IRS Blesses Private Foundation Mission-Related Investing: Implications for the Charitable Sector

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The IRS has formally confirmed that private foundations may make investments that further their charitable purposes even when those investments do not qualify as permitted program-related investments ("PRIs") under the federal tax law. This is welcome news for proponents of mission-related investing.

In Notice 2015-62, issued on Sept. 15, 2015, the IRS sought to allay concerns that a foundation that makes investments for a combination of charitable impact and financial return, rather than strictly to maximize financial return, might violate the private foundation "jeopardizing investment" rules. Under those rules, foundations and foundation managers who fail to exercise ordinary business care and prudence in managing investments may be subject to excise tax liability.

The Notice effectively gives the IRS seal of approval to the growing practice of "impact investing" or "mission-related investing," through which private foundations use their investment assets to advance their charitable missions and pursue charitable impact and outcomes.

The federal tax law specifically permits private foundations to make PRIs and provides that a PRI is not a "jeopardizing investment." To qualify as a PRI, an investment must have as its primary purpose accomplishing a charitable goal, and no significant purpose may be producing income or appreciation in value. This means that foundation investments that further charitable purposes and that are also intended to produce a return generally fall outside the definition of a PRI. The Notice makes clear that a private foundation investment that both furthers a charitable purpose and has producing a return as a significant purpose is not at risk for excise tax under the jeopardizing investment rules, even though it does not qualify as a PRI.

As the Notice explains, 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 they exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the investment. The Notice cites as an example an investment that furthers the foundation's charitable purposes but that provides a lower expected rate of return than what the foundation might obtain from an investment that is unrelated to its charitable purposes.

In the Notice the IRS indicates that its position on mission-related investing is also consistent with investment standards under state laws, such as UPMIFA, the Uniform

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Prudent Management of Institutional Funds Act, which has been adopted in 49 of the 50 states. UPMIFA permits a charitable organization, in managing and investing its assets, to consider an asset's special relationship or special value, if any, to the organization's charitable purposes. Mission-related investing, performed with the ordinary care and prudence required under the federal tax law's jeopardizing investment rules, will therefore satisfy a foundation's state law requirements for prudent investing as well.

While the Notice as a technical matter applies only to private foundations because only private foundations are subject to the "jeopardizing investment" rules, it has far broader implications. The IRS's indication that mission-related investing is consistent with the state law prudent investor standards that apply to all non-profit organizations holding assets for charitable purposes opens the door for the charitable sector generally to consider deploying a portion of investment assets for mission-related purposes. Proponents of mission-related investing hope the Notice will create even greater momentum among both private foundations and public charities to engage in mission-related investing.

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