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IRS updates private foundation rules on MRIs and equivalency determinations

The Internal Revenue Service has given new approval to mission related investments by private foundations and spelled out specific requirements for making "good faith determinations" that grants to foreign organizations are qualifying distributions that don't require expenditure responsibility.

The Tax Code, in Section 4944, imposes an excise tax on private foundation investments that "jeopardize the carrying out of any of its exempt purposes," but specifically excepts from the limitation "program related investments" where the primary purpose is to accomplish its charitable purpose and "no significant purpose" is the production of income or the appreciation of property. (See Ready Reference Page: "Foundations May Be Source of Venture Capital") PRIs are not only permitted, but are counted toward the minimum distribution requirement of the foundation.

The exception applies, however, only where there is "no significant purpose" to generate income. Some foundation managers have been concerned that they might be liable if they invested portions of their endowments in "mission related investments" or "socially responsible investments" which are aligned with their charitable goals but still provide — and are expected to provide — a return on investment, although not necessarily the highest return. Investing in alternate energy sources rather than fossil fuels might be an example.

In IRS Notice 2015-62, the Service says an investment will not be considered a jeopardizing investment "if, in making the investment, the foundation managers exercise ordinary business care and prudence (under the circumstances prevailing at the time the investment is made) in providing for the long-term and short-term financial needs of the foundation to carry out its charitable purposes. … foundation managers may consider all relevant facts and circumstances, including the relationship between a particular investment and the foundation's charitable purposes. Foundation managers are not required to select only investments that offer the highest rates of return, the lowest risks, or the greatest liquidity so long as the foundation managers exercise the requisite ordinary business care and prudence … and do not jeopardize the private foundation's charitable purposes."

The IRS says the standard "is consistent with investment standards under state laws," citing the Uniform Prudent Management of Institutional Funds Act. The relatively new UPMIFA allows managers to consider the asset's special relationship or special value, if any, to the charitable purposes of the organization. (See Ready Reference Page: "New UPMIFA Sets Rules for Management of Charitable Funds")

The IRS has also issued final regulations on standards for a private foundation to make a "good faith determination" that a foreign grantee is a charitable organization that is not equivalent to a private foundation. Grants to such organization may be qualifying distributions and not taxable expenditures. A private foundation is permitted to make a grant to a foreign organization that meets the definition of a U.S. public charity (including a supporting organization other than a non-functionally integrated Type III supporting organization) or a private operating foundation. To make grants for charitable purposes to other organizations, the foundation must exercise expenditure responsibility. The final regulation slightly modifies proposed regulations issued in 2012 and is effective as of September 25, 2015.

The final regs under Section 53.4942(a) attempt to balance two important considerations, the IRS said, —removing barriers to international grantmaking and ensuring that foundations' good faith determinations are informed by a sufficient understanding of applicable law, are based on all relevant facts, and are likely to be correct.

The final regs expand the class of advisors who may provide written advice on which a foundation may rely to include "qualified tax practitioners," including CPAs and enrolled agents. Attorneys may be in-house counsel or outside counsel. All must be licensed in their disciplines and authorized to practice in a state or as an enrolled agent at the IRS. Foundations will not be able to rely on an opinion of grantee's counsel unless that counsel meets the qualifications for a qualified tax practitioner. Opinions by foreign lawyers or CPAs not licensed in the U.S., therefore, will not be sufficient.

Foundations will also be unable to rely solely on an affidavit from the foreign grantee. Although the IRS recognized that some affidavits could be reliable because the person understood the requirements of U.S. law, it said that some of them would be unreliable because the grantee did not understand U.S. law. Therefore, reliance solely on the grantee's affidavit would not be considered a good faith determination. The IRS said, however, that a qualified tax practitioner could rely on foreign counsel for questions of foreign law or other matters within such counsel's experience.

Some private foundations who make grants to the same foreign organizations have wondered whether U.S. grantmakers may share their determinations and still meet the good faith determination standard. The IRS again said that some determinations could be good, while others would be invalid because they are not made by people familiar with U.S. law. The final regulations do not prohibit the sharing of information and determinations, but each foundation must rely on advice given to it by a qualified tax practitioner, not by another foundation.

The IRS said that these new guidelines can be used by sponsors of donor advised funds in making grants abroad "until further guidance is issued."

ORGANIZATIONAL CHART

H.F. (Gerry) Lenfest Launches the Institute for Journalism in New Media – Donating The *Philadelphia Inquirer, Daily News* and philly.com to it – and Makes a Gift of $20 million to a New Endowment to Ensure Future of Independent Journalism.

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PMN, PBC Charitable Trust protects editorial independence of The *Philadelphia Inquirer, Daily News* and philly.com.

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This structure reflects the organization's public mission. The complete independence of the journalism is maintained.

PHILADELPHIA MEDIA NETWORK

NEWSPAPER, LLC
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DIGITAL, LLC
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CONSHOHOCKEN, LLC
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*PMN, PBC is formed under Delaware Law by converting Philadelphia Media Network, LLC ("PMN, LLC") to a public benefit corporation. PMN, PBC is considered the same legal entity as PMN, LLC.

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School Can't Temporarily Drop Residential, High School Programs

Court denies request by trustees of Girard College to permit deviation from trust because of decline in financial status

Trustees of Girard College, a free elementary and secondary school for disadvantaged youth in Philadelphia, have been denied a request to eliminate their residential and high school programs temporarily in order to rebuild their reserves to assure the long-term viability of their programs. The Pennsylvania Commonwealth Court has affirmed an Orphans' Court decision denying the request. (*Estate of Stephen Girard,* No. 2254 C.D. 2014, 1/21/16.)

The school was opened in 1848 pursuant to a bequest left to the City of Philadelphia in the 1830's will of Stephen Girard, shipping magnate, merchant and banker, who was believed to be one of the richest men in America at the time of his death. He left the bulk of his estate to establish a school for at least 300 "poor male white orphan children" who could live on the campus until they were ready to move on to productive lives. The school was racially integrated in 1968 and the first girl was admitted in 1984. The school is run by the Board of City Trusts, which was created to hold charitable funds given to the City.

Following the Recession of 2008-09, the school faced significant financial issues. In 2007, the school had lost about $3.3 million on its operations. The school has traditionally had income from three major sources: coal and coal royalties, rental income from a substantial portfolio of real estate, and income from investment assets. Income was declining from all sources, and its reserve fund shrank from $330 million in 2007 to less than $200 million in 2011.

The school established a strategic planning committee that retained outside experts and considered at least 13 options for keeping the residential program. But the trustees concluded that the best course would be to temporarily suspend the high school program and drop the residential aspect for grades 1-8 in order to grow back the reserves to assure financial viability. In 2013, the school asked the Orphans' Court to approve the changes, claiming that the reserve funds would be exhausted within 25 years if it didn't make the changes. It said its financial projections did not include the cost of physical plant

renovations that were estimated at $3.8 million for "deficiency repairs" and $110 million for complete renovation.

Although the state Attorney General supported the request, the Orphans' Court turned it down, without prejudice to bring the case again if necessary. The Commonwealth Court, saying that its scope of review of a decree in equity was "particularly limited" and that the findings of the Orphans' Court could be reversed only for a clear abuse of discretion, has found no abuse of discretion and affirmed.

On appeal, the school argued that each of the three major findings of the Orphans' Court was wrong. The Orphans' Court had held that the request was not one for "administrative deviation," did not qualify for cy pres relief, and any change in circumstances were actually anticipated by Stephen Girard.

When Pennsylvania adopted the Uniform Trust Code in 2006, it provided that a court could "modify an administrative provision of a charitable trust to the extent necessary to preserve the trust." It did not define an "administrative" provision, but a prior case involving the Barnes Foundation had defined an administrative provision as one involving the details of administration which the settlor prescribed to secure the principal advantages of the trust for the beneficiaries. The Commonwealth Court agreed with the Orphans' Court that the references to maintenance, residence and lodging in Girard's will showed his intent to provide a residential program as an integral part of the school and were "dispositive," not administrative, provisions.

The codification of the cy pres standard provides that "if a particular charitable purpose becomes unlawful, impracticable or wasteful" a court may apply cy pres "to fulfill as nearly as possible the settlor's charitable intention." Because the economic fortunes of the school had turned around by the time the case got to court and it had run a surplus of $3.5 million in 2013 and projected a surplus of about $3 million in 2014 after payments into a sinking fund to pay off outstanding debt, the Orphans' Court had found that operating the residential and high school programs was not currently impracticable.

The school argued that the Orphans' Court's focus on "this year" and "coming years" was "myopic" and the program was clearly impracticable if the financial issues were not addressed promptly. On the appeal, the Attorney General supported the Orphans' Court, saying that the court did not have to grant a cy pres petition "preemptively" and that there is not necessarily such a thing as "temporary" cy pres.

The Commonwealth Court found "no error" in the Orphans' Court's determination that the residential and high school programs were "important parts" of Girard's gift, and said that it was "well within" the court's discretion to give the near-term financial projections greater weight than "the dire long-term predictions offered by the Board."

Finally, the school challenged the Orphans' Court's finding that Girard had actually anticipated the fluctuation in funding that might be available for the school. (Many common law cases require an "unanticipated" change in circumstances in order to invoke the cy pres doctrine although the current Pennsylvania law does not require it.) The Orphans' Court had pointed out that Girard's will called for the admission of new students each year to the extent that the income from the trust fund could sustain them. It also noted that enrollment had fluctuated widely over the years on the basis of available income. The Commonwealth Court found no error in the finding.

YOU NEED TO KNOW

The Commonwealth Court "commended" the trustees for beginning to "confront the myriad of financial, educational and institutional challenges currently facing" the school but essentially told them to go back to the drawing board and work within the essential residential program developed almost 200 years ago. The Court's view seems to be that there is latitude in the number of students in the program, but at least at this point, a residential program is not impracticable and cannot be eliminated.

The Court itself did not seem to deal with the concept of temporary cy pres. But it does undercut the claim that a program is impracticable today, but won't be in a few years when there is more money available.

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Court refuses to invade principal of trust

An appellate court in Pennsylvania has affirmed a trial court decision refusing to invade the principal of a charitable trust to help a beneficiary avoid insolvency. It has said that the charity's financial position is its own responsibility and distribution of principal would be contrary to the donor's intent.

Lillian E. Loucks died in 1991 and devised the residue of her estate to a trust she had previously established in 1984. The trust provided income and such principal as necessary to her for her life, and provided several individual gifts upon her death. The residue was to be held in perpetuity to provide income to support the general charitable purposes of Otterbein United Methodist Church and the York Lutheran Home, now known as SpiriTrust Lutheran. In 2015, the church filed a petition to increase its distribution from principal.

Concurring with the objection of the state Attorney General, the trial court denied the motion and the church appealed. The church said the question on appeal was whether the donor's intent was to allow the church to fail for lack of funds and to place its share with another, yet to be identified, religious organization.

The Superior Court rejected the question as presented and said the issue was determining the intent of the donor from the "four corners" of her document if possible. "Only when the language of the trust is ambiguous or conflicting or when the settlor's intent cannot be garnered from the trust language" do other principles of trust construction become applicable, it said.

The Court noted that the trust was to be held perpetually, to pay half of the income to each beneficiary. In the event that the trust balance was less than $50,000 upon her death, the fund was to be divided between the charities and paid in full. The Court noted that the trust permitted payments from principal for the donor's own benefit during her lifetime, but said there was no such language with regard to the charitable benefits.

The Court said that Pennsylvania has adopted the position of the Restatement (Second) of Trusts to permit deviation from the terms of a trust when it appears that compliance is "impossible or illegal or that owing to circumstances not known to the settlor and not anticipated by him compliance would defeat or substantially impair the accomplishment of the purposes of the trust." The Court said that compli-

ance was neither impossible nor illegal and that it could not be said that the donor failed to anticipate the possibility that one of the charities could have financial needs.

The church "relies heavily upon the fact that it is presently unable to generate sufficient money to meet its operating costs, which included attending to the needs of a significant number of indigent people," the Court wrote. "It suggests that we must determine that the settlor did not intend for it to fail for lack of funds, and that the orphan's court abused its discretion in concluding that it could not obtain distributions from its one-half of the principal of the trust to the extent needed to render it financially viable….

"While we laud Appellant's efforts to aid the poor, our task herein is to interpret the terms of the trust and ascertain whether it permits Appellant to receive principal distributions. Appellant is responsible for its own financial operations, and the state of its budgetary affairs is not a factor in interpreting the terms of this trust." (*Estate of Loucks,* Superior Ct., PA, No. 1947 MDA 2015, 9/9/16.)