Clarifying IRS’s View on Climate Change as a charitable purpose in order to mobilize Program-Related Investments for Climate Change Solutions

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I. Introduction

Mitigating climate change is going to require unlocking new sources of finance to fund the innovative technologies that will take us to a low-emissions future. Program-related investments (PRIs), investments that support charitable activities while also offering the potential return of capital, are one vehicle that could help unlock these funds. However, a lack of clarity over whether potential PRIs would be eligible, and the imposition of a heavy penalty tax for getting it wrong, has made would-be investors hesitant and created barriers to their utilization.

Part II of this memorandum provides background on the laws governing foundations and PRIs, and explains how foundation-made PRIs can help fund new clean energy technology. Part III details the historical acceptance of environmental preservation and protection as a charitable purpose by the Internal Revenue Service (IRS). This part explores whether investments in climate change solutions would qualify as furthering a charitable purpose, a necessary condition for PRIs to be made in this area. Finally, Part IV looks at the obstacles that organizations have come up against when seeking to have their environmental activities deemed a furtherance of a charitable purpose. The memorandum looks at the broader category of environmental action as there are very few cases dealing explicitly with climate change.

This memorandum concludes that the law in this area is underdeveloped. There is no explicit mention of environmental protection in the statutes governing what is charitable. See, 26 U.S.C.A. § 170(c)(2)(B); 26 U.S.C.A. § 501(c)(3). The IRS does consider environmental preservation to be a charitable purpose, however the IRS often looks for additional charitable factors and justifies the environmental activities not as charitable because of their environmental protection, but as charitable because of other benefits they provide. See, e.g., Rev. Rul. 68-14, 1968-1 C.B. 243. They are often justified as charitable under labels such as “lessening the burdens of government” and “combating neighborhood deterioration.” Id. When these factors are absent, it seems much harder to get the activity considered as charitable. The IRS has also required that the environmental benefits be sufficiently “direct” and “significant,” without clarifying what satisfies those conditions. See, e.g., I.R.S. Priv. Ltr. Rul. 201210044 (2012). When it comes to development of technology, there also appears to be a fine line between the activities being charitable as opposed to too supportive of a commercial enterprise. See, e.g., I.R.S. Priv. Ltr. Rul. 201017066 (2010). It appears that while many of these environmental purposes might be valid in their own right, there is no clarity regarding how they need to be presented in order to be found charitable. On climate change issues, there are even fewer rulings and less clarity.
II. Background

a. Types of Law

This memo examines several different types of law including the Internal Revenue Code (the Code), regulations promulgated by the Department of Treasury, Private Letter Rulings (PLRs), and Revenue Rulings. PLRs are written statements issued to taxpayers that interpret and apply tax law to the taxpayer’s specific set of facts. They cannot be relied on as precedent and are only binding on the taxpayer and their specific set of facts, though they are helpful in understanding the factors that the IRS looks to in making a determination. Revenue Rulings are official interpretations by the IRS of the Code, related statutes, tax treatises, and regulations. They apply the law to a set of facts, and can be relied upon by other taxpayers as precedent for situations with similar fact patterns.

b. Legal Background on Foundations

Legal rules governing foundations make PRIs particularly attractive, because foundations can use them to satisfy mandated payout requirements while furthering their charitable mission. Section 4942 of the Code and related regulations govern the required income distribution for private foundations. Section 4942 was passed in the Tax Reform Act of 1969 and requires private foundations to distribute a portion of their current return to charity. According to Section 823 of Public Law 97-34, the required payout for private foundations is 5% for taxable years after December 31, 1981.

In order to meet this payout requirement, the foundation must distribute funds in the form of qualifying distributions,\(^1\) which are defined as including “[a]ny amount (including program-related investments, as defined in Section 4944(c), and reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in Section 170(c)(1) or (2)(B)” and “[a]ny amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in Section 170(c)(1) or (2)(B),” with some exceptions for contributions to foundation-controlled organizations and other private foundations. Treas. Reg. § 53.4942(a)-3. Importantly, the regulations specify that PRIs can count as qualifying distributions.

Section 4944 was designed to create a tax on private foundations that make an investment that jeopardizes the execution of their exempt purposes. The definition of “jeopardizing investments” does not encompass PRIs. 26 U.S.C.A. § 4944(c). Private foundations are not able to make grants for purposes that are not described in Section 170(c)(2)(B) of the Code. Section 501(c)(3) of the Code provides exempt status to organizations that are organized and operated exclusively for these eligible purposes. Thus, generally, a private foundation may not make a grant to an organization not described in Section 501(c)(3); however, such grants are permissible if either the foundation is

\(^1\) Qualifying distributions are subtracted from the distributable amount in the calculation of undistributed income, which is taxable under § 4942(a).
reasonably assured that the grant will be used exclusively for the exempt purposes, or if the
grant is itself a charitable act or a PRI. See, Treas. Reg. § 53.4942(a)–3(a)(2)(i). Code
Section 4944 specifically makes an exception for PRIs, stating that “[f]or purposes of this
section, investments, the primary purpose of which is to accomplish one or more of the
purposes described in Section 170(c)(2)(B), and no significant purpose of which is the
production of income or the appreciation of property, shall not be considered as
investments which jeopardize the carrying out of exempt purposes.” 26 U.S.C.A. §
4944(c).

c. Legal Background on Program-Related Investments

In order to count as part of a private foundation’s qualifying distribution, a PRI
must meet three requirements. First, the primary purpose of the investment must be to
accomplish one or more of the purposes described in Section 170(c)(2)(B) of the Code.
Treas. Reg. § 53.4944-3. Second, the production of income or appreciation of property
may not be a significant purpose of the investment. Id. Finally, no purpose of the
investment can be to lobby, support or oppose public office candidates, or accomplish any
of the forbidden political purposes described in Code Section 170(c)(2)(D). Id. The
investment may be made in the form of equity, loan, loan guarantee, or other types of
investments to both nonprofit and for-profit enterprises.

1. Primary Purpose Requirement

First, Treas. Reg. § 53.4944-3(a)(1)(i) states that the “primary purpose” of the PRI
must be to “accomplish one or more of the purposes described in Section 170(c)(2)(B).” 2
This prong will be satisfied if the investment “significantly furthers the accomplishment of
the private foundation's exempt activities and if the investment would not have been made
but for such relationship between the investment and the accomplishment of the

An article examining PLRs on PRIs found that to satisfy the primary purpose test,
the IRS traditionally looks for a nexus between the foundation’s purpose and the
foundation’s exempt mission. Benjamin N. Feit, What IRS Private Letter Rulings Reveal
About Program-Related Investments, 23 TAXATION OF EXEMPTS 3, 9 (July/August 2011). It
looks at the necessity of the investment by asking whether the recipient organization is
unable to find other sources of funding, or whether the foundation is unable to satisfy its
charitable mission through other activities. Id. The IRS could reject the PRI despite the
stated charitable intention of the investment if it is too much of a commercial endeavor.
See, e.g., I.R.S. Priv. Ltr. Rul. 82-01-050 (1981) (rejecting that a foundation buying stock
in a horse-racing facility furthered the charitable purpose of fostering horse-racing and the
ownership of a for-profit hotel is not a program-related investment despite years of losses

2 IRC 170(c)(2)(B) purposes may be carried out by organizations not described in IRC 170(c) or exempt
and the foundation’s claim that the hotel ownership was intended to stimulate the local economy by providing employment).

2. Income Production Requirement

Second, PRIs must show that “no significant purpose” of the investment is “the production of income or appreciation of property.” Treas. Reg. § 53.4944-3(a)(1)(ii). The regulations state it “shall be relevant whether investors solely engaged in the investment for profit would be likely to make the investment on the same terms as the private foundation.” Treas. Reg. § 53.4944–3(a)(2)(iii). The regulations further clarify 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.” Id. Thus, this requirement can be satisfied by showing the investment is being made on terms less favorable than those that would attract typical commercial investors. This could be shown through a below-interest market rate, a below interest return-on-equity, or a higher risk level than commercial investors would accept. This test would be satisfied by showing that the investment is not attracting typical sources of funding. Another way to satisfy this requirement would be to show that the investment induces the business to further a charitable purpose that it would not have otherwise. See, Benjamin N. Feit, What IRS Private Letter Rulings Reveal About Program-Related Investments, 23 TAXATION OF EXEMPTS 3, 10-13 (July/August 2011).

3. PRI Prohibition

The third and final requirement for PRIs is that they can not be made to lobby, support or oppose public office candidates or accomplish any other purposes detailed in Code Section 170(c)(2)(D). Treas. Reg. § 53.4944-3(a)(1)(iii).

4. The Current Underutilization of PRIs

One problem leading to the underutilization of PRIs is that foundations perceive them to be burdensome and risky. Since the penalty for making a jeopardizing investment is the imposition of a significant tax, foundations do not like to proceed without getting a PLR pre-approving the transaction, or a letter from expert counsel. However, obtaining a PLR is very expensive and time consuming. The alternative, getting a confirmation letter from tax counsel stating the PRI is allowable, is also costly. Moreover, it has the disadvantage of not being binding upon the IRS. Edward Xia, Can the L3c Spur Private Foundation Program-Related Investment?, 2013 COLUM. BUS. L. REV. 242, 258-59 (2013). Since PRIs are already perceived as risky, it is even more important that the law surrounding whether climate change related PRIs are valid be clarified. The uncertainty over what kinds of environmental activities count as charitable creates just another barrier to the utilization of PRIs by foundations.
d. The Value in Unlocking Foundation Funds through PRIs

PRIs have the potential to help bring in early stage funding for clean energy projects that are not currently securing investments from commercial investors due to an unproven track record, perceived risk, or market failures. Justin Guay, Can PRI Finance Unlock Clean Energy Access?, THE HUFFINGTON POST (Apr.13, 2015), available at http://www.huffingtonpost.com/justin-guay/can-pri-finance-unlock-cl_b_7055336.html. A report by The Global Impact Investing Network and J.P. Morgan recently found $46 billion in impact investments, targeted investments in ventures with a social or environmental mission, under management globally. J.P. Morgan, SPOTLIGHT ON THE MARKET: THE IMPACT INVESTOR SURVEY (May 2, 2014). Foundations are indeed already realizing the advantages of making PRIs. The Bill & Melinda Gates Foundation has recently focused on making private-sector investments as a means to accomplish its charitable purposes, with $1.5 billion set aside for loans, equity investments, and volume guarantees. Sarah Max, From the Gates Foundation, Direct Investment, Not Just Grants, THE NEW YORK TIMES (Mar. 12, 2015), available at http://www.nytimes.com/2015/03/13/business/from-the-gatesfoundation-direct-investment-not-just-grants.html. This reveals the large amount of funds that could be potentially channeled to climate change projects through PRIs.

In February 2015, the Obama administration announced the Clean Energy Investment Initiative, which also noted the promise private sector and mission-related investments can hold in this area. The administration has a goal to catalyze $2 billion of expanded private sector investment in climate change solutions, looking particularly at innovative technologies to reduce carbon pollution. They also stressed the important role mission-driven investors such as foundations, university endowments, and other institutional investors can play. U.S. Department of Energy (DOE) has also announced that it will play a role in catalyzing these philanthropic investors. The White House, FACT SHEET: OBAMA ADMINISTRATION ANNOUNCES INITIATIVE TO SCALE UP INVESTMENT IN CLEAN ENERGY INNOVATION (Feb. 10, 2015), available at https://www.whitehouse.gov/the-press-office/2015/02/10/fact-sheet-obama-administration-announces-initiative-scale-investment-cl.

III. Legal Background on Environmental Preservation as a Charitable Purpose

As discussed above, for a PRI to qualify, the primary purpose of the investment must be to accomplish one or more of the charitable purposes described in Section 170(c)(2)(B) of the Internal Revenue Code. 26 U.S.C. § 4944(c); I.R.S. Priv. Ltr. Rul. 200136026 (2013). This section will explore in more detail how the IRS has viewed and allowed environmental preservation and protection activities to be considered as “charitable.”
Section 170(c)(2)(B) of the Code defines a charitable contribution as a gift or contribution made to a corporation, trust, or community chest, fund, or foundation “organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.” 26 U.S.C. § 170; I.R.S. Priv. Ltr. Rul. 8017049 (1980).

The term ‘charitable’ is defined in Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations for purposes of Section 501(c)(3) of the Code, the provisions of which are similar to Section 170(c)(2).5 Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term “charitable” is used in Code Section 501(c)(3) in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or to lessen neighborhood tensions; to eliminate prejudice and discrimination; to defend human and civil rights secured by law; or to combat community deterioration and juvenile delinquency. Treas. Reg. § 1.501(c)(3)-1; I.R.S. Priv. Ltr. Rul. 200610020 (2006).

An article written in 1994 by Sadie Copeland and James Bloom as part of the IRS’s continuing education program for exempt organizations specialists provides a useful historical background. I.R.S. 1994 EO CPE Text, Environmental Preservation Issues. The article notes that “[i]t is generally recognized that efforts to preserve and protect the natural environment for the benefit of the public serve a charitable purpose under IRC 501(c)(3). While not explicitly mentioned in IRC 501(c)(3), this activity would fall under the ‘generally accepted legal sense’ of charitable as described in Treas. Reg. § 1.501(c)(3)-1(d)(2).” The rest of this section will explore the history and extent to which environmental protection for the public benefit is charitable, because while environmental protection has been found to be charitable by the IRS, not every activity that results in environmental benefits is given exempt charitable status by the IRS.

5 Under §501(c)(3), the IRS allows tax exemption for nonprofit organizations. While §501(c) covers a broad range of organizations (in §§501(c)(1)-501(c)(28), this section focuses on §501(c)(3), which covers nonprofits. Organizations described in §501(c)(3), other than those testing for public safety, are eligible to receive tax-deductible contributions in accordance with §170. Distributions to §501(c)(3) organizations are deductible so long as they are described in §170(c). Just because an organization has §501(c) status does not guarantee that a distribution to it is qualifying. For example, distributions to foreign exempt organizations that have 501(c)(3) status do not qualify. Another example, described in 80-97, 1980-1 C.B. 257, describes a distribution to an cemetery company, exempt under §501(c)(13), that is nonetheless not a qualifying deduction because its purpose is not described in §170(c)(2)(b). http://www.irs.gov/pub/irs-tege/rr80-97.pdf
a. Historical Perspective Pre-1972

Prior to 1972, organizations with environmental concerns could be classified as "charitable" if they promoted recreational and historical purposes, furthered governmental efforts, or preserved educational benefits or enhanced scenic enjoyment. Protection of the environment is not explicitly mentioned in Code Section 501(c)(3). The Internal Revenue Service (IRS) recognizes the charitable nature of organizations designed to maintain and improve community recreational facilities. Rev. Rul. 70-186, 1970-1 C.B. 128 (holding that an organization formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features qualifies for exemption under Code Section 501(c)(3)).

In addition, early revenue rulings recognize organizations as charitable where they assist governmental entities in lessening “urban blight.” Rev. Rul. 68-14, 1968-1 C.B. 243 (concluding that an organization formed to promote and assist municipal authorities in city beautification projects and to educate the public in the advantages of street planting is exempt under IRC 501(c)(3)); see also Rev. Rul. 78-85, 1978-1 C.B. 150 (finding that an organization formed by residents of a city to cooperate with municipal authorities in preserving, beautifying and maintaining an urban public park is exempt under IRC 501(c)(3)).

Organizations engaged in planned land use (see, e.g., Rev. Rul. 67-391, 1967-2 C.B. 190, holding that an organization formed to develop and disseminate an urban land use plan is exempt under IRC 501(c)(3)) or pollution control have also been recognized as serving a charitable purpose. Rev. Rul. 70-79, 1970-1 C.B. 127 (holding that an organization formed to assist local governments of a metropolitan area by conducting research to develop solutions for such problems as water and air pollution, waste disposal, water supply, and transportation is exempt under IRC 501(c)(3)). The Service noted in Rev. Rul. 70-79 that the organization was assisting municipalities in the study of their pollution problems and, thus, lessening the burdens of government.

Conservation organizations that conduct educational programs have also been recognized as exempt. Rev. Rul. 67-292, 1967-2 C.B. 184 (holding that preserving a wild bird sanctuary and helping to maintain it facilitates public access and promotes the education of persons interested in observing wild birds).

b. Rev. Rul. 72-560 - Early Recognition of Preventing Environmental Deterioration as Charitable Purpose

In 1972, the Service issued Rev. Rul. 72-560, 1972 C.B. 248, which uses a different rationale in recognizing as exempt an organization formed to educate the public with respect to problems associated with solid waste pollution. The Service ruled that the recycling of the waste materials, an “essential element in the organization's efforts to combat environmental deterioration, since it prevents the pollution of the environment
caused by the usual disposition of these materials,” is analogous to the “tree planting and street cleaning operations that were held to serve a charitable purpose in Rev. Rul. 68-14, C.B. 1968-1, 243.” The ruling held that combating environmental deterioration through recycling of waste materials serves a charitable purpose as it combats community deterioration. Because Rev. Rul. 72-560 does not mention that the basis for the approval of exemption in Rev. Rul. 68-14 is that the planting and cleaning activities lessen the burdens of government, it may imply that protection of the environment is per se charitable. I.R.S. 1980 EO CPE Text, The Concept of Charity.

c. Rev. Rul. 76-204 – Preservation of Ecologically Significant Land as Charitable Purpose

In Rev. Rul. 76-204, 1976-1 C.B. 152, the Service noted that "[i]t is generally recognized that efforts to preserve and protect the natural environment for the benefit of the public serve a charitable purpose. Restatement (Second) of Trusts Section 375 (1959).” For example, the Service noted, Congress declared in the National Environmental Policy Act of 1969, 42 U.S.C. § 4321 (1969) that the “prevention and elimination of damage to the environment stimulates the health and welfare of man and enriches the understanding of ecological systems and natural resources important to the nation.” Rev. Rul. 76-204. The Service acknowledged that other laws recognize that “[a] national policy of preserving unique aspects of the natural environment for future generations is clearly mandated in the Congressional declarations of purpose and policy in numerous Federal conservation laws.” See, e.g., Wilderness Act, 16 U.S.C. § 1131 (1964); Estuarine Areas Act, 16 U.S.C. § 1221 (168); Wild and Scenic Rivers Act, 16 U.S.C. § 1271; Water Bank Act, 16 U.S.C. § 1301 (1970); Id. Rev. Rul. 76-204 concluded that an organization formed to preserve the natural environment by acquiring and maintaining ecologically significant undeveloped land such as swamps, marshes, forests, wilderness tracts, and other natural areas may qualify for exemption. Rev. Rul. 76-204 breaks from previous Service position expressed in Rev. Rul. 67-292, 1967-2 C.B. 184 (holding that an organization formed for the purpose of purchasing and maintaining a sanctuary for wild birds and animals for the education of the public is engaging in educational activities similar to those of a zoo or museum and thus qualifies for exemption). It provides that “the benefit to the public from environmental conservation derives not merely from the current educational, scientific, and recreational use that are made of our natural resources, but from their preservation as well.” The Service recognized that by “acquiring and preserving ecologically significant undeveloped land, the organization is enhancing the accomplishment of the express national policy” and, “in this sense, [it] is advancing education and science and is benefitting the public in a manner that the law regards as charitable.” Id.

d. Rev. Rul. 78-384 – Preservation of Non Ecologically Significant Land

The Service qualified this holding in Rev. Rul. 78-384, 1978-43 I.R.B. 8. In Rev. Rul. 78-384, the Service denied exemption to an organization formed to hold farmland and restrict its use for both preserving open space and for active farming. There was no claim
that the land itself was ecologically significant. The ruling found that the organization, while restricting its land to uses that do not change the environment, did not preserve land of “distinctive ecological significance.” Rev. Rul. 78-384, 1978-2 C.B. 174. Therefore, the mere preservation of existing land use patterns without showing that the preserved tract has unique environmental traits and the benefit to the public is direct and significant is not charitable. Id.

This position was weakened by the U.S. Tax Court in *Dumaine Farms v. Commissioner*, 73 T.C. 650 (1980). In that case, the organization was practicing new forms of farming that were intended to restore the soil as well as to recreate a sound environment. Although the land did not have any significant environmental attributes, the Tax Court held that the organization qualified as a scientific and educational organization. The 1994 article by the Internal Revenue Service, “Environmental Preservation Issues” by Sadie Copeland and James Bloom, note, however, that even though “[s]ome have read this decision as diluting Rev. Rul. 78-384's emphasis on environmentally significant property,” “the court did not really address the revenue ruling's premise, since in *Dumaine Farms*, exemption was narrowly based on the educational and scientific research aspects of the model farming operation” and “did not reach the concept of preserving the environment as a charitable basis in its own right.” One relevant question this case raises is whether preserving non-ecologically significant land for the purpose of keeping it as a carbon sink would qualify as a charitable purpose.

e. IRC 170(h)

In 1980, Congress added Section 170(h) to the Internal Revenue Law explicitly making conservation an exempt purpose. 26 U.S.C. § 170. In doing so, Congress expanded preservation of the environment as charitable beyond just the previous rulings that “ecologically significant” preservation was charitable. This suggests that even conservation of ordinary land could be considered charitable. I.R.S. 1980 EO CPE Text, The Concept of Charity at 6.

The Tax Treatment Extension Act of 1980 (Pub. L. 96-541, 1980-2 C.B. 596) modified Section 170 to provide a Section 170 deduction for "conservation contributions." Section 170(f)(3)(B)(iii) of the Code now provides a charitable deduction for "a qualified conservation contribution." Section 170(h)(1) of the Code defines "qualified conservation contribution" as "a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes." Under Section 170(h)(4)(A), a contribution that is made for any one of the following four conservation purposes qualifies for a charitable deduction:

“(i) the preservation of land areas for outdoor recreation by, or the education of, the general public; (ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (iii) the preservation of open space (including farmland and forest land) where such preservation is-- (I) for the scenic enjoyment
of the general public, or (II) pursuant to a clearly delineated federal, state, or local governmental conservation policy, and will yield a significant public benefit, or (iv) the preservation of an historically important area or a certified historic structure.”

Treasury Regulations Section 1.170A-14(d)(4)(iii) set forth guidelines to determine when a clearly delineated government conservation policy exists for purposes of Section 170(h)(4)(A)(iii) of the Code. The regulations provide that the program “must involve a significant commitment by the government with respect to the conservation project.” Treas. Reg. § 1.170A-14.


The regulation further cites the factors that may demonstrate significant public benefit including (1) the uniqueness of the property to the area; (2) the intensity of land development in the vicinity of the property (both existing development and foreseeable trends of development); (3) the consistency of the proposed open space use with public programs for conservation in the region, including programs for outdoor recreation, irrigation or water supply protection, water quality maintenance or enhancement, flood prevention and control, erosion control, shoreline protection, and protection of land areas included in, or related to, a government approved master plan or land management area; (4) the consistency of the proposed open space use with existing private conservation programs in the area, as evidenced by other land, protected by easement or fee ownership by organizations referred to in Section 1.170A-14(c)(1), in close proximity to the property; (5) the likelihood that development of the property would lead to or contribute to degradation of the scenic, natural, or historic character of the area; (6) the opportunity for the general public to use the property or to appreciate its scenic values; (7) the importance of the property in preserving a local or regional landscape or resource that attracts tourism or commerce to the area; (8) the likelihood that the donee will acquire equally desirable and valuable substitute property or property rights; (9) the cost to the donee of enforcing the terms of the conservation restriction; (10) the population density in the area of the property; and (11) the consistency of the proposed open space use with a legislatively mandated program identifying particular parcels of land for future protection. Treas. Reg. § 1.170-A-14(d)(4)(iv)(A).

The regulation also explains, that “although the requirements of ‘clearly delineated governmental policy’ and ‘significant public benefit’ must be met independently, for purposes of this section the two requirements may also be related.” Treas. Reg. § 1.170-A-
14(d)(4)(vi)(A). “The more specific the governmental policy with respect to the particular site to be protected, the more likely the governmental decision, by itself, will tend to establish the significant public benefit associated with the donation.” Id.

It seems that the legislative premise of Section 170(h) is consistent with the standards expressed in Rev. Rul. 76-204 and 78-384. The revenue rulings stand for the principle that the preservation of the environment (absent any significant environmental attributes) does not constitute a charitable purpose and/or activity per se. By amending Section 170(h), Congress expanded “charitability” beyond “ecologically significant.” It has determined that the preservation of farmland for farming purposes pursuant to a “clearly delineated government conservation policy” and where it yields a “significant public benefit” may qualify for exemption. In other words, as long as an organization develops a conservation program that conforms with the state conservation policies and provides a “significant public benefit,” even the preservation of ordinary land may qualify for exemption. I.R.S. 1980 EO CPE Text, The Concept of Charity at 6.

f. More Recent Rulings

In recent cases, the Service reiterated that the protection of environment is charitable, at least in some cases. In I.R.S. Priv. Ltr. Rul. 200136026 (2001), (discussed further infra) a private foundation invested in a financial intermediary formed to finance and promote the expansion of environmentally-oriented businesses that would contribute to conservation and economic development in “environmentally sensitive areas.” Relying on Rev. Rul. 76-204, the Service held that it was a valid PRI and that “[t]he promotion of conservation, protection of natural resources, and efforts to preserve and protect the environment are charitable purposes within the meaning of Section 501(c)(3) and 170(c)(2)(B) of the Code.”

Similarly, in I.R.S. Priv. Ltr. Rul. 200343028 (2003), a demonstration farm project was used to show how advanced agricultural methods, efficiently applied, help improve farm productivity and produce food to feed the people of S, an underdeveloped country, and qualified as a charitable, scientific and educational activity. The program centered on environmentally friendly farming practices. The primary purpose of the organization was the promotion of conservation. The Service held that the operation of the farm in an environmentally friendly way and the demonstration of how the farm may be operated consistent with the nature of the land and without the need to destroy the ecosystem promoted the organization’s charitable purpose of promoting conservation. The ruling cited both revenue rulings 72-560 and 76-204 in support.

There are, however, still cases where projects that seemed to have environmental aims were justified through other charitable prongs instead. I.R.S. Priv. Ltr. Rul. 200836005 (2008) (holding that a cooperative formed for the purposes of developing and/or owning renewable and non-renewable electric generation facilities, and procuring and/or selling long term electric supply or other energy-related goods or services at
competitive prices to its members, was exempt because it is an instrumentality of one or more governmental units as it serves purposes that are generally regarded as government purposes).

IV. IRS Requirement of “Direct” and “Significant” Environmental Benefits in Order for a Charitable Purpose to be Found

The previous section discussed the history of IRS considering environmental protection as a charitable purpose, and how the doctrine has evolved over the years. There still exist some limits on what kind of activities IRS will consider as charitable, and this section will explore some of these limits, including how “direct” and “significant” the environmental benefit must be. There are two main issues that arise here. First, the IRS looks for activities that have a “significant” and “direct” impact on the environment. PLRs reveal that the submitting research and evidence demonstrating this is important. Second, the charitable aspects of the activity must outweigh any potential commercial or private benefits of the activity.

While PRIs can be made to for-profit organizations, the primary purpose of the investment must be to accomplish one or more of the purposes described in Section 170(c)(2)(B) and no significant purpose of the investment can be the production of income or the appreciation of property. Treas. Reg. § 53.4944-3. As discussed above, the IRS will look into the underlying activity and dismiss it if it is too commercial, despite any stated charitable intention. Some of the cases discussed below involved 501(c)(3) organizations, which must be “organized and operated exclusively” for charitable purposes as defined by this section. Treas. Reg. § 1.501(c)(3)-1. This has been interpreted to mean the organization must have no “more than an insubstantial amount of … activities … furthering non-exempt purposes.” See, I.R.S. Priv. Ltr. Rul. 201149045 (2011). Whether the charitable purpose or commercial purpose will prevail seems to turn at least somewhat on how “direct” and “significant” the environmental protection aspect of the activity is compared to the commercial aspect.

The Code provides ten illustrative examples of PRIs. In a response to requests for additional clarity, the IRS also released proposed regulations in 2012 that would add an additional nine examples. These, in addition to PLRs, provide some light on these issues and will be discussed in the rest of this section.

a. IRS Requirement of “Direct” Environmental Benefit

While the IRS recognizes that “[o]rganizations that promote or protect the environment have been recognized as exempt” under Section 501(c)(3), it differentiates between organizations engaged in activities that provide “a direct environmental benefit to the public” and activities that provide environmental benefits that are “indirect and tangential.” I.R.S. Priv. Ltr. Rul. 201210044 (2012).
Instances where the IRS has found the benefit was direct enough includes an organization that planted trees in public areas in a city which did not have sufficient funds to do so on its own, thereby lessening the burdens of government and combating community deterioration (Rev. Rul 68-14, 1968-1 C.B. 243); an organization that was educating the public on the environmental effects of solid waste pollution (Rev. Rul. 72-560, 1972-2 C.B. 248); and an organization that acquired and maintained ecologically significant land noting that the benefit to the public was guaranteeing “future generations … the ability to enjoy the natural environment.” (Rev. Rul. 76-204, 1976-1 C.B. 152).

The IRS tends to not approve situations where the charitable environmental benefit is coupled with an overly commercial or private benefit. In these cases the environmental benefit is often seen as only incidental to the other benefits. Situations where the environment benefit is being obtained through promotion of a new green technology thus can present a particular challenge, at least in the context of 501(c)(3) status. There remains a lack of clarity over PRIs and to what extent these requirements apply to organizations making PRIs.

This is especially an issue when dealing with climate change, as the links between emissions leakage and the resulting impacts on the environment may not be as clear as in other areas of the environment, and given how global and diffuse the problem is, it requires acting on individual emissions that may not of themselves be significant, but which together cumulatively add up to significant impacts.

b. Solar Panels Found to Not be Providing a Significant Enough Benefit to Environment

An organization providing solar panels to low to middle class income households was unable to obtain 501(c)(3) status by justifying its activities as preserving the environment because the IRS found that the impact on the environment was “indirect and tangential.” I.R.S. Priv. Ltr. Rul. 201210044 (2012). The IRS also claimed that they had not provided enough credible studies or research to show that use of these particular solar systems “would have a measurable, significant impact in preserving and protecting the environment.” Id. It was additionally found to not be alleviating poverty because they didn’t serve exclusively low-income households, and also found to not be contributing to general community development or combating community deterioration. Id.

c. Promoting Energy Efficient Housing Not a Specific, Direct Enough Benefit to Environment

Similarly, an organization promoting reduction of greenhouse gases and carbon emissions by providing downpayment assistance to low and moderate-income individuals and families to help them buy energy-efficient homes that they would otherwise be unable to afford was also denied 501(c)(3) status. I.R.S. Priv. Ltr. Rul. 201017066 (2010). The IRS found that the environmental benefits provided here would be too “non-specific and
indirect.” Id. Other factors impacting this ruling, however, included the IRS finding that the private benefits from direct money assistance to homebuyers were more than just “indirect private benefits [that] are inevitable and incidental to accomplishing the exempt purpose” as had been allowed in previous rulings. Id. Additionally, the IRS stated they had not provided enough information about how the assistance would be provided and what criteria they would take into account. The organization in this case responded by citing previous revenue rulings that had recognized environmental preservation as a charitable purpose allowing an exemption, and stressed its mission to promote a green lifestyle. However, the IRS differentiated the organization from one that developed housing facilities in a deteriorated area to provide affordable housing and revitalize the depressed area, stating that the “impact from your ‘green’ housing program is vague and indefinite, except when it comes to the direct private benefit resulting from your downpayment assistance to any homebuyer.” Id. Major factors in this situation seemed to be that the private benefit was too high and that enterprise seemed too commercial.

d. Activities to Promote Use of Low Emission Fuel Efficient Technologies Found to Not of Themselves Protect the Environment

Another organization was involved in promoting the use of low emission fuel efficient technologies for use in equipment. Their activities included posting papers on the technology, providing demonstrations of the technology, and doing presentations. The IRS found “any potential environmental benefits from your activities are indirect and tangential....you provide R&D consulting to organizations engaged in developing laser Technology, you ‘facilitate R&D contracting between various government and private organizations....’, and you present and demonstrate technology developed by for-profit organizations. These activities do not, in and of themselves, preserve or protect the environment in a manner that is sufficient for § 501(c)(3) purposes.” I.R.S. Priv. Ltr. Rul. 201311028 (2013). The IRS was also concerned about the private benefit to the for-profit company producing the equipment. Id.

e. Beta Testing Green Residential Housing Products to Help get them to Market Found to Only Indirectly Benefit Environment While Directly Benefiting Private Businesses

In another case, an organization helping to beta test green residential housing products to help them get state certification was denied 501(c)(3) status because the beta testing was incidental to commercial operations and conferring a direct benefit to business manufacturers of these products. I.R.S. Priv. Ltr. Rul. 201149045 (2011). The IRS stated “any benefit to the public from your program would be indirect. The direct and primary beneficiaries would be the businesses which would be in a position to manufacture, market, install and maintain the green products.... The existence of one non-charitable purpose that is substantial in nature is cause for denial of exemption.” Id.
f. Investments in Business Promoting Biodiversity and Sustainability is a Valid PRI

A foundation supportive of biodiversity and environmental sustainability was able to make a PRI to a for-profit company that provided financing to promote “the expansion of environmentally oriented businesses that will contribute to conservation and economic development in economically and/or environmentally sensitive areas” in an international country. I.R.S. Priv. Ltr. Rul. 200136026 (2001). The company connected socially conscious investors with “businesses that involve the sustainable use of natural resources, foster the preservation of biological diversity, or engage in organic agriculture with biodiversity linkages.” Id. The company had the goal of providing investors with a minimum return on their investment as well as recognizing a clear environmental benefit through each investment. The IRS granted the PRI because it found that the company was not a “typical international venture capital fund” because its investments had a mandatory environmental component that was strictly overseen, and because the expected return was not one that would attract traditional investors. It also recognized that “Rev. Rul. 76-204, 1976-1 C.B. 152, sets forth the Service's favorable position under Section 501(c)(3) regarding environmental and conservation organizations. As stated therein, ‘it is generally recognized that efforts to preserve and protect the natural environment for the benefit of the public serve a charitable purpose. Restatement (Second) of Trusts Sec. 375 (1959).’” Id. The revenue ruling notes, “the promotion of conservation and protection of natural resources has been recognized by Congress as serving a broad public benefit.” A key factor in this case appeared to be the great lengths the company went to, including collaboration with government and non-government actors with experience with environmental issues, in order to ensure each investment actually was supporting biodiversity and habitat preservation, and an agreement for the company to return any portion of funds to the foundation that were not designated for environmental purposes.

g. Massachusetts Courts Expand the Meaning of Tangible Benefit

A recent case, New England Forestry Found., Inc. v. Bd. of Assessors of Hawley, brought in a Massachusetts court, suggests there may be some movement towards courts finding environmental benefits further a charitable purpose even when these benefits are less direct. 468 Mass. 138 (2014). In this case, the New England Forestry Foundation, a Massachusetts non-profit, owned a tract of land containing the Hawley forest. The foundation was attempting to get Clause Third property tax exemption, which provided tax exemption for real property of a charitable organization that is occupied for the purposes for which the charitable organization was organized. The Appellate Tax Board upheld the denial of the exemption status stating that forest management was not a charitable purpose and that any charitable benefits from preserving the forest did not inure to a large enough class of people, because the foundation had not promoted the use of the land by the public. The Supreme Judicial Court here first recognized that “[t]he text of Clause Third defines a charitable organization as ‘a literary, benevolent, charitable or scientific institution or temperance society incorporated in the commonwealth’ or a trust created for the same
purposes.” Id. at 149. It noted that “[h]istorically, the ‘benefit’ provided by land held as open space or in its natural state has been measured by the direct access of people to that land for such purposes as recreation, scenic views, or education.” Id. at 150. Importantly, through, the court recognized here that:

as the science of conservation has advanced, it has become more apparent that properly preserved and managed conservation land can provide a tangible benefit to a community even if few people enter the land. For example, the climate change adaptation advisory committee of the Executive Office of Energy and Environmental Affairs has identified the conservation of large forested blocks of land as an effective means of contributing to “ecosystem resilience” in the face of rising temperatures and more severe storms because forests naturally absorb carbon and other harmful emissions…Such benefits may extend beyond the parcel of land itself. Consequently, NEFF's activities are not of the sort that inure only to a limited group of people such as the organization's own members.

Id. at 150-51.

The court then granted tax exemption status. While it recognized land preservation could be charitable even if it excluded people from using the land, a heightened burden would apply in such instances with the organization bearing the burden of showing compelling facts for why exclusion was necessary to achieve the public benefit. Id. at 157. This case thus provides an instance where the benefit was still “tangible” even though it strayed from what was typically thought of as a direct benefit to the public.

h. General Observations on “Direct” and “Significant” Requirement

As noted above, to qualify as a 501(c)(3) organization, the organization must have no “more than an insubstantial amount of … activities … furthering non-exempt purposes.” See, I.R.S. Priv. Ltr. Rul. 201149045. For PRIs, no significant purpose can be the production of income (26 C.F.R. § 53.4944-3) and the investment is valid if it “significantly furthers the accomplishment of the private foundation's exempt activities” (Treas. Reg. § 53.4944-3). Further, the investment cannot be on terms too similar to those of a typical commercial venture, as the regulations specify “it shall be relevant whether investors solely engaged in the investment for profit would be likely to make the investment on the same terms as the private foundation.” Id.

In many of the examples discussed above, the IRS seemed to express discomfort with finding a charitable purpose in cases where there was a direct, significant private benefit or where the endeavor was similar to a commercial endeavor. This is definitely more pronounced in cases with 501(c)(3) status where there can be no private benefit, as opposed to PRIs, which can specifically be made to for-profit companies and where a return is allowed. However, it still suggests care needs to be taken to stress the charitable
portion and show why the private benefit is only incidental to the charitable aspect of the investment.

The proposed regulations, clearly allow for and contain an example where a private foundation is able to invest in a for-profit business involved in collecting recyclable solid waste materials and delivering them to recycling centers in a developing country to combat pollution. Key factors here are that the business was able to obtain 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 return on an investment of this type.” 77 Fed. Reg. 23429, 23431.

V. Conclusion and Next Steps

As discussed throughout this memo, there is a lack of information and clarity over the law in this area. There are few IRS rulings on PRIs made for environmental causes, and even fewer that touch on climate change. Given the fact-specific nature of these rulings and the limited information provided in a PLR, it is even harder to tell why a particular case was denied or accepted and to what extent the PLR provides clarity, it can still not be relied on as precedent. The avenues to getting approval through an individual PLR or a legal opinion are costly and take time and other resources that foundations may not have.

In comments on the proposed regulations on PRIs, the American Bar Association Section on Taxation stressed that PLRs have developed the law since the regulations were issued, but still can not be used as precedent. They also stressed the difficulty in searching through many PLRs in order to determine the law on point, and the fact that the types of PRIs and investment vehicles have changed and increased over time. ABA Section of Taxation, COMMENTS CONCERNING PROPOSED ADDITIONAL EXAMPLES ON PROGRAM-RELATED INVESTMENTS 4 (Mar. 3, 2010). Independent Sector, a coalition of almost 600 nonprofit organizations, also submitted comments stressing that the lack of guidance had “hindered the ability of private foundations to understand the Service’s direction and to structure investments that comply with the law.” Independent Sector, PROPOSED REG. 144267-11 ON PROGRAM-RELATED INVESTMENTS FOR PRIVATE FOUNDATIONS 1 (July, 16 2012). In addition to providing greater clarity through regulations, they also asked that the IRS “promulgate regulations that would allow multiple foundations to rely on a single PRI determination, rather than requiring each foundation to seek a separate determination that an investment is permissible.” Id. at 2. They also asked for “an appropriate timeframe for responding to requests for rulings on program-related investments.” Id. Here they recommended a procedure similar to the one used under IRC 4945(g) to approve procedures for making grants to individuals, which must be made in 45 days or is considered approved. Id.
A potential solution might be for the IRS to include in the regulations examples specifically addressing PRIs made for climate change related projects, or to promulgate a guidance document clarifying that these types of investments are permissible. Another helpful approach would be to have environmental protection and climate change specifically added to Section 170(c)(2)(B) and 501(c)(3) of the Code. Finally, measures to streamline and make it easier for foundations to obtain PLRs pre-approving their investments, or resources to help them determine the parameters of the law could also be helpful. This problem will require leveraging many different government agencies and branches involved in order to fully address the policy implications and free up the barriers holding back foundation-made PRIs to climate change related purposes.