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Exempt Organizations

Mission-Related Investments Won't Trigger Tax on Harming Exempt Purpose

Investments made by private foundations won't be considered to be ''jeopardizing investments'' as long as foundation managers exercise ordinary business prudence in providing for the long- and short-term financial needs of the foundations so that they can carry out their charitable purposes, the IRS said.

That applies to investments that foundation managers make that don't offer the highest rates of return, the lowest risks or the greatest liquidity, the Internal Revenue Service said in Notice 2015-62, released Sept. 15.

The guidance is aimed at so-called mission-related investments, such as investments in an endowment that corresponds to the particular values, or mission, of the foundation. For instance, an environmental charity might invest in companies that are trying to find ways to reduce carbon emissions, such as Tesla Motors Inc., rather than companies drilling for oil.

''The notice is interesting because it officially recognizes that private foundations may engage in mission-related investing (MRIs) or socially responsible investing (SRIs),'' Alexander Reid, partner-elect with Morgan Lewis & Bockius LLP, told Bloomberg BNA Sept. 15. ''MRIs and SRIs are tools that enable foundations to wield their endowments to generate positive social impact while at the same time earning investment returns that can later be used in grant-making or other charitable activity—a win-win.''

Non-Program Related Investments. Normally, foundation managers must consider expected returns, including both income and appreciation of capital, the risk of rising and falling price levels, and the need for diversification within an investment portfolio in order to have appropriately carried out the foundation's financial needs so that its tax-exempt purpose can be upheld.

However, the guidance said that as long as ordinary business care has been exercised, ''an expected rate of return that is less than what the foundation might obtain from an investment that is unrelated to its charitable purposes won't trigger the tax under Section 4944.'' That tax is on investments that jeopardize the foundation's exempt purpose.

The guidance was prompted by questions about whether investments that further charitable purposes—but don't rise to the level of program-related investments—would result in tax.

Only program-related investments qualify for an exception to the rule that no significant purpose of the investments may be production of income or the appreciation of property.

Reid pointed out that MRIs and SRIs aren't to be confused with program-related investments, which are investments that are sufficiently charitable that they qualify as meeting a private foundation's charitable distribution requirement.

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Text of Notice 2015-62 is in TaxCore.

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