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❖ Compliance Issues

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Challenges

- PRI's
 - Charitability
 - Private Benefit
 - Self-dealing
 - Procedural Requirements
- MRI's and SRI's
 - Investment Standards

Charitability - Rules (PRI's)

- 501(c)(3) – “organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes”
- 4944(c) – “primary purpose is to accomplish one or more of the purposes described in section 170(c)(2)(B)”

Charitability - Challenges

- Inherent conflict when both non-profit and for-profit investors are both involved
- Public benefit must be commensurate with investment, but hard to value
- Determinations are highly fact specific and PLR's can't be relied upon by others
- Different terms for different types of investors
- Different terms based on time of investment
- Exit strategy often relevant

Private Benefit (PRI's)

- 501(c)(3) “... no part of the net earnings of which inures to the benefit of any private shareholder or individual....”
- Often forgotten
- Even if public benefit is sufficient to justify charitability, steps must be taken to ensure private investors are not unduly enriched

Self-dealing

- § 4941 prohibits transactions with disqualified persons (DQP)
- DQP includes companies owned and controlled by DQP's
- Problem areas
 - Vehicle is a DQP
 - Other investors are DQP's

Procedural Requirements

- PRI's require Expenditure Responsibility
 - Pre-grant inquiry
 - Written Agreement
 - Regular Reporting
 - 990 Disclosure
- More flexible than 4945 rules for grants

Investment Standards (MRI, SRI)

- PRI's specifically excluded from §4943 and §4944 – MRI's and SRI's are not
- UPMIFA and UPIA require prudence in managing endowments
 - Factors include economic conditions, inflation, tax consequences, return/appreciation, other assets, payout and preservation of capital
 - Also “asset’s special relationship or value to the charitable purposes of the institution

A New Hope

- April 25, 2016, final regulations provide guidance and examples to private foundations engaging in PRI's (81 Fed. Reg. 24014)
- No new law or regulations, but new examples clarify some uncertainties in interpretations
- Hint at need for/value of Rev. Rulings

Revised Regs: Charitability

- An activity conducted in a foreign country furthers an exempt purpose if the same activity would further an exempt purpose in the US
- Exempt purposes served by a PRI are not limited to serving economically disadvantaged individuals or deteriorated urban areas
- Recipients of PRIs need not be within a charitable class if they are the instruments for furthering a exempt purpose

Revised Regs: Private Benefit

- Foundation investment in company to develop vaccine for a disease predominantly affecting poor in developing countries
- Company required to distribute at a price that is affordable to the target population
- Drug company can also sell the vaccine to those who can afford it at fair market prices
- Preamble to revised comments makes clear that there is some private benefit in all PRI's

Revised Regs: Income

- Potentially high rate of return does not automatically prevent an investment from qualifying as a PRI
- 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

Revised Regs: Structures

- PRIs can be through a variety of vehicles
 - individuals
 - other tax-exempt organizations - (c)(4)
 - for-profit organizations
 - LLC's and partnerships
 - “hybrid” organizations
- PRI's don't have to be loans
 - Equity
 - Credit enhancement