriculum, staff, facilities, and criteria governing how borrowers should use their loans.

In addition, Foundation represents it requires and monitors regular reports from intermediaries. Foundation represents it will oversee the operations of partners by providing a primary program and financial contact from Foundation's staff. Foundation states it will require service providers and intermediaries to work closely with Foundation regarding major decisions, such as planning substantive elements and providing financial and activity reports to Foundation. Foundation provides technical assistance including training, knowledge sharing, data collection assistance and educational materials.

### **Rulings Requested, Law and Analysis**

Requested Ruling 1: Loans made by Foundation pursuant to the Loan Program constitute program-related investments under IRC § 4944(c) and are not investments that jeopardize the carrying out of an exempt purpose.

Section § 170(c)(2)(B) refers to organizations organized and operated exclusively for, among other things, charitable and educational purposes.

Section 4944(a) imposes an excise tax on the making of an investment by a private foundation in such a manner as to jeopardize the carrying out of any of its exempt purposes.

Section 4944(c) provides that program-related investments shall not be considered as jeopardizing the carrying out of exempt purposes if the primary purpose of the investment is to accomplish one or more of the purposes described in IRC § 170(c)(2)(B), and no significant purpose is the production of income or the appreciation of property.

Treas. Reg. § 53.4944-3(a)(1) provides that a program-related investment is an investment which possesses the following characteristics:

- (i) The primary purpose of the investment is to accomplish one or more of the purposes described in IRC § 170(c)(2)(B);
- (ii) No significant purpose of the investment is the production of income or the appreciation of property; and
- (iii) No purpose of the investment is attempting to influence legislation or participating or intervene in (including the publishing or distributing of

statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Treas. Reg. § 53.4944-3(a)(2)(i) provides that an investment shall be considered as made primarily to accomplish one or more purposes described in IRC § 170(c)(2)(B) if it significantly furthers the accomplishment of the private foundation's exempt activities and if the investment would not have been made but for such relationship between the investment and the accomplishment of the foundation's exempt activities.

Treas. Reg. § 53.4944-3(a)(2)(iii) provides that in determining whether a significant purpose of an investment is the production of income or the appreciation of property, it shall be relevant whether investors solely engaged in the investment for profit would be likely to make the investment on the same terms as the private foundation. However, the fact that an investment produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.

Treas. Reg. § 53.4944-3(b) example 1 involves a business enterprise located in a deteriorated urban area and owned by economically disadvantaged minority group. Conventional sources of funds are unwilling or unable to provide funds to the business enterprise. A private foundation makes a loan to the business enterprise bearing interest below the market rate for commercial loans of comparable risk. Private foundation's primary purpose for making the loan is to encourage the economic development of such minority groups. The loan has no significant purpose involving the production of income or the appreciation of property. The loan significantly furthers the accomplishment of private foundation's exempt activities and would not have been made but for such relationship between the loan and private foundation's exempt activities. Therefore, the loan is a program-related investment even though private foundation may earn income from the investment in an amount comparable to or higher than earnings from conventional portfolio investments.

Treas. Reg. § 53.4944-3(b) example 4 involves a business enterprise which is not owned by low-income person or minority group members. The continued operation of the business enterprise is important to the economic well-being of a deteriorated urban area because the business enterprise employs a substantial number of low-income persons from the area. Conventional sources of funds are unwilling or unable to provide funds to the business enterprise at reasonable interest rates. A private foundation makes a loan to business enterprise at an interest rate below the market rate for commercial loans of comparable risk. The loan is made pursuant to a program run by the private foundation to assist low-income persons by providing increased economic opportunities and to prevent community deterioration. No significant purpose of the loan involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of private foundation's exempt activities and

would not have been made but for such relationship between the loan and private foundation's exempt activities. Therefore, the loan is a program-related investment.

Treas. Reg. § 53.4944-3(b) example 5 involves a business enterprise which is financially secure and the stock of which is listed and traded on a national stock exchange. Private foundation makes a loan to business enterprise at an interest rate below the market rate in order to induce business enterprise to establish a new plant in a deteriorated urban area which because of the risks involved, business enterprise would be unwilling to establish absent such inducement. The loan is made pursuant to a program run by private foundation to enhance the economic development of the area by providing employment opportunities for low-income persons at the new plant and no significant purpose involves the production of income or the appreciation of property. The loan significantly furthers the accomplishment of private foundation's exempt activities and would not have been made but for such relationship between the loan and private foundation's exempt activities. Accordingly, even though business enterprise is large and established, the investment is program-related.

Treas. Reg. § 53.4944-3(b) example 18 involves a non-profit corporation that provides child care services in a low-income neighborhood enabling many residents of the neighborhood to be gainfully employed. Non-profit corporation has determined that the demand for its services warrants the construction of a new child care facility in the same neighborhood. Non-profit corporation is unable to obtain a loan from conventional sources of funds including from a commercial bank because of non-profit corporation's credit record. Private foundation has agreed to deposit funds into Bank and Bank lends an identical amount to non-profit corporation to construct the new child care facility. The deposit agreement provides that private foundation will earn an interest rate on the deposit which is substantially less than what private foundation could otherwise earn on this sum of money if private foundation invested it elsewhere. The loan agreement between Bank and non-profit corporation requires non-profit corporation to use the proceeds from the loan to construct the new child care facility. Private foundation's primary purpose in making the deposit is to further its educational purposes by enabling non-profit corporation to provide child care services within the meaning of section 501(k). No significant purpose of the deposit involves the production of income or the appreciation of property. The deposit significantly furthers the accomplishment of private foundation's exempt activities and would not have been made but for such relationship between the deposit and private foundation's exempt activities. Accordingly, the deposit is a program-related investment.

Generally, IRC § 4944(a) imposes a tax on jeopardizing investments. However, IRC § 4944(c) provides an exception for program-related investments. The primary purpose of the Loan Program is to further Foundation's educational and charitable purpose as described in IRC § 170(c)(2)(B). Furthermore, the loans would not have been made but for such relationship between the loan and the accomplishment of

Foundation's exempt activities. Treas. Reg. §§ 53.4944-3(a)(2)(i) and 53.4944-3(b), Examples 4 and 5.

Foundation will make loans to service providers that lack stable revenue needed to qualify for commercial loans paying market-rate interest. Under the Foundation's Loan Program, Foundation will make loans bearing interest rates below market interest rates or interest free. The loans made under the Foundation's Loan Program have no significant purpose of income production or the appreciation of property.

Treas. Reg. §§ 53.4944-3(a)(1)(ii), 53.4944-3(b), Example 1.

Foundation may also make loans to more financially secure for-profit organizations solely for supporting the educational and charitable activities of the Foundation. The loans made to more financially secure entities will be made at a below market rate interest in order to induce these entities to engage in education and charitable work that they may not otherwise engage in. Loans made to these organizations have no significant purpose that involves the production of income or the appreciation of property and would not have been made but for such relationship between these entities, the Loan Program, and Foundation's exempt activities. Treas. Reg. § 53.4944-3(b), Example 5.

In addition, Foundation will make loans to intermediaries that have unique expertise in lending money to and assisting educational and community-based organizations. The intermediaries will identify qualified service providers and make loans of the Foundation's funds to these service providers. Intermediaries and service providers can only use the loan amount to advance Foundation's charitable and educational purposes. Utilizing intermediaries in this way helps Foundation effectively use its loans to further its charitable and educational purposes. Treas. Reg. § 53.4944-3(b), Example 18.

Finally, all loans made under the Foundation's Loan Program prohibit the recipients from using the loan for any purpose other than one specified in IRC §170(c)(2)(B) and to fund prohibited activities which include influencing legislation, participating in a political campaign, and undertaking any activity. Treas. Reg. § 53.4944-3(a)(1)(i) and (iii).

Therefore, the loans made under the Foundation's Loan Program are program-related investments as described in IRC § 4944(c) and Treas. Reg. § 53.4944-3.

Requested Ruling 2: Loans made by Foundation pursuant to the Loan Program constitute qualifying distributions made directly for the active conduct of activities constituting Foundation's charitable and education purposes, within the meaning of IRC § 4942(j)(3)(A).

Section 4942(g)(1) defines "qualifying distribution," in relevant part, as any amount paid to accomplish one or more purposes described in IRC § 170(c)(2)(B).

Section 4942(j)(3)(A), in relevant part, provides an organization which is an operating foundation must make qualifying distributions, within the meaning of IRC § 4942(g)(1), directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated.

Treas. Reg. § 53.4942(a)-3(a)(2)(i), in relevant part, defines the term “qualifying distribution” to mean any amount (including program related investments, as defined in IRC § 4944(c), and reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in IRC § 170(c)(2)(B), other than any contribution to a private foundation which is not an operating foundation or to an organization controlled (directly or indirectly) by the contributing private foundation or one or more disqualified persons with respect to such foundation.

Treas. Reg. § 53.4942(b)-1(b)(1), in relevant part, provides except as provided in subparagraphs (2) or (3) qualifying distributions are not made by a foundation “directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose” unless such qualifying distributions are used by the foundation itself, rather than by or through one or more grantee organizations which receive such qualifying distributions directly or indirectly from such foundation. Thus, grants made to other organizations to assist them in conducting activities which help to accomplish their exempt purpose are considered an indirect, rather than direct, means of carrying out exempt purpose of the grantor foundation, regardless of the fact that the exempt activities of the grantee organization may assist the grantor foundation in carrying out its own exempt activities.

Treas. Reg. § 53.4942(b)-1(b)(2)(i) provides that if a foundation makes or awards grants, scholarships, or other payments to individual beneficiaries (including program related investments within the meaning of IRC § 4944(c) made to individuals or corporate enterprises) to support active programs conducted to carry out the foundation’s exempt purpose, such payments will be treated as qualifying distributions made directly for the active conduct of exempt activities only if the foundation, apart from the making or awarding of the grants, scholarships, or other payments, otherwise maintains some “significant involvement” – as defined in in Treas. Reg. § 53.4942(b)-1(b)(2)(ii) – in the active programs in support of which such payments were made or awarded. Whether the making or awarding payments constitutes qualifying distributions made directly for the active conduct of the foundation’s exempt activities is to be determined on the basis of the facts and circumstances of each particular case. The test applied is a qualitative, rather than a strictly quantitative, one. Therefore, if the foundation maintains a significant involvement it will not fail to meet the general rule of Treas. Reg. § 53.4942(b)-1(b)(1) solely because more of its funds are devoted to the making or awarding of payments than to the active programs which such payments support. However, if a foundation does no more than select, screen, and investigate applicants for grants or scholarships, pursuant to which the recipients perform their work

or studies alone or exclusively under the direction of some other organization, such grants or scholarships will not be treated as qualifying distributions made directly for the active conduct of the foundation's exempt activities.

Treas. Reg. § 53.4942(b)-1(b)(2)(ii)(B) provides that a foundation will be considered as maintaining a "significant involvement" in an exempt activity in connection with which payments are made or awarded if the foundation has developed some specialized skills, expertise, or involvement in a particular discipline or substantive area, such as social work or education, it maintains a salaried staff of administrators, researchers, or other personnel who supervise or conduct programs or activities which support and advance the foundation's work in its particular area of interest, and, as a part of such programs or activities, the foundation makes or awards payments to individuals to encourage and further their involvement in the foundation's particular area of interest and in some segment of the programs or activities carried on by the foundation such as grants to engage in social work projects which are under the general direction and supervision of the foundation.

Foundation's mission is to operate and support educational programs and projects serving underserved and impoverished children and families by direct involvement in the improvement and expansion of education opportunities. Foundation will make loans under the Loan Program to service providers that provide educational and other support to underserved and impoverished children and families. As such, loans under the Loan Program are considered an indirect, rather than direct, means of carrying out the exempt purpose of the foundation and would not be qualifying distributions.

Treas. Reg. § 53.4942(b)-1(b)(1).

As discussed above, loans made under the Foundation's Loan Program were determined to qualify as a program-related investment. In general, if a foundation makes other payments, including program-related investments to corporate enterprises, to support active programs conducted to carry out a foundation's charitable, educational or other exempt purpose such other payments will be treated as qualifying distributions made directly for the active conduct of exempt activities only if the foundation maintains some significant involvement in the active programs in support of which other payments were made. Treas. Reg. § 53.4942(b)-1(b)(2)(i).

As discussed in Treas. Reg. § 53.4942(b)-1(b)(2)(i), Foundation does more than select, screen, and investigate recipients of loans under the Loan Program. Foundation will provide technical assistance to all service providers receiving loans. Furthermore, as discussed in Treas. Reg. § 53.4942(b)-1(b)(2)(ii)(B), Foundation engages a staff of full-time, salaried experts in education and related areas, as well as expert consultants that specialize in key areas to assist intermediaries and service providers who will receive training, knowledge sharing, data collection, assistance, and educational materials to facilitate capacity building.



In addition, Foundation will have stringent guidelines and rules for loans to be made under the Loan Program to intermediaries and service providers. This includes advising on how loans to service providers are to be structured and setting forth qualifications required for service providers seeking a loan from an intermediary. Foundation will have sole and absolute discretion to forgive of any portion of a loan. Foundation will require regular reports during the year from intermediaries.

Foundation will oversee operations of partners funded with loans from the Loan Program by providing a primary program and financial contact from Foundation's salaried staff. Foundation will require service providers and intermediaries to work closely with Foundation regarding major decisions such as planning substantive elements and providing financial and activity reports to Foundation.

Accordingly, as Foundation has specialized skills, expertise, and involvement in education; it maintains a salaried staff of administrators, researchers, or other personnel who supervise activities which support and advance Foundation's mission; and the Loan Program encourages others to further their involvement in Foundation's area of interest under the Foundation's general direction and supervision, Foundation will be considered as maintaining significant involvement in a charitable or educational exempt activity in connection with the loan payments made under the Loan Program as described in Treas. Reg. § 53.4942(b)-1(b)(2)(i) and (ii)(B).

## **Rulings**

Based solely on the facts and representations submitted by Foundation, we rule as follows:

1. Loans made by Foundation pursuant to the Loan Program constitute program-related investments under IRC § 4944(c) and are not investments that jeopardize the carrying out of exempt purposes.
2. Loans made by Foundation pursuant to the Loan Program constitute qualifying distributions made directly for the active conduct of activities constituting Foundation's charitable and education purposes, within the meaning of IRC § 4942(j)(3)(A).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

Except as expressly provided herein, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the IRC.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

James Zelasko  
Branch Chief  
Exempt Organizations Branch 2  
(Tax Exempt and Government Entities)

cc: