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# using upmifa to release and modify restrictions on charitable funds

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**practice areas**

nonprofit organizations

Many donors impose restrictions of various types on the funds they contribute to charity. These restrictions might limit the manner in which the funds may be invested, the manner in which they may be spent by the charity (for example, endowment funds from which only income may be spent), or the specific charitable purposes or programs in which the charity may apply the funds. The charity is bound by these restrictions in the same way that a trustee is bound by the restrictions in a trust instrument. Restrictions on charitable gift funds typically do not present a problem, as the restrictions usually align with the current charitable programs of the institution. However, many organizations have found that, over time, institutional priorities and programs change and fall out of sync with the restrictions on some charitable funds. In these instances it is desirable, or even necessary, as a matter of good stewardship and fiduciary responsibility, to explore ways in which these restrictions may be modified or released.

## **What Are Restricted Funds?**

When making gifts to a charitable institution, many donors choose to restrict the institution's use of their donation. A donor to a university may require that the funds be used solely to provide volleyball scholarships, while a donor to a nonprofit hospital may require that the funds be used exclusively to purchase surgical equipment. As one would imagine, the combination of donor wishes and institutional needs creates a nearly endless variety of restricted funds. While these restricted funds are quite common, their usefulness can occasionally become questionable. Some institutions have restricted funds dedicated to projects that have been canceled, leaving the institutions with money that they cannot use. Other institutions have a number of restricted funds for purposes that are still valid but, due to substantially reduced operating funds, risk failing unless they can find money to use for their general needs rather than specialized purposes. In addition, some institutions are in great shape, but possess funds subject to restrictions that are simply impractical



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(such as an anachronistic fund to be used to buy typewriters for underprivileged high school students, or a fund restricted to supporting students with a major no longer offered by the college). It can be difficult to persuade a court to release or modify these restrictions, especially if the donors are no longer available to grant their consent. However, due to a few provisions of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), recently adopted in many jurisdictions, charities now have much more flexibility in dealing with restricted funds.

### Background on UPMIFA

At its annual meeting in July 2006, the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and recommended it for enactment by the legislatures of the various states to replace the existing Uniform Management of Institutional Funds Act (UMIFA). UPMIFA has subsequently been approved by all states except Florida, Mississippi, and Pennsylvania. (Florida and Mississippi adopted *UMIFA*, while Pennsylvania has not adopted either of the uniform acts.) New York was the most recent state to pass UPMIFA legislation with the enactment of the New York Prudent Management of Institutional Funds Act in September 2010. The various iterations of UPMIFA enacted by the states provide boards and directors more clarity in investing and managing assets than UMIFA. UPMIFA articulates a standard of care for both managing and investing an endowment. It requires the charity to consider the charitable purposes of the charity and the purposes of the endowment fund when making investment and spending decisions. It requires the Board (and others responsible for managing and investing) to act in good faith and with the care of an ordinary prudent person and notes that the charity may incur only appropriate and reasonable costs. In addition to this update to UMIFA, UPMIFA also added Section 6: Release or Modification of Restrictions on Management, Investment, or Purpose (codified in California as Section 18506 of the Probate Code: Release or Modification of Restriction Contained in a Gift Instrument). This section sets forth the circumstances in which a charity may seek court approval for modification or release of a restriction on a fund or endowment and the requirements to do so.

### How to Modify or Release Restrictions on Funds Under UPMIFA

First, in Section 6(a), UPMIFA allows a charity to release or modify the restriction on a fund by obtaining donor consent to the modification, so long as the fund continues to be used for a "charitable purpose of the institution." This is a big improvement over the predecessor UMIFA, which allowed restrictions to be *released*, but not modified. A restriction modified or released in this way does not need to be approved by the court. The institution may simply contact the donor directly and request permission to either modify the fund for a different purpose or to eliminate the restriction on a fund entirely.

UPMIFA also allows institutions to petition the court to modify or release a restriction on a fund or endowment without donor consent. Section 6(b) allows an institution to petition the court to modify or release the *administrative* provisions of a restriction (how assets may be invested, how funds may be held, etc.) 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." For example, if Big Name Charity has a fund that can only be invested in subprime mortgage bonds (which may have seemed like a good idea at the time), this provision allows Big Name Charity to petition the



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court for permission to invest the funds differently.

Section 6(c) allows an institution to petition the court to modify or release the restrictions held on the *particular charitable purpose* of a restricted fund. Upon approval of a petition by the court, an institution may modify or release the restriction on a fund where the restriction becomes "unlawful, impracticable, impossible to achieve, or wasteful." This application of UPMIFA is perhaps the most useful to charitable institutions. Consider the following all-too-common scenario. Good Works Charity has been raising funds to build a new homeless shelter for the past decade. Numerous donors have donated funds specifically for the construction of that shelter, and those funds cannot be used for any other purpose. However, with the recent economic meltdown, Good Works Charity can barely afford to pay its administrative expenses and maintain its other projects, let alone construct a new homeless shelter. In this case, rather than struggle to meet its day-to-day costs while holding onto millions in untouchable restricted funds, Good Works Charity can petition the court for the authority to use those funds to stay afloat.

In petitioning for a release or modification described above, 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.