



This document is scheduled to be published in the Federal Register on 04/25/2016 and available online at <http://federalregister.gov/a/2016-09396>, and on [FDsys.gov](http://FDsys.gov)

## DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 53

T.D. 9762

RIN 1545-BK76

Examples of Program-Related Investments

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance to private foundations on program-related investments. The final regulations provide a series of examples illustrating investments that qualify as program-related investments. In addition to private foundations, these final regulations affect foundation managers who participate in the making of program-related investments.

DATES: These regulations are effective [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**].

FOR FURTHER INFORMATION CONTACT: Robin Ehrenberg at (202) 317-4086 (not a toll-free number)

SUPPLEMENTARY INFORMATION:

### **Background**

This document contains amendments to 26 CFR part 53 under section 4944(a) of the Internal Revenue Code (Code). Section 4944(a) imposes an excise tax on a private foundation that makes an investment that jeopardizes the

carrying out of its exempt purposes (a “jeopardizing investment”). Section 4944(c) provides that investments that are program-related investments (“PRIs”) are not jeopardizing investments. Section 4944(c) defines a PRI as an investment: (1) the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B); and (2) no significant purpose of which is the production of income or the appreciation of property.<sup>1</sup>

The regulations under section 4944(c) provide that an investment is made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B) (referred to in this preamble as “exempt purposes”) if it significantly furthers the accomplishment of the private foundation’s exempt activities and would not have been made but for the relationship between the investment and the accomplishment of those exempt activities. Section 53.4944-3(a)(2)(i). In determining whether no significant purpose of an investment is the production of income or the appreciation of property, §53.4944-3(a)(2)(iii) provides that it shall be relevant whether investors who are engaged in the investment solely for the production of income would be likely to make the investment on the same terms as the private foundation. Section 53.4944-3(a)(2)(iii) further provides that the fact that an investment produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.

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<sup>1</sup> The regulations under section 4944(c) further provide that no purpose of a PRI may be to accomplish one or more of the purposes described in section 170(c)(2)(D) (attempting to influence legislation or participating in or intervening in any political campaign). Treas. Reg. § 53.4944-3(a)(1)(iii).

Since 1972, §53.4944-3(b) has contained nine examples illustrating investments that qualify as PRIs and one example of an investment that does not qualify as a PRI. These long-standing examples focus on domestic situations principally involving economically disadvantaged individuals and deteriorated urban areas.

On April 19, 2012, a notice of proposed rulemaking (REG -144267-11) relating to PRIs was published in the **Federal Register** (77 FR 23429). The notice of proposed rulemaking (NPRM) contained proposed regulations that would add nine new examples to §53.4944-3(b). The proposed examples demonstrated that PRIs may accomplish a variety of exempt purposes (and are not limited to situations involving economically disadvantaged individuals and deteriorated urban areas), may fund activities in one or more foreign countries, and may earn a high potential rate of return. The proposed examples also illustrated that a PRI may take the form of an equity position in conjunction with making a loan, and that a private foundation's provision of credit enhancements can qualify as a PRI. In addition, the examples illustrated that loans and capital may be provided to individuals or entities that are not within a charitable class themselves, if the recipients are the instruments through which the private foundation accomplishes its exempt activities.

No public hearing on the NPRM was requested or held; however, 15 comments from the public were received. All comments are available at [www.regulations.gov](http://www.regulations.gov) or upon request. After consideration of the comments, the proposed regulations are adopted as amended by this Treasury decision.

## **Summary of Comments and Explanation of Revisions**

### **1. Recommended Changes to Proposed Examples**

While commenters generally lauded the issuance of the proposed regulations and supported issuing them as final regulations, some commenters suggested a few modifications to the examples contained in the proposed regulations.

One commenter suggested amending Example 11, which involved a private foundation's investment in a subsidiary of a drug company for the development of a vaccine to prevent a disease that predominantly affects poor individuals in developing countries. Under the investment agreement described in the Example, the subsidiary is required to distribute the vaccine to the poor individuals in developing countries at a price that is affordable to the affected population and to promptly publish its research results. The commenter recommended that the example be modified to make it clear that the subsidiary can also sell the vaccine to those who can afford it at fair market value prices. The final regulations amend Example 11 to adopt this clarification, which is appropriate given that the Example also specifies that Y's primary purpose in making the investment is to fund scientific research in the public interest and no significant purpose of the investment involves the production of income or the appreciation of property.

The commenter also recommended removing the publication requirement described in Example 11, contending that the provision of the vaccine to the poor at affordable prices without more furthers the accomplishment of exempt

purposes. Example 11 illustrated a known fact pattern that was presented in a private letter ruling issued by the IRS. Although it is not possible for the regulations to provide examples illustrating every conceivable fact pattern, the Treasury Department and the IRS note that other fact patterns that do not contain all of the same elements as those illustrated by Example 11 may nonetheless further an exempt purpose if the requirements of the regulations are otherwise satisfied. Accordingly, the final regulations do not adopt this comment.

One commenter suggested modifying Example 13, which involved a private foundation that accepts common stock in a business enterprise as part of a loan to the business and that plans to liquidate the stock as soon as the business becomes profitable or it is established that the business will never become profitable. The commenter requested that the sentence in the example regarding the liquidation of the stock be removed or amended to clarify whether a foundation must sell its stock in a business that becomes profitable for the investment in that stock to be a PRI. In response to the comment, this sentence has been removed from the example. The Treasury Department and the IRS note, however, that the establishment, at the outset of an investment, of an exit condition that is tied to the foundation's exempt purpose in making the investment can be an important indication that a foundation's primary purpose in undertaking the investment is in fact accomplishment of the exempt purpose.

Two commenters suggested modifying Example 15, which involved loans by a private foundation to two poor individuals living in a developing country where a natural disaster has occurred. One commenter noted that loans that

enable poor persons to become economically self-sufficient by starting a small business qualify as PRIs without the necessity for a natural disaster to have occurred. In response to this comment, the final regulations amend Example 15 to eliminate the reference to a natural disaster. Another commenter suggested modifying Example 15 to refer to a “foreign country” rather than a “developing country,” noting that providing disaster relief to a foreign country, whether or not it is a developing country, furthers the accomplishment of exempt purposes. As noted in the preamble to the NPRM, several examples in the proposed regulations illustrated the principle that an activity conducted in a foreign country furthers an exempt purpose if the same activity would further an exempt purpose if conducted in the United States. This principle applies equally to all foreign countries. However, the final regulations do not change the reference to a developing country in Example 15, because the example illustrates PRIs in the context of microloans, which are currently more common in developing countries. In addition, because organizations making microloans often provide loans to many individuals, the final regulations modify the example to reference loans to a group of individuals, rather than two specific individuals with identified business endeavors.

One commenter suggested modifying Example 16, which described a loan to a limited liability company (LLC), to describe an equity investment in an LLC. When a private foundation makes an equity investment in an LLC (or other entity) treated as a partnership for federal tax purposes, the activities of the LLC are attributed to the foundation for purposes of determining both whether the

foundation operates exclusively for exempt purposes (and therefore continues to qualify for exemption under section 501(c)(3)) and whether the foundation has engaged in an unrelated trade or business described in section 511. See Rev. Rul. 2004-51 (2004-1 CB 974). As a result, investments in partnership interests by section 501(c)(3) organizations raise a host of issues that are not raised by loans or by investments in stock of corporations. These issues necessitate consideration and analysis of a variety of facts and circumstances that are difficult to summarize in examples in regulations, and hence investments by section 501(c)(3) organizations in partnership interests have been addressed primarily through revenue rulings. See Rev. Rul. 2004-51, Rev. Rul. 98-15 (1998-1 CB 718). Accordingly, the Treasury Department and the IRS do not adopt this comment but are considering whether to address PRIs in the form of investments in partnership interests through the issuance of a revenue ruling.

Finally, one commenter recommended that the examples be amended to demonstrate the ability of a foundation to set PRI terms at above the prime rate. The examples in the proposed regulations generally referred to the interest rate or rate of return on a PRI as being less than the expected “market rate” for an investment of comparable risk and did not contain any suggestion that the rate of return of a PRI must fall below an absolute percentage threshold, such as the prime rate, to demonstrate no significant purpose involving the production of income or the appreciation of property. In addition, one example, Example 12, referred to the potential for a high rate of return if the recipient business is

successful. Thus, the final regulations do not adopt this comment to expressly state in an example that the rate of return on a PRI may exceed the prime rate.

## 2. Principles Illustrated in the Examples

The preamble to the NPRM noted that the additional PRI examples in the proposed regulations illustrated that: (1) An activity conducted in a foreign country furthers an exempt purpose if the same activity would further an exempt purpose if conducted in the United States; (2) the exempt purposes served by a PRI are not limited to situations involving economically disadvantaged individuals and deteriorated urban areas; (3) the recipients of PRIs need not be within a charitable class if they are the instruments for furthering a exempt purpose; (4) a potentially high rate of return does not automatically prevent an investment from qualifying as a PRI; (5) PRIs can be achieved through a variety of investments, including loans to individuals, tax-exempt organizations and for-profit organizations, and equity investments in for-profit organizations; (6) a credit enhancement arrangement may qualify as a PRI; and (7) a private foundation's acceptance of an equity position in conjunction with making a loan does not necessarily prevent the investment from qualifying as a PRI.

One commenter recommended that this statement of principles (which it called "extremely helpful guidance") be included in the text of the final regulations so that the principles are readily accessible to grantmaking organizations. The principles helped identify areas in which clarification through examples would be helpful. The Treasury Department and the IRS believe that each of these seven principles is adequately reflected in the new examples themselves. Accordingly,

the final regulations do not adopt this comment. Alternatively, the commenter suggested that the principles be preserved in another readily accessible place, like the IRS' website. In response to this comment, the IRS intends to post the principles on its website.

### 3. Recommendations for Additional Examples

A number of commenters suggested additional examples to be added to the final regulations. For example, two commenters recommended including examples involving PRIs to support news media or mixed-income housing or to lessen the burdens of government, while another commenter suggested examples involving economic development through the promotion of technology-based enterprises. The proposed regulations contained nine new examples involving many different exempt purposes, such as scientific research in the public interest, combating environmental deterioration, and education. The Treasury Department and the IRS believe these additional examples adequately illustrate the principle that a PRI may accomplish a variety of exempt purposes. These regulations under section 4944 are not intended to provide an example of every exempt purpose, and there are many examples of exempt purposes in both regulations and sub-regulatory guidance under section 501(c)(3). Therefore, additional examples of exempt purposes are not provided in these regulations. However, if commenters or other organizations believe additional guidance is needed under section 501(c)(3) regarding whether particular activities further charitable purposes, private letter rulings or guidance of general

applicability may be requested. Accordingly, the final regulations do not adopt these comments.

One commenter recommended including an additional example of a foundation assuming certain risks to catalyze the entry of private investment capital. The proposed regulations already included two examples of a foundation assuming certain risks (specifically, in the form of a deposit agreement and a guarantee) to catalyze the entry of private investment capital. Thus, the Treasury Department and the IRS do not believe that additional examples are necessary to illustrate this possibility and the final regulations do not adopt this comment.

Two commenters requested examples involving investments in low-profit limited liability companies (L3Cs) or benefit corporations. On the other hand, one commenter approved of the lack of any examples suggesting the need for a recipient of a PRI to be an L3C or benefit corporation, noting that the IRS has not recognized L3C or benefit corporation status as relevant to the determination of whether an investment is a PRI and also noting potential concerns with and lack of universal endorsement of the L3C model. The proposed regulations included one example involving a loan to an LLC; the results of that example would be the same if the limited liability company described in the example were an L3C. Similarly, the results of examples in which the PRI recipient is a corporation would apply equally if the recipient were a benefit corporation. The Treasury Department and the IRS see no need to amend the examples to refer more narrowly to an L3C or benefit corporation when such status is not determinative

of the examples' conclusions. Accordingly, the final regulations do not adopt these comments.

One commenter noted that the example in the proposed regulations of a PRI financing medical research involved a disease that predominantly affects developing countries and requested another example involving a disease that affects developed countries (but with respect to which a lack of sufficient market incentives exist for research and development of new treatments). Scientific research carried on for the purpose of discovering a cure for a disease need not involve a disease predominantly affecting developing countries to accomplish an exempt purpose described in section 501(c)(3). However, as previously noted, the PRI examples are intended to illustrate types of investments that qualify as PRIs and are not intended to address every circumstance that constitutes an exempt purpose, and thus the final regulations do not adopt this comment.

Finally, one commenter requested additional guidance regarding the circumstances under which PRIs may result in impermissible private benefit and specifically requested an example of a PRI that has the primary purpose of benefitting indigent members of a charitable class but that also benefits non-indigent individuals (other than the recipient of the PRI itself). This commenter appeared to be requesting guidance on the circumstances under which private benefit conferred by an investment might affect an organization's exempt status under section 501(c)(3) rather than under which the private benefit might affect the investment's status as a PRI, and as such would be outside of the scope of these final regulations. The effect of private benefit on exempt status is

addressed in examples in regulations under section 501(c)(3) as well as a number of revenue rulings. See §1.501(c)(3)-1(d)(1)(iii); Rev. Rul. 76-206, 1976-1 CB 154; Rev. Rul. 74-587, 1974-2 CB 162; Rev. Rul. 70-186, 1970-1 CB 128. To the degree the commenter was requesting guidance on the effect of private benefit on an investment's status as a PRI, the substantial majority of examples in the existing and proposed regulations involve some private benefit to one or more persons that are not members of a charitable class (often including the recipient of the PRI itself) that is incidental to the investment's primary purpose of accomplishing an exempt purpose. As a result, the Treasury Department and the IRS do not believe that additional examples on this issue are necessary, and the final regulations do not adopt this comment

#### 4. Procedures for the IRS to Rule on PRIs

A number of commenters requested that the IRS adopt procedures that would allow private foundations considering a PRI to obtain determinations or guidance from the IRS regarding the PRI in ways that are more expeditious and less costly than the private letter ruling process.

One commenter proposed that the IRS create a process similar to the one established under section 4945(g) for approving procedures for making grants to individuals. Under §53.4945-4(d)(3), if a foundation that properly submits a request for approval of grant procedures has not been notified by the IRS that its procedures are not acceptable by the 45th day after the submission, the procedures will be considered as approved from the date of submission until receipt of actual notice from the IRS that such procedures do not meet the

necessary requirements. Section 4945(g) specifically requires that procedures for making grants to individuals be approved by the IRS to avoid an excise tax being applied to such grants. Section 4944 contains no such requirement of advance approval of PRIs and hence is not analogous to section 4945(g).

Accordingly, the final regulations do not adopt this comment.

One commenter recommended allowing private foundations to request determinations that their investments are PRIs using Form 8940, *Request for Miscellaneous Determination*, and also to request expedited review of such requests when the closing of financing of a PRI is scheduled four months or six months from the date the request is submitted. Determination requests that are submitted to Exempt Organizations Determinations using Form 8940 are listed in section 7.04 of Rev. Proc. 2015-4 (2015-1 IRB 144). Allowing determination requests regarding PRIs to be submitted to Exempt Organizations Determinations using Form 8940 (as well as expedited review of such requests) would require amendments to Rev. Proc. 2015-4, not the proposed regulations, and would require changes to tax administration programs. Hence it is outside the scope of these final regulations.

Two commenters recommended allowing IRS private letter rulings (PLRs) regarding PRIs to be relied on by other private foundations, so that each private foundation investing in one project that qualifies as a PRI does not have to obtain its own PLR. We note that a PLR is not necessary for an investment to qualify as a PRI. Furthermore, allowing a private foundation to rely on a letter ruling issued to another taxpayer would require amendments to section 11 of Rev. Proc. 2015-

1 (2015-1 IRB 1), not the proposed regulations, and raises tax administration issues. Hence it is outside the scope of these final regulations.

In addition to the changes noted above, the final regulations also correct the reference to section 4942 in §53.4944-3(a)(2)(ii) to reflect prior changes to that statute.

### **Statement of Availability of IRS Documents**

IRS Revenue Procedures, Revenue Rulings notices, notices and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

### **Special Analyses**

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the NPRM preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business

Administration for comment on its impact on business and no comments were received.

### **Drafting Information**

The principal author of these regulations is Robin Ehrenberg, Office of the Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury Department and the IRS participated in their development.

### **List of Subjects in 26 CFR Part 53**

Excise Taxes, Foundations, Investments, Lobbying, Reporting and Recordkeeping Requirements, Trusts and trustees.

### **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 53 is amended as follows:

#### **Part 53--FOUNDATION AND SIMILAR EXCISE TAXES**

Par. 1. The authority citation for part 53 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. In § 53.4944-3:

1. Amend paragraph (a)(2)(ii) by removing the language “section 4942(j)(5)(B)” and adding in its place “section 4942(j)(4)(B)”.
2. Amend paragraph (b) by adding Examples 11 through 19.
3. Add paragraph (c).

The additions read as follows:

§53.4944-3 Exception for program-related investments.

\* \* \* \* \*

(b) \* \* \*

Example 11. X is a business enterprise that researches and develops new drugs. X's research demonstrates that a vaccine can be developed within ten years to prevent a disease that predominantly affects poor individuals in developing countries. However, neither X nor other commercial enterprises like X will devote their resources to develop the vaccine because the potential return on investment is significantly less than required by X or other commercial enterprises to undertake a project to develop new drugs. Y, a private foundation, enters into an investment agreement with X in order to induce X to develop the vaccine. Pursuant to the investment agreement, Y purchases shares of the common stock of S, a subsidiary corporation that X establishes to research and develop the vaccine. The agreement requires S to distribute the vaccine to poor individuals in developing countries at a price that is affordable to the affected population, although, the agreement does not preclude S from selling the vaccine to other individuals at a market rate. The agreement also requires S to publish the research results, disclosing substantially all information about the results that would be useful to the interested public. S agrees that the publication of its research results will be made as promptly after the completion of the research as is reasonably possible without jeopardizing S's right to secure patents necessary to protect its ownership or control of the results of the research. The expected rate of return on Y's investment in S is less than the expected market rate of return for an investment of similar risk. Y's primary purpose in making the investment is to fund scientific research in the public interest. No significant purpose of the investment 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, Y's purchase of the common stock of S is a program-related investment.

Example 12. Q, a developing country, produces a substantial amount of recyclable solid waste materials that are currently disposed of in landfills and by incineration, contributing significantly to environmental deterioration in Q. X is a new business enterprise located in Q. X's only activity will be collecting recyclable solid waste materials in Q and delivering those materials to recycling centers that are inaccessible to a majority of the population. If successful, the recycling collection business would prevent pollution in Q caused by the usual disposition of solid waste materials. X has obtained funding from only a few commercial investors who are concerned about the environmental impact of solid waste disposal. Although X made substantial efforts to procure additional funding, X has not been able to obtain sufficient funding because the expected rate of return is significantly less than the acceptable rate of return on an investment of this type. Because X has been unable to attract additional

investors on the same terms as the initial investors, Y, a private foundation, enters into an investment agreement with X to purchase shares of X's common stock on the same terms as X's initial investors. Although there is a high risk associated with the investment in X, there is also the potential for a high rate of return if X is successful in the recycling business in Q. Y's primary purpose in making the investment is to combat environmental deterioration. No significant purpose of the investment 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, Y's purchase of the X common stock is a program-related investment.

Example 13. Assume the facts as stated in Example 12, except that X offers Y shares of X's common stock in order to induce Y to make a below-market rate loan to X. X previously made the same offer to a number of commercial investors. These investors were unwilling to provide loans to X on such terms because the expected return on the combined package of stock and debt was below the expected market return for such a package based on the level of risk involved, and they were also unwilling to provide loans on other terms X considers economically feasible. Y accepts the stock and makes the loan on the same terms that X offered to the commercial investors. Y's primary purpose in making the investment is to combat environmental deterioration. No significant purpose of the investment 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 loan accompanied by the acceptance of common stock is a program-related investment.

Example 14. X is a business enterprise located in V, a rural area in State Z. X employs a large number of poor individuals in V. A natural disaster occurs in V, causing significant damage to the area. The business operations of X are harmed because of damage to X's equipment and buildings. X has insufficient funds to continue its business operations and conventional sources of funds are unwilling or unable to provide loans to X on terms it considers economically feasible. In order to enable X to continue its business operations, 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 in making the loan is to provide relief to the poor and distressed. No significant purpose of the loan 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, the loan is a program-related investment.

Example 15. Y, a private foundation, makes loans bearing interest below the market rate for commercial loans of comparable risk to poor individuals who

live in W, a developing country, to enable them to start small businesses such as a roadside fruit stand. Conventional sources of funds were unwilling or unable to provide such loans on terms they consider economically feasible. Y's primary purpose in making the loans is to provide relief to the poor and distressed. No significant purpose of the loans involves the production of income or the appreciation of property. The loans significantly further the accomplishment of Y's exempt activities and would not have been made but for such relationship between the loans and Y's exempt activities. Accordingly, the loans to the poor individuals who live in W are program-related investments.

Example 16. X is a limited liability company treated as a partnership for federal income tax purposes. X purchases coffee from poor farmers residing in a developing country, either directly or through farmer-owned cooperatives. To fund the provision of efficient water management, crop cultivation, pest management, and farm management training to the poor farmers by X, Y, a private foundation, makes a loan to X bearing interest below the market rate for commercial loans of comparable risk. The loan agreement requires X to use the proceeds from the loan to provide the training to the poor farmers. X would not provide such training to the poor farmers absent the loan. Y's primary purpose in making the loan is to educate poor farmers about advanced agricultural methods. No significant purpose of the loan 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, the loan is a program-related investment.

Example 17. X is a social welfare organization that is recognized as an organization described in section 501(c)(4). X was formed to develop and encourage interest in painting, sculpture, and other art forms by, among other things, conducting weekly community art exhibits. X needs to purchase a large exhibition space to accommodate the demand for exhibition space within the community. 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 at an interest rate below the market rate for commercial loans of comparable risk to fund the purchase of the new space. Y's primary purpose in making the loan is to promote the arts. No significant purpose of the loan 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, the loan is a program-related investment.

Example 18. X is a non-profit corporation that provides child care services in a low-income neighborhood, enabling many residents of the neighborhood to be gainfully employed. X meets the requirements of section 501(k) and is recognized as an organization described in section 501(c)(3). X's current child care facility has reached capacity and has a long waiting list. X has determined

that the demand for its services warrants the construction of a new child care facility in the same neighborhood. X is unable to obtain a loan from conventional sources of funds including B, a commercial bank because of X's credit record. Pursuant to a deposit agreement, Y, a private foundation, deposits \$h in B, and B lends an identical amount to X to construct the new child care facility. The deposit agreement requires Y to keep \$h on deposit with B during the term of X's loan and provides that if X defaults on the loan, B may deduct the amount of the default from the deposit. To facilitate B's access to the funds in the event of default, the agreement requires that the funds be invested in instruments that allow B to access them readily. The deposit agreement also provides that Y will earn interest at a rate of t% on the deposit. The t% rate is substantially less than Y could otherwise earn on this sum of money, if Y invested it elsewhere. The loan agreement between B and X requires X to use the proceeds from the loan to construct the new child care facility. Y's primary purpose in making the deposit is to further its educational purposes by enabling X to provide child care services within the meaning of section 501(k). No significant purpose of the deposit involves the production of income or the appreciation of property. The deposit significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the deposit and Y's exempt activities. Accordingly, the deposit is a program-related investment.

Example 19. Assume the same facts as stated in Example 18, except that instead of making a deposit of \$h into B, Y enters into a guarantee agreement with B. The guarantee agreement provides that if X defaults on the loan, Y will repay the balance due on the loan to B. B was unwilling to make the loan to X in the absence of Y's guarantee. X must use the proceeds from the loan to construct the new child care facility. At the same time, X and Y enter into a reimbursement agreement whereby X agrees to reimburse Y for any and all amounts paid to B under the guarantee agreement. The signed guarantee and reimbursement agreements together constitute a "guarantee and reimbursement arrangement." Y's primary purpose in entering into the guarantee and reimbursement arrangement is to further Y's educational purposes. No significant purpose of the guarantee and reimbursement arrangement involves the production of income or the appreciation of property. The guarantee and reimbursement arrangement significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the guarantee and reimbursement arrangement and Y's exempt activities. Accordingly, the guarantee and reimbursement arrangement is a program-related investment.

(c) Effective/applicability date. Paragraphs (a)(2)(ii) and (b), Examples 11 through 19 of this section, apply on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

John Dalrymple,

Deputy Commissioner for Services and Enforcement.

Approved: April 5, 2016.

Mark J. Mazur,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2016-09396 Filed: 4/21/2016 4:15 pm; Publication Date: 4/25/2016]