

**Exploring *Impact Investing* and *Impact Investing*:  
Recent Federal Tax and Other Guidance Regarding Program  
Related Investments and Other Impact Investments**

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# Exploring *Impact Investing* and *Impact Investing*: Recent Federal Tax and Other Guidance Regarding PRIs and Other Impact Investments

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This outline discusses the definition of “impact investing” and then reviews the Federal tax rules relating to private foundation investments and recent guidance concerning different types of “impact investments” – including program-related investments, which are defined in the tax code, and other types of impact investing, which are not.

## I. Defining Impact Investing

### A. What is impact investing?

1. The term “impact investing” has no legal definition, and has been defined in a number of ways by various groups interested in the intersection of traditional investment practices and positive social or environmental outcomes. This lack of consistent terminology was noted by the Department of Labor when it recently issued guidance relating to consideration of environmental, social and governance factors when making investments of ERISA plan assets:

“The Department has been asked periodically over the last 30 years to consider the application of ERISA’s fiduciary rules to pension plan investments selected because of the collateral economic or social benefits they may further in addition to their investment returns. *Various terms have been used to describe this and related investment behaviors, such as socially responsible investing, sustainable and responsible investing, environmental, social and governance (ESG) investing, impact investing, and economically targeted investing (ETI).*”<sup>2</sup>

2. Impact investing has been defined broadly by some. For example, the Global Impact Investing Network (“GIIN”) defines impact investments as “investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return.”<sup>3</sup> This definition is quite broad, encompassing both below-market and market rate investments that are intended to achieve some sort of social or environmental impact, whether or not this purpose of social or environmental impact is “primary,” and whether or not it is considered “charitable” under the tax code.

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<sup>1</sup> © Copyright 2017 M. Ruth Madrigal. All rights reserved. Ruth Madrigal is a partner in the Exempt Organizations practice group at Steptoe & Johnson LLP in Washington, D.C. From 2010 to 2016, she worked in the Treasury Department’s Office of Tax Policy, where she was responsible for providing legal and policy advice regarding tax-exempt organizations, including charities, and their donors.

<sup>2</sup> United States Department of Labor Fact Sheet, “Economically Targeted Investments (ETIs) and Investment Strategies that Consider Environmental, Social, and Governance (ESG) Factors,” Oct. 22, 2015 (emphasis added). Available online at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/fsetis.pdf> (last visited Apr. 16, 2017).

<sup>3</sup> Global Impact Investing Network, “What You Need to Know About Impact Investing,” at <https://thegiin.org/impact-investing/need-to-know/#s1> (last visited Apr. 16, 2017).

3. Impact investing has been defined more narrowly by others. For example, a recent World Resources Institute (WRI) report defines “impact investing” as “[i]nvestments in companies or funds with the *primary* intention of generating positive social and/or environmental impact alongside financial returns.”<sup>4</sup> However, the report also noted that the term is “sometimes used as an umbrella term synonymous with sustainable investing, rather than a separate asset class.”<sup>5</sup>
4. Part of the difficulty may be that impact investing isn’t just one thing – it covers a broad range of activities, conducted by a diverse group of people, with varying backgrounds, motivations and priorities. There are some coming to impact investing from the investment community or with an investment perspective who are quite clearly focused on investment returns, with social or environmental benefits as a nice plus. And there are those doing impact investing – perhaps for generations – from the charitable community who are focused squarely on the impact these investments make on the people and communities they serve (and if they produce a return, all the better).
5. What impact investing is – and whether it works – may be very different, depending on what the investor is primarily seeking: *impact* investing or impact *investing*.

## B. Legal guidance

1. Although there is no legal definition of impact investing, there is legal guidance addressing different types of impact investing. In recent years, the federal government has issued a number of pieces of guidance intended to facilitate impact investing in its various forms.
2. *Impact* Investing
  - a. *Impact* investing is using investment tools or forms to achieve charitable, social, or environmental impact.
  - b. Grants for charitable purposes may be considered *impact* investments – they have no financial return and capital is lost, but they are made because they can accomplish the desired charitable impact. However many do not consider grants to be impact investments, because there is no anticipation of financial return.
  - c. Program-related investments (“PRIs”) are another type of *impact* investment that are defined in the tax code – and have been since 1969. As discussed in more detail below, PRIs have a strong charity requirement: the primary purpose of the investment must be to accomplish the foundation’s charitable purpose and financial returns may not be a significant purpose. Regulations from the early 1970’s provided examples of how both equity and debt PRIs were being used in urban community development. In 2012, the Treasury Department issued proposed regulations providing additional examples of what

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<sup>4</sup> Lewis, E., A. Pinchot, and G. Christianson, 2016, “Navigating the Sustainable Investment Landscape,” Working Paper, Washington, DC: World Resources Institute at p.9 (Table 2) (emphasis added). Available online at <http://www.wri.org/publication/sustainable-investment-landscape> (last visited Apr. 16, 2017).

<sup>5</sup> Id. at p.46.

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