

Massachusetts and Rhode Island Charities: Unlocking Restricted Funds

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For many charitable institutions, accepting gifts subject to certain donor-imposed restrictions is in the normal course of business. While these restricted funds are quite common, their usefulness can occasionally become impractical. This frustration of purpose is particularly common for gifts made many decades ago. For example, some institutions have restricted funds dedicated to projects that have been rendered moot or completed, leaving the institutions with money that they cannot use. Fortunately, when these situations arise, Massachusetts and Rhode Island law affords charities the opportunity to release or modify restrictions under certain conditions.

This Client Alert provides a high-level overview of treatment and classification of endowment funds for charitable organizations; discusses the Uniform Prudent Management of Institutional Funds Act (UPMIFA), a uniform law that governs the management of endowment funds; and highlights UPMIFA procedures for institutions that want to release or modify donor restrictions.

Legally Binding Endowment Restrictions

The first question is whether the restricted fund at issue is, in fact, considered an endowment for legal purposes. An endowment for legal purposes is generally created only when a donor makes a gift designated as an endowment, makes a gift with spending restrictions, or makes a gift in response to a charity's solicitation for endowment funding. Importantly, board-designated or "quasi" endowments (i.e. funds set aside or designated only by a Board of Directors or similar governing body) are not treated as endowments for legal purposes. Unlike donor-imposed restrictions, the board can remove board-imposed restrictions at any time as long as the charity has not co-mingled donor-restricted funds with board-restricted funds.

The Uniform Prudent Management of Institutional Funds Act (UPMIFA)

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) is a uniform law which has been adopted in virtually every state and provides standards and procedures for charities managing institutional funds (i.e., the investment assets the institution holds) as well as specific rules applicable to endowment funds. Each state follows variations on these rules and procedures, so a close review of state law is necessary to determine the most cost-effective approach to obtain a release or modification of a restriction. The details below are based on the UPMIFA as adopted in Massachusetts and Rhode Island.

Generally, the UPMIFA provides that an institution may only use its endowment funds in accordance with the donor's restrictions as found in a gift instrument. A gift instrument may be as simple as a memo on a check or as elaborate, and as a better practice, as a gift agreement. If no gift instrument exists, then the restrictions will be the terms of the solicitation. The UPMIFA also establishes procedures for institutions that want to release or modify donor restrictions placed on the management, investment, or charitable purpose of an endowment fund. As described in detail below, an institution may seek written consent from the donor to release or modify such a restriction, or it may seek court permission. In addition, for certain endowment funds that are relatively small and old (subject to state-specific thresholds), an institution may be able to release or modify restriction without donor consent or court involvement.

Releasing or Modifying Restrictions

A charity may generally only expend endowment funds for the purpose for which they were restricted and in such amounts that are determined to be prudent, charities occasionally may pursue releasing or modifying

restrictions for more spending flexibility.

Consult the Gift Instrument. The terms of the gift instrument might allow the charity to release restrictions—including a requirement to hold the fund as an endowment—in some circumstances. Charities must carefully consider the specific language of the gift instrument, and any legal enforceability questions, before concluding that they have this power and ensure that any actions taken are consistent with applicable law, the gift instrument, the charity's governing documents, and the best interests of the charity.

Modification by Donor Consent. The UPMIFA expressly provides that institutions may release or modify restrictions imposed on endowments funds with donor consent. Where donors are accessible and agreeable, this is often the most efficient method of releasing or modifying a restriction. Even this approach, however, can get complicated. For example, there may be dozens of donors to a specific endowment. Moreover, before approaching a donor, thoughtful consideration should be given to the necessity and scope of the release or modification, and the charity should be able and willing to articulate not only the reason for the desired change, but how the change will continue to serve the donor's purpose while better serving the charity's purpose.

Oftentimes, even where charities have determined a legal basis exists to spend or borrow from an endowment, they nevertheless seek approval from major donors.

Modification by a Court. In circumstances where donor consent is not feasible or even possible, petitioning a court to modify the use of the fund may be available.

Massachusetts and Rhode Island courts may modify certain endowment fund restrictions pursuant to two equitable doctrines, codified in the UPMIFA. These two doctrines recognize that with the passage of time and changed circumstances, a donor's original charitable intent—and the mechanisms for advancing that intent—may someday become obsolete.

1. The *cy pres* doctrine permits a court to modify an endowment fund's charitable purpose or use restriction if the purpose or restriction has become "unlawful, impracticable, impossible to achieve or wasteful"; *cy pres* modifications must be consistent with the charitable purposes reflected in the original gift instrument.
2. The doctrine of equitable deviation permits a court to modify a management, investment, or durational restriction on an endowment 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"; deviation modifications should be consistent with the donor's probable intent.

In Massachusetts cases in which court approval is sought, the Attorney General must be made a party to any such application and resulting proceeding. In Rhode Island cases in which court approval is sought, the charity must notify the attorney general of the application, and the attorney general must be given an opportunity to be heard.

A threshold determination of whether to seek judicial relief under these equitable doctrines depends on the facts and circumstances of each case, the specific relief sought, and whether the institution meets the requisite evidentiary standards. In petitioning for a release or modification, the quality and persuasiveness of the petition is crucial to the success of the request. A judge must be convinced that modifying or releasing the restriction on a fund is consistent with the donor's intent and that the charitable purpose of the gift continues on after the modification or release is granted. Every restricted fund has a different story behind it, and, correspondingly, each petition to modify or release a restriction should be uniquely tailored to tell that story.

Administrative Modification. For certain endowment funds that are relatively small and old (subject to state-specific thresholds), a charity may be able to modify or release a restriction without donor consent or court involvement.

In Massachusetts, if a fund has a total value of less than \$75,000 and is greater than 20 years old, an institution may apply to the Attorney General for consent to either

1. Modify a restriction contained in a gift instrument on the management, investment, or duration of the institutional fund if the restriction has become impractical or wasteful, 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 (*administrative equitable deviation*); or
2. Modify the purpose of the institutional fund or the restriction on the use of the fund in a manner consistent with the charitable purposes expressed in the gift instrument if a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund has become unlawful, impracticable, impossible to achieve or wasteful (*administrative cy pres*).

In Rhode Island, if a fund has a total value of less than \$25,000; is greater than 20 years old; and the charity determines that a restriction on the management, investment, or purpose of the fund is unlawful, impracticable, impossible to achieve, or wasteful, the charity can (after notice to the Attorney General) release or modify the restriction. It must thereafter use the funds in a manner consistent with the charitable purposes expressed in the gift instrument.

[Partridge Snow & Hahn](#) has multifaceted practice areas, including [Nonprofit & Tax-Exempt](#), to guide you through the advice necessary to address the complex legal needs unique to your situation. For more information or assistance with releasing or modifying restrictions on endowment funds, please connect with [Elizabeth O. Manchester](#), [Morgan E. Hedly](#), or [Paul M. Kessimian](#).

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