IS PHILANTHROPY THE RIGHT WORD ANYMORE? NEW APPROACHES FOR DONORS AND THEIR ADVISERS

RICHARD J. DUFFY AND AVERY TUCKER FONTAINE

This article examines how to advise wealthy families and the nonprofits they support to adjust strategy in the new environment for philanthropy.

Topsy turvy; the new environment for philanthropy

In what is arguably the equivalent of the philanthropist's inverted yield curve, currently over $502 billion[1] worth of global capital seeks opportunities in both revenue and social return models for direct investment, while $427.71 billion[2] domestically seeks pure social return in traditional philanthropy. It took over 50 years to build the philanthropic marketplace in the United States to this level; in less than a decade, the estimated market size of direct investment into double and triple bottom line entrepreneurs has outpaced domestic philanthropic giving.

What is happening here? Are we, as critics claim, becoming ever more polarized, with philanthropy and social impact investing the latest tools to divide us? Or, are we just really frustrated? We have not solved our biggest issues in 50 years of modern philanthropy, which has never budged beyond 2% of Gross Domestic Product.

What other solutions can we find? Maybe, as Ross Baird so eloquently describes in his book, *The Innovation Blind Spot,*[3] we stop thinking in a binary way about capital. It does not have to seek only profit or only social good. We no longer have two distinct pockets; we have one big pocket seeking returns along a spectrum, based on our individual value systems. As Ross Baird notes, we have gone from two-pocket thinking to one-pocket thinking, and in order to accomplish that, we need to be more ambitious for each local community. Remember—think globally, act locally. Turn this "philanthropy with a Capital P" thing on its ear.

The logistics are daunting. How do we mass customize meeting the demands of those with financial means, each with a different goal in mind? We are doing it in every other industry. Look at the iPhone, Amazon, and donor advised funds. Why not wealth management and estate planning?

The next logical question becomes: How do we advise wealthy families and the nonprofits they support to adjust strategy in this new environment? We cannot ignore the logic that drives many wealthy families' decisions—tax-efficient investing and estate planning. Can benefactors feel good about efficiency? Yes, except funding social solutions is not an efficient market. Therein lies the opportunity. So let us harness some of that market power for better social outcomes.

A portfolio approach to deploying capital across various models to fund social goals seems quite technical, and it can be. In order to break it down, we begin with a framework.

RICHARD J. DUFFY is a partner at the law firm of Phillips Nizer LLP, New York City, and a member of the firm's Private Client Services Group. AVERY TUCKER FONTAINE is Head of Strategic Philanthropy at BNY Mellon Wealth Management.

EXHIBIT 1
Fund the Ecosystem: Social Investment Continuum

Traditional Nonprofits	Nonprofits with Income Generating Model	For Profit Social Ventures	Socially Responsible Businesses	Traditional For Profits
Organizations structured for a public or mutual benefit other than generating profit for owners or investors.	Nonprofits that incorporate some form of revenue generation through commercial means into their operations.	For-profit venture that measures both profit and a social outcome. Can include a third measure for environment. Double or Triple Bottom Line Model.	For-profit business focused on both maximizing profits for shareholders and giving back to the wider community. Often a Private B or Benefit Corporate Designation	For-profit public company that integrates Environmental, Social and Governance (ESG) concerns into core business and financial decisions.
Grant Support	Grant Support Equity Sub Loans Senior Loans Cash	Loan Guarantee Equity Sub Loans Senior Loans Cash	Cash Private Equity Sub Loans Senior Loans	Common Stock Debt Securities Preferred Stock

The Social Investment Continuum

The Social Investment Continuum (a version of that created by the FB Heron Foundation) provides a basic outline to begin advising families, individuals, and nonprofits (see Exhibit 1). Because donors are using new methods of funding change, nonprofits also have to adapt strategy to meet burgeoning demand.

Let us focus first on donor behavior.

How does this work?

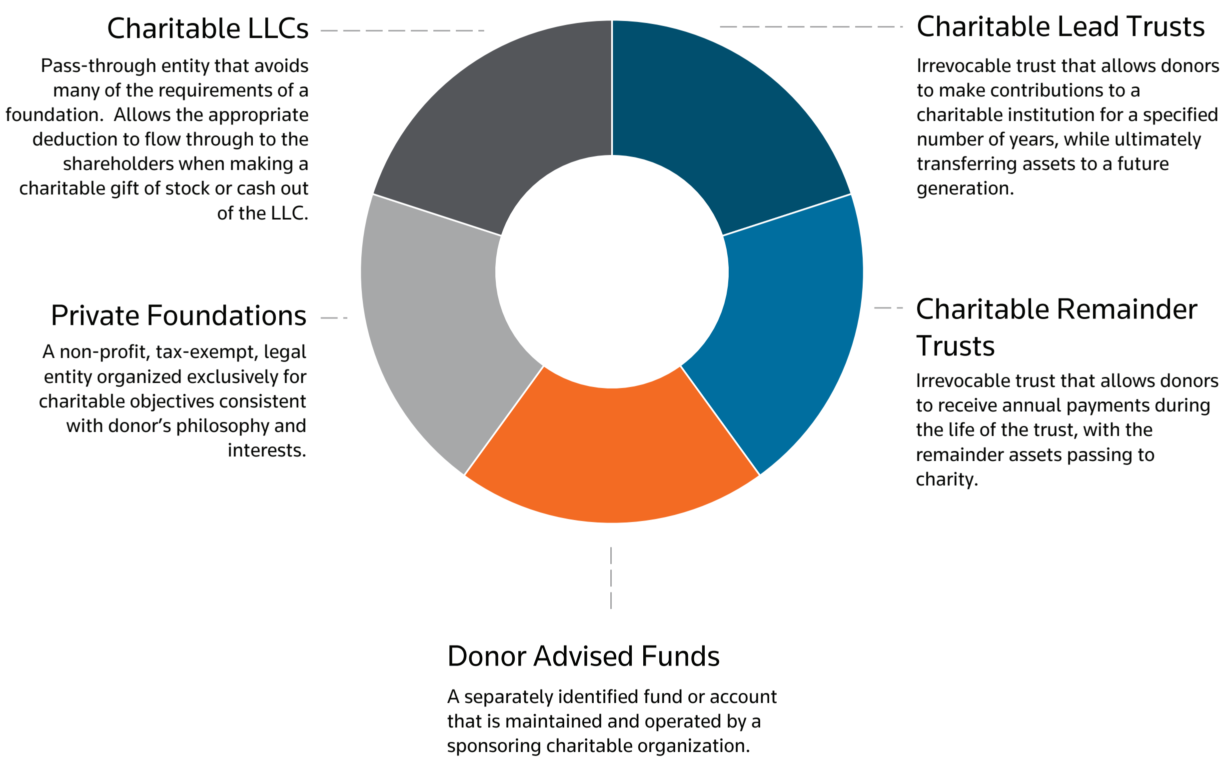
Ultimately, where traditional philanthropy ends, new funding models, impact investing in particular, are picking up the baton to continue funding social innovations. Donors no longer have to choose between two polar organization types: nonprofit vs for-profit. Instead, donors can be both philanthropic and savvy investors across a spectrum of models aligned with their specific values. The idea that a good business model solves a problem, regardless of tax identification type, compels donors to think beyond traditional philanthropy.

What does it mean to deploy capital for good across both nonprofit and for-profit models?

Education/at-risk youth example. The Pearce Family[4] does not consider themselves extremely wealthy, but are comfortable and have means to share. The husband and wife have run a business for many years and are in the middle of succession planning. In discussions with their lawyer, they want to ensure their philanthropic ideals are passed on to the great-grandchildren they may or may not meet. They are aware, however, that times are changing and they want to tweak their philanthropy to be modern and meet the demands of their Generation X, Y, and Z children and grandchildren.

1 2019 GIIN Impact Investor Survey, The Global Impact Investing Network (GIIN).
2 Giving USA 2019: The Annual Report on Philanthropy for the Year 2018.
3 *The Innovation Blind Spot*, by Ross Baird, September 2017, BenBella Books.
4 Fictitious family—for demonstration purposes.

EXHIBIT 2
Fund the Ecosystem: Organizing Your Philanthropy to Fund Models



Their passion has always been the value of education, with a focus on how to help low-income students succeed. Recently, the Pearce Family has been frustrated with the college admissions scandals and is concerned about the best way to go about preserving their social values for future generations. Words like "philanthropy" and "legacy" seem too high-minded. They want to see results. They know their approach needs partnership across different kinds of models and new ideas. It needs disruption, so they consider the below options as a starting point:

- *Nonprofits*: Continue making grants to the institutions the family knows and loves—after-school programs, scholarship programs, church programs, and alma maters.
- *Nonprofit with revenue-generating model*: Loan money to a nonprofit running a daycare program; provide equity, debt, or grant funding to a student loan nonprofit business model. *For example:* grant to a community development finance institution (CDFI) making micro-loans to local entrepreneurs focused on education and at-risk youth issues. Pay for Success models work well here also.
- *For-purpose social venture*: Invest equity, debt, or sign a loan guarantee to support education technology startups using gaming, artificial intelligence (AI), and coding skills applicable to students, teachers, and school systems. *For example:* video games designed to reduce anxiety in children and young adults, models supporting early reading for first through fifth graders (data shows steep declines in graduation and earning rates if children cannot read on grade level by fifth grade).
- *Socially responsible business*: Invest in a company, perhaps a B-Corp, hiring from underserved communities or benefiting educational outcomes. *For example:* Education Funding Partners, Laureate Education, Better World Books, HoneyBee (addresses predatory lending practices for young adults building credit, paying off student loans, etc.).

5 Fictitious family—for demonstration purposes.

6 *The Creative Economy: How People Make Money From Ideas*, by John Howkins, November 2013, Penguin UK.

7 P.L. 115-97, 131 Stat. 2054, 12/22/17.

EXHIBIT 3

Fund the Ecosystem: Deploying Capital to Reflect Values

	Traditional Nonprofits	Nonprofits with Income Generating Model	For Profit Social Ventures	Socially Responsible Businesses	Traditional For Profits
	Organizations structured for a public or mutual benefit other than generating profit for owners or investors.	Nonprofits that incorporate some form of revenue generation through commercial means into their operations.	For-profit venture that measures both profit and a social outcome. Can include a third measure for environment. Double or Triple Bottom Line Model.	For-profit business focused on maximizing profits for shareholders and giving back to the wider community. Often a Private B or Benefit Corporate Designation.	For-profit public company integrating Environmental, Social and Governance (ESG) concerns into core business and financial decisions.
Funding Type	• Grant Support	• Grant Support • Equity • Sub Loans • Senior Loans • Cash	• Loan Guarantee • Equity • Sub Loans • Senior Loans • Cash	• Cash • Private Equity • Sub Loans • Senior Loans	• Common Stock • Debt Securities • Preferred Stock
Charitable Vehicle Application	• Charitable Lead Trust • Charitable Remainder Trust • Private Foundation • Donor Advised Fund • Charitable LLC	• Charitable Lead Trust • Charitable Remainder Trust • Private Foundation (Grants, PRI, Pay for Success) • Donor Advised Fund (grant or loan guarantee) • Charitable LLC (grant, equity or debt)	• Private Foundation (PRI, Pay for Success) • Donor Advised Fund (loan guarantee, equity or debt) • Charitable LLC (equity or debt) • All Vehicles: Direct investment in social venture fund for equity or debt.	• All Vehicles: Direct investment in B corps, businesses solving a social or environmental problem, private equity or debt for double or triple bottom line models, and social venture funds	• All Vehicles: Debt or equity investment in a sustainably run business, a business solving a social or environmental problem, responsible investment strategies, private equity or debt for double or triple bottom line models and social venture funds • Divestment from businesses that are not aligned with personal values or beliefs

- *Traditional for-profit companies*: Invest in a traditional public company or investment strategy, such as an exchange-traded fund (ETF), mutual fund, private equity, or debt which involve refinancing student debt, funding education more responsibly, creating opportunities for the next generations, or tackling teen and young adult addiction, as examples.

Next, let us explore an example of donor behavior geared toward helping nonprofits compete in a disrupted environment as they fund across the spectrum.

Arts/culture/creative economy example. The Davis Family[5] has a multi-generational passion for the arts, which began with their great-grandparents' trips to Europe in the 1920s. Not only did they become collectors, but they also became advocates for the benefits of sound design in all areas of life. In the past 20 years or so, the concept developed by John Howkins in *The Creative Economy*[6] perfectly describes their view on the relevance and unique contribution the arts have in our social fabric.

Next generation: The family is bringing on their next generation and is interested in moving beyond pure check-writing philanthropy. They currently give to several museums and art collectives, but they are frustrated because their traditional philanthropy is beginning to feel stale. They often ask their professional advisers: Am I doing any good writing these checks? What am I accomplishing through philanthropy?

The professional advisers may hear these questions and assume the family is tiring of their philanthropic giving, which can be a misconception because often the opposite is true. The doubts/concerns we hear are often a request for help. One solution is to use the spectrum above to dive deeper into their interests and to expand the family's understanding of how many ways creative thinking and design principles are needed in today's economy.

What does it look like for the Davis Family to fund across the spectrum of social investment?

- *Nonprofits:* Continue making grants to the institutions the family knows and loves. Perhaps expand the traditional grant-making across various constituencies: children and teenagers, adults, arts funding in lower-income school districts. Or, partner with the same institutions specifically to help them compete more effectively. Fund a digital marketing position or vendor, fund overhead for improving technology systems, work to increase their capacity to partner across the spectrum. Another option: partner with a favorite museum to create a fund to invest in local creative economy entrepreneurs.
- *Nonprofit with revenue-generating model:* Loan money to restore an historic theater as the cornerstone of a downtown revitalization project. Fund public/private partnerships to improve outcomes in public school arts education programs. *For example:* aggregate effectiveness by lending or granting to a CDFI, making loans to local entrepreneurs focused on creative economy models, usually local craftsmen, community revitalization projects, or any disrupter using a design-focused solution to solve environmental, education, or homelessness issues.
- *For-purpose social venture:* Invest equity, debt, or sign a loan guarantee to support arts education, technology startups using virtual reality, gaming, and design-centered problem-solving. *For example:* video games designed to reduce anxiety in children and young adults are relevant here as well. ArtLifting (sells art/supports homeless population); Equinox Studios (affordable artist work space in Seattle).
- *Socially responsible business:* Invest in a company, perhaps a B-Corp, hiring from or benefiting the arts. *For example:* Etsy, Kickstarter, Patagonia, Creative Action Network, venture funds focused on social measures, like Village Capital, RSF Ventures, and SJF Ventures.
- *Traditional for-profit companies:* Invest in ETFs, mutual funds, or directly into companies addressing the targeted issues. Food security,

Services and Information

TAXATION OF EXEMPTS

TO ORDER

Subscription Department 1-800-431-9025

FAX 1-800-452-9009

Internet http://store.tax.thomsonreuters.com/accounting/Brand/WGL/c/3700

Or mail to:
Thomson Reuters
P.O. Box 115008, Carrollton, TX 75011-5008

CUSTOMER SERVICE

Billing Inquiries, Back Issues, and Change of Address 1-800-431-9025

Internet http://support.rg.thomsonreuters.com

Or send correspondence to the above address.

TO PLACE AN AD

Display or Classified Advertising 800-322-3192

FAX 651-687-7374

E-mail terry.storholm@tr.com

EDITORIAL INQUIRIES

Phone 201-536-4963

E-mail dan.feld@tr.com

Address to:
Taxation of Exempts
Thomson Reuters/WG&L
121 River Street, 10th Floor
Hoboken, NJ 07030

PERMISSION TO PHOTOCOPY

Contact:
Copyright Clearance Center 978-750-8400

FAX 978-646-8600

Or mail to:
222 Rosewood Drive
Danvers, MA 01923

TAXATION OF EXEMPTS is available on the Internet as part of CHECKPOINT from Thomson Reuters Tax & Accounting.

environmental solutions, education, and economic development solutions all depend upon creative, design-centered innovation. Buying shares of those large, publicly traded companies across industries that rely on such innovation to thrive is one way to tilt an investment portfolio.

Use of charitable vehicles

Which charitable vehicles can donors use to accomplish all of this? While every family is different, the tax code changes in the Tax Cuts and Jobs Act (TCJA)[7] create opportunities and challenges to planning, both to preserve wealth and to deploy capital according to specific values. The challenge advising individuals and families focused on specific mission areas lies in the stacking of appropriate charitable vehicles to help fund multiple types of models. Working with professional advisers, we explore several options for each category:

- *Nonprofits:* Charitable lead trusts, charitable remainder trusts, foundations, donor advised funds (DAFs), and charitable LLCs are appropriate vehicles to fund nonprofits.
- *Nonprofit with revenue-generating model:* Charitable lead trusts, charitable remainder trusts, foundations (use grants, program-related investments, Pay for Success models), DAFs (grants, loan guarantees), and charitable LLCs (equity or debt).
- *For-purpose social venture:* Foundations (use program-related investments, Pay for Success models), DAFs (loan guarantees), and charitable LLCs (equity or debt). All vehicles can invest equity or debt in social venture funds or directly into double or triple bottom line business models.
- *Socially responsible business:* All vehicles can make direct investments in Certified B Corporations ("B Corps."), businesses solving a social or environmental problem, private equity or debt for double or triple bottom line models, and social venture funds.
- *Traditional for-profit companies:* All vehicles can invest debt or equity in a sustainably run business, a business solving a social or environmental problem, responsible investment strategies, private equity or debt for double or triple bottom line models, and social venture funds.

Conclusion

Professional advisers must first listen carefully to the concerns and objectives of their clients and be prepared to offer strategic funding models. A multidisciplinary approach is invited, and the funding models are myriad.

The investment market offers many possibilities. The funding vehicles that are selected often need to be created (for example, charitable trusts and charitable LLCs; owners of certain for-profit businesses have a pathway in limited situations to have the profits of their businesses provide direct cash flow to their private foundation[8]). Tax planning, accounting, tax reporting, and lifetime estate planning (as well as post-mortem planning for one or more generations) should be embraced to create a durable tapestry for realization of desired outcomes. Both the donor/investor and the stewards of the capital need to be fully informed, and methods to measure results are essential.

Donors no longer have to choose between two polar organization types: nonprofit vs for-profit; instead, donors can be both philanthropic and savvy investors across a spectrum of models aligned with their specific values.

Professional advisers have to think creatively. The tools are available. We need to be disrupted. Professional advisers who embrace the disruption can join hands with the families, individuals, and nonprofits they advise to provide the appropriate framework. ■

8 Internal Revenue Code Section 4943(g).