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**Commerciality, Charitability, and
Confusion in the Charitable Sector:
Exploring What's Charitable,
What's Not and
Why There is a Difference**

**Joshua J. Mintz
John E. Tyler III**

Author Contact Information:

Joshua J. Mintz
John D. and Catherine T. MacArthur
Foundation, Chicago, IL
jmintz@macfound.org
312.920.6250

John E. Tyler III
Ewing Marion Kauffman Foundation
Kansas City, MO
jtyler@kauffman.org
816.932.1293

The world of philanthropy is evolving quickly and challenging traditional notions of charitable purpose and other fundamental underpinnings of philanthropy. This session will explore some of the pertinent issues ahead for philanthropy in 2017 and beyond and how philanthropy will be impacted by these changes, including evolving notions of charitable purpose.

Among the most useful, aggregated resources for identifying situations in which commerciality and charitability co-exist are the examples in the regulations about program related investments. The regulations disclaim any recognition or validation of the charitability of the circumstances presented because the purposes of the examples is to elucidate structural uses of program related investments under the jeopardy investments rules applicable to private foundations rather than to address charitability under §§ 501(c)(3) or 170. Even so, the underlying substantive transactions described in the examples identify many of the circumstances likely to be most relevant for purposes of the topic of this session.

The papers that follow the examples provide more insights into analyzing charitability in a hybrid activity with commercial elements (or even priorities) and practical considerations for pursuing or implementing such activities/transactions if a charity decides to do so, including with regard to the role of impact and its assessment. The second paper also identifies some of the challenges ahead for private foundations in 2017 given legal, economic and political changes, and suggests some practical responses.

26 C.F.R. § 53.4944-3(b)

Initially issued December 27, 1972

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Example 1

X is a small business enterprise located in a deteriorated urban area and owned by members of an economically disadvantaged minority group. Conventional sources of funds are unwilling or unable to provide funds to X on terms it considers economically feasible. Y, a private foundation, makes a loan to X bearing interest below the market rate for commercial loans of comparable risk. Y'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 Y's exempt activities and would not have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment even though Y may earn income from the investment in an amount comparable to or higher than earnings from conventional portfolio investments.

Example 2

Assume the facts as stated in Example (1), except that after the date of execution of the loan Y extends the due date of the loan. The extension is granted in order to permit X to achieve greater financial stability before it is required to repay the loan. Since the change

in the terms of the loan is made primarily for exempt purposes and not for any significant purpose involving the production of income or the appreciation of property, the loan shall continue to qualify as a program-related investment.

Example 3

X is a small business enterprise located in a deteriorated urban area and owned by members of an economically disadvantaged minority group. Conventional sources of funds are unwilling to provide funds to X at reasonable interest rates unless it increases the amount of its equity capital. Consequently, Y, a private foundation, purchases shares of X's common stock. Y's primary purpose in purchasing the stock is to encourage the economic development of such minority group, and no significant purpose involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the investment and Y's exempt activities. Accordingly, the purchase of the common stock is a program-related investment, even though Y may realize a profit if X is successful and the common stock appreciates in value.

Example 4

X is a business enterprise which is not owned by low-income persons or minority group members, but the continued operation of X is important to the economic well-being of a deteriorated urban area because X employs a substantial number of low-income persons from such area. Conventional sources of funds are unwilling or unable to provide funds to X at reasonable interest rates. Y, a private foundation, makes a loan to X at an interest rate below the market rate for commercial loans of comparable risk. The loan is made pursuant to a program run by Y 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 Y's exempt activities and would not have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment.

Example 5

X is a business enterprise which is financially secure and the stock of which is listed and traded on a national exchange. Y, a private foundation, makes a loan to X at an interest rate below the market rate in order to induce X to establish a new plant in a deteriorated urban area which, because of the high risks involved, X would be unwilling to establish absent such inducement. The loan is made pursuant to a program run by Y to enhance the economic development of the area by, for example, 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 Y's exempt activities and would not have been made but for such relationship between the loan and Y's exempt activities. Accordingly, even though X is large and established, the investment is program-related.

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