

# Impact Investing by Public Charities



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## Why Should Public Charities Care About “Impact Investments”?

- “Impact investments” includes Program-Related Investments (“PRIs”) and Mission-Related Investments (“MRIs”).
  - PRIs are a hybrid between grants and investments, but still involve the primary purpose of having a charitable impact.
    - i.e. below-market-rate loans, loan guarantees, deposits or linked deposits in community development bank, or equity investments
  - MRIs are market-based investments that compliment a charity’s overall mission.
- Public charities can take advantage of impact investment strategies without complying with the same restrictions placed on private foundations, while using the private foundation rules as a guide.

## PRI Rules in the *Private Foundation* Context

- To qualify as a PRI, the investment must meet three conditions (Treas. Reg. § 53.4944-3(a)(1)):
  1. The primary purpose of the investment is to accomplish one or more “charitable purposes.”
    - Proposed Regulation (REG-144267-11) provides new examples of qualifying PRIs, including environmental preservation and foreign investments for disaster relief or that fund educational programs for the poor and distressed.
  2. Neither the production of income nor the appreciation of property is a significant purpose of the investment.
    - Below-market-rate loans are relatively easy to qualify, but equity investments may require additional planning (such as imposing a cap on returns, or structuring as tranche funds).
  3. The purposes of the investment do not include engaging in lobbying or advocacy, or supporting or opposing a candidate for public office.

# IRS Guidance for Public Charities ... Or Lack Thereof?

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- Public charities may transfer funds to for-profits, provided use limited to charitable purposes and nonprofit retains discretion and control (Rev. Rul. 68-489).
- In Rev. Rul. 74-587, the IRS recognized as a charitable activity investments by a public charity in businesses located in economically depressed areas:
  - Provided funds and working capital to corporations or individual business owners deemed too risky by commercial sources.
  - Loans and equity investments “are not undertaken for purposes of profit or gain but for the purpose of advancing the charitable goals of the organization and not investments for profit in any conventional business sense.”

## Form 990 Reporting of Program Investments

- Form 990, Schedule D, Part VIII, requires reporting of “Investments — Program Related”
  - The 990 instructions explain that “[p]rogram-related investments are investments made primarily to accomplish the organization's exempt purposes rather than to produce income. Examples of program-related investments include student loans and notes receivable from other exempt organizations that obtained the funds to pursue the filing organization's exempt function”
  - Sounds a lot like the definition for private foundations.

## Examples of Public Charities Making PRIs

- **Grassroots Business Fund** is dedicated to addressing extreme poverty in remote areas of the world by making structured investments to Grassroots Business Organizations (“GBOs”), usually through equity investments or below-market loans.
  - Provides “patient capital” loans that have much longer term repayment schedules than are available from conventional financial intermediaries.
  - Provides grants to GBOs to establish accounting systems or create business plans, but the Fund retains discretion and control over all grant funds and it will take legal action to recover funds not used for its charitable purpose.

## Examples of Public Charities Making PRIs

- **In-Q-Tel** fosters the use of new and emerging technologies to solve the most pressing information technology (“IT”) problems of the CIA by contracting with IT collaborators and making targeted investments in companies that are developing technology crucial to the CIA’s ability to fulfill its mission.
  - Provides “seed money” in areas of critical needs to the CIA, thereby aligning strategic objectives of technology companies with those of the CIA.
  - Makes equity investments in, or engages in joint ventures with, companies with significant numbers of other investors – thus making more choices available to the CIA.

## Examples of Public Charities Making PRIs

- **Global Innovation Fund** (a public charity “in formation”) provides grants and risk capital to social innovations that aim to improve people’s lives in the developing world, focusing on those earning less than \$5 per day.
  - Connects successful innovators with partners and follow-on funding to support their growth.
  - Provides seed capital to support start-up and field-testing of innovations, funds innovations that demonstrate promise, or that have a strong track record of social impact.
  - Requires for-profit institutions to give compelling rationale for why they are requesting grants, such as why the innovation can be considered a public good that benefits society.



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