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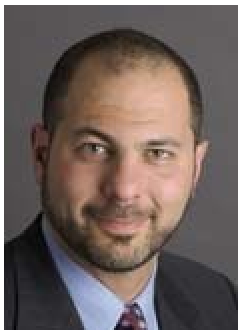
Unscrambling 'MRIs' and 'PRIs'

David Levitt | April 5, 2011


David Levitt

Mission-related investments ("MRIs") and program-related investments ("PRIs") are two distinct tools that can be used by a private foundation to further its mission.

While PRIs must primarily serve a charitable purpose and in many respects are treated similar to grants for tax purposes, an MRI is fundamentally a financial investment rather than a grant and must meet applicable prudent investor standards like more conventional investments.

Despite current common usage, there is no legal definition of an MRI and no legal requirements to qualify for this status.

An MRI can be any investment in which the investor intends to generate both a social (including educational or environmental) return as well as a financial return, so that the ultimate goal of the investment is not exclusively about profit.

A PRI, on the other hand, must meet specific requirements under the federal tax code in order to qualify.

A PRI must be primarily for a charitable purpose, must lack any significant investment purpose, and may not be used for electioneering or lobbying.

In addition to determining whether a proposed investment can meet this test for a PRI, or be prudent enough for an MRI, a private foundation should take into account other tax consequences that flow from making one type of investment over the other.

For instance:

- PRIs typically count towards a foundation's minimum payout requirement; MRIs do not.
- PRIs are exempt from excess business holding restrictions; MRIs are not.
- PRIs may be subject to expenditure responsibility, including reporting obligations and requiring the ability to withdraw from the investment under certain circumstances; MRIs are not.
- MRIs can result in unrelated business taxable income; PRIs will not.

These federal tax rules not only affect a foundation's compliance obligations, but often as a result play a significant role in shaping the actual terms of the investment.

Therefore, a private foundation should consider these implications carefully before making an investment decision.

A foundation also should consider the impact of the proposed investment on the investment recipient and other investors.

Can the recipient reasonably expect to meet, and does it wish to be bound by, the standard that is necessary for a PRI to be primarily about a charitable purpose?

How will other investors react to the investment terms? Will they need to be renegotiated in the future to accommodate further investment?

An MRI, on the other hand, does not require including charitable benchmarks, withdrawal rights, or other PRI restrictions, which reduces the regulatory burden on the foundation and may avoid repelling other more conventional investors.

What about charities other than private foundations?

There is no statutory definition of a program-related investment for non-private foundations that explicitly classifies these investments as charitable.

Nevertheless, other charities still can pursue investments that align with or further their charitable mission.

The IRS Form 990 return filed annually by public charities and other exempt organizations takes program-related investments into account, defining them as "investments made primarily to accomplish the organization's exempt purposes rather than to produce income."

While similar to the statutory definition of a private foundation PRI, there are important differences. In addition, other tax consequences applicable to private foundations would not apply.

To avoid confusion, it may be better to refer to non-foundation investments as something other than "PRIs" to distinguish from those private foundation investments that do need to meet a specific statutory test.

With respect to pursuing MRIs, one initial step a charity should consider is amending its investment policy, if necessary, both to include MRIs as a specific percentage of its overall investment portfolio and to acknowledge that charitable considerations may be taken into account in making investment decisions, consistent with what applicable state law permits.

PRIs are more akin to charitable activities rather than investment activities and therefore typically would not be addressed in the investment policy.

Both MRIs and PRIs can involve integrating a charity's program activities with its investment activities and coordinating both program staff and investment staff to assess and participate in an investment opportunity.

They are a means of, and in many cases require, breaking down any firewall that may exist between these two functions.

While developing the skills and mindset to engage in these investments may be a challenge for charities new to the area, the expanded opportunities to leverage assets in furtherance of mission, as well as generate a financial return, may be worth it.

David Levitt is a principal with Adler & Colvin, a San Francisco-based law firm that works with nonprofits, grantmakers and individual and corporate donors.