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Austin, TX**De-mystifying Program-Related Investments****Christine Looney
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I. INTRODUCTION

- A. Section 4944: Taxes on Investments Which Jeopardize Charitable Purposes. Section 4944 of the Internal Revenue Code, as amended (the "Code"), imposes an excise tax on investments that are made by a private foundation in such a manner as to jeopardize the carrying out of any of the private foundation's exempt purposes. These investments are referred to as "jeopardizing investments."
- B. Section 4944 c : Program Related Investments. Section 4944(c)¹ provides a specific exception from the jeopardizing investment rules for program related investments ("PRIs"), which are defined as "investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property."

II. SECTION 4944: TAXES ON INVESTMENTS WHICH JEOPARDIZE CHARITABLE PURPOSES

- A. Section 4944 imposes an excise tax on investments that are made by a private foundation in such a manner as to jeopardize the carrying out of any of the private foundation's exempt purposes. These investments are referred to as "jeopardizing investments."
1. An investment is considered to jeopardize the carrying out of the exempt purposes of a private foundation if it is determined that the foundation managers, in making the investment, failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long- and short-term financial needs of the foundation to carry out its exempt purposes. (see Treasury Regulation §53.4944-1 (a)(2)(i))
 2. In exercising the requisite standard of care and prudence, foundation managers may take into account the expected return (including both income and appreciation of capital), the risks of rising and falling price levels, and the need for diversification within the investment portfolio (for example, with respect to type of security, type of industry, maturity of company, degree of risk and potential for return). (see Treasury Regulation §53.4944-1(a)(2)(i))
 3. The determination whether an investment jeopardizes the carrying out of the exempt purposes of a foundation will be made on an investment by investment basis, in each case taking into account the foundation's portfolio as a whole. (see Treasury Regulation §53.4944-1 (a)(2)(i))
 4. No category of investments will be treated as a per se jeopardizing investment, but the regulations include a list of the following types and methods of investment that will be closely scrutinized: (i) trading in securities on margin; (ii) trading in

¹ Sections cited hereinafter refer, unless otherwise noted, to sections of the Code.

5. commodity futures; (iii) investments in working interests in oil and gas wells; (iv) the purchase of "puts," "calls," and "straddles;" (v) the purchase of warrants, and (vi) selling short.² (see Treasury Regulation §53.4944-1 (a)(2)(i))
 6. The determination whether the investment of any amount jeopardizes the carrying out of a foundation's exempt purposes is to be made as of the time that the foundation makes the investment and not subsequently on the basis of hindsight. (see Treasury Regulation §53.4944-1 (a)(2)(i))
 - a. Once it has been determined that an investment does not jeopardize the carrying out of a foundation's exempt purposes, the investment will never be considered to jeopardize the carrying out of such purposes, even if the foundation subsequently realizes a loss, (see Treasury Regulation §53.4944-1(a)(2)(i))
 - b. The jeopardizing investment rules do not, however, exempt any person from compliance with any federal or state law imposing any obligation, duty, responsibility or other standard of conduct with respect to the operation or administration of a private foundation. (see Treasury Regulation §53.4944-1(a)(2)(i))
 7. The prohibition on jeopardizing investments does not apply to an investment made by any person that is later gratuitously transferred to a private foundation. If, however, the foundation pays consideration to the transferee upon the transfer, the foundation will be treated as having made an investment in the amount of the consideration. (see Treasury Regulation §53.4944-1(a)(2)(ii)(a))
- B. Section 4944(a)(1) imposes an initial excise tax on the private foundation equal to 10%³ of the amount so invested in the jeopardizing investment for each taxable year in the taxable period. If the 10% tax is imposed and the investment is not removed from jeopardy within the taxable period, section 4944(b)(1) imposes an additional excise tax on the private foundation equal to 25% of the amount of the investment.
1. Section 4962 allows the IRS to abate or refund an initial tax on a jeopardizing investment if it is established that the violation was due to reasonable cause and not to willful neglect, and the violation was corrected within the required correction period.
- C. When an initial tax is imposed on a private foundation, section 4944(a)(2) imposes an initial excise tax equal to 10% of the amount so invested on any foundation managers who participated in the making of the investment, knowing that it was jeopardizing the carrying out of any of the private foundation's exempt purposes. If the 10% tax is

² The examples of types and methods of investment that will be closely scrutinized were added to the Treasury Regulations in 1972 and have not been updated since.

³ Please note when looking at the Treasury Regulations that the amount of the initial tax on the foundation and its managers was increased from 5% to 10% in the Pension Protection Act of 2006, but the Treasury Regulations have not yet been updated.

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