FOUNDATIONSOURCE

WEBINAR

Differentiated Giving:

Mastering Underutilized Private Foundation Strategies for Greater Impact

Q&A

At their most basic, private foundations are funding vehicles to support the work of public charities. But many private foundations don't realize all of the unique advantages they have at their disposal to make an even bigger difference. By employing little-known strategies, they have the potential to maximize their impact and increase the types of organizations and individuals they can give to.

Foundation Source recently hosted a webinar to explore how foundations can get creative with their giving. Participants highlighted some of the most effective strategies and also shared examples of how foundations employ them. **Gillian Howell, head of client advisory solutions,** moderated the discussion with three of our in-house subject matter experts: **Alex Correa, senior director of client services; Julia DeMeo, southeast managing director; and Kimberly Scott, senior director of client services.**

GILLIAN HOWELL
Head of Client Advisory Solutions

ALEX CORREA
Senior Director of Client Services

JULIA DEMEO
Southeast Managing Director

KIMBERLY SCOTT
Senior Director of Client Services

Gillian Howell: How do minimum distribution requirements (MDRs) work for private foundations?

Julia DeMeo: Private foundations are required to pay out 5% of their assets each year for charitable purposes. That's calculated based on the prior year's average assets. The distribution requirement includes both grants and expenses. In any year that a private foundation exceeds the 5% distribution, they can carry forward the excess distribution for up to five years.

In years when their endowment investments have higher gains, the distribution requirement will go up the following year. With the additional philanthropic dollars, foundations can make more distributions in the current year by supporting other areas of giving or being responsive to unexpected situations or crises. A foundation may also want to distribute more than 5% if they're planning to add additional assets, such as having a liquidity event, selling a business, receiving an inheritance, or donating appreciated securities.

Howell: I'm not sure everyone appreciates that expenses count toward the MDR. How do you best leverage them?

DeMeo: Foundations can pay for all legitimate and reasonable expenses incurred in carrying out the charitable purpose of the foundation—pretty much any fees that help the foundation become more effective, like joining donor networks, marketing, conferences, and workshops. In the year of creation, that includes any administrative, legal, and accounting expenses in connection with formation of the foundation.

Expenses and salaries need to be deemed fair and reasonable, especially when it comes to compensating family members. Use this checklist developed by our legal team to help with compensation guidelines.

Howell: Can you share how some Foundation Source clients have used expenses?

Kimberly Scott: One of our clients is a husband and wife that have a foundation in New York. They decided to have their annual board meeting in Jamaica. They told us they were going to discuss grant-making strategies and look at their investment policy. They wanted the foundation to pay for their travel, accommodations, and food while they were there. We advised them that the IRS would not approve it. If there had been a component where they were surveying local organizations, looking to make grants there, this could possibly have worked. But that's not what they were planning to do.

Contrast that with another client, a foundation with four generations of the family involved. They lived all across the country, so every year they would fly to one central location for the board meeting. They would also incorporate a family vacation with the board meeting that included non-board members. This worked because they were meticulous in separating the expenses that were foundation-related from personal and vacation expenses.

Howell: Let's talk about program-related investments, PRIs. How do foundations leverage them as part of their overall charitable giving strategy? Can you give some examples?

Alex Correa: When people think of private foundations, they just think about cutting checks to public charities. But that's not the only way to give. A PRI is an alternative way to support charitable causes in the form of a loan, loan guarantee, or equity investment.

There are several advantages to PRIs. First, you can reuse the same dollars for the benefit of multiple charities because as the funds roll back in, they can be redistributed. And PRIs also count toward satisfying your annual minimum distribution requirement, just like a traditional grant would.

There are also benefits to recipients. With a PRI, there's the ability to raise a larger pool of funds than may be possible through grants alone and get financing for a project that may be considered too risky by a traditional commercial lender. If a charity has a PRI, they can potentially attract other lenders to a project by having a lead funder take on early risk.

Howell: Can you share an example from Foundation Source clients?

Correa: We had a foundation whose goal was to survive in perpetuity. They were already supporting nonprofits with traditional grants, but they didn't want to spend down their assets. We introduced the concept of PRI loans. They went to the nonprofits they had been funding and asked, "What if instead of $5,000 one-time grants, we could make $25,000 or $50,000 PRI loans that could be paid back over a few years?" In the last two years, they've granted about 20 PRI loans, and they're all coming back, many with interest.

Howell: What is a direct charitable activity (DCA) and how do they differ from traditional foundation activities?

Scott: A DCA allows private foundations to carry out their own programs instead of giving through a charitable organization. Private foundations, their directors, officers, and even staff members are in a unique position to leverage their skills to address a particular problem directly.

One recent client noticed that a lot of local children that lived in non-English speaking households were struggling with their reading. The directors saw an opportunity to jump in. They started hosting reading workshops and trainings to focus on the entire family and partnered with libraries to bring books to families. They saw an impact on literacy and overall school readiness.

Another client wanted to provide business attire for people who were recently released from prison and who were looking to get back into the workforce. It was pretty successful, but then they saw that tattoo removal was something that could be a huge benefit too.

At Foundation Source, we can help you come up with a well-thought-out and impactful program.

Howell: Can you explain the strategy around granting to individuals (GTI) and ways to execute it?

Scott: Private foundations generally make donations to charitable, IRS-approved organizations. But private foundations are also allowed to provide funds to individuals or families who fall into certain charitable classes. During COVID, we saw a lot of clients supporting hard-hit families.

One foundation that comes to mind wanted to support local restaurant workers that had either been laid off or had a significant reduction in hours and were struggling to pay their bills. They were able to make over 100 small grants in 2020. The recipients had to document their need.

We had another client who wanted to go to Walmart and pay for the groceries of random shoppers. That's great, but the IRS wouldn't necessarily see that as charitable without having a documented need of each shopper. So that wasn't something that the foundation could do without IRS penalties. A well-thought-out GTI can be a really wonderful and personal approach to a foundation's overall mission.

Howell: Scholarships are another form of grants to individuals. Can you share some examples of how clients have used them to stand out?

Correa: The one I think of is a client who wanted to have a scholarship program for kids that are often not considered for scholarships: C students. Over the years there were countless success stories from these recipients as they went off to do amazing things.

Howell: I want to highlight another high-impact private foundation strategy and that's giving awards and prizes. Can you give us a brief overview?

Correa: Prize philanthropy recognizes achievements or drives developments that benefit society. In recent years, this type of philanthropy has become more popular amongst a wider segment of donors. This type of giving is also considered grants to individuals and in some cases may require advance approval from the IRS.

If you want to avoid the process of obtaining advance approval, your award program must fulfill several criteria. First, you can't impose any conditions on how the awardee spends the award. Then, no award may be given to a disqualified person like a family member. There must be a broad charitable class. Lastly, you need to develop a mechanism for getting the word out to ensure that there's broad participation in the program.

Howell: What are the options for grantmaking internationally?

Scott: Generally, private foundations give to IRS-approved organizations, which are inherently domestic U.S. organizations. But many foundations have an interest in supporting international causes and there are a few mechanisms to do that.

The easiest option is if a foreign organization has a U.S.-based "Friends of" organization that is a recognized 501(c)(3) public charity. Another fairly simple option would be to make a gift through a domestic partner that works with a particular foreign organization. They act almost like a donor-advised fund for international programs and they facilitate the support to foreign organizations, while the private foundation has the simplicity of giving to a U.S. public charity.

Another option would be to obtain what's called an equivalence determination, which is a legal opinion that the intended recipient, the foreign organization, is actually the equivalent of the IRS-approved public charity. These determinations can typically be relied upon for a few years, and the public foundation can make repeat gifts.

Then the last option would be to exercise what's known as expenditure responsibility, which is an IRS-mandated documentation process that verifies the granted funds are used for charitable purposes.

Howell: Can you give an example of how to use an expenditure responsibility?

Scott: First, remember that the onus is on the foundation to ensure that the funds are used charitably. We had a foundation that used different methods to do their giving. With this foundation, their family is in Pakistan, and they wanted to support various Pakistani organizations. When they first started, they used an expenditure responsibility. They were very specific about what the funds could be used for and required follow-up reports from each of these organizations.

As the years went by and they built trust with the organizations, they got an equivalence determination, which gave them a lot more flexibility. It reduced the amount of paperwork and did not need to specify exactly what the funds could be used for.

This is a condensed, edited version of the conversation.
Get full insights by watching the entire webinar here.

HAVE A QUESTION?

Call 800.839.0054 or send us an email at info@foundationsource.com.

www.foundationsource.com