

Alert

TAX EXEMPT ORGANIZATIONS PRACTICE GROUP | FEBRUARY 2007

WIGGIN AND DANA

Counsellors at Law

UPMIFA: Proposed legislation that may affect Connecticut charities and charitable funds

In 2006 the National Conference of Commissioners on Uniform State Laws approved the *Uniform Prudent Management of Institutional Funds Act* (“UPMIFA”) and recommended that it be adopted in all states. UPMIFA has now been proposed for consideration in the current session of the Connecticut General Assembly. If enacted into law, UPMIFA will replace the Connecticut Uniform Management of Institutional Funds Act (“CUMIFA”), which was enacted in its original form in 1973. Both CUMIFA and UPMIFA apply to funds, including endowment funds, held by a charitable organization for its own use and purposes. If enacted as proposed, UPMIFA will apply to all such funds held by a charity, whether the fund was created before or after the passage of the new law.

Background

Currently, CUMIFA provides guidance to charitable organizations concerning the management and investment of funds and the accumulation or spending of income and appreciation on investments, and creates a procedure to release donor-imposed restrictions on gifts that are now “obsolete, inappropriate or impracticable.” The most significant contribution of CUMIFA was that it permitted charitable organizations to use modern investment techniques such as total-return investing and to determine endowment fund spending based on spending rates rather than on determinations of income versus principal. UPMIFA, if enacted, will retain those provisions but will also change the law in two ways that may be significant to Connecticut charities.

Proposed changes to Connecticut law under UPMIFA

Elimination of the “Historic Dollar Value” Concept. Under CUMIFA, a charity is not permitted to appropriate for expenditure any net appreciation on an endowment fund if the value of the fund is or will become less than the “historic dollar value” of the fund. The historic dollar value is the original value of the fund plus the value of any subsequent contributions to the fund at the time they were made. Under this rule, if a declining stock market, for example, has caused the value of an endowment fund to fall below its historic dollar value, the charity may not spend any subsequent investment gains on the fund until the fund’s value once again exceeds the historic dollar value. This rule is particularly problematic for new endowment gifts. For example, if a charity has a five percent spending policy and receives an endowment gift in 2006, the application of the spending policy to the gift in 2007 might cause the value of the gift to fall below its historic dollar value, depending on investment results. UPMIFA would eliminate the concept of historic dollar value. A charity would be able to spend a portion of the fund even if it meant invading the original amount—the principal—of the fund, as long as the spending decision was prudent.

Charities May Release Donor-Imposed Restrictions on Older, Small Funds.

As proposed, UPMIFA would permit charities the flexibility to release or modify, under certain circumstances and without the need for court approval, a restriction imposed by a donor if the charity determines that the restriction is unlawful,

UPMIFA: Proposed legislation that may affect Connecticut charities and charitable funds CONTINUED

WIGGIN AND DANA

Counsellors at Law

impracticable, impossible to achieve or wasteful. To qualify, the fund would need to be more than twenty years old and have a value of less than \$25,000. The charity would be required to use the fund in a manner generally consistent with the charitable purposes expressed in the gift instrument. Before modifying the restrictions, the charity would also be required to give sixty days notice to the Attorney General, who could object to the charity's intentions. Under current law, a charity always needs to go to the Superior Court and seek permission to release a restriction, which can be a costly and time-consuming process.

Rules for Prudent Investing and

Spending. As proposed, UPMIFA requires that funds be invested prudently and the appreciation on invested funds be spent prudently. A prudent charity would be required to: (1) give primary consideration to donor intent as expressed in a gift instrument; (2) act in good faith, with the care an ordinarily prudent person would exercise; (3) incur only reasonable costs in investing and managing charitable funds; (4) make a reasonable effort to verify relevant facts; (5) make decisions about each asset in the context of the portfolio of investments, as part of an overall investment strategy; (6) diversify investments, unless, due to special circumstances, the purposes of the fund are better served without diversification; (7) dispose of unsuitable assets, and (8) in general, develop an investment strategy appropriate for the fund and the charity. These prudence rules would not be new to Connecticut law. For all practical purposes, the same rules have been in place under CUMIFA since 1997, when it was amended to incorporate the standards of the Connecticut Uniform Prudent Investor Act.

UPMIFA includes an optional provision which would create a default spending cap on appreciation of seven percent in any

given year. A state, if it wishes to do so, can insert into its version of UPMIFA a provision that spending over seven percent of the value of an endowment in any one year creates a rebuttable presumption of imprudence. The presumption is meant to protect against spending an endowment too quickly. The bill as proposed in the Connecticut General Assembly does not contain this optional provision at the present time.

If you have any questions about UPMIFA or would like additional information, please feel free to contact Melinda Agsten, Karen Clute or David Ormstedt.

**TAX EXEMPT ORGANIZATIONS
PRACTICE GROUP CONTACTS**

MELINDA A. AGSTEN
203.498.4326, magsten@wiggins.com

AARON S. BAYER
860.297.3759, abayer@wiggins.com

PATRICIA R. BEAUREGARD
203.498.4423, pbeauregard@wiggins.com

ROBERT W. BENJAMIN
212.551.2602, rbenjamin@wiggins.com

BENNETT J. BERNBLUM
203.498.4336, bbernblum@wiggins.com

ROBERT F. CAVANAGH
203.498.4305, rcavanagh@wiggins.com

KAREN L. CLUTE
203.498.4349, kclute@wiggins.com

ALYSSA B. CUNNINGHAM
860.297.3723, acunningham@wiggins.com

MARK E. HARANZO
203.363.7640, mharanzo@wiggins.com

CHARLES C. KINGSLEY
203.498.4307, ckingsley@wiggins.com

DAVID E. ORMSTEDT
860.297.3739, dormstedt@wiggins.com

Nothing in this advisory constitutes legal advice, which can only be obtained as a result of personal consultation with an attorney. The information published here is believed to be accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues. U.S. Treasury Circular 230 Notice: Any U.S. federal tax advice included in this communication was not intended or written to be used, and cannot be used, for the purposes of avoiding U.S. federal tax penalties.