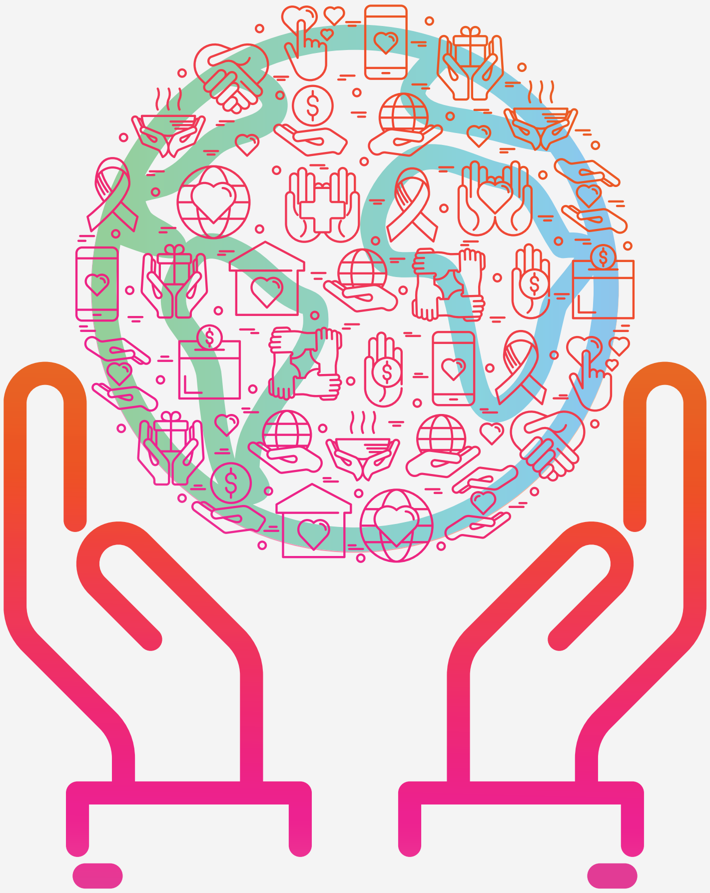


A Brave New World:

Making an Impact Beyond Traditional Grantmaking

by Kerri Mast, Wealth Planner

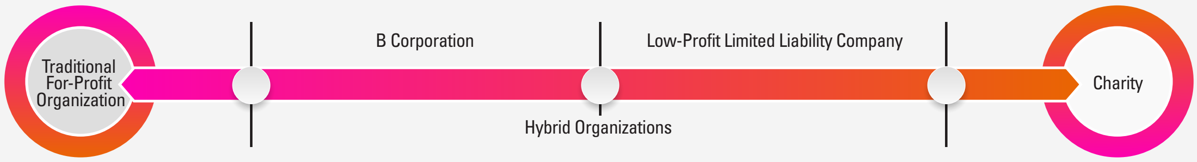
Many philanthropists utilize private foundations and donor-advised funds to make grants to public charities in furtherance of their philanthropic goals. While these vehicles are effective, they are subject to certain limitations. Recognizing these limitations, philanthropists may seek innovative solutions to address our society's most pressing issues by considering a new organizational structure, maximizing the impact of their investments and making nontraditional grants.

Considering a New Structure

We often think of commercial activity and charitable activity as separate and discrete. In some instances, though, there may be a benefit to blurring the lines between these activities.

Hybrid Structure. Generally, a business organization exists to engage in commercial activity for profit and maximize value for shareholders. A nonprofit organization, on the other hand, exists for purposes other than profit and might measure success based on impact within the community. However, there are hybrid organizations that seek to combine the best attributes of a profit motive organization and a nonprofit organization.

A benefit corporation (often called a "B corp") seeks profit as well as positive social impact. Profit generally remains the primary motive, but B corps are required to balance the need to provide value for shareholders with the impact of their



decisions on their community and the environment. While a B corp can be attractive to community-oriented profit motive organizations, there is no clear guidance regarding how to balance these two goals.

Another hybrid structure is a low-profit limited liability company (L3C). Similar to a B corp, the L3C has as one of its purposes positive social impact. However, the L3C goes further than the B corp in prioritizing the social impact. While the B corp is required to balance social impact and profit, the L3C is required to prioritize the positive social impact over the profit motive. For example, the Illinois L3C statute requires that no significant purpose of the organization is the production of income. However, to the extent income and profits are generated, they are permitted to be distributed among the owners.

Newman's Own Exception. In addition to these hybrid structures, there is an opportunity to structure ownership of a business within a well-known philanthropic vehicle – the private foundation. For nearly five decades, private foundations have been prohibited from owning business enterprises. Recently, an exception was made to this prohibition. As a result of the Philanthropic Enterprise Act of 2017, if certain requirements are met, business owners who want to devote all of the profit from their company to charity may contribute ownership of their business to their private foundation. This exception has come to be known as the "Newman's Own exception," as a reference to Paul Newman's commitment to use for charity 100% of the profits from the company he founded, Newman's Own. The Newman's Own exception is a blurring of lines between commercial and charitable activity, as it allows for the existence of a charitable business enterprise.

Maximizing the Investment Impact

Philanthropists also may try to further their philanthropic goals through their investment returns. While traditional investments solely seek financial return, philanthropists may seek investments where there is positive social impact in addition to financial return.

Impact investing is an evolving practice that seeks to generate positive social impact and positive financial return. The extent to which impact investments weigh and prioritize social impact and financial return varies depending on the investor.

One type of impact investment is a program-related investment (PRI), which prioritizes social impact above financial return. For a PRI, the primary purpose is to accomplish one or more of a private foundation's exempt purposes, and the possibility of a financial return is secondary. Private foundations generally are prohibited from making risky investments, called jeopardizing investments. A jeopardizing investment is one that shows a lack of reasonable business care and prudence in providing for the long- and short-term financial needs of the foundation. Private foundations are subject to a tax on any jeopardizing investments. However, if an investment qualifies as a PRI, it will not be subject to the tax on jeopardizing investments even if it otherwise would be considered risky. For example, a high-risk investment in a nonprofit, low-income housing project might be a PRI. PRIs may also be made in L3C organizations.

Nontraditional Grants

Philanthropists may also seek creative solutions to grantmaking.

Grants to Individuals. Philanthropists who are interested in supporting individuals often create or support scholarship funds through colleges and universities. However, private foundations can make grants directly to individuals for travel, study or other similar purposes, provided certain conditions are met. The grant must be awarded on an objective and nondiscriminatory basis, and the procedure for making the grant must be approved in advance by the Internal Revenue Service. In addition, the grant must either qualify as a scholarship or fellowship as an educational institution, qualify as a prize or award or achieve a specific objective, such as producing a report or enhancing a specific talent of the recipient. Making grants directly to individuals is not without its administrative challenges, but these challenges can be overcome with appropriate planning and support.

Grants Requiring Expenditure Responsibility. Although we traditionally think of making grants to public charities, nontraditional grants may be possible, such as a grant to a foreign charity or a noncharitable organization that is doing charitable work. These grants require a higher level of due diligence, called "expenditure responsibility," which includes a pre-grant inquiry, a written agreement outlining the terms of the grant and a follow-up report. The exercise of expenditure responsibility is intended to ensure that assets set aside for charity are used for charitable purposes. Many private foundations and donor-advised fund sponsors shy away from grants requiring expenditure responsibility because of the additional oversight required. However, while the additional requirements add administrative complexity, they are not onerous and should not deter philanthropists from considering grants that achieve their goals.

Conclusion

Traditional grantmaking comprises much of the philanthropy we see today. However, there are other options philanthropists might consider as they contemplate how to best meet their goals. ■

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