Current Developments, Cases, Analysis, Planning Advice

FAMILY FOUNDATION Advisor

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ALSO IN THIS ISSUE

Program-Related Investments in the 2020 Landscape

Katherine. E. David, J.D.

Introduction

Under IRC §4942, each year, a private foundation must make qualifying distributions in an amount roughly equal to 5% of the net value of its non-exempt-use assets. A typical grant-making family foundation satisfies most of its minimum distribution requirement by making grants to public charities. During the COVID-19 pandemic and resulting economic downturn, many public charities face unprecedented need, and a foundation looking to satisfy its minimum distribution requirement by making grants currently easily could find worthy recipients. However, current grant-making might not be the best choice for all foundations. As discussed in our prior issue, set-asides create an avenue for foundations to meet the minimum distribution requirement without having to liquidate investments at a loss or fund projects that have been paused because of stay-at-home orders.[1] This article describes how program-related investments (PRIs) can be used to meet specific challenges brought by the COVID-19 pandemic and other recent events.

What Is a PRI?

In simple terms, a PRI is a loan or capital investment made by a private foundation primarily to further its tax-exempt purpose. PRIs are not the same as grants. Unlike grants, which are no-strings-attached gifts, PRIs structured as loans are expected to be repaid. PRIs structured as capital investments create an equity interest, which becomes an asset of the private foundation. PRIs are different from typical investments because, although they might generate income, the production of income is not their primary purpose.

In order to qualify as a PRI, an investment must have three characteristics:

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Reopening the Workplace: Considerations and Tools for Private Foundations

Introduction

In order to slow the spread of COVID-19, many state and local governments issued orders mandating that employees work from home. As these same jurisdictions move toward "reopening," employees are returning to the office environment. Foundations that maintain offices must keep abreast of state and local rules and orders and the evolving dictates of the CDC and OSHA requirements. A full discussion of those considerations is outside the scope of this article. However, this article provides a general guide to key considerations for keeping an office environment safe and provides a sample foundation COVID-19 policy and screening tool.

Know and Follow Applicable Rules and Recommendations

Different workplaces have different COVID-19 risk profiles. Foundations that

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- Its primary purpose must be to accomplish a tax-exempt purpose described in IRC §170(c)(2)(B);
- It cannot have as a significant purpose the production of income or the appreciation of property; and
- It cannot be made for any purpose of influencing legislation or intervening in favor of or in opposition to a candidate for public office.[2]

Regulations under IRC §4944 provide guidance to private foundations on PRIs. The regulations provide a series of examples illustrating investments that qualify as PRIs and demonstrate that PRIs "may accomplish a variety of exempt purposes."[3]

Example of a PRI Structured as a Loan. A private foundation identifies a small family-owned restaurant that is located in an economically underserved urban area. The restaurant employs area residents who have limited job opportunities near their homes and pays them a living wage. It also serves as a neighborhood gathering place and contributes to the prevention of community deterioration. The restaurant was damaged in the unrest that followed a peaceful march for racial equality held in June 2020 and was forced to close. The owners would like to repair the building and resume operations. The restaurant and its owners do not have sufficient cash to fund the repairs, and local banks are unwilling to provide funds on terms that the restaurant owners consider economically feasible. The private foundation makes a loan to the restaurant, at an interest rate below the market rate for commercial loans of comparable risk. The private foundation's primary purpose for making the loan is to provide employment opportunities in an economically underserved area and to combat community deterioration.[4]

Example of a PRI Structured as a Capital Investment. A private foundation identifies a small-scale manufacturing operation (operated through a corporation) that has the ability to produce low-cost personal protective equipment (PPE). The corporation is not owned by low-income or minority group members, but its continued operation is important to ensure the area's continued supply of PPE. The corporation needs money to upgrade its machinery and expand the manufacturing floor. Local banks are unwilling to provide funds to the corporation unless it increases its equity capital. The private foundation purchases shares of the corporation's common stock, primarily to increase the corporation's equity capital and thus to facilitate a bank loan and promote the health of the local community.[5]

Practice Point: PRIs should not be confused with investments that are merely "mission related." It is true that foundation managers are permitted to consider all relevant facts and circumstances including the relationship between a particular investment and the foundation's tax-exempt purposes, in deciding whether to make an investment,[6] and that an investment that furthers a foundation's mission will not be treated as a jeopardizing investment subject to excise tax under IRC §4945, even if it offers a lower rate of return, more risk, or less liquidity than a traditional investment does.[7] However, a mission-related investment that does not satisfy the criteria to be classified as a PRI does not have "the quantum of charity" that PRIs have[8] and thus does not generate all of the benefits that a PRI would.

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IRS Offers Settlement for Syndicated Conservation Easements

On June 25, 2020, the IRS Office of Chief Counsel announced a time-limited settlement offer to certain taxpayers with pending docketed Tax Court cases involving syndicated conservation easement transactions.[1] The IRS will notify eligible taxpayers by mail, so a taxpayer must wait for a letter before taking action.

Background

Basics of Syndicated Conservation Easements. In a syndicated conservation easement, a promoter offers to prospective investors in a partnership or other pass-through entity the possibility of a charitable contribution deduction in an amount that significantly exceeds (by a factor of 2½) the amount invested. A syndicated conservation easement works as follows:

- A potential investor receives oral or written promotional materials that offer an investment in a pass-through entity that will generate charitable contribution deductions in excess of the amount invested.
- The investor purchases an interest in a pass-through entity that holds real property (either directly or through tiered pass-through entities).
- The promotor obtains an appraisal that purports to be a qualified appraisal for purposes of IRC §170(f)(11)(E)(i) but that greatly inflates the value of the easement based on unreasonable conclusions about the development potential of the property.
- The entity that holds the real property contributes a conservation easement to a qualified IRC §501(c)(3) organization, and the charitable contribution deduction is allocated to the investor.
- The investor reports a charitable contribution deduction with respect to the easement on his or her federal income tax return.
- The promotor receives a fee or other consideration with respect to the promotion, which could be in the form of an interest in the pass-through entity.

The IRS Commissioner has warned that "the IRS will continue to actively identify, audit, and litigate conservation easement deals as part of its vigorous and relentless effort to combat abusive transactions."

IRS Casts a Skeptical Eye. In December 2016, the IRS announced that it intended to challenge syndicated conservation easements.[2] An IRS challenge could be based on a variety of grounds, including over-valuation of the conservation easement, the partnership anti-abuse rule, and economic substance. It is important to recognize that the IRS only needs to succeed on just one theory in order for a taxpayer to be liable for underpayment, interest, and penalties.

Transactions that are the same as—or substantially similar to—the transaction described in Notice 2017-10 are listed transactions. Taxpayers who enter these transactions must disclose the transactions to the IRS for each taxable year in which the taxpayer participated in the transactions. The IRS advises that a taxpayer that already has filed a tax return claiming the purported tax benefits of such a transaction "should take appropriate corrective action and ensure that their transactions are disclosed properly"[3] (namely, by filing amended returns).

Caution: Participants who fail to make the required disclosure are subject to a penalty equal to 75% of the decrease in tax shown on the return as a result of the transaction, up to $200,000 ($100,000 for individuals). The minimum penalty is $10,000 ($5,000 for individuals).[4] In addition, the IRS may impose other penalties on persons involved in these transactions, including the accuracy-related penalty, the penalty for understatement of a taxpayer's liability by a tax-return preparer, and the penalty for certain valuation misstatements attributable to incorrect appraisals.

The Spotlight Gets Hotter. In 2019, the IRS added syndicated conservation easements to its annual "Dirty Dozen" list of tax scams. Further, IRS lawyers have been reviewing Tax Court cases involving conservation easements to determine whether the IRS should assert penalties or issues not raised before a taxpayer filed its petition.[5] The IRS had data scientists reviewing "mountains of data" to find relationships among promoters, appraisers, and law firms to lead to more taxpayer examinations and penalties.[6] As part of its overall plan to develop a "comprehensive, coordinated enforcement strategy to address abusive syndicated conservation easement transactions" the IRS has created two new officers that are actively investigating these transactions: the Promotor Investigation Coordinator and the Office of Fraud Enforcement."[7]

IRS Commissioner Chuck Retting has warned that "the IRS will continue to actively identify, audit, and litigate conservation easement deals as part of its vigorous and relentless effort to combat abusive transactions."[8] And, the Tax Court has held in the government's favor in several recent opinions and orders.

The Settlement Offer

Notwithstanding its recent successes in the Tax Court, the IRS Office of Chief Counsel has decided to offer taxpayers an opportunity to resolve certain docketed

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cases on standardized terms. The key terms of the settlement offer include:

- The taxpayer's charitable contribution deduction for the contributed easement is disallowed in full.
- All partners must agree to settle, and the partnership must pay the full amount of tax, penalties, and interest.
- "Investor" partners may deduct their cost of acquiring their partnership interest and pay a reduced penalty of 10%–20%, depending on the ratio of the deduction claimed to the amount of the investment.
- Partners who provided services in connection with any syndicated conservation easement transaction must pay the maximum penalty asserted by the IRS (typically 40%) with no deduction for costs.[9]

Caution: According to the IRS, taxpayers should not expect to settle their docketed Tax Court cases on better terms. Given the existing state of the law and the cases the Independent Officer of Appeals has encountered to date, the Office of Chief Counsel "will continue to vigorously litigate their cases to the fullest extent possible."[10]

What to Do if You're Eligible for a Settlement

Taxpayers who are eligible for the program will be notified by a letter setting forth the applicable terms. The IRS notes that some promoters may tell their clients that their facts are "better" than—or "different" from the facts in the adverse Tax Court cases and encourage their clients to litigate rather than settle. The IRS encourages taxpayers to consult with independent counsel (i.e., a qualified advisor who was not involved in promoting the transaction or selected by the promotor to defend it) when deciding whether to accept the offer.[11]

Endnotes

1. IRS News Release, "IRS offers settlement for syndicated conservation easements, letters being mailed to certain taxpayers with pending litigation," IR-2020-130 (June 25, 2020).

2. Notice 2017-10, 2017-4 IRB 544 (1Dec. 23, 2016).

3. Id.

4. IRC §6707A.

5. See Kristen A. Parillo & William Hoffman, "IRS Looking for Promoter Links as Easement Crackdown Grows," 2019 TNTF 240-1 (Dec. 13, 2019), Tax Analysts Doc. 2019-47134.

6. Id.

7. IRS News Release, supra note 1.

8. Id.

9. Id.

10. Id.

11. Id. ■

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Benefits of an Expenditure's Classification as a PRI

The classification of a private foundation's investment as a PRI has several tax benefits. First, as with mission-related investments, a PRI will not be considered a "jeopardizing investment."[9] Second, a PRI is treated as a qualifying distribution for purposes of IRC §4942,[10] and the value of a PRI is excluded from a private foundation's investment base for purposes of calculating its annual minimum distribution.[11] PRIs do not constitute taxable expenditures, provided the private foundation exercises expenditure responsibility when it is required to do so.[12]

Practice Point: An additional benefit, relevant to PRIs structured as capital investments, is that PRIs are not considered business holdings for the purpose of calculating excess business holdings under IRC §4943.[13]

Prior Guidance on PRIs

The regulations defining PRIs were issued in 1972[14] and contain examples that focus on "domestic situations principally involving economically disadvantaged individuals and deteriorated urban areas"[15] (which were hot issues at the time[16]) and thus offered limited guidance to private foundations seeking to make a PRI in other factual situations. The original regulation remained unchanged for over 40 years, during which PRIs were not widely used. One possible reason private foundations may have been reluctant to use PRIs is because the examples given in the 1972 regulations are somewhat narrow in scope. In any event, notwithstanding their long existence, PRIs are not necessarily part of the mainstream private-foundation toolbox.

Current Regulations

In 2016, the IRS and Treasury released new final regulations under IRC §4944.[17] The new regulations provide a series of examples that show the breadth of situations in which PRIs can be used and illustrate the IRS's thinking that a PRI may include the following investment practices and principles:

- An activity conducted in a foreign country furthers a charitable purpose if the same activity would further a charitable purpose if conducted in the United States;
- The tax-exempt purposes served by a PRI are not limited to situations involving economically disadvantaged individuals and deteriorated urban areas. The examples include a broad range of tax-exempt purposes: advancing science, combating environmental deterioration, and promoting the arts, for example;
- The recipients of PRIs need not be within a charitable class if they are the instruments for furthering a charitable purpose;
- A potentially high rate of return does not automatically prevent an investment from qualifying as program-related;
- 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;
- A credit enhancement arrangement (such as a loan guarantee or bank deposit agreement) might qualify as a PRI; and
- 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.

While these principles are not affirmatively laid out in the final regulations, they are posted as guidance on the IRS web-

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site,[18] and the IRS and Treasury interpret the final regulations to reflect these principles.[19] A variety of real-world scenarios find support in the final regulations and the preamble to the Treasury Decision implementing them.

Sales at Market Rate as Well as at Affordable Prices. Example 11 to the regulations describes as a PRI a private foundation's investment agreement with a business enterprise that researches and develops new drugs. Under the agreement, vaccines will be distributed to poor individuals in developing countries at a price that is affordable to the affected population. The foundation'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 final regulations make clear, however, that the business enterprise also may sell the vaccine to those who can afford it at fair market value prices without jeopardizing the foundation's investment's qualification as a PRI.

Practice Point: Example 11 would support a favorable determination in a scenario where, for instance, a private foundation invests in a medical equipment manufacturer that is researching and developing rapid testing for COVID-19, for the purpose of making testing capability available to nonprofit community clinics at an affordable price and to for-profit testing facilities at fair market value.

Caution: In this same example, the IRS declined to remove a statement that the investment agreement requires the business enterprise to publish its research results, disclosing substantially all information that would be useful to the interested public, noting that Example 11 illustrated a known-facts pattern based on a previously issued private letter ruling. However, the preamble to the final regulations acknowledges that other fact patterns that do not contain all of the same elements described in Example 11 nevertheless might qualify as PRIs.

Exit From Profitable Investments Not Necessarily Required. Example 13 to the regulations describes as a PRI a transaction in which a foundation accepts common stock in a business enterprise as part of a loan to the business. Prior to being finalized in final regulations, the text in proposed regulations provided that the foundation planned to liquidate the stock as soon as (1) the business became profitable or (2) it was established that the business would never become profitable. To avoid the implication that a foundation would have to sell stock in a business that becomes profitable in order for the investment to constitute a PRI, the final regulations do not contain the statement regarding a plan to liquidate. However, the preamble to the final regulations cautions that the preestablishment of an exit condition that is tied to the foundation's exempt purpose can be an important indication that the foundation's primary purpose in making an investment is the accomplishment of its exempt purpose (and not production of income). Thus, while a foundation is not precluded from retaining a PRI once a business becomes profitable, it should ensure that all other facts support the conclusion that the investment constitutes a PRI.

Practice Point: Example 13 would support a scenario like this: A private foundation (Foundation) makes an investment in a promising start-up drug company (Company) that seeks to develop a vaccine for COVID-19. Company offers Foundation shares of common stock in order to induce Foundation to make a below-market rate loan to it. Company previously made the same offer to commercial investors, but they were unwilling to provide loans because the expected return on the combined package of stock and debt did not justify the financial risk. Foundation accepts the stock and makes the loan on the same terms previously offered to commercial investors. Foundation's primary purpose in making the investment is to slow or stop the spread of COVID-19, and the investment would not have been made but for the relationship between it and Foundation's exempt activities.

Microloans Can Constitute PRIs. Example 15 to the regulations illustrates PRIs in the context of microloans. As originally presented in the proposed regulations, Example 15 described loans by a private foundation to two poor individuals living in a developing country where a natural disaster had occurred. The final regulations do not contain the reference to a natural disaster, making clear that loans that enable poor persons to become economically self-sufficient by starting a small business can qualify as PRIs even in the absence of a natural disaster. The final regulations also describe loans to a group of individuals (rather than two specific individuals) to reflect the fact that organizations that make microloans often provide loans to many individuals. Although T.D. 9762 does not affirmatively address the issue, it does not appear that one should draw an adverse inference from this change: microloans to one or two individuals nevertheless could constitute PRIs.

Practice Point: Example 15 would support a scenario, for instance, where a private foundation makes a microloan to a minority individual to enable the recipient to start a small business such as a sidewalk food service, if the primary purpose of the loan is to provide relief to the poor and distressed and no significant purpose involves the production of income or the appreciation of property. The definition of "program related investment" is broad enough to include a similar scenario: rather than making a microloan, a foundation purchases the equipment necessary to operate a sidewalk food service. It allows an economically disadvantaged individual use of the equipment for a period of up to two years, at free or below-market rent, until the individual has generated enough income to purchase his own equipment. At such point, the foundation makes use of the equipment available to another individual.

The positive examples in the regulations are based on published guidance and transactions described in private letter rulings.[20] The regulations do not include any negative examples illustrating a "close-call" investment that does not qualify as a PRI. The absence of negative guidance suggests that in the 40-plus years that the existing regulations have been in effect, taxpayers have been "getting it right," not attempting to treat ineligible investments as PRIs. And, the regulations clearly indicate that the scope of eligible investments is broader than the existing regulations might lead

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taxpayers to conclude. Ruth Madrigal, an attorney-adviser in Treasury's Office of Tax Legislative Counsel has stated that the examples in the regulations illustrate the breadth and flexibility of PRIs as a tool for furthering charitable purposes in more current situations.[21] This environment should be heartening to a private foundation seeking to determine whether a proposed investment might qualify as a PRI.

What Guidance Is Lacking?

As set out in the preamble to T.D. 9762, the regulations do not address three important issues.

Equity Investments in Partnerships. First, Example 16 to the regulations describes a below-market loan to a limited liability company (LLC) that purchases coffee from poor farmers in a developing country. The loan agreement requires the LLC to use the loan proceeds to provide training to the farmers, and the LLC would not provide the training without the loan. One comment on the proposed regulations suggested modifying Example 16 to describe an equity investment rather than a loan. As the preamble to T.D. 9762 points out, investments in partnerships (including limited liability companies treated as partnerships) by IRC §501(c)(3) organizations raise a host of issues that are not raised by loans or by investments in corporations. In particular, a partnership's activities are attributed to its exempt organization-owner for purposes of determining whether the exempt organization is engaged in an unrelated trade or business, and may be attributed to the exempt organization-owner for purposes of determining whether the exempt organization operates exclusively for tax-exempt purposes. These issues are difficult to summarize or address in regulations that govern PRIs. However, the preamble to T.D. 9762 indicates that the IRS and Treasury are considering whether to address PRIs in the form of investments in partnerships through the issuance of a revenue ruling.

Practice Point: The regulations do not specifically prohibit equity investments in partnerships from qualifying as PRIs, and the investment would not be treated as an excess business holding. A foundation should recognize that its income from the investment may constitute unrelated business taxable income.[22]

The examples in the regulations illustrate the breadth and flexibility of PRIs in more current situations. This environment should be heartening to a private foundation seeking to determine whether a proposed investment might qualify as a PRI.

L3Cs and Benefit Corporations. The regulations do not specifically address the effect a business enterprise's status as a low-profit LLC (known as an "L3C") or benefit corporation should have on the question of whether an investment in or loan to the enterprise qualifies as a PRI. By way of background, L3Cs and benefit corporations are for-profit entities. Thus, they cannot qualify for tax-exemption under IRC §501(c)(3) and cannot readily attract funding from private foundations on the basis of being a public charity. What separates L3Cs and benefit corporations from typical LLCs or corporations is that they are devoted to a socially beneficial mission.

The L3C form is designed in part to attract PRIs. A typical L3C enabling statute tracks the language of the PRI Treasury regulations, providing that an L3C:

- Must be organized to significantly further an IRC §170(c)(2)(B) purpose;
- Must not have been created for a significant purpose of the production of income or the appreciation of property; and
- Cannot have as a purpose the influencing legislation or intervening in favor of or in opposition to a candidate for public office.[23]

To date, the IRS has not recognized L3C or benefit-corporation status as relevant to the determination of whether an investment is a PRI and declined to do so in the final regulations. The preamble to T.D. 9762 indicates that Example 16, which addresses a loan to an LLC, would apply equally to an L3C, and that examples in which the PRI recipient is a corporation would apply equally if the recipient were a benefit corporation. In short, the IRS and Treasury give no deference to the fact that the recipient of a purported PRI is an L3C or benefit corporation rather than an LLC or typical corporation.

Practice Point: A private foundation considering a capital investment in or a loan to an L3C or benefit corporation might take comfort in the fact that the relevant enabling statute tracks the regulatory definition of a PRI. Nevertheless, to date, the IRS has declined to publish guidance stating that transactions involving L3Cs and benefit corporations are (or at least are presumed to be) PRIs.

Streamlined Procedure for Rulings on PRIs. A private foundation is not required to obtain advance approval of an investment in order to treat it as a PRI. However, a foundation that does not want to bear the risk of "getting it wrong" may seek a private letter ruling. In particular, prior to 2012, private foundations seeking certainty were forced to seek a written legal opinion or a private letter ruling if their proposed investment was outside of the narrow scope of PRIs blessed in the long-standing regulations. No doubt some private foundations abandoned potential investments because of the effort and expense obtaining certainty entailed.

In some instances, multiple private foundations might seek to make an investment on substantially the same terms and thus would benefit from a single private letter ruling that applies to each of them. For example, say a fund organized as a limited partnership will make loans to growth-oriented businesses in targeted urban core areas that are not able to obtain traditional financing. The fund's purpose in mak-

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ing the loans is charitable: promoting economic development by creating jobs for the underprivileged, eliminating prejudice and discrimination, and combatting community deterioration. Assume further that a number of private foundations are interested in investing as limited partners of the fund and intend their investments to qualify as PRIs. It would reduce costs and increase efficiency if all private foundations that invest in the fund pursuant to the limited partnership agreement could rely on a single PRI.[24]

According to the preamble to T.D. 9762, two commentators recommended that other private foundations be allowed to rely on a private letter ruling regarding a PRI issued to another foundation. The IRS and Treasury declined to adopt this recommendation, noting that such a change would require amendments to the revenue procedure governing requests for private letter rulings and would raise tax administration issues.

The IRS and Treasury also have declined to adopt deemed-approval procedures for PRIs similar to the deemed-approval procedure that applies in the context of grants to individuals under IRC §4945, and have declined to permit private foundations to request determinations that their investments are PRIs using Form 8940, Request for Miscellaneous Determination, rather than a request for private letter ruling.

On balance, it seems that, in light of the favorable final regulations, the IRS and Treasury are not inclined to facilitate private foundations' pursuit of private letter rulings (which are not required) when the guidance that has been issued should provide adequate affirmative guidance for many transactions.

Conclusion

PRIs have been available to private foundations for almost 50 years, but the typical family foundation carries out its tax-exempt purpose simply by making grants to public charities.[25] Historically, the lack of guidance surrounding PRIs may have prevented many foundations from pursuing them and slowed their positioning as a go-to foundation strategy. The regulations and other guidance indicate that the government takes a favorable view of PRIs. Navigating these unprecedented times certainly will require a range of strategies, and PRIs could be an important way for foundations to address some of the most significant challenges society is facing.

Endnotes

1. See "Can Set-Asides Help Your Foundation Weather the Coronavirus Storm?" 19(3) Fam. Found. Adv. 1 (Mar./Apr. 2020).

2. Treas. Reg. §53.4944(a)(1).

3. T.D. 9762 (Apr. 21, 2016).

4. See Treas. Reg. §53.4944-3(b), Example 4.

5. See Treas. Reg. §53.4944-3(b), Examples 3, 4.

6. Notice 2015-62, §3 (Sept. 15, 2015).

7. See generally, "Recent IRS Guidance Affirms 'Mission-Related' Investing," 15(1) Fam. Found. Advisor 1 (Nov./Dec. 2015).

8. Comments of Ruth Madrigal at Exempt Organizations session of American Bar Association Section of Taxation meeting, Chicago (Sept. 18, 2015).

9. Treas. Reg. §53.4944-3(a).

10. Treas. Reg. §53.4942(a)-3(a)(2)(i).

11. Treas. Reg. §53.4942(a)–2(c)(3)(ii)(d).

12. Treas. Reg. §§53.4945-5(b)(4); 4945-6(c)(1)(i).

13. Treas. Reg. §53.4943-10(b).

14. T.D. 7240 (Dec. 28, 1972).

15. Preamble to Proposed Regulations under Code §4944, Reg-144267-11, Internal Revenue Bulletin 2012-21 (May 2, 2012).

16. See Anne Field, "IRS Rule Could Help the Fledgling L3C" (May 4, 2012). Available at http://forbes.com/sites/annefield/2012/05/04/irs-rules-could-help-the-fledgling-l3c/.

17. T.D. 9762 (April 21, 2016).

18. Internal Revenue Service, "Program-Related Investments." Available at https://irs.gov/charities-non-profits/private-foundations/program-related-investments.

19. T.D. 9762.

20. Preamble to Proposed Regulations under IRC §4944, supra note 15.

21. Fred Stokeld, "Proposed Regs on Program-Related Investments Should Be Helpful, Treasury Official Says," Tax Notes Today, Doc 2012-8378 (April 20, 2012).

22. See "New Proposed Regulations on 'Grouping' Unrelated Trades or Businesses for Purposes of UBTI Calculation," on page 16 of this issue.

23. See, e.g., 11 Vt. Stat. Ann. § 3001(27) (Vermont's definition of "L3C"). Vermont was the first state to authorize L3Cs, which it did in 2008.

24. See Letter from Rob Collier, President and CEO, Council of Michigan Foundations, to Ruth Madrigal, Office of Tax Policy, U.S. Department of Treasury, Re: Our Meeting with you on Wednesday, April 13 at 4:00 p.m. (April 8, 2016), reprinted in Tax Notes Today, Doc. 2016-8231 (April 20, 2016).

25. See Grantspace, "What is a program-related investment." Available at https://grantspace.org/resources/knowledge-base/pris/.

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maintain offices have the same risks and mitigation strategies as many other office environments. For them, social-distancing policies and procedures are a key consideration. Some jurisdictions may require office-based employers to have written social distancing plans, and a foundation would need to adopt one to be compliant with local law. Even if a written policy is not required, a foundation can help keep its employees safe, encourage concerned employees to return to the office, and potentially reduce employer liability by adopting—and adhering to—a written policy. Appendix 1 to this article contains a sample foundation policy.

The Office Environment

Steps to Take Prior to Reopening. The CDC recommends a variety of steps to follow before resuming office operations.[1] These include:

- Ensure that ventilation systems operate properly and review start-up guidance for facilities that have been shut down.
- Increase circulation of outdoor air by opening windows and doors and using fans.

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- Evaluate the building and its mechanical and life-safety systems to determine if the building is ready for occupancy.
- Check for hazards associated with prolonged shutdown, such as mold, rodents, pests, and stagnant water systems—and fix anything that needs fixing.
- Consult CDC guidelines to determine and acquire appropriate personal protective equipment.

Reconsider Your Office Layout. Foundations that rely on cubicles or open office spaces may need to reconfigure their spaces, including by spreading out workstations and installing barriers to allow for social distancing and to reduce transmission of the virus through shared room air. Foundations that rely on shared equipment (computers, printers, kitchen equipment) should (1) reduce their reliance on these tools and (2) have procedures and supplies to regularly sanitize them.

Practice Point: Foundations should proactively consider how their own policies and practices dovetail with those of grantees and other stakeholders. For example, how will site visits be conducted? Will the foundation's office be available for meetings with grantees and other third parties?

Teleworking as an Alternative

In order to comply with local law regarding occupancy limits, to address employee preferences and fears, or to reduce its leasehold footprint, a foundation may decide to allow employees to work from home indefinitely. In such case, job descriptions should be updated to address whether essential functions can be performed remotely.

Data Security Issues. A foundation should re-examine its bring-your-own-device (BYOD) and data security policies if employees will be using personal devices to perform their job functions. A foundation should ensure it has the ability to monitor information contained on or accessed by those devices, has a reliable method to remotely "wipe" foundation data from the devices, and has determined how the foundation's policies on harassment, and social media apply to personal devices.

A foundation also may need to adopt other policies related to:

- Where and how confidential paper documents must be stored;
- Ensuring privacy of phone calls and online meetings that an employee participates in from a residence that is shared with others;
- Security measures (passwords, meeting "waiting rooms") required for web-based meeting platforms; and/or
- Security measures (passwords, metadata removal) required to transmit documents electronically.

Equipment Expense Reimbursement. In some cases, an employee might need to upgrade her Internet service in order to work from home. And, even if the employee's existing equipment and service is sufficient, local law may require the employer to pay a portion of the cost, to avoid getting a "free ride" at an employee's expense. In order to maintain productivity at home, an employee may need to acquire or upgrade printers, monitors, and office furniture. Depending on its jurisdiction, a foundation may be required to reimburse employees for these types of home office business expenses.

Productivity and Wage and Hour Issues. Managing employees who are working remotely (and who may have varying levels of skill with remote-working technology) is more challenging than managing employees in the office. Foundation managers must develop systems to track and maintain productivity without subjecting employees to inappropriate "surveillance." And, because working from home blurs the line between "on" and "off the clock," managers should take care to ensure that they comply with wage and hour and overtime requirements.

Conclusion

Foundation managers should regularly consult guidance provided by the CDC and other government agencies. The CDC website contains detailed interim guidance for employers responding to COVID-19,[2] which sets out high-level recommendations to guide foundation action. Foundation managers should consider and implement this and other guidance in the context of their operations and specific needs.

Endnotes

1. Centers for Disease Control and Prevention, "COVID-19 Employer Information for Office Buildings." Available at https://www.cdc.gov/coronavirus/2019-ncov/community/office-buildings.html.

2. See Centers for Disease Control and Prevention, "Interim Guidance for Businesses and Employers Responding to Coronavirus Disease 2019 (COVID-19), May 2020" available at https://www.cdc.gov/coronavirus/2019-ncov/community/guidance-business-response.html. ■

Appendix 1
[FOUNDATION] Coronavirus (COVID-19) Policy

In this Coronavirus (COVID-19) Policy, you will find essential guidelines the [FOUNDATION] (the "Foundation") requires employees to adopt and follow during the coronavirus outbreak until further notice.

Scope & Purpose

The COVID-19 Policy includes the measures the Foundation is actively taking to mitigate the spread of the novel coronavirus, also known as COVID-19. The Foundation requests that you follow these rules to sustain a healthy and safe workplace in this unusual environment. This COVID-19 Policy is subject to changes and modifications at the Foundation's discretion at any time. This policy applies to all Foundation employees for the duration that it is in effect.

Guidelines

In-Office/Building Safety Requirements

A. Self-Screening: Due to the recent developments surrounding COVID-19, the Foundation requires that all employees self-screen for symptoms related to COVID-19 prior to reporting to work in the Foundation office. You must self-screen daily for COVID-related symptoms prior to entering the Foundation office

See REOPENING WORKPLACE, next page

REOPENING WORKPLACE, from page 8

or coming into close contact with the Foundation's employees, grantees, vendors, and community partners on Foundation business.

Your arrival at the Foundation's office each day constitutes your acknowledgement that you have self-screened that day and are not experiencing any of the following symptoms:

- Feeling feverish or having a measured temperature greater than or equal to 100º Fahrenheit (You must take your temperature prior to coming to work every day until further notice.); and/or
- Cough;
- Shortness of breath or difficult breathing;
- Chills;
- Repeated shaking with chills;
- Muscle pain;
- Headache;
- Sore throat;
- Loss of taste or smell;
- Gastrointestinal issues (nausea, diarrhea, and/or vomiting); and
  - — That you have not had any known close contact with a person who is confirmed to have COVID-19; and
  - — That you have not traveled domestically and/or internationally to or from a COVID-19 hotspot.

B. Go Home/Stay Home: If you have displayed one or more of the symptoms listed above, have been diagnosed with COVID-19, or have come in close contact with someone diagnosed with COVID-19 or traveled domestically or internationally to an area with COVID-19, you may not enter the Foundation's office or be in close contact with the Foundation's employees, grantees, vendors, and community partners on Foundation business. Instead, follow these instructions:

INSTRUCTIONS

- Go-Home/Stay Home immediately;
- Notify your supervisor from home as soon as possible;
- Seek appropriate medical attention (you will need to submit appropriate documentation in order to return to work); and
- Notify your supervisor of your medical status.

Your manager will provide further instructions based on your specific situation.

C. Return to Work: An employee who has been diagnosed with COVID-19 or has exhibited COVID-19 symptoms may not return to work until the following three (3) criteria are met:

- At least three days (72 hours) have passed since recovery (resolution of fever without the use of fever-reducing medication);
- The employee has improvement in symptoms; and
- At least 14 days have passed since the symptoms first appeared.

D. At-Work Screening: Until further notice, all employees must take their temperature with the contactless thermometer provided and log their answers to screening questions when they arrive at work. [***Editor's note:*** *Appendix 2 provides a sample screening log.*]

Each employee must complete a daily log entry answering the screening questions and indicating and whether the employee's temperature is at or below 100º. If the employee's temperature is below 100º and the employee answers the screening questions in the negative, the employee may proceed to work. If the employee has a temperature of 100º degrees or more or answers any of the screening questions in the affirmative, the employee must go home and stay home.

E. Safety Protocols: Upon entering the Foundation office, employees are asked to follow all guidelines regarding face coverings, social distancing and new elevator and restroom policies. These policies are clearly visible on signage throughout the building. It is suggested that team members also follow tips to limit touch exposure (use key fobs or access cards to press buttons, etc.) or wear gloves when traveling outside the Foundation office. Employees must follow these rules:

- Upon entering the office, employees are required to sanitize their hands at the sanitization station just inside the door. PPE (Personal Protective Equipment) such as masks, gloves, sanitizers, and wipes are also available there for employee and visitor use.
- Employees should all sanitize their office equipment with sanitizing wipes on a frequent basis, including computers, keyboard, desks, phones, personal devices, etc.
- Employees who wish to converse with one another while in-office are required to wear masks and maintain the six-foot social distancing measures currently in place.
- All employees and visitors will be required to wear a mask at all times in the office unless seated at their desks, alone in a private office with the door closed.

Where appropriate, replace in-person meetings with video or telephone conferences and minimize personal contact with colleagues (handshakes, hugs, etc.) Visitors shall also be limited as much as possible and should be scheduled and approved in advance.

Breakroom: Only one person is allowed in the breakroom at a time. Employees must wear a mask and gloves while in the breakroom and must sanitize any used areas before leaving.

Foundation employees are required to comply with the safety protocols of any office or facility that they visit on Foundation business.

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F. General Hygiene Rules: Wash your hands after using the restroom, before eating, and if you cough/sneeze into your hands (follow the 20-second hand-washing rule). You can also use the sanitizers located around the office at several marked locations.

Cough/sneeze into your sleeve, preferably into your elbow. If you use a tissue, discard it properly and clean/sanitize your hands immediately.

Avoid touching your face, particularly eyes, nose, and mouth, with your hands to prevent yourself from getting infected.

G. Paid Time Off/Work From Home:

PTO arrangements:

If an employee has any COVID-19 symptoms, the employee may request paid time off or to work from home.

If employees have a positive COVID-19 diagnosis, they can return to the office only after they have fully recovered, with a doctor's note confirming their recovery and release from quarantine.

Work from home requests:

An employee who is exhibiting COVID-19 symptoms, but is able to work, can request to work from home.

Employees who have recently returned from areas with a high number of COVID-19 cases (based on CDC guidance) will be asked to self-quarantine and work from home for 14 calendar days, and return to the office only if they are fully asymptomatic and are not registering a temperature above 99.1º.

An employee who has been in close contact with someone infected by COVID-19, with high chances of being infected personally, should request to work from home. These employees should not come into physical contact with any colleagues during this time.

Employees who need to provide care to a family member infected by COVID-19 may also request to work from home. They will only be permitted to return to the office 14 calendar days after their family member has fully recovered, provided that they are asymptomatic or have a doctor's note confirming they do not have the virus. Employees should not come into physical contact with any colleagues during this time.

If an employee wishes to work from home for a reason not covered here, please contact _____ to discuss.

Employee's Acknowledgement of the Foundation Coronavirus (COVID-19) Policy

I acknowledge that I have received a copy of the [FOUNDATION] Coronavirus (COVID-19) Policy. I further agree that I have read and agree to abide by the Policy and understand that if I violate this Policy, I may be subject to disciplinary action up to and including termination. I understand that during the time this policy is in effect, it supersedes any other Foundation policy or guidance. I agree that if there is any part of this policy or provision that I do not understand, I will seek clarification from my supervisor.

_____
Printed Name

_____
Signature

_____
Date

Appendix 2

Sample COVID-19 Screening Log

Employee Name:_____

Have you traveled domestically or internationally in the last 14 days from an area with a high-number of COVID-19 cases? (See *https://www.cdc.gov/coronavirus/2019-ncov/travelers/map-and-travel-notices.html.*)

YES NO

Have you had any close contact with or cared for someone diagnosed with COVID-19 within the last 14 days?

YES NO

Have you been diagnosed with COVID-19?

YES NO

Have you been experiencing any of the following COVID-19 symptoms, including but not limited to the following, in the past 14 days?

- Fever of 100º F or more?
- Shortness of breath or difficult breathing;
- Chills;
- Repeated shaking with chills;
- Muscle pain;
- Headache;
- Sore throat;
- Loss of taste or smell; or
- Gastrointestinal issues (nausea, diarrhea and/or vomiting)

YES NO

- Is your temperature over 100º F?

YES NO

Sample Documents for an Employer-Sponsored Foundation's COVID-19 Relief Fund

Introduction

Since March 2020, Americans have been living under the specter of the COVID-19 pandemic. The disease itself, financial worry caused by reduced economic activity and lost jobs, social isolation, and the pressure on people who must continue working despite the physical risks or lack of child care have caused suffering for millions. Employers—and employer-sponsored foundations—may be able to use employee-assistance funds to provide relief.[1]

Qualified Disaster Relief

On March 13, 2020, President Trump declared the ongoing COVID-19 a national emergency, which constitutes a "qualified disaster" for purposes of IRC §139. Under IRC §139, an individual's gross income does not include any amount paid to him or for his benefit to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses as a result of a qualified disaster.

The exhibits to this article (on pages 11–12) present a sample program statement that an employer-sponsored foundation can use to establish an IRC §139-compliant employee relief fund, sample language that can be used to publicize cash assistance available for needs arising from the COVID-19 pandemic, and a sample application that eligible employees can use to apply for one-time cash grants that should be excludible from income as qualified disaster relief payments. These sample documents can be modified to reflect payments directly from an employer rather than an employer-sponsored foundation.

To ensure that a disaster-relief fund benefits a charitable class and meets the requirements of IRC §501(c)(3), the fund itself must be intended to be available following all disasters, not just the current coronavirus pandemic.

Practice Point: In order to ensure that a disaster-relief fund benefits a charitable class and meets the requirements of IRC §501(c)(3), the fund itself must be intended to be available following all disasters (present and future), not just the current coronavirus pandemic. The information for employees provided in the following exhibits, however, is intended just as an example of specific relief that the foundation will provide in response to the COVID-19 pandemic.

Endnote

1. For prior coverage, see Katherine E. David, "Responding to COVID-19: Precedents to Guide Foundations in Unprecedented Times," 19(3) Family Found. Adv. 3 (Mar./Apr. 2020). ■

Exhibit 1
[Company] Foundation Relief Fund Policy

Purpose

The purpose of the [Company] Foundation Relief Fund (the "Fund") is to help affected individuals pay for reasonable and necessary personal, family, living, and funeral expenses that are not covered by insurance or otherwise, following an event that the President has declared a major disaster or emergency under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. The Fund is not intended to pay for nonessential, luxury, or decorative items or services.

Eligibility

[Company] Foundation may use the Fund to operate multiple programs, each of which may have its own eligibility criteria. [Company] Foundation also may make grants from the Fund to other organizations (whether taxable or tax-exempt), to enable other organizations operate programs consistent with the purpose of the Fund. In connection with such a grant, [Company] Foundation may establish the eligibility criteria for individual recipients and condition the grant on the recipient organization's adherence to the eligibility criteria.

Determinations

For purposes of the programs that the Fund operates directly, [Company] Foundation maintains a selection committee for the Fund that reviews applications, confirms applicants' needs, and determines the amount that will be paid to each individual.

A majority of the members of the selection committee are "rank and file" employees of [Company] and are not in a position to exercise substantial influence over the affairs of Company. In order to streamline assistance, the selection committee may establish fixed payment amounts that are reasonably expected to cover similarly situated individuals' unreimbursed reasonable and necessary personal, family, living, and funeral expenses.

In the case of grants to other organizations, [Company] Foundation identifies recipient organizations. In connection with such a grant, [Company] Foundation may establish a determinations process and condition the grant on the recipient organization's adherence to the determinations process.

See SAMPLE DOCUMENTS, next page

Exhibit 2
[Company] Foundation Relief Fund Information for Employees Needing Assistance as a Result of the COVID-19 Pandemic

[Editor's Note: *This sample form assumes that the selection committee has opted to streamline assistance by establishing a fixed payment amount. Language can be modified to explain how individualized amounts will be determined.*]

In response to the unprecedented global pandemic caused by COVID-19, [Company] Foundation wants to ensure that employees of [Company] will be provided for during any stay-at-home order, and that they have resources to meet the challenges that arise when they return to work.

Thus, [Company] Foundation is offering cash assistance to Company employees who need help paying for personal, family, or living expenses during the COVID-19 pandemic.

In order to be eligible, you must be an active employee of Company in good standing who would have been scheduled to work during the period covered by a stay-at-home order or who is facing increased personal expenses because of returning to work.

TO APPLY:

To request a payment, please fill out the application [INSERT LINK TO ONLINE FORM, OR OTHER DIRECTIONS INDICATING WHERE EMPLOYEES CAN OBTAIN AN APPLICATION FORM.]

If the application is complete and submitted by [DATE], the applicant (subject to approval) will receive a one-time grant of [AMOUNT] on [DATE].

Information obtained through the application process is kept confidential and shared only on a need-to-know basis or as required by law or court order.

QUESTIONS?

Please contact [NAME] at [PHONE NUMBER] or email [EMAIL ADDRESS] if you have any questions or need assistance with obtaining or filling out the application.

Exhibit 3
[Company] Foundation Relief Fund FAQs Regarding COVID-19 Assistance

Q1: What is the [Company] Foundation Relief Fund?

A1: [Company] Foundation operates [Company] Foundation Relief Fund to help affected individuals pay for reasonable and necessary personal, family, living, and funeral expenses following a major disaster or emergency.

Q2: Who can receive assistance from [Company] Foundation Relief Fund?

A2: [Company] Foundation Relief Fund operates different programs to provide assistance to various groups of individuals following major disasters or emergencies. Currently, [Company] Foundation Relief Fund is operating the program, COVID-19 Assistance, to help employees of [Company], in response to the global pandemic caused by COVID-19.

Q3: What assistance does COVID-19 Assistance provide?

A3: COVID-19 Assistance provides a one-time cash grant, which employees will use to pay for reasonable and necessary personal, family, and living expenses during the COVID-19 pandemic. Each employee will receive [AMOUNT] Employees must apply by [DATE] in order to be eligible for assistance.

Q4: How do employees receive their payments?

A4: Employees will receive their payments through direct deposit into the bank account they use to receive their regular wages.

Q5: Is the assistance that a part-time employee receives through COVID-19 Assistance treated as taxable wages?

A5: The assistance that an employee receives through COVID-19 Assistance is a "qualified disaster relief payment." It is not treated as wages and is not taxable to the recipient.

Q6: Will the assistance a part-time employee receives through COVID-19 Assistance be reported on the employee's Form W-2 or on a Form 1099?

A6: The assistance that an employee receives is a "qualified disaster relief payment." These payments are not reported on Form W-2 or Form 1099. These payments are not taxable to the recipient and are not included in the recipient's gross income for federal income tax purposes.

Q7: Does receipt of assistance through COVID-19 Assistance affect an individual's ability to claim unemployment benefits?

A7: [STATE] law has specific requirements for individuals to be able to receive unemployment benefits. To determine whether you are eligible for unemployment benefits, please contact the [STATE] Workforce Commission at [PHONE NUMBER].

Q8: What assistance is [Company] Foundation providing to members of the public who are affected by COVID-19?

A8: At this time, [Company] Foundation is focusing its efforts on providing assistance to employees of Company.

Q9: Will [Company] Foundation provide assistance to members of the public?

A9: [Company] Foundation is committed to using its resources to strengthen and serve the community through impactful programs. [Company] Foundation will continue to evaluate the community's needs resulting from COVID-19 and how its resources can be used to meet those needs.

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bition on excess business holdings limits a private foundation's ability to operate—or own an interest in—a business enterprise, and thus limits the situations in which a private foundation might be exposed to UBIT. However, IRC §4943 does not place an absolute prohibition on a private foundation owning an interest in a business enterprise. For example, a foundation could own less than 20% of a business.[4] It could own a higher percentage—even all—of a business enterprise acquired by gift or devise within the last five years.[5] Or, it might qualify for the "Newman's Own exception,"[6] which permits a foundation to own 100% of the voting stock in a business enterprise acquired by means other than purchase, so long as all of the profits from the business are devoted to charity. In all these situations, if the business enterprise is unincorporated, the foundation will be subject to tax on its UBTI.

New Section 512(a)(6)

Under prior law, an organization that operated multiple trades or businesses would aggregate items of income, gain, deduction, and loss from all lines of business to determine its UBIT liability. As a result, income and gain from a profitable trade or business could be offset by deductions and losses from an unprofitable one, thereby reducing the organization's tax liability.

The Tax Cuts and Jobs Act[7] added new IRC §512(a)(6), which now requires an organization that has more than one unrelated trade or business to calculate its UBTI, including for purposes of determining any net operating loss (NOL) deduction, separately with respect to each trade or business. Under IRC §512(a)(6), for an organization with more than one unrelated trade or business:

- UBTI, including for purposes of determining any NOL deduction, is computed separately with respect to each trade or business and without regard to the $1,000 specific deduction under IRC §512(b)(2) (thereby preventing an organization from obtaining a $1,000 deduction per business and allowing only a single $1,000 deduction). The UBTI with respect to any trade or business cannot be less than zero.
- The organization's UBTI is the sum of the UBTI calculated for each trade or business, less the $1,000 specific deduction.

In changing how the calculation is done, Congress intended "that a deduction from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same tax year."[8] And, going forward, an NOL that arises from a particular trade or business can be used only to offset income from the same trade or business.[9]

Practice Point: Although for purposes of calculating UBIT, income from one unrelated trade or business cannot be netted against losses or deductions from a different unrelated trade or business, the rules are different when one is calculating an organization's support for purposes of determining whether it is a public charity under IRC §170 or IRC §509(a)(2). In the latter case, the term "net income from unrelated business activities" is determined without reference to new IRC §512(b)(6). An organization that conducts two or more unrelated businesses calculates its support by aggregating gross income from all unrelated businesses and all deductions allowed with respect to those unrelated business activities.[10]

Guidance Under New IRC §512(a)(6)

In August 2018, the IRS issued Notice 2018-67,[11] which provided interim guidance (the "Notice"). The Notice allowed an organization to rely on a "reasonable, good-faith interpretation" of the existing rules when determining whether it has more than one unrelated trade or business for purposes of IRC §512(a)(6). For purposes of the Notice, a reasonable, good-faith interpretation includes consideration of IRC §§511–514, all the facts and circumstances, and the six-digit codes of the North American Industry Classification System (NAICS).[12] NAICS is a hierarchical classification system. Each digit in a six-digit code places an industry in progressively narrower categories.[13] The more leading digits that two industries share, the more alike they are. The first two digits designate a sector (such as Retail Trade, Real Estate and Rental and Leasing, or Accommodation and Food Service). The third digit designates the subsector. The fourth digit designates the industry group, and the fifth digit designates the industry. When applicable, a sixth digit is used to designate the national industry, to reflect differences among the United States, Canada, and Mexico. A zero as the sixth digit indicates that no differences exist between countries.

Simplification of Use of NAICS Codes. The Notice provides a safe harbor that the full NAICS six-digit codes are considered a reasonable, good-faith interpretation and requested comments regarding whether separate trades or businesses should be identified by fewer than six of the NAICS-code digits. After considering the comments, the IRS and Treasury determined that the specificity of NAICS six-digit codes is unduly burdensome. Therefore, the proposed regulations provide that an exempt organization generally will identify its separate unrelated trades or businesses using the first two digits of the NAICS codes, resulting in unrelated trades or businesses being grouped into 20 relatively broad sectors rather than identified as one of over 1,000 specific industries.[14] Example 1 shows how this would work in practice.

> ***Example 1:*** Museum operates a gift shop and a snack bar on its ground floor, and a full-service restaurant on its top floor. The snack bar generates losses, but the other two operations are profitable. Museum can treat the snack bar and restaurant as a single unrelated trade or business, because both fall within sector 72 (Accommodation and Food Service). Losses from the snack bar may be used to offset income from the restaurant. The gift shop is in sector 45 (Retail Trade) and thus is a separate trade or businesses. Income and losses of the snack bar and restaurant cannot be netted against losses or income of the gift shop.

Caution: The proposed regulations clarify that the NAICS code chosen must identify the unrelated trade or businesses in which the organization is engaged. It cannot simply describe the activities that constitute the basis for the organization's exemption.

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Example 2: Hospital, as an organization, falls within sector 62 (Health Care and Social Assistance). Hospital operates multiple unrelated businesses, including a pharmacy that is open to the public and a fully furnished medical office building that is leased to physician-members of the public. Each of the trades or businesses must be assigned to a sector (such as Retail Trade and Real Estate and Rental and Leasing) for purposes of determining whether any can be "grouped."

Permitted Aggregation of Investment Activities. The proposed regulations permit an organization to aggregate the following investment activities rather than identifying them using an NAICS code:

- Qualifying partnership interests;
- Qualifying S corporation interests; and
- Debt-financed property or properties.[15]

This rule reduces the burden on organizations, particularly those that own interests in multitier partnerships that operate multiple trades or businesses. Such an organization would have a difficult time obtaining sufficient information about the trade or business activities of lower-tier partnerships in order to comply with IRC §512(a)(6). Under the proposed regulations, an organization can treat all investment activities as a separate unrelated trade or business for purpose of IRC §512(a)(6) rather than designating each of the various trades or businesses by their NAICS two-digit code and grouping accordingly.

Tiered Partnership Provisions. The Notice permits organizations to aggregate their qualifying partnership interests (QPIs), resulting in the treatment of the aggregate group of QPIs as a single trade or businesses for purposes of IRC §512(a)(6)(A) (similar rules apply for purposes of interests in S corporations). The proposed regulations retain this concept, with certain modifications. In order to be a QPI, a partnership interest must meet either a "de minimis test" or a "control test."[16]

The "De Minimis Test." A partnership interest meets the "de minimis test" if the organization (directly or indirectly) does not own more than 2% of the profits interest and 2% of the capital interest.[17]

The "Control Test." A partnership interest meets the "control test" if the organization (together with its supporting organizations and controlled entities) (1) holds no more than 20% of the capital interest; and (2) does not have a controlling interest in the partnership.[18] For purposes of this test, all facts and circumstances, including the partnership agreement, are relevant in determining whether an organization has control over the partnership. An organization is deemed to control a partnership if:

- The organization, by itself, may require the partnership to perform, or may prevent the partnership from performing, any act that significantly affects the operations of the partnership;
- Any of the organization's officers, directors, trustees, or employees has right to participate in the management of the partnership at any time or conduct the partnership's business at any time; or
- The organization, by itself, has the power to appoint or remove any of the partnership's officers or employees or a majority of directors.[19]

Caution: In order to comply with IRC §501(c)(3) (as well as for business reasons), an organization might be required to "control" the partnership and thus be unable to satisfy the control test. In such case, unless that partnership interest satisfies the strict "de minimis test," the organization will be required to calculate UBTI for each trade or business of the partnership and its subsidiaries.

Practice Point: The proposed regulations contain a look-through rule that could cause a lower-tier partnership interest to be a QPI even though the organization does not satisfy the de minimis test or the control test with respect to the upper-tier partnership. Any partnership in which an organization holds an indirect interest may be a QPI if the indirectly held partnership interests meets the requirements of the de minimis test. Example 3 illustrates how the look-through rule works.

Example 3: Organization directly holds 50% of the capital interests of a partnership that it does not control. The directly held partnership holds 4% of the capital and profits interests of a lower-tier partnership (LT-1) *and* 10% of the capital and profits of another lower-tier partnership (LT-2). Organization can aggregate its interest in LT-1 with its other QPIs because it indirectly holds 2% of the capital and profits interest of LT-1 (50% x 4% = 2%) and thus passes the de minimis test with respect to LT-1. However, Organization cannot aggregate its interest in LT-2 with its QPIs, because it indirectly holds 5% of the capital and profits interest of LT-2 (50% x 10% = 5%) and thus fails the de minimis test with respect to LT-2.

Like the Notice, the final regulations provide transition relief for partnership interests acquired before August 21, 2018. An organization may treat such a partnership interest as comprising a single trade or business regardless of whether the partnership directly or indirectly conducts multiple trades or businesses.[20]

Caution: The proposed regulations add a provision stating that, once an organization designates a partnership interest as a QPI (in accordance with forms and instructions), it cannot later identify the unrelated trades or businesses conducted by that partnership using NAICS two-digit codes unless and until the partnership interest no longer is a QPI.[21]

Conclusion

For many organizations, IRC §512(a)(6) will increase the amount of UBTI. And, because the Tax Cuts and Jobs Act replaced the graduated corporate tax rates with a single 21% rate, organizations with small amounts of UBTI likely will see their tax bills go up as a result of the rate increase. Foundations should carefully apply the proposed regulations to make sure that unrelated trades and businesses are grouped in a way that produces the lowest amount of taxable income.

Endnotes

1. Reg-106864-18.
2. IRC §§511(a)(1), 513(a).
3. IRC §512(c).
4. IRC §4943(c).
5. IRC §4943(c)(6).

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Favorable Guidance on Leave-Based Donation Programs Issued

On June 11, the IRS issued Notice 2020-46, regarding the tax treatment of leave-based donation programs, where employees can elect to forgo vacation, sick, or personal leave in exchange for cash payments the employer makes to organizations described in IRC §170.

Ordinarily, vacation, sick, and personal leave pay paid by the employer are income to the employee and are subject to withholding as if they were regular wage payments. Further, if an employee who has the right to receive income directs the income to be paid directly to a tax-exempt organization, the employee nevertheless recognizes the income under the assignment of income doctrine. The income must be included on the employee's Form W-2, Wage and Tax Statement and is subject to income and employment tax withholding.

In order to facilitate and encourage relief to victims of the COVID-19 pandemic, Notice 2020-46 provides that cash payments an employer makes to an organization described in IRC §170 in exchange for vacation, sick, or personal leave that an employee elects to forgo will not be treated as wages or compensation to the employee or otherwise be included in the employee's gross income if the payments are made (1) for the relief of victims of the COVID-19 pandemic in the United States and five U.S. territories; and (2) before January 1, 2021. Because the payments are not included in income, employees may not claim a charitable contribution deduction for the value of their forgone leave. The employer may deduct the payments under the rules of IRC §170 or IRC §162 if the employer otherwise meets the respective requirements of either section.

Note: Notice 2020-46 is not limited to contributions to public charities. It appears a private foundation that provides relief to victims of the COVID-19 pandemic is an eligible beneficiary under Notice 2020-46.

Practice Point: The Notice does not require the recipient organization to be organized exclusively for the purpose of providing relief to victims of the COVID-19 pandemic or otherwise specify how an employer or employee must document that the payment was made to provide relief to victims of the COVID-19 pandemic. Notice 2020-46 refers to victims of the COVID-19 pandemic, not to victims of the COVID-19 disease. Accordingly, it seems to allow contributions to organizations that provide relief to individuals who suffer from both the direct and collateral consequences of COVID-19, including illness, job loss, financial insecurity, and social isolation. For administrative ease, to help ensure that the use requirements of the Notice are met—and potentially to produce a larger impact—employers should consider designating one (or a small handful) of IRC §170 organizations that provide relief to COVID-19 victims to which employees may direct their contributions. Exhibit A provides a sample communication that an employer can adapt and use to inform employees about the opportunity to give to selected organizations and claim the benefits of Notice 2020-46. ■

Exhibit A
[Company] Employee Leave Donation Program

We at [Company] take pride in supporting our community. During the COVID-19 pandemic, our generosity is more needed than ever. [Company] has identified [three] organizations that operate programs to provide relief to victims of the COVID-19 pandemic and that Company employees might wish to support.

- [Food Bank provides meal distributions for children who are food insecure and who do not have access to school- and community-center based programs that are suspended during the local quarantine.]
- [Community Clinic provides free testing to individuals who may have been exposed to COVID-19.]
- [Senior Center matches homebound seniors with child and adult community volunteers who provide bi-weekly telephone and on-line check-ins and "socially-distant visits" during the pandemic.]

[Company] employees may donate the value of their unused vacation, sick, and personal leave time to these three organizations, for use in these programs. [Company] will make a cash contribution equal to the value of any time you donate. The value of the time you donate will not be included as wages or salary on your Form W-2 and will not be subject to income or employment tax. Please note that your contribution through this leave donation program is not tax-deductible to you.

To make a contribution, please complete the form below and return it to [Human Resources] at any time prior to [date that would result in payment on or before December 31, 2020, based on internal processing time].

Employee Name _____

Employee ID Number _____

No./Hours to be donated to [Food Bank] (specify vacation, sick, or personal) _____

No./Hours to be donated to [Community Clinic] (specify vacation, sick, or personal) ____

No./Hours to be donated to [Senior Center] (specify vacation, sick, or personal) _____

_____
Employee Signature

_____
Date

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6. For prior coverage, see "'Newman's Own' Exception Creates New Opportunities for Donors and Private Foundations," 18(1) Fam. Found Adv. 13 (Nov./Dec. 2018).
7. Pub. L. No. 115-97 (Dec. 22, 2017).
8. H.R. Rep. No. 115-466 at 548 (2017).
9. IRC §512(a)(6)(A).
10. Prop. Reg. §§1.170A-9(f)(7)(v); 1.509(a)-3(a)(3)(i).
11. 2018-36 IRB 409 (Sept. 4, 2018); for prior coverage, see "IRS Issues Interim Guidance for "Grouping" Unrelated Trades or Businesses for Purposes of UBTI Calculation," 18(1) Fam. Found. Adv. 16 (Nov./Dec. 2018).
12. 2018-36 IRB 409 at 3.02.
13. U.S. Census Bureau, North American Industry Classification System Frequently Asked Questions (FAQs). Available at https://census.gov/eos/www/naics/faqs/faqs.html#q5.
14. Prop. Reg. §1.509(a)-6(a)(2).
15. Prop. Reg. §1.512(a)-6(c)(1).
16. Prop. Reg. §1.512(a)-6(c)(2).
17. Prop. Reg. §1.512(a)-6(c)(3).
18. Prop. Reg. §1.512(a)-6(c)(4).
19. Prop. Reg. §1.512(a)-6(c)(4)(iii).
20. Prop. Reg. §1.512(a)-6(c)(7).
21. Prop. Reg. §1.512(a)-6(c)(1)(iii). ■

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New Proposed Regulations on "Grouping" Unrelated Trades or Businesses for Purposes of UBTI Calculation

Introduction

The IRS has issued proposed regulations[1] that provide guidance on how an exempt organization subject to the unrelated business income tax (UBIT) under IRC §511 determines if it has more than one unrelated trade or business, and, if so, how it calculates unrelated business taxable income. Under the proposed changes, many foundations could find they face higher tax bills.

Under the proposed changes, many foundations could find they face higher tax bills.

Background

Although IRC §501(c)(3) organizations commonly are referred to as "tax exempt," they are subject to tax on the income derived from any unrelated trade or business that they regularly carry on.[2] The organization does not need to conduct the trade or business directly in order to be subject to tax. If the trade or business is conducted by a partnership (or an entity treated as a partnership for federal income tax purposes) of which the organization is a partner, the organization includes in its unrelated business taxable income (UBTI) its distributive share of partnership gross income (even if not distributed) and partnership deductions directly connected with such income.[3]

Practice Point: The IRC §4943 prohi-

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