FOUNDATIONSOURCE

5 Giving Strategies for Sophisticated Investors

THESE ADVANCED TAX AND INVESTMENT STRATEGIES CAN ENHANCE YOUR CLIENTS' PHILANTHROPY

When most high-net-worth individuals engage in charitable giving, they do so primarily through cash donations to nonprofit organizations. However, they may be overlooking opportunities to extend their charitable capital and make their gifts even more impactful.

One of the many advantages of using a private foundation as a charitable giving vehicle is its ability to employ a number of creative tax and investment strategies. Of all the giving vehicles, private foundations offer the most flexibility, and thanks to tech-driven efficiencies, they're easier to manage and have a much lower entry point than ever before.

From our work with thousands of private foundations, we've identified five strategies that the most experienced and knowledgeable philanthropists incorporate into their charitable giving plans, usually with guidance from their professional advisors. They center around helping a foundation meet its 5% annual payout requirement—the amount of charitable funding that must be distributed every year.

Advisors with competencies in these types of techniques often have a competitive advantage over their peers and, most importantly, are better able to serve their clients and optimize their offering.

Here's a look at five sophisticated strategies that foundations and their advisors are using to maximize their philanthropy.

1 Donate Stock

Rather than liquidate their stock holdings to make cash donations, foundations sometimes give actual shares directly to a grantee. For example, a family that runs a foundation may feel hesitant to sell certain closely held stock or they might expect a stock to appreciate further. In the latter case, if the grantee holds the investment, it could become far more valuable in the future.

2 Use Tangible Assets

Making illiquid or real assets available for grantees to use is another way foundations can meet their 5% annual payout requirement without having to donate cash or sell securities. For example, a foundation might rent a piece of real estate to a nonprofit at a below-market rate. Doing so benefits the nonprofit and potentially provides a small amount of income to the foundation.

Additionally, since the asset is in use, it can be excluded from the foundation's minimum distribution requirement (MDR) calculation, thereby reducing the disbursement obligation. (If the foundation uses a portion of the building for noncharitable activities, an accountant can help determine how to best track and report that.)

3 Make Program-Related Investments

Foundations can make program-related investments (PRIs) into for-profit businesses to achieve some of their philanthropic goals and meet their MDR. For instance, a foundation dedicated to eradicating a particular disease might invest in a company that's working on a treatment or cure.

Since PRIs are investments rather than grants, they may also generate a return for the foundation. PRI proceeds would then go back into the foundation's endowment and can be used for future PRIs or grants. These investments often work well for foundations run by sophisticated, active investors, angel investors or venture capitalists who have experience analyzing and valuing companies.

4 Give More in Bull Markets

A foundation that distributes more than the required 5% in a given year can bank credits for the amount above its MDR for up to five years. These 'credits' can be used to meet the MDR in future years. This is especially valuable when markets are down and liquidating part of the portfolio could lock in losses and potentially eat into the foundation's principal.

Our data show that foundations distributed an average of 6.6% of their portfolios in 2022, following an average 7% distribution in 2021 and 7.5% in 2020. The higher distributions in 2021 and 2020, which were years of double-digit market growth, provided the additional benefit of insulating the foundations from forced withdrawals during 2022's more volatile market environment. The nearly 1,000 foundations that we studied have collectively amassed more than $1 billion in excess grant carry-overs for the 5-year period from 2018-2022 as a result of consistently giving above the 5% MDR, which can provide an important cushion for future volatility.

5 Leverage Expenses

A foundation's expenses can also count toward the 5% MDR, as long as they help further the foundation's mission. Such expenses essentially become part of the foundation's grantmaking.

For example, one of our foundation clients has a mission to expand access to higher education for marginalized populations. It commissioned a study to understand the proximity of community colleges to public transit systems, then used that information to lobby for expanded bus and rail lines that would improve access for students without personal transportation. It was able to fund the study through its MDR, since the expense was directly related to its mission.

The most suitable approach for a given foundation depends on its specific goals and how actively the donors wish to be involved. In many cases, the most efficient and effective approach involves a combination of the above strategies alongside direct cash grants. Consulting with tax and philanthropic professionals can help determine what would work best.

QUESTIONS?

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