The emergence of global philanthrocapitalism

By Dr. Ineke A. Koele, Lawyer, Tax Attorney and Founder, Koele Private Client & Charity, The Netherlands

What is philanthrocapitalism?

We are living in a timeframe where the traditional three-sector division between government, the for-profit sector and the non-profit sector is becoming blurred and high speed internationalisation and interdependency is taking place.

Wealthy families are increasingly trying to find ways of using business methods to achieve public good. These 'philanthrocapitalists' are becoming 'hyperagents' in philanthropy, not only using their resources, but also their business acumen, vision, experience, network and drive. A common feature is that they all are results driven and strive for effectiveness.

This new tendency is innovative: philanthropy is no longer supposed to be just about giving away money, but it may include producing money with money. The philanthrocapitalist wants to use his or her donation or investment to enable scale to the philanthropic activity, to achieve a far bigger impact if compared to the traditional way of giving.

At the same time, the for-profit sector is catching the same philanthrocapitalism bug and has started trying to do good, not only for the purposes of its own public relations, but as a way to achieve impact. Businesses and 'modern' charities start co-operating at a high abstract level, uniting their unique features, skills and powers, with high-scale and low-cost results. On the private individual side, more passive investors embrace the 'double bottom line' of social benefit and financial gain by investing funds in social enterprises or quickly emerging impact investment funds. The impact investor typically expects a financial return below market conditions in addition to a social impact.

As Matthew Bishop and Michael Green, authors of *Philanthrocapitalism. How giving can save the world* put it: "Rejecting the idea that business is about short-term profits, damn the consequences to society and the environment, these philanthrocapitalists think the winners from our economic system should give back and that business can 'do well by doing good'."

Why should private clients consider philanthrocapitalism?

There are many reasons why private clients may consider philanthrocapitalism on some level.

In general, a philanthrocapitalist does not view him or herself as giving something away, but considers it as an investment in the future of humanity. Wealthy individuals can afford to take risks that others cannot, and are able to operate in circumstances without restrictions like, for example, shareholders control, voting polls, politics, the need to raise money for daily maintenance, and other pressing factors.

In other words: a philanthrocapitalist expands his or her abilities to another level which (for those who are sensitive to it) can bring enormous joy and satisfaction.

Successful entrepreneurs may decide not to try to sell their enterprises ultimately to private equity investors or large conglomerates, but instead prefer to sell their successful business to key managers of the business and support these 'buy in' successors both financially and otherwise for a certain period of time, changing from a full entrepreneurial model to a coaching model over time. New models are created, in a co-operative style in conjunction with philanthropic devices, where the objective value of the enterprise is reduced in order to make it affordable for the successors. The seller-entrepreneur may be happier with a considerably lower price, but a sustainable business and ongoing involvement in the business at a different pace or level.

For larger family enterprises, the co-operation between the for-profit enterprise and a family philanthropy vehicle offers many opportunities in terms of family governance, family bonding, defining strategy and values, preparing heirs and younger family members. The added value in terms of strengthening the viability of the family enterprise in this way cannot be overestimated.

The American National Centre of Family Philanthropy describes this in the *Value of Family in Philanthropy* as follows: "family philanthropy offers the family the opportunity to feed itself – to develop leadership, to develop links across generations that mean something.

There just aren't that many places where you can add to the social interaction of the family relationship a piece of work. Work adds meaning and intensity to the family's relationships that nothing else can – not being, not playing, not talking together. There is a wholly legitimate purpose to philanthropy as a source of meaning to a donor and a family."[1]

Where the philanthropy is strategic in the sense that it has a meaningful connection with the activities of the for-profit enterprise, and may eventually co-operate with the for-profit enterprise in order to achieve the highest possible impact in reaching its objectives, this is a win-win type of philanthrocapitalism.

Other arguments in favour of wealthy families creating philanthrocapitalist structures and activities, is to benefit ultimately from asset protection and tax benefits in an overall context. Probably the best way to create discrete structures that are effectively sheltering assets in a tax beneficial way, in the year 2013, is the use of onshore purpose funds with mixed charitable and private purposes in countries where the tax treatment is neutral or beneficial. An example hereof is found in the Dutch family foundation which offers neutral (transparent) tax treatment as of 2010.

Last but not least, social investments or impact investing – defined by its emphasis on social impact as well as financial returns – are considered to be an emerging asset class. New subsets of social investments emerge such as micro franchising and venture philanthropy. This asset class is considered by many to be vital, viable and reliable since it is not yet viewed as a part of the real capitalistic system.

What are the best philanthrocapitalist structures?

In practice, the law does not always keep pace with developments. In some countries that can be a problem, in others this may be seen as an advantage.

The philanthrocapitalist embraces sustainable structures and is likely, therefore, to concentrate on solutions in 'onshore' or 'high tax' jurisdictions.

The differences in approach between the various countries look at first glance substantial and detailed.

In general terms, we can say that in countries with developed charity legislation like the US and the UK, there have been legislative developments to embrace this new development. When we look closer, it seems that this is partly required due to the restrictive and detailed character of the charity oversight legislation.

In the US, the Low Profit Limited Liability Company (L3C) has been developed in order to facilitate the co-mingling of interests from charitable foundations and private sector interests to deliver exclusively charitable purposes as defined in the US Revenue Code. An L3C can make a low profit of 1% - 10%, but this is secondary to its social purpose. Unlike a traditional charity, however an L3C may distribute its low profits to its investors (charities and private parties alike). It has been envisaged that the investment in a L3C would be qualifying as a 'programme related investment' (PRI) that qualifies for the 5% mandatory pay-out by US private foundations, which would enable those foundations to recycle funds rather than just give their money away. Nonetheless, the Internal Revenue Service has refused to confirm that investments in L3C's automatically qualify as Programme Related Investments. Other initiatives to shape social enterprises, are Benefits Corporations, and Flexible Purpose Corporations that allow corporations to strive for societal purposes along with the purpose of generating shareholder profits.

In the UK, the development of the Community Interest Corporation was intended to suit the intentions of social entrepreneurs, allowing a limited dividend distribution and remuneration for its board members. It does not benefit from favourable tax incentives. In practice still, most social enterprises are charities and there are plans to create a new legal form that is transparent for tax purposes, similar to the L3C, the social enterprise LLC.

Also, in Canada two provinces, British Columbia and Nova Scotia have passed similar legislation (Community Interest Companies Act and Community Contribution Company respectively). None of these entities, however, benefit from any form of federal or provincial tax incentive.

On the European continent, the legislator is less active in creating new legal frameworks to embrace this new development.

When concentrating on Germany and the Netherlands, the practice of 'philanthrocapitalism' is developing while using (tailor-made) structures with foundations, associations, partnerships, co-operatives in combination with regular corporate entities. Structures may be parallel (eg a corporate structure separated from a philanthropic structure) or integrated (eg a corporate entity and a foundation participate in a joint venture, using a partnership or corporate entity). Foundations and associations may qualify as 'charitable' or not. Whilst the charity label may offer considerable tax advantages, especially where gifts are involved, for operationally active organisations the 'charity' tax label does not always provide tax benefits that would be expected from the efforts of maintaining this status. Absence of regulatory oversight is certainly an issue in Germany, where gemeinnützige organisations are the subject of very strict administrative oversight.

In the Netherlands, which has always had a very liberal and practical tax regime for charities, new transparency rules will be introduced as of 2014, whilst since 2012 commercial activities have been subjected in most situations to corporate income tax since they are considered to be on the same level playing field as corporations. In the meantime, it has been confirmed in Parliament that charities are perfectly able to perform commercial activities, and there are no impediments for charitable foundations or associations to invest in partnerships, corporations and the like. Where, however, a charity has a pure business model i.e. its public benefit activities and commercial activities are indispensably intertwined, the tax administration does have a problem in acknowledging this to be a charity.

The Dutch approach may also be illustrated by the fact that a Bill introducing a separate legal form of Social Enterprise which has been circulating for a few years, was withdrawn by the Ministry of Justice in January this year as it was not considered to be required by practice.

What will the future bring?

Philanthrocapitalism is emerging and the non-profit and for-profit sector are moving in eachothers' direction. Families may 'balance' two types of activities, or alternatively may try to integrate the two different worlds in one legal and tax efficient structure. Philanthropic organisations create their own business models to be more effective and create more impact and continuity through independency from gifts and subsidies. That creates tension on the existing framework of tax privileged charities. We need creative and bold thinking of legislators and tax administrators to create new and sensitive lines between the tax preferential modern types of philanthro(capitalistic) organisations and the mere business type of organisations. This is a global process.

Referred to as 'the Fourth Sector', social entrepreneurs are increasingly viewed as filling a void left unaddressed by the good old public, private and non-profit sectors. The challenge to integrate the built up resources in the private and business sector (partly offshore and out of the tax net) with public benefit purposes to achieve impact for the benefit of society could be embraced to address effectively many of the major issues our societies face today.

Some people say that we need innovative thinking on new legal vehicles which align tax incentives and corresponding organisational models to accommodate this Fourth Sector and believe that a new approach can help avoid the harm that could ultimately be done to the vast charitable sector by these new developments.

Others, like Dan Palotta,[2] suggest that the existing paradigm of the charitable sector should be expanded in a revolutionary way and freed from its existing Puritan constraints.

Whether the existing framework is adapted to the new reality, or new paradigms will emerge, in both situations we need a conceptual discussion on the ius constituendum of the philanthrocapitalistic sector.

END NOTES:

1. *See website www.ncfp.org.*
2. *Dan Palotta, Uncharitable: How Restraints on Nonprofits undermine their potential', Tufts University Press, 2008.*

Trends in cross border philanthropy in 2012
July/August 2012, Issue 228
ARCHIVE LINK offshoreinvestment.com/archive