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Unrelated Business Income Tax (UBIT): A Primer

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As nonprofits continue to diversify funding streams to decrease reliance on traditional sources of revenue such as grants and membership dues, they are entertaining entrepreneurial business endeavors. While many of these activities are related to their tax-exempt missions, others are not. All nonprofits should consider UBIT[1] implications every time they consider new revenue-generating activities. The IRS, to ensure that tax-exempt organizations are not given an unfair competitive advantage over for-profit commercial entities, added the UBIT rules to ensure that exempt organizations pay their fair share when engaged in commercial activity outside the scope of their exempt purposes. The rules surrounding UBIT are complex. This article outlines some of the key concepts as they apply to 501(c)(3) organizations.[2]

Unrelated business income for most nonprofits is income from an activity if it meets three requirements:

I. It is a trade or business;

II. It is regularly carried on; and

III. It is not substantially related to furthering the exempt purpose of the organization.

The Code defines a "trade or business" as including "any activity which is carried on for the production of income from the sale of goods or the performance of services."[3] This is, of course, a sweeping definition. The truth is that nearly every undertaking of an exempt organization is a business.

A business activity is considered to be regularly carried on if it is pursued in a manner similar to comparable commercial activities. If income-producing activities are of a kind normally undertaken by

1 The IRS has a new Publication 598 (hyperlink), which explains UBIT. (UBIT Code Sections 511-513.)

2 There are also certain exceptions with respect to the operations of 501(c)(7), 501(c)(9), 501(c)(17), or 501(c)(20) organizations. [I.R.C. § 501(c)(20) was repealed]

3 I.R.C. § 513(c).

nonexempt commercial organizations only on a seasonal basis, the conduct of the activities by an exempt organization during a significant portion of the season ordinarily constitutes the regular conduct of a business. For example, the sale of holiday cards only during the holiday period would be considered a business activity regularly carried on. The IRS also considers an activity "substantially related" to the organization's exempt purposes only when the conduct of the business activity has a substantial causal relationship to the achievement of an exempt purpose as stated in the original 1023 application and by the organization's Articles and Bylaws, including any board resolutions on the subject. It is substantially related only if the causal relationship is a significant one.[4]

There are further prongs to the "substantially related" question. Namely, the "size and extent" test, the "same state" rule, the "dual use" rule, and the "exploitation" rule. Moreover, a business activity may be partially related and partially unrelated.

A major overlay to these three main requirements is the "fragmentation" rule. Codified in Section 513(c), this rule permits the IRS to "fragment" an overall business activity into its income producing "parts" and test each of those parts against the UBIT requirements set forth above. The regulations describe the fragmentation rule as follows: "Activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization."[5] A key consideration may be the percentage of the charity's resources devoted to the unrelated business activities. These are outside the scope of this article but worth looking into. There are a number of modifications, exemptions, and exceptions to the general definition of unrelated business income.[6]

There are exclusions[7] for income derived from passive investments such as dividends, interest, annuities, royalties,[8] rents, and capital gains. A "royalty" is a payment for the use of a valuable right, such as a name or logo. A royalty is not taxable to a tax-exempt organization so long as the organization provides only incidental services in connection with receipt of these revenues. Rent is also excluded from UBIT so long as the organization is not in the business of renting real or personal property.[9]

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4 The regulations state that in order for a trade or business to be substantially related, it must bear a "causal relationship" to the accomplishment of the organization's exempt purpose and "contribute importantly" to that purpose. Treas. Reg. § 1.513-1(d)(2).

5 *Id.* § 1.513-1(b).

6 An exception means that the thing left out does not follow the same rule or custom as the other things in that group. An exemption is permission to be left out that is granted by someone with authority.

7 Exclusion of Passive Income, i.e., "Modifications" under I.R.C. § 512(b).

8 *Sierra Club, Inc. v. Comm'r*, 86 F.3d 1526, 1531 (9th Cir. 1996).

9 All of the above rules concerning passive assets are changed if the asset was acquired using borrowed funds. *Unrelated debt-financed income* – If an exempt organization borrows in order to acquire income-producing property, all or part of that income may be subject to UBIT, even if it otherwise would have been excluded under an exception.

Capital gains are always excluded so long as they are truly capital gains. In other words, if the organization is found to be a dealer with respect to the property involved, the resulting income is ordinary income, not capital gains.

In order to evaluate a potential UBIT situation, an organization should:

1) Review the purposes of the organization by examining:
   a. the statement of purposes in its Articles,
   b. language in its Bylaws,
   c. other applicable documents such as the mission statement, Part III in its annual 990, and any board resolutions, andthe original 1023 application.
2) Identify each of the organization's discrete program activities. Check whether the activity was referenced in the organization's application for recognition of tax exemption (Form 1023 or 1024), if one was filed. If it was portrayed as a program activity (related business) in that document, it will be more difficult for the IRS to subsequently assert that the activity is an unrelated business.
3) Evaluate the activity in light of the three requirements. Is the program or activity a trade or business, regularly carried on, and is there a material nexus between the activity and the exempt purposes of the organization?

If the three criteria described above are applicable to a particular business activity, the commercial revenue still may not be subject to UBIT. Decide if it might be the subject of a statutory exception and whether the income involved is the subject of an exclusion such as passive rental income. If not excludable, consider restructuring the activity to take advantage of one of the following exceptions.

Some of the many exceptions to UBIT include the volunteer labor, the donated goods, the convenience of members,[10] and the low-cost exceptions.[11] The volunteer labor exception allows that a business in which substantially all of the work in carrying on the activity is performed by volunteers, i.e., without compensation, is exempt. Likewise, a business that involves selling merchandise in which substantially all items have been contributed to the organization will not incur UBIT. Low-cost items sent to potential donors in order to encourage contributions to the organization will generally not incur UBIT if the donor did not request the distribution, the distribution is made without the express consent of the recipient, and the item is accompanied by a request for a charitable contribution to the organization, along with a statement that the recipient may keep the item regardless of whether he or she makes a contribution. Additionally, any trade or business is excluded from UBIT if it is carried on by an organization for the convenience of its members, students, patients, officers, or employees.

If you determine that revenues are subject to UBIT, file an Unrelated Business Income form (a 990-T) and report the income. That income would be taxed at corporate rates. It

10 I.R.Cs. § 513(a)(2).
11 Some types of Bingo are also exempted.

would also be prudent to use IRS Form 990-W, Estimated Tax on Unrelated Business Taxable Income for Tax-Exempt Organizations. IRS Form 990-W is a worksheet designed to assist in calculating potential UBIT. This form is important because if an organization incurs UBIT in excess of $500.00 during the fiscal year, it must make quarterly estimated tax deposits prior to filing its tax return. Failure to make adequate quarterly tax payments may result in substantial penalties.

Even if a business activity is determined to be subject to UBIT, there is little risk of jeopardizing its tax-exempt status so long as the activity remains insubstantial in relation to the organization's other activities. An organization risks loss of its exempt status if it derives a "substantial" percent of its income from unrelated activities. Neither the IRS nor case law has completely defined the term "substantial" in this context. There is no bright line regarding the percentage of allowable unrelated business income, but as a general rule if unrelated income regularly falls within the range of 15 percent to 30 percent of gross income, it might be prudent to consider establishing a for-profit subsidiary. Certainly, once unrelated income begins to exceed 50 percent, it becomes difficult to demonstrate to the IRS that the organization primarily furthers tax-exempt purposes.

This article does not cover the entirety of the various revenue streams such as advertising income, the treatment of both corporate sponsorships and travel tours, revenue from partnerships or other joint ventures, public entertainment, convention and trade show activity, sponsorship payments, rental or exchange of mailing lists, and business conducted via the Internet.[12] Please see a CPA to maximize the amount of deductible expenses that can be marshaled in computing UBIT. A CPA would be able to adjust some of your revenues to fall within an exemption, for example: if an organization is a partner in a partnership engaged in unrelated business or if it owns S Corporation stock, it would report the income from its partnership or S Corporation holdings as unrelated taxable income. If, however, the organization owns stock in a corporation and receives a dividend, such dividend would fall within this passive investment exception.[13]

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12 Cataloging all of the exceptions has been done meticulously by the leading treatises on exempt organizations. *See* Frances R. Hill & Douglas M. Mancino, *Taxation of Exempt Organizations* (2002 & supp. 2013).

13 IRS Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this document is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter that is contained in this document.

Fiduciary Duties and ESG Investing: Can Charities Adopt Investment Policies That Include Consideration of Environmental, Social, and Governance Factors

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Changes in SRI and the Development of ESG Investing

Socially responsible investing (SRI) is a type of investing that considers social, environmental, and ethical factors together with more traditional financial information in making investment decisions. An SRI investor is someone who wants to effect positive social change while generating financial returns.[1] Although some types of SRI existed earlier, the development of SRI on a larger scale began in the 1960s and 1970s when critics of South African apartheid urged universities and pensions to divest stocks held in companies located in or doing business in South Africa.[2] Some SRI funds included a variety of social, ethical, and environmental issues,[3] and when South Africa abolished apartheid, rather than disappearing, as some expected, SRI took off.

Many early SRI funds used negative screens. In addition to the South Africa screens, the most common negative screens were the "sin stocks": tobacco, alcohol, firearms, and gambling. New strategies developed, and SRI funds began using best-in-class strategies. These strategies use positive screens and look for the best companies within a target group. At the same time SRI investors used shareholder advocacy—proxy voting—to push companies to change in desired ways.

The term "ESG investing" describes an SRI strategy that uses material environmental, social, and governance (ESG) factors, together with traditional financial information, in making investment decisions. Investors began to realize that non-financial data could provide useful information about a company's long-term risks and opportunities. For example, a company that plans to reduce its energy consumption may decrease its costs of production and improve its return to investors. A company that uses foreign suppliers that provide safe working conditions for factory workers might pay more for the labor than another company but have lower risks related to liability, breaks in the supply chain, and negative consumer relations. In contrast, a company that operates with unsafe conditions might experience a catastrophic event that could cause a break in production and result in bad publicity and even boycotts. Some analysts use governance information as a proxy for good management.

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1 *See* Maria O'Brien Hylton, *"Socially Responsible" Investing: Doing Good Versus Doing Well in an Inefficient Market*, 42 Am. U. L. Rev. 1 nn.2–3 (1993) (citing several attempts at defining socially responsible investing).

2 *See* Joel C. Dobris, *Arguments in Favor of Fiduciary Divestment of "South African" Securities*, 65 Neb. L. Rev. 209 (1986); John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 Mich. L. Rev. 72, 72 (1980).

3 *See* Social Investment Forum, After South Africa: The State of Socially Responsible Investing in the United States (1995), http://www.ussif.org/files/Publications/95_trends_Report.pdf (describing issues addressed in early negative and positive screens).

A recent Supreme Court decision holding that fiduciaries have an ongoing duty to monitor investments[4] serves as a reminder that fiduciaries should examine their investment policies periodically. Fiduciaries responsible for charitable funds may wonder whether their investment policies can consider ESG factors as part of the investment strategy. Misinformation about the fiduciary duties of trustees has misled trustees and their lawyers and sometimes blocked even a discussion of this question. The trustees and their advisors need legal guidance that explains how the consideration of ESG factors as part of an investment policy fits within the fiduciary duties of loyalty and prudence. This article describes the fiduciary duties that apply to trustees and directors who manage charitable assets and explains why a prudent investor can consider ESG factors.

Fiduciary Duties of Those Who Manage Charitable Assets

The fiduciaries who manage charitable assets have three core duties: the duty of obedience, the duty of loyalty, and the duty of care (also known as the duty of prudence). These duties all play a role in the fiduciaries' investment decisions, and this article focuses on investment decisions made for endowment assets, both donor-restricted endowments and board-designated endowments.[5] Endowment assets are important for the future ability of a charity to carry out its mission, and may play a direct role in connection with the mission through the manner in which the charity invests the assets.

Duty of Obedience—Fiduciaries Must Carry Out the Mission of the Charity

Fiduciaries should understand the charity's mission and act to support and carry it out.[6] The duty of obedience also requires the fiduciaries to comply with state and federal laws and with any donor restrictions agreed to by the charity. If a donor asks the charity to invest a donation in a particular way and the charity agrees, then the charity must follow that restriction on investment decision-making. For example, a donor might make a gift only if the charity agrees not to invest any portion of the gift in stocks of coal companies. If the charity accepts the gift, then the charity accepts the restriction. The duty of obedience complements the other two key duties—the duties of loyalty and prudence.

Duty of Loyalty—Fiduciaries Must Act in the Sole Interests (Trust Law) or Best Interests (Non-profit Corporate Law) of the Charity

A fiduciary cannot make an investment decision based on private benefit to the fiduciary, to a third party, or for a purpose not related to the charity.[7] Breaches of the duty of loyalty tend to take the form of self-dealing or conflicts of interest. A director might encourage the board of directors to choose her company as the contractor for a new building, or a sole

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4 *Tibble v. Edison Int'l*, 135 S. Ct. 1823 (2015).

5 Uniform Prudent Management of Institutional Funds Act defines endowments as funds that cannot be spent in the current year due to donor restrictions. A board-designated "endowment" can be recharacterized and spent at any time, but typically will be invested on a long-term basis.

6 Restatement (Third) of Trusts § 76 (2007).

7 *Id.* § 78 cmt. f.

trustee might rent office space in a building owned by his father. The transactions might not be breaches of the duty of loyalty, depending on the circumstances and whether the transactions benefited the charity, but the duty of loyalty would come into play. Even if a transaction does not benefit the fiduciary, a breach can occur if the transaction is not in the best interests of the charity. For example, if the directors interviewed three contractors and selected the most expensive one, not because he was better qualified but because he needed the job due to financial hardship, that choice would not be in the charity's best interests. While it would be nice to help the contractor, unless the charity's mission related to providing jobs for financially vulnerable contractors, the choice of contractor would breach the duty of loyalty.

Duty of Care—Fiduciaries Must Manage Assets as a Prudent Person Would; in Investing Assets, Fiduciaries Must Act as Prudent Investors

The fiduciaries must manage the charity's property as a prudent person would, keeping in mind the purposes of the charity.[8] A trustee or director must exercise reasonable care and skill in managing the property, and must use the level of caution appropriate to the circumstances of the charity.[9] A fiduciary must keep the property safe,[10] must not commingle the property with the fiduciary's own property,[11] and must keep proper records and accountings related to the property.[12]

In addition to various duties related to protecting the property, the fiduciary must act as a prudent investor with respect to any investment assets.[13] The prudent investor standard first appeared in a Massachusetts case, *Harvard College v. Amory*,[14] in 1830. The standard took shape over subsequent years, as states adopted it through legislation or case law. Then in the early 1990s the Restatement (Third) of Trusts adopted the prudent investor rule, and shortly thereafter the Uniform Law Commission promulgated the Uniform Prudent Investor Act (UPIA). Most states have adopted UPIA and all states have some version of the prudent investor rule, either through statutes or case law.[15] UPIA is based on modern portfolio theory, an investment theory that correlates returns with risks, posits that diversification can reduce risks, and provides that risk should be judged across a portfolio and not asset by asset. UPIA directs trustees to evaluate investment decisions by considering general economic conditions as well as conditions specific to the trust and its beneficiaries, and to manage the portfolio

8 *See id.* § 77; Unif. Trust Code § 804 (Prudent Administration); Revised Model Nonprofit Corporation Act § 8.30.
9 *See* Restatement (Third) of Trusts § 77 cmt. b.
10 George G. Bogert & George T. Bogert, *The Law of Trusts and Trustees* § 541 (rev. 2d ed. 1993); Unif. Trust Code § 809 (Control and Protection of Trust Property).
11 Bogert & Bogert, *supra* note 10, § 596; Restatement (Third) of Trusts § 84.
12 Restatement (Third) of Trusts § 83.
13 *See id.* § 77 cmt. a (referring to §§ 90-92).
14 26 Mass. (9 Pick.) 446 (1830).
15 Forty-five states have adopted statutes based on UPIA or adopting its principles. The other states have comparable statutes that pre-dated the promulgation of UPIA in 1994. Thus, the principles discussed as the "prudent investor rule" guide fiduciary practice in all states.

with due attention to the appropriate level of risk and return for the trust, depending on its purposes and the circumstances of its beneficiaries.[16] UPIA permits delegation of investment decision-making authority so long as the trustees "exercise reasonable care, skill, and caution" in establishing the scope and terms of the delegation and in selecting and monitoring financial managers.[17] UPIA applies to trusts and, therefore, to charities organized as trusts.

Trust law has long informed the law of charities, so the prudent investor standard applies to fiduciaries of charities however organized. In addition, and more directly, the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which has been adopted in all states except Pennsylvania, applies the prudent investor standard to directors of charities organized as non-profit corporations.[18] Under both UPIA and UPMIFA a prudent investor considers the purposes of the charity and the funds, general economic factors, the appropriate level of risk, appropriate time horizons, and costs associated with different investment options.

The understanding of what it means to be a prudent investor changes over time. In fact, the evolving ideas of what constitutes prudent behavior make prudence valuable as a legal standard. As the norms of investment decision-making change, the standard adjusts and maintains its usefulness.[19]

In the first half of the 20th century, the prudent investor standard focused on conservative investments. In the second half of the 20th century, the standard adjusted as modern portfolio theory influenced investors. Now, in the 21st century, prudence includes a variety of investment strategies, including ESG investing.

Duty of Loyalty—Can a Fiduciary Consider Non-financial Interests of a Charity When Making Investment Decisions?

If a charity acquires assets to use directly in its charitable activities, for example if a university buys a building to use for classrooms or laboratory space, the decision to acquire the assets aligns with the charity's mission. Decisions involving investment assets raise more complicated questions. Fiduciaries investing assets for a charity will seek to maximize income within the charity's risk tolerance so that the income will be available for the purposes of the charity. The charity may also want to use its investments to support its charitable mission. The questions are whether and under what circumstances a charity can consider non-financial interests of the charity when making decisions about investment assets.

The clearest legal support for consideration of a charity's mission in making investment decisions comes from a comment to the prudent investor standard in the Restatement (Third)

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16 UPIA § 2(b).

17 *Id.* § 9(a).

18 ULC website.

19 The Introductory Note to the Prudent Investor Rule in Restatement (Third) of Trusts concurs: "Trust investment law should reflect and accommodate current knowledge and concepts. It should also avoid repeating the mistake of freezing its rules against future learning and developments." Restatement (Third) of Trusts § 90 (2007), Reporter's General Note.

of Trusts. The comment says that a prudent investor must comply with the duty of loyalty[20] and then states:

> [S]ocial considerations may be taken into account in investing the funds of charitable trusts to the extent the charitable purposes would justify an expenditure of trust funds for the social issue or cause in question or to the extent the investment decision can be justified on grounds of advancing, financially or operationally, a charitable activity conducted by the trust.[21]

Because trust law informs the law of charities, and because UPMIFA adopted the language of UPIA, the comment can be considered to be applicable to charities however created. Thus, investments that help to carry out the mission of the charity fall within the duty of loyalty.

Both UPIA and UPMIFA back this conclusion, with provisions that say that a fiduciary shall consider the purposes of the charity in making investment decisions.[22] These acts also say that the fiduciary should consider "an asset's special relationship or special value, if any, to" the "purposes" of the charity.[23] The statutes could be read to mean that a fiduciary should consider the purposes of the charity in determining the appropriate level of risk or the appropriate time horizon for an investment. Nonetheless, both statutes state that a charity's purposes must be considered and neither statute precludes a fiduciary from considering the mission in connection with investments.

If ESG factors relate to a charity's mission, then including those factors as part of an investment policy would comply with the duty of loyalty. For example, the Jessie Smith Noyes Foundation uses its investments to support its mission.[24] If ESG factors do not clearly relate to a charity's mission, however, then the duty of loyalty might preclude ESG investing if below-market returns resulted. This is the concern voiced in an official comment published with UPIA:

> No form of so-called "social investing" is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries—for example, by accepting below-market returns—in favor of the interests of the persons supposedly benefitted by pursuing the particular social cause.[25]

The comment to UPIA was published in 1994, at a time when little data on performance of SRI funds existed. A common assumption at that time was that SRI as then practiced would result in lower returns, due to restrictions on diversification. Empirical studies have now shown that the effect of SRI on fund performance is most often neutral or positive. The

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20 *Id.* § 90(c)(1).
21 *Id.* § 90 cmt. c.
22 UPIA § 2(a); UPMIFA § 3(a).
23 UPIA § 2(c)(8) (1994); UPMIFA § 3(e)(1)(H).
24 Jessie Smith Noyes Foundation, Investment Policy, http://www.noyes.org/mission-based-investing/investment-policy (last visited Aug. 3, 2015).
25 UPIA § 5 cmt.

concern voiced in the comment, that investments would be used for a social purpose unrelated to the beneficiaries' interests, at a financial cost to the beneficiaries, does not apply to ESG investing when conducted as part of an overall investment strategy that evaluates financial and material non-financial factors.

Duty of Prudence—Can a Prudent Investor Consider ESG Factors in Making Investment Decisions?

The prudent investor standard is an industry norm, so looking at what other prudent investors do provides guidance for trustees. Three types of information indicate increased use of ESG factors in making investment decisions. First, empirical studies comparing funds using some form of SRI with non-SRI funds have shown neutral or positive results from the use of SRI.[26] Second, a study has shown that financial analysts access ESG information, presumably for use in evaluating companies.[27] And third, companies increasingly use sustainability reporting or integrated reporting to reach various constituencies.[28]

Different forms of SRI have been analyzed empirically to compare the results of SRI funds with those of non-SRI funds over both short and long time periods. The general findings of most of these empirical studies are that SRI funds perform as well as or better than non-SRI funds. The studies that focus on ESG investing found better results for funds using that strategy. Funds that used negative screens as the sole SRI strategy performed the least well, although the majority of those funds showed a neutral rather than negative correlation.

For example, a 2012 Deutsche Bank meta-study reviewed more than 100 academic studies, 56 research papers, and four other meta-studies and found that companies with high ratings for CSR and ESG have a lower cost of capital, both debt and equity.[29] All of the companies with high ratings in CSR showed market- and accounting-based outperformance, and for companies with high ratings in ESG, 89% of the studies showed market-based outperformance and 85% showed accounting-based outperformance. High ratings in either category correlated with overperformance in corporate financial performance. In looking at funds, the study found results on performance either neutral or mixed.

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26 *See, e.g.*, Christophe Revelli & Jean-Laurent Viviani, *Financial Performance of Socially Responsible Investing (SRI): What Have We Learned? A Meta-Analysis*, 24 Bus. Ethics: A European Rev. 158 (2015) (an international study finding neutral results); Deutsche Bank Group, Sustainable Investing: Establishing Long-Term Value and Performance (June 2012), https://institutional.deutscheawm.com/content/_media/Sustainable_Investing_2012.pdf (meta-study finding that companies with high ratings in CSR and ESG overperformed in corporate financial performance and have a lower cost of capital than other companies); The Asset Management Working Group of the United Nations Environment Programme Finance Initiative & Mercer, Demystifying Responsible Investment Performance (Oct. 2007), http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf (meta-study of 20 studies analyzing ESG factors found neutral or positive results in all but with three studies, and those used screening as a strategy); Robert G. Eccles et al., *The Impact of Corporate Sustainability on Organizational Processes and Performance* (Harv. Bus. Sch., Working Paper No. 17950, 2012) (finding that companies that had integrated social and environmental issues into their business structure and policies outperformed those that had not).

27 Robert G. Eccles et al., *Market Interest in Nonfinancial Information* 1 (Harv. Bus. Sch., Working Paper No. 12-018, 2011) (providing information about market interest in ESG data).

28 *Id.*

29 Sustainable Investing, *supra* note 26.

A 15-year study published in 2011 showed that companies that integrated social and environmental issues into company policies and strategies outperformed companies that did not do so, both in stock market performance and accounting performance.[30] Perhaps for that reason, financial analysts increasingly use ESG information. One study counted "hits" when the analysts accessed the ESG data on Bloomberg's database and found a significant level of interest.[31] Although the study did not show how analysts used the data, the authors suggest that the analysts likely want to understand whether companies are using ESG information and also probably link transparency with good governance. Another study demonstrated that analysts recommend companies with strong CSR ratings more favorably than companies with lower ratings.[32]

Over 1200 institutional investors have signed the U.N. Principles for Responsible Investment.[33] These investors have agreed to incorporate ESG factors into their investment decision-making and to push companies to disclose information about their ESG practices.[34] The Principles encourage investors to consider ESG factors as part of a conventional investment analysis.

A challenge for investors who want to use ESG information to evaluate companies has been the lack of standardized reporting. In recent years, investors, customers, and other stakeholders have requested non-financial as well as financial information about companies, and in response more companies have issued sustainability reports. The number of S&P 500 companies disclosing ESG information rose from 19-20% in 2010 to 53% in 2012,[35] and a survey published in 2013 found that 71% of the 100 largest companies in 41 countries and 93% of the world's 250 largest companies reported on corporate responsibility or sustainability.[36] Many of the companies reporting use a Sustainability Reporting Framework developed by the Global Reporting Initiative.[37]

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30 *Impact of Corporate Sustainability*, *supra* note 26 (finding that companies that had integrated social and environmental issues into their business structure and policies outperformed those that had not).

31 *Market Interest in Nonfinancial Information*, *supra* note 27, at 1.

32 Ioannis Ioannou & George Serafeim, *The Impact of Corporate Social Responsibility on Investment Recommendations: Analysts' Perceptions and Shifting Institutional Logics*, Strategic Mgmt. J. (forthcoming 2015) (citing to a number of studies and scholarly articles describing the importance to companies of establishing CSR policies and practices).

33 U.N. Principles for Responsible Investment, PRI Fact Sheet, http://www.unpri.org/news/pri-fact-sheet/ (last visited Aug. 3, 2015).

34 U.N. Principles for Responsible Investment, The Six Principles, http://www.unpri.org/about-pri/the-six-principles/ (last visited Aug. 3, 2015).

35 Governance and Accountability Institute, 2012 Corporate ESG/Sustainability/Responsibility Reporting –Does It Matter?, at 3 (2012), http://www.ga-institute.com/fileadmin/user_upload/Reports/SP500_-_Final_12-15-12.pdf.

36 *See* KPMG International, The KPMG Survey of Corporate Responsibility Reporting 2013 (Dec. 2013), https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/corporate-responsibility/Documents/corporate-responsibility-reporting-survey-2013-exec-summary.pdf.

37 Global Reporting Initiative, What Is GRI?, https://www.globalreporting.org/information/about-gri/what-is-GRI/Pages/default.aspx (last visited Aug. 3, 2015).

In order to provide financial and non-financial data in one integrated report, the International Integrated Reporting Council released an integrated reporting framework in 2013.[38] Companies can use General Accepted Accounting Principles for the financial information presented in an integrated report and Sustainability Accounting Standards Board (SASB) standards for the non-financial information. SASB has already developed standards for seven sectors and will finish the remaining sectors by 2016.[39] Once SASB completes the sustainability standards, companies will have a framework and standards to use for reporting. As sustainability reporting becomes standardized, investors will be able to use the information more easily and more effectively.

Studies have shown that ESG investing does not result in a cost to a portfolio. Thus, a prudent investor can consider ESG factors in making investment decisions, and can invest in SRI funds using ESG factor strategies without worrying about breaching the duty of care. Prudence is a market standard, based on what prudent investors do, and increasingly investors pay attention to ESG factors. ESG factors tend to identify long-term strengths or risks, and thus a charity concerned about its long-term viability, through its endowment or otherwise, may be particularly interested in incorporating ESG factor analysis into its investment policy.

Fiduciaries Managing a Charity Can Adopt an ESG Strategy

The fiduciaries managing charitable funds must comply with the duty of obedience to the mission of the charity, the duty of loyalty to act in the best interests of the charity, and the duty of care to manage the funds as a prudent investor would. For some charities, ESG factors will align with their mission and incorporating ESG investing into the charity's investment policy will further that mission. For other charities, the link between mission and ESG factors will be less clear. Both groups of charities can adopt ESG investing because ESG analysis complies with the duty to act as a prudent investor.

The prudent investor standard continues to evolve to adapt to new investment strategies. A decision to incorporate ESG investing as part of the investment policy does not necessitate a cost to the portfolio and thus will not be considered a breach of the duty of loyalty or prudence. Thus, a prudent investor can consider ESG investing as part of an overall strategy that considers financial and material non-financial information in making investment decisions. Indeed, given the recent Supreme Court decision holding that fiduciaries have an ongoing duty to monitor investments, fiduciaries should review their investment policies and consider whether changes are appropriate.

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38 International Integrated Reporting Council, The International <IR> Framework (Dec. 2013), http://integratedreporting.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf.

39 *See* Sustainability Accounting Standards Board, http://www.sasb.org/standards/status-standard/ (last visited Aug. 3, 2015); Sustainability Accounting Standards Board, Vision and Mission, http://www.sasb.org/sasb/vision-mission/ (last visited Aug. 3, 2015).

NOLS Brown Bag Lunch Discussions

The Nonprofit Organization Law Section is pleased to offer a brown bag lunch discussion series in an effort to provide section members an opportunity to connect with peers and discuss issues they are encountering in their practice in an informal, collegial setting.

Brown bag lunch discussions are scheduled as follows

Wednesday, August 12, 2015
Wednesday, November 4, 2015

Please note, this is not a lecture format. Attendees will be encouraged to engage in the discussion, share challenges they have encountered, as well as practices they have found to be effective.

All brown bag lunch discussion will be held from noon – **1:00 p.m.** at the offices of **Tonkon Torp, LLP, 888 SW 5th Ave., Suite 1600, Portland, Oregon 97204**. Please note, this is not a lecture format. Attendees are encouraged to engage in the discussion, share challenges they have encountered and practices they have found to be effective. A conference call number will be provided for those who cannot attend in person and would like to participate by phone. Please contact Susan Bower at susan.a.bower@doj.state.or.us.

The **NOLS Newsletter** is published quarterly by the Nonprofit Organizations Law Section of the Oregon State Bar.

NOLS Publications Committee:

Susan Bower, Chair
Anne O'Malley
Jane Hanawalt
Matthew Lowe

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The purpose of this newsletter is to provide information on current developments in the law. Attorneys using information in this publication for dealing with legal matters should also research original sources and other authorities. The opinions and recommendations expressed are the author's own and do not necessarily reflect the views of the NOL Section or the Oregon State Bar.

Oregon State Bar

Advanced Topics in Nonprofit Law

Cosponsored by the Nonprofit Organizations Law Section

Register now at osbar.inreachce.com (search for NP15)

Friday, September 18, 2015

8:30 a.m. – 4:30 p.m.

Oregon State Bar Center
16037 SW Upper Boones Ferry Road, Tigard

CLE credits: 6.25 General and 1 Ethics

Register at **osbar.inreachce.com** *(search for NP15)*

With more than 22,000 nonprofit organizations calling Oregon home, attorneys who advise them need to be well-versed on a wide variety of nonprofit issues. This advanced level seminar is a great resource if you have a practice that touches the nonprofit world. Explore nonprofit fraud trends and prevention, and learn how to handle audit response letters using ABA guidelines. Take a look at the latest legislative changes and case law. Understand how SRI and ESG factors can impact a charity's investment strategy. Discuss ethical considerations when representing nonprofits. Examine the framework for utilizing a fiscal sponsor, and hear one attorney's experience with crowdfunding and nonprofits. You will also receive an overview of nonprofit mergers, including alternatives.

Register by 9/14/15 and save $20.

Nonprofit Organizations Law Section members save $20 off registration rates.

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Use your credit card or pay by check (select electronic check or mail-in/fax-in check at the online checkout).

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Call the OSB CLE Service Center at (503) 431-6413 or (800) 452-8260, ext. 413, for assistance.

LIVE EVENT

Early registration discount
—Register by 9/14/15 and save $20.

$125 New lawyer (*admitted after 1/1/13*)

$180 NOL Section member

$200 OSB Member

$210 Non-OSB member

A box lunch is included in registration fee courtesy of the Nonprofit Organizations Law Section.

$ 15 Print course materials (*Electronic materials are included with your registration.)*

LIVE WEBCAST

$200 Webcast registration
(Includes online access to recorded seminar for 60 days after the live event.)

Agenda

7:30 **Registration**

8:30 **Nonprofit Fraud: Trends, Investigation and Prevention**

- Legal, practical, and law enforcement perspectives on fraud and embezzlement in the charitable world

Detective Elizabeth Cruthers, *Portland Police Bureau, White Collar Crime Unit, Portland*

Kris Kalanges, *CPA, Financial Investigator, ODJ, Charitable Activities Section, Portland*

Douglas Pearson, *CFE, Chief Investigator, ODJ, Charitable Activities Section, Portland*

Detective Brian Sitton, *Portland Police Bureau, White Collar Crime Unit, Portland*

9:30 **Audit Response Letters**

- Utilizing the ABA guidelines
- Obtaining client consent and approval of response
- Protecting attorney-client privilege and work product
- Determining materiality to financial statements

Jane Hanawalt, *Law Offices of Jane C. Hanawalt, Florence*

10:00 **Break**

10:15 **Legislative/Caselaw Update**

Michele Wasson, *Stoel Rives LLP, Portland*

11:00 **From SRI to ESG: Using Environmental Social and Governance Factors as Part of a Charity's Investment Strategy**

- Developments in socially responsive investing (SRI)
- Duty of loyalty and mission-related investing
- The evolution of the prudent investor standard

Professor Susan Gary, *University of Oregon School of Law, Eugene*

11:45 **Nonprofit Organizations Law Section Annual Meeting**

Susan Bower, *Chair, NOL Section*

Thank you to the Nonprofit Organizations Law Section for generously sponsoring lunch.

Noon **Lunch**

(Box lunch included with registration. Please make your selection when registering.)

12:45 **Current Ethical Issues in Representing Nonprofits**

- Boards in conflict
- Representing multiple related entities
- Ethical boundaries when serving on multiple boards

Helen Hierschbiel, *Oregon State Bar, Tigard*

1:45 **Fiscal Sponsorships**

- When to use a fiscal sponsor
- Common types of fiscal sponsor relationships
- Fiscal sponsor duties
- Writing a Fiscal Sponsor Agreement (FSA)

David Atkin, *Center for Nonprofit Law, Eugene*

2:45 **Break**

3:00 **Crowdfunding and Nonprofits: One Practitioner's Experience**

- Crowdfunding: How is it done?
- Legal pitfalls
- Board responsibilities
- Potential for fraud

Earl Christison IV, *Novation Law, Keizer*

3:30 **Mergers**

- Overview of the merger process
- Steps of a merger
- Alternatives

Cynthia Cumfer, *Attorney at Law, Portland*

4:30 **Adjourn**

Planning Committee

David Atkin, *Center for Nonprofit Law, Eugene*

Richard Baroway, *Tomasi Salyer Baroway, Portland*

Nancy Chafin, *Chafin Law Firm, Portland*

Jane Hanawalt, *Law Offices of Jane C. Hanawalt, Florence*

Nancy Murray, *Attorney at Law, Portland*

Products

DVDs and audio CDs will be available approximately two weeks after the live program. Please call the OSB CLE Service Center at (503) 431-6413 or (800) 452-8260, ext. 413, to place your order.

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