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Person To Contact: _____, ID No. _____

Telephone Number: _____

Refer Reply To:
CC:EEE:EOET:EO2
PLR-120396-20

Date:
March 12, 2021

LEGEND

Foundation =
Grantee =
Foreign Country =
Loan Amount =
State =

Dear _____ :

We are responding to a letter submitted on your behalf by your authorized representative dated September 3, 2020, as supplemented with additional supporting documentation on October 30, 2020. Your letter requests rulings regarding the application of §§ 4944 and 4942 of the Internal Revenue Code of 1986, as amended (hereafter “IRC,” or the “Code”) to your loan to Grantee.

FACTS

This ruling is based only on the representations and documents submitted on Foundation’s behalf by Foundation’s authorized representative in support of Foundation’s letter request. The relevant facts, as provided and relied upon, are as follows.

Foundation is a State non-stock corporation recognized by the IRS as a tax-exempt organization described in IRC § 501(c)(3) and classified as a private foundation under IRC § 509(a). Foundation represents that its mission is to advance the arts and art education by empowering local artists and cultural institutions to expand public access to a broader range of art and widen engagement with art by a cross section of the public. In furtherance of its mission, Foundation represents that it engages in a wide

range of activities including grant-making to promote access to capital for local art and cultural institutions.

Foundation represents that Grantee is a limited liability partnership established under the laws of Foreign Country as an alternative investment fund within the meaning of Foreign Country's local tax laws. Grantee has not applied for or received a determination letter from the IRS that Grantee is an organization described under IRC §§ 501(c)(3) or 4942(j)(3). Foundation has not made a good faith determination that Grantee is an organization described under IRC §§ 509(a)(1)-(3) (other than an organization described in IRC § 4942(g)(4)(A)(i) or (ii) or 4940(d)(2).

Foundation represents Grantee is not an organization controlled by Foundation and is not a disqualified person or controlled by a disqualified person of Foundation. Grantee's activities are directed by an investment manager pursuant to a written management agreement requiring the investment manager to manage the assets of Grantee in furtherance of charitable purposes, according to an established written investment policy.

Foundation proposes to make a loan to Grantee in the form of an unsecured line of credit not exceeding Loan Amount, subject to a written agreement by and between Foundation and Grantee (the "Loan Agreement"). Grantee will make secondary grants of the Loan Agreement funds, as unsecured loans, directly to museums, art galleries, and other arts organizations located in Foreign Country ("Secondary Grantee(s)"). Loan Agreement funds and all loans to Secondary Grantees will carry interest at below-market rates as outlined by formulas in the Loan Agreement. The Loan Agreement also prohibits set-off of assets and permits Grantee to retire the debt by delivering notice to Foundation of inability to pay any outstanding debt as a result of using all available funds in furtherance of IRC § 170(c)(2)(B) exempt purposes.

Funds provided by Foundation under the Loan Agreement are restricted by the Loan Agreement to use in furtherance of Foundation's charitable purposes within the meaning of IRC § 170(c)(2)(B) and may not be used to influence legislation or intervene in political campaigns, consistent with IRC § 170(c)(2)(D). The Loan Agreement requires Grantee to demonstrate to Foundation that all Secondary Grantee activities align with Foundation's charitable mission. The Loan Agreement requires Grantee's on-going reporting to Foundation of Secondary Grantee's use of Loan Agreement funds.

Foundation represents that the Loan Agreement is provided in conjunction with a network of other creditors to Grantee simultaneously providing similar loans to Grantee by direct written agreement with Grantee. This network of creditors is a combination of for-profit financial institutions and non-profit entities ("Funders"). All Funders have agreed to a written articulation of their rights as creditors to Grantee by and among themselves (the "Intercreditor Agreement"). The Intercreditor Agreement (i) outlines the order for which Grantee may draw on all loans provided by Funders, (ii) determines the order of repayment of all loans, and (iii) commits all lending to the charitable purposes

already established in the Loan Agreement. According to the Intercreditor Agreement, Foundation is a “mezzanine” lender with repayment rights subordinate to at least one other Funder.

The Intercreditor Agreement requires Grantee to establish an investment committee comprised of Funder representatives. Grantee will present Funders with data from all applicant Secondary Grantees and Funders will make recommendations or request additional information regarding all Secondary Grantees. Funders will not make decisions regarding applicant approval. Grantee will make all funding decisions, subject to investment guidelines established in the Intercreditor Agreement. The investment guidelines provided require the Grantee to establish a clear charitable purpose to all Secondary Grantee activities. Grantee will also appoint an investment manager to oversee lending and provide regular reporting summarizing the program’s impact on developing the wider arts and cultural sector.

RULINGS REQUESTED

Foundation requests the following rulings:

1. Foundation’s Loan Agreement loan to Grantee qualifies as a program-related investment under IRC § 4944; and
2. Foundation’s Loan Agreement loan to Grantee, as a program-related investment, is a qualifying distribution under IRC § 4942.

LAW AND ANALYSIS

Requested Ruling 1: Foundation’s Loan Agreement loan to Grantee qualifies as a program-related investment under IRC § 4944.

Law

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

Rev. Rul. 64-174, 1964-1 C.B. 183, held exempt under IRC § 501(c)(3) an organization that created interest in theatre by aiding local communities to establish their own charitable and educational repertory theatres. The IRS reasoned that cultural organizations devoted to the promotion of the arts may qualify for exemption as educational or charitable.

Rev. Rul. 66-178, 1966-1 C.B. 138, held exempt under IRC § 501(c)(3) an organization created to foster and develop the arts by sponsoring a public art exhibit at which the works of unknown but promising artists were selected for public display.

IRC § 170(c)(2)(D) provides that attempting to influence legislation and participating or intervening in any political campaign on behalf of, or in opposition to, any candidate for public office is not a charitable activity.

IRC § 4944(a) imposes an excise tax on the making of an investment by a private foundation in such a manner jeopardizing the private foundation's ability to carry out of any of its exempt purposes.

IRC § 4944(c) provides that program-related investments do not jeopardize the carrying out of a private foundation's exempt purpose because 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 of the program-related investment 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 to accomplish one or more of the purposes described in IRC § 170(c)(2)(D).

Treas. Reg. § 53.4944-3(a)(2)(i) provides that an investment is made primarily to accomplish one or more purposes described in IRC § 170(c)(2)(B) if the investment (i) significantly furthers the accomplishment of the private foundation's exempt activities and (ii) the investment would not have been made but for the relationship between the investment and that 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 is 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. The fact that an investment produces significant income or capital appreciation is not, however, in the absence of other factors, conclusive evidence of a significant purpose involving the production of income or the appreciation of property.

Treas. Reg. § 53.4944-3(b) example 16 involves a private foundation's below-market interest-bearing loan to a limited liability company electing treatment as a partnership. Under the terms of the loan, the limited liability company is required to use the proceeds from the loan to provide training to economically disadvantaged farmers in a developing country. The terms of the loan are consistent with the private foundation's IRC § 170(c)(2)(B) exempt purposes. Even though the loan is to a commercial entity, the investment would not have been made but for the relationship between the investment

and the accomplishment of the foundation's exempt purposes. The loan accomplishes the private foundation's exempt purposes and no significant purpose of the loan is the production of income. The loan is a program-related investment.

Treas. Reg. § 53.4944-3(b) example 17 involves a private foundation's below-market interest-bearing loan to a social welfare organization formed to develop interest in art by conducting weekly community art exhibits. The private foundation provides the loan to the social welfare organization to assist the social welfare organization with the purchase of a new community exhibition space. The private foundation's primary purpose in making the loan is to promote the arts and no significant purpose of the loan involves the production of income or the appreciation of property. The loan furthers the private foundation's exempt purposes and would not have been made but for the relationship between the loan and the accomplishment of those exempt purposes. The loan is a program-related investment.

Analysis

IRC § 4944(a) imposes an excise tax on the making of an investment in such a manner jeopardizing the Foundation's ability to carry out of any of its exempt purposes. Foundation's Loan Agreement loan to Grantee is a program-related investment within the meaning of IRC § 4944(c) and, therefore, not subject to the IRC § 4944(a) excise tax.

IRC § 4944(c) provides that a program-related investment will not jeopardize the carrying out of Foundation's exempt purpose if the primary purpose of the investment is to accomplish a purpose described in IRC § 170(c)(2)(B). Amounts paid for educational and charitable purposes are included in IRC § 170(c)(2)(B). Organizations devoted to the promotion of the arts may qualify for exemption as educational or charitable. Rev. Rul. 64-174 and Rev. Rul. 66-178. The purpose of Foundation's loan to Grantee is to further Foundation's mission of advancing the arts and art education in Foreign Country by empowering local artists and cultural institutions to expand public access to a broader range of art and widen engagement with art by a cross section of the public. Accordingly, Foundation's Loan Agreement furthers the accomplishment of Foundation's § 170(c)(2)(B) exempt purpose.

The Loan Agreement terms significantly further the accomplishment of Foundation's IRC § 170(c)(2)(B) exempt purposes while demonstrating the investment would not have been made but for the relationship between the investment and that accomplishment of Foundation's exempt purposes. Treas. Reg. § 53.4944-3(a)(2)(i). As discussed above, Foundation's loan to Grantee furthers Foundation's exempt purpose. Additionally, the interest rates associated with the Loan Agreement are capped below commercial market rates. The Loan Agreement and Intercreditor Agreement prohibit the use of loan funds for purposes not described in IRC § 170(c)(2)(B), including purposes described in IRC § 170(c)(2)(D). Foundation's Loan Agreement is consistent with Treas. Reg. § 53.4944-3(b) examples 16 and 17.

IRC § 4944(c) requires that no significant purpose of Foundation's Loan Agreement is the production of income or the appreciation of property. The Loan Agreement terms provided indicate that investors solely engaged in investing for profit would not be likely to make this investment on the same terms as Foundation. Treas. Reg. § 53.4944-3(a)(2)(iii). The restrictions and terms in the Loan Agreement demonstrate Foundation's Loan Agreement has no significant purpose involving the production of income or the appreciation of property, consistent with Treas. Reg. § 53.4944-3(b) example 16.

Foundation's Loan Agreement 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 to accomplish one or more of the purposes described in IRC § 170(c)(2)(D). Treas. Reg. § 53.4944-3(a)(1). Accordingly, loans granted by Foundation in the manner described above are program-related investments within the meaning of IRC § 4944(c).

Requested Ruling 2: Foundation's Loan Agreement loan to Grantee, as a program-related investment, is a qualifying distribution under IRC § 4942.

Law

IRC § 4942(a) imposes an excise tax on the undistributed income (distributable income less any "qualifying distributions") of private foundations qualifying for exemption from tax under IRC § 509(a).

IRC § 4942(g)(1)(A) defines qualifying distributions to mean, in relevant part, any amount paid by a private foundation to accomplish one or more exempt purposes as described in IRC § 170(c)(2)(B), other than any contribution, including grants, to an organization directly or indirectly controlled by the private foundation or its disqualified persons within the meaning of IRC § 4946(a)(1) and Treas. Reg. § 53.4946-1(a)(1).

Treas. Reg. § 53.4942(a)-3(a)(2)(i) provides that qualifying distributions include program-related investments, defined in IRC § 4944(c).

Treas. Reg. § 53.4942(a)-3(a)(2)(i)(a)-(c) provides that any payment, including a program-related investment, cannot be treated as a qualifying distribution if paid to (i) any organization controlled by the contributor or one of their disqualified persons, or (ii) private non-operating foundations (and certain supporting organizations) that do not satisfy the distribution requirements of Treas. Reg. § 53.4942(c).

Treas. Reg. § 53.4942(a)-3(a)(6) provides that distributions, for IRC § 170(c)(2)(B) purposes, to a foreign organization that has not received a determination letter confirming that it is an organization described in IRC §§ 509(a)(1)-(3) or 4942(j)(3) will be treated as distributions made to an organization described in IRC §§ 509(a)(1)-(3) or

4942(j)(3) if the distributing foundation has made a good faith determination that the recipient organization is an organization described in IRC §§ 509(a)(1)-(3) or 4942(j)(3).

Treas. Reg. § 53.4942(b)-1(b)(1) provides that private foundation grants to for-profit organizations generally are an indirect means of carrying out the grantor private foundation's own exempt purposes if the for-profit organization uses the grant in furtherance of the grantor's exempt purposes. These grants will be qualifying distributions pursuant to IRC § 4942 when paid to the grantee if they are not made to organizations controlled by the grantor.

Treas. Reg. § 53.4942(a)-3(c)(4) provides that where a grantee uses grant funds to make a subsequent payment to a secondary grantee, the subsequent payment will not be treated as a grant by the private foundation to the secondary grantee if the distributing private foundation does not earmark the use of the grant funds for any named secondary grantee and does not otherwise retain power to cause the selection of the secondary grantee. Whether or not the private foundation has "reason to believe" a secondary grantee will benefit from the original grant, the private foundation has not made a grant to the secondary grantee as long as the original grantee exercises control, in fact, over the selection process.

Treas. Reg. § 53.4942(a)-3(a)(3) explains that furnishing support to an organization does not determine "control," even if that support carries restrictions and involvement by the private foundation. Control, for purposes of applying Treas. Reg. § 53.4942(a)-3(a)(3), is determined by the private foundation's involvement with the grantee. Under Treas. Reg. § 53.4942(a)-3(a)(3), "an organization is 'controlled' by a foundation or the foundation's disqualified persons if any of such persons may, by aggregating their votes or positions of authority, require the [grantee] organization to make an expenditure, or prevent the [grantee] organization from making an expenditure, regardless of the method by which the control is exercised or exercisable."

Analysis

IRC § 4942(a) imposes an excise tax on Foundation's undistributed income (Foundation's distributable income less any qualifying distributions). Foundation's Loan Agreement loan to Grantee is a qualifying distribution under IRC § 4942 equal to amounts actually distributed to Grantee for IRC § 170(c)(2)(B) purposes.

Ruling #1 concludes that Foundation's Loan Agreement loan to Grantee is a program-related investment. Foundation's Loan Agreement, as such, is an indirect means of furthering Foundation's exempt purpose, as provided in Treas. Reg. § 53.4942(b)-1(b)(1), because Foundation's involvement with Grantee's use of Loan Agreement funds is limited to screening potential Secondary Grantees and receiving regular reporting from Grantee for the purpose of enforcing the terms of the Loan Agreement. Foundation's Loan Agreement will therefore create qualifying distributions in amounts equal to any funds transferred from Foundation to Grantee at the time of transfer if the

Foundation (i) does not control Grantee, and (ii) Grantee is not an entity otherwise described in Treas. Reg. § 53.4942(a)-3(a)(2)(i)(a)-(c).

Foundation represents that Grantee is not an organization controlled by Foundation, within the meaning of Treas. Reg. § 53.4942(a)-3(a)(3) and is not a disqualified person (or controlled by a disqualified person). The Loan Agreement restricts Grantee's use of Loan Agreement funds to IRC § 170(c)(2)(B) exempt purposes and provides Foundation a position on Grantee's advisory committee created to receive reporting regarding Grantee's use of Loan Agreement funds. Nothing in the documentation provided, however, creates a formal interest or position of decision-making authority for Foundation in Grantee. Although Foundation is permitted to receive information related to prospective and actual Secondary Grantees as well as provide input to Grantee, Foundation has no authority to approve or reject Secondary Grantees.

Grantee is not a private non-operating foundation (or supporting organization). Foundation represents that Grantee has not applied for or received a determination letter from the IRS that it is an organization described in IRC §§ 501(c)(3) or 4942(j)(3). Foundation has also not made a good faith determination that Grantee is an organization described in IRC §§ 509(a)(1)-(3) or 4942(j)(3). Treas. Reg. § 53.4942(a)-3(a)(6).

By application of Treas. Reg. § 53.4942(a)-3(c)(4), Foundation's Loan Agreement loan is considered only as to Grantee because Foundation does not have any authority to earmark Loan Agreement funds to any Secondary Grantee. Foundation and Foundation's disqualified persons, as noted, are given no formal decision-making authority or other interest in Grantee aside from Foundation's ability to enforce the terms of its Loan Agreement. Proscriptive agreement terms and conditions provided in a grant agreement are not sufficient to create a control relationship between Foundation and Grantee (or, similarly, any prospective or actual Secondary Grantee).

Foundation's Loan Agreement loan to Grantee is a program-related investment, therefore, Loan Agreement funds actually paid to Grantee constitute qualifying distributions within the meaning of IRC § 4942(g)(1)(A).

CONCLUSION

1. Foundation's Loan Agreement loan to Grantee is a program-related investment under IRC § 4944; and
2. Foundation's Loan Agreement loan to Grantee, as a program-related investment, is a qualifying distribution under IRC § 4942.

The rulings contained in this letter are based upon information and representations submitted by or on behalf of Foundation and accompanied by a penalty of perjury statement executed by an appropriate party, as specified in Rev. Proc. 2021-1, 2021-1

I.R.B. 1, § 7.01(16)(b). This office has not verified any of the material submitted in support of the request for rulings, and such material is subject to verification on examination. The Associate Office will revoke or modify a letter ruling and apply the revocation retroactively in the following situations: (i) there has been a misstatement or omission of controlling facts; (ii) the facts at the time of the transaction are materially different from the controlling facts on which the ruling is based; or (iii) the transaction involves a continuing action or series of actions and the controlling facts change during the course of the transaction. See Rev. Proc. 2021-1, § 11.05.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the proposed transaction under any other provision of the Code or Treasury Regulations.

This letter is directed only to Foundation. IRC § 6110(k)(3) 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 Foundation's authorized representatives.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

James Zelasko
Branch Chief
Exempt Organizations Branch 2
(Employee Benefits, Exempt Organizations, and
Employment Taxes)

cc: