

PLANNED GIVING T·O·D·A·Y®

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PROVEN, PRACTICAL
GUIDANCE FROM
THE PLANNED
GIVING EXPERTS

Changing the Purpose on Past Charitable Gifts

BY BARBARA RHOMBERG

Donor-restricted gifts can be a mixed blessing. Sometimes charities hold donated funds that are difficult to use for their originally designated purpose. This arises most often with endowment funds that were established years or decades ago.

Purpose restrictions in current-use funds can also be problematic, if unanticipated circumstances develop after the gifts were made. At other times, it is the donors (or their family members) who change their minds and ask to redirect previous contributions.

In either case, a charity may be interested in changing the purpose of previously made gifts, so that money can be released for a different use. Any organization contemplating such a move must consider:

- ◆ Donor relations with those who gave the restricted funds
- ◆ Public relations with other donors, volunteers, and the at-large community
- ◆ Accounting standards for reporting restricted fund transactions
- ◆ Legal rules governing the use of donor-restricted gifts

All of these considerations are important, but this article focuses on the legal aspects of changing the purpose of restricted funds.

Enforceability of Restrictions

A charity's legal obligation to use a gift for the purpose specified by the donor

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Insights from Georgia's Leading Gift Planners

BY BARRY H. SPENCER

Planned giving is a major opportunity for growth and sustainability for charities across the United States and Canada. Since 1995, the Donor Motivation Program® has kept a finger on the pulse of the planned giving challenges and opportunities development professionals are facing.

I recently shared our national report (The Seven Most Influential Planned Giving Trends) in Atlanta. It led me to expand on the research, to take the pulse of these trends at the local level among Georgia's leading educational, arts, human services, community, and health care institutions and professionals.

Over about a 20-week period, confidential in-depth interviews were conducted

with development professionals across Georgia. Follow-up interviews also were conducted to verify findings for a supplemental special report, which are summarized in this article.

Overwhelming Consensus

Given the love of charity and wealth held among donors in Georgia — and that donors stand to benefit greatly from gift planning — these factors highlight a significant opportunity for charities.

However, too few Georgia nonprofits, similar to the findings nationally, are capturing the opportunity because of a lack of organization-wide commitment

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stems primarily out of charitable trust law. Gifts and bequests to charitable organizations are deemed to create a charitable trust, and the purpose restrictions imposed by donors are enforceable under trust law. This is true even if the gift is made to a nonprofit corporation or association, rather than trust-form charity. Using the contributions for another purpose, even a worthy or charitable one, is a breach of trust.

Charitable trust restrictions are usually established by the donor through bequest terms, a gift agreement, or written instructions. If a charity asks donors to contribute for a specific purpose, the resulting gifts are restricted and held in trust for that use under UPMIFA §2(3).

Contract law is also a factor when funds were received in connection with a gift or grant agreement, though applicable law varies from state to state. Pledge agreements that seek to make future charitable gifts are sometimes enforceable. Under traditional contract law principles, a charitable pledge is enforceable when the charity provides return consideration to the donor, or when the charity or other donors rely to their detriment on the pledge. While a court recently ruled that a foundation has a contract claim against a donor, others denied enforcing a pledge because consideration and detrimental reliance were lacking.

Although most court cases about the enforceability of gift agreements arise when charities try to enforce a pledge against a donor or donor's estate, a charity's promise to use funds for a particular purpose may be enforceable against the charity as contractual obligation when the gift was made pursuant to an enforceable agreement.

Under the traditional trust law doctrine of cy pres, a court may modify the terms of a charitable trust when its stated purpose has become impossible, impracticable, illegal, or wasteful. The modified use must fulfill the donor's charitable intent as closely as possible.

Cy pres is used to modify stand-alone charitable trusts, but this doctrine also has been applied to restricted gifts and endowments held by nonprofit corporations and associations. It may still be used to modify charitable gifts when the Uniform Prudent Management of Institutional

Funds Act (UPMIFA) does not apply. For example, if real estate was donated for use in a nonprofit's program, UPMIFA does not apply. A cy pres action would therefore be required to modify the donor's restrictions on use of the property.

UPMIFA is often thought of as a law that regulates endowment spending. However, it applies more broadly to all institutional funds (not just endowments) and it both codifies and expands the cy pres doctrine relating to the modification of donor restrictions. It is a uniform law, meaning a committee of experts wrote a model statute and encouraged state legislatures to adopt it. UPMIFA has been enacted in 49 states (all but Pennsylvania) and in the District of Columbia. Some state legislatures tinkered with the model law when they enacted it, so provisions vary somewhat from state to state.

UPMIFA applies to all institutional funds, and "institution" is defined in §2(4) to mean any entity that is organized and operated exclusively for charitable purposes. The term also includes a government agency or instrumentality to the extent that it holds funds exclusively for charitable purposes. A split-interest trust after all noncharitable interests have terminated is an institution under UPMIFA.

Institutional fund is defined in UPMIFA §2(5) as "a fund held by an institution exclusively for charitable purposes." This includes both endowed and nonendowed funds. The definition of "institutional fund" excludes (1) program-related assets held to accomplish an exempt purpose and not for investment, (2) funds held by outside noncharitable trustees, and (3) any fund in which a beneficiary that is not an institution has an interest. Under these broad definitions, UPMIFA applies to any charitable or educational nonprofit organization (including state universities) and covers both endowed and nonendowed funds.

For institutional funds, it enables a charity to modify restrictions contained in the gift instrument. Section 2(3) of UPMIFA defines gift instrument as "a record or records, including an institutional solicitation, under which property is granted to, transferred to, or held by an institution as an institutional fund." This includes will and trust language, gift and pledge agreements, and transmittal letters from the donor. It also

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encompasses proposals or solicitation language from the charity.

UPMIFA provides three ways that a charity can modify restrictions on institutional funds: by donor consent, by court order, or for small old funds with notice to the state's attorney general.

Donor Consent

Purpose restrictions can be changed with the written consent of the donor in §6(a) of UPMIFA.

If the donor consents in a record, an institution may release or modify, in whole or in part, a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund. A release or modification may not allow a fund to be used for a purpose other than a charitable purpose of the institution.

The donor's consent must be in a record. UPMIFA §2(8) defines a record as "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form." A letter or agreement signed by the donor meets this standard, but the donor's consent need not be so formal — an email from the donor will also suffice. However, a donor's verbal permission to modify the terms of the gift would not satisfy the statute, since the consent would not then be in a record.

While donor consent is required, the charity holding the fund must also take some action. UPMIFA states that the institution (not the donor) releases the restriction. The charity's action to modify the restriction, by the board of directors or by staff if such authority is delegated, should be documented in the charity's records.

If the donor consents in writing to change a fund's purpose, there is no requirement that the new purpose be

related in any way to the original gift designation — the donor and charity can agree to do something completely different, as long as the new use is a charitable one. Further, no justification or grounds for modification is required. The change can be made simply because the donor and charity have changed their minds.

Court Order

A charity may also get a court order that permits a modification of fund terms. UPMIFA §6(c) provides, "If a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund becomes unlawful, impracticable, impossible to achieve, or wasteful, the court ... may modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purposes expressed in the gift instrument."

The original fund purpose must be unlawful, impracticable, impossible to achieve, or wasteful for a charity to alter a fund purpose using this second mechanism. The court may only act if the charity can show that one of these specific grounds for modification exists. A restriction is impracticable if adhering to the restriction is unreasonably difficult or would not accomplish the donor's overall charitable objective. It is not enough to show that the funds could be better spent by changing the donor's designated purpose.

The new fund purpose must be consistent with the charitable purposes expressed in the gift instrument. This UPMIFA provision is a codification of cy pres, which mandates a use as close as possible to the donor's original designation. The wording of UPMIFA is different, but the court will still look for a use that conforms as much as practicable to expressed donor intent.

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ally make their gifts — outright, irrevocable, and revocable.

Can you imagine a method for considering the cumulative lifetime value of a donor? If so, can you further imagine a way of considering the lifetime value of a fundraiser? One CFO compared the lifetime value of a fundraiser to that of a

long-term bond. It is well beyond that of any single transaction of the moment.

Assess the condition of silos in your own development program (by which I mean to ask, "How is your 'Matrix?').

Discuss challenges and opportunities for your own prospects who might be candidates for blended gifts, following the donor-focused personalized philanthropy model, in contrast to a transaction-based model.

UPMIFA
provides three
ways a charity
can modify
restrictions.

Endnote

* "The Matrix" is a 1999 science fiction movie.

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Equitable deviation is a trust law procedure that allows the administrative terms of a trust to be modified. UPMIFA also codifies this doctrine, and provides that a court can order relief from a fund's cumbersome administrative requirements or unfortunate investment restrictions. Section 6(b) provides that a court can modify restrictions in a gift instrument "regarding the management or investment of an institutional fund if the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund ... To the extent practicable, any modification must be made in accordance with the donor's probable intention."

UPMIFA requires that the state's attorney general be notified of any petition asking a court to modify the charitable purpose or administrative terms of a fund.

Small Old Funds

The third method of modifying purpose restrictions applies only to small old funds (how old and how small the fund must be depends on the version of UPMIFA adopted in the charity's state). For qualifying small old funds, UPMIFA §6(d) allows the charity to modify the terms unilaterally following notice to the state's attorney general.

If an institution determines that a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund is unlawful, impracticable, impossible to achieve, or wasteful, the institution, [60 days] after notification to the [attorney general], may release or modify the restriction, in whole or part, if: (1) the institutional fund subject to the restriction has a total value of less than [\$25,000]; (2) more than [20] years have elapsed since the fund was established; and (3) the institution uses the property in a manner consistent with the charitable purposes expressed in the gift instrument.

The model UPMIFA statute requires that a fund be older than 20 years, and with a total value of less than \$25,000, for this third method of fund modification to apply. Some states, for example

Oregon and Texas, enacted these criteria without change. A number of states increased the dollar limit on the size of the fund; in New York and California, for example, funds up to \$100,000 may be modified under this provision. Ohio raised the limit to \$250,000, and applies it to funds that are at least 10 years old.

The model law did not require any notice to the donor prior to the modification of small old funds. The drafters reasoned that "an institution's concern for donor relations would serve as a sufficient incentive for notifying donors when donors can be located."

Some states, such as California and New York, added a legal requirement that charities notify donors when they propose to modify small old funds under this provision. California requires notice to donors at their last known address in the nonprofit's records. New York requires notice to individual donors if they are alive, and to institutional donors if they still exist and carry on activities, if the donors can be identified and located with reasonable efforts.

Under this method, the original fund restrictions must be unlawful, impracticable, impossible to achieve, or wasteful, and the revised fund purpose must be consistent with the charitable purposes expressed in the gift instrument. These substantive requirements are the same as if the charity had sought a court order to modify the fund. The UPMIFA provision for modifying small old funds provides a simplified process to avoid the (often prohibitive) cost of going to court.

The language of the model act allows restrictions on the "management, investment, or purpose of an institutional fund" to be modified if the requisite cause can be shown. This seems to include an endowment restriction, which would likely be characterized as either a purpose or a management restriction. It follows that a fund could be unendowed if the charity can show that continuing to hold the fund as an endowment is impracticable, and that current use (rather than combining it with a larger endowment fund) is most consistent with donor intent.

Changing the purpose of previously received gifts takes time and resources, but the rewards can be enormous for a charity that has disused and unusable funds that can be put back to work.