

Community trusts; provisions of governing instruments. Examples are given of provisions in the governing instruments of community trusts that meet the requirements of section 1.170A-9(e)(11)(v)(B) of the regulations.

Advice has been requested whether the governing instrument provisions set forth below as examples satisfy certain requirements of the Income Tax Regulations under section 170(b)(1)(A)(vi) of the Internal Revenue Code of 1954 as they apply to community trusts. A community trust that is described in section 170(b)(1)(A)(vi) is not a private foundation by reason of section 509(a)(1).

Section 1.170A-9(e)(11)(i) of the regulations provides that a community trust that meets certain requirements will be treated as a single entity rather than as an aggregation of separate funds. Section 1.170A-9(e)(11)(v)(B) of the regulations provides that as one of these requirements the governing body of a community trust must have the power in its governing instrument or otherwise--

(1) To modify any restriction or condition on the distribution of funds for any specified charitable purposes or to specified organizations, if in the sole judgment of the governing body (without the necessity of the approval of any participating trustee, custodian, or agent), such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served;

(2) To replace any participating trustee, custodian, or agent for breach of fiduciary duty under State law; and

(3) To replace any participating trustee, custodian, or agent for failure to produce a reasonable (as determined by the governing body) return of net income (within the meaning of section 1.170A-9(e)(11)(v)(F) of the regulations) over a reasonable period of time (as determined by the governing body).

EXAMPLE 1. A community trust's articles of incorporation include the following provisions;

Powers of Governing Board

(1) The Board of Directors shall have the power

(a) to modify any restriction or condition on the distribution of funds for any specified charitable purposes or to specified organizations, if in their sole judgment (without the approval of any trustee, custodian, or agent), such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with

the charitable needs of (name of community or area served);

(b) to replace any participating trustee, custodian, or agent for breach of fiduciary duty under the laws of the State of ___; and

(c) to replace any participating trustee, custodian, or agent for failure to produce a reasonable (as determined by the Board of Directors) return of net income (or appreciation when not inconsistent with this community trust's need for current income) with due regard to safety of principal, over a reasonable period of time (as determined by the Board of Directors).

(2) In determining whether there is a reasonable return of net income with respect to the exercise of the power described in subparagraph (c) of Paragraph (1) of this Article,

(a) there shall be excluded from such determination such assets as are held for the active conduct of this community trust's exempt activities; and

(b) such determination shall be made separately with respect to each restricted fund and shall be made in the aggregate with respect to the unrestricted funds of this community trust.

A 'restricted fund' means a fund, any income of which has been designated by the donor of the gift or bequest to which such income is attributable as being available only for the use or benefit of a named charitable organization or agency or for the use or benefit of a particular class of charitable organizations or agencies, the members of which are readily ascertainable and are less than five in number.

(3) If it appears that there may be grounds for exercising the power described in subparagraphs (b) or (c) of Paragraph 1 of this Article with respect to any fund, the Board of Directors shall notify the participating trustee, custodian, or agent involved and provide a reasonable opportunity for explanation and/or correction. Before exercising the power granted to the Board of Directors under subparagraphs (b) or (c) of Paragraph 1 of this Article, the Board of Directors may seek advice of legal counsel as to whether a breach or failure has been committed under the laws of the State of _____. The Board of Directors shall exercise a power described in this Article only upon the vote of (not more than a simple majority) of the members of the Board of Directors.

(4) Upon the exercise of the power under subparagraphs (b) or (c) of Paragraph 1 of this Article to replace any participating trustee, custodian, or agent, the Board of Directors shall have the power to select a successor trustee,

custodian, or agent to whose custody the fund or funds held by the former trustee, custodian, or agent shall be transferred.

EXAMPLE 2. The community trust's creating document is a trust indenture. The indenture includes the following provisions;

(1) Any other provisions notwithstanding in this instrument or in any instrument making a transfer creating or adding to a fund or trust under this instrument, the Distribution Committee (or governing body) shall have the following powers:

(a) to modify any restriction or condition on the distribution of funds for any specified charitable purposes or to specified organizations, if in the sole judgment of the Distribution Committee (without the approval of any participating trustee, custodian, or agent), such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of (name of community or area served);

(b) to replace any participating trustee, custodian, or agent for breach of fiduciary duty under the laws of the State of ___ and

(c) to replace any participating trustee, custodian, or agent for failure to produce a reasonable (as determined by the Distribution Committee or governing body) return of net income (or appreciation when not inconsistent with this community trust's need for current income), with due regard to safety of principal, over a reasonable period of time (as determined by the Distribution Committee or governing body).

(2) Any other provisions notwithstanding in this instrument or any instrument of transfer, the determination whether there is a reasonable return of net income with respect to the exercise of the power described in subparagraph (c) of Paragraph (1) of this Article shall be made separately with respect to each restricted trust or fund and shall be made in the aggregate with respect to unrestricted trusts or funds of this community trust. As used herein, the term 'restricted trust or fund' means a trust or fund, any income of which has been designated by the donor of the gift or bequest to which such income is attributable as being available only for the use or benefit of a named charitable organization or agency or for the use or benefit of a particular class of charitable organizations or agencies, the members of which are readily ascertainable and are less than five in number.

(3) If it appears that there may be grounds for exercising the power described in subparagraphs (b) or (c) of paragraph 1 of this Article with respect to any fund or trust, the Distribution Committee (or governing body) shall notify the

participating trustee, custodian, or agent involved and provide a reasonable opportunity for explanation and/or correction. Before exercising the power granted to the Distribution Committee (or governing body) under subparagraphs (b) or (c) of paragraph 1 of this Article the Distribution Committee (or governing body) may seek advice of legal counsel as to whether a breach or failure has been committed under the laws of the State of _____. The Distribution Committee (or governing body) shall exercise a power described in this Article only upon the vote of (not more than a simple majority) of the members of the Distribution Committee (or governing body).

(4) Upon the exercise of the foregoing power to replace any participating trustee, custodian, or agent, the Distribution Committee (or governing body) shall have the power, subject to the approval of the _____ Court, where appropriate, to select a successor trustee, custodian, or agent to which the fund or funds held by the former trustee, custodian, or agent shall be transferred.

The provisions set forth above in Examples 1 and 2 provide the governing body (the Board of Directors or Distribution Committee) of a community trust with the power to modify any restriction or condition on the distribution of funds for any specified charitable purposes or to specified organizations, to replace any participating trustee, custodian, or agent for breach of fiduciary duty under State law, and to replace any participating trustee, custodian, or agent for failure to produce a reasonable return of net income over a reasonable period of time.

The language of the provisions set forth in Examples 1 and 2 is not the only language that a community trust may use to satisfy the requirements of section 1.170A-9(e)(11)(v)(B) of the regulations; however, if a community trust adopts the provisions as set forth in Example 1 or 2, it will satisfy those requirements.